

Federal Tax Procedure (2023.2 Practitioner Ed.)

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This publication is in two versions, called editions, for two different audiences. The Student Edition—**without footnotes**—is for tax law students. The Student Edition presents the key concepts and discussions that I think students should learn in a law school class on tax procedure. The Practitioner Edition—**with footnotes**—is for practitioners with the caveat that it is not the definitive work on the topic (see Ch. 1 on Purpose and Scope). The Practitioner Edition has the same text as the Student Edition but offers footnotes that go beyond what students’ need. I use the footnotes for my own discipline to ensure that I support the statements in the text. I also use the footnotes also to offer more detail on tax procedure matters.

I have a Federal Tax Procedure Blog which I may use for updates, corrections, expansions, etc. (which I generally call errata) to this book. I will continue to use the blog for that purpose. I will not post all revisions I make to the working draft for next year’s editions, but I will post the more material items. I encourage readers to check periodically the Federal Tax Procedure Blog.

I welcome feedback from readers, particularly any suggestions for improvements— either in the substance or in the presentation. Feedback can be given by email (jack@tjtaxlaw.com).

I state my appreciation to those who read either Edition. Reading takes time and engagement. I hope the text is worthy of your time and engagement.

This is Second Version of the 2023 Edition, which I call the **2023.2** Version. This is the first time I have offered a revised version of the annual publication. I explain the reasons for this revised versions on my Federal Tax Procedure Blog page titled. Federal Tax Procedure Book [here](#) under the caption “**REASONS FOR SECOND 2023 VERSIONS JANUARY 2024.**”

Revisions Through January 1, 2024

Thanks

My wife, Irene, is a great supporter.

My former partner, Larry Jones, continues to act as a friend and mentor. We still share ideas often, although we are both retired.

Over the years, I have had substantial editorial assistance all my projects from my former assistant, Merry Davis, and from my current assistants, Theresa Mickiewicz and Irene Townsend. They made this book better than I could have made it without them. Thanks also to Larry's assistant, Dawn Reesing. Larry, Merry, Dawn, and I made a good team while we were together as Townsend & Jones.

John Griffing of Griffing Leazer in Charlotte, NC, has made major contributions incident to his review to use the book in teaching at Wake Forest University Law School.

Others have also contributed greatly. I mention only a few.

First, I have been greatly influenced by my students over the years at the University of Houston School of Law where I taught for many years until Fall 2015. These students, many of whom became my colleagues and my friends, gave me the encouragement and incentive to do my best and held me accountable, as I hope all readers of this book will do as well. My students have made me a better teacher and lawyer. I hope I also have contributed to their development as lawyers.

My colleagues at the Department of Justice Tax Division where I started the practice of tax law gave me a solid foundation. At DOJ Tax, I was blessed to be influenced by giants—like the late Professor Ernest Brown, one of my reviewers in the Appellate Section, and John Murray, my boss in the Trial Section, and others too numerous to mention. DOJ Tax was the most wonderful work experience I have had because of the people. In addition, the people I dealt with at the IRS taught me a great deal about professionalism and service to the country.

Since I entered private practice many years ago, I have continued to be inspired by my friends at the Tax Division and the IRS and have also been influenced by my colleagues in the private bar, many of whom are also giants and most of whom are friends, tolerating gracefully both my excesses and deficiencies.

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Ch. 1. Purpose and Scope.

This book is written principally for a law school course in federal tax procedure. Why is tax procedure important? A giant among my colleagues, Judge Fran Allegra of the Court of Federal Claims, articulated tax procedure's importance well in one of the great tax procedure opinions (*Principal Life Insurance Company v. United States*, 95 Fed. Cl. 786, 788 (2010)):¹

The procedural aspects of the tax laws are of overriding importance in many controversies eclipsing or making moot substantive issues such as the allowance of deductions or credits, recognition or deferral of income, and methods of accounting. At times, the questions spawned by these procedures take on an almost metaphysical cast like “when is taxable income taxed?” The ontology needed to solve such abstruse inquiries comes not from philosophical tomes, but from Chapters 63 through 66 of the Internal Revenue Code of 1986, which supply interfused rules mapping the contours of commonly-used, but frequently-misunderstood, tax concepts such as assessment, deposit, and overpayment.

This book is not about tax policy—those large issues of how the incidence of taxation falls on the citizens of this country and how the tax system contributes to or impedes the realization of the American dream. With the input of the citizens, the President and interest groups, Congress considers those policy issues and makes those decisions. This book is about the procedure necessary to implement those policy decisions.

I urge students to engage with the procedure system. Ask where each piece fits in the larger whole. The tax system is a huge system requiring elaborate procedures to make it work. Choices are made for these procedures. Different choices could have been made, but the choices made establish a system that, for the most part, works. It is not a perfect system and needs to be refined from time to time. For most procedures, the problems have been eliminated or mitigated and the system works. But new problems and new challenges arise constantly, hence the need for annual revisions to this text.

I “publish” the book in pdf format in two editions: The Student Edition is without footnotes; and the Practitioner Edition includes footnotes. For a law school course, I encourage students to use the Student Edition (no footnotes). The footnotes are distracting and are not needed for the tax procedure course as I taught it for a number of years at the University of Houston Law School. **I have additional information about the book on my Federal Tax Procedure blog (<https://federaltaxprocedure.blogspot.com/>). Since I use many acronyms (used broadly to cover other shorthand devices), I also link there a web page listing these shorthand devices in alphabetical order: <https://federaltaxprocedure.blogspot.com/p/acronyms-and-initialisms-for-use-with.html>.**

On the topic of footnotes, Justice Scalia stated his lack of appreciation for footnotes in the oral argument in a Supreme Court case when a lawyer referred to a footnote in a prior Supreme

¹ During my teaching years, after the *Principal Life* decision was published, I made it a centerpiece of a review class toward the end of the semester. Please note that I have “cleaned up” the quote adopting a convention that I explain on p. 3.

Court opinion, whereupon Justice Scalia responded: “I had not recollected that footnote. I will -- I will find it. I don't read footnotes, normally.”² But, even as he claimed to not read footnotes normally, he did write them;³ it is hard to believe that any Supreme Court advocate in oral argument would have told Justice Scalia that he or she—the advocate—did not read footnotes anymore, particularly Justice Scalia’s footnotes. Regardless of whether Justice Scalia’s claimed reading practice is good or bad (actually I like to read and write footnotes), I have attempted to put in the text (rather than the footnotes) the material that I believe a student should know for a law school class in tax procedure. Accordingly, the Student Edition has no footnotes.⁴

In earlier versions of this text, I offered in an Appendix a long—too long—digression on footnotes. For the book versions starting in 2021, I have eliminated that Appendix. So that the content is not lost, however, I posted the contents of the eliminated Appendix C to my Federal Tax Procedure Blog and provide the link to that posting in, you guessed it, a footnote below. The blog entry is not required reading or even recommended reading. But you might find some humor there.⁵

For those requiring more detail than the Practitioner Edition, I recommend Michael Saltzman and Leslie Book, IRS Practice and Procedure (Thomsen Reuters 2015) which, I think, is the authoritative discussion of federal tax procedure.⁶ (Full disclosure: I was the principal author of Chapter 12 of the 2015 edition of this treatise, titled Criminal Penalties and the Investigation Function, and its updates.) I will sometimes cite to or quote from this Saltzman treatise in this book (particularly in the footnotes in this book), and will shorthand to just Saltzman, with the section (from the online edition). For example, the cite is in this format: “Saltzman Treatise, ¶ 10.04[1][a] The Process for Making an Assessment Based on a Math or Clerical Error.” Professor Book and some colleagues publish the helpful **Procedurally Taxing Blog** which is now part of Tax Notes (a subscription service). I also provide links and other resources in the Appendix on p. 1062.

My principal focus is on the Internal Revenue Code. I encourage the student to read the Code Sections cited in the text. I cite in the footnotes many Code sections and subsections that are not important for the student to know or read. I also cite regulations in the footnotes; most of the regulations citations are not important for the student. For cases, I include in the text only the case

² As reported in the Tax ProfBlog reported on 3/20/06 and the Wall Street Journal Law Blog on 3/20/06. The case was *Cuno v. DaimlerChrysler, Inc.*, 545 U.S. 1165 (2006). Others report the quote a bit differently. E.g., Lawrence Wrightsman, Oral Arguments Before the Supreme Court: An Empirical Approach (Oxford University Press 2008) (quoting Justice Scalia as saying “I don’t read footnotes anymore.”). It was so characteristic of Justice Scalia to make such hyperbolic comments, that I suspect we all can imagine him saying some such for its immediate effect on the discussion at hand.

³ For similar statements about Justice Scalia, see William Jay, Tribute: The Justice who said he hated writing (SCOTUSBlog 3/4/16) (“‘I don’t read footnotes,’ Justice Antonin Scalia often said, and perhaps he didn’t, but oh, how he could write them.”).

⁴ Initially, when I prepared the first edition of this textbook, I had a single version with no footnotes. I was writing at the time only for my law students. I did not feel the need to cite any authority other than myself for most of the statements in the text, but I cited in the text the really key authorities—Code sections and cases. As I worked on succeeding editions, however, I felt the need to include footnotes, but tried to keep my focus to make students the focus of the text rather than the footnotes.

⁵ See the Appendix-Resources on p. 1062 for a link to a Federal Tax Procedure Blog discussion of footnotes.

⁶ I was the principal author of Chapter 12 of the 2015 edition of this treatise, titled Criminal Penalties and the Investigation Function. I also author the updates to that chapter. I also maintain a Federal Tax Crimes Blog.

names and citations for key cases that the student should know by name because those case names have become terms of art known that should be known to the students.

Acronyms and similar shorthand reference techniques (all of which I lump under the term acronyms) are ubiquitous in the practice of tax law, as in the law and life itself. I use acronyms relevant to this class and define each acronym at least when first I use it. I have a list of acronyms (as defined) on my Federal Tax Procedure Blog which is linked on the Appendix-Resources at p. 1062.

For more technical legal writing issues such as quotations and citations, I am somewhat eclectic and not always consistent. I never mastered The Bluebook: A Uniform System of Citation (Harvard Law Review Association in periodic editions), the standard used for years by many, if not most scholarly legal publications, particularly in law reviews.⁷ This authoritative source is often shortened to the “Bluebook”⁸ and sometimes as the Harvard Blue Book because of the publisher.⁹ I did not get into serious legal writing until the Department of Justice Tax Division (“DOJ Tax”), particularly in the Appellate Section where we had style checkers to clean up our work with DOJ Tax’s own system of citation. Now, I just use the system I have developed over the years (mostly consistent with the standard authorities), I hope, however, that readers will be able to discern without any difficulty what my citations mean.

I often in this text (and other writings) follow Jack Metzler’s “cleaned up” device to omit distractions in quotes (such as ellipses, internal quotation marks, brackets, extraneous words) to make a quotation more readable.¹⁰ Since the “cleaned up” device is getting more and more traction in legal writing by judges¹¹ and scholars, I assume that readers will already be familiar with the device. In this text, I use the device often but not always.

When I clean up, I will usually use the “clean up” signal. Sometimes I will clean up without signaling. One example of cleaning up in this text without the “cleaned up” signal will be to eliminate parallel citations from Supreme Court cases appearing in quotations. I will thus include in a quote only the U.S. citation and eliminate the parallel citations to S.Ct. Or L.Ed. I will retain the S. Ct. Citation where the U.S. citation is not available because of the time lag between original

⁷ The Wikipedia entry for the publication includes:

The Bluebook * * * prescribes the most widely used legal citation system in the United States. The Bluebook is compiled by the Harvard Law Review Association, the Columbia Law Review, the University of Pennsylvania Law Review, and the Yale Law Journal. Currently, it is in its 20th edition. It is so named because its cover is blue.

⁸ This citation Bluebook should not be confused with the Joint Committee on Taxation (“JCT”) staff explanation of legislation after it is enacted which are often referred to as “Blue Books.” I discuss the JCT Blue Books later in the text (beginning on p. 22) in discussing sources for interpreting legislation.

⁹ Although, as noted in the preceding footnote, it is a collaborative effort of other law schools.

¹⁰ Metzler, Jack, Cleaning Up Quotations (March 17, 2017). 18 J. App. Prac. & Process 143 ((2017); Jason P. Steed, Cleaning Up Quotations in Legal Writing (ABA Appellate Practice 12/7/17); and Eugene Volokh, New Twist on Legal Citations: The “(Cleaned Up)” Parenthetical (Volokh Conspiracy 7/24/18) (“I like ‘cleaned up,’ because it helps focus readers on the important thing– the substance of the quoted text– without distracting them with the unimportant.”).

¹¹ E.g., Brownback v. King, 592 U.S. ___, ___, 141 S. Ct. 740, 748 (2021) (Thomas, J., for majority). Brownback was the first Supreme Court case using the cleaned up technique, but courts of appeals had used it often before. Since Brownback, I have noted its more common use in legal opinions.

publication of the opinion and publication of the U.S. report. Another example where I do give the “cleaned up” signal is that, in quoting in the text, I will omit footnotes that are not relevant to the cleaned up text quoted and usually will not flag the omission with a signal such as “footnote omitted.”

Another deviation for an often used scholarly style convention is in footnote citations where I cite authorities in multiple footnotes. Each time I cite an authority, I usually give the full case, article or other citation rather than a shorthand citation with a reference back to the page and footnote where I first cited the authority.¹² I do that to make it easier for readers of the Practitioner Edition to get into, understand and check the citations in the context of which I cite them without the commotion of tracking down the original footnote for the full citation. Where I cite an authority in close proximity to an earlier full citation (e.g., preceding footnote), I may shorthand the citation. Also, when I cite an authority in a footnote, I often quote or summarize the portion of the cited authority to give myself and readers some assurance that I am using the authority correctly. Over the entire book, this will add many extra words and make the book longer; I believe that tradeoff is worth it.

There are several ways to access the information in the pdfs of the Student and Practitioner editions. The Table of Contents is a handy way of finding subjects. I do not provide an index of words or key words and do not provide an index of authorities. Both take more time and basic word processor expertise than I have. I find that Adobe Acrobat’s search features do most of the work of such indices. The simple search is <CTRL-F>, and the advanced search is <SHIFT-CTRL-F>. Some versions of Adobe Acrobat offer more robust search tools.

Finally, in a subject this complex, a publication this large, and with limited editorial and research assistance, I make mistakes. Sometimes I make substantive mistakes; sometimes I make presentation mistakes (grammar, spelling, awkward sentences, etc.). I urge readers who spot such errors or just have an idea as to how the material can be better presented to contact me about their ideas. **I provide this book for free distribution; I urge that readers who find it useful, “pay” for by contributing to future editions by emailing me about errors or confusing language, glitches, etc. I can be reached at jack@tjtaxlaw.com. Thank you for your interest in the book and your contributions to future editions.**

¹² For example, I use John A. Townsend, Tax Treaty Interpretation, 55 Tax Law. 219 (2001) rather than Townsend, *supra* note 7 or some variant of that shorthand convention.

Ch. 2. Structure of the Federal Revenue Function.

Revenue is the life blood of Government and society as we know it. As Justice Holmes famously said: “Taxes are what we pay for civilized society.”¹³ All taxpayers,¹⁴ of course, do not place the same value on civilized society; dealing with that difference in attitude is a large part of what this class is about. That taxes are a significant component of our Government and society, however, cannot be seriously questioned.

The revenue function of our federal government is massive and engages each of the three branches of Government -- the legislature, the executive and the courts. The criminal aspects of the revenue function also involve another branch of Government—the grand jury—which the Supreme Court describes as “an institution separate from the courts, over whose functioning the courts do not preside.”¹⁵ I touch on the grand jury lightly in this course which is designed to deal principally with civil procedural aspects of the tax system.¹⁶

I. Legislative Branch.

A. House/Senate Roles in Tax Legislation.

1. Constitution’s Origination Clause.

The Constitution provides (Article I, § 7): “All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with amendments as on other Bills.”¹⁷ This provision is referred to as the Origination Clause.¹⁸ The Senate may amend House-originated revenue bills as it deems appropriate, but the Senate may not: (1) initiate a bill that includes a provision to raise revenue; or (2) incorporate revenue measures in amendments to House-originated nonrevenue bills.¹⁹

¹³ *Compania de Tabacos v. Collector*, 275 U.S. 87, 100 (1927) (dissenting).

Taxes even have important religious dimensions. Jesus famously said that we should “Give to Caesar what is Caesar’s, and to God what is God’s.” Matthew 22:21 (New International Version).

¹⁴ I use the term taxpayer in this text in a sense broader than just those who actually pay tax, but also usually include in the term those persons who owe taxes without regard to whether they paid them. Thus, for example, a total tax scofflaw may not pay any tax and not file any return, even though he owes tax and is required to file. That person will usually be referred to as a taxpayer.

¹⁵ *United States v. Williams*, 504 U.S. 36, 47 (1992).

¹⁶ The grand jury text I use is Paul S. Diamond, *Federal Grand Jury Practice and Procedure* (Juris Publishing, Inc. 5th ed. 2012, with pocket supplements).

¹⁷ The requirement applies to all laws relating to taxes rather than just laws that increase taxes. *Armstrong v. United States*, 759 F.2d 1378 (9th Cir. 1985) (sustaining the TEFRA **partnership procedure** legislation which started off in the House as tax reduction legislation).

¹⁸ For good articles on the history, application and interpretation of the Origination Clause, see Rebecca M. Kysar, *The ‘Shell Bill’ Game: Avoidance and the Origination Clause*, 91 Wash. U. L. Rev. 659 (2014); and Michael W. Evans, “A Source of Frequent and Obstinate Altercations”: The History and Application of the Origination Clause, 105 Tax Notes 1215 (Nov. 29, 2004).

¹⁹ James V. Saturno, *The Origination Clause of the U.S. Constitution: Interpretation and Enforcement* (CRS Report RL31399 3/15/2011).

However clear this provision may seem, the devil is in the details or in the interpretation as we discuss in this text.²⁰ The House and Senate interpret the Clause in their legislative activity.²¹ Then, the ultimate arbiter is the courts. The Supreme Court holds that the Origination Clause is implicated when (1) raising money is the primary purpose of the measure, rather than an incidental effect; and (2) the resulting funds are for the expenses or obligations of the government generally, rather than a single, specific purpose.²²

The Origination Clause is not commonly implicated in mainstream tax legislation where the Houses of Congress will usually attend to the niceties.²³ In some outlier but important cases, it may be implicated. For example, during President Obama’s administration, it arose in litigation involving the attempts to defeat the Affordable Care Act (“ACA”) because some of its provisions do raise revenue.²⁴ The House passed a revenue bill that was not the ACA and sent it to the Senate. The Senate substituted by amendment the ACA which was completely different from the revenue bill originated in and passed by the House. The ACA provided for large amounts of revenue to fund much of the cost of the ACA. Did the ACA violate the Origination Clause? Can it be that the Senate’s power to amend a House revenue bill, expressly recognized in the text of the Origination Clause permits Senate to substitute altogether?²⁵ The Court did not reach that issue, because a different stream of authority permitted the ACA not to be considered a revenue act at all, thus avoiding the Origination Clause:

1. Under a purposive approach, the bill's primary purpose was to regulate health insurance and not to raise revenue. The revenue in question was to spur conduct

²⁰ James V. Saturno, The Origination Clause of the U.S. Constitution: Interpretation and Enforcement (CRS Report RL31399 3/15/2011) (“The Constitution does not provide specific guidelines as to what constitutes a bill for raising revenue. What constitutes ‘a bill for raising revenue’ is therefore a question of interpretation.”).

²¹ Since the Senate amendments must be passed by the House, the House has a procedure, called “blue-slipping, to reject and return to the Senate revenue bills that were not originated in the House. James V. Saturno, Blue-Slipping: Enforcing the Origination Clause in the House of Representatives (CRS Report RS21236 1/23/17). Of course, for bills that did originate in the House and were simply amended in the Senate, even by full substitution (such as the ACA), the blue-slip process would not apply.

²² James V. Saturno, The Origination Clause of the U.S. Constitution: Interpretation and Enforcement 8 (CRS Report RL31399 3/15/2011) (this is almost an exact quote); see also James V. Saturno, Blue-Slipping: Enforcing the Origination Clause in the House of Representatives (CRS Report RS21236 1/23/17). For example, in *United States v. Munoz-Flores*, 495 U.S. 385, 398 (1990), the Supreme Court held that “a statute that creates a particular governmental program and that raises revenue to support that program, as opposed to a statute that raises revenue to support Government generally, is not a Bill for raising Revenue within the meaning of the Origination Clause.” (Internal quotation marks and brackets omitted). See also *Retfalvi v. United States*, 930 F.3d 600 (4th Cir. 2019)

²³ See e.g., James V. Saturno, Blue-Slipping: Enforcing the Origination Clause in the House of Representatives (CRS RS21236 1/23/17) (“The House’s primary method for enforcement of the Origination Clause is through a process known as “blue-slipping.”¹ Blue-slipping is the term applied to the act of returning to the Senate a measure that the House has determined violates its prerogatives as defined by the Origination Clause.”).

²⁴ *Sissel v. U.S. Dept. of Health and Human Services*, 760 F.3d 1, 7-10 (D.C. Cir. 2015), reh. en banc den. 799 F.3d 103 (D.C. Cir. 2015), cert. den. 2016 U.S. LEXIS 703 (U.S., Jan. 19, 2016). I recommend also reviewing the concurring and dissenting opinions to the denial of rehearing en banc in *Sissel*.

²⁵ The concurring and dissenting opinions to the rehearing en banc in *Sissel* discuss this issue. Judge Kavanaugh, in dissent, handles the issue summarily: “Although the original House bill was amended and its language replaced in the Senate, such Senate amendments are permissible under the Clause’s text and precedent.” Judge Kavanaugh then discusses the interpretive history behind that conclusion, noting many examples of what he calls “gut and replace” legislation, examples which he says matter in interpreting the clause.

- (purchase of health insurance) rather than raise revenue (although raising revenue was an incidental effect, the Origination Clause is not implicated by such incidental effects).
2. The Senate amendment adding the ACA was a bill that originated in the House and thus met the requirements of the Origination Clause.
 3. The ACA raised revenue for specific program purposes and not for general revenue purposes and thus met the requirements of the Origination Clause.

These explanations may or may not be satisfying, but in the end it would be the rare revenue raising measure that proceeded to final enactment that would not meet the requirements of the Origination Clause.

The Origination Clause presents a lot more nuance than I provide here where I just want to introduce the concept and move on to other important issues for tax procedure.²⁶

2. Budget Reconciliation.

Another feature of tax legislation is that it may be enacted under the budget reconciliation process that, most prominently, was used in late 2017 to enact major tax legislation.²⁷ Normally, under Senate rules, major tax legislation requires 60% vote. The budget reconciliation process requires only a majority vote in the Senate. I don't think it would be helpful in this book to discuss the arcana of the budget reconciliation process.²⁸ I will say that its use for tax legislation, particularly legislation that enacts tax cuts that will increase the deficit, is controversial but used occasionally to pass tax cuts that otherwise would not obtain the required 60 votes in the Senate.²⁹

²⁶ One puzzle caused by overlapping constitutional provisions is whether the Senate's treaty power can trump the Origination Clause, Rebecca M. Kysar, On the Constitutionality of Tax Treaties, 38 Yale J. Int'l L. 1 (2013) (arguing that self-executing tax treaties may run afoul of the Origination Clause; tax treaties that are not self-executing but require congressional action can be constitutional so long as the Origination Clause is met in the executing legislation.).

²⁷ P.L. 115-97, 115-97, 131 Stat. 2054 (Dec. 22, 2017). This legislation is unofficially referred to as the Tax Cuts and Jobs Act ("TCJA"). For political reasons, tax and other legislation usually has names, referred to as "short titles," designed to "sell" the legislation to the public (even if deceptive as to the general nature of the legislation). Hence, in the 2017 tax legislation cited at the beginning of this footnote, the Republicans who controlled the process tried to enact a "short title" of "Tax Cuts and Jobs Act." However, the budget reconciliation process permits only legislation that is germane to the process. The Senate Parliamentarian "ruled that it [the short title] was extraneous to the bill's purpose of affecting revenues, which is what a reconciliation bill is limited to." See Victor Thuronyi, The Law With No Name or the "2017 Budget Reconciliation Act" (The Surly Subgroup 12/20/17) (noting also that the opponents of the law give it the informal short title of Trump Tax Scam). Although the "short title" did not make it into the Act, the act is still referred to as the Tax Cuts and Jobs Act of 2017 ("TCJA").

²⁸ One of the arcana of the budget reconciliation process is called the "Byrd rule" in the Senate, currently codified at 2 U.S.C. § 644, titled "Extraneous matter in reconciliation legislation." In high summary, the Byrd rule permits any member to call out provision(s) that are "extraneous" to budget reconciliation. Extraneous means provisions that are not related to federal revenue and spending. § 644(b). Extraneous for this purpose includes items that will add to the deficit after the budget window, usually 10 years. § 644(b)(1)(E). See generally Ellen P. April and Daniel J. Hemel, The Tax Legislative Process: A Byrd's Eye View, 81 Law & Contemp. Prob. 99 (2018) (a good summary of the use and abuse of budget reconciliation and the Byrd Rule in the context of the TCJA).

²⁹ For those desiring more, a good starting point for further understanding, see the Wikipedia Entry titled "Reconciliation (United States Congress)" (Last edited on 7/15/18 and viewed on 7/16/18).

B. Statutes and Their Meanings; Statutory Interpretation.

1. The Legislative Process.

The two houses of Congress pass a bill, and the President signs it into law. The executive and judicial branches then implement the statute in their respective spheres of constitutional authority. I address those branches below. But first I discuss aspects of the legislative process that bear upon how the executive and judicial branches apply the statute through a process of interpretation.

2. Statutory Interpretation.

Statutory interpretation, a large topic, is a core instruction in law schools. I present in summary some of the themes of statutory interpretation, particularly where applicable in tax cases. The themes appear in statutory interpretation and in Constitutional interpretation; I focus on statutory interpretation.

a. Read the Statute.

The cardinal rule – articulated by Justice Frankfurter and oft repeated – is: “(1) Read the statute; (2) read the statute; (3) read the statute!”³⁰ Reading the statute may not be the end of the process of statutory interpretation but it surely is the beginning.

b. Approaches to Statutory Interpretation.

(1) Introduction-Textualism, Purposivism.

There are two broad categories interpretation for constitutional and statutory text. They are: (i) textualism and (ii) purposivism.³¹ “Textualism stands in contrast to purposivism.”³²

³⁰ Henry J. Friendly, Mr. Justice Frankfurter and the Reading of Statutes, in *Benchmarks* 196, 202 (1967) (quoting Justice Frankfurter), See *In re England*, 375 F. 3d 1169, 1181-1182 (D.C. Circuit 2004) (Roberts, J., quoting Justice Frankfurter in Judge Friendly’s book). Some perhaps less than careful authors citing this aphorism (even if seemingly repetitive) seem to attribute the quote to Judge Friendly without acknowledging that Judge Friendly was quoting Justice Frankfurter. E.g., *United States v. Palomares*, 52 F. 4th 640, 648 (5th Cir. 2022) (Oldham, J., concurring), citing to *United States v. Koutsostamatis*, 956 F.3d 301, 306 (5th Cir. 2020) without attributing the quote to Justice Frankfurter; interestingly, *Koutsostamatis* does attribute the aphorism to Justice Frankfurter). My anecdotal search of Supreme Court and Court of Appeals’ citing the aphorism usually note the Judge Friendly source with attribution to Justice Frankfurter.

³¹ Professor Solum posits three broad categories, adding “intentionalism” to the categories in the text. See *Text Over Intent and the Demise of Legislative History*, 43 *Dayton L. Rev.* 103, 113-114 (2018). In the section on purposivism, I include intentionalism, particularly in the footnotes.

Others include “pragmatism” in interpretation as a separate category. E.g., Richard A. Posner, *The Federal Judiciary: Strengths and Weaknesses* (Cambridge and London: Harvard University Press 2017). I am not convinced that pragmatism is separate category, because I think it falls into a liberal application of purposivism, using the same tools and techniques purposivists would but considering real world consequences and societal understandings.

³² Thomas W. Merrill, *Legitimate Interpretation - Or Legitimate Adjudication?*, 105 *Cornell L. Rev.* 1395 (2020); (“In statutory interpretation, the primary theoretical debate pits ‘textualists’ against ‘purposivists.’”). As stated, (continued...)

All theories of statutory interpretation are based on the notion that, in interpreting statutes, courts are the “faithful agents” of Congress which enacted the statutes.³³ Neither of the categories—textualism and purposivism—have a stronger claim to serving faithful agency better than the other.³⁴

I caution readers not to place too much reliance on the slogans that are bandied about in this area. An example is the notion that textualism, through claimed better emphasis on the text, is the better strategy because of its supposed fidelity to the text Congress enacted. All statutory interpretations must be grounded in the statutory text. Thus, even judges with a more liberal, often purposive inclination, can declare, as did Justice Kagan, that “[w]e’re all textualists now.”³⁵ So, it is important to get past the **slogans** to understand what the interpretive strategy really is, how it works, and whether it is outcome determinative in cases.³⁶

³²(...continued)

these are poles on a continuum, with differences in meaning along the continuum between the poles.

³³ E.g., Abbe R. Gluck and Lisa Schultz Bressman, Statutory Interpretation from the Inside - An Empirical Study of Congressional Drafting, Delegation, and the Canons: Part I, 65 Stan. L. Rev. 901, 907 & 813 (2013) (“The faithful-agent model has had remarkable staying power as the ‘umbrella’ justificatory model of most interpretive approaches, even though it offers little specific assistance in answering questions at this level of detail”; and “The two leading theories, purposivism and textualism, both claim consistency with a ‘faithful-agent’ vision of the judicial role.”); and Amy Coney Barrett, 2019 Sumner Canary Memorial Lecture: Assorted Canards of Contemporary Legal Analysis: Redux, 70 Case W. Res. L. Rev. 855, 863 (2020) (“Textualists and purposivists are both inclined to ground their approaches to statutory interpretation in the concept of faithful agency, giving voice and authority to what the enacting Congress did in a particular statute,” citing John F. Manning, Textualism and the Equity of the Statute, 101 Colum. L. Rev. 1, 9 (2001)).

³⁴ E.g., Abbe R. Gluck, Justice Scalia's Unfinished Business in Statutory Interpretation, Where Textualism's Formalisms Gave Up, 92 Notre Dame L. Rev. 2053, 2059 (2017) (“Textualists and purposivists have debated for years about who is being a better ‘faithful agent’ and what interpretive rules best accomplish faithful agency, without ever disagreeing that the goal was to be a faithful agent in the first place,” stating in fn. 30 “Compare, e.g., William N. Eskridge, Jr., All About Words: Early Understandings of the “Judicial Power” in Statutory Interpretation, 1776-1806, 101 Colum. L. Rev. 990, 993 (2001), with John F. Manning, Textualism and the Equity of the Statute, 101 Colum. L. Rev. 1, 7-9 (2001) (each arguing his own preferred methodology better serves faithful agency than the other’s)); see also John F. Manning, What Divides Textualists from Purposivists?, 106 Colum. L. Rev. 70 (2006).

³⁵ Justice Kagan’s dissenting opinion in West Virginia v. EPA, 597 U. S. _____, 142 S. Ct. 2587, 2642(2022), citing Justice Elena Kagan, The Scalia Lecture: A Dialogue with Justice Kagan on the Reading of Statutes at 8:28 (Nov. 25, 2015).

³⁶ A similar bugaboo slogan, more minim than maxim, in textualism is the claim sometimes made that the text is to be interpreted narrowly or strictly, presumably with the narrow or strict interpretation favoring one party or the other. It is thus sometimes said that “exemptions from taxation are to be construed narrowly,” E.g., Mayo Foundation for Medical Ed. and Research v. United States, 562 U.S. 44, 59-60 (2010), quoting Bingler v. Johnson, 394 U. S. 741, 752 (1969)). A better approach is to interpret statutes reasonably. Est. of Keeter v. Commissioner, 75 F.4th 1268, 1279 (11th Cir. 7/5/23) (cleaned up: “save for a handful of special circumstances, we do not adopt ‘strict’ or ‘narrow’ interpretations of statutes—even tax ones. [citing Scalia & Garner, Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 362 (2012). Our role, instead, is to give statutes a “fair reading,”(quoting Antonin Scalia, A Matter of Interpretation: Federal Courts and the Law 23 (1997)). See also Andrew R. Roberson and Roger J. Jones, Lenity and Strict Construction -- Overlooked Tools of Construction?, 2014 TNT 74-5 at nns. 17-19 (4/17/14) (saying that the courts’ use of the tax strict construction canon or standard repeatedly applied in earlier years has diminished over the years).

(2) Textualism.

Textualism is an interpretive strategy that claims to focus principally or even exclusively on the statutory text enacted by Congress. The claim for textualism is that it produces determinate answers. The question is how much freedom for interpretation does the text reasonably allow? Is the text so crystal clear that it allows only one meaning with no interpretation required?

Those, like Justice Scalia, branding themselves true textualists (true textualists would not include Justice Kagan, just a claimed textualist, among their ranks) will usually focus on the meaning at the time the statute was enacted (or for constitutional interpretation when the constitution or amendment was ratified). This falls under the broad umbrella of “originalism” both in statutory and constitutional interpretation.

An utterance can have at least three meanings: the meaning that the person speaking intended, the meaning that the words by themselves would convey, and the meaning attributed by the person to whom the words were directed. So, in statutory interpretation, does the textualist judge try to determine (i) what the legislature “intended” the words to mean, (ii) what the words mean in some objective sense without consideration of what the legislature intended or even what some intended audience might have thought the words to mean at the time, or (iii) what the actual intended audience (or some hypothesized intended audience) would understand the words to mean at the time of enactment? In statutory and constitutional interpretation, **category (i)** is often called original intent, **category (ii)** I call “plain meaning,” some objective meaning unconcerned with the intent of the author or understanding of the audience, and **category (iii)**, much in vogue now, is often called “original public meaning” or sometimes just ordinary meaning that some imagined reasonable person (or reasonable audience) at the time of enactment would have attached to the text.³⁷ Problems inhere in all of the approaches, which I cannot explore further here.³⁸

³⁷ See e.g., Tara Leigh Grove, Testing Textualism’s “Ordinary Meaning”, 90 Geo. Wash. L. Rev. 101, 113-119 (2022) (discussing the “hypothetical reasonable reader” construct). Earlier in the article (pp. 112-113), she notes characterizations by prominent authorities (Justice Scalia, Justice Gorsuch, Judge Easterbrook, John Manning, and, in a co-authored treatise, Justice Scalia and Bryan Garner) for various formulations— e.g., “objectively reasonable person,” and “a reasonable and reasonably well-informed citizen, but noting the Scalia and Garner “envision a highly sophisticated ‘reasonable reader.’” She quotes from the Scalia and Garner text, Reading Law: The Interpretation of Legal Texts 33 (2012) (emphasis supplied):

The interpretive approach we endorse is that of the “fair reading”: determining the application of a governing text to given facts on the basis of how a **reasonable reader, fully competent in the language**, would have understood the text at the time it was issued. **The endeavor requires aptitude in language, sound judgment, the suppression of personal preferences regarding the outcome, and, with older texts, historical linguistic research.**

My less than expert comment about the term reasonable is that it may offer the “interpreter” the opportunity to read in their own values or preferences into the exercise, perhaps without even thinking about it. For, example, in the *Chevron* deference focus on “reasonable” interpretations, prominent jurist Judge Jon Newman of the Second Circuit noted that there is no accepted definition of reasonable and might have sufficient flexibility to permit the judge to adopt interpretations with which they agree. Jon O. Newman, On Reasonableness: The Many Meanings of Law’s Most Ubiquitous Concept, 21 J. App. Prac. & Process 1, 83 (2021).

³⁸ Currently in vogue among textualists is the use of dictionaries more or less contemporaneous with the enactment of the statutory text as guiding the search for the original meaning or original public meaning. Recently, in the mix for some “corpus linguistics,” “the use of datasets to study linguistic phenomena, including searching databases (continued...) ”

As best I understand it, textualist judges will more readily find that texts have some plain or ordinary meaning, with minimum interpretation (other than the focus on originalism discussed above). As Justice Scalia noted in the *Chevron* deference³⁹ context which arises only if the statutory language is ambiguous (i.e., not plain), the textualist is much more likely to find statutory text unambiguous (plain).⁴⁰ And, although textualism has been a mantra for conservative leaning judges for a long time, Justice Scalia famously proclaimed that “[W]e must lay to rest at the outset the slander that [textualism] is a device calculated to produce socially or politically conservative outcomes.”⁴¹ As if to prove the point, in a 2020 case, textualist Justices squared off in the majority and dissenting opinions, with a textualist Justice authoring the majority opinion (Justice Gorsuch, joined by the liberal Justices) holding that discrimination on the basis of sexual orientation was prohibited, proclaiming that was a textualist interpretation, but with the dissenting Justices (Alito and Kavanaugh) promoting their textualist interpretation and insisting that the majority opinion was not a textualist interpretation.⁴²

Moreover, even textualists reject textualism in some cases. For example, the absurdity canon (also called anti-absurdity canon) avoids a plain text meaning if it produces an absurd result.⁴³ So, we know there are limits to the textualist interpretive strategy. And perhaps in recognition now, although there are some claims that judges are all textualists now, a recent survey of forty-two federal appellate judges found few of the judges that were even close to being full bore textualists.⁴⁴

The role, if any, of legislative history has been a flashpoint for hard-core textualists. Legislative history is different from statutory history; statutory history is “the formal changes in the

³⁸(...continued)

to determine the frequency with which a word appears alongside other words in a given time period.” See Tara Leigh Grove, Testing Textualism’s “Ordinary Meaning”, 90 Geo. Wash. L. Rev. 101, 103 n. 3 (2022) (citing several works, including perhaps the most prominent, Thomas R. Lee & Stephen C. Mouritsen, Judging Ordinary Meaning, 127 YALE L.J. 788, 792, 828–30 (2018), advocating corpus linguistics.

³⁹ Discussed below beginning at p. 86.

⁴⁰ Antonin Scalia, Judicial Deference to Administrative Interpretations of Law, 1989 Duke L.J. 511, 521 (“One who finds more often (as I do) that the meaning of a statute is apparent from its text and from its relationship with other laws, thereby finds less often that the triggering requirement for *Chevron* deference exists.”).

⁴¹ Antonin Scalia & Bryan A. Garner, Reading Law: The Interpretation of Legal Texts 16 (2012).

⁴² See Justice Alito’s dissent in *Bostock v. Clayton County*, 590 U.S. ___, ___, 140 S.Ct. 1731, 1755-1756 (2020):

The Court attempts to pass off its decision as the inevitable product of the textualist school of statutory interpretation championed by our late colleague Justice Scalia, but no one should be fooled. The Court’s opinion is like a pirate ship. It sails under a textualist flag, but what it actually represents is a theory of statutory interpretation that Justice Scalia excoriated--the theory that courts should “update” old statutes so that they better reflect the current values of society. See A. Scalia, A Matter of Interpretation 22.

See my blog Textualism’s Malleability -- Picking Your Friends (Federal Tax Procedure Blog 6/24/20).

⁴³ E.g., *Rector of Holy Trinity Church v. United States*, 143 U.S. 457, 460 (1892) (“If a literal construction of the words of a statute be absurd, the act must be so construed as to avoid the absurdity.”); and Scalia & Garner, A. Garner, Reading Law: The Interpretation of Legal Texts, 234-239 (“A provision may be either disregarded or judicially corrected as an error * * * if failing to do so would result in a disposition that no reasonable person could approve.”).

⁴⁴ Abbe R. Gluck & Richard A. Posner, Statutory Interpretation on the Bench: A Survey of Forty-Two Judges on the Federal Courts of Appeals, 131 Harv. L. R. 1298, 1322-1323 (2018).

[statute] made by the legislature when it enacts new laws or changes them over time.”⁴⁵ The textualist concept, championed by and closely identified with Justice Scalia, is that only the text of the statute was enacted by Congress.⁴⁶ The legislative history was not enacted by Congress and thus, at most, represents only the views of the subset of members of Congress who produced the legislative history. For textualists, use of material extraneous to the statutory text (including, most prominently, legislative history) “greatly increases the scope of manipulated interpretation, making possible some interpretations that the traditional rules of constructions could never possibly support.”⁴⁷ However, even textualists sometimes cite legislative history but claim to avoid the use of legislative history to “muddy the meaning of the clear statutory language.”⁴⁸ In other words, textualists—at least true textualists—may use legislative history when it confirms their determination of the text’s plain or ordinary meaning but claim not to use legislative history when the legislative history is inconsistent with their determination of the plain or ordinary meaning.⁴⁹

Some have noted that the textualists’ claims about legislative history are in some tension with their claims about the “originalism” interpretive strategies that textualists claim to use. Legislative history would at least be some evidence of “ordinary or public meaning” of the statutory words at the time.⁵⁰

(3) Purposivism.

Other jurists find that broader legislative context, including legislative history, assists in interpreting text and are willing to look to that broader context to determine how the enacted text should be interpreted to honor and apply the meaning Congress had or should be deemed to have had for the text.⁵¹ This is not the same as a search for Congress’ collective “intent,” but, to honor the

⁴⁵ William N. Eskridge, Jr., Interpreting Law: A Primer on How to Read Statutes and the Constitution 204 (Foundation Press 2016).

⁴⁶ A good Scalia soundbite is: “the only language adopted in a fashion that entitles it to our attention is the text of the enacted statute.” E.g., *Zedner v. United States*, 547 U.S. 489, 509–10 (2006) (Scalia, J. concurring).

⁴⁷ Antonin Scalia and Bryan A. Garner, Reading Law: The Interpretation of Legal Texts xxviii (2012); John F. Manning, Inside Congress’ Mind, 115 Colum. L. Rev. 1911, 1925-1926 (2015) (“textualists fear that its [legislative history] gives judges too much discretion to push their own preferred outcomes”).

⁴⁸ *Food Mktg. Inst. v. Argus Leader Media*, 588 U.S. ___, ___, 139 S. Ct. 2356, 2364 (2019) (per Justice Gorsuch for the majority, “Even those of us who sometimes consult legislative history will never allow it to be used to ‘muddy’ the meaning of ‘clear statutory language.’”)

⁴⁹ Such generalizations are always subject to exceptions, but I won’t dive into that morass for now.

⁵⁰ Michael C. Dorf, How Scalia Saved Originalism by Destroying It (Dorf on Law 3/16/18) (quoting Justice Scalia’s rationale for referring to Constitutional legislative history (Federalist Papers) not to show the framer’s intent but to “display how the Constitution was originally understood”).

⁵¹ Victoria Nourse, Misunderstanding Congress: Statutory Interpretation, the Supermajoritarian Difficulty, and the Separation of Powers, 99 Geo. L. J. 1119 (2011); and see also former Justice Stevens’ Foreword in William N. Eskridge, Jr., Interpreting Law: A Primer on How to Read Statutes and the Constitution vi (Foundation Press 2016) (readers might also want to review Eskridge’s Chapter 4, Legislative History, pp. 191-258). Purposivism as contrasted with textualism might be read as textualists not considering the purpose of the statutes. Bryan Garner, a noted commentator of legal interpretation says:

The second philosophy is the badly named purposivism, which asks about the legislature’s broad purpose in enacting the statute — elevating that over the particulars of phrasing. Why badly named?

The answer is that textualists also care about purpose if it can be gleaned from the language of the

(continued...)

primacy of Congress' role, it considers all factors even if beyond the statutory text that bear on Congress' will in enacting the statute.⁵² This approach to interpretation has different iterations that go by terms such as purposivism, intentionalism,⁵³ and the practical reason (or dynamic) method. I use the term purposivism because it appears to be the broad umbrella term to contrast with the rival statutory theory of textualism.⁵⁴

(4) Common Goal; Different Approaches; Different Outcomes.

The proponents of each of these two rival broad categories of statutory interpretation claim that they are faithful agents of Congress. They just approach the goal in different ways that they, respectively, feel better assures that Congress and not the courts make the law. In many, I suspect most, cases, the two inquiries reach the same results in resolving the cases at hand.⁵⁵ But the two approaches—depending upon how they are applied—could reach different outcomes.

(5) On Legislative History.

I noted above that, in the chasm between textualists and purposivists, the role in interpretation that legislative history should play is a flashpoint. The legislative history is the course of congressional consideration in identifying the need for legislation, drafting or revising the bills, expressions by persons involved in the process as to how they understood the text of the bills, and the final statutory legislative text. The principal sources of legislative history are the committee reports which I discuss below. Other sources include committee hearings, statements made on the floor of Congress in debating the legislation, and submissions to Congress by the executive branch. There is a long and substantial history of judicial use of legislative history in statutory interpretation, particularly in the tax area.

Legislative history is a broad term, with some legislative history more persuasive than others (at least for those willing to consider legislative history).⁵⁶ In terms of the legislative process and

⁵¹(...continued)

statute. But unlike textualists, purposivists will search out purpose by going well beyond the statutory words (as by resorting to the unenacted words of legislative history).

Bryan Garner, Why Judges Use Dictionaries and Grammars (NR Plus Magazine 5/1/23).

⁵² See John F. Manning, Inside Congress' Mind, 115 Colum. L. Rev. 1911, 1943-1945 (2015).

⁵³ Professor Solum states intentionalism as a separate category from textualism and purposivism but notes that some authors do not. Lawrence B. Solum, Legal Theory Lexicon: Theories of Statutory Interpretation and Construction (Legal Theory Blog 5/21/17). I include intentionalism within the category of purposivism because they both focus on broader context than the statutory text or the statutory context that is the focus of textualism.

⁵⁴ Amy Coney Barrett, Substantive Canons and Faithful Agency, 90 B.U.L. Rev. 109, 112 (2010) (noting that the “rival theories” in statutory interpretation are “purposivism and textualism”). Barrett, now a Supreme Court Justice, also notes (pp. 113-114) that “dynamic statutory interpretation” resembles purposivism; for purposes of this summary overview, I just use the term purposivism.

⁵⁵ For deeper reading, see John F. Manning, What Divides Textualists from Purposivists?, 106 Colum. L. Rev. 70 (2006); and Jonathan T. Molot, The Rise and Fall of Textualism, 106 Colum. L. Rev. 1 (2006). Both authors suggest considerable common ground, although using different labels to get there.

⁵⁶ Robert A. Katzman, Madison Lecture: Statutes, 87 N.Y.U.L. Rev. 637, 682 (2012) (“[A]ll legislative (continued...)”).

reliable indicators of the meaning of statutory text, the committee reports accompanying legislation are generally viewed as a reliable form of legislative history (eclipsed only by conference committee reports discussed below).⁵⁷ In both houses, proposed legislation is generally first considered substantively in committees which generally give the most detailed consideration of proposed statutory text; those committees often offer reports explaining the proposed statutory text that they send to the floors of their respective Houses.⁵⁸

For tax legislation, because of the historic influence of the tax writing committees and their staffs and the assistance of the Joint Committee on Taxation (“JCT”),⁵⁹ the committee reports of the House Ways and Means Committee and the Senate Finance Committee have been the most frequently used legislative history guide to interpreting the statutory text.⁶⁰ Often said to rank even higher than committee reports in authoritativeness is the particular form of legislative history accompanying and explaining statutory text produced in a Conference Committee to work out differences in legislation between the two Houses of Congress. In considering legislative history in a particular case, it is important to understand the legislative processes that produced the legislative history and whether those processes make the legislative history a reliable indicator of the actual or deemed meaning of the statutory text.⁶¹

⁵⁶(...continued)

history is not created equal,” quoting Chief Justice John Roberts.

⁵⁷ *Chai v. Commissioner*, 851 F.3d 190, 219 (2d Cir. 2017) (“The most enlightening source of legislative history is generally a committee report, particularly a conference committee report, which we have identified as among the most authoritative and reliable materials of legislative history.”) (Cleaned up).

⁵⁸ Related to the statutory history genre is consideration is drafting history--changes of the text of a bill as it moved through the legislative process; textualists find drafting history more palatable than, for example, traditional legislative history (such as committee reports). See James J. Brudney & Lawrence Baum, Protean Statutory Interpretation in the Courts of Appeals, 58 Wm. & Mary L. Rev. 681, 688-689, 715-716 (2017). Those authors also note (p. 721; see also 743-744) that the Supreme Court’s references to such drafting history do not contain the type of diminutive qualifiers that often accompany references to committee reports and other lesser forms of legislative history.

⁵⁹ On the JCT role to assist the tax committees in the preparation of proposed tax legislation, see George K. Yin, How Codification of the Tax Statutes and the Emergence of the Staff of the Joint Committee on Taxation Helped Change the Nature of the Legislative Process, 71 Tax L. Rev. 723, 728 (2018).

⁶⁰ Lawrence Zelenak, The Court and the Code: A Response to the Warp and Woof of Statutory Interpretation, 58 Duke L.J. 1783, 1783-1784 (2009) (“the quality of the committee reports on federal tax legislation - in terms of both process and product - is extremely high”; correspondingly, “Justice Scalia’s arguments for disregarding legislative history are, therefore, particularly weak in the tax context.”). Indeed, one author argues that there should be a “JCT Canon” of interpretation according special interpretive value to legislative history produced by the JCT, particularly when the JCT interpretation is reflected in regulations. Clint Wallace, Congressional Control of Tax Rulemaking, 71 Tax L. Rev. 179 (2017).

⁶¹ Oft cited rankings of legislative history are in William N. Eskridge, Jr., Dynamic Statutory Interpretation 222 fig.7.1 (Harvard University Press 1994) (providing a graphic showing a ranking of legislative history resources from lowest to highest); William N. Eskridge, Jr., Philip P. Frickey & Elizabeth Garrett, Cases and Materials on Legislation 981-82, 1000-01, 1020-21 (4th ed. 2007) (discussing hierarchy of legislative history resources); and Frank B. Cross, The Theory and Practice of Statutory Interpretation (Stanford University Press 2009), pp. 64-65 (ranking Conference Committee Reports first and Congressional Committee Reports second). I found a particularly useful discussion of presumptions and exceptions in determining the reliability of legislative history in James J. Brudney, Canon Shortfalls and the Virtues of Political Branch Interpretive Assets, 98 Calif. L. Rev. 1199, 1226-1227 (2010) (stating that consideration of any particular legislative history must be based on “the realities of Congress’s lawmaking processes” so that “Courts are attempting to invoke the best evidence of ‘consensus within the legislature that can be routinely (continued...)”).

So, where are we now on the judicial use on legislative history in statutory interpretation? In a 2019 concurring opinion, Justice Gorsuch said: “Members of this Court sometimes disagree about the usefulness of pre-enactment legislative history.”⁶² And, in the Circuit Courts, a study based on a dataset of more than 240,000 majority opinions indicated that even textualist judges most likely to be influenced by Justice Scalia’s rejection of legislative history tend to use the more persuasive types of legislative history (conference and committee reports). The authors thus conclude the judges “appear to have accepted the hierarchy of legislative materials that had previously prevailed and that Scalia had rejected.”⁶³ Justice Scalia, the authors claim, “influenced, but he did not persuade.”⁶⁴ An outstanding article by Professor George K. Yin, former Chief of Staff at the JCT debunked Justice Scalia’s claims about legislative history for tax legislation because of the expertise and care generally taken in crafting the tax statutes and legislative history.⁶⁵

c. Canons of Statutory Construction.

Canons of statutory construction are “rules of thumb that help courts determine the meaning of legislation.”⁶⁶ They are said to “limit judicial discretion and render statutory meaning more predictable.”⁶⁷ On the other hand, they are said to be “readily manipulable and [frustrate] the policy preferences of Congress.”⁶⁸ Karl Llewellyn famously observed that “there are two opposing canons on almost every point.”⁶⁹ A variation on the theme is that maxims might be viewed as minims because, as courts have said, they reveal so little and are “singularly unhelpful when it comes to deciding cases.”⁷⁰

⁶¹(...continued)

discerned’ or the evidence that is deemed to have been noticed, understood, and endorsed by a reasonable legislator.”).

⁶² *Kisor v. Wilkie*, 588 U.S. ___, ___, 139 S.Ct. 2400, 2441 (2019) (Gorsuch, J., concurring) (noting also (pp. 2441-2442) the disagreement about pre-enactment legislative history, but that the Justice “all agree that legislators’ statements about the meaning of an already-enacted statute are not a legitimate tool of statutory interpretation, much less a controlling one. (Cleaned up).

⁶³ Stuart Minor Benjamin and Kristen Renberg, The Paradoxical Impact of Scalia’s Campaign Against Legislative History 157 (SSRN 2020), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3599422. See also Stuart Benjamin, In His Advocacy Against Legislative History, Did Scalia Get Half a Loaf, or None at All? (The Volokh Conspiracy 5/15/20). In *Battat v. Commissioner*, 148 T.C. 32, 36 n. 8 (2017), the Court observed that “the Supreme Court continues to refer to legislative history,” citing Supreme Court cases including a 2010 opinion, this case, *Samantar v. Yousef*, 560 U.S. 305, 316 n.9 (2010) with a quote that Supreme Court past precedents “utilize” legislative history and future precedents likely will also).

⁶⁴ *Id.*, at 159.

⁶⁵ George K. Yin, Textualism, the Role and Authoritativeness of Tax Legislative History, and Stanley Surrey (Last Revised July 11, 2023). Law and Contemporary Problems, Forthcoming, Available at SSRN: <https://ssrn.com/abstract=4286174>.

⁶⁶ *Connecticut Nat. Bank v. Germain*, 503 U.S. 249, 253-254 (1992).

⁶⁷ James J. Brudney and Corey Ditslear, The Warp and Woof of Statutory Interpretation: Comparing Supreme Court Approaches in Tax Law and Workplace Law, 58 Duke L. J. 1231, 1233 (2009).

⁶⁸ *Id.*, p. 1233.

⁶⁹ Karl Llewellyn, Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are To Be Construed, 3 Vand. L. Rev. 395, 401 (1950). The judicial and other authorities’ deployment of this quote is too extensive to cite. A recent example is *Lockhart v. United States*, 577 U.S. 347, 361 (2016).

⁷⁰ See *United States v. Ingredient Technology*, 698 F.2d 88, 94 (1983), a famous tax criminal tax opinion, attributing the maxim/minim notion to Roscoe Pound and citing *Sheppard v. United States*, 176 Ct. Cl. 244, 361 F.2d (continued...)

This is not great praise for canons. So, how seriously should the canons be taken in statutory interpretation? I cannot answer that question other than to say that they are used—and used often enough to be fairly certain that they sometimes contribute to the outcome of opinions rather than being mere sound-bites deployed to justify conclusions already reached. The canons thus serve as “America’s common law of statutory interpretation” that “reflect centuries of judicial practice * * * and reflect norms of continuity and incrementalism.”⁷¹ Because of that, congressional legislation is crafted with these canons in mind.

Canons are generally said to fall into two broad categories: language (or linguistic) canons and substantive canons, described by one scholar as follows:

Language canons inform how text is read. For example, the Latin maxim *expressio unius est exclusio alterius* dictates that the express listing of certain items in a statute presumptively excludes any unmentioned comparable items. Substantive canons, on the other hand, inform the substantive meanings of statutes based on normative concerns. For example, the rule of lenity requires that ambiguous criminal statutes be interpreted in favor of the defendant.⁷²

Since this is not a book on statutory interpretation, I just want to focus on two issues related to canons that are appropriate to tax law and procedure.

First, particularly in the tax shelter context, many expressions are bandied about as if they are guiding precepts in discerning the meaning of the statutory text. Students of tax law will already have heard precepts, often called tax common law doctrines, such as the business purpose doctrine, substance over form, and economic substance, which inform the application of the statute even when the statutory text says nothing about those precepts.⁷³ These precepts function like substantive canons.⁷⁴

⁷⁰(...continued)

972, 977 n.9 (6th Cir. 1966); *Goldstein v. Commissioner*, 364 F.2d 734, 741 n.7 (2d Cir. 1966). Similarly, Judge Learned Hand referring to a tax canon that tax law concerns substance rather than form, referred to those concepts as “anodynes for the pains of reasoning,” meaning the pain of rigorous statutory interpretation without meaningless crutches. *Commissioner, v. Sansone*, 60 F.2d 931, 933 (2d Cir. 1932).

⁷¹ William N. Eskridge, Jr., *Interpreting Law: A Primer on How to Read Statutes and the Constitution* 15 (Foundation Press 2016).

⁷² Jonathan H. Choi, *The Substantive Canons of Tax Law*, 72 *Stan. L. Rev.* 195, 210 (2020).

⁷³ For example:

Economic Substance Doctrine: *Santander Holdings United States v. United States*, 844 F.3d 15, 21 (1st Cir. 2016), “The economic substance doctrine, like other common law tax doctrines, can thus perhaps best be thought of as a tool of statutory interpretation.”; *Mazzei v. Commissioner*, 150 T.C.138, 153 (2018) (quoting *Santander*)

Substance Over Form Doctrine: *Benenson v. Commissioner*, 910 F.3d 690, 699 (2d Cir. 2018) ((substance over form doctrine “serves to ensure that the tax code’s; technical language conform[s] more precisely with Congressional intent.” quoting *Benenson v. Commissioner*, 887 F.3d 511, 517 (1st Cir. 2018)).

Step Transaction Doctrine: *Benenson v. Commissioner*, 910 F.3d 690, 702 (2d Cir. 2018) (“the step transaction doctrine, like the substance over form doctrine is a tool of statutory construction”).

⁷⁴ See e.g., Jonathan H. Choi, *The Substantive Canons of Tax Law*, 72 *Stan. L. Rev.* 195, 199-200 (2020) (arguing that these anti-abuse doctrines “should be understood as **substantive** canons of construction, used by judges (continued...)

Second, later in this text (beginning on p. 86), I will discuss the concept of deference to agency interpretations of statutory text, commonly now called *Chevron* deference. For the present, basically the concept of deference is that a court in its interpretation and application of a statute will defer to an agency reasonable interpretation of ambiguous statutory text even if the court believes that interpretation is not the best interpretation. Deference, where applicable, is based on a presumption that, in using ambiguous statutory text, Congress intended the agency to resolve the ambiguity by reasonable interpretations. Deference functions like canons in the sense that, when applicable, deference provides a default rule for decision.⁷⁵

C. Congressional Explanations of Statutory Text.

1. General.

I focus in this section on legislative history whereby some members of congress, including committees, express their understandings of the reasons for the statutory text and the interpretation of the statutory text. The legislative history process is the same for all legislation, but I focus here on tax legislation.⁷⁶

2. Congressional Committee Reports.

Substantive consideration of tax bills in each house is principally through the committee having jurisdiction over taxes. In the House of Representatives, the Ways and Means Committee considers tax legislation; in the Senate, the Finance Committee considers tax legislation. Each committee considers proposed tax legislation and makes recommendations in the form of bills sent to the floor of their respective houses for floor debate and action. Each committee has its own staff and draws on the expertise of the staff of the prestigious and relatively nonpartisan Joint Committee on Taxation (“JCT”), discussed below, which gives each committee’s actions a degree of technical expertise and authority often not present in committee reports in other areas of legislation.⁷⁷

⁷⁴(...continued)

as rebuttable presumptions of meaning in interpreting the Code” and “are justifiable as background norms familiar to drafters of statutes (especially the staff experts actually responsible for the bulk of statutory drafting), regulators, courts, and practitioners, and that the anti-abuse doctrines therefore underlie the best reading of the Code.”)

⁷⁵ Professor Eskridge lists *Chevron* deference – and its weaker deference sibling, *Skidmore* deference, as “Extrinsic Source Canons.” William N. Eskridge, Jr., Interpreting Law: A Primer on How to Read Statutes and the Constitution 417 (Foundation Press 2016). A listing of substantive tax canons appears as an appendix to Jonathan H. Choi, The Substantive Canons of Tax Law, 72 *Stan. L. Rev.* 195, 247-260 (2020). Caveat, as I note elsewhere, *Skidmore* is not a deference authority; rather it just demands that the court consider the agency interpretation in interpreting a statute.

⁷⁶ For a particularly astute discussion of tax legislative history and its authoritativeness, see George K. Yin, Textualism, the Role and Authoritativeness of Tax Legislative History, and Stanley Surrey (December 4, 2022). *Law and Contemporary Problems*, Forthcoming, Available at SSRN: <https://ssrn.com/abstract=4286174>.

⁷⁷ See James J. Brudney and Corey Ditslear, The Warp and Woof of Statutory Interpretation: Comparing Supreme Court Approaches in Tax Law and Workplace Law, 58 *Duke L. J.* 1231, 1236 & 1246-1247 (2009); and Lawrence Zelenak, The Court and the Code: A Response to the Warp and Woof of Statutory Interpretation, 58 *Duke L.J.* 1783, 1783-1784 (2009) (“I agree with Professors Brudney and Ditslear that the quality of the committee reports on federal tax legislation - in terms of both process and product - is extremely high and that Justice Scalia's arguments
(continued...)”)

Each Committee's recommendations in the form of a bill are usually accompanied by a Committee Report. In general, for tax legislation, the Committee Report explains the bill—the problems that the Committee drafted the bill text to solve and an explanation of how the text will apply to solve the problems. For major tax legislation, the general format for the Committee Report is: (i) statement of “present law”—the background for the change in the law; (ii) statement of the “Reasons for Change,” and (iii) “Explanation of the Provision” to effect the change.⁷⁸

Committee Reports are published in the Congressional Record and, for tax legislation, are published in part in the Internal Revenue Bulletins (“I.R.B.”) and formerly in the Cumulative Bulletins (which is no longer published).⁷⁹

Whether and how useful Committee Reports are in interpreting the legislation is a disputed topic that frequently engages the courts and legal pundits. Given the legislative process where the substantive consideration and comment on pending legislation is principally (sometimes exclusively) in the Committee, it should not be surprising that courts looking beyond the statute for meaning tend to give significant weight to the Committee Reports.⁸⁰

The committees also hold hearings on significant legislation. The materials submitted and transcripts from the hearings may be helpful in understanding context but they rarely are persuasive of themselves because, unlike the Committee Reports, they rarely reflect anything that could be called a consensus.

3. Conference Committees and Reports.

If the House and Senate tax bills differ, the differences are worked out in “conference” through an ad hoc Conference Committee comprised of representatives from the House and the Senate committees having jurisdiction over tax.⁸¹ The Conference Committee resolves the differences and agrees upon a single bill that is presented to the Senate and House of Representatives for passage.⁸² The Conference Committee produces (i) the statutory text that the Committee approves and is enacted by the two houses (the statutory text is formally called the Conference Committee Report) and (ii) an explanation called the statement of managers (or joint statement,

⁷⁷(...continued)

for disregarding legislative history are, therefore, particularly weak in the tax context.”).

⁷⁸ See e.g., *Tigers Eye Trading LLC v. Commissioner*, 138 T.C. 67, 91 (2012), aff'd in part and rev'd in part sub nom. *Logan Tr. v. Commissioner*, 616 Fed. Appx. 426, 428 (D.C. Cir. 2015).

⁷⁹ IRM 4.10.7.2.2.1 (09-12-2022), Publication of Committee Reports

⁸⁰ The courts have waxed and waned with enthusiasm about committee reports in interpreting statutory text. I address that issue elsewhere, but it is fair to say here that, for tax legislation, courts have often over the years found committee reports worth considering.

⁸¹ A good general discussion of the matters contained in this section of the text is Elizabeth Rybicki, [Resolving Legislative Differences in Congress: Conference Committees and Amendments Between the Houses](#) (CRS Report 98-696 8/3/15).

⁸² For an anecdotal example of the Conference Committee consideration and decision-making on the text approved by the Committee, see Leila Carney and Chris Rizek, [In The Room Where It Happens, It Doesn't Always Happen Exactly Right](#) (Procedurally Taxing Blog 5/3/23 as revised on 5/8/23) (involving Committee Consideration of amendment of the innocent spouse provision).

explanation or some variation)⁸³ explaining the decisions in reaching the statutory text.⁸⁴ The Report and statement of managers are often referred to collectively as the Conference Committee Report⁸⁵ (although, technically, the Report is only the statutory text that is enacted by Congress and is not the statement of managers).⁸⁶ The statement of the managers serves the same function as committee reports earlier mentioned—i.e., it states publicly the Conference Committee’s reasons for resolving the differences and understandings of the agreed statutory text. Logically, because of the joint involvement of members of both houses at this critical last stage of legislation, conference committee reports are the most persuasive form of legislative history.⁸⁷

4. Joint Committee on Taxation (“JCT”).

The Joint Committee on Taxation (“JCT”) is a joint congressional committee with representatives of the Ways and Means and Senate Finance Committees.⁸⁸ The JCT is significantly involved in the tax legislation process.⁸⁹

⁸³ Sometimes also called the Joint Explanatory Statement of the Committee on Conference. Christopher M. Davis, Conference Reports and Joint Explanatory Statements (CRS Report 6/11/15). I principally use statement of managers because that is the term used by the JCT for tax conferences. See JCT webpage titled “Joint Committee Role in the Tax Legislative Process” (viewed 8/1/18).

⁸⁴ Christopher M. Davis, Conference Reports and Joint Explanatory Statements 1 (CRS Report 6/11/15) (“[T]he [conference] committee presents and explains its agreements in two documents: first, a conference report; and second, a joint explanatory statement, often called a statement of managers. The conference report presents the formal legislative language on which the conference committee has agreed. The joint explanatory statement explains the various elements of the conferees’ agreement in relation to the positions that the House and Senate had committed to the conference committee.”). The two separate documents may be combined for publication, but only the Report is voted upon by the respective houses of Congress. The JCT Staff assists the conference committee during its deliberations and then prepares the final statement of managers. See JCT webpage titled “Role of JCT” (viewed 7/19/20).

⁸⁵ E.g., Arlington Central School Dist. Bd. of Ed. v. Murphy, 548 U.S. 291, 311 (2006); and Robert A. Katzmann, Response to Judge Kavanaugh’s Review of Judging Statutes, 29 Harv. L. Rev. F. 388, 393 (2016).

⁸⁶ E.g., Victoria F. Nourse, A Decision Theory of Statutory Interpretation: Legislative History by the Rules, 122 Yale L.J. 80, 100 n. 119 (2012) (“It is fairly easy to find opinions that make simple mistakes about congressional procedure, for example, failing to distinguish conference committee reports as the text of the bill as opposed to the joint explanation to the conference committee, which is the legislative history of the conferees’ agreed-upon text.”).

⁸⁷ Lawrence + Mem’l Hosp. v. Burwell, 812 F.3d 257, 266-267 (2d Cir. 2016) (“highest form of legislative history,” citing Disabled in Action of Metro. New York v. Hammons, 202 F.3d 110, 124 (2d Cir. 2000) and Robert A. Katzmann, Judging Statutes 38, 54 (2014)); Nestle Purina Petcare Co. v. Commissioner, 594 F.3d 968 (8th Cir. 2010) (citing Sierra Club v. Clark, 755 F.2d 608, 615 (8th Cir. 1985) which quoted Demby v. Schweiker, 671 F.2d 507, 510 (D.C. Cir. 1981) (“Because a ‘conference report represents the final statement of terms agreed to by both houses, next to the statute itself it is the most persuasive evidence of congressional intent.”); and Nw. Forest Res. Council v. Glickman, 82 F.3d 825, 835 (9th Cir. 1996) (“[A] congressional conference report is recognized as the most reliable evidence of congressional intent because it ‘represents the final statement of the terms agreed to by both houses.”).

⁸⁸ The JCT is authorized by Subtitle G of the Code (§§ 8001-8023). See JCT web page titled “Statutory Basis” (viewed 7/19/22). My description of the JCT is based principally on two excellent articles, George K. Yin, James Couzens, Andrew Mellon, The “Greatest Tax Suit in the History of the World,” and the Creation of the Joint Committee on Taxation and its Staff, 66 Tax L. Rev. 787 (2013); and Yin, How Codification of the Tax Statutes and the Emergence of the Staff of the Joint Committee on Taxation Helped Change the Nature of the Legislative Process, 71 Tax L. Rev. 723 (2018). Yin, a University of Virginia professor of tax law is the former JCT Chief of Staff.

⁸⁹ See JCT webpage titled “Overview” (viewed 7/18/22).

The JCT is a bipartisan committee with 10 members—five from each House’s tax writing committee (Ways and Means in the House and Senate Finance in Senate), with three of the five from each House being from the majority party and the other two from each house being from the minority party.⁹⁰ The Chair and Vice Chair are elected by the Committee from among its members.⁹¹ The JCT has the power to appoint staff, including a Chief of Staff.⁹² The staff is nonpartisan.

The JCT’s duties include:

- Principally, in general overview, to provide tax policy advice and assistance to Congress members and tax committees involved in the tax legislation process.⁹³ This includes advising on the drafting of statutory language and the tax writing committee’s explanations in the report accompanying tax legislation.
- to make revenue estimates used by Congress for all proposed tax legislation.
- to review all tax refunds in excess of \$2 million (discussed below beginning on p. 838).
- to monitor the administration of the tax laws by the IRS (§ 8022).

Occasionally, the staff performs tax-related investigations, prominent examples being examining President Nixon’s tax returns and the tax positions of the Enron Corp. The JCT and its chief of staff are given direct access to otherwise confidential tax return information and permitted to delegate that access to others (§ 6103(f)).

D. Floor Consideration.

After being reported out of the committee, the full House of Representatives and Senate will consider and, in some cases, debate the recommendations prior to approving the text of the bills. Those deliberations are legislative history also, but discerning consensus of understanding from floor statements or record insertions by individual legislators is problematic. Sometimes, in the past at least, if the comments on the floor were made by the Chairman of the tax committee in that house, the comments have been considered persuasive.⁹⁴ Or sometimes, by de facto consensus of the legislators, there may be an orchestrated dialog—referred to as a colloquy—during the floor consideration designed to put a spin on the statutory language that, due to circumstances, may be considered authoritative.⁹⁵ But generally, floor discussions are not considered authoritative in and of themselves because there is usually no confirmation that the statements reflect a consensus.

⁹⁰ § 8002(a).

⁹¹ § 8003.

⁹² § 8004.

⁹³ See JCT webpage titled “Joint Committee Role” (viewed 7/18/22) (stating the JCT staff is “closely involved in every aspect of the tax legislative process” and describing the roles that it plays.

⁹⁴ See, e.g., *Walt Disney Productions v. United States*, 480 F.2d 66, 68 (9th Cir. 1973), cert. denied 415 U.S. 934 (1974); cf. *Balestra v. United States*, 803 F.3d 1363, 1370 (Fed Cir. 2015) (referring to floor statements of Senator Bentsen who introduced the amendment in question; “these statements indicate that Senator Bentsen, and presumably the Senate and Congress, intended * * * *”)

⁹⁵ For a particularly thoughtful discussion by the former chair of the House Ways and Means Committee on the use of colloquies as interpretive aids of congressional intent as to the text of a statute, see *Glass v. Commissioner*, 87 T.C. 1087, 1168-69 (1986).

E. Summaries of Proposed Legislation and Other Proposals.

The committees in their deliberations and the senators or representatives in their floor discussions may also consider summaries of the proposed text of the bills prepared by the JCT. These summaries are in the legislative history but it is sometimes unclear what use the committees or the full houses actually made of the summaries, so the extent to which a court might consider them authoritative is heavily dependent upon the particular circumstances.⁹⁶

Similarly, the text may have originally been presented as proposed legislation by the Treasury Department on behalf of the administration along with discussion of the purposes and effect of the text, if enacted.⁹⁷ Those discussions are helpful background but, again, it may be difficult to determine that they represented a consensus of the legislators.

Proposals considered by the tax writing committees may come from other sources or other sources / interests may become involved in the consideration in a way that does not get into the more direct forms of legislative history. What is the value, if any, of those sources in any attempt to determine what it is that Congress did? The answer appears to be virtually none when those efforts were not made a formal part of the legislative history.⁹⁸

F. Subsequent Legislative History?

1. The Oxymoron of Subsequent Legislative History.

After legislation is enacted, a committee or member may state in a committee meeting or committee report or on the floor of the House an interpretation of the previously enacted legislation. Courts give little weight to such subsequent post-enactment “legislative history,” if it can even be considered legislative history.⁹⁹

⁹⁶ The issue of the use of summaries was addressed but hardly resolved in *Robinson v. Commissioner*, 119 T.C. 44 (2002), in the context of JCT summaries for the Conference Committee. I discuss the Conference Committee below, but the role of such JCT summaries apply equally to all committees involved in the tax writing process.

⁹⁷ For some Treasury proposals, the JCT staff may make recommendations on the same subject and prepare a comparison of the staff and Treasury recommendations. E.g., Joint Committee on Taxation, “Comparison of Joint Committee Staff and Treasury Recommendations Relating to Penalty and Interest Provisions of the Internal Revenue Code,” JCX-79-99 (Nov. 5, 1999).

⁹⁸ For example, in *United States v. G-I Holdings, Inc. (In re G-I Holdings, Inc.)*, 369 B.R. 832 (D. N.J. 2007), in a bankruptcy proceeding with a large amount of taxes in issue, the taxpayer sought to introduce the affidavit of a lobbyist involved in the process of “encouraging” the Congressional powers to be to insert a favorable effective date provision the language of which apparently did not achieve its goal. The purpose of the affidavit was to give the court some pertinent “legislative history” that would permit it to interpret the provision in its favor. The Court was not amused or, perhaps, appreciative, and denied the maneuver. The Court reasoned that the testimony in the affidavit was not legislative history and not helpful to the court in interpreting the statute.

⁹⁹ *Kisor v. Wilkie*, 588 U.S. ___, 139 S.Ct. 2400, 2441-2442 (2019) (Gorsuch, J., concurring) (noting also the disagreement about *pre-enactment* legislative history, but that the Justices “all agree that legislators’ statements about the meaning of an already-enacted statute are not a legitimate tool of statutory interpretation, much less a controlling one.” (Cleaned up)); *Barber v. Thomas*, 560 U.S. 474, 486 (2010) (“And whatever interpretive force one attaches to legislative history, the Court normally gives little weight to statements, such as those of the individual legislators, made
(continued...)”).

Still, some suggest that some post-enactment legislative history may be persuasive in understanding the intent of Congress. A study based on survey of congressional staffers suggests that some subsequent legislative history if proximate in time and drafted by persons with the expertise to know what occurred and came out of the legislative process might be valuable.¹⁰⁰

2. For Tax, There's the JCT Blue Book.

After a major revenue act or at the end of each Congress, the JCT Staff will usually produce a Staff General Explanation of the legislation. This Staff General Explanation is often referred to as the “Blue Book” because of its blue cover in printed format¹⁰¹ The Blue Book states the JCT Staff's understanding of the legislation that was passed based upon the legislative history and the JCT Staff's insight into the process of the legislation. The general format for the Blue Book is the same as for the Committee Reports for major tax legislation: for each major provision or related set of provisions in the act, the JCT Staff states its understanding of the law that was the background motivating the provision(s), the reasons for the change to the law, explanation of the provision making the change to the law, and the effective date of the provision.

At least in recent times, the content of the Blue Book hews closely to the language of the statute and legislative history (such as the pre-enactment committee reports). Most of the Blue Book's explanation of the legislation thus might be viewed as a virtual cut and paste compilation of the portions of the legislative history relevant to the statute in its final form.¹⁰² It has thus been said that the purpose of the Blue Book is to “to provide a single, comprehensive source of legislative history for major tax acts.”¹⁰³

The Blue Book may, however, interpret the legislation to address issues not addressed or ambiguous in the text of the regular legislative history. In stating its understanding in words different than the statute and legislative history, the Staff may add nuance or interpretations perhaps not compelled by the statute or legislative history. Therein lies the rub. The Blue Book is not itself legislative history; that nuance and those interpretations are not legislative history. When the Blue Book differs, even subtly, from the statute or legislative history, the issue is whether the departure

⁹⁹(...continued)

after the bill in question has become law.”); *Sullivan v. Finkelstein*, 496 U.S. 617, 632 (1990) (Scalia, J., concurring in part) (“Arguments based on subsequent legislative history, like arguments based on antecedent futurity, should not be taken seriously, not even in a footnote.”).

¹⁰⁰ Abbe R. Gluck and Lisa Schultz Bressman, *Statutory Interpretation from the Inside - An Empirical Study of Congressional Drafting, Delegation, and the Canons: Part I*, 65 *Stan. L. Rev.* 901, 984 (2013).

¹⁰¹ Marc J. Gerson, *Technically Speaking: The Art of Tax Technical Corrections*, 114 *Tax Notes* 927, 931 (Mar. 5, 2007), citing Michael Livingston, *What's Blue and White and Not Quite as Good as a Committee Report: General Explanations and the Role of 'Subsequent' Tax Legislative History*, 11 *Am. J. Tax Pol'y* 91, 98 (Spring 1994)).

¹⁰² A JCT staff member explained to me this process of closely hewing to the actual legislative history and where the legislative history did not address an issue that, in the Staff's view, should be addressed, it might note in the Blue Book the need for technical corrections, a process whereby actual legislation is subsequently enacted to correct problems in the statute.

¹⁰³ Livingston, *What's Blue and White and Not Quite as Good as a Committee Report: General Explanations and the Role of 'Subsequent' Tax Legislative History*, 11 *Am. J. Tax Pol'y* 91, 98 (Spring 1994).

has some authority because of the key vantage point of the Staff of the JCT in the legislation process.¹⁰⁴ Some courts are wary of the Blue Book where it goes beyond parroting or paraphrasing the statute or the legislative history;¹⁰⁵ of course, when all the Blue Book does is parrot the statute or legislative history, the statute or legislative history is the source for interpretation, without the Blue Book adding any authority.

Although not legislative history, courts, even those which on occasion express concern about the role of the Blue book, rely upon the Blue Book as some indication of what Congress intended.¹⁰⁶ Others, including famously Justice Scalia, treat the Blue Book only as relevant and persuasive as a law review article.¹⁰⁷

I ask readers to consider whether the two explanations of the uses of the Blue Book are consistent. Is the Blue Book written by those intimately involved in the legislative process no more persuasive than a law review article?¹⁰⁸ What does it mean for the Blue Book to be persuasive? There is one analog to the Blue Book that I am familiar with. Shortly after enactment of the Administrative Procedure Act (“APA”), the Attorney General published a Manual on the Administrative Procedure Act (1947). The Supreme Court has said that the Manual is entitled to “some deference because of the role played by the Department of Justice in drafting the legislation.”¹⁰⁹ If the Attorney General’s Manual interpretation of the APA is entitled to deference,

¹⁰⁴ My understanding is that, in the past, the Administration and private interests would lobby for favorable interpretations.

¹⁰⁵ E.g., *Federal National Mortgage Association v. United States*, 379 F.3d 1303, 1309 (Fed. Cir. 2004) (“As a post-enactment explanation, the Blue Book interpretation is entitled to little weight. *Jones v. United States*, 526 U.S. 227, 238, 143 L. Ed. 2d 311, 119 S. Ct. 1215 (1999).”); and *Exxon Mobil Corporation v. Commissioner*, 689 F.3d 191, 201 (2d Cir. 2012) (quoting and stated its “agreement”). For a thoughtful exposition of this view, see *AD Global Fund LLC v. United States*, 67 Fed. Cl. 657, 677- 678 (2005), aff’d 481 F.3d 1351 (Fed. Cir. 2007).

¹⁰⁶ See *Kikalos v. Commissioner*, 190 F.3d 791, 798 (7th Cir. 1999) (“This [Blue Book] gloss on the meaning of the statute does not carry the same weight as legislative history, but in view of its authorship, it is nonetheless ‘highly indicative of what Congress did, in fact, intend.’” (Citations omitted).) See also Michael Livingston, What’s Blue and White and Not Quite as Good as a Committee Report: General Explanations and the Role of “Subsequent” Tax Legislative History, 11 Am. J. Tax Pol’y 91, 103 (1994) (“Courts have almost uniformly been willing to consult the Blue Book.”); see also Michael Livingston, Congress, the Courts and the Code: Legislative History and the Interpretation of Tax Statutes, 69 Tex. L. Rev. 819, 885-886 (1991). For lively debate over the role of the blue book, see *Robinson v. Commissioner*, 119 T.C. 44 (2002), reviewed opinion, see particularly the concurrence of Judge Thornton.

¹⁰⁷ *United States v. Woods*, 571 U.S. 31,47-48 (2013) (case citations and quotations omitted for readability). The Tax Court adopted the key language from this quote. *Rafizadeh v. Commissioner*, 150 T.C. 1, 6. n4 (2018) (“the Blue Book is not legislative history but, ‘like a law review article, may be relevant to the extent it is persuasive,’” quoting *United States v. Woods*, 571 U.S. 31, 47 2013)).

¹⁰⁸ See e.g., § 1.6662-4(d)(3)(iii) (recognizing Blue Book, and not law-review articles, as a form of “substantial authority” for the purpose of defending against a substantial-understatement penalty). And, to extend further, what would *Chevron* deference say about raising the Blue Book above law review articles in a regulation?

¹⁰⁹ *Kisor v. Wilkie*, 588 U.S. ___, 139 S.Ct. 2400, 2420 (2019) (plurality opinion, quote cleaned up; citing *Vermont Yankee Nuclear Power Corp. v. Natural Resources Defense Council, Inc.*, 435 U. S. 519, 546 (1978)); *Steadman v. SEC*, 450 U.S. 91, 102 n. 22 (1981) (also citing *Vermont Yankee*); and see also Robin J. Arzt, Recommendations for a New Independent Adjudication Agency to Make the Final Administrative Adjudications of Social Security Act Benefits Claims, 23 J. Nat’l Ass’n Admin. L. Judges 267, 330-31 (2003) (citing *Vermont Yankee* and *Steadman* and stating that the Manual is part of the legislative history of the APA”; the statement of its status as legislative history is perhaps hyperbole in today’s refined notions of legislative history, but it does come close).

then the JCT’s Blue Book which shares the key legislative process characteristic should be entitled to some consideration in the nature of deference.

The concept of deference raises another reason for providing “some deference” to the Blue Book. I discuss later in this text the issue of proper deference to be given agency interpretations of statutory text. There are two forms of deference agency interpretations – most relevant here, a strong form labeled as *Chevron* deference (see deference discussion below beginning on p. 86). I find it odd that agency interpretations by a party with skin in the game (the Attorney General in the APA context) in a dispute between the Government and an adverse party may be given deference, when Blue Book interpretations by a relatively nonpartisan JCT staff intimately involved in the tax legislating process should not also be entitled to some deference.

Blue Books are also used to identify potential areas in which the legislative language may not have achieved or fully achieved Congress’ intent for the legislation and thus provides a roadmap for potential “technical corrections” legislation (which I discuss below) or for the IRS to address in Regulations under the IRS rule-making authority.¹¹⁰

3. Even Less Formal Indications of Legislative Intent.

There have been sporadic attempts to use isolated post-enactment comments or even testimony from legislators as evidence of the meaning of statutory text. Suffice it to say that such comments or testimony is given no weight, although it might achieve *Chevron* or *Skidmore* deference if the IRS incorporates that meaning into regulations or subregulatory guidance documents.¹¹¹

G. Technical Corrections Legislation; Statutory Clarifications.

Because of the frequency and complexity of tax legislation, glitches and unintended consequences are inevitable. Glitches are not a major problem to the extent that they can be addressed effectively in the Blue Book or via the IRS rule-making authority that are likely to be respected by the courts. However, if the statutory language itself needs a fix, the fix often comes via “technical corrections” corrective legislation.¹¹² That process is defined as:

A technical correction [is] legislation that is designed to correct errors in existing law in order to fully implement the intended policies of previously enacted legislation. The principal factor in determining whether a provision is technical is the original

¹¹⁰ Marc J. Gerson, Technically Speaking: The Art of Tax Technical Corrections, 114 Tax Notes 927 (2007).

¹¹¹ *Tualatin Valley Builders Supply, Inc. v. United States*, 522 F.3d 937, 941 (9th Cir. 2008) (discussing *Chevron* and *Skidmore* deference).

¹¹² For good general discussion of the process, see Marc J. Gerson, Technically Speaking: The Art of Tax Technical Corrections, 114 Tax Notes 927 (2007). An example of a clear need for a correction is the inadvertent omission of § 6501(h) from the 1954 Code upon its original enactment, an omission corrected in the Technical Amendments Act of 1958, P.L. 85-866. The discussion in the text are derived from Gerson’s article unless otherwise attributed.

intent of the underlying legislation. Once it is determined that the existing statute does not properly implement legislative intent, and that the proposed change conforms to and does not alter the intent, the provision is deemed to be technical.

The following are key features of the technical corrections legislation:

- The fix is generally retroactive to the effective date of the legislation that is being corrected.
- The fix is deemed to be revenue neutral because it is merely implementing the original intent which was previously scored.
- The need for technical corrections may be recognized in the process of preparing the Blue Book but may also be proposed by any of the affected constituencies (the IRS or Treasury, taxpayers, professional groups, trade associations, or members of congress or their staffs).

A related category of legislation is a “statutory clarification” that may function likely a technical correction but subject to terms imposed in the clarification. For example, § 6426(e), enacted in 2005 and repeatedly extended, allowed a credit for “producing any alternative fuel mixture for sale or use in a trade or business of the taxpayer.” The statute provided a definition. In 2019, Congress enacted a “Clarification” designed to insure that the original statute’s definition did not include certain types of fuel. Congress intended the clarification to be curative, to express Congress’ original intent with the text originally enacted.¹¹³ The clarification statute provided that it applied to “fuel sold or used before [the clarification Act’s] date of enactment” if the claims for the credit had “not been paid or allowed,” and if the claims “were made on or after January 8, 2018.” As a curative statute, the retroactivity (although somewhat limited) was approved.

H. The Code and Uncodified Tax Legislation.

1. General—Codified and Uncodified Laws.

Congress enacts law. Those laws appear in the Statutes at Large.¹¹⁴ The Statutes at Large are “legal evidence of the law.”¹¹⁵ The Statutes at Large are published in chronological order.¹¹⁶

In order to make the law more accessible, many laws are presented in the U.S. Code (“U.S.C.”) which arranges laws into 54 broad “Titles” according to subject matter.¹¹⁷ The Office of

¹¹³ I summarize the discussion in the text from *Valero Marketing and Supply Co. v. United States*, (W.D. Tex. No. 5:19-CV-328-DAE Order dated 7/31/20).

¹¹⁴ See Library of Congress web page titled “Statutes at Large,” (viewed 7/18/22). 1 U.S.C. § 112 (i) directs the “Archivist of the United States” to compile, edit, index and publish the Statutes at Large; and (ii) provides that the “Statutes at Large shall be legal evidence of laws, concurrent resolutions, treaties, international agreements other than treaties, proclamations by the President, and proposed or ratified amendments to the Constitution of the United States therein contained.”

¹¹⁵ 1 U.S.C. § 112.

¹¹⁶ *Gonzalez v. Vill. of W. Milwaukee*, 671 F.3d 649, 661 n.6 (7th Cir. 2012).

¹¹⁷ See Office of the Law Revision Counsel, United States Code: Detailed Guide to the United States Code (continued...)

Law Revision Counsel (“OLRC”) within the House of Representatives maintains these Code Titles.¹¹⁸

These U.S.C. Titles are of two types—(i) Titles that, after compilation,¹¹⁹ have been enacted by Congress (“Positive Law Titles”) and (ii) Titles that have not been enacted but are the OLRC’s editorial compilations of the underlying Statutes at Large (“Non-positive Law Titles”).¹²⁰ For example, Title 18, Crimes and Criminal Procedure, has been enacted as a positive law, hence Title 18 is a Positive Law Title; Title 18 is **the** Statute at Large for all of Title 18 and is legal evidence of the law.¹²¹ Where the U.S. Code itself is not enacted as a Positive Law Title but is instead the compilation by the OLRC from Statutes at Large, the U.S. Code is only prima facie evidence of the law (i.e., the underlying Statutes at Large) but is not the law; the Statutes at Large are the evidence of the law.¹²² Where the U.S. Code is enacted as positive law (such as Title 18)¹²³ and subsequently amended, the amended U.S. Code is the law because the Code is the Statute at Large rather than a compilation of the Statutes at Large.

The Internal Revenue Code (“IRC”) was first enacted as positive law in 1939¹²⁴ and then again in 1954¹²⁵ and 1986.¹²⁶ Unlike the other Positive Law USC Titles (e.g., Title 18), the IRC was not enacted as a Positive Law USC Title with a Title number (e.g., 26) but was rather enacted as the IRC.¹²⁷ Title 26 (26 U.S.C.) is **not** a Positive Law Title (hence not Positive Law); the IRC is Positive

¹¹⁷(...continued)

Content and Features, (viewed 8/15/23) (I refer to this site in this section as “Office of Law Revision Counsel Guide”); and Will Baude, Reminder: The United States Code is not the law (The Volokh Conspiracy 5/15/17). Professor Baude gives credit for his comments to an article that “rocked my world when I was in law school” -- Tobias A. Dorsey, Some Reflections on Not Reading the Statutes, 10 Green Bag 282 (2007) (Dorsey was the Assistant Counsel in the Office of the Legislative Counsel, U.S. House of Representatives, which means that he knows whereof he speaks).

For an example of an omission of such a Code compilation and the underlying statute at large, with the statute at large controlling, see *American Lung Ass'n v. EPA*, 985 F.3d 914, 980 (D.C. Cir. 2021).

¹¹⁸ 2 U.S.C. §§ 285, 285a and 285b.

¹¹⁹ In some cases in the compilation process, the compiler may misstate what was in the original or amended Statutes at Large. The error then is codified into law when the compiled U.S.C. is enacted. This is rare. For a discussion, see Will Baude, Codifiers' Errors and 42 U.S.C. 1983 (The Volokh Conspiracy 6/12/23) (noting that this may be a problem for a textualist).

¹²⁰ See House Office of Law Revision web page titled Positive Law Codification (viewed 7/18/22).

¹²¹ Act June 25, 1948, ch. 645, § 1, 62 Stat. 683; see 1 U.S.C. § 204, Notes. See *Gonzalez v. Vill. of W. Milwaukee*, 671 F.3d 649, 661 n.6 (7th Cir. 2012).

¹²² See House Office of Law Revision web page titled “Positive Law Codification” (viewed 7/18/22). 1 U.S.C. § 204(a) provides that, generally, the U.S. Code provisions “establish prima facie the laws of the United States,” but “whenever titles of such Code shall have been enacted into positive law the text thereof shall be legal evidence of the laws therein contained.” See also Mary Whisner, The United States Code, Prima Facie Evidence, and Positive Law, 101 Law Libr. J. 545, 547 (2009).

¹²³ There is a list of Codes that have been enacted as positive law in the note to 1 U.S.C. § 204(a).

¹²⁴ See George K. Yin, How Codification of the Tax Statutes and the Emergence of the Staff of the Joint Committee on Taxation Helped Change the Nature of the Legislative Process, 71 Tax L. Rev. 723 (2018).

¹²⁵ The 1954 Code was published in volume 68A of the United States Statutes at Large.

¹²⁶ The re-enactment of the 1954 Code as the Internal Revenue Code of 1986 was in Public Law 99-514, 100 Stat. 2085, § 2(a).

¹²⁷ See 1 U.S.C. § 204, Notes.

Law. The IRC is the only Positive Law Code that was **not** enacted as a Positive Law Title in the U.S.C.¹²⁸

There is a wrinkle here, though. Congress does not re-enact the IRC except on rare occasions with many years intervening (there have been only 3 IRC's since Congress began enacting IRC's in 1939).¹²⁹ For large Codes in a dynamic environment (such as tax), the Codes will be amended often. To cite the actual law (as opposed to the 26 U.S.C. compilation) as of a given date, one would have to cite the most recent IRC (in this case, IRC of 1986) and track and cite all statutes amending the relevant section of that IRC. The annual compilation in 26 U.S.C. does that work for us by bringing its compiled sections up to date frequently (soon after enactment of the amendment to the IRC) with a tracking of the statutes producing up to date text. In most cases, persons needing to cite the IRC cite 26 U.S.C. (which, to repeat, for each year is a mirror image of the most recent IRC), paying attention to the amendments to the IRC to ensure working with the text of the law as applicable to the time period or event in question.¹³⁰ Thus, if one cites § 7805 in a case where 2012 is the relevant year, the citation would be 26 U.S.C. § 7805 (2012)¹³¹ or, in cases where the year is not significant (such as in a law review article discussing law generally, with assumption that it is a current version), one could leave off the year (e.g., 26 U.S.C. § 7805).¹³² (I leave off the year in this book except where dating is critical.) A quick and dirty way to use 26 U.S.C. (and indeed all U.S.C. Titles) is to refer to the current version and make sure from the notes that the text has not been amended at any relevant time that would make the current text potentially not applicable.¹³³ Alternatively, one could cite the original IRC with explanation to show relevant amendments but that is much more tedious than the U.S.C. strategy and, in my experience, rarely done for the IRC. Remember that, as noted above, the Code compilation in the 26 U.S.C. is prima facie evidence of the law.¹³⁴ That is generally good enough for the work courts and practitioners do.

A similar problem is encountered for statutes that are compiled into Non-Positive Law Titles. The underlying statutes are the law, not the Non-Positive Law Title U.S.C. compilations. Hence, properly, citations to that law should be to the underlying statutes and amendments rather than to the Non-Positive Law Titles. The logistical problem is that the Statutes at Large are not updated with

¹²⁸ See 1 U.S.C. § 204, Notes.

¹²⁹ The Internal Revenue Codes of 1939, 1954 and 1986, respectively.

¹³⁰ For example, the citation would be to 26 U.S.C. § 7805 (with any citation to and explanation of relevant amendments since IRC 1986 was adopted) instead of IRC § 7805, with citation of relevant amendments. If there have been any relevant amendments since the key date or year, the year of the compilation is offered (e.g., 26 U.S.C. § 7805 2016). The key sources for the U.S.C. (such as the Office of Law Revision Counsel's codified version) shows the history of amendments. For this reason, when dates are critical, it is better form to include the year of the U.S.C. compilation to show that it is the U.S.C. as applicable to the period or events being discussed.

¹³¹ Example for this format is *United States v. Home Concrete & Supply, LLC*, 566 U.S. 478, 480 (2012) (“26 U. S. C. § 6501(a) (2000 ed.)”).

¹³² Example for this format is *Mayo Foundation for Med. Educ. v. United States*, 562 U.S. 44, 47 (2011) (“26 U.S.C. § 3121(b)(10)”).

¹³³ See Eugene Volokh, [When Key Features of a Federal Law Don't Appear in the Main Text of the U.S. Code Entry](#) (The Volokh Conspiracy 2/16/23) (an example of a statute of limitations that was in a statute at large but not in Title 18). The notes to the Title 18 provision alert readers, but it is important for a U.S.C. sections to read the notes to make sure something is not out there that affects the provision.

¹³⁴ 1 U.S.C. § 204(a)

amendments after the date of enactment.¹³⁵ Hence, care must be taken in working with Non-Positive Law Titles. The practical solution as with amendments to Positive Law Titles is to work from the relevant version of the U.S.C. compilation where the compilers have done that work and there is a presumption that the compiled version of the relevant statute accurately states the law.

As should be apparent, however, Non-Positive Law U.S.C. Titles may not tell the whole story that might be discerned from a direct reading of the Statutes at Large (including original enactment and all amendments). For example, related sections of the Statutes at Large may be split up in the codification process or even there might be a change in language.¹³⁶

Moreover, there is law-enacted statutes—that is never codified (i.e., for tax legislation, not codified into the IRC of 1986 (codified into 26 U.S.C.) and appears only in the Statutes at Large; in such cases, that law either does not appear in the official statutory text of the U.S.C. but, at least sometimes, may appear in a note to a section in the official U.S.C. Title; care should be taken to ensure that third party publishers’ versions of the Title include those notes which can be helpful. A good example of such “uncodified” tax law is § 530 of the Revenue Act of 1978, which is legislation giving taxpayers certain relief in the ongoing problem of characterizing service providers as employees or independent contractors; that uncodified provision is referred to in a note to 26 U.S.C. § 3401.¹³⁷ (I discuss § 530 relief in its context later in the text beginning on p. 96.)

One issue that I think arises principally for Non-Positive Law Titles (which are compilations of the underlying Statutes at Large) relates to enacted findings and purposes which are statements

¹³⁵ Justice Frankfurter, reportedly, had an adamant insistence on reading the Statutes at Large rather than the Non-Positive Law Title compilations. Tobias A. Dorsey, Some Reflections on Not Reading the Statutes, 10 Green Bag 282 (2007) (but also noting for balance that everyone else did the same in Justice Frankfurter’s day),

¹³⁶ See e.g., *American Lung Ass'n v. EPA*, 985 F.3d 914, 980 (D.C. Cir. 2021) (“the way in which the codifiers assembled the U.S. Code version of Section 7411(d) by omitting the Senate Amendment conflicts with the Statutes at Large, which is the definitive legal evidence of what the law is. 1 U.S.C. § 112; see id. § 204(a) (United States Code provides only prima facie evidence of the federal law)”).

¹³⁷ In *Bruecher Found. Servs. v. United States*, 383 Fed. Appx. 381 (5th Cir. Tex. 2010), the court noted the original enactment and subsequent history of § 530 and says that § 530 is “codified as a note to 26 U.S.C. § 3401.” The official Title 26 at the House of Representatives’ Office of Law Revision web site for § 3401 offers a range of notes (such as effective dates for amendments) and includes § 530 in its entirety. If you use a third party reproduction of the Code (such as Cornell’s LII here), it is important to make sure it offers the notes. (LII offers the notes and other links for “Authorities” and “IRS Rulings” which, I think is principally regulations.)

The Office of Law Revision Counsel Guide refers to notes as “statutory notes” which may be either statutory or editorial. “Statutory notes are provisions of law that are set out as notes under a Code section rather than as a Code section. A statutory note can consist of as much as an entire act * * * [such as § 530 discussed above) or as little as a clause * * * .” As I understand the concept, the statutory notes (even when they consist of entire statutes) are not part of the Title (here Title 26 as to § 530) but are editorial decisions made by the Code compilers. Thus, § 530 is not part of the enacted Title 26, although it does appear as a note in the official compiled version of Title 26. I may be wrong in this assumption, however. See *Nat'l Veterans Legal Servs. Program v. United States*, 968 F.3d 1340, 1343 (Fed. Cir. 2020) (“That this text appears as a statutory note, rather than as section text, is “of no moment.” *Conyers v. Merit Sys. Prot. Bd.*, 388 F.3d 1380, 1382 n.2 (Fed. Cir. 2004)”); I tried briefly to go through the trail of the cited case and could not get a clear understanding; thus, I think that § 530, although appearing in the statutory note is not part of the positive law codified in the IRC but a note added by the codifier, so that the law is the original noncodified statute.).

The notes may not include all such noncodified statutes and do not include other forms of “law” such as treaties or regulations.

enacted into the actual law.¹³⁸ The enacted findings and purposes serve the same function as statements and purposes appearing in legislative history. A stated concern for the use of legislative history in statutory interpretation is that it is not enacted. Enacted findings and purposes are enacted, and thus serve a legitimate role in statutory interpretation under any interpretive strategy.¹³⁹ When a Statute at Large is compiled into the Non-Positive Law Titles, the enacted findings and purposes will usually not be incorporated into the Code sections and will appear, if at all, only in notes to the compiled Code sections. It is thus critically important to refer to the Statutes at Large (where the findings and purposes will appear prominently) or to the notes in the Non-Positive Law Titles. I don't think this is an issue for the IRC because the statute is the Code and the findings and purposes appear in the legislative history (usually drafted with the involvement of the staff of the Joint Committee on Taxation ("JCT")). In all events, it is probably good practice to always read the notes of sections in the Code.

The principal statutes cited in this book are all positive law. As noted the IRC itself was enacted as a separate Code. Where I cite a Code section without further description, I will be referring to the IRC. When I cite other Code provisions, I will identify the Title. The other commonly cited statutes are positive law Titles:

- 5 U.S.C., Government Organizations and Employees (including sections commonly called the Administrative Procedure Act for the source prior to codifying as positive law Title).
- 11 U.S.C., Bankruptcy
- 18 U.S.C., Crimes and Criminal Procedure
- 31 U.S.C., Money and Finance (including the money and financial reporting requirements such as FBARs).

2. Tax Treaties.

Normally, tax treaties are created and modified by country-to-country bilateral and sometimes multilateral negotiations, with agreements (treaties) then approved by the Senate. Under the Constitution, treaties with foreign countries are U.S. law.¹⁴⁰ Although the precise parameters of that mandate may be unclear, for present purposes treaties are given a status co-equal to legislation.¹⁴¹ Among other things, this means that the later in time trumps the earlier.

¹³⁸ See Jarrod Shobe, Enacted Legislative Findings and Purposes, 86 U. Chi. L. Rev. 669 (2019). The statements in the paragraph in the text above are drawn from this article. Another good discussion is Daniel A. Crane, Enacted Legislative Findings and the Deference Problem, 102 Geo. L.J. 637 (2014).

¹³⁹ This is not to say that unenacted findings (or the equivalent) in legislative history should be entitled to lesser weight than enacted findings. Some scholars assert that courts do not make distinctions between the enacted and unenacted findings in the analogous context of constitutional consideration of the statutes. Daniel A. Crane, Enacted Legislative Findings and the Deference Problem, 102 Geo. L.J. 637, 647 ff (2014).

¹⁴⁰ U.S. Const. art. VI, § 1, cl. 2 ("This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all **Treaties** made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land.").

¹⁴¹ The rule as codified for tax treaties is in § 7852(d)(1) ("For purposes of determining the relationship between a provision of a treaty and any law of the United States affecting revenue, neither the treaty nor the law shall
(continued...)

Taxes may be dealt with in any type of treaty, but tax issues are usually addressed in special types of treaties. For example, a common type of tax treaty among countries—particularly developed countries—is a type commonly referred to as a double tax treaty¹⁴² which is designed to avoid, to the extent reasonable, double income taxation on commerce between the treaty states. Tax treaties have not created taxes (although conceivably they could), but tax treaties figure prominently in the application of the tax laws. Two good examples come readily to mind. First, U.S. corporations paying dividends to foreigners must withhold for U.S. income tax up to 30% of the dividends, but many of our treaties allow a significantly reduced treaty rate.¹⁴³ Second, U.S. tax law prescribes a regime for taxing foreign corporations doing business in the U.S., but treaties may require a regime different from the one required by statute.¹⁴⁴

Treaty effects on the Code will not appear in the Code itself. Practitioners must be aware that

- this form of nonstatutory law may trump legislation (including an IRC provision) enacted before the treaty provision.
- disclosure is required when taxpayers take a “position that a treaty of the United States overrules (or otherwise modifies) an internal revenue law of the United States,” with the disclosure on the filed return or, if no return is required, “in such form as the Secretary may prescribe.”¹⁴⁵

In terms of process as to how these treaties come into existence, they are shaped both by the executive branch which negotiates the treaties and by the legislative branch—specifically the Senate, which must advise and consent to the treaties. In that process, as noted, the executive branch negotiates the treaty and submits it to the Senate along with a Treasury Explanation of the Treaty. In the Senate, the treaty is referred to the Senate Foreign Relations Committee which considers the treaty and, if approved, sends it to the Senate along with a committee report explaining what the Foreign Relations Committee believes it has approved and why it approved it. The Senate then votes on the treaties and, if approved, they “enter into force”—treaty speak for become effective.

¹⁴¹(...continued)

have preferential status by reason of its being a treaty or law.”)

¹⁴² The more precise title for U.S. double tax treaties is “Convention Between the United States of America and [The Other Treaty State] for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital and to Certain Other Taxes.” The U.S. has a model double tax convention that serves nominally in negotiations as the U.S. opening rounds for negotiating a double tax treaty with present or future treaty partners. See IRS web page titled “United States Model - Tax Treaty Documents” (last reviewed or updated 10/19/20 and viewed on 7/24/19/20). The most recent model double tax treaty of 2016 does not yet have a Technical Explanation that usually accompanies U.S. model tax treaties. The IRS projected that the Technical Explanation would issue shortly after the 2016 Model was issued but has not issued one yet. For my thoughts on the treaty process and the interpretation of tax treaties, see John A. Townsend, Tax Treaty Interpretation, 55 Tax Law. 219 (2001).

¹⁴³ § 1441. Examples of tax treaties with lower rates are: U.S.-United Kingdom double tax treaty of 2001, Article 10, which provides 5 or 15% withholding rates; U.S.-Federal Republic of Germany double tax treaty of 1990, Article 10, which provides 5% or 15% withholding rates. A handy IRS table for withholding rates on various payments to foreign persons, including dividends, may be found here (visited 6/23/17).

¹⁴⁴ *National Westminster Bank, PLC v. United States*, 512 F.3d 1347 (Fed. Cir. 2008). See also Richard L. Reinhold & Catherine A. Harrington, What NatWest Tells Us About Tax Treaty Interpretation, 119 Tax Notes 169 (2008).

¹⁴⁵ § 6114(a). See Reg. § 301.6114-1.

One major question for treaties is how they are to be interpreted. A treaty may be analogized to a contract. Over a long history, our courts have developed tools for interpreting contracts so that legal disputes involving the contracts can be resolved. In contract interpretation, courts often say the goal is to resolve a contract dispute based on the shared understanding or expectation of the parties. But a contract dispute case must still be decided even if there is no discernible shared understanding or expectation of the parties.¹⁴⁶ And how do you determine the shared understanding or expectation of a contract? Can you look to the contracts' negotiation history—analogue to legislative history for a statute? All of those issues that have occupied our courts for so long in contract and statutory interpretation exist in treaty interpretation.¹⁴⁷

Thus, it is said that treaties should be interpreted consistent with the shared understandings or expectations or deemed such of the treaty partners.¹⁴⁸ As to the meaning of the treaty it negotiated, do Executive Branch statements before, during and after the Senate consideration attract any special deference like *Chevron* deference? Or should we look to the meaning the Senate had in ratifying the treaty? Or, finally as to the Executive Branch role in foreign affairs arising from the Constitution and statutes, mean that some level of deference, akin to *Chevron* deference, be given to Executive Branch interpretation of treaties?¹⁴⁹

I suggest that it is not just the text of the treaty that is, under the Constitution, the law of the land, but the text of the treaty as interpreted by the Senate and President, in their respective spheres of competence in the treaty approval process that control treaty interpretation in U.S. courts as to U.S. law. And, even beyond what might have been the status at the time of ratification, the ongoing role of the Executive Branch in foreign affairs should give the Executive Branch treaty interpretation some special role, whether called deference or something else. There are major subtleties in that statement, so I will just expand a bit in the footnotes rather than going into that distracting issue in the text.¹⁵⁰

¹⁴⁶ This is exemplified in the famous case of the good ships “Peerless.” *Raffles v. Wichelhaus* (1864) 159 Eng. Rep. 375; 2 Hurl. & C. 906, as discussed in William Baude & Stephen E. Sachs, The Law of Interpretation, 130 Harv. L. Rev. 1079, 1083 (2017).

¹⁴⁷ See generally Gregory H. Fox, Paul R. Dubinsky, and Brad R. Roth, Supreme Law of the Land: Debating the Contemporary Effects of Treaties within the United States Legal System (Cambridge University Press 2017).

¹⁴⁸ *Nat'l Westminster Bank, PLC v. United States*, 512 F.3d 1347 (Fed. Cir. 2008); Richard A. Reinhold and Catherine A. Harrington, What NatWest Tells Us About Treaty Interpretation, 119 Tax Notes 169 (2008).

¹⁴⁹ E.g., Curtis A. Bradley, Chevron Deference and Foreign Affairs, 86 Va. L. Rev. 649 (2000) (suggesting some form of deference to Executive Branch treaty interpretation, with many opinions reconciled by presuming “that the United States treaty makers delegated interpretive power to the Executive Branch because of its special expertise in foreign affairs.” (Id., at 702.)); and Eric A. Posner and Cass R. Sunstein, Chevronizing Foreign Relations Law, 116 Yale L. J. 1170, 1176 (2007) (For Executive Branch foreign affairs interpretations in foreign affairs (including treaties), “courts should generally defer to the executive on the ground that resolving ambiguities requires judgments of policy and principle, and the foreign policy expertise of the executive places it in the best position to make those judgments.”).

¹⁵⁰ My views are set forth in John A. Townsend, Tax Treaty Interpretation, 55 Tax Law. 219, 253-263 (2001). In summary, I believe that, in considering whether to ratify a treaty, the Senate considers the interpretation of the Executive Branch and its own interpretation in approving the treaty. Those understandings may not be consistent with the treaty partner's understanding. I believe that, in determining the law under the treaty, the U.S. courts should strive to determine the interpretation the President had in negotiating and then the Senate had in ratifying the treaty. And to
(continued...)

I. Oversight Functions.

In addition to its role in passing substantive tax legislation, Congress serves an important oversight function with the IRS. In this oversight role, Congress reviews whether the IRS is working efficiently and in the best interests of the citizens of the United States.¹⁵¹ Both houses of Congress have various committees with some oversight function; the principal ones are:¹⁵²

- House Committee on Oversight and Government Reform;
- House Committee on Ways and Means: Subcommittee on Oversight;
- House Committee on Appropriations: Financial Services Subcommittee;
- Senate Finance Committee: Subcommittee on Taxation and IRS Oversight;
- Senate Committee on Appropriations; Senate Committee on Homeland Security and Governmental Affairs;
- Joint Committee on Taxation (JCT).

In addition, the Government Accountability Office (“GAO”), although an independent watchdog headed by the Comptroller of the U.S., is designed to support Congress by its investigations, at the request of congressional committees and subcommittees, into government operations including the IRS.

A prominent example of a proper oversight role for Congress was a Senate subcommittee investigation into the role of professional firms—accounting firms, law firms, banking firms and investment firms—in the U.S. tax shelter industry. The investigation was by the Permanent Subcommittee on Investigations of the Senate Committee on Homeland Security and Governmental Affairs.¹⁵³ The investigation resulted in dramatic hearings and dramatic reports of mischief and

¹⁵⁰(...continued)

go one step further, I believe then in tax treaty interpretation the Executive Branch interpretations should qualify for deference because of the role the Constitution assigns to the Executive Branch for conducting foreign affairs. A much stronger case for deference exists here than in *Chevron* where the Court simply assumed a delegation to the agency to resolve ambiguity. I caution readers that my views are not the mainstream (or should I say, are not the shared understanding of the commentators or the courts). My case for looking to the understanding of the Executive Branch and the Senate for U.S. courts to apply U.S. law could mean that some other tribunal—say in the treaty partner’s jurisdiction or even in some international court—might determine a different interpretation and that might impose some liability on the U.S. under the treaty, but that should not defeat the need to apply U.S. law based on the President’s and the Senate’s understanding of the treaty that was negotiated and ratified.

¹⁵¹ For example, in a particularly prominent case, a House subcommittee investigated IRS improprieties. See *United States v. Payner*, 447 U.S. 727, 733 n. 5 (1980), citing Oversight Hearings into the Operations of the IRS before a Subcommittee of the House Committee on Government Operations (Operation Tradewinds, Project Haven, and Narcotics Traffickers Tax Program), 94th Cong., 1st Sess. (1975).

¹⁵² This list is from Bryan Camp, [Lesson From Congress Overbearing Oversight](#) (Tax Prof Blog 1/28/19). Further buttressing the congressional oversight role are two offices in the Treasury and IRS respectively that perform oversight functions and report to Congress—the Treasury Inspector General for Tax Administration (“TIGTA”) and the Taxpayer Advocate (“TAS”).

¹⁵³ When the investigation started and had its first hearings and minority report, the Committee was named the Committee on Governmental Affairs. Before the Subcommittee Report in 2005, the Committee had been renamed as indicated in the text.

illegality in these components of the tax shelter industry.¹⁵⁴ The hearings and initial report were followed by the largest criminal indictment in history wherein 19 individuals related to KPMG promoted shelters were indicted.¹⁵⁵ Other indictments followed for professionals (lawyers and accountants) connected with major law and accounting firms. Subsequently the same subcommittee conducted a major investigation into offshore tax evasion.¹⁵⁶

In addition, in the 1970s Congress or the JCT reviewed the returns of Presidents Nixon and Ford and Vice President nominee Rockefeller in the wake of the scandal leading to President Nixon's resignation.¹⁵⁷ The scandal implicated in part tax issues for President Nixon and Vice President, Spiro Agnew. The most rigorous review was performed by the JCT Staff on Nixon's returns and, without reaching conclusions as to penalties, the JCT Staff Report found that Nixon incorrectly reported numerous items with "possible deficiencies in tax and interest totaling \$477,431 through the date of the report." The parallel IRS audit and results were described:

The IRS audit also concluded with proposed adjustments resulting in substantial deficiencies. It was subsequently revealed that Mr. Nixon paid the deficiencies determined by the IRS for each of the years 1970 through 1972, with interest. In addition, because collection of tax for the 1969 tax year was barred by the three-year limitations period generally applicable, Mr. Nixon voluntarily paid the taxes for 1969 that the Joint Committee staff had calculated, but did not pay interest with respect to that year.¹⁵⁸

J. IRS as Political Scapegoat.

Members of Congressmen and other political actors, for political reasons, often use the IRS as scapegoat and this affects legislation that Congress passes that often does more harm than good. I mention here the prime example during my career.

After highly publicized and politicized hearings into alleged IRS abuses, Congress passed the IRS Restructuring and Reform Act of 1998 ("1998 Restructuring Act").¹⁵⁹ Prior to this act, the

¹⁵⁴ The investigation produced two reports. The first, a minority staff report gunned by the minority leader, Senator Carol Levin, was released contemporaneously with the highly touted hearings on November 18 & November 20, 2003. The Staff Report is titled U.S. Tax Shelter Industry: The Role of Accountants, Lawyers and Financial Professionals and is subtitled "Four KPMG Case Studies: FLIP, OPIS, BLIPS, and SC2. The second report, a full committee report, is titled The Role of Professional Firms in the U.S. Tax Shelter Industry, published on February 8, 2005.

¹⁵⁵ The case involved was *United States v. Stein, et al.* (SDNY No. 05 CR 00888), originally brought in 2005. The sprawling case spawned many important opinions as the parties sparred at the trial level and a major appellate opinion in *United States v. Stein*, 541 F.3d 130 (2d Cir. 2008), affirming the dismissal of 13 defendants because the prosecutors improperly influenced KPMG to quit paying their attorneys' fees.

¹⁵⁶ See Report of the Permanent Subcommittee on Investigations, Tax Havens Banks and Tax Compliance (July 17, 2008).

¹⁵⁷ These investigations are reviewed in JCT Staff, Background Regarding the Confidentiality and Disclosure of Federal Tax Returns 23-29 (JCX-3-19 2/4/19). The paragraph of the text is from this report.

¹⁵⁸ *Id.*, at p. 26.

¹⁵⁹ Pub. L. No. 105-206, 112 Stat. 685, 722 (July 22, 1998).

IRS had functioned under the general supervision of Treasury through a Commissioner of Internal Revenue appointed by the President. A key institutional management function dictated by the 1998 Restructuring Act was to create an Oversight Board within the Treasury Department, but this Board has not done much and is nonfunctional now (see discussion on beginning on p. 38). At the time of the consideration of the 1998 Restructuring Act, the Commissioner had announced certain major management reorganizations to mitigate or eliminate problems which Congress was addressing itself and features of this plan were enacted into law.

The engine that fueled the 1998 Restructuring Act was a highly publicized and politicized Senate Finance Committee and House Ways and Means Committee hearings into alleged IRS abuse. Prior to those hearings, a blue-ribbon panel had recommended significant changes to the IRS, but the congressional hearings so politicized the issues that I believe Congress lost its ability or desire to act rationally and in the best interests of the country. For political gain, the politicians (Republicans) on the Committee set about a path of slandering an agency that was, in fact, serving the country a lot better than those politicians asserted.¹⁶⁰ Those politicians unfairly brought discredit upon an agency that fairly—not perfectly—served a critical role in the operation of democracy as we know it. Further, those politicians passed legislation that, on balance, created more problems than it solved.¹⁶¹ Beyond the specifics of the legislation, the hearings and public ill-will fueled by the hearings sent shock waves throughout the IRS and, in some major respects, impaired the IRS from serving its critical mission. A subsequent investigation by Congress' own semi-independent investment authority, the Government Accountability Office (often initialized "GAO"),¹⁶² determined that the politically charged allegations of IRS abuse were in major part false.¹⁶³ In short, for political gain, Congress trashed and I think substantially damaged a fine agency that served this country well; just as any large organization, it needed fixes but most of the problems Congress imagined were nonexistent and its solutions to the nonexistent problem were inappropriate.

¹⁶⁰ Professor Bryan Camp, as astute observer of the tax legislation and the administrative process, observed that Congress' 1998 fulminations became "one might say hysterical" and "worked itself into a lather" over the wrong problem. See Bryan T. Camp, Theory and Practice in Tax Administration, 29 Va. Tax Rev. 227, 270 (2009). For a more detailed discussion, see Leandra Lederman, IRS Reform: Politics as Usual, 7 Colum. J. Tax Law 36 55-60 (2016).

¹⁶¹ As stated, this is the author's opinion, but other more recognized and astute observers of the process also share the opinion. See Mortimer Caplin, The Tax Lawyer's Role in the Way the American Tax System Works, 106 Tax Notes 697 (Feb. 7, 2005).

¹⁶² This office was formerly known as the General Accounting Office.

¹⁶³ GAO Special Report on Tax Administration: Investigation of Allegations of Taxpayer Abuse and Employee Misconduct Raised at Senate Finance Committee's IRS Oversight Hearings (GAO/GGD-99-82 5/24/99). Keep in mind that the GAO is Congress' investigator and managed to produce a report that, in its conclusions, was nothing short of a criticism of the hearings. See also e.g., Ryan J. Donmeyer, Secret GAO Report is the Latest to Discredit Roth's IRS Hearings 87 Tax Notes 463 (Apr. 24, 2000); and Amy Hamilton, A Look at Taxpayer Attitudes on the Fifth Anniversary of IRS Reform, 2003 TNT 140-4 (7/22/03) ("Cohen [former IRS Commissioner] said that nearly everyone now agrees that the 1998 Senate Finance Committee hearings into alleged IRS abuses of taxpayers were 'grossly unfair.' Jeff Trinca, who served as chief of staff of the National Commission on Restructuring the IRS, called the hearings 'a circus added at the end of a year of a lot of hard work.'"); Mortimer M. Caplin, The Tax Lawyer's Role in the Way the American Tax System Works (13th Annual Erwin N. Griswold Lecture Before The American College of Tax Counsel 1/22/05) (GAO and TIGTA Reports "established that much of the testimony was not only misleading but false; IRS may have made mistakes, but they were not malicious or systemic."); and Bryan T. Camp, "The Evil That Men Do Lives After Them", 2004 TNT 144-34 (7/27/04).

We have recently seen other instances of this type of behavior in Congress. It is usually fueled by politicians desiring to inflame a portion of the electorate having a deep distrust of the administrative state and the IRS in particular. By wild imaginings of abuse, the politicians can overstate the case, create storm and fury, and make IRS inefficient by, inter alia, laying the groundwork for decreasing the budget of the IRS, thus making its job harder. That is the state of politics as it plays out with the IRS and is not likely to change while politicians willing to play this game can stymie the process.

II. Executive Branch.

A. Treasury Department.

1. General.

Section 7801(a) provides that the “the administration and enforcement of this title shall be performed by or under the supervision of the Secretary of the Treasury.” Among the responsibilities of the Secretary are, to the extent practicable, to investigate persons who may have unpaid tax liabilities.¹⁶⁴ Within the Treasury Department, by appropriate delegations, the IRS is the principal administrator and enforcer of the tax laws.¹⁶⁵ Other components of Treasury, however, play certain key tax roles in administration of the Internal Revenue Code.

2. Assistant Secretary (Tax Policy).

Treasury's Office of the Tax Policy is managed by the Assistant Secretary of Treasury (Tax Policy) who is “the senior advisor to the Secretary of the Treasury for analyzing, developing, and implementing Federal tax policies and programs.”¹⁶⁶ The Office serves the following key functions: (1) assists in development and implementation of federal tax policies and programs; (2) provides official estimates of all government receipts for the President's budget, for fiscal policy decisions, and for Treasury cash management decisions; (3) develops and reviews regulations and rulings to administer the tax code; (4) negotiates tax treaties for the United States; (5) provides economic and

¹⁶⁴ § 7601(a).

¹⁶⁵ Section 7701(a)(11)(B) defines Secretary as “the Secretary of the Treasury or his delegate.” § 7701(a)(12)(A)(i) defines “delegate” to include “any officer or employee of any other department or agency of the United States, or of any possession thereof, duly authorized by the Secretary (directly, or indirectly by one or more redelegations of authority) to perform such functions.” See Reg. § 301.7701-9. Section 7803(a) creates the office of Commissioner of Internal Revenue and specifies that the Commissioner “shall have such duties and powers as the Secretary may prescribe” including administration of the internal revenue laws. § 7803(a)(2). The Secretary of Treasury has broadly delegated responsibility for the “administrations and enforcement of the internal revenue laws.” Treas. Order 150-10 (Apr. 22, 1982). The IRM describes the delegation process. IRM 1.11.4 Servicewide Delegation Order Process; see IRM 1.11.4.1 (04-09-2020), Program Scope and Objectives. For example, IRM 1.11.4.6.3(1).c Examples (04-09-2020), Servicewide Delegation Order Content, provides “If, during a reorganization, position titles change, without substantive change in responsibility, a delegation order is still effective for the new position title until the delegation order is revised.”

¹⁶⁶ U.S. Treasury web site for Office of Tax Policy (viewed 6/23/17).

legal policy analysis for domestic and international tax policy decisions; and (6) prepares reports of tax policy issues mandated by Congress or the administration.¹⁶⁷

The Office of Tax Policy has a significant staff and, because of its key high-level role is considered a great opportunity for Government service for the best and brightest.

3. Treasury Inspector General for Tax Administration.

The Treasury Inspector General for Tax Administration (“TIGTA”) is a Treasury function outside the IRS established by the 1998 Restructuring Act to provide independent oversight of IRS activities.¹⁶⁸ TIGTA investigates misconduct of IRS employees but its more visible role is to conduct audits, investigations, and evaluations of IRS programs and operations (including the Oversight Board); to evaluate the adequacy and security of IRS technology; and to review a limited sample of the IRS's assertion of privileges to deny requests under the Freedom of Information Act (“FOIA”) and the Privacy Act. In addition, TIGTA studies and reports to Congress on compliance with key facets of the 1998 Restructuring Act.¹⁶⁹

TIGTA reports are often useful to practitioners for understanding the operations of the IRS.

4. Chief Counsel of IRS

The IRS Chief Counsel, a Presidential appointee, is the IRS's top lawyer, reporting to both the Commissioner and the Secretary of Treasury.¹⁷⁰ The Chief Counsel is a Treasury officer with duties in the IRS as designated by the Secretary of Treasury. The Chief Counsel is a very important person within the IRS, having principal responsibility for the legal function in the IRS. I deal more with Chief Counsel's function within the IRS below beginning on p. 43.

B. IRS.

1. Overview.

a. General - The Revenue Function.

The IRS, a branch of Treasury, is the principal component of Treasury charged with the administration of the tax laws. I hope that, even as a relative novice to the tax law, you have some sense of the magnitude of the task assigned to the IRS. The following statistics from the IRS Data Book for 2022¹⁷¹ (for fiscal year ending 9/30/22) should reinforce the magnitude of the task:

¹⁶⁷ Id.

¹⁶⁸ RRA § 1103 (making two inspector generals in the Treasury with TIGTA being the inspector general focused on tax administration. See TIGTA's web site here which is probably worth poking around from time to time.

¹⁶⁹ § 7803(d).

¹⁷⁰ § 7803(b).

¹⁷¹ See 2022 Data Book, <https://www.irs.gov/pub/irs-pdf/p55b.pdf>

- The IRS collected over \$4.9 trillion in gross collections (including taxes, penalties and interest and in Fiscal Year (FY) 2022 and issued or credited over \$641.7 billion in refunds (including interest).¹⁷²

- The IRS received over 269 million tax returns, excluding information returns such as W-2s and 1099s.¹⁷³

Managing the function obviously requires a large bureaucracy. The 2022 Data Book reports that the IRS had 85,241 employees at the end of the fiscal year.¹⁷⁴ These employees and the functions they serve are organized with a pyramid structure typical of large organizations.¹⁷⁵

Managing the function requires frequent points of contact between the public and the agency. To assist the many IRS players involved in their mission, the IRS has adopted the following mission statement:

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and enforce the law with integrity and fairness to all.¹⁷⁶

The articulated goal views taxpayers as customers to be serviced; in this model, the broad goal is for satisfied customers. This goal is recognized formally in the Taxpayer First Act of 2019 which directs Treasury to develop and submit “submit to Congress a written comprehensive customer service strategy” for the IRS and update its guidance and training materials “so as to be easily understood by customer service employees of the Internal Revenue Service.”¹⁷⁷ I discuss the Report, issued in January 2021, below beginning on p. 54. Obviously, the concept of customer service and customer satisfaction needs to be considered in context. I doubt that many, if any, persons who are investigated and prosecuted for a tax crime are going to feel like customers or feel well served or satisfied. Nor will any person who is sent a large tax bill or who, owing the IRS, is subject to enforced collection measures equate those actions with customer service. But given a different view of its role as servant of the taxpayers (which means, of course, doing all of those things to ensure that everyone pays his or her fair share of the cost of government), the focus on customer service has begun to ripple through the management plans and thinking of the IRS. Whether customer service was ever absent from the IRS is doubtful, but the focus on it may lead to improvements in the public perception of the role of the IRS.

¹⁷² 2022 Data Book, Table 1.

¹⁷³ 2022 Data Book, Table 2.

¹⁷⁴ 2022 Data Book, Table 32. Table 31 reports 116,673 “Full-time equivalent positions realized,” and describes how that number was determined.

¹⁷⁵ Large organizations require a pyramid structure (the issue being how steep the outside walls of the pyramid must/should be), with “headquarters” centralized functions (usually in Washington), intermediate functions (at various levels and geographically dispersed), and local front line functions where the public (and their tax representatives) interface with the IRS.

¹⁷⁶ IRS Web Page titled “The Agency, Its Mission and Statutory Authority” (last reviewed or updated 5/31/22 and viewed 7/13/22).

¹⁷⁷ Taxpayer First Act of 2019, § 1101, P.L. 116-25, 133 Stat 981 (July 1, 2019).

b. The NonRevenue Function.

Initially, the IRS served the revenue function of collecting taxes imposed by Congress. For a long time, now, the IRS has performed functions other than collecting taxes. Examples:

- The Code provides a refundable child tax credit that is not a revenue raising feature but uses tax procedure—specifically the refund procedure—to provide support to families.¹⁷⁸
- The Affordable Care Act (“ACA”) formerly provided an individual mandate penalty which the IRS collected via the income tax return.¹⁷⁹ The penalty was not intended as a revenue raiser but as an incentive the citizens to obtain health insurance.
- The ACA also provided a premium tax credit to subsidize the cost of health insurance purchased through an exchange.¹⁸⁰
- Some tax provisions blend nonrevenue function and revenue functions. For example, estate and gift taxes may have goals other than purely revenue raising although they do raise revenue. So too, even a graduated income tax.

In this book, I will deal with tax procedures without distinguishing between the revenue and nonrevenue functions of the IRS.

2. Oversight Board.

The IRS is a Treasury agency with lines of authority through the Commissioner of Internal Revenue to the Secretary of the Treasury. An Oversight Board, however, has certain functions with respect to IRS administration, management, conduct, direction and supervision of the execution and application of the internal revenue laws.¹⁸¹ The Board has the following specific responsibilities:

1. review and approve the IRS's strategic plans and operational functions (such as modernization, outsourcing, training, and education).
2. recommend candidates for appointment as IRS Commissioner, as well as recommend whether the Commissioner should be removed.
3. review the Commissioner's selection, evaluation and compensation of senior executives.
4. review and approve any major reorganization of the IRS.
5. participate in the IRS budget preparation process.

¹⁷⁸ § 24(d). Serving nonrevenue goals may be achieved through both refundable and nonrefundable tax credits. A tax credit even when nonrefundable simply takes lowers tax otherwise due to achieve a nonrevenue policy goal. Thus, for example, the Code offers credits for earned income that benefits lower earning citizens, health insurance costs for certain individuals, and a first time home buyer credit. §§ 32, 35, & 36.

¹⁷⁹ This “penalty” was sustained in *National Federation of Independent Business v. Sebelius*, 567 U.S. 519 (2012), but is no longer applicable after 2018.

¹⁸⁰ § 36B(a), (b), and (c); Reg. § 1.36B-2(a).

¹⁸¹ § 7802(c). The Board was created by the 1998 Restructuring Act.

The Oversight Board is expressly denied certain responsibilities.¹⁸² Generally, these are responsibilities for tax policy and certain specific organizational functions (such as specific examinations or personnel actions) that would be micro-managing rather than overseeing.

The Board is composed of nine members.¹⁸³ Seven members are appointed by the President and confirmed by the Senate. Of this seven, one must be a full-time federal employee or a representative of IRS employees. The other two members are ex officio (by virtue of the office they hold) and are the Commissioner and the Treasury Secretary (or his or her Deputy). The President appoints the other Board members with the advice and consent of the Senate. The Board members serve staggered five-year terms. The Board positions are not full-time positions, but the Board is to be a working group rather than just an advisory group. The Board members are paid \$30,000 per year, with the Chairperson being paid \$50,000 per year.¹⁸⁴

As of the last time I viewed a Treasury web page describing the Oversight Board (7/24/21), that web page informed the public (as it had for several years):

The IRS Oversight Board does not currently have enough members confirmed by the U.S. Senate to make up a quorum and as a result has suspended operations. The Board will reconvene once it has a quorum.¹⁸⁵

That web page appears be no longer active (as checked on 7/18/22), but I understand from colleagues that the IRS Oversight Board is still inactive because of a lack of a quorum and, apparently, any interest in constituting a quorum.

3. Commissioner of Internal Revenue.

The Commissioner of Internal Revenue is a Presidential appointee confirmed by the Senate. The Commissioner heads the vast IRS bureaucracy.¹⁸⁶ Historically, the Commissioner has been a leading tax practitioner, most often a tax lawyer. Because of the perception that tax practitioners may not be the best managers, the statute now requires that the person appointed have “demonstrated ability in management.”¹⁸⁷ Tax practitioners are not necessarily excluded, but the field is much broader now. The most recent Commissioner is Daniel Werfel.

When the Commissioner position is not filled by a duly appointed and approved person, a senior IRS official will serve as Acting Commissioner.

¹⁸² § 7802(c)(2).

¹⁸³ § 7802(b).

¹⁸⁴ § 7802(e)(1).

¹⁸⁵ In preparing this 2023 edition, I could not locate the web page. I leave it above from an earlier page because I understand the status is the same. See Internal Revenue Service Oversight Board. (2023, February 10). In Wikipedia. https://en.wikipedia.org/wiki/Internal_Revenue_Service_Oversight_Board.

¹⁸⁶ § 7803.

¹⁸⁷ § 7803(a)(1)(A).

The Commissioner's duties are set forth very broadly to manage the internal revenue function (including its relationship to foreign countries through the treaty program) and assist in recommending the Chief Counsel.¹⁸⁸

4. Structure.

a. General.

The IRS is organized into four major operating divisions aligned generally by broad categories of taxpayer. Each division is then organized along functional lines, based upon the perception that a functional approach can better serve taxpayers. The purpose of the functional structure is to organize all levels based on groups of taxpayers with similar needs. The plan eliminates all regional and district level functions (although the various divisions will certainly have regional and district level functions within their respective areas of focus).

The IRS has four civil compliance operating divisions:

1. Wage and Investment Division (“W&I”)
2. Small Business/Self-Employed Division (“SB/SE”)
3. Large Business and International Division (“LB&I”)
4. Tax Exempt and Governmental Entities Division (“TE/GE”).

The IRS has a separate Appeals Office function that serves generally to hear taxpayer appeals from decisions made by these civil compliance operating divisions. The name of the office was changed by statute in 2019 to “Internal Revenue Service Independent Office of Appeals.”¹⁸⁹ I generally refer in this book to this function as the Appeals Office or just Appeals rather than the longer form. Although I refer to various aspects of the Appeals Office in various parts of the book, I discuss the Appeals Office in considerable detail in Chapter 8, titled Appeals.

The IRS also has a Criminal Investigation division that conducts criminal investigations and makes referrals to the DOJ Tax Division for criminal prosecution or grand jury investigation.

Various other functions within the IRS that are not necessarily related to taxpayers fitting neatly within these descriptions will either be placed within one of the divisions or elsewhere in the organization. For example, the Tax Treaty function and Advance Pricing Agreement function will be in the Large and Mid-Size Business function, because most (but certainly not all) of the taxpayers needing those services would otherwise be in that Division.

b. Civil Compliance Function.

(1) Goal of the Civil Compliance Function.

¹⁸⁸ § 7803(a)(2).
¹⁸⁹ § 7803(e)(1), as added by Taxpayer First Act of 2019, § 1001(a), P.L. 116-25, 133 Stat 981 (July 1, 2019)

The IRS has a robust civil compliance function to support the self-reporting and self-paying features of our system. The civil compliance function has the most observable impact in raising revenue—by ascertaining unreported liabilities and collecting unpaid tax. The civil compliance function has related impacts in encouraging taxpayers subject to those compliance activities to become more compliant in the future and conceivably, through creating a perception that the IRS is “on the beat,” encourage taxpayers not directly subject to the compliance activities to comply with their self-reporting and self-paying obligations. The civil compliance function, in broad strokes, consists of an examination function to determine unreported tax liability, a collection function to collect unpaid tax liability, and an appeals function where taxpayers can get an independent review of IRS examination and collection activity.

(2) Examination Function.

The examination function determines whether taxes in addition to those reported by the taxpayer are due and owing; if so, it sets in process procedures for assessing and collecting the unreported taxes. This is often referred to as the audit function. The office handling this function is often referred to as “Examination.” Many lawyers’ principal interface with the Examination function will be in IRS audits. As indicated from the IRS’s functional structure, audits will be handled by the compliance operating division that covers the particular taxpayer. Dealing with the examination function will be a significant area of your practice as a tax practitioner. I discuss examinations in more detail below. See Ch. 7. The IRS Compliance Function - Examination. The examination function is served by each of the civil compliance divisions.

IRS personnel involved in the examination function are divided into the following categories: (i) examining agents for more complex returns, called **Revenue Agents** (sometimes initialized to “RAs”); and (ii) examining agents for less complex tax law and account issues, called **Tax Examiners** (“TEs”) and **Tax Compliance Officers** (“TCOs”).¹⁹⁰ Generally, in this book, I refer to the IRS personnel involved in the examination function as Revenue Agents.

(3) Collection Function.

Historically, the IRS's examination function has been different from its collection function. IRS examination personnel – historically called Revenue Agents – performed the examination function to determine whether the taxpayer owed more tax than the taxpayer reported voluntarily. Different IRS personnel – called Revenue or Collection Officers – then performed the function of collecting the tax from the taxpayer. The collection function may be analogized to accounts receivable or bill collection function in a business organization. Collection functions offer certain appeals and litigation opportunities to correct errors or abuses in IRS actions. I discuss collection procedures in Ch. 12. Collection Procedures.

¹⁹⁰ IRS webpage titled “How the IRS Ensures Compliance with the Tax Laws” (last reviewed or updated 10/23/23, viewed 11/30/23); see also IRM Part 4, ch. 23, section 21 titled “Tax Compliance Officer Employment Tax Procedures” (last reviewed or updated 11/26/21, and viewed 11/30/23).

In the past, the personnel involved in the examination function were not concerned with collection, and the personnel involved in the collection function were not concerned with whether the taxpayer really owed the tax they were charged with collecting. Part of the focus of the new IRS is to resolve both the examination function and collection function in the least number of steps. This means that persons previously involved in determining the amount of the correct liability (the historical examination function) may be involved at that stage in also determining how and when the IRS collects from the taxpayer. Similarly, where personnel are involved in a collection function and the taxpayer asserts some defense that he or she may not owe the amount the IRS seeks to collect, the IRS collection officer may become more actively involved in the examination function, at least by assisting the taxpayer get to the right office for help on that issue.

The bottom line at this point, however, is that the IRS has a huge collection function -- taxpayers in the aggregate owe large liabilities that, for one reason or another, they have not paid. Just as any creditor, the IRS has an incentive to see if it can act to encourage collection of the amounts owed.

(4) Appeals Function.

The IRS has an internal Appeals function designed to offer an independent review of determinations by the IRS civil compliance functions (such as audits and collection actions). The Appeals function is handled by the IRS Independent Office of Appeals.¹⁹¹ (I often refer to this office as IRS Appeals or simply “Appeals.”) Organizationally, Appeals is separate from the examination and collection functions, and various administrative and statutory procedures are designed to assure Appeals’ independence. Generally, the taxpayer and the tax practitioner go to Appeals for an independent review and resolution of positions taken by the examination or collection functions of the IRS. Dealing with the Appeals function will be a significant part of your practice as a tax practitioner. I discuss Appeals and practice in that office in more detail below in Ch. 8. Appeals/

c. Criminal Investigation.

Criminal Investigation serves the tax administration function of investigating tax crimes and referring cases to DOJ Tax for criminal prosecution or for further grand jury investigation. This office, often referred to as “CI” or “CID,”¹⁹² is independent of the four operating civil compliance divisions described above.

I discuss IRS criminal investigations in Ch. 6. Penalties, subheading II. Criminal Penalties.

¹⁹¹ § 7803(e)(1), as added by the Taxpayer First Act of 2019, § 1001(a), P.L. 116-25, 133 Stat 981 (July 1, 2019).

¹⁹² The office formerly was named Criminal Investigation Division, hence the acronym CID. The name was shorted to Criminal Investigation, hence CI. Many experienced, aka older, practitioners continue to use the former acronym.

d. Chief Counsel.

The Chief Counsel is the IRS's top lawyer.¹⁹³ The current Chief Counsel is Michael Desmond. The Chief Counsel's summary job description is:

Chief Counsel (Counsel) provides legal interpretation and represents the IRS with complete impartiality, so that taxpayers know the law is being applied with integrity and fairness. Counsel reports to the Commissioner of Internal Revenue on tax matters and reports to the Treasury General Counsel on other matters.¹⁹⁴

The Chief Counsel of the IRS supervises approximately 1,500 attorneys.¹⁹⁵

The Chief Counsel's Office plays a central role in the administration of the Federal tax laws. Its attorneys provide the IRS guidance on the correct interpretation of the tax laws, represent the IRS in litigation, and provide all other legal support the IRS needs to carry out its mission.¹⁹⁶ For example, the Chief Counsel's Office drafts regulations, rulings, and other published legal guidance; handles tens of thousands of cases per year in the U.S. Tax Court¹⁹⁷ and bankruptcy courts and works closely with the Department of Justice on other tax litigation in other Federal courts; and provides specific legal advice and determinations to taxpayers and to various IRS offices both before and after taxes are filed.

Attorneys within the office of Chief Counsel are organized along the functional lines in the current IRS organization. The four civil compliance divisions thus have Chief Counsel attorneys assigned to them to provide legal assistance in serving their functions. For example, they may help in framing requests for information or documents. Organizationally, the attorneys still report to Chief Counsel, but they serve the operating divisions to which they are assigned. In addition, Chief Counsel attorneys are assigned to the IRS's office of Criminal Investigation ("CI") where they will assist IRS criminal investigation agents (historically referred to as "Special Agents") and serve the CI function.

Tax practitioners, particularly lawyers, most often encounter attorneys from the Chief Counsel's office when litigating cases in the Tax Court. Chief Counsel's attorneys represent the IRS in the Tax Court. By contrast, in the other courts in which tax cases may be litigated (the district courts and the Court of Federal Claims), the IRS is represented by attorneys from the Tax Division of the Department of Justice (I usually refer to the Tax Division as "DOJ Tax," although in some cases at the trial level, the IRS may be represented by IRS Chief Counsel attorneys designated as Special AUSAs in discrete cases such as bankruptcy).

¹⁹³ § 7803(b).

¹⁹⁴ IRM 1.1.1.5(4) (07-29-2019), Structure of the IRS; for a more detailed statement of the Chief Counsel's duties and the structure of the office of Chief Counsel, see IRM 1.1.6, 1.1.6.1 (06-18-2015), Chief Counsel for the Internal Revenue Service.

¹⁹⁵ See Treasury web page titled "Office of Chief Counsel At-a-Glance" (last reviewed or updated 8/2/23 and viewed 8/15/23).

¹⁹⁶ § 7803(b)(2); IRM 1.1.6.1 (06-18-2015), Chief Counsel for the Internal Revenue Service.

¹⁹⁷ § 7452.

IRS Counsel has taken more active roles in audits and collection matters, as they are closer to the IRS operating divisions and IRS personnel they serve. For example, particularly in larger or more sensitive cases, IRS Counsel may be involved in drafting information document requests (“IDRs”) or summonses and otherwise advising line personnel on how to best proceed. Often this activity is not easily observable by taxpayers and their practitioners.

e. Taxpayer Advocate.

The IRS has a taxpayer advocate function that, broadly speaking, represents taxpayer interests.¹⁹⁸ The function is called the “Office of the Taxpayer Advocate and is headed by the National Taxpayer Advocate (“NTA”) who reports directly to the Commissioner. § 7803(c) The NTA is appointed by the Secretary of the Treasury after consultation with the Commissioner and the Oversight Board.¹⁹⁹ The NTA heads the Taxpayer Advocate Service (“TAS”).

The office's principal functions are:

- (1) to assist taxpayers resolve problems with the IRS; and
- (2) to identify taxpayer problem areas in dealing with the IRS and to propose changes in the administrative practices and legislative changes to mitigate the problems.²⁰⁰

The NTA’s office is in Washington at the IRS. The TAS has local offices in each state staffed by local IRS employees and headed by a Local Taxpayer Advocate (“LTA”). These offices are independent of the other local IRS functions and report to the NTA.²⁰¹

The TAS may assist taxpayers in many ways. Basically, this function is designed as a failsafe, to operate when there is a breakdown or hardship resulting from administration of the IRS's other functions. The office is not designed to make the taxpayer happy, but rather to ensure that the administrative processes are fair and appropriate, and to provide a remedy when the normal processing produces a bad result.

The principal tool the IRS is the Taxpayer Assistance Order (“TAO”) which orders the IRS operating unit to take action or to stop action with a particular taxpayer to alleviate hardship.²⁰² These are most often used with regard to collection actions, such as liens and levies. I discuss below beginning p. 755 a typical use of the TAS to deal with collection inequities.²⁰³ Even when a formal TAO does not come from the TAS, the TAS inquiry to the operating division may be able to persuade the operating division to give some relief to the taxpayer.

¹⁹⁸ § 7803(c). A good summary of the Taxpayer Advocate function is contained in IRS Publication 1546.

¹⁹⁹ § 7803(c)(1)(B)(ii).

²⁰⁰ § 7803(c)(2).

²⁰¹ § 7803(c)(4).

²⁰² § 7811. See IRM 13.1.20 TAS Taxpayer Assistance Order (TAOs).

²⁰³ See beginning p. 755. For more detail, see Keith Fogg, [What is a Taxpayer Assistance Order?](#) (Procedurally Taxing Blog 3/17/17) (accessed 3/17/17).

Up a level from the TAO is the Taxpayer Advocate Directive (“TAD”) used to affect broader processes than for a particular taxpayer.²⁰⁴ The TAD authority is found in a delegation from the Commissioner, but that delegation is recognized in the Code.²⁰⁵ By TAD, the NTA may “mandate administrative or procedural changes to improve the operation of a functional process or to grant relief to groups of taxpayers (or all taxpayers) when implementation will protect the rights of taxpayers, prevent undue burden, ensure equitable treatment or provide an essential service to taxpayers.”²⁰⁶ The Commissioner or Deputy Commissioner modify, rescind or ensure compliance with the TAD within 90 days.²⁰⁷

In addition to assisting taxpayers, the NTA observes how the IRS is functioning and might be improved. In that role, the NTA makes an annual report to Congress in December of each year summarizing the 10 most serious problems encountered by taxpayers, recommendations for solving or mitigating these problems, and recommendations for other ways to improve IRS customer service and reducing taxpayer burden.²⁰⁸ The NTA also makes an annual Objectives Report in June to identify the NTA’s goals and planned activity for the coming year.²⁰⁹ The NTA a blog called NTA Blog where the NTA reports on important issues within the scope of the NTA responsibility.²¹⁰

(1) Low-Income Taxpayer Clinics (“LITC”).

The TAS provides grants to independent low-income taxpayer clinics (“LITC”) to underwrite the cost of representing low-income taxpayers in controversies with the IRS. § 7526. Each qualifying clinic must have 90% of taxpayers served with income not in excess of 250% of the poverty level and must charge no more than a nominal fee.²¹¹ The clinics are not part of the IRS or the TAS.

f. Representing Taxpayers Before the IRS.

(1) General: Circular 230.

Tax practitioners serve a critical role in the tax system. They prepare returns, they advise as to expected tax consequences of contemplated transactions how the transactions should be reported

²⁰⁴ For example, the NTA issued a TAD in 2018 ordering the IRS not to assign to private collection agencies the debt of any taxpayer whose income was less than 250% of the federal poverty level.

²⁰⁵ IRM 1.2.2.12.3 (01-17-2001), Delegation Order 13-3 (formerly DO-250, Rev. 1), Authority to Issue Taxpayer Advocate Directives; see § 7803(c)(5), as added by Taxpayer First Act of 2019, § 1301, P.L. 116-25, 133 Stat 981 (July 1, 2019).

²⁰⁶ Id.

²⁰⁷ § 7803(c)(5), as added by Taxpayer First Act of 2019, § 1301, P.L. 116-25, 133 Stat 981 (July 1, 2019). For an example of a TAD that could require significant expense to implement, see Erin M. Collins, IRS Deputy Commissioners Respond to Taxpayer Advocate Directive on Scanning Technology; National Taxpayer Advocate Appeals Decision to IRS Commissioner (NTA Blog 8/4/22) (involving an appeal to the IRS Commissioner from Deputy Commissioners’ response).

²⁰⁸ 7803(c)(2)(B)(ii)(III).

²⁰⁹ Id.

²¹⁰ The NTA Blog is here.

²¹¹ § 7526(b)(1).

on returns, and they assist taxpayers in defending against IRS compliance efforts, including audits and collections. In a sense, they are on the front-lines of taxpayer compliance with the system. They can abuse their roles. As we see in this course, there are disincentives through criminal penalties, civil monetary penalties, and other civil liabilities that may apply to abusive practice as a tax practitioner. I deal here with the authority and ability to practice before the IRS and the IRS's ability to sanction practitioners for inappropriate behavior.

Treasury is authorized to “regulate the practice of representatives of persons before the Department of the Treasury,” including admission character and competency requirements and the power to “suspend or disbar.” 31 U.S.C. § 330(a)(1). IRS is a branch of Treasury and derives its authority to regulate tax practitioners from this provision. The regulatory guidelines for tax practitioners practicing before the IRS are set forth in Treasury Department Circular 230 which are regulations promulgated under § 330.²¹²

The statutory authority is “to regulate practice” before Treasury. If the conduct is not “practice” before Treasury (including the IRS), Treasury cannot regulate the conduct. (From this point on, I will be dealing with practice before the IRS, a branch of Treasury, but the statutory authority is the broader one for practice before Treasury.) As defined in Circular 230 (relating to the IRS),

(4) Practice before the Internal Revenue Service comprehends all matters connected with a presentation to the Internal Revenue Service or any of its officers or employees relating to a taxpayer's rights, privileges, or liabilities under laws or regulations administered by the Internal Revenue Service. Such presentations include, but are not limited to, preparing documents; filing documents; corresponding and communicating with the Internal Revenue Service; rendering written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion; and representing a client at conferences, hearings, and meetings.²¹³

Practice thus includes representing taxpayers in the following IRS functions: examinations, collection matters, Appeals Office consideration and similar situations where the representative deals with IRS personnel. The IRS does not have the authority to regulate return preparers based on their return preparation because preparing returns is not practice before the IRS.²¹⁴ For the same reason, preparing amended returns is not practice before the IRS.²¹⁵ Based on this limitation, the IRS

²¹² 31 C.F.R. Part 10. For an important critique of Circular 230 by the former Director of OPR, see Karen L. Hawkins, 2017 Erwin N. Griswold Lecture Before the American College of Tax Counsel: A (Not So) Modest Proposal, 70 Tax Law. 647 (2017). Chief among her complaints is that the detailed, complex and confusing rules force lawyers to deal with minutiae rather than “broad foundational principles of ethical conduct which could be considered and utilized to analyze fact-specific behavior in daily practice.” The result is rules gaming. For a more favorable view of Circular 230, see Dennis J. Ventry, Jr. & Bradley T. Borden, Probability, Professionalism, and Protecting Taxpayers, 68 Tax Law. 83 (2014).

²¹³ Circular 230, § 10.2(4).

²¹⁴ *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014).

²¹⁵ *Ridgely v. Lew*, 55 F. Supp.3d 89 (D. D.C. 2014).

cannot regulate fees charged by return preparers, so the courts cannot prohibit contingency fees for preparation of refund claims.²¹⁶

The practitioners thus subject to Circular 230 all practice in some way directly with the IRS in the representation of taxpayers. Treasury has authority “to impose standards” on persons who render written tax advice with respect to plans or arrangements having a potential for tax avoidance or evasion.²¹⁷ In any event, the IRS has included the authority in its definition of practice before the IRS in Circular 230.

The IRS has two offices that deal with practice before the IRS. These are the Office of Professional Responsibility (“OPR”) and the Return Preparer Office (“RPO”).²¹⁸ The IRS explains their roles as:

The Office of Professional Responsibility generally has responsibility for matters related to practitioner conduct, and exclusive responsibility for discipline, including disciplinary proceedings and sanctions. The Return Preparer Office is responsible for matters related to the issuance of PTINs, acting on applications for enrollment and administering competency testing and continuing education for designated groups.²¹⁹

For this purpose, practice before the IRS is:

- Communicating with the IRS on behalf of a taxpayer regarding the taxpayer's rights, privileges, or liabilities under laws and regulations administered by the IRS.
- Representing a taxpayer at conferences, hearings, or meetings with the IRS.
- Preparing, filing or submitting documents, or advising on the preparation, filing or submission of documents, including tax returns, with the IRS on behalf of a taxpayer.
- Providing a client with written tax advice on one or more Federal matters.²²⁰

I break down my discussion by the two offices—OPR and RPO—that regulate practitioners. I start first with OPR because that has been the traditional office for practitioner regulation and covers the ground except related to return preparers, the regulation of whom is limited for the reasons noted above.

²¹⁶ *Ridgely v. Lew*, 55 F. Supp.3d 89 (D. D.C. 2014).

²¹⁷ 31 U.S.C. § 330(e). The wording of § 330(e) says that "nothing in this section or any other provision of law" shall be construed to limit this authority to regulate such written advice. Assuming subsection (e) is not meaningless, subsection (e) might give, by implication, the IRS authority under subsection (a) to impose standards. See also Dennis B. Drapkin, *Loving and Ridgely: Implications for Practitioners*, 2015 TNT 140-8 (7/22/15) (noting that the legislative history indicates that subsection (e) was to confirm authority that already existing elsewhere in the Code, which would be § 330(a)(1)).

²¹⁸ Acronyms are bad enough, but when closely related concepts are just the inverse of each other, well there is bound to be confusion.

²¹⁹ IRS web page titled “Publication 947 (02/2018), Practice Before the IRS and Power of Attorney” (Last reviewed or update 2/27/18 and viewed 8/15/19).

²²⁰ Id. I have not researched the issue but it is not readily apparent to me how the limitation to the regulation of practice so strictly construed in the return preparer cases (*Loving* and *Ridgely*) would not also apply to legal advice rendered to clients without any involvement of the IRS.

(2) Practitioner Discipline and OPR.

OPR is referred cases from sources outside OPR—internal IRS sources from IRS field personnel dealing with practitioners and external sources, principally TIGTA and DOJ Tax.²²¹

Although I will not expect you to know the rules of Circular 230 for the examination in this class, you will certainly need to know them if you practice before the IRS. Accordingly, I provide here some of the rules you can get a feeling for the types of rules to which you will be subject as a practitioner. I think most of these rules should be self-evident to the ethical and qualified tax practitioner; nevertheless, since the practice is not limited that qualified and ethical practitioners,²²² a summary of some of the requirements of Circular 230 may be helpful to practitioners to understand the gist of the requirements.²²³

- Due Diligence.²²⁴ The practitioner must exercise due diligence as to accuracy in submissions to the IRS and representations made by the practitioner or the taxpayer to the IRS. The practitioner can rely upon the work of third parties, if the practitioner does due diligence appropriate to the nature of the reliance, including, as to returns and other documents submitted, making “reasonable inquiries if the information as furnished appears to be incorrect, inconsistent with an important fact or another factual assumption, or incomplete.”²²⁵
- Competence.²²⁶ The practitioner must have “the appropriate level of knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.”
- Conflicts of Interest.²²⁷ The practitioner must consider and avoid conflicts of interest except to the extent that the conflict can be and is waived in writing by the client. A conflict is representing another client with adverse interests or some other relationship that will or could cause your representation of the client to be materially affected.

²²¹ Karen L. Hawkins, 2017 Erwin N. Griswold Lecture Before the American College of Tax Counsel: A (Not So) Modest Proposal, 70 Tax Law. 647, 656 (2017). Hawkins notes that, although there are IRM provisions for mandatory referrals for certain practitioner conduct, “only the most committed” IRS personnel took the thankless effort to prepare the necessary referral documents. And, even then, referrals were often made for improper reasons.

²²² I owe a debt to my ethics professor at the University of Virginia Law School, A. J. G. Priest for the concept that a qualified and ethical practitioner will be able to intuit the right conduct from just being qualified which includes being ethical and thinking through the situation at hand.

²²³ In this summary, I principally rely upon IRS Document titled “Guidance to Practitioners Regarding Professional Obligations Under Treasury Circular No. 230” (Rev. 8/15 and viewed 7/22/18). Some of the text is fairly close to exact quotes, but I sometimes avoid using quotation marks so as to not chop up the presentation. In some cases, I rely directly upon Circular 230 (as revised June 2014); all references to Circular 230 sections are to that version. There are many discussions of Circular 230. However, I do recommend Dennis J. Ventry, Jr. & Bradley T. Borden, Probability, Professionalism, and Protecting Taxpayers, 68 Tax Law. 83, 84 (2014).

²²⁴ Circular 230, § 10.22 (due diligence as to accuracy)

²²⁵ Circular 230, § 10.34(d).

²²⁶ Circular 230, § 10.35.

²²⁷ Circular 230, § 10.29.

- Tax Return Positions.²²⁸ Practitioners cannot sign a tax return (including a refund claim) or advise a client to do so if the return has a position that (i) “lacks a reasonable basis,” (ii) “is an unreasonable position as defined in Internal Revenue Code § 6694(a)(2)” or regulations thereunder; or, (iii) “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.”
- Written Tax Advice.²²⁹ Practitioner rendering written advice must (i) base the advice on reasonable factual and legal assumptions, (ii) reasonably consider all relevant facts known or reasonably knowable, (iii) use reasonable efforts to determine the relevant facts, (iv) not rely on unreasonable representations, statements, findings or agreements; (v) relate applicable law and authorities to facts; and (vi) not base evaluation on the audit lottery.²³⁰ The practitioner may rely upon others rendering advice if those others are known to be competent to provide the advice.
- Errors and Omissions.²³¹ If the practitioner knows that a client has not complied with U.S. tax law (including by error or omission on returns, affidavit or other documents submitted to the IRS), the practitioner must advise the client of the noncompliance and the potential consequences (including civil or criminal penalties).
- Furnishing Information to the IRS/OPR.²³² The practitioner should promptly respond to proper and lawful requests for information unless there is an appropriate privilege. If the information or document is not in the practitioner’s or client’s possession, the practitioner should notify the requesting IRS personnel regarding who has the information or document, but the practitioner is not required to make inquiries of anyone other than the client or verify the information provided by the client as to the person(s) in possession of the information or documents. The practitioner must avoid submitting frivolous information or information that demonstrates disregard of a rule or regulation.
- Handling Matters Promptly.²³³ The practitioner must not unreasonably delay the IRS matter.

Although not free from doubt, the current thinking appears to be that OPR must bring an action to penalize a practitioner within five years of the act on which the desired penalty is based.²³⁴

²²⁸ Circular 230, § 10.34.

²²⁹ Circular 230, § 10.37.

²³⁰ See Michael B. Lang and Jay A. Soled, Disclosing Audit Risk to Taxpayers, 36 Va. Tax Rev. 423 (2017) (arguing that tax preparers and advisers should be able to discuss audit risk with their clients, provided that the audit risk is not considered in the advice as to the return position probability assessment (such as reasonable basis, substantial authority and more likely than not).

²³¹ Circular 230, § 10.21.

²³² Circular 230, § 10.20(a).

²³³ Circular 230, § 10.23.

²³⁴ See Jeremiah Coder, OPR Restricted to 5-Year Time Limit in Failure to File Cases, 131 Tax Notes 1220 (June 20, 2011) (“In decisions posted to the OPR website on June 15, the appellate authority held that 28 U.S.C. 2462 bars OPR from charging practitioners with disreputable conduct under Circular 230 section 10.51 when a failure to file, or failure to timely file, their personal tax returns involves years further back than five years,” citing *Director*, (continued...)

OPR's disciplinary authority includes.²³⁵

Circular 230 discipline includes Censure (essentially a public reprimand), Suspension of practice privileges and Disbarment. A suspension can be for a fixed term or may be indefinite, and a practitioner must request and be granted reinstatement by the OPR before practice privileges are restored. When a practitioner is suspended for a fixed term, the individual may not petition to be reinstated to practice before the end of the term. When a practitioner is disbarred, s/he may not petition for reinstatement for five years. The OPR also may propose a monetary penalty on any practitioner who engages in conduct subject to sanction. The monetary penalty may be proposed against the individual or a firm, or both, and can be in addition to any Censure, Suspension or Disbarment. The amount of the penalty may be up to the amount of gross income derived or to be derived from the conduct giving rise to the penalty.

If formal discipline is not appropriate, the OPR may issue a private reprimand or a cautionary "soft letter." The "soft letter" typically advises a practitioner of allegations and warns against noncompliance with obligations under Circular 230, but does not reach a conclusion as to whether a violation was actually committed.

The IRS provides a useful summary of the procedures it applies discipline under the Circular 230 regulations:²³⁶

Due process protections are incorporated throughout the disciplinary process. During the investigation, the practitioner may propose a resolution of the matter, which may include discipline or other corrective action. If the OPR and the practitioner cannot agree on a resolution of the matter and the OPR believes discipline is appropriate, a formal "complaint" is drafted and the case is referred to the Office of Chief Counsel, General Legal Services (GLS). GLS sends a letter to the practitioner offering a final opportunity to resolve the matter without a proceeding. If settlement is not reached, GLS files the complaint to commence a civil proceeding before an Administrative Law Judge (ALJ). The ALJ presides over the proceeding and decides the merits of the case against the practitioner (the "respondent"). The proceeding is generally governed by the Administrative Procedure Act (5 USC § 500 et seq.). The ALJ may order a hearing to be held, during which the government and respondent

²³⁴(...continued)

Office of Professional Responsibility v. Baldwin, No. 2010-08 (June 15, 2011) and *Director, Office of Professional Responsibility v. Hernandez*, No. 2010-09 (June 15, 2011)). See *Director v. Navatsyk*, Decision and Order on Default (11/5/10), reprinted at 2011 TNT 148-11.

²³⁵ The following matter in the text is from an IRS webpage titled "Frequently Asked Questions (FAQ's), Q. 7 (last updated 9/23/21 and viewed 7/18/22). For more information on practice before the IRS, see IRS Publication 947, Practice Before the IRS and Power of Attorney.

²³⁶ The following matter in the text is from an IRS webpage titled "Frequently Asked Questions (FAQ's), Q. 8 (last updated 9/23/21 and viewed 7/18/22). For more information on practice before the IRS, see IRS Publication 947, Practice Before the IRS and Power of Attorney.

present their evidence and arguments. The case may be settled by concurrence of both parties at any time prior to a decision.

If a hearing is conducted, and after post-hearing briefs are submitted, the ALJ issues an Initial Decision and Order. The ALJ may find the OPR has proven the allegations of the complaint and conclude the respondent committed violations of Circular 230 for which the respondent should be sanctioned. The ALJ may then go on to impose the sanction which the OPR proposed. Alternatively, the ALJ may rule in the OPR's favor on the facts and law but increase or reduce the recommended sanction. Or the ALJ may reject both the OPR's version of events and its recommendation of a sanction, and thus dismiss the case.

Following the ALJ's Decision and Order, either party may appeal the case to the Treasury Appellate Authority. If neither party appeals within 30 days, the ALJ's Initial Decision and Order becomes the Final Agency Decision. If either party appeals, the Treasury Appellate Authority will, after receiving briefs from both parties and reviewing the record, render the Final Agency Decision. For the OPR, a decision by the Appellate Authority is a final determination in the case.

A practitioner who is not satisfied with the Treasury Appellate Authority's Final Agency Decision may file a complaint in U.S. District Court to contest it. This proceeding is also conducted according to the Administrative Procedures Act, under which the Federal district judge will review findings of facts based only on the administrative record and will set aside agency action only if arbitrary or capricious, contrary to law, or an abuse of discretion. The proceeding is not a trial de novo.

In addition to the conditions and potential sanctions from the regulation of practice, practitioners are subject to civil and criminal penalties which I cover later in this book.

CPAs and attorneys must comply with the ethical requirements of their respective professions in all of their practice, including before the IRS and otherwise representing taxpayers with respect to tax matters. I do not discuss these in this book because it would divert us from the focus of this text and all readers should have other opportunities to study those rules.²³⁷

(3) Return Preparer Authority and the RPO.

Another category of tax service provider is the return preparer who is not enrolled. This category is often referred to as "unenrolled preparers."²³⁸ Historically, merely preparing tax returns did not subject unenrolled preparers to regulation except for criminal or civil sanctions for misconduct. Specifically, unenrolled preparers were not subject to requirements for licensing, certification, minimum education, experience, or other credentials. The result was that the tax

²³⁷ A good introduction may be found in Jay A. Soled, Third-Party Civil Tax Penalties and Professional Standards, 2004 Wis. L. Rev. 1611, 1625-1628 (2004).

²³⁸ AICPA v. IRS, 746 Fed. Appx. 1, 2018 U.S. App. LEXIS 22583 (D.C. Cir. 2018).

preparer community was and is populated by the full range of professionals, from the highly ethical and competent to the highly unethical and incompetent.

In 2009, Treasury made an ill-fated effort to regulate paid return preparers. I won't get into the details of that effort, for the program was rejected in the courts as outside the scope of the Treasury's authority under 31 U.S.C. § 330.²³⁹ The requirement for preparers to obtain and include on prepared returns a Preparer Taxpayer Identification Number ("PTIN"), however survived.²⁴⁰

In response to the limitations on its authority, the IRS announced a voluntary Annual Filing Season Program for unenrolled preparers.²⁴¹ Under the program, unenrolled preparers obtain a "Record of Completion" if they obtain a PTIN, take an annual "federal tax filing season refresher course," pass a comprehension test, complete a minimum of 18 hours of continuing education" and consent to certain duties and restrictions in Circular 230.²⁴² The benefits of the Program are that qualifying unenrolled preparers: (i) may display the certificate of the Record of Completion in marketing their services, (ii) are listed in a public IRS database, called a Public Directory, which taxpayers can consult in locating return preparers and (iii) have a "limited practice right" to represent taxpayers in initial stages of an audit.²⁴³

The Return Preparer Office ("RPO") regulates the return preparer registration and authorization requirements. The RPO is relatively new and hence has not flanged out its role in the system. However, the RPO states that its strategic goals are to (i) Register and promote a qualified tax professional community; (ii) Improve the compliance and accuracy of tax returns prepared by

²³⁹ The history is recounted in The Internal Revenue Service Lacks a Coordinated Strategy to Address Unregulated Return Preparer Misconduct (TIGTA Report Ref. 2018-30-042 (7/25/18)). The key case was *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014).

²⁴⁰ See IRS web page titled: "PTIN Requirements for Tax Return Preparers," (last reviewed or revised 7/13/22, viewed 7/28/22). The page states "Anyone who prepares or assists in preparing federal tax returns for compensation must have a valid 2019 PTIN before preparing returns. All enrolled agents must also have a valid PTIN."

In *Montrois v. United States*, 916 F.3d 1056 (D.C. Cir. 2019), cert. denied ___ U.S. ___, 140 S.Ct.39 (2019), the Court reasoned that the PTIN fee could be charged under the Independent Offices Appropriations Act, which allows federal agencies to charge fees for services in certain conditions. 31 U.S.C. § 9701. See Frank G. Colella, D.C. Circuit Affirms IRS Authority to Require Practitioner Tax Id Numbers & Impose a User Fee: Montrois v. United States, 20 Houston Business & Tax Law J. 56 (2020).

²⁴¹ See IRS website titled "Annual Filing Season Program" (last reviewed or updated 5/7/19 and viewed 7/9/19). In *AICPA v. IRS*, 746 Fed. Appx. 1, 2018 U.S. App. LEXIS 22583 (D.C. Cir. 2018), the Court held that "the Program does not violate the APA in any of the ways the AICPA alleges."

²⁴² *AICPA v. IRS*, 746 Fed. Appx. 1, 2018 U.S. App. LEXIS 22583 (D.C. Cir. 2018) (the sentence in the text is substantially the same as the sentence in the opinion; the opinion cites Rev. Proc. 2014-42, § 4.05(1)-(4). Some unenrolled preparers are exempt from the course requirements if they belong to professional groups and meet other program requirements (including 15 CE credits: 10 federal tax law, three (3) federal tax law updates, and two (2) ethics.). See IRS web page titled "General Requirements for the Annual Filing Season Program Record of Completion" (Last reviewed or updated 6/20/18 and viewed 8/19/18).

²⁴³ Rev. Proc. 2014-42, 2014-29 I.R.B. 192, § 6. See also IRS web page titled "Frequently Asked Questions: Annual Filing Season Program" (last reviewed or updated 3/25/22 and viewed 7/28/22) ("Return preparers who complete the requirements for the Annual Filing Season Program will be issued a Record of Completion that they can display and use to differentiate themselves in the marketplace if desired.").

tax preparers; and (iii) Engage stakeholders to create an environment that fosters compliance and program improvement.²⁴⁴

(4) Form 2848; CAF and PTIN.

Representing a taxpayer before the IRS requires that the IRS to have authority to discuss the taxpayer's tax matters with the taxpayer's representative. I discuss elsewhere the privacy rules imposed upon the IRS in § 6103. The IRS is prohibited by law from discussing taxpayer return information except in certain narrow situations, the pertinent one here being where the taxpayer has authorized an eligible representative to represent the taxpayer before the IRS. This is usually done through a **Form 2848**, Power of Attorney and Declaration of Representative, which identifies the taxpayer, identifies the representative, and states the scope of the authority given to the representative. There is a different form, **Form 8821**, Tax Information Authorization, that can be used where the person identified in the form is given authorization to obtain IRS information only but not otherwise represent the taxpayer before the IRS.

As I mentioned above, lawyers and CPAs by virtue of their state licenses, are automatically entitled to practice before the IRS. Others, referred to as Enrolled Agents, may qualify to practice by taking an examination.²⁴⁵

On the Form 2848, the representative must identify his eligibility and provide the representative's CAF number which is a unique identifying number for the eligible IRS representative²⁴⁶ and PTIN if the representative has a PTIN. I have discussed PTINs above. The CAF is a different number generally assigned first when the taxpayer files the first Form 2848.

Once a Form 2848 is filed, the IRS must generally deal with the taxpayer through the representative and provide the representative a copy of all notices or written communication required to be given the taxpayer, unless restricted by the taxpayer.²⁴⁷ However, if the representative is unreasonably uncooperative, an IRS agent may request bypass authority—in the form of a Bypass Order given to both the taxpayer and the representative—to deal directly with the taxpayer.²⁴⁸

(5) Other Miscellaneous OPR Regulation.

The foregoing are the principal types of regulation you will encounter in your practice. The IRS, however, has much broader regulatory authority. OPR jurisdiction under Title 31 is not limited to tax and, indeed, may cover many of the programs that the IRS administers, such as Healthcare.

²⁴⁴ IRS website titled "Return Preparer Office (RPO) At-a-Glance" (last reviewed or updated 1/7/22 and viewed 7/18/22).

²⁴⁵ Circular 230, § 10.3(c).

²⁴⁶ See generally IRS Publication 947, Practice Before the IRS and Power of Attorney.

²⁴⁷ 26 C.F.R. § 601.506(a).

²⁴⁸ 26 C.F.R. § 601.506(b) (allowing agent to request permission from his supervisor to bypass representative and contact taxpayer directly when representative "has unreasonably delayed or hindered an examination . . . by failing to furnish, after repeated request, non-privileged information necessary to the examination").

g. Service Centers.

The principal operational function with which you will deal as a practitioner is the Service Center. The IRS has 9 Service Centers around the country. The principal roles of the Service Center in terms of what the practitioner sees are: (1) Taxpayers file tax returns with the Service Center, which is set up to accept mass filings; returns are not filed in the local IRS offices; (2) the Service Center processes the returns to catch obvious errors (return not signed or otherwise facially deficient), enters return data into the computer, performs computer matching of the items on the return with information the IRS has from other sources (such as Forms 1099-NEC and W-2's), and “scores” the returns for audit potential; (3) the Service Center makes the assessments required by the returns or by audits; (4) having made an assessment, the Service Center generates the notice and demand for the taxpayer to pay the taxes thus assessed (if not paid already); and (5) the Service Center has a problems resolution office to assist taxpayers in resolving problems with respect to their dealings with the Service Center. The Service Center also performs a number of IRS operations that can be centralized into those centers.

h. IRS Reorganization Per TFA (2019).

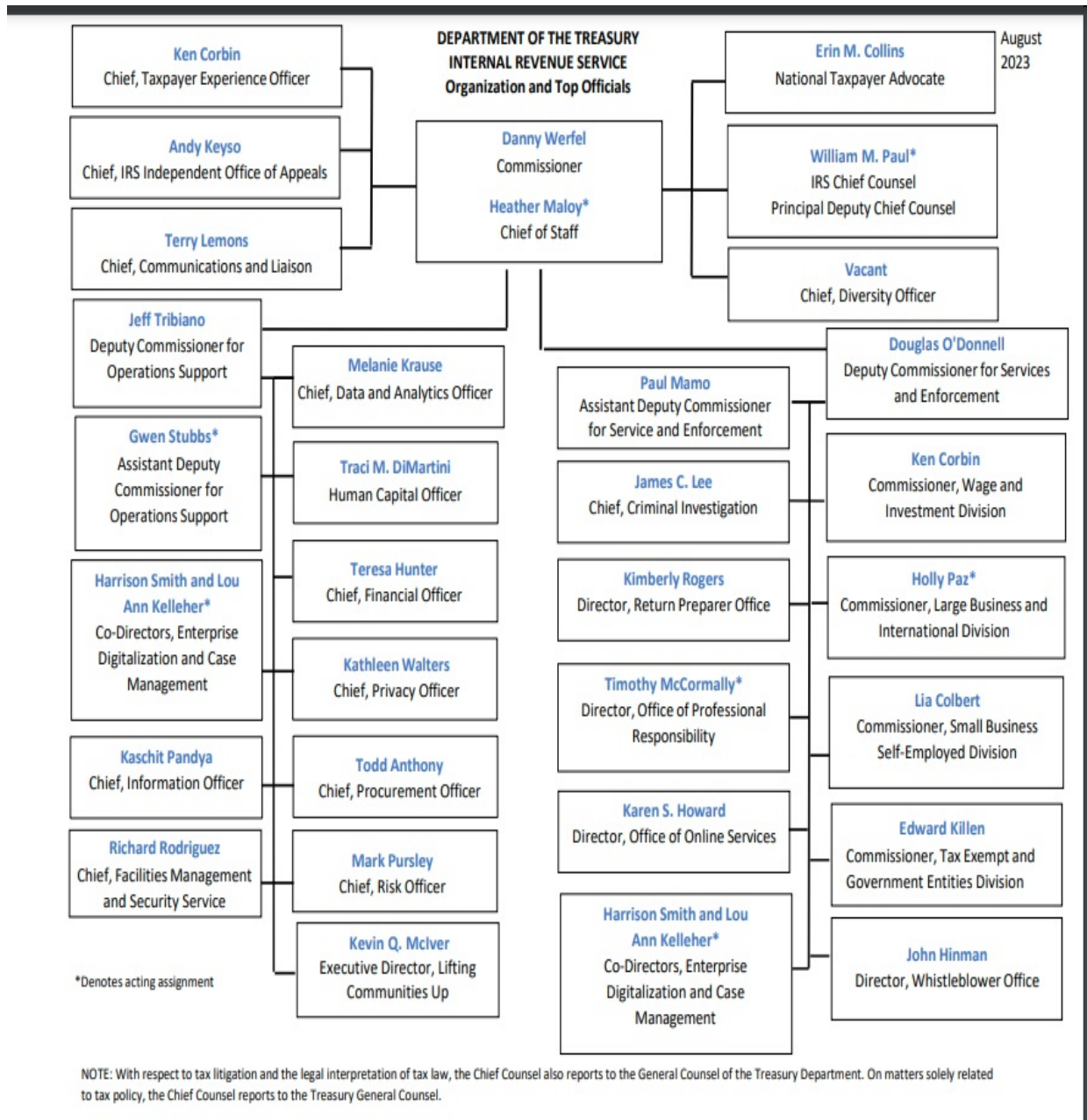
The Taxpayer First Act required Treasury, not later than September 30, 2020, to submit to Congress “a comprehensive written plan to redesign the organization of the Internal Revenue Service,” including “streamline the structure of the agency including minimizing the duplication of services and responsibilities within the agency.”²⁴⁹ The Report was finally issued in January 2021. IRS Publication 5426, Taxpayer First Act Report to Congress (January 2021).

I offer here only a high-level summary, because the primary target for this book is the student of tax procedure. I offer some references for more detail in the footnote.²⁵⁰ At a general level, the plan provides these organizational steps relevant to the compliance issues discussed in this book: Consolidate previously segmented examination operations into one function to reduce internal duplication and fragmentation of activities and provide consistent outcomes for resolving taxpayer compliance issues.

I offer the current organizational chart for the IRS:

²⁴⁹ Taxpayer First Act of 2019, § 1302, P.L. 116-25, 133 Stat 981 (July 1, 2019).

²⁵⁰ Saltzman Treatise, ¶1.02[5][a]-[f].



The chart may be viewed here with narrative discussion on the IRS web site titled “Today’s IRS Organization” (Last Reviewed or Updated: 03-Aug-2023, viewed 8/18/23).
<https://www.irs.gov/about-irs/todays-irs-organization>

5. IRS Guidance–Deference to Treasury/IRS Statutory Interpretation.

a. Introduction.

In this section, I introduce the various Treasury and IRS publications which offer guidance to taxpayers and insight into the IRS administration of the tax laws. A major theme will be “rulemaking” under the APA and the related area of judicial deference to IRS interpretations of the Internal Revenue Code. Rulemaking and deference are terms of art in the administrative law world.

In editions of this book prior to 2019, the discussion of IRS Guidance was more detailed than in this edition, particularly in the area of deference. For the 2019 editions, I determined that the level of detail was not appropriate for the target audience of the text—law students in a tax procedure class. I accordingly have substantially summarized the discussion to make it more appropriate for law students studying tax procedure. I have published the more detailed discussion in articles available SSRN.²⁵¹

b. Congressional Delegation and Major Questions.

In determining the authority of agency (including Treasury) rulemaking, the key theme is to find some congressional delegation of authority to make rules that may apply to persons the agency regulates. Such authority is called legislative authority for statute equivalent rules and interpretive authority for rules that interpret the statute. Given the vagaries of wording for congressional delegations (with some delegations being implicit, if at all), some feel that caution is required before assuming that Congress meant to delegate any authority with respect to matters of great national economic significance without the delegation being explicit. From these “concerns” (mostly political even when promoted by judges), the concept of the “major questions doctrine” has arisen as a predicate bar to some agency rules. The Supreme Court recognized the “major questions doctrine” by that name only in 2022,²⁵² but its substance was recognized in previous Supreme Court cases.²⁵³ So, as we go through the forms of agency rulemaking and guidance, remember that for the more important forms of guidance (usually notice and comment regulations), there may be a predicate issue of whether the major questions doctrine will preclude any force to the guidance in litigation. I don’t think that is much of an issue in the bulk of tax guidance because rarely, if ever, will there be a level of national significance that would force even a conservative and libertarian majority on the Supreme Court to invoke the major questions doctrine.

²⁵¹ The most specific articles are titled and cited (in the SSRN format):

- Townsend, John A., IRS Guidance – Rulemaking and Deference to IRS Statutory Interpretation. (July 11, 2018). Available at SSRN: <https://ssrn.com/abstract=3212060>.
- Townsend, John A., The Report of the Death of the Interpretive Regulation Is an Exaggeration (January 27, 2020). Available at SSRN: <https://ssrn.com/abstract=3400489>.

I also point readers to my Federal Tax Procedure Blog, <https://federaltaxprocedure.blogspot.com/>, where I will post more recent thoughts on this and other issues.

²⁵² *West Virginia v. EPA*, 597 U. S. ____, 142 S. Ct. 2587, 2609 (2022). The dissent in the case written by Justice Kagan questioned whether there was, at least until that case, a major questions doctrine but simply was a consideration in statutory interpretation to determine whether there was a delegation in the first place.

²⁵³ E.g., *FDA v. Brown & Williamson Tobacco Corp.*, 529 U. S. 120 (2000); and *King v. Burwell*, 576 U. S. 473 (2015).

c. The APA: Agency Rulemaking and Guidance.

Under the Administrative Procedure Act (“APA”),²⁵⁴ federal administrative agencies make rules in various formats that govern their administration of laws Congress entrusted to the agencies. The principal categories for such rules are regulations (in the case of the IRS, Treasury Regulations) and subregulatory guidance (below regulations, in the case of the IRS such as Revenue Rulings and Revenue Procedures, Notices, etc.). Those rules can be substantive interpretations of the statutes that guide agency personnel and persons subject to agency administration or procedural guiding the agency in its administration. In this section, I consider the IRS’s (or Treasury’s in the case of regulations) rulemaking authority, the various ways in which the IRS (or Treasury) offers rulemaking and guidance, and the authority of that rulemaking and guidance in the interpretation of the statutes the IRS administers (principally the Internal Revenue Code). The major questions doctrine applied principally to preempt the potential application of the *Chevron* deference (discussed below) to an agency interpretation.

d. IRS Rule Making Authority.

(1) Rulemaking, APA, Tax Exceptionalism.

In the federal system, implementation and enforcement of the laws are assigned to the executive branch. The executive branch operates through federal agencies, such as in the present context, the Treasury Department and its component, the IRS.²⁵⁵ (For ease of reference, I usually refer to the IRS as the agency to which tax administration is delegated, although the statutes generally delegate tax administration to the “Secretary of the Treasury”; generally, Treasury delegates tax administration to the IRS subject to such oversight as Treasury deems appropriate.) A key task in the IRS administration of tax law is issuing guidance that may inform and affect taxpayers, IRS personnel, and courts in application of the tax law.²⁵⁶

The foundation for Treasury and IRS rulemaking is administrative law and its subset, the APA. A good starting place is Justice Scalia’s famous sound-bite: “administrative law is not for sissies.”²⁵⁷ That may be hyperbole, but not much.

²⁵⁴ The APA was originally enacted as Administrative Procedure Act of 1946, Pub. L. No. 404, 60 Stat. 237. The APA was enacted as positive law in 5 U.S.C. § 551, et seq. (On the difference between U.S.C. Titles that are positive law and codifications of underlying statutes at large, see p. 25 n. 117. I use the 26 U.S.C. citations in this text. The title 5 citations are often combined with a reference to the APA, with the understanding that Title 5 is not the APA (e.g., amendments to Title 5 are not in the APA), but a convenient way of referencing the general provisions in Title 5.

²⁵⁵ § 7801(a) (“Except as otherwise expressly provided by law, the administration and enforcement of this title shall be performed by or under the supervision of the Secretary of the Treasury”).

²⁵⁶ An excellent article updating a prior article is found at Mitchell Rogovin and Donald L. Korb, The Four R’s Revisited: Regulations, Rulings, Reliance and Retroactivity in the 21st Century: A View from Within, 46 Duq. L. Rev. 323 (2008); a more recent helpful article is Stephanie Hunter McMahon, The Perfect Process is the Enemy of the Good Tax: Exceptional Regulatory Process, 35 Va. Tax Rev. 553, 560-572 (2016).

²⁵⁷ Antonin Scalia, Judicial Deference to Administrative Interpretations of Law, 1989 Duke L.J. 511, 511.

The particular area of administrative law I discuss in this section is the range of IRS rulemaking and related guidance via the various types of pronouncements it makes. I first identify the more commonly encountered formats the IRS uses for rulemaking and other guidance. I then discuss the courts' approaches to the weight to give these guidance formats in the interpretation of the tax laws, devoting attention to the Supreme Court's opinion *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984) and *Chevron's* progeny. The *Chevron* deference regime is often referred to as the *Chevron* Framework, and I will generally use that term. By deference, I mean that the reviewing court in interpreting the law is influenced by the agency's interpretation of the law and may adopt the agency interpretation by deferring to the agency interpretation even when the court believes another interpretation is best. There is a lot of nuance behind that thumbnail; I will summarize some of that nuance below.

The APA governs the rulemaking authority of administrative agencies. The Treasury, an administrative agency, is subject to the APA, and hence its branch, the IRS, is subject to the APA as well (reminder, I generally refer in this discussion to the IRS even when, perhaps, Treasury might be the more proper reference).

Over the years some practitioners and scholars, encouraged by some perceived ambiguous signals from the Supreme Court, have claimed that the tax law and the IRS have a special place in the federal administrative universe that is different from other laws and agencies.²⁵⁸ This claim has sometimes been called "**tax exceptionalism.**" The claim has nuances in several potential APA contexts, but the one most prominently addressed in the tax area was whether IRS rulemaking was subject to the deference regime summarized above and discussed in more detail below (particularly, the *Chevron* Framework of deference for regulations). Actually, the claim of tax exceptionalism from the APA based on deference is odd because the APA does not deal with deference at all; it is not clear how deference could affect the APA and give even facial credibility that tax was exceptional from the APA. In *Mayo Foundation for Medical Ed. & Research v. United States*, 562 U.S. 44 (2011), which was not an APA case, the Supreme Court rejected the notion of tax exceptionalism for judicial deference to IRS interpretations. I discuss *Chevron* deference, including *Mayo*, below, but for the present discussion, the general rule is that the APA and the deference regimes with respect to agency interpretations applies to the IRS the same way it applies to other federal agencies.

Federal agency administration is governed by general administrative requirements. such as the APA, but those general administrative requirements are subject to congressionally prescribed exceptions or differences, depending upon the agency. Any differences in tax administrative requirements are based on interpretations of statutes that govern the processes, rather than some lurking understanding that tax is just different and not subject all or some of the general rules. In my view, tax administration is not exceptional in the federal agency universe.

²⁵⁸ E.g., David Berke, *Reworking the Revolution: Treasury Rulemaking and Administrative Law*, 7 Mich. J. Environ. & Admin. Law 353, 358-364, 371-387 (2018); and Kristin E. Hickman, *The Need for Mead: Rejecting Tax Exceptionalism in Judicial Deference*, 90 Minn. L. Rev. 1537 (2006).

Before focusing on IRS rulemaking specifically, the APA general background applicable to all agencies is appropriate. Under the APA, agencies may make rules in two process categories—rulemaking (having two subcategories, formal and informal) and agency adjudication (also with formal and informal subcategories). Treasury does not use the adjudication category (with trial-like procedures presided over by administrative law judges),²⁵⁹ so I focus here on rulemaking.²⁶⁰ Within the rulemaking category, most agencies, including Treasury, use only the informal rulemaking subcategory via notice and comment regulations.²⁶¹ Notice and comment Regulations are published in the Federal Register and codified in the Code of Federal Regulations. I discuss the informal rulemaking process for notice and comment regulations below on p. 61.

For taxpayer guidance other than such regulations, agencies may use less formal guidance documents, often called guidance documents but which I generally call subregulatory guidance documents, that may affect the application of laws that the agencies administer. In the tax context, these subregulatory guidance documents have various formats generally published in the Internal Revenue Bulletin (which I initialize in this text to “I.R.B.,” although in more formal citations it is “I.R.B.”), a general publication for guidance including Treasury Decisions (copies of final regulations officially published in the Federal Register),²⁶² Executive Orders, Notices, Tax Conventions, Revenue Rulings and Revenue Procedures (discussed below), and sometimes “Frequently Asked Questions” (“FAQs”).²⁶³ The I.R.B. formerly was available in hard copy format

²⁵⁹ In some agencies, the adjudication process occurs in certain trial like proceedings with administrative law judges. An example is the immigration trial proceedings in the Department of Homeland Security (“DHS”) where immigration judges hear “wide variety of proceedings in which the Government of the United States is one party and the other party is an alien, a citizen, or a business firm.” DOJ Web page titled “Board of Immigration Appeals” (last updated 9/14/21, viewed 7/19/18). Appeals from these trial level proceedings (and certain DHS director decisions) are taken to the Board of Immigration Appeals (“BIA”), a body within the Department of Justice. *Id.* There is no analogous trial or appeals level proceedings within the Treasury or IRS. In the tax world, appeals from IRS decision making are through litigation outside the agency—in the Tax Court, the district court or Court of Federal Claims. I discuss these forms of litigation in Chapter 10.

²⁶⁰ Agency adjudication does play a role in the concept of deference to agency statutory interpretations. For example, BIA decisions on appeal from DHS immigration judge decisions may be given *Chevron* deference. E.g., *Pereira v. Sessions*, 585 U.S. ___, 138 S.Ct. 2105 (2018).

²⁶¹ The informal rulemaking process is described in 5 U.S.C. § 553, whereas the formal rulemaking process is described in § 556. David L. Franklin, *Legislative Rules, Nonlegislative Rules, and the Perils of the Short Cut*, 120 Yale L.J. 276, 282 (2010) (“The first technique, so-called ‘formal’ rulemaking, involves onerous trial-type hearings and is rarely required unless a specific statute calls for rules to be ‘made on the record after opportunity for an agency hearing.’ Far more common is the second technique, variously known as ‘informal,’ ‘notice-and-comment,’ or ‘section 553’ rulemaking.”). The formal rulemaking process is rarely used in agencies generally. See *Perez v. Mortgage Bankers Assn.*, 575 U. S. 92, 128 n5 (2015) (Thomas, concurring) (noting that (i) “almost all rulemaking is today accomplished through informal notice and comment,” in contrast to the formal rulemaking process requiring “elaborate trial-like hearings in which proponents of particular rules would introduce evidence and bear the burden of proof in support of those proposed rules,” citing 5 U. S. C. §556; and (ii) “formal rulemaking is the Yeti of administrative law” with “isolated sightings of it in the ratemaking context, but elsewhere it proves elusive.”). Informal rulemaking is permitted unless the authorizing statute mandates formal rulemaking. *United States v. Florida East Coast R. Co.*, 410 US 224, 236-238 (1973).

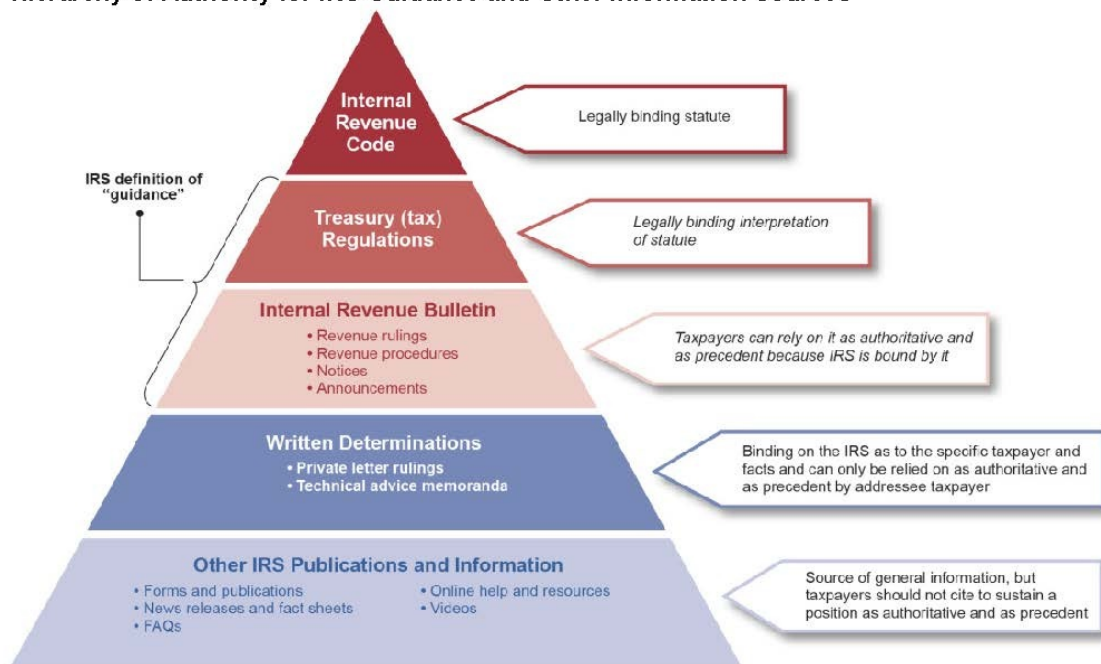
²⁶² Treasury Decisions advise the public of final or temporary regulations. IRM 32.1.1.2.5 (08-02-2018), Treasury Decision (TD).

²⁶³ Reg. § 601.601(d); IRM 4.10.7.2.4 (01-10-2018), Internal Revenue Bulletin. The I.R.B. is the “authoritative instrument” to publish subregulatory guidance documents that the IRS must rely upon and taxpayers may
(continued...)

but is now available only on the IRS web site.²⁶⁴ Prior to 2009, the IRS compiled the contents of the weekly I.R.B. semiannually into a Cumulative Bulletin (“C.B.,” but sometimes “Cum. Bull.”).²⁶⁵

I discuss Treasury and IRS rulemaking in three major categories: (i) Regulations (formally promulgated regulations with notice and comment); (ii) Subregulatory Guidance; and (iii) other forms of IRS documents that offer insight to practitioners but are not intended by the IRS as guidance documents. Here is a graphic from a GAO publication²⁶⁶ that breaks down these categories under the top-level Internal Revenue Code:

Hierarchy of Authority for IRS Guidance and Other Information Sources



Source: GAO analysis of IRS documents. | GAO-16-720

I refer to the hierarchy in this graph as the “GAO IRS Guidance Hierarchy.”

²⁶³(...continued)

rely upon.

²⁶⁴ Announcement 2013-12, I.R.B. 2013-11.

²⁶⁵ Reg. § 601.601(d); IRM 4.10.7.2.5 (09-12-2022), Cumulative Bulletin, noting that “the creation of the CB was eliminated as announced in Announcement 2013-12, 2013-11 IRB 651. The final edition of the CB is the 2008-2 edition.”

²⁶⁶ GAO Report titled Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance (GAO-16-720 September 2016),

IRS guidance documents may be categorized in other ways. For this Chapter, I categorize the guidance in two key categories:

- **Treasury Regulations**
- **Subregulatory Guidance.** Subregulatory Guidance generally encompasses all categories below regulations.

(2) Treasury Regulations.

(a) Final, Temporary, Proposed.

The IRS Guidance Hierarchy summarily describes this category as “Legally binding interpretation of statute.” I caution that the description is not right (in my judgment) as stated. If it is read as meaning that regulations are the law, it is only true as to the subcategory of regulations called legislative regulations; it is not true as to the subcategory called interpretive regulations which are not legally binding on taxpayers if the interpretations are not reasonable interpretations of the statute. I will get deeper into those legislative-interpretive subcategories below (beginning on p. 66), so I just focus on the general role of regulations here. When I refer to regulations here, I am generally referring to Treasury Regulations formally promulgated by Treasury rather than its branch, the IRS; the IRS is heavily involved in the drafting of Treasury Regulations but only the Treasury issues regulations. Guidance other than regulations (generally called subregulatory guidance) is issued by the IRS. This distinction between regulations and subregulatory guidance may be applied to guidance documents from other agencies as well.

Regulations are the most authoritative form of agency (Treasury here) guidance. Regulations receive the greatest consideration and process within agencies. Regulations are generally subject to the APA’s process of notice and public comment prior to becoming final.

The steps agencies must use for legislative regulations and, though not required, may use for interpretive regulations are (summarized):²⁶⁷

- (1) the agency (Treasury here) internally identifies and develops a proposal which requires multiple layers of review before the content of a proposed regulation is approved;²⁶⁸

²⁶⁷ The APA formal steps are designed for legislative regulations where the process, often called Notice and Comment, requires the agency to seek input from affected persons before new obligations are imposed upon them. Treasury generally uses Notice and Comment for interpretive regulations although the APA does not require Notice and Comment for interpretive regulations.

I recommend the Reg Map downloadable here: <https://www.reginfo.gov/public/reginfo/Regmap/index.jsp>

²⁶⁸ IRM 32.1.1.2.1 (08-02-2018), Advance Notice of Proposed Rulemaking. Each year, the IRS issues a Priority Guidance List “to identify and prioritize the tax issues that should be addressed through regulations, revenue rulings, revenue procedures, notices, and other published administrative guidance.” See IRS web page titled “Priority Guidance Plan” (Last Reviewed or Updated 6/2/22, viewed 7/19/22).

(2) unless there is good cause for immediate effectiveness (but not retroactive effectiveness) for **legislative** regulations (“Good Cause”),²⁶⁹ the agency (Treasury here) issues formal public Notice of Proposed Rulemaking (“NPRM”) in the Federal Register of the proposed regulation (with details and legal authority),²⁷⁰

(3) the public then has an opportunity to comment by written submissions and, sometimes, public hearings;²⁷¹ and

(4) after consideration of the comments,²⁷² the agency (Treasury here) takes actions deemed appropriate (including withdrawing the proposal, substantially modifying the proposal²⁷³ and either adopting in final with explanation of the key decisions made in the final or resubmitting for an additional round of notice and public comment).²⁷⁴ The end of the process, if completed after certain other Executive Branch review,²⁷⁵ is a final regulation (“with concise general statement of their basis

²⁶⁹ 5 U.S.C. § 553(b)(B) (Good Cause exception); IRM 32.1.1.2.2 (08-02-2018), Notice of Proposed Rulemaking. APA § 553(b) provides the Good Cause exception to the Notice and Comment requirement for legislative regulations where the agency finds it to be “impracticable, unnecessary, or contrary to the public interest.” I note in the text that the APA requirement for Good Cause applies only to legislative regulations. In Treasury and IRS Policy Statement on the Tax Regulatory Process (3/5/19) (sometimes referred to as the “Treasury/IRS Policy Statement”), Treasury and the IRS commit as a matter of “sound regulatory practice” to make a Good Cause statement for interpretive regulations.

²⁷⁰ 5 U.S.C. § 553(b). Reg. § 601.601(a)(2) (“Where required by 5 U.S.C. 553 and in such other instances as may be desirable, the Commissioner publishes in the Federal Register general notice of proposed rules.”). The proposed regulations are not authority but the IRS “generally should look to the proposed regulations to determine the office’s position on the issue” and “ordinarily should not take any position in litigation or advice that would yield a result that would be harsher to the taxpayer than what the taxpayer would be allowed under the proposed regulations.” IRM 32.1.1.2.2 (08-02-2018), Notice of Proposed Rulemaking.

²⁷¹ 5 U.S.C. § 553(c).

²⁷² Reg. § 601.601(b). The APA contemplates formal written comments addressing the NPRM. Nevertheless, it has been noted that comments are often made to Treasury or IRS personnel informally (such as in telephone calls). Stephanie Hunter McMahon, The Perfect Process is the Enemy of the Good Tax: Exceptional Regulatory Process, 35 Va. Tax Rev. 553, 562-563 (2016) (noting that this informal process may give interest groups extensive off the record influence with the Treasury or IRS).

²⁷³ The agency must restart the Notice and Comment process if, after considering comments, it makes changes that are not a logical outgrowth of the original proposed rule. *Long Island Care at Home, Ltd. v. Coke*, 551 U.S. 158, 160 (2007).

²⁷⁴ The IRS’s description of the process, see Reg. § 601.601(a)-(d). See also *Perez v. Mortgage Bankers Assn.*, 575 U.S. 92, 96 (2015).

²⁷⁵ Before regulations involving significant regulatory action are finalized, there are certain additional administration review requirements for significant regulatory action. Executive Order 12866, 3 C.F.R. 638 (1994), requires Office of Management and Budget (“OMB”) review of “significant regulatory actions” (generally a rule published in the Federal Register, including regulations “which the agency intends to have the force and effect of law, that is designed to implement, interpret, or prescribe law or policy”) and the Regulatory Flexibility Act, 5 U.S.C. §§ 601-612 may require the agency to prepare a regulatory flexibility analysis. 5 U.S.C. § 603-604. The OMB’s Office of Information and Regulatory Affairs (“OIRA”) provides that general review. Under a prior Memorandum of Agreement (“MOA”) between Treasury and OMB, the Treasury did not submit interpretive regulations (in the Treasury’s view, most Treasury Regulations) to OIRA for review because the economic impact flowed from the statute rather than the regulatory action. GAO Report titled Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance (GAO-16-720 September 2016), p. 25-28 (but noting that any regulation having “significant
(continued...)

and purpose”).²⁷⁶ Final Treasury Regulations are promulgated by a Treasury Decision (“T.D.”).²⁷⁷ The T.D. contains the text and a preamble that provides APA-required “concise general statement” of the rule and its “basis and purpose.”²⁷⁸ The Final Regulations are published in the Federal Register.²⁷⁹ Agency regulations are compiled in the Code of Federal Regulations (“C.F.R.”);²⁸⁰ Treasury Regulations are codified at 26 C.F.R.

The process is substantial and may take a long period of time. A 2009 GAO study showed, based on a limited data set, that Notice and Comment regulations take an average of four years to complete, with a range from 1 year to nearly 14 years.²⁸¹

Steps (2) and (3) are generally referred to as the Notice and Comment requirements.

Notice and comment are not mere formalities. They are basic to our system of administrative law. They serve the public interest by providing a forum for the robust debate of competing and frequently complicated policy considerations having far-reaching implications and, in so doing, foster reasoned decisionmaking.²⁸²

²⁷⁵(...continued)

economic impact” may require review in any event); IRM 32.1.5.4.7.4.3 (11-18-2019), Executive Order 12866, as supplemented by Executive Order 13563; see also Jeremiah Coder, Why Treasury Regulations Are Rarely "Significant," 136 Tax Notes 867 (Aug. 20, 2012) (noting the political dynamics of the IRS’s reluctance to submit regulations to OIRA review); and Susan E. Dudley & Sally Katzen, The Story Behind the IRS’s Exemption From Oversight (Wall Street Journal 2/22/18). On April 11, 2018, Treasury and OMB reached a new MOA incorporating some of the features of the old but expanding the Treasury’s obligation to submit for OIRA review. A significant tax regulatory action must be submitted for OIRA review prior to promulgation under the following conditions: (1) the action is inconsistent with action taken or planned by another agency; (2) the action “raises novel or policy issues, such as prescribing a rule of conduct backed by an assessable penalty” and (3) the action has an annual non-revenue effect on the economy of \$100 million or more, measured against a no-action baseline.” I think that the principal effect of the new MOA in the current context is to make clear that the Treasury must submit for OIRA review interpretive regulations otherwise meeting the requirement for OIRA review. In effect, this makes the distinction between legislative regulations and interpretive regulations irrelevant for purposes of OIRA review, but I don’t think it negates the distinction in other contexts or says that the distinction does not exist. For a recent discussion of this OMB review, see Clint Wallace, Centralized Review of Tax Regulations, 70 Ala. L. Rev. 455 (2018). Tax regulations under § 7805(a), after publication of proposed or temporary regulations, must be submitted to the Small Business Administration for review and comment. § 7805(f).

²⁷⁶ 5 U.S.C. § 553(c).

²⁷⁷ IRM 32.1.1.2.5 (08-02-2018), Treasury Decision (TD).

²⁷⁸ 5 U.S.C. § 553(c).

²⁷⁹ 44 U.S.C. § 1505(a).

²⁸⁰ An annual edition of the C.F.R. is available on the Government Publishing Office web site titled “Code of Federal Regulations (Annual Edition) (viewed 7/17/18).

²⁸¹ Federal Rulemaking: Improvements Needed to Monitoring and Evaluation of Rules Development as Well as to the Transparency of OMB Regulatory Reviews 5 (GAO-09-205 (2009)). The report indicated that the time varies by agency. (Id., p. 17-19.) Treasury was not in the data set. The Report is cited in this context in *Azar v. Allina Health Servs.*, 587 U.S. ___, ___, 139 S. Ct. 1804, 1822 (2019) (Breyer, J., dissenting).

²⁸² *Natural Resources Defense Council v. National Highway Traffic Safety Administration*, 894 F.3d. 95, 115 (2d Cir. 2018). See also *Nat’l Labor Relations Bd. v. Wyman-Gordon Co.*, 394 U.S. 759, 764 (1969) (noting that the process is “designed to assure fairness and mature consideration of rules of general application.”); and *Chrysler Corp. v. Brown*, 441 U.S. 281, 303 (1979).

The promulgated final regulation in Step (4) is the key step. In that step, the agency must provide a reasoned basis and purpose for the regulation which will permit courts to test the validity of the regulation.²⁸³ Courts have required considerable detail in the reasoned basis and purpose.²⁸⁴ Courts may set aside the regulation if “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” 5 U.S.C. § 706(2)(A); see *Motor Vehicle Manufacturers Association v. State Farm Mutual Automobile Insurance Co.*, 463 U.S. 29 (1983) (referred to as *State Farm*). The regulation is subject to robust judicial review on the basis of the reasons the agency states for the regulation.²⁸⁵ Without requiring the agency to state a meaningful reasoned basis and then allowing it to be tested, the Notice and Comment step could be rendered meaningless.²⁸⁶

The APA exempts from the Notice and Comment and Prospectivity requirements

- (i) “interpretative rules [now commonly called “**interpretive** rules”], general statements of policy, or rules of agency organization, procedure, or practice”; and
- (ii) rules promulgated “when the agency for good cause finds ... that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.”²⁸⁷

²⁸³ 5 U.S.C. § 553(c).

²⁸⁴ Although the statutory text of § 553(c), read literally, suggests only a summary statement of basis and purpose, courts require agencies to provide considerable detail to provide meaningful judicial review, detail which includes identifying and responding meaningfully to significant comments received during the comment process. Kathryn A. Watts, Rulemaking as Legislating, 103 Geo. L. J. 1003, 1050 (2015) (agencies must respond to “in detail to every significant comment”); and Kristin E. Hickman, Coloring Outside the Lines: Examining Treasury’s (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements, 82 Notre Dame L. Rev. 1727, 1733 (2007). Notice and Comment 1/23/19). More detail permits more robust arbitrary and capricious review.

²⁸⁵ *SEC v. Chenery*, 332 U.S. 194, 196 (1943) (often referred to as “*Chenery II*”) (requiring that the agency action be upheld on the basis of the reasons the agency stated in adopting the regulation); see also *State Farm*, 463 U.S. p. 43 (quoting *Chenery*).

²⁸⁶ I have masked in the above text a key issue discussed in this article as to the distinction between legislative and interpretive regulations. Legislative regulations are valid only if they are not arbitrary and capricious (the § 706(2)(A)/*State Farm* inquiry). Interpretive rules that are not the best interpretation of the statute may achieve some form of deference only if they reasonably interpret the statutory text. An unreasonable interpretation, I suppose, might be so unreasonable as to be considered arbitrary and capricious (although in the *Chevron* Framework, an unreasonable interpretation would not pass *Chevron* Step One or would fail *Chevron* Step Two, so that the arbitrary and capricious standard is not reached.) For example, if Treasury adopted an interpretation of the trade or business deduction in § 162 which permitted deduction of expenses for travel in Chevrolets but not in Fords, the interpretation would be both unreasonable **and** could be characterized as arbitrary and capricious. But I would think that there could be some interpretations that a court might consider unreasonable measured against the statutory text that a court would not conclude to be arbitrary and capricious. For more on the difference between *Chevron* reasonableness review and § 706(2)(A) arbitrary and capricious review, see *Judulang v. Holder*, 565 U.S. 42, 52 n. 7 (2011); and Distinction Between APA Arbitrary and Capricious Review and Chevron Interpretive Reasonableness Review (Federal Tax Procedure Blog 6/19/20; 7/24/20), here discussing the misreading of *Judulang* and referring to my larger SSRN article discussing the matter.

²⁸⁷ 5 U.S.C. § 553(b). The Good Cause basis for immediate effect without Notice and Comment “applies only in circumstances when notice and comment is impracticable, unnecessary, or contrary to the public interest”; and “is generally limited to emergency situations, or where delay could result in serious harm.” *Natural Resources Defense Council v. National Highway Traffic Safety Administration*, 894 F.3d. 95, 113-114 (2d Cir. 2018) (cleaned up).

The requirements of Notice and Comment and statement of “good cause” (“Good Cause”) for immediate effectiveness do not apply to interpretive rules.²⁸⁸ The IRS (Treasury) practice has been to issue interpretive regulations with notice and comment and, by 2019 policy statement, to make a Good Cause statement if the interpretation is in a Temporary Regulation to be effective before completion of the notice and comment process.²⁸⁹ (I will discuss the policy statement below, but for now just remember that, under the APA, the notice and comment process and the Good Cause statement are not required for interpretive regulations, even though an agency (Treasury here) uses the notice and comment process for interpretive regulations.)

One of the steps is the NPRM whereby, in giving notice, Treasury sets forth **Proposed Regulations**. Proposed regulations generally may not be relied upon except that they may offer guidance in the absence of final regulations.²⁹⁰ However, taxpayers may rely upon a proposed regulation if (i) there are no applicable final or temporary regulations and (ii) the IRS so states in the preamble to the proposed regulation.²⁹¹ This category is sometimes referred to as “reliance regulations.” Further, in the absence of final or temporary regulations on point, proposed regulations should generally guide IRS attorneys in taking positions and “ordinarily should not take any position in litigation or advice that would yield a result that would be harsher to the taxpayer than what the taxpayer would be allowed under the proposed regulations.”²⁹² Courts will not treat proposed regulations favoring an IRS litigating position as any more authoritative than “a position advanced on brief by the respondent.”²⁹³ (However, if the proposed regulations are issued contemporaneously with temporary regulations (required by § 7805(e)(1)) then the mirrored temporary regulations may have some authority beyond that conferred upon proposed regulations.)

Where circumstances justify issuing more immediately applicable authoritative regulatory guidance, Treasury may issue **Temporary Regulations** that become applicable immediately without Notice and Comment.²⁹⁴ Recall that the APA generally allows for immediate applicability without Notice and Comment “when the agency for good cause finds ... that notice and public procedure

²⁸⁸ I do not recall that I have seen a definitive statement of Congress’ reasons for exempting interpretive rules from the Notice and Comment and Prospectivity requirements. Based on my reading, though, I surmise: (i) as to Notice and Comment, the requirement that the interpretation be a reasonable interpretation of the statutory text was felt to be sufficiently constraining that the more public development process would not be appropriate; and (ii), as to the Prospectivity requirement, since interpretive rules like judicial interpretations interpret the statute, there was no reason for the type of Prospectivity required for new law created by legislative regulations. Moreover, interpretive regulations do not have the force of law as that term is used for legislative regulations which are the law.

²⁸⁹ Treasury and IRS Policy Statement on the Tax Regulatory Process (3/5/19).

²⁹⁰ IRM 32.1.1.2.2(2) (08-02-2018), Notice of Proposed Rulemaking.

²⁹¹ IRM 32.1.1.2.2(2) (08-02-2018), Notice of Proposed Rulemaking. For an example, see proposed regulations based on the “modification of section 958(b) of the Internal Revenue Code (“Code”) by the Tax Cuts and Jobs Act, which was enacted on December 22, 2017.” (These were published in the Federal Register, 84 FR 52398 (10/2/19)). The following statement is made in the document: “A taxpayer may rely on the proposed regulations with respect to any period before the date that these regulations are published as final regulations in the Federal Register.”

²⁹² IRM 32.1.1.2.2(3) (08-02-2018), Notice of Proposed Rulemaking.

²⁹³ *Zinniel v. Commissioner*, 89 T.C. 357, 369 (1987).

²⁹⁴ See generally Stephanie Hunter McMahon, The Perfect Process is the Enemy of the Good Tax: Exceptional Regulatory Process, 35 Va. Tax Rev. 553, 581 ff. (2016) for a summary of the legislative authority for Temporary Regulations.

thereon are impracticable, unnecessary, or contrary to the public interest.”²⁹⁵ That “Good Cause” authority, as a practical matter, applies only for legislative regulations otherwise required to be effective after notice and comment. So Treasury could issue an immediately effective interpretive regulation as a Temporary Regulation. Indeed, an interpretive regulation may not only be **immediately** effective, but the **interpretation** can be **retroactively** effective applying to conduct prior to the issuance of the interpretive regulation (whether final or Temporary) subject to certain constraints in § 7805 and other general fairness constraints.²⁹⁶ Treasury recently committed that, although not required by the APA, as a matter of sound regulatory policy, Treasury would issue Temporary Regulations with a Good Cause statement for immediate effectiveness.²⁹⁷ That policy did not speak to retroactive application of the interpretation to conduct prior to the Temporary Regulation. (It has always been the law the interpretive regulations generally can apply retroactively to the date of the statute.) A Temporary Regulation issued after November 20, 1988 must expire within 3 years of issuance;²⁹⁸ a Temporary Regulation issued before that date has no automatic expiration date²⁹⁹ and some of those may still apply because not withdrawn.³⁰⁰

Finally, Congress with the consent of the President can legislatively override regulations, both by regular legislation and, as to very recently proposed regulations, under the Congressional Review Act (“CRA”).³⁰¹ The CRA gives Congress an expedited procedure to disapprove a proposed agency major rule (here regulation) adopted very late in an administration via joint congressional resolution requiring either the signature or veto of the President. A regulation once disapproved by the Congress and signed by the President cannot be readopted without new legislation.³⁰² This authority seems to have practical application only when there is a change of administration.

(b) Interpretive or Legislative.

I offer here a summary of the distinction between legislative and interpretive rules, in the current context regulations. I offer more (much more detail) in my John A. Townsend, *The Report of the Death of the Interpretive Regulation Is an Exaggeration* (SSRN last revised 4/8/22), available at <https://ssrn.com/abstract=3400489>; a much shorter summary of the article is John A. Townsend, *A Key Point Summary of The Report of the Death of the Interpretive Regulation Is an Exaggeration* (SSRN 4/21/22), <https://ssrn.com/abstract=4089906>. The article and summary address the APA, the

²⁹⁵ 5 U.S.C. § 553(b)(B).

²⁹⁶ See the general discussion of retroactivity beginning on p. 71.

²⁹⁷ Treasury and IRS Policy Statement on the Tax Regulatory Process (3/5/19).

²⁹⁸ § 7805(e).

²⁹⁹ *Hewlett-Packard Co. & Consol. Subsidiaries v. Commissioner*, 139 T.C. 255, 265 n.15 (2012) (citing Technical and Miscellaneous Revenue Act of 1988, Pub. L. 100–647, § 6232(a), 102 Stat. 3734), *aff’d*, 875 F.3d 494 (2017).

³⁰⁰ For an application of pre-1988 temporary regulation, see e.g., *Hewlett-Packard* cited in preceding footnote, and *United States v. Parks*, 2022 U.S. Dist. LEXIS 210055 (Mich. S.D. 11/18/22) (involving Temp Reg. 26 C.F.R. § 22.0(b) which the court held still to be in effect and rejected the Government’s argument that it had been overruled by prior guidance).

³⁰¹ 5 U.S.C. Ch. 8, Congressional Review and Agency Rulemaking, §§ 801-808, enacted as Title II, Subtitle E, of the Small Business Regulatory Enforcement Fairness Act of 1996, Pub. L. No. 104-121, 110 Stat. 871 (1996).

³⁰² 5 U.S.C. § 801(b)(2).

APA categories of legislative and interpretive regulations, and judicial deference, now generally called *Chevron* deference based on principles in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). Significant portions of the discussion in the portion of the Tax Procedure book are drawn from the article and summary. (For those wanting a more current discussion by Professors Kristin Hickman, Bryan Camp and myself, I strongly recommend a series of Procedurally Taxing blog postings which are summarized with links in Samantha Galvin, June 2022 Digest (Procedurally Taxing Blog 7/5/22). **I avoid many of the details and only offer here high level summaries.**

The Administrative Procedure Act (“APA”)³⁰³ is a key foundation of what has been called the administrative state. It sets forth procedures and processes that administrative agencies must or should follow for various tasks assigned to them by Congress. In this section we deal with agency rulemaking. In the tax area, rulemaking encompasses Treasury Regulations (which for tax generally are what is called notice and comment regulations) and IRS subregulatory guidance (such as Revenue Rulings, Revenue Procedure, Notice).

The APA’s general rulemaking requirements have two important categories of rulemaking—**legislative and interpretive rulemaking**. Legislative rulemaking must be by notice and comment regulation and generally may be prospective only. Interpretive rulemaking may be by regulation and subregulatory guidance. Since Treasury (including IRS) only issues notice and comment regulations, I focus only on interpretive rulemaking by regulation and refer to this category as **interpretive regulations** (to distinguish from **legislative regulations**).

Legislative regulations (sometimes called “substantive” regulations) are promulgated by the agency pursuant to specific congressional statutory delegation to the agency to make the law. Legislative regulations are “the administrative counterpart of statutes,”³⁰⁴ i.e., “from the perspective of agency personnel, regulated parties, and courts, these rules have a status akin to that of a statute.”³⁰⁵ Under this concept, legislative regulations do not interpret statutory text; they create rules which are the equivalent of a statute and thus are the law rather than an interpretation of the law. It is thus commonly said that legislative regulations, like statutes, have the “force of law” or the common variant, “force and effect of law.”³⁰⁶

Under the APA, legislative regulations are the law unless “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.”³⁰⁷ (I refer to this standard as the “arbitrary and

³⁰³ The APA was originally enacted as the Administrative Procedure Act of 1946 (“APA”), Pub. L. No. 79-404, 60 Stat. 237. The APA is codified in 5 U.S.C. § 551, et seq., but the APA is the law rather than the codification/compilation in 5 U.S.C. Nevertheless, courts and authors commonly refer to the 5 U.S.C. compilation.

³⁰⁴ Kenneth Culp Davis, Administrative Rules - Interpretative, Legislative, and Retroactive, 57 Yale L.J. 919, 944 (1948).

³⁰⁵ Thomas W. Merrill & Kathryn Tongue Watts, Agency Rules with the Force of Law: The Original Convention, 116 Harv. L. Rev. 467, 476-477 (2002).

³⁰⁶ E.g., *Chrysler Corp. v. Brown*, 441 U.S. 281, 301-302 (1979) (“properly promulgated, substantive [legislative] agency regulations have the “force and effect of law.””

³⁰⁷ 5 U.S.C. § 706(2)(A); see also *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. (continued...)

capricious” standard³⁰⁸ but will use the longer form where quoting or context makes it important) This is often referred to as the *State Farm* standard or some variant, after the leading Supreme Court case applying the standard. *Motor Vehicle Mfrs. Assn. of United States, Inc. v. State Farm Mut. Automobile Ins. Co.*, 463 U.S. 29 (1983). This standard can be applied to interpretive regulations to test whether they have been adopted with appropriate procedural regularity but does not test whether an interpretive regulation is a reasonable interpretation.

Legislative regulations require: (i) formal notice in Federal Register and public opportunity to comment before promulgated (Notice and Comment), (ii) in promulgating final legislative regulations the agency must engage in reasoned decision making stating the bases for its decisions, and (iii) the regulations law, just as statutes, must generally be prospective in application (“Prospectivity”).³⁰⁹

The classic tax example of legislative regulations is the consolidated return regulations created by Treasury pursuant to the authority delegated in § 1502 to prescribe regulations as to effect corporate consolidated reporting. Absent Treasury’s promulgation of consolidated return regulations implementing the delegation of legislative authority in § 1502, courts could not through a process of interpreting § 1502 derive the consolidated return rules to resolve disputes between taxpayers and the IRS. Thus, for example, if a court were to declare a legislative regulation such as the consolidated return regulations invalid, there would be no law to apply.

Interpretive regulations—referred to as “interpretative” in the APA— are promulgated by the agency (Treasury here) to interpret the statute.³¹⁰ Under classic administrative law concepts, only the statute is the law; the interpretation of the statute is not the law. Unlike legislative regulations, interpretive regulations do not make the law and are tested against the statutory text they interpret. The APA expressly excludes interpretive rules (including interpretive regulations) from the requirements of Notice and Comment and Prospectivity.³¹¹ At the agency’s choice, interpretive rules may be published as regulations with Notice and Comment; for a long time, Treasury has generally promulgated interpretive regulations with Notice and Comment.³¹² An interpretive regulation may apply the interpretation to conduct since the effective date of the statute interpreted,

³⁰⁷(...continued)

29 (1983) (“*State Farm*”); *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 844 (1984); and *Batterton v. Francis*, 432 U.S. 416, 425-426 (1977).

³⁰⁸ The statute uses the disjunctive “or.” Most authorities refer to the standard as the “arbitrary and capricious” standard. I will use the more conventional reference—arbitrary and capricious—except when quoting.

³⁰⁹ 5 U.S.C. § 553(b)-(d).

³¹⁰ Although the APA uses “interpretative” (e.g., 5 U.S.C. § 553(b)(3)(A)), interpretive is the more common phrasing today.” *Perez v. Mortg. Bankers Ass’n*, 575 U.S. 92, 96 n. 1 (2015).

³¹¹ 5 U.S.C. § 553(b)(A) exempting from pre-promulgation notice “interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice” (in our categories, interpretive regulations are exempted from the notice requirement) and 5 U.S.C. § 553(d)(2), exempting from Prospectivity requirement “interpretative rules and statements of policy.”

³¹² Michael Asimow, Public Participation in the Adoption of Interpretive Rules and Policy Statements, 75 Mich. L. Rev. 520, 524 (1977).

even if the interpretation is promulgated as agency guidance much later.³¹³ This is sometimes called retroactive, but the interpretation must be within the range of reasonable interpretations of the statute from the effective date, so that the interpretation just clarifies which among the reasonable interpretations applies to the statutory text. In that sense, statutory text being interpreted is the law from effective date and, conceptually, there is no retroactive application of the statutory text. Nevertheless, it is common to speak of retroactive application of the interpretation; I will use that term here even though it is misleading for the reason noted. And, under the concept of application from the effective date of the statute, if court determines that an agency interpretation will not be respected, the court then interprets and applies the interpretation to the statute to resolve the case at hand.

Treasury issues interpretive regulations under the Authority of § 7805(a) authorizing Treasury to “all needful rules and regulations for the enforcement of this title.” Section 7805(a) has historically been viewed in the legislative/interpretive divide to authorize only interpretive regulations and not legislative regulations.³¹⁴ Certainly, the statutory text is not the type of specific legislative authority, required for legislative regulations such as in § 1502 for consolidated return regulations.

Under the traditional understanding, a good tax example of an interpretive regulation is the IRS’s regulations interpretation of the business deduction allowed in § 162 for “away from home” meals and lodging expenses at issue in *United States v. Correll*, 389 U.S. 299 (1967). In a regulation, Treasury interpreted that statutory text to require stopping for sleep or rest, an overnight rule; the Supreme Court adopted—via deference—that interpretation in *Correll*.³¹⁵ Note that the interpretation is not a necessary interpretation of the statutory text “away from home”; it is simply one among several possible reasonable interpretations that the IRS chose to implement the statute. The *Correll* Court said: “The role of the judiciary in cases of this sort begins and ends with assuring that the Commissioner’s regulations fall within his authority to implement the congressional mandate in some reasonable manner.”³¹⁶ Historically, interpretive regulations are **not** said to have the “force of law”; rather, the statute has the force of law.

³¹³ See 5 U.S.C. 553(d). I discuss the general retroactivity issue beginning on p. 71 and the retroactivity of interpretive regulations beginning on p. 71.

³¹⁴ Stanley S. Surrey, *Scope and Effect of Treasury Regulations under the Income, Estate and Gift Taxes*, 88 U. Pa. L. Rev. 556, 557-558 (1940) (1939 Code predecessor of § 7805(b) in same language; “[T]his provision does not invest interpretative regulations with the force of law. The standard of “needful... for the enforcement” of a revenue act would hardly seem adequate in this regard to support a delegation of legislative power.”); and Richard Murphy, *Pragmatic Administrative Law and Tax Exceptionalism*, 64 Duke L.J. Online 21, (2014) (“The common view after adoption of the APA, shared by Professor Kenneth Culp Davis, continued to be that most Treasury regulations were interpretive.”). For a sampling of cases, see e.g., *Cottage Savings Assn v. Commissioner*, 499 U.S. 554, 560-61 (1991) (§ 7805(a) authorizes “regulatory interpretations”); *Kikalos v. Commissioner*, 190 F.3d 791, 795 (7th Cir. 1999) (Regulations promulgated under § 7805(a) called “interpretive regulations”); *Nalle v. Commissioner*, 997 F.2d 1134, 1136 (5th Cir. 1993) (“interpretive regulation promulgated pursuant to the Commissioner’s authority under section 7805(a)”);

³¹⁵ The interpretation was originally in a subregulatory document but, by the time the case reached the Supreme Court, the interpretation had been adopted in a regulation. Reg. § 1.162-17(b)(3)(ii), (b)(4), (c)(2). The Supreme Court tested the interpretation as a regulation.

³¹⁶ 389 U.S., at 307.

Justice Scalia, an administrative law expert (having taught the subject in law school) succinctly summarized the difference between legislative and interpretive regulations as follows:

- “interpretive regulations * * * reasonably and authoritatively construe the statute itself.”
- “substantive [legislative] regulations [are] promulgated under an express delegation of authority to impose freestanding legal obligations beyond those created by the statute itself.”³¹⁷

Another formulation is whether the rule creates new law not within the interpretive scope of the statutory text or instead just interprets the statutory text.

I have just stated the classic administrative law concept of the interpretive regulation which does not make law and its distinction from a legislative regulation which does make law. Beginning sometime in the 1990s, invoking various strands of reasoning (perhaps reflecting some type of realism approach when interpretations qualify for *Chevron* deference), some scholars began claiming that *Chevron*-qualified regulations that do no more than interpret the statute are really legislative regulations because *Chevron* deference gives them the “force of law,” a characterization that historically described only legislative regulations. So the reasoning goes, if interpretive regulations have the “force of law,” they are legislative rather than interpretive. The prominent advocate of that position is Professor Kristin Hickman, a force in the intersection of administrative law and tax law, who claims: “In summary, there are no Treasury regulations that are interpretive rules as that term is understood for purposes of the Administrative Procedure Act.”³¹⁸ That claim, if true for Treasury regulations interpreting statutory text, is true for all agency regulations.

In an article, I oppose that claim and adopt the traditional understanding that interpretive regulations are a viable APA category as set forth in the preceding paragraphs. That traditional understanding allows interpretive rules (which as noted above are not the law but interpretations of the law). In contrast to Professor Hickman’s bold claim that interpretive regulations no longer exist, I cite Justice Breyer, an administrative law expert,³¹⁹ who, in 2019, stated, equally boldly, in oral argument in an administrative law case: “there are hundreds of thousands, possibly millions of interpretive regulations.”³²⁰ I agree with Justice Breyer’s claim, although I managed in the article to pack my statement of the claim in a lot more words than and with less authorial gravitas than he did. Finally, it is important to note that the “force of law” claims have only been deployed by the Supreme Court only in a deference context and has never been deployed by the Supreme Court to

³¹⁷ E.g., *Global Crossing Telecomm. Inc. v. Metrophones Telecom*, 550 U.S. 45, 69 (2007) (Scalia dissenting). There is no indication that the majority opinion disagreed with his description of the categories.

³¹⁸ My article quotes this claim and takes the claim as its point of departure. John A. Townsend, [The Report of the Death of the Interpretive Regulation Is an Exaggeration](#) (SSRN revised 4/8/22).

³¹⁹ Justice Breyer was formerly a professor of administrative law at Harvard Law School and was the lead author on a leading administrative law book which continues with his name as a nominal author. Stephen G. Breyer, et al., [Administrative Law and Regulatory Policy](#) (8th ed. 2017 Walters Kluwer),

³²⁰ *Id.*, p. 5, citing in fn. 18 *Kisor v. Wilkie* (Sup. Ct. No. 18-15), Transcript of Oral Argument 3/27/19, p. 10.

declare that interpretive regulations have the force of law to make them legislative regulations under the APA.

(c) Retroactivity of Regulations.

Can regulations be retroactive to the date of the statute? Legislative regulations generally cannot be retroactive to the date of the legislative authority statute. Indeed, legislative regulations generally cannot be retroactive before final promulgation after notice and comment, with one exception. Treasury Temporary Regulations which are **legislative** (called interim-final by other agencies) may be immediately effective before notice and comment with a good cause statement but cannot be retroactively effective. Treasury **interpretive** Temporary Regulations can be retroactive to the effective date of the statute.

Reflecting this retroactivity feature for interpretive regulations, § 7805(b) (and its predecessors) provided that Treasury had discretionary authority to limit retroactivity of rules and regulations under § 7805(a). In 1996, Congress amended § 7805(b) to limit retroactivity for regulations. The provision provides that temporary and final regulations may not apply to taxable periods prior to the earliest of the following dates:

- (1) if issued within 18 months of the date of the statute, then to “the date of the enactment” of the statute;³²¹
- (2) if issued later than 18 months, then the earliest of the following dates: (a) the date the final regulation was published; (b) the date on which any Proposed or Temporary Regulation was published; and (c) the date on which any notice substantially describes the contents of the expected Proposed, Temporary or Final Regulation;³²²
- (3) if necessary “to prevent abuse,” with no limitation as to the date of retroactivity;³²³
- (4) “to correct a procedural defect in the issuance of any prior regulation,” with no indication as to the date of retroactivity;³²⁴
- (5) if “relating to internal Treasury Department policies, practices, or procedures,” with no limitation as to the date of retroactivity.³²⁵

These are limitations on the regulations but not the interpretation. If the interpretation is the best interpretation of the statutory text, then perforce the interpretations will apply from the effective date of the statute (whether or not the interpretation is in a regulation). In other words, if the IRS were to include the interpretation in a regulation which violated the time limitations, that would not invalidate the interpretation or prevent the interpretation from applying from the effective date of the statute; it would just invalidate the regulation. In practical effect, all that would mean is that the

³²¹ § 7805(b)(2).

³²² § 7805(b)(1).

³²³ § 7805(b)(3).

³²⁴ § 7805(b)(4). This is like a legislative technical correction of an earlier statute; the technical correction is generally applied retroactive to the date of the statute it corrects. Marc J. Gerson, Technically Speaking: The Art of Tax Technical Corrections, 114 Tax Notes 927 (Mar. 5, 2007).

³²⁵ § 7805(b)(5).

interpretation would not qualify for *Chevron* deference if the interpretation was not the best interpretation of the statute.

(d) Nonexistent/Phantom Regulations.

Congress will sometimes direct or authorize the IRS to issue regulations to flesh out the statutory scheme. The direction or authorization may be for interpretive regulations or legislative regulations (although here again there is a problem for those who read *Chevron* as making all notice and comment regulations legislative regulations). For any number of reasons, the IRS may not get around to promulgating the required regulations for long periods. The party—often the taxpayer—suffering from the absence of regulations may seek in audits or litigation the result that would have obtained had the regulations been promulgated. How do the IRS and the courts resolve cases which would be subject to such regulations if they existed? If Congress intended the regulations to confer a taxpayer benefit, can the IRS deny the benefit by not issuing regulations? Should the IRS or the courts create, in effect, a “phantom” regulation to resolve the case based on the policies and directions reflected in the statute (as discerned from the statute or legislative history that is persuasive as to the legislative intent of, if one prefers, the statutes’ original meaning)?

The authority creates some guidance, although often not definitive. In a 2016 reviewed opinion,³²⁶ the Tax Court concluded the task is to determine whether the statutory text, considered in light of interpretive tools (including legislative history the judge resorts to legislative history), can be applied without further explication in a regulation. The analysis turns upon whether “Congress couched its delegation of rulemaking authority in mandatory or permissive terms.” If mandatory, the Court could treat the delegation of authority as “self-executing” and could discern from the statutory text as interpreted the result that Congress intended the IRS to adopt and apply in the case at hand.

In *Whirlpool v. Commissioner*, 19 F.4th 944 (6th Cir. 2021), pet. for writ of certiorari denied 598 U.S. ___ (Sup. Ct. No. 22-9 11/21/22), the statute (§ 954(d)(2)) provided that certain income earned by a controlled foreign corporation (“CFC”) through a separate subsidiary corporation was subject to tax-unfavorable treatment, and gave Treasury authority “under regulations prescribed by the Secretary” to treat branch income as subject to the same tax unfavorable treatment if the branch income “has substantially the same effect as if such branch or similar establishment were a wholly owned subsidiary corporation deriving such income.” The Sixth Circuit held that the statute could apply to impose the result in the absence of regulations. One author treats the result as a phantom regulation.³²⁷ I think however that, at the risk of engaging in semantics, the issue is not whether the Sixth Circuit has created whole cloth a regulation to apply in the absence of a regulation but has properly interpreted the statute to impose the result in the absence of a regulation. The taxpayer has applied for certiorari, so perhaps the Supreme Court will offer more guidance in the area.

(e) Politics and Regulations.

³²⁶ *15 West 17th Street LLC v. Commissioner*, 147 T.C. 557 (2016) (Reviewed opinion).
³²⁷ Andy Grewal, [The Solicitor General Embraces Phantom Tax Regulations](#) (Notice & Comment 10/21/22).

I avoid discussing transitory developments driven by shifting political winds, except to the extent that they result in systemic changes related to tax procedure that will last beyond the current shifts in the political winds. I do mention briefly some of the political winds, ill or not, that are blowing.

Right-leaning, generally Republican, political winds blow against the perceived enemy of “job killing regulations” and the related theme of distrust of the administrative state. One specific instance of this angst is the accelerating attacks by conservative judges on the *Chevron* deference to reasonable agency interpretations of ambiguous statutory text.³²⁸

(3) Subregulatory Guidance.

Regulations are the most formal of IRS guidance. The IRS issues less formal guidance in many types of publications. I discuss the more prominent of these less formal publications in this section. I include these less formal publications under the category “subregulatory” guidance because that is a term often used to describe agency publications issued outside the regulations requirements.³²⁹

(a) Revenue Rulings and Procedures.

i) Revenue Rulings.

A Revenue Ruling is an IRS “official interpretation” of the Code, related statutes, tax treaties and regulations based on applying the interpretation of the law to a stated set of specific facts.³³⁰ Revenue Rulings are the “the second most important agency pronouncements that interpret the Code.”³³¹ Revenue Rulings promote uniformity of interpretation within the IRS and permit taxpayers to rely on them “in determining the tax treatment of their own transaction” without having to “request specific rulings applying the principles of a published revenue ruling to the facts of their particular cases.”³³² Interpretations in Revenue Rulings generally apply retroactively.³³³ Taxpayers may rely upon the Revenue Ruling without seeking a private letter ruling (which is discussed

³²⁸ *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

³²⁹ For other discussions of these subregulatory categories, see Stephanie Hunter McMahon, Classifying Tax Guidance According to End Users, 73 *The Tax Lawyer* 245 (2020), particularly at 248 n. 9 citing other discussions of the various forms of guidance.

³³⁰ IRM 32.2.2.3.1 (08-11-2004), Revenue Ruling Defined. See also Reg. 601.601(d)(2)(i)(a); and Rev. Proc. 89-14, 1989-8 I.R.B. 20.

³³¹ *Stichting Pensioenfonds Voor de Gezondheid v. United States*, 129 F.3d 195, 198 (D.C. Cir. 1997).

³³² Reg. 601.601(d)(2)(v)(e). See also Rev. Proc. 89-14, 1989-1 C.B. 814, at section 7.01(5); IRM 32.2.2.10 (08-11-2004), Force and Effect of Revenue Rulings, Revenue Procedures, Notices, Announcements, and News Releases; and Mitchell Rogovin and Donald L. Korb, The Four R’s Revisited: Regulations, Rulings, Reliance, and Retroactivity in the 21st Century: A View From Within, 46 *Duquesne L. Rev.* 323, 331 (2008).

³³³ Reg. 601.601(d)(2)(v)(c) (“Revenue Rulings [with certain exceptions] * * * apply retroactively unless the Revenue Ruling includes a specific statement indicating, under the authority of section 7805(b) of the Internal Revenue Code of 1954, the extent to which it is to be applied without retroactive effect.”)

below). Although the IRS has the power to change a position in a Revenue Ruling retroactively,³³⁴ the IRS will not generally make a change in position retroactively even if a particular taxpayer was not aware of it or did not rely upon it.³³⁵

The usual format for a Revenue Ruling is to state an assumed set of facts (often based upon a real fact situation of which the national office is aware but cleansed so as to not identify the taxpayer) and state the IRS's opinion as to what the substantive legal result should be.³³⁶

Revenue Rulings are issued under the authority of § 7805(a). Revenue Rulings are not issued with public notice and comment, but there is a multistage administrative procedure for issuing Revenue Rulings, including review within both the IRS and Treasury.³³⁷ Revenue Rulings are published by the IRS in the weekly I.R.B.³³⁸

Within the IRS, Revenue Rulings are used as authority and binding on IRS agents in audits.³³⁹ This means that, if the Revenue Ruling supports the taxpayer, the agent may not make a different audit determination. If, however, the Revenue Ruling supports the adjustment the agent proposes, **the agent** should follow the Revenue Ruling. This does not mean that the taxpayer loses, for the taxpayer can go to Appeals which can settle based on litigating hazards regardless of the Revenue Ruling and, if unsuccessful in Appeals, eventually litigate where the outcome is not controlled by the Revenue Ruling.

Occasionally in litigation in the past, the IRS has taken positions that contradict or appear to contradict Revenue Rulings; in those cases, the courts appeared quite willing to hold the IRS to

³³⁴ *Dixon v. United States*, 381 U.S. 68, 73 (1965) (holding that “the IRS may correct mistakes of law “even where a taxpayer may have relied to his detriment on the * * * [IRS’] mistake.”). The IRS may change the interpretation in the Revenue Ruling by issuing a new Revenue Ruling or simply by revoking the Revenue Ruling. The IRS may also, in some “rare situations” suspend a Revenue Ruling “pending some future action, such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.” IRM 32.2.2.8.1(9) (08-11-2004), Use of Terms (“Suspended”). See e.g., Rev. Rul. 2019-9, 2019-14 I.R.B. (suspending two Revenue Rulings pending completion of a study).

³³⁵ Rogovin & Korb, *supra*, pp. 335-336.

³³⁶ Reg. 601.201(a)(2) and 601.601(d)(2)(i)(a).

³³⁷ See IRM 32.2.2.9 (09-16-2011), Responsibility for Publishing Revenue Rulings, Revenue Procedures, Notices, Announcements, and News Releases.

³³⁸ Mitchell Rogovin and Donald L. Krob, The Four R’s Revisited: Regulations, Rulings, Reliance, and Retroactivity in the 21st Century: A View From Within, 46 Duquesne L. Rev. 323, 330(2008) (citing Treas. Reg. § 601.601(d)(2) (1987)).

³³⁹ Reg. 601.601(d)(2)(v)(d). See generally Rev. Rul. 53-2, 1953-1 C.B. 484.

the Revenue Rulings.³⁴⁰ As a result, the IRS announced that it will not take positions in litigation contrary to published guidance, including Revenue Rulings.³⁴¹

More often, however, in litigation, it is the taxpayer seeking to avoid the position the IRS asserted in a Revenue Ruling. Then, the issue of whether the Revenue Ruling is just one lawyer's opinion or is entitled to deference becomes important. I address later the deference that courts accord to interpretations in Revenue Rulings but for now suffice it to say that Revenue Rulings are usually accorded a weak form of deference—called *Skidmore* deference—that permits the Revenue Ruling to affect the interpretation applied by the court only if the court believes the position in the Revenue Ruling is persuasive.

ii) Revenue Procedures.

A Revenue Procedure is an “official statement” of an IRS procedure that either “affects the rights or duties of taxpayers or other members of the public under the Internal Revenue Code, related statutes, tax treaties, and regulations, or information” or should be publicly known.³⁴² Revenue Procedures thus differ from Revenue Rulings which advise the public of IRS substantive law positions. For example, the IRS uses Revenue Procedures to advise the public about detailed requirements for requests for private letter rulings (discussed immediately below).³⁴³ In this sense, they act as “check lists” that taxpayers and practitioners follow to seek private letter rulings. Like Revenue Rulings, Revenue Procedures are published in IRBs. Revenue Procedures generally go through the same internal processing as Revenue Rulings.³⁴⁴

(b) Notices.

The IRS publishes “Notices” that are less formal than Regulations, specifically not having any notice and comment period which is the key feature of Regulations and having less internal review within the IRS and Treasury. These notices are used to provide quicker notice to the public

³⁴⁰ See e.g., *Rauenhorst v. Commissioner*, 119 T.C. 157 (2002) (holding Revenue Ruling is a concession by the IRS, avoiding the necessity of determining the application of the law to the facts); and *McLendon v. Commissioner*, 135 F.3d 1017 (5th Cir., 1998); see also IRS CC-2002-043, 2002 WTD 223-29 (cautioning IRS attorneys in light of *Rauenhorst* to follow published guidance.) This rule is a subset of a larger rule, called variously the *Accardi* principle or doctrine, for the case name U.S. ex rel. *Accardi v. Shaughnessy*, 347 U.S. 260, 266-67 (1954); and a predecessor case, *Ariz. Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co.*, 284 U.S. 370 (1932), which as currently interpreted and applied (if applied), “Agency violations of their own regulations, whether or not also in violation of the Constitution, may well be inconsistent with the standards of agency action which the APA directs the courts to enforce.” *Accardi*, p. 754-754. The Supreme Court guidance seems to apply the principle only to legislative rules and not interpretive rules. Cass R. Sunstein & Adrian Vermeule, *The Morality of Administrative Law*, Harv. L. Rev. 1924, 1959 (2018); and also Thomas W. Merrill, *The Accardi Principle*, 74 Geo. Wash. L. Rev. 569, 600-03 (2006).

³⁴¹ CC-2003-014, published at 2003 TNT 93-7 (instructing IRS attorneys to not take positions inconsistent with public positions in “final guidance,” defined as “final regulations, temporary regulations, revenue rulings, revenue procedures.”)

³⁴² IRM 32.2.2.3.2 (08-11-2004), Revenue Procedure Defined. See also Reg. 601.601(d)(2)(i) (b); see *Eaton Corp. v. Commissioner*, 140 T.C. 410, 416 n. 3 (2013); and Rogovin & Korb, pp. 336-337.vv

³⁴³ Rev. Proc. 2020-1, 2020-1 I.R.B.

³⁴⁴ IRM 32.2.2.9.2 (08-11-2004), Responsibility for Preparing Revenue Rulings, Revenue Procedures, Notices, Announcements, and News Releases.

than allowed by the other forms of pronouncement. These notices “have proven particularly useful for quickly disseminating information that allows taxpayers to understand exactly which transactions will be of interest to the Service, including so-called “listed transactions” and “transactions of interest,” both of which are “reportable transactions” under section 6011. The notices are published in the Internal Revenue Bulletin (I.R.B.).

(4) Other Guidance Documents.

I offer in this section other documents that are not expressly intended as general guidance to taxpayers but which can be used by them or their practitioners in planning transactions, dealing with agents in audits or collection activities (even though not binding on the agents), and in litigation.

(a) Letter Rulings.

i) Nature of the Letter Ruling.

A letter ruling (commonly called a “private letter ruling” (“PLR”)), is a ruling issued to a taxpayer by the IRS National Office as to the application of the tax law to a transaction (1) that the taxpayer contemplates undertaking or (2) that the taxpayer has undertaken and needs guidance to file the return.³⁴⁵ By far the bulk of the rulings are issued in the first category—contemplated transactions—where the taxpayer needs certainty or “comfort” as to the tax consequence before entering into the transaction. Letter rulings are requested from and issued by the National Office of the IRS.³⁴⁶ The resulting letter ruling is not a formal position of the IRS; rather, it is just a ruling approved with far less internal process and consideration than are regulations. The taxpayer must file the PLR with all relevant tax returns.³⁴⁷

Usually, the taxpayer requesting the PLR is engaged in the process leading to the ruling, at least sufficiently to ensure that the legal issues are developed from the taxpayer’s perspective. If the IRS makes a preliminary decision to deny the ruling request, the IRS will notify the taxpayer and offer the opportunity to withdraw the ruling request. Based on my anecdotal evidence, most taxpayers withdraw the request rather than force the IRS to issue an unfavorable PLR.³⁴⁸

³⁴⁵ Reg. § 601.201(a)(2) (“A ruling is a written statement issued to a taxpayer or his authorized representative by the National Office which interprets and applies the tax laws to a specific set of facts. Rulings are issued only by the National Office.”) & § 601.201(b). See also Rev. Procs. 2021-1, 2023-3, and 2023-7 in 2021-1 I.R.B., (providing revised list of areas in which letter rulings or determination letters will not be issued).

³⁴⁶ For the process, see 32.3.2.3 (07-09-2014), General Procedures for Handling Requests for Letter Rulings.

³⁴⁷ IRM 32.3.2.3.2.2(3) (08-11-2004), Caveats to be Included in Letter Rulings, Technical Advice Memoranda, and Accounting Method and Period Change Letters.

³⁴⁸ In *Anonymous v. Commissioner*, 134 T.C. 13 (2009), the taxpayer declined to withdraw the request and then complained about the IRS’s decision to issue the unfavorable ruling and make it public as required for PLRs (see in the text below). Strange indeed.

The IRS annually publishes, as the first Revenue Procedures, the procedures for requesting PLRs and the so-called “user fees” for PLRs.³⁴⁹ The IRS also issues annually Revenue Procedures relating to issues on which the IRS will not rule.³⁵⁰

The IRS publishes the PLRs after redacting confidential and identifying information.³⁵¹ The publication is made through the IRS FOIA reading room.³⁵²

ii) Retroactive Revocation.

The black letter law is that the IRS may correct an erroneous legal interpretation retroactively.³⁵³ The theory is that an erroneous interpretation is a nullity. Obviously, however, where a taxpayer in good faith has requested and received a specific ruling and then relied upon the ruling in completing a transaction, retroactive revocation can be viewed as unfair and inequitable. Generally, therefore, the IRS exercises its discretion and revokes only prospectively.³⁵⁴ By contrast, in those less common cases where the PLR issues after the fact as to a completed transaction, the case against retroactivity is less compelling and the revocation will generally be retroactive.³⁵⁵

The governing Rev. Proc. for PLRs states the IRS current practice with respect to retroactivity. The PLR may be revoked in certain limited circumstances involving a change in the facts upon which the PLR was granted (e.g., if the taxpayer has made material misstatements of fact in the process of requesting and obtaining a ruling³⁵⁶). If there is no change in the facts, however, the IRS will not retroactively revoke provided that there is no change in the applicable law, the PLR was for a proposed transaction, and the taxpayer undertook the transaction in good faith in circumstances where revocation would be to the taxpayer’s detriment.³⁵⁷ In other words, even where the law might permit the IRS to apply a different legal interpretation retroactively, the IRS is exercising its discretion not to do so where the conditions are met.

³⁴⁹ The current iteration is Rev. Proc. 2023-1, 2022-1 I.R.B. 1.

³⁵⁰ The current iterations are Rev. Procs. 2023–3; Rev. Proc. 2023-4; 2021-5; and Rev. Proc. 2023–7, all in I.R.B. 2023-1.

³⁵¹ The IRS numbering system for the published private letter rulings is a series of digits with the year first, the numerical week in the year next and the next digits being the sequentially issued rulings during that week. Thus, a PLR issued in the 2nd week of 2009 would have the following prefix: 200902. The final digits will be the sequential number of the PLR as issued during that week.

³⁵² <https://www.irs.gov/privacy-disclosure/foia-library>.

³⁵³ See *Automobile Club v. Commissioner*, 353 US 180 (1957); cf. *Dixon v. United States*, 381 US 68, 73, 73 (1965) (holding that “the IRS may correct mistakes of law “even where a taxpayer may have relied to his detriment on the * * * [IRS’] mistake.”); and *Dickman v. Commissioner*, 465 U.S. 330, 343 (1984)

³⁵⁴ Reg. § 601.201(l)(5) provides that a PLR issued with respect to a proposed transaction that is relied upon in good faith will generally not be revoked retroactively. See also, Emily Cauble, [Detrimental Reliance on IRS Guidance](#), 2015 Wis. L. Rev. 421, 440 (2015).

³⁵⁵ Reg. § 601.201(l)(9) (“taxpayers will not be afforded protection against retroactive revocation . . . since they will not have entered into the transactions in reliance on the rulings.”).

³⁵⁶ Rev. Proc. 2023-1, 2022-1 I.R.B., § 11.05.

³⁵⁷ Rev. Proc. 2023-1, 2022-1 I.R.B., § 11.06.

(b) Technical Advice–TAMs, TEAMs.

During the course of an audit, an agent may seek to support an adjustment on the basis of an issue as to which the law may not be clear. The agent may seek advice from the local IRS Counsel who is usually not a specialist in the substantive issue involved. Alternatively, the agent may seek a Technical Advice in the form of a Technical Advice Memorandum (“TAM”) from the National Office and obtain a definitive (at least internally definitive) position on the issue.³⁵⁸ The TAM “represent[s] the views of the Office of Chief Counsel as to the application of tax law, tax treaties, regulations, revenue rulings, or other published precedents to the facts of specific cases.”³⁵⁹ The request for a TAM may also be made in other contexts such as examining a claim for refund. Technical Advice is sought only for closed transactions. Technical Advice is designed to resolve legal issues, not factual issues.³⁶⁰ The taxpayer may even initiate the process for technical advice.³⁶¹ Once the process is started, the taxpayer will be involved in the process because it requires that the IRS and the taxpayer agree upon the facts, at least sufficiently for the National Office to render its legal position. The taxpayer will have the opportunity to “brief” his position, so that the National Office will have that input in reaching its decision. And, if the National Office personnel determine that the TAM will be adverse to the taxpayer, the taxpayer may have a conference with National Office personnel if requested.³⁶² The final step in the TAM process is the finalization and issuance of the TAM. The TAM is the IRS position on the facts stated.³⁶³

The IRS has developed an alternative to the TAM, known as the Technical Expedited Advice Memorandum (“TEAM”).³⁶⁴ This process provides TAM-quality advice to the field in a shorter time frame.³⁶⁵

(c) FAQs

The IRS sometimes publishes Frequently Asked Questions (“FAQs”) to offer its personnel and taxpayers guidance.³⁶⁶ FAQs may be incorporated in the I.R.B. or only on the IRS website. When incorporated in the I.R.B., they bind the IRS but not necessarily taxpayers; when not

³⁵⁸ See generally, Reg. § 601.105(d)(5); and Rev. Proc. 2022-2, 2022-1, I.R.B. 116 (explaining when and how technical advice is given in a TAM and the rights that a taxpayer has in the process).

³⁵⁹ IRM 33.2.1 Issuing Technical Advice Memorandum and Technical Expedited Advice Memoranda, IRM 33.2.1.1 (08-11-2004), Purpose and Authority.

³⁶⁰ The procedures for technical advice are set forth in Revenue Procedures updated periodically by the IRS. See Rev. Proc. 2023-2.

³⁶¹ Reg. § 601.105(d)(5)(iii); IRM 1.2.1.5.25 (07-25-1967), Policy Statement 4-82, Taxpayer may request referral of issue under jurisdiction of District Director to National Office; IRM 33.2.2.1 (08-11-2004), Requesting Technical Advice or Technical Expedited Advice,

³⁶² Reg. § 601.105(d)(5)(v).

³⁶³ Reg. § 601.105(d)(5)(viii).

³⁶⁴ IRM 33.2.2.1 (08-11-2004), Requests for Technical Advice and Technical Expedited Advice.

³⁶⁵ Id.

³⁶⁶ See e.g., IRS web page titled “Frequently Asked Questions and Answers” (Page Last Reviewed or Updated: 27-Feb-2018) and viewed on 3/8/18).

incorporated in the I.R.B. they may not even bind the IRS.³⁶⁷ FAQs are not listed as one of the authorities that may be used to avoid the accuracy related penalties.³⁶⁸ FAQs are often used to provide quick guidance to taxpayers who need it before some more formal guidance could be processed; hence FAQs are not subject to the type of review that more formal guidance receives and are not authority binding on the IRS.³⁶⁹ Finally, although not designated FAQs, some regulations use a Q&A format similar to FAQs;³⁷⁰ being regulations, the review process is much more rigorous, the regulations' Q&As are authority that may be relied upon by taxpayers and the IRS, and the regulations are subject to *Chevron* deference if otherwise appropriate.

In 2021, the IRS announced that it was updating its process for certain FAQs related to newly enacted legislation.³⁷¹ The revised process will announce FAQs on newly enacted tax legislation in a news release posted on IRS.gov in a separate Fact Sheet. The FAQs will be dated and earlier versions will be easily available. Contemporaneously, the IRS clarified that, if a taxpayer relies in good faith on an FAQ and the reliance is reasonable, the taxpayer will have a reasonable cause defense to any negligence of other accuracy related penalty if the FAQ was not correct.

(d) IRM - Internal Revenue Manual.

The IRS publishes an Internal Revenue Manual (“IRM”) which is a large compendium of internal administrative procedures.³⁷² The IRM meets the IRS’s FOIA obligation applicable to all agencies to maintain and make available to the public records of policies, authorities, procedures and organizational operations.³⁷³ Most of the IRM has been made public on the IRS website³⁷⁴ and is easily searchable with search engines such as Google. Some portions of the IRM are not made public, however.³⁷⁵

³⁶⁷ Regulatory Guidance Processes: Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance 12-13 (GAO-16-720 Sept. 2016).

³⁶⁸ Reg. § 301.6662-4(d)(3)(iii) (Types of authority). However, it is reported that IRS Acting Chief Counsel William M. Paul that, for reasonable cause relief to the accuracy related penalty, § 6662, the “IRS is comfortable with the view that if a taxpayer relies in good faith on an FAQ and that reliance is reasonable under all the facts and circumstances, the taxpayer should have a reasonable cause defense and should not be subject to a negligence penalty or other accuracy-related penalty.” IRS to Address Concerns with FAQs in Announcement Soon (BloombergTax 6/24/21).

³⁶⁹ Protecting the Rights of Taxpayers Who Rely on IRS “Frequently Asked Questions” (FAQs) (NTA Blog 7/7/20).

³⁷⁰ Reg. § 301.6330-1(a)(3), Q&A A10 (relating to notices of federal tax liens).

³⁷¹ IR-2021-202 (10/15/21).

³⁷² IRM 1.11.2.2 (08-12-2021), IRM Standards (“The IRM is the primary, official compilation of instructions to staff that relate to the administration and operation of the IRS.”).

³⁷³ JCT Staff, Background Regarding the Confidentiality and Disclosure of Federal Tax Returns 18 n. 73 (JCX-3-19 2/4/19).

³⁷⁴ IRS web page titled “Internal Revenue Manuals” (last reviewed or updated 7/22/18 and viewed 7/22/18).

³⁷⁵ JCX-3-19, at p. 18 n. 73.

The IRM is “separated into 39 parts, which cover various subject matters (e.g., how to audit tax returns, collect taxes, process returns, and assess penalties). The parts are then divided into chapters that, in turn, are separated into sections and subsections.”³⁷⁶

The IRM is quite useful for determining authorities and proper procedures within the IRS. Access to the IRM is important in a tax practice generally and in tax controversy practice specifically.

Does the taxpayer have any relief if the IRS violates the IRM and thereby potentially harms the taxpayer? In *United States v. Caceres*, 440 U.S. 741 (1979), the Supreme Court answered the question no. And, although the IRM is not law, the IRM may be persuasive as to the IRS’s interpretation of the statute. *Ginsburg v. Commissioner*, 127 T.C. 75, 87 (2006).

(e) AODs Positions on Decided Cases.

When the IRS loses a legal issue in court, the IRS may prepare a document called an Action on Decision (“AOD”), published in the I.R.B., stating how the IRS treat the decision disposing of other cases.³⁷⁷ The categories for such AODs are: (i) “acquiescence” - the IRS will follow the holding to dispose of cases with “the same controlling facts, but “does not indicate approval or disapproval of the reasoning”; (ii) “acquiescence result only” - the IRS will follow the holding to dispose of cases with the same controlling facts but will indicate “disagreement or concern with some or all of the reasons assigned by the court for its conclusions:” and (iii) “nonacquiescence” - although the case was not appealed, the IRS “does not agree with the holding of the court and will not follow it nationwide in disposing of other cases” except, if a circuit court decision, will generally follow it in the circuit.³⁷⁸ When the AOD nonacquiesces in a Court of Appeals decision, the AOD will state that the decision is precedent that the IRS will follow for taxpayers in the Circuit, but that in other Circuits the IRS will apply the position stated in the AOD.

(f) Information Letter.

An “Information Letter”

provides general statements of well-defined law without applying them to a specific set of facts. They are furnished by the IRS National Office in response to requests for general information by taxpayers, by congress-persons on behalf of constituents, or by congress-persons on their own behalf.³⁷⁹

³⁷⁶ JCX-3-19, at p. 18.

³⁷⁷ IRM 36.3.1 Actions on Decision. Prior to 1991, the IRS issued AODs only for Tax Court decisions; beginning in 1991, the IRS expanded the AOD program to include civil tax cases in other courts (courts of appeals, district courts and Court of Federal Claims) where guidance is determined to be helpful. The IRS offers access to AODs on its web site titled Actions on Decisions (AOD), in reverse chronological order starting with 1997.

³⁷⁸ IRM 36.3.1.4 (03-14-2013), Drafting an AOD.

³⁷⁹ See IRS Web page titled “Information Letters” (viewed 7/24/21, with the last indicated release for 6/25/21). The site indicates that there are 3,025 files as of 7/24/21.

The IRM indicates that information letters may be issued to a taxpayer if the taxpayer's ruling request does not meet the requirements for a ruling when general information may be helpful to the taxpayer.³⁸⁰

(g) Chief Counsel Advice.

The broad category of Chief Counsel Advice is defined in § 6110(b)(1)(A) to mean any “written advice or instruction, under whatever name or designation, prepared by any national office component of the Office of Chief Counsel” to convey legal interpretations or advice on positions or policy to IRS field or service center employees.³⁸¹ Over the years, the IRS has developed various formats in which such Chief Counsel legal advice appears. Such advice has been given various names or labels over the years, but they all would fit in the broad category of Chief Counsel Advice. Examples are:³⁸²

- Chief Counsel Advice (“CCA”) - CCAs are a subset of the broad category which happen to have the same name as the broad category. A CCA document might be referred to as CCA 201721015 (2/12/17, released 5/26/17).³⁸³
- Field Service Advice (“FSA”) - “case specific advice provided to examiners by the Associate Chief Counsel. FSA does not represent a final determination of the Service's position, even in the case for which it was requested.”³⁸⁴
- Legal Advice Issues by Associate Chief Counsel. Legal advice, signed by National office Chief Counsel executives to provide authoritative legal opinions on certain matters, such as industry-wide issues.
- Legal Advice Issued by Field Attorneys (“LAFA”) - Referred to as LAFA 20171201F.
- Chief Counsel Notice (“CCN”) - directives that provide interim guidance, furnish temporary procedures, describe changes in litigating positions, or announce administrative information.

Pursuant to § 6110, these forms of advice are made publicly available on the IRS FOIA web site.³⁸⁵ The documents are redacted to excise information that would identify the taxpayer involved.

³⁸⁰ IRM 32.3.3.1 (08-11-2004), Scope of Information Letters. See also Anna Gooch (Guest Blogger), Tax Questions, User Fees, and Private Letter Rulings (Procedurally Taxing Blog 11/9/20).

³⁸¹ A useful compendium of the various formats for such advice is contained on the New York University Law School web site titled “Federal Tax Research: IRS Documents” (last Updated: Jul 12, 2023 8:38 AM and viewed on Aug 14, 2023 9:30 PM). I have used this resource for some of the discussion of these publications. I refer to the source as NYU Federal Tax Research: IRS Documents (which is the titled of the web page).

³⁸² Tax researchers will often see references to documents called General Counsel Memoranda (GCMs). These were good indicators of IRS positions in their day but are no longer used except to revoke older GCMs.

³⁸³ IRM 4.8.8.12.1.3 (12-06-2013), Requests for Chief Counsel Advice

³⁸⁴ Apparently, this category is no longer used. Formerly, the category was described in IRM 4.8.8.12.1.3 (12-06-2013), Requests for Field Service Advice, but that IRM provision has been renamed IRM 4.8.8.12.1.3 (12-06-2013), Requests for Chief Counsel Advice.

³⁸⁵ See IRS web page titled “FOIA Library” (Page Last Reviewed or Updated: 04-Jun-2018 and viewed on 7/10/18).

(h) News Releases.

The IRS also often issues “News Releases,” which have a naming convention of “IR-[Year]-sequential number (for example, IR-2018-16).³⁸⁶ These may be used to advise of IRS positions, but are not designed to provide formal discussion of IRS positions.

(i) Audit Technique Guides.

The IRS publishes Audit Technique Guides (“ATGs”). ATGs provides industry specific guidelines for its examiners to use in audits.³⁸⁷ For example, just to pick the items from the “A” section of the alphabetical list of ATGs: Aerospace Industry, Architects and Landscape Architects, Art Galleries, and Attorneys. For each business segment covered, the ATGs contain examination techniques, common industry issues, business practices, industry terminology and other information. The IRS advises that, although ATGs are designed to guide examiners, ATGs are “also useful to small business owners and tax professionals who prepare returns” and specifically may be helpful for “business and tax planning purposes.”³⁸⁸ Practitioners representing clients in IRS business audits will find the ATGs a valuable resource.

(j) IRS Publications.

The IRS publishes documents it calls Publications offering taxpayers a range of guidance on the tax law and their obligations under the tax law.³⁸⁹ A good example is Publication 17 (2016), Your Federal Income Tax (for use in preparing 2016 income tax returns) which offers a general guide to the income tax law that many taxpayers find useful. While often at a very basic level, these publications do advise the public on the IRS’s position on many of the law’s requirements, they are not statements of the IRS’s legal position and are not technically binding on the IRS or on taxpayers.

(5) Less Formal Documents; Public Access.

The more formal IRS interpretations have historically been published so as to be easily accessible to the public. Regulations are published in the Federal Register; Revenue Rulings and Procedures and some notices are published in the Internal Revenue Bulletins (IRBs). Less formal written interpretations (such as PLRs and TAMs) formerly were not made available to the public. These written determinations usually interpret the substantive law in the context of a taxpayer’s facts. For example, a PLR or TAM will address a taxpayer’s facts and apply an interpretation of the law to the facts. These written determinations and the interpretations are not intended to be formal IRS interpretations (such as by regulation or Revenue Ruling) and hence require lower levels of review and procedure.

³⁸⁶ Links to the news releases are on the IRS web site titled “News Release and Fact Sheet Archive” (Page Last Reviewed or Updated: 08-Jun-2018 and viewed on 7/10/18).

³⁸⁷ The ATGs are briefly explained and listed by industry on the IRS web page, titled Audit Technique Guides (viewed on 6/10/17, and last updated on 3/1/17), here.

³⁸⁸ Id.

³⁸⁹ The IRS lists the publications and links to pdf versions on its Web Page titled “Publications Online” (last reviewed or Updated 7/27/21 and viewed on 7/27/21).

Notwithstanding that these written determinations are not formal IRS interpretations, IRS personnel can access these determinations and use their interpretations to influence the IRS actions involving other taxpayers. Furthermore, the taxpayers and practitioners involved in the process of the written determinations would often know of the interpretations (e.g., they would have copies of the TAMs and PLRs) and could use the interpretations in the future to their benefit in other matters before the IRS.

In 1976, Congress enacted § 6110.³⁹⁰ That section starts with the command that “the text of any written determination and any background file document relating to such written determination shall be open to public inspection.” § 6110(a). A written determination includes a “ruling, determination letter, technical advice memorandum, or Chief Counsel advice.” § 6110(b)(1).

Pursuant to this command, the IRS routinely makes available the text of written determinations less formal than Revenue Rulings and Revenue Procedures. The IRS must redact the portion of the written determination that discloses certain matters where nondisclosure is warranted (such as taxpayer identification (cf. § 6013), information otherwise exempt from disclosure by statute or executive order relating to national defense or foreign policy, trade secrets or financial information and certain other sensitive matter). § 6110(c).³⁹¹ The text that is disclosed even as redacted will show the IRS’s informal interpretations of the law.

The IRS makes these written determinations available on its FOIA Electronic Reading Room web site.³⁹² Also, many tax publishers publish these informal written determinations as the IRS makes them available. In a tax practice, these written determinations made public under § 6110 must be consulted in researching tax issues, particularly with respect to transactions, return reporting, and litigation.

Recognizing the relatively informal genesis of such written determinations (including PLRs), Congress provided in § 6110(k)(3):

(3) Precedential status. Unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent. * * * *

³⁹⁰ P.L. 94-455, title XII, § 1201(a), Oct. 4, 1976, 90 Stat. 1660. There have been some subsequent amendments. All citations to § 6110 are to the section as it exists currently.

³⁹¹ The IRS must engage the taxpayer to whom the ruling is addressed in the process of determining what portion of the determination will be disclosed and the Code provides administrative and judicial processes for resolution of disputes as to the disclosures to be made. § 6110(f)(1). In *Anonymous v. Commissioner*, 134 T.C. 13 (2009), the anonymous taxpayer sought to enjoin the IRS from disclosing an unfavorable PLR or, alternatively, redact certain terms that allegedly identified the taxpayer. The Tax Court held that the Court had no authority to prohibit the public release of the PLR but held for future decision whether certain terms that might identify the taxpayer should be redacted.

³⁹² The web site is titled “Electronic Reading Room” (Last Reviewed or Updated 8/27/17 and viewed on 7/19/18). Scroll down to “Non-precedential Rulings & Advice” which has links to the following categories of documents: Actions on Decisions (AOD); Appeals Settlement Guidelines; Chief Counsel Bulletins; General Counsel Memoranda; Information Letters; IRS Written Determinations (Private Letter Rulings (PLR), Technical Advice Memorandum (TAM), & Chief Counsel Advice (CCA)); Legal Advice Issued by Associate Chief Counsel; Legal Advice Issued by Field Attorneys; Legal Advice Issued to Program Managers.

The statutory prohibition is straightforward and seems to preclude the use of these informal written determinations by the IRS, taxpayers or courts in interpreting the tax law in a way that is contrary to the interpretation derived from traditional tools of statutory interpretation. In a very general sense, this is true.

The nuance comes in meaning of “used or cited as precedent.” Precedent normally means that an interpretation previously applied by some authoritative interpreter (such as a higher court) is mandatory or persuasive authority in the current interpretation and might control even if the ordinary tools of statutory interpretation would not compel it. It is a fully developed concept in relation to judicial precedent such as decided case opinions.³⁹³ Prior interpretations of a higher court or the same court may be deemed controlling precedent for the court making the current interpretation of the law.³⁹⁴ Other court interpretations may be deemed persuasive authority, not exactly precedent, to the extent that the court making the current interpretation is persuaded that the prior decision reached the correct interpretation of the law. Of course, IRS written determinations are not judicial precedent, but could be deployed as precedent in a similar manner except for the prohibition on the use as precedent.

Section 6110(k)(3) does not prohibit use other than as precedent. Previous interpretations, particularly from sources deemed credible, tend to have some influence in the development of the law even though they are not precedential.³⁹⁵ Particular contexts will present nuanced opportunities to use written determinations to influence outcomes despite 6110(k)(3)’s prohibition on use or citation as precedent.³⁹⁶

³⁹³ E.g., Bryan A. Garner, et al., The Law of Judicial Precedent (Thomson Reuters 2016).

³⁹⁴ See generally Bryan A. Garner, et al., The Law of Judicial Precedent (Thomson Reuters 2016), which treats the subject of judicial precedent in great detail (discussing the complexity of the term judicial precedent and the fact that few lawyers even understand more than a sound bite on the subject; the inference I draw is that, perhaps, the drafters of § 6110(k)(3) really understood the nuance of the term in the statute (even assuming that they were using the word “precedent” in an analogous way to judicial precedent). The Garner text discusses judicial precedent in 779 pages of text (with copious footnotes) even before reaching the epilogue, glossary, table of cases, bibliography, acknowledgments and index (which together add 131 pages). I would be tempted to deal with that nuance but would not want to do that in the text for which such nuance, even if informative generally, would be a distraction for tax procedure students. Accordingly, in the text and even in this footnote, I deal with the glittering generalities as I extrapolate what Congress must have meant by the term “precedent” in § 6110(k)(3).

³⁹⁵ See Yehonatan Givati, Resolving Legal Uncertainty: the Unfulfilled Promise of Advance Tax Rulings, 29 Va. Tax Rev. 137, 158-161 (2009) (noting de facto effect from publication, including IRS duty of consistency); and Judy S. Kwok, The Perils of Bright Lines: Section 6110(k)(3) and the Ambiguous Precedential Status of Written Determinations, 24 Va. Tax Rev. 863, 884 & 907 (2005); Stephanie Hoffer, Hobgoblin of Little Minds No More: Justice Requires an IRS Duty of Consistency, 2006 Utah L. Rev. 317, 344-345 (2006) (noting “Taken as a whole, the body of decisions discussed above shows that section 6110(k)(3) of the Code should not prevent courts from using private letter rulings as evidence in consistency cases. Furthermore, these cases demonstrate that some courts have already mandated consistency based not only on the existence but also on the contents of private letter rulings.”). See also *Hanover Bank v. Commissioner*, 369 US 672, 686 (1962) (“although the petitioners are not entitled to rely upon unpublished private rulings which were not issued specifically to them, such rulings do reveal the interpretation put upon the statute by the agency charged with the responsibility of administering the revenue laws.”).

³⁹⁶ For example, PLRs “may be cited as evidence of administrative interpretation,” *Comerica Bank, N.A. v. United States*, 93 F.3d 225, 230 (6th Cir. 1996). This presumes that for purposes other than precedent, the development of administration is relevant to the outcome of the matter at hand.

The Supreme Court may have breathed new life into this issue in the *Chevron*³⁹⁷ and *Skidmore*³⁹⁸ lines of cases where deference may be given to administrative interpretations other than Regulations, particularly if they evidence long-standing interpretations and are otherwise persuasive.³⁹⁹ In short, these nonprecedential written determinations may influence current interpretation because the reasoning in them is persuasive. I will return to this issue in discussing the Supreme Court's decisions in *Chevron* and *Skidmore* and their progeny below.

e. Litigating IRS Guidance.

For most agency guidance, particularly guidance in a binding format such as legislative regulations, affected parties have an opportunity to raise procedural challenges in court under the APA upon promulgation of the guidance and before the agency attempts to enforce the guidance against the affected parties.⁴⁰⁰ The statute of limitations for such review is the general six-year statute of limitations in 28 U.S.C. § 2401(a).⁴⁰¹ However, for Treasury interpretive guidance documents (both regulations and subregulatory), such pre-enforcement litigation challenges are generally prohibited under the Anti-Injunction Act (“AIA”), § 7421(a), and related statutory⁴⁰² and common law prohibitions (discussed below starting on p. 650) which have historically channeled tax litigation, including challenges to agency guidance, into post-enforcement litigation venues such as deficiency, refund or collection suits.⁴⁰³ Those post-enforcement venues have their own statutes of limitations triggered by the enforcement being challenged (e.g., a deficiency notice, denial of a claim for refund, or collection action). Accordingly, historically, litigation challenging IRS agency guidance has not been allowed for pre-enforcement procedural challenges but there have been exceptions including a recent Supreme Court case.⁴⁰⁴ If § 2401(a) were applicable, post-enforcement

³⁹⁷ *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

³⁹⁸ *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944).

³⁹⁹ E.g., *Taproot Administrative Services, Inc. v. Commissioner*, 679 F.3d 1109, 1116-1117 (9th Cir. 2011) (finding a revenue ruling persuasive under *Skidmore*, noting (p. 1117 n. 15) that, although PLRS “may not be used or cited as precedent under I.R.C. § 6110(k)(3),” “they may be used as evidence of an administrative practice of the Commissioner.”).

⁴⁰⁰ See generally Kristin E. Hickman & Gerald Kerska, Restoring the Lost Anti-Injunction Act, 103 Va. L. Rev. 1683 (2017) (referred to in the footnotes in this section as Hickman & Kerska, *supra*).

⁴⁰¹ Hickman & Kerska, *supra*, 1760 n. 441. Based on recent Supreme Court opinions determining that at least some statutes of limitations are not jurisdictional, thus permitting equitable tolling, the D.C. Circuit has held that § 2401's statute of limitations in APA actions is not jurisdictional. *Jackson v. Modly*, 949 F.3d 763 (D.C. Cir. 2020); and *DeSuze v. Ammon*, 990 F.3d 264 (2d Cir. 2021).

⁴⁰² The Declaratory Judgment Act (“DJA”), 28 U.S.C. § 2201(a), prohibits actions in tax cases in a manner that, as interpreted, is “coterminous” with the AIA’s prohibition. *The Green Solution Retail, Inc. v. United States*, 855 F.3d 1111 (10th Cir. 2017) (citing *Cohen v. United States*, 650 F.3d 717, 730-31, 397 U.S. App. D.C. 33 (D.C. Cir. 2011) (en banc)). For more on the Declaratory Judgment Act and the AIA, see beginning p. 650.

⁴⁰³ See generally Hickman & Kerska, *supra*.

⁴⁰⁴ *CIC Services, LLC v. IRS*, 583 U.S. ___, 141 S. Ct. 1582 (2021). See generally Hickman & Kerska, *supra*.

In *Altera Corp. v. Commissioner*, 926 F.3d 1061 (9th Cir. 2018), the taxpayer challenged in a straight-forward Tax Court deficiency redetermination case a regulations interpretation of § 482. The challenge was well after six years from the date the regulation was adopted. The Ninth Circuit panel on the reargument in *Altera* asked the parties to brief the issue of whether § 2401(a) was a potential bar to the suit, because *Altera* was raising procedural challenges. DOJ Tax responded that § 2401(a)'s six-year statute of limitations did not apply from the date of the regulation and that, rather,

(continued...)

review would not be adequate for APA procedural challenges in tax litigation because, in most cases, the six-year statute would have expired before IRS enforcement action made the case ripe for the traditional tax challenge venues. As a result, the general six-year statute of limitations in § 2401(a) has not barred procedural challenges to IRS guidance in post-enforcement cases outside the six-year period in § 2401(a).

Another issue in litigating IRS guidance is the Anti-Injunction Act (“AIA”), § 7421, which generally prohibits suits seeking injunctions or injunction-like relief with respect to issues affecting tax matters. I discuss the AIA and its relationship to litigating tax guidance below beginning on p. 650. Suffice it to say, generally speaking, that (i) IRS guidance must be litigated only in the established avenues for post-enforcement tax litigation (deficiency proceedings, refund suits, etc.) and not in suits seeking injunctions or injunction equivalents; and (iii) nevertheless where guidance is issued with some potential penalty consequences making the post-enforcement remedies ineffective, the pre-enforcement guidance may be litigated.

f. Deference to IRS Interpretation of the Code.

In this section I provide a very high-level summary of the concept of deference to agency interpretations of statutes. Since I have articles that develop far more nuance and the articles are readily available (p. 66), I will generally not provide authority in the text or footnotes for all statements that I think are generally uncontroversial.

Congress assigns to Federal agencies various responsibilities to administer complex laws and administrative schemes that regulate a complex economy and various other aspects of our society.

⁴⁰⁴(...continued)

the statutes of limitation normally applying to post-enforcement tax litigation applied. Under this position, Altera Corp’s challenge to the regulation in a deficiency redetermination proceeding in the Tax Court was clearly timely. In any event, DOJ Tax argued that the Commissioner had waived the statute of limitations defense. In the final opinion, the Court relegated the issue to a footnote (p. 1075, n. 6), concluding that the Commissioner had waived the statute of limitations defense by not asserting it. The Court seems to have skirted the issue of whether there was a defense that could be waived. It is not at all clear that, given the well-established methods for contesting the validity of regulations in post-enforcement proceedings (such as deficiency proceedings in the Tax Court and refund suits), a pre-enforcement post promulgation review is available for tax regulations because of § 7421(a), the Anti Injunction Act (AIA) and related statutes and concepts pushing litigation to the standard post-enforcement procedures. One could argue that the Court could not have gotten to waiver without a defense in the first place and there could be a defense in the first place only if the taxpayer had a post-promulgation, pre-enforcement right to contest the regulation, thus invoking the six-year statute that could be waived. Under that way of thinking, the Court decided the issue. But I don’t think that is what the Court intended to do, because it concludes “Therefore, we need not address it.” The “it,” I think, is whether § 2401 applied in the first place, which would have required that there be some post-promulgation, pre-enforcement remedy. For a succinct discussion of the issue, see Kristin Hickman, *Altera Meets Chamber Of Commerce* (Tax Prof Blog 10/17/17) and for more detail see Alan Horwitz, *Supplemental Briefing Completed in Altera* (Tax Appellate Blog 10/10/18) (with links to the supplemental briefing in *Altera* and a Government Statute of Limitations Letter Brief). Now, tax procedure students should thank me for relegating this to a footnote, and a long one at that, which even practitioners are unlikely to encounter.

Finally, in *Bullock v. IRS*, 401 F. Supp. 3d 1144 (D. Mont. 2019), prompt APA review was allowed but not in a context where the aggrieved parties (States of Montana and New Jersey) had traditional post-enforcement review. See also *South Carolina v. Regan*, 465 U.S. 367 (1984) (creating limited exception to the AIA where the state lacked any other means of litigating its claims).

In carrying out their assignments, agencies routinely interpret the statutes and issue statutory interpretive guidance that IRS personnel should follow and that may affect those subject to the law. The interpretations may be challenged in court. Since virtually the beginning of the country, courts have given some level of respect, often called deference, for agency interpretations of the statutes they administer.

Let's start with the concept of deference because there is considerable confusion as to what it means. Some read deference as requiring that a court apply a reasonable agency interpretation of ambiguous statutory text without regard to whether the agency interpretation is the best interpretation. However, if the agency interpretation is the best interpretation of the ambiguous statutory text, a court does not defer to that interpretation. Deference is only outcome determinative when a court defers to a reasonable agency interpretation that is not the best interpretation of the statute.⁴⁰⁵ Hence, unlike many scholars and courts, I define deference as a court applying a reasonable agency interpretation of ambiguous statutory text despite the court's belief that the agency interpretation is not the best interpretation of the ambiguous statutory text. I suggest that, so defined, outcome determinative deference is more rare than the politically charged commotion about deference suggests.⁴⁰⁶

This form of deference is now generally referred to as *Chevron* deference, named for the deference framework adopted in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984). There are weaker forms of "respect" given to agency interpretations that may erroneously be called deference, the principal one for present purposes is so-called "*Skidmore* deference," named for *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944). *Skidmore*, however, does not require that a court defer to an agency interpretation when the court has its own interpretation that is the best interpretation; rather, *Skidmore* requires that the court respect the agency interpretation in considering whether it is persuaded that the agency interpretation is the best interpretation. In that sense, *Skidmore* is not deference but is a reminder that Agency views, including interpretations, of the statute the agency administers are worthy of respect in determining the best interpretation. Nevertheless, a practice has grown up to refer to *Skidmore* "respect" for agency interpretations as *Skidmore* deference. I will use the term in this section but caveat that *Skidmore* "deference" is not deference.

The IRS (sometimes referred to as Treasury, the parent agency) is an Executive Branch Agency tasked with administering the ubiquitous tax laws. IRS guidance documents (principally Treasury regulations) interpreting the tax law are subject to *Chevron* deference. *Mayo Foundation for Medical Ed. & Research v. United States*, 562 U.S. 44 (2011) ("*Mayo*") (*Mayo* is also interpreted as finally rejecting tax exceptionalism, a spurious myth that tax administration was exceptional under administrative law and the APA).⁴⁰⁷

⁴⁰⁵ See [Rationality and Chevron](#) (Federal Tax Procedure Blog 3/22/22); and [Is Chevron on Life Support; Does It Matter?](#) (Federal Tax Procedure Blog 4/2/22; 4/3/23) (at Observation #4); see also [Proposed Four Step Chevron Test to Isolate When Deference is Outcome Determinative](#) (Federal Tax Procedure Blog 12/10/21; 12/11/21).

⁴⁰⁶ [Is Chevron on Life Support; Does It Matter?](#) (Federal Tax Procedure Blog 4/2/22; 4/3/23) (analyzing Court of Appeals cases for one year allegedly apply *Chevron* deference but with little deference to be found).

⁴⁰⁷ On the nonsense of tax exceptionalism, see Alice G. Abreu & Richard K. Greenstein, [Tax: Different](#), (continued...)

Chevron carried forward past deference to reasonable agency interpretations of ambiguous statutory text but with the innovation of a regularized process for determining when deference would apply. That regularized process is now called the *Chevron* Framework or some variation. I use here the term *Chevron* Framework. The *Chevron* Framework is:

Chevron Step One - Applying the “traditional rules of statutory construction” (sometimes called *Chevron* footnote 9),⁴⁰⁸ the court determines whether the statutory text is ambiguous. Ambiguous means that the statute text has more than one reasonable interpretation. If the text is not ambiguous (has only one reasonable interpretation), the court applies that interpretation to the text. In deference parlance, without ambiguity there is no agency interpretive space.

Chevron Step Two - This step is reached only if the statute is ambiguous as determined in Step One. The court will defer to a **reasonable** agency interpretation within the scope of the statute’s ambiguity even though the court believes its own different interpretation is the best interpretation. Stated otherwise, if the court interprets the ambiguous statutory text the same way the agency interprets it, then it applies the court’s own interpretation and there is no deference. Deference applies only when the court believes that its own interpretation is more reasonable (the best) than the agency’s reasonable but “not best” interpretation. Of course, if the agency interpretation is unreasonable, the court applies its own interpretation without any deference.

Some scholars add opening or intermediate steps, calling them for example, *Chevron* Step Zero⁴⁰⁹ or *Chevron* Step One and a Half, or some variation. Those perceived steps beyond the

⁴⁰⁷(...continued)

Not Exceptional, 71 Admin. L. Rev. 663, 701 (2019). The authors’ argument is the same as my argument in its bottom line but is much more academic. I focus in my argument on the underlying administrative law pretensions for tax exceptionalism—the legislative/interpretive divide under the APA and the deference issue and dealing in more detail with the historical development, including the APA and cases involving that divide. I suppose that, not surprisingly, the same exceptional claim was made and debunked for the Tax Court. Stephanie Hoffer & Christopher J. Walker, The Death of Tax Court Exceptionalism, 99 Minn. L. Rev. 221 (2014).

Other legal disciplines have spawned claims of exceptionalism, but when stripped of the hyperbole, those disciplines, like tax, are just different but not exceptional. E.g., Jonathan M. Seymour, Against Bankruptcy Exceptionalism, 89 U. Chi. L. Rev. 1925 (2022) (“I conclude that there are many singular aspects of bankruptcy but none that justify treating it specially. Bankruptcy is distinctive, but it is not exceptional.” Also noting (p. 1960-1961) that similar claims of exceptionalism are made for patent specialty, citing Tejas N. Narechania, Certiorari, Universality, and a Patent Puzzle, 116 Mich. L. Rev. 1345, 1390-91 (2018) (such claims “are generally under siege by a generalist Supreme Court.”).

⁴⁰⁸ *Chevron* Footnote 9 (p. 853 n. 9):

The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent. If 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.

⁴⁰⁹ Simply Step Zero is a determination that there is some reason not to apply the *Chevron* Framework. For example, the Major Questions Doctrine determines that there is some reason—a major question—that the implicit (continued...)

commonly formulated Two-Step set forth above require a level of detail and nuance not appropriate for a book on tax procedure, so I do nothing other than to alert readers to their existence.

Chevron articulated several themes supporting deference, including (i) implied congressional delegation to the agency to adopt reasonable interpretations of statutory ambiguities in the administration of the overall scheme entrusted to the agency, (ii) agency expertise in the complex administrative scheme, and (iii) agencies being closer to the electorate through the President as opposed to unelected and life tenured judges with no constituency. *Chevron* deference applies only to ambiguous statutory text; no deference applies to agency interpretations of another form of law, judicial opinions, that may have textual ambiguity.

Chevron deference for reasonable interpretations must be distinguished from arbitrary and capricious review based on 5 U.S.C. § 706(2)(A), a review that is commonly referred to as *State Farm* review based on a leading case. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983). *State Farm* review is a review of the procedural regularity of agency rulemaking, including principally for present purposes regulations. In *State Farm* arbitrary and capricious review of regulations, the principal focus is whether the agency engaged in articulated reasoned decisionmaking properly engaging and responding to comments from the regulated public by following the procedures (notice and comment for regulations).

Chevron deference and *State Farm* / arbitrary and capricious review are different standards, although there is some loose language in cases and scholarly publications suggesting that the two may be the same.⁴¹⁰

Chevron deference is controversial, at least as conservative/libertarian political talking points to attack the perceived evils of the administrative state. The claim, summarized, is that courts are the only branch that interprets the law—in the famous words of Chief Justice John Marshall: “it is emphatically the province and duty of the judicial department to say what the law is.” *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 177 (1803). With that sound bite, the opponents of deference claim that all the interpretive space in statutory ambiguity is constitutionally allocated to the Judicial Branch and not to the Executive Branch. The American juridical experience is that courts have deferred to or respected agency interpretations since virtually the inception of the nation. Scholars sometimes reconcile deference with courts as interpreters by saying that, even when deferring, it is still the court interpreting the law—saying what the law is—by making the choice to defer. Getting further into the weeds on the debate about the legality of deference—a mostly ideologically/politically charged adventure—is not appropriate here. Suffice it to say now that, although under attack from some powerful voices, *Chevron* deference is the law of the land.

⁴⁰⁹(...continued)

assumption of interpretive authority should not apply. In such a case, the court grants no deference to the agency interpretation, although it may use Skidmore respect in making its own “best” interpretation of the statute.

⁴¹⁰ I negate this spurious suggestion in See John A. Townsend, [The Report of the Death of the Interpretive Regulation Is an Exaggeration](#) 94-97 (SSRN last revised 4/8/22).

So, what exactly does *Chevron* deference mean? What are the nuances inherent in the two-step *Chevron* framework provided above?

One consequence of conceding agency interpretive authority in the *Chevron* space is that the agency can adopt one reasonable interpretation and then later adopt another reasonable interpretation based on its continuing experience. And, since that *Chevron* space is the prerogative of the agency, then presumably the agency can by regulation change an interpretation even after a court has interpreted the statute differently so long as the prior court decision left the *Chevron* space open. *National Cable & Telecommunications Association v. Brand X Internet Services*, 545 U.S. 967 (2005) (commonly referred to as *Brand X*).

I identify some issues under *Chevron* as follows:

- (1) Does *Chevron* deference apply to--**even only to**--legislative regulations? There is considerable confusion here, with the oft stated view that *Chevron* deference applies to legislative regulations. My cut, thinking conceptually, is that deference deals with interpretive space from ambiguity in a statute. A legislative regulation does not interpret ambiguous statutory text but is the law just as if it were the statute if it is **procedurally** valid. Just as courts do not defer to statutes, so to courts should not defer to legislative regulations functioning like statutes. Deference is meaningful only for agency interpretations. (I note that making the category error for deference purposes to treat as legislative regulations those regulations that do no more than interpret ambiguous statutory text is harmless, because courts doing that still apply the *Chevron* Framework, an interpretive framework; that category error is not harmless, however, if it is used to categorize for APA purposes.)
- (2) What does ambiguity mean? As noted by then Judge (now Justice Kavanaugh), “it is so difficult to make clarity versus ambiguity determinations in a coherent, evenhanded way.” Is this an eye of the beholder situation where different judges are left to find ambiguity, with resulting agency interpretive space, differently, depending upon their judicial or ideological outlooks? What tools of judicial construction do courts apply to determine ambiguity and the resulting agency interpretive space? If a judge can determine the best interpretation of a statute is there any ambiguity for *Chevron* deference to operate? If not, is *Chevron* then limited to a default tie-breaker rule when in equipoise as to the best interpretation, somewhat like a burden of persuasion in fact finding where the trier cannot find a key fact does or does not exist? (For discussion of the equipoise concept in fact finding, see Ch. 10. Titled Litigation at paragraph III.E.1. subparagraphs c., d., and e.) Can legislative history be used at Step One to infuse ambiguity into what might otherwise be the plain meaning of the statute? At Step Two, what is a reasonable agency interpretation within the scope of the ambiguity (or even is that already decided at Step One)?

- (3) May *Chevron*-entitled regulations be retroactive? Traditionally, interpretive regulations could be retroactive to the date of the statute, whereas the APA requires that legislative regulations must be prospective only, except in certain cases with a “Good Cause” statement for immediate effect (but not retroactively). The retroactivity issue will thus turn on whether *Chevron*-entitled regulations are necessarily legislative rather than interpretive. Critically, § 7805(b) limits retroactivity for general authority Treasury regulations under § 7805(a). Is § 7805(b) a limitation on retroactivity otherwise allowed for interpretive regulations or an exception to the prospectivity required for legislative regulations? There is debate over that issue, but I think the better view is that § 7805(a) authorizes only interpretive regulations and not legislative which would mean that § 7805(a) regulations not subject to § 7805(b)’s limits can be fully retroactive.
- (4) What deference, if any, is given to subregulatory interpretations? In the case of the IRS, subregulatory interpretations are the guidance document interpretations of lesser stature than notice and comment regulations, such as Revenue Rulings to even lesser forms of guidance such as private letter rulings. Although the Supreme Court has indicated, perhaps by dicta, that deference may apply to some subregulatory interpretations, it has not actually approved such deference. And the IRS and Treasury have stated that they will not rely on *Chevron* deference for subregulatory interpretations. Subregulatory interpretations may be entitled to so-called *Skidmore* deference, which as I noted is not deference at all because the *Skidmore* applies only if the court is persuaded as to the interpretation.
- (5) What deference is given to agency subregulatory interpretations of ambiguous regulations? Deference is given to those interpretations in a form often called *Auer* deference (but sometimes called *Seminole Rock* deference).⁴¹¹ In *Kisor v. Wilkie*, ___ U.S. ___, 139 S.Ct. 2400 (2019), the Supreme Court substantially approved *Auer* deference for subregulatory guidance interpreting regulations but with significant limitations. The current deference concept is thus now sometimes called *Kisor* deference alone⁴¹² or sometimes called *Kisor* deference with references to *Auer* and *Seminole Rock*.⁴¹³ Deference to interpretations of ambiguous regulations may be analogized to *Chevron* deference to ambiguous statutes.

This sampling of issues should be a sufficient introduction to deference for this book. One final caveat, when reading a case that seems to bandy about *Chevron* as requiring that the court apply an agency interpretation, read it carefully to see whether the court is really applying an agency interpretation that is the best interpretation, meaning that the court is not deferring to the agency interpretation.⁴¹⁴

⁴¹¹ *Auer v. Robbins*, 519 U.S. 452 (1997); and *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410 (1945).

⁴¹² E.g. Aaron Nielson, *Kisor Deference*, 36 Yale J. on Reg.: Notice & Comment (6/26/19)

⁴¹³ One author says that it is still *Auer* deference “reformulated by *Kisor*,” whatever that means. Jonathan H. Adler, *Auer Deference Post-Kisor* (The Volokh Conspiracy 7/31/19).

⁴¹⁴ I took two large data sets for Court of Appeals decisions seeming to apply *Chevron* deference. While
(continued...)

Finally, there are two pending developments that might affect the continuing shape of Chevron deference. The first development, perhaps only partly political, is that the Supreme Court accepted certiorari in *Loper Bright Enterprises v. Raimondo (SEC)* (Sup. Ct. Dkt. 22-451)⁴¹⁵ to consider the following question in the October 2023 term:

Whether the Court should overrule *Chevron* or, at least clarify that statutory silence concerning controversial powers expressly but narrowly granted elsewhere in the statute does not constitute an ambiguity requiring deference to the agency.

Since anti-deference is feeds into the conservative and libertarian fear of the administrative state, it appears that former President trump stacked the Supreme Court with three conservative justices⁴¹⁶ to add to the one (Justice Thomas) who have already expressed skepticism about *Chevron* and Justices Roberts and Alito who may be amenable to constricting *Chevron*.⁴¹⁷

⁴¹⁴(...continued)

it is often difficult to decipher from the mash of words around *Chevron* what the courts are actually doing. But, from those data sets, a substantial number, although noising about *Chevron* as if it were meaningful to the outcome, were not deferring to a less persuasive agency interpretation. See [Chevron Step Two Reasonableness and Agency Best Interpretations in Courts of Appeals](#) (Federal Tax Procedure Blog 2/9/23); and [Is Chevron on Life Support; Does It Matter?](#) (Federal Tax Procedure Blog 4/2/22; 4/3/22).

⁴¹⁵ [The Supreme Court docket entries with links to filed documents are here. The Supreme Court accepted cert in another case with the same facts to consider the same issue. *Relentless, Inc. v. Department of Commerce* \(Sup. Ct. Dkt 22-1219\). The speculation is that, with one Justice recusing in *Loper Bright*, accepting cert in *Relentless* for consideration at the same time will permit the Supreme Court to have a full nine Justice opinion or opinions \(surely the latter\) on the issue for cert. John Elwood, \[Preemption of consumer protection laws, bankruptcy claims, COVID mandates and ... Chevron deference again?\]\(#\) \(SCOTUSblog 10/11/23\).](#)

⁴¹⁶ E.g., Jeremy W. Peters, [Trump's New Judicial Litmus Test: 'Shrinking the Administrative State'](#) (NYT 3/26/18) (noting administrative state angst with anti-Chevron as a litmus test for Trump's judicial, particularly Supreme Court Justice, nominees and further noting that "one person who likely would have not made the cut under the Trump administration's guidelines is Justice Scalia, who for most of his career embraced the *Chevron* deference doctrine."); Cass R. Sunstein & Adrian Vermeule, [The Unbearable Rightness of Auer](#), 84 U. Chi. L. Rev. 297, 299 (2017) (asserting that "the issue of *Auer* deference appears to be a stalking horse for much larger game—namely, a wholesale critique of the administrative state."); and Christopher J. Walker, [Kavanaugh on administrative law and separation of powers](#) (SCOTUSBlog 7/26/18) ("In recent years, there has been a growing call (mainly from those right-of-center) to eliminate—or at least narrow—administrative law's judicial-deference doctrines regarding federal agency interpretations of law."). Professor Gillian Metzger develops the historical thesis that current concern about the administrative state has its origin in the struggle over the New Deal in the 1930s. Gillian E. Metzger, [1930s Redux: The Administrative State Under Siege](#), 131 Harv. L. Rev. 1 (2017).

⁴¹⁷ Justice Thomas has recanted his earlier support for *Chevron*. See *Baldwin v. United States*, 589 U.S. ___, 140 S. Ct. 690, 691 (2020) (Justice Thomas dissenting to denial of petition for writ of certiorari); Justice Alito has expressed his concern. See *Pereira v. Sessions*, 585 U.S. ___, 138 S.Ct. 2105, 2121 (2018) (Justice Alito dissenting); and see also Kristin Hickman & Aaron Nielson, [Narrowing Chevron's Domain](#), 70 Duke L.J. 931, 935 (2021) (Roberts and Alito urging narrower version of *Chevron*).

For what it is worth, it is reported that, before his death, Justice Scalia, long the strongest advocate for Chevron deference, was reconsidering because agencies were "agencies were exploiting Chevron to usurp Congress'[s] lawmaking authority." Cass R. Sunstein, [Chevron as Law](#), 107 Geo. L.J. 1613, 1661 n. 246 (2019) (quoting Robin Bravender, [Alito Snubs Chevron, Obama EPA's 'Eraser'](#), E&E NEWS (Nov. 17, 2016), <https://www.eenews.net/stories/1060045952> [<https://perma.cc/DA4N-LG9N>]).

Second, in a continuing quixotic adventure for Republicans in the House, on June 15, 2023 the House of Representatives passed a bill with short name “Separation of Powers Restoration Act of 2023” or “SOPRA.” On June 20, 2023, the Senate received and referred the Bill to the Homeland Security and Governmental Affairs Committee. The bill if enacted (a big if because the Republicans do not control the Senate and President Biden has promised to veto if both Houses pass the Act) will amend the APA to Republicans think eliminate to deference. It is far more likely that, if something is done about *Chevron*, the Supreme Court because the House action is just a faint to the base without likelihood of enactment.⁴¹⁸

6. IRS Duty of Consistency.

a. General.

The IRS should administer the tax law in a way that treats similarly situated taxpayers similarly.⁴¹⁹ In a system as complex and involving millions of taxpayers and hundreds of millions of returns and filings, consistency is the goal but cannot be achieved perfectly. The large question addressed here is whether one taxpayer can avoid paying taxes (or penalties or interest thereon) that he or she owes simply because another taxpayer does not? The answer to that question has to be no. Taxpayers avoid paying—in some cases evade—taxes they owe every day, and the system would grind to a halt if all taxpayers were relieved of their obligation to pay. So, I hope the student knows that one taxpayers’ nonpayment of tax does not relieve another taxpayer of the duty to pay. That is and has to be the general rule.⁴²⁰

General rules are general rules, and there may be exceptions in some very egregious situations. However, given the reason for the general rule, I hope you can see that the exceptions will be narrow and circumscribed indeed. I deal here with two special areas in which there are exceptions. Note how narrow the exceptions are and how they involve competitive factors beyond just one taxpayer avoiding tax that others have to pay.

Before moving to the examples, I do want you to consider that there are myriad ways in which lack of consistency among taxpayers may be presented. The most obvious way is that many taxpayers are treated differently because they claim a benefit they are not entitled to and are never audited. Or the IRS may audit a taxpayer and, even if the agent spots the issue, for some reason the agent erroneously does not make the good adjustment. Or, one taxpayer may apply for a private letter ruling and gets the favorable ruling, but another taxpayer is audited and the IRS requires that taxpayer to pay tax on the same issue. Or, in litigation, the judge or the jury relieves one taxpayer

⁴¹⁸ I am not sure that the language of the bill will necessarily achieve what the Republicans think it will. But they are apparently more interested in throwing red meat to their base than crafting a bill that will really work their intention.

⁴¹⁹ For a good introduction to the problems discussed in this section, see 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).

⁴²⁰ See 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). Professor Johnson makes legislative recommendations offering some limited remedies to inconsistency in more egregious cases.

of tax but, where the case is not precedent, the IRS, another judge or another jury imposes the tax on a taxpayer. These are just examples of the way the issue can be presented.

b. Competitive Issues - Examples.

(1) The *IBM* Case.

Can the taxpayer complain about more favorable tax treatment given to a competitor? Allowing the taxpayer seeking the private letter ruling to obtain a benefit ultimately contrary to the law while denying that benefit to others, particularly competitors where the erroneous benefit gives a material competitive advantage, has at least the appearance of unfairness. The Court of Claims—the predecessor to the current Court of Appeals for the Federal Circuit—addressed this issue in 1966 in *International Business Machines Corp. v. United States*.⁴²¹

In *IBM*, One of IBMs competitors in the highly competitive computer business had sought and obtained a ruling that ultimately proved to be based on an incorrect interpretation of law. Shortly thereafter, IBM learned of the ruling and sought one for itself. After over two years consideration / reconsideration of the issue, the IRS denied IBM's requested ruling and revoked the ruling to the competitor **but** revoked the ruling prospectively only. During the interim before prospective revocation (about 2 ½ years), the competitor had a substantial advantage over IBM, which had not sought a ruling and was taxed on the basis of the correct interpretation of law. In a fairness / equity-based decision, the court required the IRS to refund the taxes during the period to IBM. The technical basis for the ruling was that (i) § 7805(b), as then in effect,⁴²² authorized IRS discretion to apply interpretations prospectively (thus implicitly permitting the IRS to apply wrong interpretations prior to a prospective application date), and (ii) that the IRS's refusal to make prospective the ruling it gave IBM was an abuse of discretion because of the favorable interpretation that the competitor secured in the interim before its ruling was revoked prospectively.

IBM illustrates the tensions in this area. Certainly, IBM had equities in its favor, and the Court responded. But can it be that the IRS, by making an incorrect interpretation of law as to one taxpayer, determines the law—in effect overrides the will of Congress by adopting the incorrect interpretation—for all taxpayers during the periods the incorrect interpretation is outstanding? That concept is disturbing indeed.⁴²³

Would it make any difference whether the incorrect interpretation were adopted on audit as opposed to in a private letter ruling? The bottom-line competitive result is the same—one competitor achieves a competitive advantage because of the inconsistent application of the tax law.

⁴²¹ 343 F.2d 914 (Ct. Cl. 1965), cert. denied, 382 US 1028 (1966), nonacq. AOD 2012-02; 2012-40 I.R.B. 1.

⁴²² Subsequently, in 1996, § 7805(b) was amended to allow limited retroactivity for § 7805(a) regulations. See discussion at p. 71.

⁴²³ See e.g., *Merck & Co., Inc. v. United States*, 652 F.3d 475, 487 (3d Cir. 2011) (3d Cir. 2011) (citing *Hostar Marine Transp. Sys., Inc. v. United States*, 592 F.3d 202, 210 (1st Cir. 2010).

The implications of *IBM* are startling and far-reaching indeed. Probably for this reason, *IBM* is generally considered *sui generis* -- that is, limited to its facts; and similar relief is virtually never given and even when a court recognizes any continuing validity limits it to situations where the taxpayer requested and was denied a PLR for beneficial treatment that a competitor was granted.⁴²⁴ Nevertheless, in a large dollar case, even long shots must be pursued vigorously.⁴²⁵

(2) Employee-Independent Contractor Issue.

Another area where you may encounter concerns about the competitive effect of different tax interpretations to common fact patterns is the classification of service providers as employees or independent contractors. Persons who engage such service providers have one set of tax responsibilities if the service providers are employees (withholding income tax and employee's share of FICA and paying over the withheld tax to the IRS, along with the employer's share of FICA and reporting the wages to the IRS and the taxpayer on Form W-2) and another, much more limited and less costly, set of tax responsibilities if the service providers are independent contractors (principally just to provide the IRS and the taxpayer the gross payment information on Form 1099-NEC). The employer of the employee has the obligation to withhold and pay over. § 3401(d).⁴²⁶ The difference between an employee and an independent contractor is determined under a common law test that uses multiple factors and produces uncertain results in a broad spectrum of cases.⁴²⁷

The IRS generally prefers persons engaging service providers to treat them as employees because the employer will, in effect, become the collection agent for the IRS and the social security system through withholding. The service providers in many businesses where the characterization as employee or independent contractor is close often prefer being treated as independent contractors, because they have much greater chance of dropping outside the IRS's collection system or because they prefer not to be subject to withholding. The employers of such service providers will often prefer to treat the service providers as independent contractors because their costs are lower as they, in effect, benefit from the fact that the service providers are willing to work for less because they do not pay their full share of income and self-employment taxes. Furthermore, by treating the service

⁴²⁴ E.g., *Baker v. United States*, 748 F.2d 1465, 1469 n.9 (11th Cir. 1984) ("taxpayers who have not requested or received private letter rulings from the IRS will not succeed on a claim of discriminatory treatment because other taxpayers have received private letter rulings on the tax consequences of the same activities"); and *Florida Power & Light Co. v. United States*, 375 F.3d 1119, 1124 (Fed. Cir. 2004) (explaining that *IBM* is "limited to its facts," applying only when the plaintiff taxpayer also sought a private letter ruling that contradicts another taxpayer's private letter ruling).

⁴²⁵ Students desiring to pursue this issue further are referred to Lawrence Zelenak, [Should Courts Require the Internal Revenue Service to be Consistent?](#), 40 Tax L. Rev. 411 (1985) (arguing that they should). An aggressive pursuit of a large dollar claim in the setting of a hokey tax shelter, might however evoke a judicial response of "chutzpah" with respect to some of the peripheral claims that gild the lily of the basic *IBM* claim. See e.g., *Merck & Co., Inc. v. United States*, 652 F.3d 475, 488 (3d Cir. 2011) (3d Cir. 2011).

⁴²⁶ § 3401(d)(1) provides an exception for a payor who would be an employer under the common law test but "does not have control of the payment of the wages for such services:" in that case, it is the person who does have control of the payment of the wages who is the employer required to withhold and pay over. This special category of employer is often called the statutory employer. In the text above, I assume that the employer is the common law employer.

⁴²⁷ For a recent discussion, see Bryan Camp, [Lesson From The Tax Court: Distinguishing Employees From Independent Contractors](#) (Tax Prof Blog 5/2/22).

provider as an independent contractor, the business owner may be able to exclude that person from costly benefits otherwise provided to employees. (That is not exactly a tax issue, but it is a cost that may attend the business owner treating the service provider as an employee.) Thus, from both the business owner and service provider perspective, it is often preferable to treat the service provider as an independent contractor, albeit for different reasons.

From time to time, the IRS will audit a business owner's position as to the alleged independent contractors. This may occur either as part of a routine audit or as part of an industry-wide initiative. If the business owner has wrongly characterized his service providers as independent contractors a retroactive tax bill for the withholding and employee's share of FICA can be staggering -- i.e., it could put the business owner out of business and certainly would put him at a competitive disadvantage if his competitors or some substantial portion of them successfully treated their service providers as independent contractors.

For this reason, after giving up on developing a test that would give business owners greater certainty as to the proper characterization of their service providers, Congress enacted special legislation to address the competitive issue. In late 1970s, Congress prohibited the IRS from issuing regulations and rulings on the status of workers. Further, Congress enacted so-called § 530 relief, not part of the Internal Revenue Code (Title 26),⁴²⁸ that prohibits the IRS from recharacterizing service providers from independent contractor status to employee status if the following conditions are present: (1) the business owner did not treat as an employee an individual in a substantially similar position for any period and filed all returns consistently; (2) the business owner has consistently filed returns (e.g., Forms 1099) consistent with the worker not being an employee; and (3) the business owner had a reasonable basis for treating the service provider as an independent contractor. Reasonable basis includes the following:

(A) judicial precedent or published rulings, whether or not relating to the particular industry or business in which the taxpayer is engaged, or technical advice, a letter ruling, or a determination letter pertaining to the taxpayer; or

(B) a past Internal Revenue Service audit (not necessarily for employment tax purposes) of the taxpayer, if the audit entailed no assessment attributable to the taxpayer's employment tax treatment of individuals holding positions substantially similar to the position held by the individual whose status is at issue (a taxpayer does not meet this test if, in the conduct of a prior audit, an assessment attributable to the taxpayer's treatment of the individual was offset by other claims asserted by the taxpayer); or

⁴²⁸ Section 530 relief is provided by § 530 of the Revenue Act of 1978 and is not in the text of the Internal Revenue Code; for a good discussion of the relief, see IRM 4.23.5.3 (11-22-2017), Section 530 of the Revenue Act of 1978. The text of § 530 does appear as a note in the official compilation of Title 26. The official Title 26 at the House of Representatives' Office of Law Revision web site for § 3401 offers in the notes § 530 in its entirety. If you use a third party reproduction of the Code (such as Cornell's LII here), it is important to make sure it offers the notes. (LII offers the notes and other links for "Authorities" and "IRS Rulings" which, I think is principally regulations.)

(C) long-standing recognized practice of a significant segment of the industry in which the individual was engaged (the practice need not be uniform throughout an entire industry).⁴²⁹

A taxpayer who fails to meet any of the three “safe havens” may nevertheless be entitled to relief if the taxpayer can demonstrate, in some other manner, a reasonable basis for not treating the individual as an employee. “Reasonable basis” should be construed liberally in favor of the taxpayer.⁴³⁰

The IRS had for years taken the position that the filing requirement for § 530 relief required timely filing of informational returns, although the statute does not impose the timely requirement. The IRS’s interpretation was set forth as a general rule in a Revenue Procedure; an earlier specific application denying relief was included in a Revenue Ruling where the filing was not made until an audit commenced.⁴³¹ The Tax Court, however, held that the statute itself did not impose a timely filing requirement and, applying the *Skidmore* analysis, the IRS pronouncements did not qualify for deference because they failed to articulate a persuasive rationale for denying relief as a general rule in all cases of late filing.⁴³² The Court concluded that the IRS’s expansive application of the nonstatutory requirement would impose a penalty in addition to the regular late filing ad valorem penalty (discussed below in the penalty chapter). If there is no requirement of timely filing, taxpayers subject to an IRS audit on the issue can meet the filing requirement simply by filing delinquent Forms 1096 and 1099. The Fifth Circuit held in an unpublished opinion that the untimely filing must be before the employment taxes are assessed against “employer.”⁴³³

The IRS has another possible relief opportunity called Voluntary Classification Settlement Program (“VCSP”) described in Ann. 2012-45, 2012-51 I.R.B. 724. As recently described by the Tax Court,

The VCSP provides partial relief from federal employment taxes for eligible taxpayers that agree to treat workers prospectively as employees. To be eligible for the VCSP, a taxpayer must: (1) have consistently treated the workers as nonemployees; (2) have filed all required Forms 1099, consistent with the nonemployee treatment, for the previous three years; and (3) not currently be under employment tax audit by the Internal Revenue Service (IRS).⁴³⁴

⁴²⁹ Rev. Proc. 85-18, 1985-1 C.B. 581.

⁴³⁰ H.R. Rep. No. 95-1748, 95th Cong., 2d Sess. 5 (1978), 1978-3 (Vol. 1) C.B. 629, 633. For case granting this relief, see *Peno Trucking Inc. v. Commissioner*, unpublished (6th Cir. 2008), unofficially reported at 2008 TNT 194-75, reversing the Tax Court on this issue (T.C. Memo. 2007-66).

⁴³¹ Rev. Proc. 85-18, 1985-1 C.B. 518; Rev. Rul. 81-224, 1981-2 C.B. 197.

⁴³² *Medical Emergency Care Associates, S.C. v. Commissioner*, 120 T.C. 436 (2003).

⁴³³ *Bruecher Found. Servs. v. United States*, 2010 U.S. App. LEXIS 12598 (5th Cir. 2010) (Unpublished opinion); see Hale E. Sheppard, Must Taxpayers File “Timely” Forms 1099 to Obtain Code Sec. 530 Relief? Unexpected Answers from a Recent Worker-Classification Case, *Taxes - the Tax Magazine* 55 (May 2013) (a very thorough article on the specific issue, but with good background on § 530).

⁴³⁴ *Treece Financial Serv. Group v. Commissioner*, 158 T.C. ____ No. 6 (2022), Slip Op. 3 (cleaned up).

7. IRS Abuse and the 10 Deadly Sins.

I discuss the IRS's examination and collection functions in later chapters. These are the principal contacts the IRS has with the taxpayer. We will see that, in pursuing these functions, IRS officials are given significant powers. These powers work well and appropriately most of the time, but they can be misused.

In hearings leading to the 1998 Restructuring Act, the Republican majority on the Senate Finance Committee trotted out taxpayers and IRS agents who testified as to alleged IRS abuses against taxpayers. After enactment of the 1998 Restructuring Act, studies of these witnesses' charges showed most of them to be untrue or unverifiable, casting doubt upon the SFC majority's extrapolation from those charges that abuse was rampant in the IRS. (It is not and never was.) Nevertheless, in the heat of political passion bashing the IRS immediately after the charges were made before a complicitous Senate Finance Committee, Congress enacted legislation outside the Code (i.e., not codified in the Code) but still the law.⁴³⁵

That legislation provides:

The IRS must terminate an IRS employee if there is a final administrative or judicial determination that the employee committed any act or omission in performing official duties⁴³⁶ The following list of 10 items—the 10 Deadly Sins—may result in employee termination:⁴³⁷

(1) willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer's home, personal belongings, or business assets;

(2) providing a false statement under oath with respect to a material matter involving a taxpayer or taxpayer representative;

(3) with respect to a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service, the violation of (A) any constitutional right or (B) any civil right established under certain specified statutes, such as the Civil Rights Acts;

(4) falsifying or destroying documents to conceal mistakes made by any employee with respect to a matter involving a taxpayer or taxpayer representative;

(5) assault or battery on a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service, but only if there is a criminal conviction, or a final judgment by a court in a civil case, with respect to the assault or battery;

⁴³⁵ § 1203 of the 1998 Restructuring Act.

⁴³⁶ § 1203(a).

⁴³⁷ § 1203(b).

(6) violations of the Code, regulations, or policies of the Internal Revenue Service (including the IRM) for the purpose of retaliating against, or harassing, a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service;

(7) willful misuse of the provisions of § 6103 (the confidentiality provisions for tax return information)⁴³⁸ for the purpose of concealing information from a Congressional inquiry;

(8) willful failure to file any required federal tax return unless such failure is due to reasonable cause and not to willful neglect;⁴³⁹

(9) willful understatement of federal tax liability, unless such understatement is due to reasonable cause and not to willful neglect;⁴⁴⁰ and

(10) threatening to audit a taxpayer for the purpose of extracting personal gain or benefit.

Items (8) and (9) relate to IRS employees' conduct in filing their own tax returns. Items 1 - 6 and 10 relate to conduct affecting other taxpayers, which was the principal target of Congress' attention. Item 7 relates to potential abuse of Congress by withholding information from it.

Although the general rule is that the listed infractions require termination of employment, the Commissioner may make a nondelegable determination that mitigating factors exist and not terminate the employee.

A noted commentator (Keith Fogg of the Procedurally Taxing Blog) has assessed this legislation as follows:

Section 1203 conveys that Congress sought to offer symbolic legislation rather than pass a law seeking to meaningful[ly] influence behavior in way that would positively influence compliance. * * * * Having lived with the misguided symbolism of 1203 for 15 years, the time has come to move the discussion to legislation that can create a more effective compliance atmosphere.⁴⁴¹

Professor Fogg does not think that there should be no punishment for misbehavior that brings discredit on the IRS and treats taxpayers unfairly. He just thinks the more targeted punishment that addresses the real issues based on careful research rather than political passion is required. And, for

⁴³⁸ We study these provisions below.

⁴³⁹ The phrase "due to reasonable cause and not to willful neglect" is a term of art used in the penalty provisions generally applicable to all taxpayers. Taxpayers generally are subject to civil tax penalties for negligent or other conduct that fails to meet this standard. IRS employees are subject also to termination from employment.

⁴⁴⁰ See the preceding footnote.

⁴⁴¹ Keith Fogg, Revisiting the Revenue Reform Act of 1998 – The 10 Deadly Sins (Procedurally Taxing Blog 11/12/13).

most of the ones dealing with IRS employees' tax noncompliance, why should not all Government employees and contractors be punished for tax noncompliance.

Congress further required investigations into abuses. The GAO, the investigative arm of Congress, studied the specific abuses alleged in the hearings leading to this legislation (and, for the most part, either could not verify or found the allegations to be false).⁴⁴² In addition, TIGTA (p. 36) studies these issues on an ongoing basis and periodically reports to Congress. The reports to date indicate some abuse in the IRS (a not surprising finding given its size), but hardly indicate that they are widespread. For the reason that such abuses are not and never were widespread in the IRS and the chilling effect the statute has on legitimate enforcement efforts (i.e., IRS employees fearing the statute forego legitimate administrative actions), some thoughtful observers have called for its repeal.⁴⁴³

8. Taxpayer ID Numbers (SSNs, ITINs, and EINs).

All taxpayers interfacing with the IRS must have identification numbers. The individual taxpayer uses his Social Security Number ("SSN") or, if not eligible for an SSN, then an Individual Taxpayer Identification Number ("ITIN") which the IRS assigns on application and must be periodically renewed.⁴⁴⁴ Entities or businesses use an Employer Identification Number ("EIN") which the IRS assigns on application. These are unique taxpayer identification numbers and must be used in communications (correspondence, filings, etc.) with the IRS.

9. Taxpayer Bill of Rights.

In 2014, the IRS adopted a "Taxpayer Bill of Rights" (often referred to as "TBOR")⁴⁴⁵ which appears on its web site.⁴⁴⁶ The bullet-point components of that Bill of Rights are:

- The Right to Be Informed

⁴⁴² See Mortimer Caplin, The Tax Lawyer's Role in the Way the American Tax System Works, 106 Tax Notes 697 (Feb. 7, 2005) saying:

Later, however, after enactment of RRA 98, court proceedings and various government reports by the GAO and the Treasury Inspector General for Tax Administration clearly established that much of the testimony was not only misleading but false; the IRS may have made mistakes, but they were not malicious or systemic. Numerous corrective news stories began to appear with sharp headlines like the following: "IRS Abuse Charges Discredited"; "Highly Publicized Horror Story That Led to Curbs on IRS Quietly Unravels"; "IRS Watchdog Finds Complaints Unfounded"; "Court Is Asked to Block False Complaints Against IRS"; "Secret GAO Report Is Latest to Discredit Roth's IRS Hearings." But publication came too late; the damage was already done.

⁴⁴³ E.g., Mortimer Caplin, The State of IRS Administration and Our Tax System in General, 103 Tax Notes 473 (2004) and 2004 TNT 81-32 (4/27/04).

⁴⁴⁴ See IRS web page titled "Taxpayer Identification Numbers (TIN)" (last reviewed or updated 5/24/22 and viewed 7/20/22).

⁴⁴⁵ The history leading to the IRS' adoption of TBOR is recounted in *Moya v. Commissioner*, 152 T.C. 182 (2019).

⁴⁴⁶ IRS web page titled "Taxpayer Bill of Rights" (Last Reviewed or Updated 6/4/21 and viewed on 7/24/21). The web site in most cases provides links with further links for more detail than the cryptic descriptions of the right incorporated in the Bill of Rights.

- The Right to Quality Service
- The Right to Pay No More than the Correct Amount of Tax
- The Right to Challenge the IRS’s Position and Be Heard
- The Right to Appeal an IRS Decision in an Independent Forum
- The Right to Finality
- The Right to Privacy
- The Right to Confidentiality
- The Right to Retain Representation
- The Right to a Fair and Just Tax System

TBOR is as an “organizing framework” which did “not create new rights or remedies, [but] only to group existing rights into categories that are easier for taxpayers and IRS employees to understand and remember.”⁴⁴⁷

TBOR was then codified in 2015 in § 7803(a)(3).⁴⁴⁸ The statutory adoption of TBOR, as with TBOR, did not create new rights or remedies.⁴⁴⁹

Most of the rights in TBOR are aspirational⁴⁵⁰ but have components of the administrative system designed to effect the aspirations. For example, “The Right to a Fair and Just Tax System” is meaningful only if there are procedures (the topic of this book) that implement such a system; but the mere statement of the right does little more than state an aspiration and is not, on its own enforceable or measurable.⁴⁵¹ Some reflect policy judgments where the choices made by Congress determine how the right is interpreted and implemented. Most of what I cover in this text will relate to the subjects encompassed within the TBOR.

The current TBOR in § 7803(a)(3) has some history of prior iterations of taxpayer rights, also referred to as Taxpayer Bills of Rights. I don’t think that history is appropriate for presenting in the text here, but just be aware that references in cases and administrative materials may be referring to earlier versions of TBOR.⁴⁵² More importantly, the various statutory iterations of TBOR

⁴⁴⁷ *Moya v. Commissioner*, 152 T.C. 182, 196 (2019).

⁴⁴⁸ The history leading to this enactment is recounted in *Moya v. Commissioner*, 152 T.C. 182 (2019).

⁴⁴⁹ *Shnier v. United States*, No. 18-1257, 2020 U.S. Claims LEXIS 2331 (Fed. Cl. Nov. 17, 2020), citing *Yates v. United States*, No. 20-169T, 2020 WL 5587366, at *6 (Fed. Cl. Sept. 18, 2020) and *Facebook, Inc. v. IRS*, No. 17-CV-06490, 2018 WL 2215743, at *13 (N.D. Cal. May 14, 2018)).

⁴⁵⁰ Attempts to enforce judicially the general aspirational statements have not been successful. See *Facebook, Inc. v. IRS*, 2018 WL 2215743 (N.D. Cal. May 14, 2018); *Moya v. Commissioner*, 152 T.C. 182 (2019); and *Atlantic Pacific Management Group, LLC v. Commissioner*, 152 T.C. 17 (2019). That is because the aspirational statements are not intended to confer rights.

⁴⁵¹ In the National Taxpayer Advocate’s Annual Report to Congress 2017, the NTA identified as Most Serious Problem #8 that “The IRS Does Not Effectively Evaluate and Measure Its Adherence to the Taxpayer’s Right to a Fair and Just Tax System.” Some argue that there remains a “central weakness in the current law, namely that there is no formal way to ensure that IRS employees act consistently with or even consider taxpayer rights.” Book, Leslie, [Giving Taxpayer Rights a Seat at the Table](https://ssrn.com/abstract=3331332) (February 8, 2019). Available at SSRN: <https://ssrn.com/abstract=3331332>.

⁴⁵² The first TBOR was enacted in 1988. Pub. L. No. 100-647, 102 Stat. 3342 (1988). The second, often referred to as TBOR 2, was enacted in 1996. P.L. 104-168, 110 Stat. 1452. The third, often referred to as TBOR 3, was enacted in 1998. P.L. 105-206, 112 Stat. 685.

included specific procedures designed to support the aspirations that currently appear in § 7803(a)(3). For example, elaborate Collection Due Process (“CDP”) procedures (discussed later in the text, beginning on p. 733) were adopted in the 1998 TBOR. So, references to TBOR may be to the specific Code provisions that implement the general aspirational statements now appearing in § 7803(a)(3).

Although not part of the Taxpayer Bill of Rights, in the 1998 Restructuring Act but intended to ensure fair treatment for taxpayers, Congress passed non-codified legislation to prohibit the use of any record of tax enforcement results (“ROTER”) or production goals in evaluating employees.⁴⁵³ Rather, the IRS must evaluate performance based on fair and equitable treatment of taxpayers.⁴⁵⁴ Management must quarterly self-certify compliance with these requirements.⁴⁵⁵ And TIGTA must annually report on IRS compliance with these requirements.⁴⁵⁶

Finally, § 7433 which grants a remedy for certain unauthorized collection actions is sometimes referred to as TBOR, and to distinguish from later TBOR statutes is sometimes called TBOR I.⁴⁵⁷ Enactments in 1996 and then in 1998, enacting § 7803(a)(3), are referred to as TBOR II and TBOR III, respectively.⁴⁵⁸ I think that when TBOR is now used in tax parlance without specific reference to which of the three is meant, the understanding is that § 7803(a)(3), TBOR III, is meant.

⁴⁵³ § 1204(a), Pub. L. No. 105-206, 112 Stat. 685. TIGTA is required to annually report on compliance with these requirements.

⁴⁵⁴ § 1204(b).

⁴⁵⁵ § 1204(c).

⁴⁵⁶ See e.g., Fiscal Year 2022 Statutory Audit of Compliance With Legal Guidelines Restricting the Use of Records of Tax Enforcement Results (TIGTA Ref. No. 2022-30-067 9/27/22).

⁴⁵⁷ *Kim v. United States*, 632 F.3d 713, 715 n.1 (D.C. Cir. 2011) (“The proper name of the Act is the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, §§ 3000-3804, 112 Stat. 685, 726-83 (codified in scattered titles of the U.S.C.)”).

§ 7433 was adopted as the Taxpayer Bill of Rights in 1988, before the TBOR described in § 7803(a)(3). For this reason, § 7433 is sometimes referred to as TBOR I. E.g., Bryan Camp, Lesson From The District Court: OIC Rejection Is No Basis For Wrongful Collection Suit Under §7433 (Tax Prof Blog 1/14/19). Congress thereafter in 1996 enacted legislation commonly called TBOR II and then in 1998 enacted the current § 7803(a)(3), which is sometimes called TBOR III. E.g., *Martin v. United States*, 2006 U.S. Dist. LEXIS 68125, at *18 n.3 (D.D.C. Sep. 22, 2006) (tracing the three enactments referred to as Bill of Rights).

⁴⁵⁸ See preceding footnote. Another provision, § 7433, is also sometimes called the Taxpayer Bill of Rights. *Kim v. United States*, 632 F.3d 713, 715 n.1 (D.C. Cir. 2011)

C. Department of Justice.

1. Tax Division (“DOJ Tax”).

DOJ Tax⁴⁵⁹ is responsible for litigating tax cases in all courts except the United States Tax Court.⁴⁶⁰ The IRS Chief Counsel's office handles the litigation in the Tax Court.⁴⁶¹ DOJ Tax litigates tax cases in the

- District Courts (including the bankruptcy courts, although IRS attorneys are sometimes designated as Special Assistant U.S. Attorneys to permit their appearance in bankruptcy courts on IRS matters and, in some civil and criminal tax cases, a local AUSA may handle the matter or join with the Tax Division attorney in doing so);
- the Court of Federal Claims;
- the Courts of Appeals (mostly federal including the Federal Circuit and state courts of appeals or state supreme courts); and
- the U.S. Supreme Court (although principal responsibility is with the Office of the Solicitor General).

DOJ Tax trial level activities are divided functionally between civil and criminal. Civil litigation is handled by civil sections—**three** Civil Trial Sections handling the litigation in district courts in three geographical areas of the country and one Court of Federal Claims Section handling litigation in that court which handles civil claims against the Government. **DOJ Tax Appellate handles all appellate level cases (that is, handling all tax cases in the various courts of appeals (mostly federal but in some state appellate courts as well) and in the Supreme Court working with the Office of the Solicitor General which makes final decisions as to all tax briefs or other papers filed with the Supreme Court).**⁴⁶²

The Criminal Enforcement Section (“CES”) handles the criminal functions of DOJ Tax at the trial level. This includes approving all tax prosecutions, representation before grand juries for further investigation or seeking indictments, prosecuting criminal tax cases (some of the trial representation may be shared with local AUSAs). CES has three geographic branches handling criminal matters. The Appellate function in criminal cases in the Courts of Appeals is handled by

⁴⁵⁹ The DOJ Tax web home page is titled “Tax Division” <https://www.justice.gov/tax> (viewed on 7/20/22).

⁴⁶⁰ President Franklin D. Roosevelt by executive order (EO 6166 6/12/33) transferred to DOJ “functions of prosecuting in the courts of the United States claims and demands by, and offenses against, the Government of the United States and of defending claims and demands against the Government exercised by an agency or officer.” Tax disputes are included in the scope of this order, but the responsibility for Tax Court litigation remains with the IRS as noted above. Within the DOJ, the responsibility for tax litigation is with the Tax Division but, as noted below in the text, the Solicitor General has the responsibility for approving all Government appeals from adverse trial level decisions (including tax cases both in the Tax Court and elsewhere) and for handling all Government cases (including tax cases) in the Supreme Court.

⁴⁶¹ § 7452.

⁴⁶² DOJ Tax Appellate attorneys played parts in the drama that formed the basis of the movie, “On the Basis of Sex,” portraying Justice Ginsburg’s rise to national prominence via a federal tax appeal. *Moritz v. Commissioner*, 469 F.2d 466 (10th Cir. 1972), cert. denied, 412 U.S. 906 (1973). The portrayal is in some respects relative to the appellate function exaggerated for dramatic effect.

the Criminal Appeals and Tax Enforcement Policy Section (“CATEPS”). Then for Supreme Court work, CATEPS works with the S.G.’s office, with the S.G.’s office having the final say.

DOJ Tax is headed by an Assistant Attorney General (“AAG”) who is a presidential appointee traditionally recruited from the private bar, usually as a reward for assistance in the political success of the President or for some powerful politician who can influence the presidential appointment process. The AAG might have had government experience in the past, but it is not the practice to appoint someone to the position directly from government service. Usually, however, a senior DOJ Tax official (referred to as a Deputy Assistant Attorney General), who may also be a political appointee, will serve as Acting AAG during periods when the AAG's office is vacant. The Deputy AAGs will usually include one chosen from private practice and one from career DOJ Tax officials.

Once a civil or criminal case is referred to DOJ Tax, DOJ Tax has the exclusive authority to compromise the case; prior to that referral, the IRS has exclusive authority to compromise. § 7122(a).⁴⁶³ However, as to DOJ Tax’s exclusive authority to settle, it must be kept in mind that the model is somewhat like attorney (DOJ Tax) and client (IRS). This is not a perfect fit because the attorney-client model would require the lawyer (DOJ Tax) to comply with the client’s (IRS’s decisions). The statutory structure does not fit this model, for DOJ Tax can operate from a different perspective and therefore need not always follow the client’s wishes or instructions. Suffice it to say, however, that the DOJ Tax will seek the IRS’s views and will make a different decision only in the rare case that DOJ Tax feels that the priorities from its perspective dictate a decision different than the one preferred by the IRS.⁴⁶⁴

⁴⁶³ *Isley v. Commissioner*, 141 T.C.349 (2013) (holding that Section 7122(a) requires DOJ approval to compromise the tax liability for the period(s) of referral, at least during the period that DOJ either directly or through the courts had continuing responsibility; in that case, it was the continuing requirement in the judgement in the criminal case to file returns and pay taxes during the period of supervised release that required DOJ approval); *United States v. Jackson*, 2013 U.S. App. LEXIS 1674 (3d Cir. 2013) (with discussion of authority as to the IRS’s lack of authority to settle after referral to DOJ Tax, even after the case is referred back to the IRS); see also *Faust v. United States*, 28 F.3d 105 (9th Cir. 1994). See IRS Has No Authority To Settle Cases Referred to DOJ Tax Even After They Are Returned (Federal Tax Crimes Blog 8/3/13), discussing *Jackson*; and IRS authority to settle after referral to DOJ Tax (Federal Tax Crimes Blog 11/11/13), discussing *Isley*. For this reason, should the IRS abate a tax assessment while the tax liability has been referred to the DOJ Tax Division, the abatement is without authority, a mistake, and the abated assessment may be re-assessed without the normal procedures for assessment. CCA CC-2011-020 (9/15/11), quoted and followed in *Waltner v. United States*, 2021 U.S. App. LEXIS 28711 (9th Cir. Sep. 22, 2021) (Unpublished). For a comparison of DOJ Tax’s broad compromise authority with the authority of IRS attorneys in tax litigation, see Keith Fogg, Contrasting the Compromise Standards between the Chief Counsel, IRS and the Department of Justice in Litigated Cases (Procedurally Taxing Blog 6/23/15).

⁴⁶⁴ Before the referral when the IRS has exclusive authority to settle, the IRS usually will not ask DOJ Tax for its advice, but in cases where seeking the DOJ Tax advice is appropriate, the IRS will do so but likely, because of the secrecy rules will have to make some form of referral so that the facts underlying the advice can be shared with DOJ Tax. Perhaps that will not be a full-bore referral that would transfer exclusive authority to DOJ Tax to settle the case (but, quite frankly, I have not researched this issue enough to do anything than raise the issue).

2. Office of the Solicitor General.

The Solicitor General of the United States (“SG”)⁴⁶⁵ has two key roles in tax litigation.

First, and most prominently, the office of the SG oversees all representation of the United States before the Supreme Court. The SG’s office thus files all papers (including petitions for writ of certiorari and briefs on the merits) and makes all oral arguments in the Supreme Court. (An exception is that high level political appointees, such as the AAG are sometimes given the opportunity to argue one case in their area of responsibility.)⁴⁶⁶ Because of the SG’s role with the most frequent party before the Court and the fact that the SG often argues cases before the Supreme Court, the SG has been referred to as the “10th Justice.”⁴⁶⁷

Second, in tax cases, the initial draft of briefs, petitions and other pleadings in the Supreme Court will usually be substantially prepared by the DOJ Tax Appellate Section and may be substantially commented upon by the various tax constituencies in the IRS and DOJ Tax. The final draft of those papers, however, are revised as appropriate (including substantially rewritten, if appropriate) by the SG's office.

Third, the SG must approve all government appeals in tax cases.

Within the SG's office, there is usually a “tax assistant” -- i.e., an Assistant SG who handles most of the tax cases that come to the SG's office. The SG is usually not a tax lawyer, and therefore relies substantially on the tax assistant. There has been one instance in which the SG was a lawyer of some renown in the tax universe -- Erwin Griswold, who was former tax professor and Dean at Harvard Law School and a giant in the tax profession.⁴⁶⁸

⁴⁶⁵ The Solicitor General web page is titled “Office of the Solicitor General” <https://www.justice.gov/osg> (viewed 7/20/22).

⁴⁶⁶ One exception to the statement of which I am aware is that Ernest J. Brown, formerly professor of law at Harvard Law School, was an attorney in the DOJ Tax Appellate for many years after he retired from Harvard. He was permitted to argue a case for the SG’s Office before the Supreme Court. See *Commissioner v. First Sec. Bank*, 405 U.S. 394 (1972).

⁴⁶⁷ Seth Stern, On the Court: The ‘10th justice’ becomes the 9th (Harvard Law Bulletin Winter 2011) (“On the elevation of former Harvard Law Dean Elena Kagan from her position as Solicitor General to Associate Justice of the Supreme Court). Being a “10th Justice” does not mean that the SG has a seat at the decision table. But it does mean that, depending upon the particular SG (probably most of them except for those who may be suspect for some reason), the SG’s arguments are considered very seriously. For example, in the tax arena, the SG’s office carefully regulates the Government’s positions in the Supreme Court – from ensuring that petitions for certiorari are filed only in the most important cases (perhaps 6-8 a year) to ensuring that arguments then presented on the merits are worthy of the Court’s resources. I suspect that the SG’s offices serve that same function in other areas of the Government’s interface with the Supreme Court.

⁴⁶⁸ Dean Griswold also played a role in the movie “On the Basis of Sex” which has as its backdrop the tax case of *Moritz v. Commissioner*, 469 F.2d 466 (10th Cir. 1972), cert. denied, 412 U.S. 906 (1973). Dean Griswold was the S.G. for the events portrayed in the movie, but likely had no role until the petition for certiorari was recommended. His portrayal in the movie is thus exaggerated for dramatic effect. Still, Dean Griswold did make the final decision to seek certiorari in the case, probably as a favor to Ernest Brown, former professor at Harvard law School, who was invested in the case (as the DOJ Tax Appellate reviewer). I worked at DOJ Tax with Professor Brown and still
(continued...)

The SG's lawyers are the crème de la crème and usually beyond political influence. These qualities have been carefully cultivated over the years and have given the office of the Solicitor General substantial influence at the Supreme Court. This is particularly illustrated in the tax area. The SG will carefully limit the times during any given term that the United States will either petition the Supreme Court for certiorari or acquiesce in a taxpayer's petition for writ of certiorari. It is said that the Supreme Court, disliking tax cases, has a tolerance for about only four to six tax cases per term, and the SG is careful to serve up only the ones in which his unique perspective of tax and Supreme Court priorities tells him that the Court may grant certiorari.

The SG's understanding of the limits of the Supreme Court's interest in tax cases was illustrated to me when I was a relatively fledgling lawyer in the Appellate Section. I handled and lost a case in a court of appeals where there was in my judgment a clear conflict among the circuits and the Government was clearly right (in my view). The issue involved the application of the mitigation provisions of the Code designed to mitigate the harsh effects of the statute of limitations. (I cover the mitigation provisions starting on p. 263.) Suffice it to say at this point that the mitigation provisions have a threshold complexity that courts and many practitioners find daunting but, when understood, are logical and beautiful. In any event, as I said, there did appear to be a conflict among the circuits and, at the time, a conflict was almost guaranteed certiorari material. I therefore recommended that the United States seek certiorari in the case. The SG (Dean Griswold whom I mentioned in two paragraphs up) himself nixed the recommendation, noting in handwriting on my recommendation that (and this is a paraphrase but pretty close to the actual quote) “We can't take a mitigation case to the Supreme Court. They will never understand it.”

Although instances of political influence in the SG's office are rare, one such instance is prominent in the tax law history. In the mid to late 1970s, the IRS began revoking the tax exempt status of organizations that practiced some forms of racial discrimination. The revocations were not based on a specific Code provision denying tax exempt status for racially discriminatory practices, but rather upon evolving judicial interpretations that excluded organizations practicing racial discrimination from the general definition of charitable organizations for some purposes. The Code definition of tax-exempt organizations relied on those general evolving law definitions of charitable organizations. The otherwise charitable organizations such as schools which desired to continue their discriminatory practices—often in the name of claimed religion beliefs—challenged this administrative denial of tax exempt status.

Two such cases in which the IRS had succeeded in denying tax exempt status at the Circuit Court level finally reached the Supreme Court in the early 1980's.⁴⁶⁹ By that time, President Reagan had been elected with a substantial boost from the South where there were significant constituencies

⁴⁶⁸(...continued)

remember is claim that there are no constitutional issues in tax.

⁴⁶⁹ While with the Government, I handled one of the cases at the trial level to decision, and the Government prevailed. *Goldsboro Christian Schools v. United States*, 436 F. Supp. 1314 (E.D. N.C. 1977). I handled the other case involving Bob Jones University, the case that ended up as the lead case in the Supreme Court, until I left DOJ Tax in 1977; *Bob Jones* was completed at the trial level by another DOJ Tax attorney and the Government lost at the trial level. *Bob Jones University v. United States*, 468 F. Supp. 890 (D. S.C. 1978), rev'd 639 F.2d 147 (4th Cir. 1980), aff'd 461 U.S. 574 (1983).

favoring some forms of racial discrimination, and religious schools were their poster children. The President directed the SG's office to disavow the position the Government had earlier asserted successfully in the court of appeals, thus agreeing that the organizations qualified for tax exempt status even if they racially discriminated. Because the SG had recused himself on the case, the lot fell to the Acting SG, who felt strongly that the White House was wrong on the merits and on its attempt to influence the SG's office. The Acting SG agreed that the President was constitutionally entitled to direct the position taken by the Executive Branch, however mistaken and misguided it may be. But the Acting SG agreed to put his name on the brief espousing a position he thought was wrong, only if he was allowed to state in a footnote that he did not agree with the position advocated in the brief. That Acting SG's action was gutsy and shows a remarkable degree of independence because the President could have fired him and replaced him with someone willing to do the President's bidding without a distracting footnote slap at the blatant political move. (There would undoubtedly have been a number of political sycophants who would have volunteered; but the political flak from such conduct would have been serious, since it would have echoed President's Nixon's command to fire the Special Prosecutor which the Attorney General and Deputy Attorney General resigned rather than perform with a resulting public firestorm that participated greatly in Nixon's fall.)

Perceiving the interference in the SG's office, the Supreme Court invited a prominent DC attorney to file an amicus brief in support of the decisions rendered by the Fourth Circuit that stripped the schools of their tax exempt statuses. So, President Reagan got his way on the nominal position in the SG's brief but lost on the merits in the Supreme Court.⁴⁷⁰ President Reagan's advisors certainly knew the position would fail, so the net effect was that President Reagan played to an important constituency at the cost of improperly influencing the SG's office and irritating the Supreme Court. In the political equation, President Reagan apparently concluded that was a reasonable price to pay. Fortunately, such episodes are rare, very rare.

III. Judicial Branch.

A. Introduction.

The Judicial Branch of Government is the ultimate forum for resolution of issues created by the IRS administration of the tax laws. In the context of the focus of this course, we will see it when the taxpayer asks a court to review some action taken by the IRS—whether it is the assertion of additional tax due and owing (by deficiency notice), the denial of a claim for refund, improper administrative action (such as wrongful levy), etc.

In this discussion, I offer a summary of the judicial branch that may engage in tax and tax related litigation. I provide a more detailed discussion in Chapter 10.

⁴⁷⁰ See *Bob Jones University v. United States*, 461 U.S. 574 (1983).

B. The Courts.

1. Article III Courts.

Article III of the Constitution establishes the Judicial Branch of our Government.⁴⁷¹ Judicial functions may be performed outside Article III (the prominent examples for present purposes being the Court of Federal Claims and the Tax Court), but generally the ultimate judicial function is handled by courts created under Article III of the Constitution. The key features of Article III courts are that the judges have lifetime tenure and, at the trial level, may impanel juries to find facts. The Article III Courts are the United States District Courts, the United States Courts of Appeals, and the United States Supreme Court. I hope that by now you understand the key features and roles of these courts in our judicial system. They serve the same roles in the tax system.

United States District Courts will have United States Magistrate Judges, who are not Article III Judges, but who are judicial officers assisting the District Courts in the management of the cases, performing many of the functions that the District Courts would otherwise have to perform. Bankruptcy judges, who are also not Article III judges, function under the auspices of the District Court and will sometimes resolve tax issues. For this class, I will expect you to know only the role of the District Court Judges.

I mentioned above the SG's understanding of the limits of the Supreme Court's interest in tax cases. Consider also the following: First, in explaining a practice among Justice Rehnquist's clerks, Judge Roberts, the current Chief Justice succeeding Justice Rehnquist, is quoted as saying of past practice when he was clerk:

Justice Rehnquist let the clerks decide who would handle which case. They used a system similar to the NFL draft, but with a twist. The clerks could use a vote to claim a case or to reject one, all before knowing whether Justice Rehnquist would be assigned to write the majority opinion or decide to write a concurrence or dissent. A clerk who did not vote carefully . . . "could get stuck with a lot of tax cases."⁴⁷²

A similar anecdote is Justice Souter's famous answer to the question of why he sang with Chief Justice Rehnquist at the Court's annual Christmas party, "I have to. Otherwise I get all the tax cases."⁴⁷³

⁴⁷¹ The web page is titled United States Courts (viewed 7/24/17)

⁴⁷² Adam Liptak and Todd S. Purdum, As Clerk for Rehnquist, Nominee Stood Out for Conservative Rigor, Washington Post Web Edition (7/31/05).

⁴⁷³ As reported in Bernard Schwartz, The Unpublished Opinions of the Rehnquist Court 7-8 (1996), also reporting that "Some justices have said that they would rather volunteer to wash windows than be assigned the chore of writing tax opinions." Following that line, some other anecdotes from Green Bag 2-3 (Autumn 2001), under the topic "Taxing Cases":

- Justice Brennan's normal reactions to tax case cert petitions: "This is a tax case. Deny."
- Justice Blackmun, the only Justice with extensive tax background: "If one's in the doghouse with the Chief, he gets the crud, He gets the tax cases, and some of the Indian cases."
- Quoting Justice Powell: "A dog is a case that you wish the Chief Justice had assigned to some other
(continued...)

And also consider that, when the Supreme Court does take important tax case, it is apt to create great mischief.⁴⁷⁴

2. Article I Courts.

a. General.

The other types of independent courts that we have are Article I Courts—i.e., courts created under the Article I legislative authority of the Congress rather than under Article III judicial authority. The key differences from Article III courts are that Article I judges do not have lifetime tenure and may not impanel juries to resolve disputed facts. The Article I courts pertinent to this class are the United States Court of Federal Claims and the United States Tax Court. Both of these courts are courts of nationwide jurisdiction, hearing cases originating throughout the United States, although the courts themselves are located in Washington, D.C.

b. Court of Federal Claims.

The United States Court of Federal Claims is a court authorized under Article I of the Constitution⁴⁷⁵ that has jurisdiction over various types of claims against the Government, including tax claims.⁴⁷⁶ The Court stated its role as:

Because of the Court of Federal Claims' unique role in providing a forum for litigants who could not otherwise seek a remedy for their injuries, some have called the Court of Federal Claims the People's Court or the conscience of the federal government. This Court thus plays a vital role in creating government legal accountability in the government's day-to-day dealings with citizens. The bounds of this vital role, however, are not limitless — and we necessarily are constrained by

⁴⁷³(...continued)

Justice.” A deadly dull case, “a tax case, for example.”

Scholars have also noted “the widespread view among the Supreme Court justices that tax cases are boring.” Lawrence Zelenak, The Court and the Code: A Response to the Warp and Woof of Statutory Interpretation, 58 Duke L.J. 1783, 1789 (2009) (citing James J. Brudney & Corey Ditslear, The Warp and Woof of Statutory Interpretation: Comparing Supreme Court Approaches in Tax Law and Workplace Law, 58 Duke L.J. 1231, 1272-1273 (2009) (“Some of the Justices likely deferred to Justice Blackmun simply because they were not interested in tax law - something Blackmun recognized inside the Court as well as in public statements.”).

⁴⁷⁴ Charles I. Kingson, How Tax Thinks, 37 Suffolk U. L. Rev. 1031 (2004) (critiquing two leading Supreme Court cases: *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978) and *Commissioner v. Brown*, 380 U.S. 563 (1965)); see also Charles I. Kingson, Confusion Over Tax Ownership, 93 Tax Notes 409 (Oct. 8, 2001) (critiquing the same). I also cite *Gitlitz v. Commissioner*, 531 U.S. 206 (2001) as a prime example of Supreme Court’s mischief in this area. See René Matteotti, Struggling With Words in Tax Jurisprudence -- A Plea for an Equal Treatment Mode of Analysis in Construing Tax Statutes, 2005 TNT 130-30. My quip, not much of an overstatement, is that tax cases are too important to let the Supreme Court decide them.

⁴⁷⁵ See “About the Court” web page on the Court’s web site: <https://www.usfc.uscourts.gov/about-court> (viewed on 7/20/22) (“The United States Court of Federal Claims was recreated in October 1982 by the Federal Courts Improvement Act pursuant to Article 1 of the United States Constitution.”).

⁴⁷⁶ The Court of Federal Claims is the successor to the Court of Claims.

our procedural rules and binding precedents in our ability to provide such legal accountability.⁴⁷⁷

That is principally to say that the Court of Federal Claims, like Article III courts, is a court of limited jurisdiction in which the United States has consented to be sued. Among the jurisdiction conferred upon the Court of Federal Claims is tax refund jurisdiction.⁴⁷⁸

The current Court of Federal Claims was previously an Article III Court with trial and appellate jurisdiction known as the Court of Claims. Accordingly, opinions by the Court of Federal Claims cite Court of Claims opinions as precedent.⁴⁷⁹ Because of its prior status as an Article III Court, the Court of Federal Claims is within the Judicial Conference of the U.S., which provides administration.⁴⁸⁰ Court of Federal Claims Judges may be removed by a majority of the judges on the Court of Appeals for the Federal Circuit “only for incompetency, misconduct, neglect of duty, engaging in the practice of law, or physical or mental disability.”⁴⁸¹

c. U.S. Tax Court.

The U.S. Tax Court is an Article I court independent of the Article III judicial system and independent of the executive branch. § 7441.⁴⁸² The Tax Court is said to be a “legislative court.”⁴⁸³

⁴⁷⁷ *Gaynor v. United States*, 2020 U.S. Claims LEXIS 2138 (2020) (cleaned up),

⁴⁷⁸ Congress conferred jurisdiction on the Claims Court in the Tucker Act, now 28 U.S.C. § 1491(a)(1), which authorizes the court in relevant part “to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress.” This “jurisdiction” waives sovereign immunity for claims premised on other sources of law that “can fairly be interpreted as mandating compensation by the Federal Government for the damages sustained.” *Jan's Helicopter Serv., Inc. v. FAA*, 525 F.3d 1299, 1306 (Fed. Cir. 2008) (quoting *United States v. Mitchell*, 463 U.S. 206, 216-17 (1983)). The tax-related remedy generally invoked in this court is the refund remedy authorized in 28 U.S.C. § 1346(a)(1).

⁴⁷⁹ *Coltec Industries, Inc. v. United States*, 454 F.3d 1340, 1353 (Fed. Cir. 2006) (“there can be no question that the Court of Federal Claims is required to follow the precedent of the Supreme Court, our court, and our predecessor court, the Court of Claims”).

⁴⁸⁰ Leandra Lederman, (Un)Appealing Deference to the Tax Court, 63 Duke L.J. 1833, 1836 n. 6 (2014).

⁴⁸¹ 28 U.S.C. § 176(a).

⁴⁸² See *Burns, Stix Friedman & Co. v. Commissioner*, 57 T.C. 392, 395 (1971); and *Freytag v. Commissioner*, 501 U.S. 868, 890-892 (1991). A bit of history (summarized from Brant J. Hellwig, The Constitutional Nature of the United States Tax Court, 35 Va. Tax Rev. 269, 271-272 (2015)): Prior to 1969, the Tax Court (and its predecessor, the Board of Tax Appeals) was an executive branch agency; in 1969, Congress revised § 7441 to state that the Tax Court is established “under Article I of the Constitution”; in 2015, Congress amended § 7331 to add “The Tax Court is not an agency of, and shall be independent of, the executive branch of the Government” which codifies a clause from *Freytag v. Commissioner*, p. 891 “[t]he Tax Court remains independent of the Executive * * * Branch[es].” In *Freytag* at p. 888, the Court noted the clear intent of the 1969 amendment to § 7441 (with language still in the statute) to make the court an “Article I legislative court.” Notwithstanding, the precise location of the Tax Court in the Government branches is not definitively settled. See also Keith Fogg, The Ongoing Effort to Properly Situate the Tax Court (Procedurally Taxing Blog 5/24/22); and Ben Chanenson (Guest Blogger), Where is the Tax Court located? (Procedurally Taxing Blog 3/16/23).

Although not a branch of the Executive Department, the President has the power to remove Tax Court judges “for inefficiency, neglect of duty, or malfeasance in office, but for no other cause.” § 7443(f). The President’s limited power to remove Tax Court judges does not violate separation of powers principles. *Battat v. Commissioner*, 148 T.C. 59 (2017) (holding that the interbranch removal power did not implicate Article III because the Tax Court does not
(continued...)

The Tax Court has jurisdiction over tax related claims only. Generally, the Tax Court has jurisdiction to redetermine deficiencies proposed by the IRS and resolve certain other disputes with the IRS. The Tax Court is the principal court in which tax controversies are litigated.⁴⁸⁴

The current Tax Court is the successor to the Board of Tax Appeals, established in 1924 as an independent Executive Branch agency.⁴⁸⁵ The Board of Tax Appeals was physically located in the IRS main office building. The Board of Tax Appeals was renamed the Tax Court of the United States in 1942.⁴⁸⁶ In 1969, The Tax Court was changed to an Article I Court from an historically administrative court and renamed to U.S. Tax Court.⁴⁸⁷ Prior to 1969, the Tax Court (and its predecessor) officed in the IRS headquarters; in 1969, the Tax Court moved into its own courthouse building. The opinions from these bodies are precedent in the current Tax Court. The Tax Court is not subject to the Administrative Office of U.S. Courts or the U.S. Judicial Conference because of this history.⁴⁸⁸ Tax Court Judges may be removed “for inefficiency, neglect of duty, or malfeasance in office, but for no other cause.”⁴⁸⁹ I cite in the footnotes some sources for further reading on Tax Court history.⁴⁹⁰

Each Article I court, like the Article III courts, has jurisdictional prerequisites which must be satisfied; I deal with those in more detail below in Chapter 10 Litigation (beginning on p. 530).

⁴⁸²(...continued)

exercise Article III judicial power; *Battat* also has a good discussion of the history of the Tax Court from its inception as the Board of Tax Appeals to its current status); and *Kuretski v. Commissioner*, 755 F.3d 929 (D.C. Cir. 2014).

⁴⁸³ *Freytag v. Commissioner*, 501 U.S. 868, 888 (1991) (stating “the clear intent of Congress to transform the Tax Court into an Article I legislative court.”); see also Brant J. Hellwig, The Constitutional Nature of the United States Tax Court, 35 Va. Tax Rev. 269, 304 (2015) (noting the “the conventional reference to the Tax Court as an Article I legislative court.”).

⁴⁸⁴ Leandra Lederman, (Un)Appealing Deference to the Tax Court, 63 Duke L.J. 1833, 1834 (2014) (“the Tax Court is the trial court of choice for over 95 percent of litigated federal tax cases.”).

⁴⁸⁵ Revenue Act of 1924, sec. 900, Ch. 234, 43 Stat. 253, 336 et seq. (June 2, 1924). See particularly § 900(k) (“The Board shall be an independent agency in the executive branch of the Government.”).

⁴⁸⁶ Revenue Act of 1942, sec. 504(a), Pub. L. 753, Ch. 619, 56 Stat. 798, 957 (October 21, 1942).

⁴⁸⁷ § 7441; Tax Reform Act of 1969, Pub. L. 91-172, secs. 951-962, 83 Stat. 730; see *Freytag v. Commissioner*, 501 U.S. 868, 887 (1991).

⁴⁸⁸ S. Rep. No. 91-552, at 304 n.3 (1969), reprinted in 1969 U.S.C.C.A.N. 2027, 2343 n. 81 (the “amendments do not place the Tax Court under the supervision of the Judicial Conference or the Director of the Administrative Office of the Article III courts or give them any power or control over the Tax Court.”). See also Leandra Lederman, (Un)Appealing Deference to the Tax Court, 63 Duke L.J. 1833, 1836 n. 6 (2014); and Leandra Lederman, Tax Appeal: A Proposal To Make the United States Tax Court More Judicial, 85 Wash. U. L. Rev. 1195, 1199 (2008) (asserting that “Congress should recognize the entirely judicial nature of the Tax Court by making it subject to the [Administrative Office of U.S. Courts]; the Rules Enabling Act; and, with respect to its rulemaking, the Judicial Conference.”).

⁴⁸⁹ § 7443(f).

⁴⁹⁰ Harold Dubroff & Brant J. Hellwig, The United States Tax Court: An Historical Analysis 226-228 (2d ed. 2014); James S. Halpern, What Has the Tax Court Been Doing? An Update, Tax Notes 1277, 1284-1286 (May 30, 2016); Leandra Lederman, (Un)Appealing Deference to the Tax Court, 63 Duke L.J. 1833, 1836 n. 6 (2014); and Leandra Lederman, Tax Appeal: A Proposal To Make the United States Tax Court More Judicial, 85 Wash. U. L. Rev. 1195, 1199 (2008); David Laro, The Evolution of the Tax Court as an Independent Tribunal, 1995 U. Ill. L. Rev. 17, 18.

In the Tax Court, the petitioner (usually the taxpayer) and the respondent is always the IRS now appearing under the title “Commissioner of Internal Revenue. Formerly, the respondent was always the person serving as Commissioner at the time the petition was filed, with perhaps a name changed as the case progressed and new Commissioners were confirmed. At some point (not sure exactly when), the respondent became just the “Commissioner of Internal Revenue,” the title.⁴⁹¹

⁴⁹¹ Former Commissioner ascribes that transition to the effort of Former Harvard Law Dean Erwin T. Griswold (later Solicitor General in the 1970s):

[Just] before leaving the S.G.’s office, he was instrumental in the rule change that allowed appeals in tax cases to be made under the general title “Commissioner of Internal Revenue,” without the need to specify the name of the incumbent. That’s why you see older tax cases bearing the names of particular Commissioners — David Burnet or Guy T. Helvering, for example — and, later, hardly any with names like Latham, Caplin, Cohen, Thrower and the like. Let me mournfully add: “Sic transit gloria mundi”—so passes away the glory of this world!

Mortimer M. Caplin, The Tax Lawyer’s Role in the Way the American Tax System Works (13th Annual Erwin N. Griswold Lecture Before The American College of Tax Counsel 1/22/05). I worked sometimes with Dean Griswold while I was a lowly “trial attorney” in the Tax Division Appellate Section in the early 1970s. As I recall we referred to him among ourselves as Dean Griswold, although he could than had the more correct title of General Griswold. I can’t recall what I called him in his presence, perhaps your holiness or some other reflecting his gravitas. In any event, as a consummate tax scholar, he paid attention to a number of our cases that entered his office. He had to approve all Government appeals from lower courts to Courts of Appeals and then, of course, all Government petitions for certiorari. He was a mensch, certainly in tax. For an anecdote of his wisdom as S.G. nixing my recommendation to petition for certiorari in a mitigation case I lost in the Fifth Circuit, see p. 106.

Ch. 3. Returns and Payments.

I. The Self-Assessment System.

This chapter deals principally with the obligations that taxpayers file timely and accurate returns. This chapter deals with the voluntary payment of taxes along with the returns (or in advance through withholding or estimated taxes). I defer until a later chapter discussion of taxes that are due but not paid timely—a general subject referred to as Collections.

Our tax system is described as a “self-assessment” system. This means that the taxpayer reports the amount of the tax obligation via a tax return. The IRS must assess the tax reported on the return. § 6201(a)(1).⁴⁹² The taxes thus reported are often referred to colloquially as “self-assessed” which is probably a fair characterization since the statutory requirement that the IRS assess the amount reported is mandatory, making the IRS’s formal assessment a ministerial act.

Our tax system is also sometimes referred to as a **voluntary** assessment or **voluntary** self-assessment system. “Voluntary” is a euphemism. Judge Learned Hand famously said: “[T]axes are enforced exactions, not voluntary contributions.”⁴⁹³ I discuss in Chapter 6 a system of penalties (criminal and civil) that encourages taxpayers to file returns reporting their tax liabilities correctly and pay the amounts they owe. If the penalties did not exist, our tax system might be considered voluntary, for even if the law commanded some action (e.g., the filing of a true, correct, and complete return and payment of all tax), the absence of penalties would take the practical compulsion out of the law.

We can fairly speculate that such a real voluntary system would have a low level of compliance. In any event, the penalties do exist, so the “voluntary” description is not apt. Still, as euphemism, it’s not bad, particularly when you consider that in other countries, even those with penalties in the law, tax noncompliance is rampant and may even approach a sport for those playing the game and entertainment sometimes for bystanders. To the extent that that’s not the case in the United States, so the myth goes, it is because our citizens generally do what the law requires (motivated in significant part by a penalty system) and in other countries their citizens don’t. Still, there are the penalties, civil and criminal, to induce this “voluntary compliance,” that has been called a system of taxation by confession.⁴⁹⁴

⁴⁹² This is a “summary assessment” without any further predicate requirements (such as a notice of deficiency) than the taxpayer reporting the liability on the return. *Murray v. Commissioner*, 24 F.3d 901, 903 (7th Cir. 1994); *MEI Productions v. Commissioner*, T.C. Memo. 2020-11, at *17-18 (“Summary assessments are not subject to the deficiency procedures.” *Meyer v. Commissioner*, 97 T.C. 555, 559-560 (1991)).

⁴⁹³ *Commissioner v. Newman*, 159 F.2d 848, 851 (2d Cir. 1947).

⁴⁹⁴ *United States v. Kahriger*, 345 U.S. 22, 36 (1953) (Black, J.).

II. The Return.

A. Return Filing Requirement.

1. Returns to Report Tax Liabilities.

The filing of the return starts various legal and administrative processes that constitute a significant portion of this course. Although the IRS has general Regulation authority to require returns with “the information required by such forms or regulations” (§ 6011), the Code specifically requires the following returns that you will most frequently encounter in tax practice:

1. Income tax returns for individuals when income exceeds the exemption and standard deduction amounts. § 6012(a)(1). The general forms for individual income tax are: (i) for U.S. citizens and resident aliens, Form 1040, U.S. Individual Income Tax Return; and (ii) for nonresident aliens subject to U.S. income tax, Form 1040-NR, U.S. Nonresident Alien Income Tax Return. Less complex fact patterns may permit some variant form (such as Form 1040-EZ, Income Tax Return for Single and Joint Filers With No Dependents and Form 1040-SR, a simplified form for seniors (65 and older) that can be used for 2019 and later years).

2. Income tax returns for corporations subject to tax regardless of the amount of income. § 6012(a)(2). The form for the corporate income tax varies depending upon tax status. The C corporation return is Form 1120. The S Corporation return is Form 1120-S. Other special corporation forms may be used.

3. Income tax returns for estates having gross income in excess of \$600 or having any nonresident alien beneficiary. § 6012(a)(3) & (a)(5). The form for the estate income tax is Form 1041, U.S. Income Tax Return for Estates and Trusts.

4. Income tax returns for trusts having (1) any taxable income, (2) gross income in excess of \$600, or (3) any nonresident alien beneficiary. § 6012(a)(4) & (a)(5). The form for the trust income tax is Form 1041, U.S. Income Tax Return for Estates and Trusts.

5. Transfer tax liability returns (estate tax, gift tax and generation skipping tax) where transfers exceed certain amounts. §§ 6018⁴⁹⁵ and 6019. For estate tax returns, (i) the gross estate of U.S. citizen decedents must exceed the basic exclusion amount (currently \$10,000,000 (through 2025) with a cost of living adjustment),⁴⁹⁶ and (ii) the gross estate of nonresident aliens with

⁴⁹⁵ Linked to the estate tax return filing requirement are requirements designed to coordinate the subsequent income tax reporting for property received from an estate which, under § 1014(a), takes a basis equaling the value reported for estate tax purposes. The executor is required to file a return and notify the IRS and each beneficiary of the value of the property reported for estate tax purposes. §§ 6018(a) & 6035(a)(1). To the extent that the executor is unable to do so, persons having an interest in such property (generally beneficiaries) are required to file statements reporting the value and hence the basis. §§ 6018(b), 6035(a)(2). The Form designated for the executor to report to the IRS and beneficiaries is Form 8971, Information Regarding Beneficiaries Acquiring Property From a Decedent.

⁴⁹⁶ §§ 6018(a)(1) and 2010(c) (defining the exclusion amount).

property in the U.S. subject to tax must exceed \$60,000.⁴⁹⁷ The estate tax return is Form 706, United States Estate (and Generation-Skipping Transfer) Tax Return. The gift tax return is required for gifts in excess of the gift tax exclusion amount (currently \$15,000) unless the excess is covered by the charitable deduction or the gift spousal gift deduction.⁴⁹⁸ The gift tax return is Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return,

The foregoing are examples of the more significant tax liability return filing requirements that are encountered in tax practice. There is a plethora of other tax liability return filing requirements. In addition, as I note below, there is a plethora of information return filing requirements where no tax liability is reported.

If an individual taxpayer fails to file an income tax return, the IRS may file a substitute for return (“SFR”) for the taxpayer and/or invoke deficiency procedures to result in the taxpayer settling up with the IRS for taxes he or she may owe.⁴⁹⁹ I discuss these procedures later in the text. In addition, as noted, the IRS has civil and criminal penalties that may apply in the case of failure to file.

Certain taxpayers may elect to not show the tax due on the return otherwise properly reporting income, deductions, and credits, whereupon the IRS will compute the tax and notify the taxpayer of the tax due.⁵⁰⁰ This election is available only to certain taxpayers (e.g., conjunctive requirements of no itemization, gross income of less than \$10,000, no income other than wages, dividends and interest). As stated, qualifying taxpayers are likely to be few. By regulation, the IRS has expanded the categories of taxpayers included.⁵⁰¹ I have never seen taxpayers use this election in my practice. Since, once the other parts of the return must be completed, the tax calculation is relatively simple (taxable income taken to the tax table should do it), it seems to me not that great a relief provision for all except those taxpayers owing little, if any, tax.

2. Information Returns or Reports.

a. The Concept.

Many returns are “information returns” that report tax-relevant information but require no tax payments by the person required to file the returns.⁵⁰² The requirement for most of these returns is in §§ 6031-6060 which includes far more than 30 code sections because many are separate

⁴⁹⁷ § 6018(a).

⁴⁹⁸ § 6019, referring to §§ 2522 and 2523.

⁴⁹⁹ § 6020.

⁵⁰⁰ § 6014. When this election is properly made, the payment due date for purposes of the payment delinquency penalty is 30 days after the date of notice, made by a notice and demand for payment. § 6151(b)(1).

⁵⁰¹ § 6014(b) (authorizing expansion by regulation); Reg. § 1.6014-2(b).

⁵⁰² Section 6724(d)(1) contains a listing of the Code sections for information returns for the penalty provisions for failure to provide the returns.

sections have an alphabetical code suffix, such as 4 separate sections for §§ 6038A-D and 24 separate sections for §§ 6050A-Y. There are more than 50 information reporting forms.⁵⁰³

These information returns facilitate the return preparation process and permit the IRS to determine whether the components of income have been properly reported on the returns of the taxpayers who are supposed to report the income.⁵⁰⁴ Often the IRS makes that determination through computer matching techniques where information reported on information returns is matched against the individual income tax returns of the ultimate taxpayer. The IRS reports that its “Tax Gap studies through the years have consistently demonstrated that third-party [information] reporting significantly raises voluntary compliance.”⁵⁰⁵

One of the risks of information returns is that the information can be incorrect. In such cases, the IRS’s reliance on the information returns will be incorrect. Section 6201(d) provides that, if, in a court proceeding involving a deficiency based on an information return, a taxpayer “asserts a reasonable dispute” as to the information return reporting and the taxpayer has “fully cooperated” with the IRS, the IRS has the burden to produce “reasonable and probative information” in addition to the information return.⁵⁰⁶ This production burden “creates a legal requirement to contact third parties to verify income” where the conditions are met.⁵⁰⁷

b. Common Information Returns or Reports.

(1) Service Payments—W-2s and 1099-MISCs.

An employer must file information returns for wages and salaries paid to employees (Forms 941) and send each employee a Form W-2, and businesses making payments to independent contractors must file forms with the IRS for the payments made and send each independent contractor a Form 1099-MISC reporting the amounts paid.⁵⁰⁸ Generally, these information forms are required for businesses rather than individuals. A nonbusiness taxpayer—i.e., individual—is required to make informational filings with respect to a household employee, although this informational

⁵⁰³ TIGTA Report, The Use of Schedule K-1 Data to Address Taxpayer Noncompliance Can Be Improved 1 (Ref. No. 2019-30-07 9/27/19).

⁵⁰⁴ These information returns, if incorrect, can create significant problems for the persons identified in the form. For example, if a person files with the IRS a false Form 1099-NEC reporting independent contractor income to a third party with whom he had a grudge but no independent contractor relationship, the third party will likely not report the income and thus be subject to audit by the IRS. Section 7434(a) imposes civil liability for filing a “fraudulent information return with respect to payments purported to be made to any other person.” I discuss § 7434(a) below beginning on p. 121.

⁵⁰⁵ IRS web page titled “IRS releases new Tax Gap estimates; compliance rates remain substantially unchanged from prior study” (last reviewed or updated 9/26/19 and viewed 10/2/19).

⁵⁰⁶ See *Del Monico v. Commissioner*, T.C. Memo. 2004-92.

⁵⁰⁷ IRM 4.12.1.6 (10-05-2010), Income Probes (Nonfilers); and IRM 4.12.1.25.1 (10-05-2010), Unreported income - Information Returns; IRM 4.10.4.3.6.2 (08-09-2011), Specific Item Probes Using Information Returns Program (IRP) Cases; see also Keith Fogg, Proving a Negative – The Use of IRC 6201(d) (Procedurally Taxing Blog 1/19/17) (noting that the § 6201(d) burden should be reflected in the administrative proceedings such as audits and appeals where litigation may follow and that, if the taxpayer has a good case as to the error in the information return, the case may be a good one for a qualified offer under § 7430).

⁵⁰⁸ See e.g., §§ 6041, 6042, 6049, and 6051.

filing is accompanied by a requirement to pay Social Security taxes (but not withholding which is generally required for business taxpayers) with respect to the household employee.⁵⁰⁹

The recipient taxpayers use the information to complete their tax returns, and the IRS uses the information on the forms filed with the IRS for matching against the income the various taxpayers report on their returns.

Significant penalties apply for failure to file these information returns which are so critical to the IRS's enforcement program. I do not deal in detail with the information returns and penalties in this text. I do expect you to know generally that there are institutional preferences reflected in legislation to impose on business taxpayers an obligation to file informational returns that can be used in IRS enforcement efforts with respect to other taxpayers having some relationship to the business taxpayer upon whom the obligation is imposed. You noticed also that I said business taxpayer here, but it is not always a business taxpayer. I do also expect you to know that that many audits are generated by discrepancies between the information returns filed with the IRS and the taxpayer's tax returns or failures to file returns.

(2) Other Forms 1099.

The IRS has a series of Form 1099 information returns for payments or equivalents to make sure that potential income is in the system, thus encouraging taxpayers to report income properly

Some common examples are:

- From 1099-A, Acquisition or Abandonment of Secured Property, required for trade or businesses that lend money secured by property who takes the security in full or partial satisfaction of the debt, which may be a taxable event to the owner of the property owner.⁵¹⁰
- From 1099-C, Cancellation of Debt, required for financial and other institutions in the business of money lending to report cancellation of debt ("COD") that may be taxable income to the debtor.⁵¹¹ Since COD income may involve no movement of cash, it may escape other mechanisms to remind the taxpayer and the IRS that it is taxable.⁵¹²

⁵⁰⁹ Form 1040, Schedule H, Household Employment Taxes.

⁵¹⁰ § 6050J(a).

⁵¹¹ § 61(a)(12). See *United States v. Kirby Lumber Co.*, 284 U.S. 1 (1931).

⁵¹² § 6050P. COD income can be complex (see e.g., § 108), so the amount reported on the form is not necessarily income. See e.g., IRS website titled "Topic Number 431 - Canceled Debt – Is It Taxable or Not?" (Last reviewed or updated 2/13/18 and accessed 12/5/18). And the mere filing of the Form is not a cancellation or the creditor's agreement to cancel. Indeed, although there is some conflict, the issuance Form 1099-C and reporting of the income may constitute a release of the debt. See *FDIC v. Cashion*, 720 F.3d 169, 179 (4th Cir. 2013) ("filing a Form 1099-C is a creditor's required means of satisfying a reporting obligation to the IRS; it is not a means of accomplishing an actual discharge of debt, nor is it required only where an actual discharge has already occurred."); and *In re Reed*, 492 B.R. 261 (Bankr. E.D. Tenn. 2013).

- Form 1099-DIV, Dividends and Distributions, for corporations paying dividends or distributions.⁵¹³
- Form 1099-INT, Interest Income, for persons paying interest income, for interest payments.⁵¹⁴
- Form 1099-K, Payment Card and Third Party Network Transactions.⁵¹⁵
- Form 1099-MISC, Miscellaneous Income. This form reports many miscellaneous types of payments, including (as noted above) payments to service providers who are not employees, royalties, rents, etc.
- Form 1099-NEC, Nonemployee Compensation. This form, recently reinstated, is to report remuneration paid to persons other than employees (such as independent contractors).
- Form 1099-OID, Original Issue Discount.
- **Form 1099-S, Proceeds from Real Estate Transactions**

(3) Flow-Through Entities.

Partnerships and S Corporations generally report no tax liability but are required to file returns (Forms 1065 for partnerships and 1120-S for S Corporations) so that the components of income are reported in the aggregate and then allocated to each partner.⁵¹⁶ The entity sends to each partner a Form K-1 reporting the components of income allocated to that partner so the partner can, in turn, report the partner's share of those components on the partner's income tax return and pay any resulting tax liability.⁵¹⁷ Trusts and Estates have similar reporting requirements for beneficiaries to whom tax items are allocated.⁵¹⁸

(4) Funds Flows (CTRs, CMIRs & SARs).

There are still other return or related reporting requirements that are designed to identify income of types that might easily escape the tax system or that might evidence nontax illegal conduct. The broadest example is § 6050I which requires that persons involved in a trade or business who receive currency or monetary instruments in excess of \$10,000 in one transaction (or more than one transaction if the transactions are related) to report the receipt to the IRS. The Bank Secrecy Act imposes a parallel reporting requirement for currency or monetary instrument receipts in excess of \$10,000.⁵¹⁹ The tax and the BSA reports are jointly made on a single Form 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business, with which serves as IRS Form 8300 and

⁵¹³ § 6042.

⁵¹⁴ § 6049.

⁵¹⁵ § 6050W.

⁵¹⁶ § 6031.

⁵¹⁷ See TIGTA Report, The Use of Schedule K-1 Data to Address Taxpayer Noncompliance Can Be Improved 1-2 (Ref. No. 2019-30-07 9/27/19) (listing the entity returns and the K-1 for each sent to trust beneficiaries, partners, and shareholders).

⁵¹⁸ § 6034A.

⁵¹⁹ Bank Secrecy Act, 31 U.S.C. § 5331(a) requiring a nonfinancial institution to report (a) receipt of coins or currency in excess of \$10,000 in a single or more than one related transactions or (b) any transaction required to be reported under § 6050I(g). Basically, there is an overlap with § 6050I.

FinCEN Form 8300.⁵²⁰ FinCEN (acronym for Treasury’s Financial Crimes Enforcement Network) has delegated to the IRS authority to examine trades or business for compliance with Form 8300.⁵²¹ There is a related BSA form, FinCEN Form 112, Bank Secrecy Act Currency Transaction Report, for financial institutions to report to FinCEN deposits and withdrawals of currency in excess of \$10,000.⁵²² I refer generally to all of these forms as CTRs.

CTR reports are useful for both IRS civil audit purposes and for tax and nontax criminal enforcement. For example, in preparation for an audit or during the audit, as appropriate, the IRS revenue agent may review the CTR data.⁵²³ CTR reports are also useful in criminal tax investigations and in other criminal investigations (such as money laundering or drug dealing). For example, a drug dealer purchases an upscale Mercedes for \$150,000 cash; the dealership will report the purchase and the report may catch IRS and other law enforcement attention via data mining algorithms that relate the cash data point to other factors.⁵²⁴

There are other reporting requirements outside the Internal Revenue Code that produce information that, like the CTRs, regarding funds flow that might be useful in civil and criminal tax contexts (as well as other law enforcement contexts). Two such principal reporting requirements are:

- Report of International Transportation of Currency or Monetary Instruments (“CMIR”), made on FinCEN Form 105.⁵²⁵ The form must be filed (i) by any person transporting (on the person or by mail or other means) currency or monetary instruments exceeding \$10,000 into or outside the U.S. or (ii) by any person who receives in the U.S. currency or monetary instruments exceeding \$10,000 from any place outside the U.S.⁵²⁶

⁵²⁰ 31 U.S.C. § 1010.330(e) requires makes the § 6050I regulations requirements for the CTR application to the FinCEN CTR, hence the joint form.

⁵²¹ TIGTA report titled “The Internal Revenue Service’s Bank Secrecy Act Program Has Minimal Impact on Compliance” p. 2 (Ref. Num. 2018-30-071 9/24/18).

⁵²² 31 U.S.C. § 5313.

⁵²³ See Memo from Director SB/SE Examination-Field and Campus Policy Memo titled “Guidance for Addressing Currency Transaction Report Information” dated 8/12/19 stating the guidance “to clarify actions examiners must take to analyze and document Currency Transaction Report (CTR) data during an audit conducted under Title 26 of the United States Code. This Guidance document contains changes that will be incorporated into the IRM 4.10.4.X (MM-DD-YYYY) Currency Transaction Report (CTR) Information.

⁵²⁴ A CTR reporting a \$20,000 cash payment will likely not be investigated based on the filing alone. A filing reporting a \$1,000,000 cash payment, I suspect, likely would be investigated at some level based on the filing alone. I am just speculating on these parameters, but assuming that the speculation is reasonably good speculation, I cannot even speculate where the break point is in between these parameters. I don’t know whether, for example, an automobile dealer report of \$150,000 would itself be investigated. However, even if the information form itself does not trigger an inquiry or investigation, if the agency is looking at the person for some other reason, the agency will have easy access to these and related filings for a more complete financial road map. And, as noted, law enforcement and IRS computer algorithms may link that data point to others to trigger an investigation.

⁵²⁵ 31 U.S.C. § 5316; and 31 C.F.R. § 103.23(a).

⁵²⁶ Form 105, Instructions.

- Suspicious Activity Report (“SAR”) required for financial institutions to report for “any suspicious transaction.”⁵²⁷ SARs are made available to appropriate law enforcement agencies, including the IRS or state tax enforcement agencies. The financial institutions filing these reports are prohibited from disclosing the SARs to anyone involved in the transaction.⁵²⁸ Financial institutions are required to establish effective suspicious activity monitoring and reporting, which combined with the “know your customer” requirements offer a great deal of information via the SARs that is useful to law enforcement, including the IRS.

(5) FBARs and Foreign Asset Reports.

The Bank Secrecy Act in Title 31 requires that U.S. persons (citizens and residents) file Foreign Bank Account Reports (“FBARs”) to report their interests in foreign financial accounts. The Form for reporting is FinCEN Form 114, Report of Foreign Bank and Financial Accounts. FBARs are required for several law enforcement purposes such as money laundering, drug enforcement and tax enforcement. Since 2009, FBAR enforcement has been a major tax enforcement initiative. Because of its importance and because it does not fit neatly in a presentation of tax procedure, I devote a separate chapter to FBAR and related reporting. See Ch. 17, titled, Foreign Bank Account Reports (“FBARs”) and Related, beginning in p. 967. I do note here that, inspired by the FBARs, Congress enacted a separate but related filing requirement in § 6038 which is implemented by Form 8938 included with Form 1040. Since that requirement is related to the FBARs, I cover it also in Ch. 17.

(6) Foreign Bank Reporting (FATCA).

In 2010, after IRS and DOJ initiatives with respect to U.S. taxpayers avoiding U.S. income tax and FBAR filing obligations for foreign accounts, Congress enacted the Foreign Account Tax Compliance Act (“FATCA”) designed to impose upon foreign financial institutions a system of reporting to the IRS income from foreign financial accounts or backup withholding with respect to the income from those accounts.⁵²⁹ With respect to the reporting obligation, this is similar to the information forms required for U.S. financial institutions (e.g., Form 1099-INT). I discuss FATCA

⁵²⁷ The principal SAR reporting requirement for present purposes is under the Bank Secrecy Act, 31 U.S.C. § 5318(g). There are other SAR reporting requirements. For example, one SAR form I found for 2003, identified the following SAR reporting requirements:

Board of Governors of the Federal Reserve System: 12 U.S.C. 324, 334, 611a, 1844(b) and (c), 3105(c) (2) and 3106(a). Federal Deposit Insurance Corporation: 12 U.S.C. 93a, 1818, 1881-84, 3401-22. Office of the Comptroller of the Currency: 12 U.S.C. 93a, 1818, 1881-84, 3401-22. Office of Thrift Supervision: 12 U.S.C. 1463 and 1464. National Credit Union Administration: 12 U.S.C. 1766(a), 1786(q). Financial Crimes Enforcement Network: 31 U.S.C. 5318(g).

Even where reports are made under other statutes, the SAR may be filed with FinCEN or parallel SARs must be filed with FinCEN may be required. E.g., 12 C.F.R. § 21.11(c)(1)-(4). For purposes of readers of this text, the FinCEN SAR report is the one used for civil and criminal tax enforcement.

⁵²⁸ 31 U.S.C. § 5318(g)(2)(A). Improper disclosure is a criminal violation. 31 U.S.C. § 5322.

⁵²⁹ Subtitle A of Title V of the Hiring Incentives to Restore Employment Act is commonly referred to as FATCA. Pub. L. No. 111-147, §§ 501-541, 124 Stat. 71, 97-117 (2010).

in Chapter 17 dealing with special compliance issues for foreign accounts and assets; the FATCA discussion starts on p. 991.

(7) Other.

There are still other filing requirements in the Code dealing with special problems. The tax shelter registration requirements are a good example.⁵³⁰ I discuss the registration requirements and other facets of the tax shelter problem below (see beginning p. 848).

c. Liability for Fraudulent Information Returns (§ 7434).

Information returns, if incorrect, can create significant hassles for the persons identified in the form. For example, if a person files with the IRS a false Form 1099-NEC reporting independent contractor income to a third party with whom he had a grudge but no independent contractor relationship, the third party will likely not report the income and thus be subject to audit by the IRS. Section 7434(a) imposes civil liability if a person “willfully files a fraudulent information return with respect to payments purported to be made to any other person.” The liability is the greater of (a) \$5,000 or (b) the sum of (i) actual damages, (ii) costs of the action, and (iii) in the court’s discretion, reasonable attorneys’ fees.⁵³¹

The statute of limitations for the action is the later of 6 years from the filing of the fraudulent information return or 1 year after the date that the fraudulent information return would have been discovered by exercise of reasonable care.⁵³² And, the person filing the suit under § 7434 must contemporaneously with filing provide a copy with the IRS.⁵³³

Some issues that have arisen with respect to this liability are:

- What is the proper application of the willfully and fraudulent elements of the statute? The 11th Circuit held in 2023 that: “In sum, 26 U.S.C. § 7434 requires a plaintiff to show that (1) the defendant filed an information return on his or her behalf, (2) the return was false as to the amount paid, and (3) the defendant acted knowingly or recklessly.”⁵³⁴

⁵³⁰ See §§ 6111 and 6112.

⁵³¹ § 7434(b).

⁵³² § 7434(c).

⁵³³ § 7434(d).

⁵³⁴ *Doherty v. Turner Broadcasting Sys*, 72 F.4th 324, 329 (D.C. Cir. 2023). Note that normally, at least in criminal statutes, a fraudulent act connotes the actor seeking some monetary or property benefit to which he is not entitled. Although the Court adopted traditional definitions of fraud, it did not include the monetary or property benefit. See also the similar issue presented with respect to the defraud conspiracy which reads that fraud element as going beyond the traditional elements for fraud.

- Whether an information return properly reporting the payments but mischaracterizing whether the payee is an independent contractor or an employee is subject to the provision.⁵³⁵
- Whether § 7434 liability extends not only to the person who filed the fraudulent information form (e.g., a corporate employer or contractor) but to any person (such as a corporate officer) who causes that person to file the fraudulent information return.⁵³⁶
- Whether § 7434 applies to a fraudulent failure to file the information return.⁵³⁷

B. Certain Types of Elections Not on Returns.

1. Introduction.

The Code offers the taxpayer elections which can have a significant tax impact. Many of these are made on the return. I do not deal with those here because the return instructions will be sufficient in those cases and they involve no special procedural issues.

I do note one procedural issue with a common election. Many taxpayers—indeed most taxpayers of the type you would likely represent—claim itemized deductions. Itemized deductions are claimed by taxpayer election—effected by actually claiming them on the return.⁵³⁸ If the taxpayer does not file a return, the taxpayer may not get the benefit of itemized deductions.⁵³⁹ There is no requirement that return be timely filed nor is there any time stated for the filing of a delinquent return, so this problem may be fixed easily. There are other elections in the Code that require a return making an election within a certain time period.⁵⁴⁰

2. S Corporation Elections.

One of the most common elections other than on the return itself is the S Corporation election. The election is made on Form 2553 which must be filed before or within the first 2 ½

⁵³⁵ *Derolf v. Risinger Bros. Transfer, Inc.*, 259 F. Supp. 3d 87 (D.C. Ill. 2017) (discussing the issue, the conflict among the district courts, and holding that fraud related to the amount of payment is required, citing *Liverett v. Torres Advanced Enter. Sols. LLC*, 192 F. Supp. 3d 648 (E.D. Va. 2016) which seems to be the leading authority per Stephen Olsen, [Can Intentionally Filing an Improper Information Return Justify a Claim for Damages Under Section 7434?...Part II](#) (Procedurally Taxing Blog 9/26/17); see also Omeed Firouzi (Guest Blogger), [Can Intentionally Filing an Improper Information Return Justify a Claim for Damages Under Section 7434?](#) (Procedurally Taxing Blog 6/4/20).

⁵³⁶ *Czerw v. Lafayette Storage & Moving Corp.*, 2018 U.S. Dist. LEXIS 192353 (W.D. N.Y. 2018) (collecting cases).

⁵³⁷ § 7434(a) applies only to a person who “willfully files” the fraudulent information return, so fraudulent failure to file is not covered. *Katzman v. Essex Waterfront Owners LLC*, 660 F.3d 565 (2d Cir. 2011).

⁵³⁸ § 63(e).

⁵³⁹ See e.g., *Jahn v. Commissioner*, 2010 U.S. App. LEXIS 17525 (3d Cir. 2010) (unpublished opinion); for an extreme extension of this rule, see *United States v. Kellar*, 2010 U.S. App. LEXIS 19129 (5th Cir. 2010) (unpublished) where the sentencing court excluded itemized deductions from the sentencing tax loss calculation for the years the taxpayers did not file returns.

⁵⁴⁰ See *Swallows Holding Ltd. v. Commissioner*, 515 F.3d 162 (3d Cir. 2008) (election under § 882 required by regulation to be filed within time period; held, regulation requirement is valid).

months of the taxable year to be valid for the year.⁵⁴¹ The IRS may grant relief from the failure to timely file and, indeed, the tax publishers routinely report the granting of such relief.

3. Check-The-Box on Entity Characterization.

Under the so-called “check-the-box” election allowed by the Regulations,⁵⁴² a taxpayer which is an entity having certain corporate and noncorporate characteristics may elect to be treated as a corporation or some other appropriate entity such as a partnership or a tax nothing.⁵⁴³ An example of such an entity is a state-law Limited Liability Company (“LLC”). An LLC with two or more members may elect to be treated as either a corporation or a partnership; an LLC with only one member may elect to be treated as a corporation or a tax nothing where the results of the entity’s operations are reported directly on the single members’ tax return. The default rule requiring no formal election for domestic entities that have the hybrid characteristics is to treat them as a partnership or, if a single member entity, a tax nothing.⁵⁴⁴ So, the formal election, made on Form 8832, Entity Classification Election, is actually required only if the entity wants to be treated as a corporation. That election—whether the default rule or the formal election—determines the return filing requirements under the rules stated above.

An entity may change its classification, but if it does so it then must wait five years before changing classification again.⁵⁴⁵ Care must be taken, of course, in changing characterizations because of the collateral tax consequences. For example, if an entity is being taxed as a corporation and is eligible to elect to be treated as a partnership, the election to change will result in the entity as a corporation being liquidated with the tax consequences that attend liquidation of a corporation followed by a contribution to a partnership if the entity had two or more members. Similarly, if an entity is being taxed as a partnership or as a tax nothing, the election to be taxed as a corporation will result in a capital contribution to a deemed newly formed corporation with the tax consequences which that entails.

This election to avoid corporation status is not the same as electing S Corporation treatment. S Corporations are not treated as partnerships or tax-nothings, and there may be some significant differences in certain aspects.⁵⁴⁶

⁵⁴¹ § 1362(b)(2).

⁵⁴² Reg. § 301.7701-3. These regulations are not statutorily authorized in the sense that there is no Code or separate statute allowing the IRS to allow or honor such elections. Congress was, however, well aware of the process and, in this sense, allowed it. And, so long as the taxpayer makes the election (either actually or by inaction, thus invoking the default rules) and does not complain, the IRS will not complain either and there will be no judicial test of its authority. In *McNamee v. Dept of Treasury*, 488 F.3d 100 (2d Cir. 2007), the Court applied the *Chevron / Mead* line of authority to give the IRS broadly leeway to impose the rules of the game by regulation and declined to permit a taxpayer who elected tax nothing status for his LLC to avoid the rules.

⁵⁴³ An entity treated as a tax nothing would be reported on the individual tax return on Schedule C and would be included on a corporate return as simply a division, the results of which are in the aggregate data reported on the return.

⁵⁴⁴ Reg. § 301.7701-3(b)(1).

⁵⁴⁵ Reg. § 1.7701-3(c)(1)(iv).

⁵⁴⁶ See e.g., Reg. § 1.1361-4(a)(7), Reg. § 301.7701-2(c)(2) as amended by T.D. 9356. These Regulations
(continued...)

The Tax Court held in a reviewed decision that, although the check-the-box regulations govern the tax treatment for income tax purposes, it may not govern the tax treatment for all tax purposes.⁵⁴⁷ In that case, the issue was whether a tax-nothing LLC—a check-the-box entity owned by a single member—was to be treated as a tax-nothing for purposes of calculating the gift tax with respect to gifts of membership interests in the LLC. The Court held that the regulations did not purport to sweep that far to override the settled rule that the gift tax applies to the state law interest transferred.⁵⁴⁸ The holding drew vigorous dissents.

C. Jurat and Signature.

Section 6065 requires returns to be submitted under penalties of perjury unless provided otherwise by the IRS.⁵⁴⁹ The penalty of perjury statement, often referred to as the “jurat,” on the individual income tax return (Form 1040) is:

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and complete.

⁵⁴⁶(...continued)

treat the check-the-box entity as the employer and as a corporation (meaning limited liability) for tax purposes, except that a sole member is treated as self-employed for purposes of the SECA tax. Prior to that amendment, the applicable regulation imposed direct liability on the sole member of a check-the-box entity, but the amended regulation reversed that to make the entity only directly liable (although, of course, the sole member can be liable for the trust fund portion under the TFRP in § 6672). Because of the broad power the IRS has by regulation under *Chevron* and its progeny, courts have uniformly held that the amended regulation does not invalidate the effect of the prior regulation prior to the effective date of the amended regulation. See *McNamee v. Dept of Treasury*, 488 F.3d 100 (2d Cir. 2007); *Littriello v. United States*, 484 F.3d 372 (6th Cir. 2007) and *Medical Practice Solutions LLC v. Commissioner*, 132 T.C. 125 (2009) (holding consistent with *McNamee* and *Littriello*, rejecting argument that merely because the rule was changed by a later applicable regulation did not mean that the earlier regulation was invalid).

⁵⁴⁷ *Pierre v. Commissioner*, 133 T.C. 24 (2009).

⁵⁴⁸ I believe it is fair to say that, had the Regulations clearly stated that the check-the-box election covered the gift tax consequences, the Regulations might have been sustained under *Chevron* and its progeny.

⁵⁴⁹ See Reg. § 1.6065 -1(a). See also §§ 6011(a) and 6061(a) requiring returns pursuant to requirements in regulations. Filing in digital or electronic form is treated for all purposes, civil and criminal, as filed “in the same manner as though signed or subscribed.” § 6016(b). In *Lee v. United States*, 84 F.4th 1271, 1275 (11th Cir. 11/24/23), the Court described the process that a taxpayer and the practitioner must use for electronic filing:

Before a CPA or tax adviser files a taxpayer's return electronically, the taxpayer must complete Form 8879. By signing this form, a taxpayer declares “[u]nder penalties of perjury” that the income tax return is “to the best of [the taxpayer's] knowledge and belief . . . true, correct, and complete.” IRS Form 8879, Part II. The form authorizes the electronic return originator (ERO) — often the tax preparer — to affix the taxpayer's signature on the return and to transmit the return on the taxpayer's behalf. *Id.* IRS publications prescribe detailed procedures for e-filed returns. See IRS Pub. 1345, *Authorized IRS E-File Providers of Individual Income Tax Returns*, 19–27 (Nov. 2022). Taxpayers must sign and date Form 8879 with an approved signature method, and EROs “must originate the electronic submission of a return as soon as possible” after the taxpayer completes Form 8879. *Id.* at 22.

This jurat is from the 2021 return. In earlier years, it was differently worded, but I don't think the variations have much importance, except perhaps at the remote margins.⁵⁵⁰ The jurat has always clearly indicated that the taxpayer is submitted the information on the returns under penalties of perjury.

The purpose of the jurat is to impose upon taxpayers the seriousness of the act by providing the basis for prosecution under § 7206(1), often called tax perjury or the tax perjury statute.⁵⁵¹ I discuss the tax crimes (including tax perjury) below (beginning on p. 299). The commonly encountered tax returns -- corporate and individual income tax returns and estate and gift tax returns -- do contain a jurat.

One caveat regarding the jurat. IRS forms that do not have a jurat can still result in criminal prosecution under 18 U.S.C. § 1001, if the information in the form is false. I summarize the criminal penalties in Ch. 6 Penalties/

Most of the returns relevant to this course require also a signature of the taxpayer. § 6061(a). However, consistent with modern technology, § 6061(b) requires the IRS to “develop procedures for the acceptance of signatures in digital or other electronic form,” and also permits in the meantime for the IRS, by published guidance, to waive the signature requirement or provide alternative methods of signing or subscribing, with the alternative methods treated as if they had been signed or subscribed for civil and criminal penalty purposes.⁵⁵²

⁵⁵⁰ For example, on the 2017 1040 it was:

Under penalties of perjury, I declare that I have examined this return and accompanying schedules and statements, and to the best of my knowledge and belief, they are true, correct, and accurately list all amounts and sources of income I received during the tax year.

⁵⁵¹ The heading for the subsection is “Declaration under penalties of perjury.” The DOJ CTM states that “Section 7206(1) is referred to as the ‘tax perjury statute,’ because it makes the falsehood itself a crime.” but cautions that “Although referred to as the ‘tax perjury statute,’ Section 7206(1) prosecutions are not perjury prosecutions.” CTM 12.03 Generally; and CTM 12.09[2] Law Of Perjury Does Not Apply To Section 7206(1) Prosecutions. Thus features critical to perjury prosecutions (such as the two-witness rule) do not apply to § 7206(1) prosecutions. See also *Siravo v. United States*, 377 F.2d 469, 472 (1st Cir. 1967) (rejecting an argument as semantics that, as a perjury crime, requiring a false statement of fact rather than an omission of a critical schedule because the jurat swore that the return, signed under penalties of perjury, swore that it was “true and correct.”) Another difference between § 7206(1) and perjury is that corporations can be guilty of § 7206(1) but not perjury.

In *Siravo v. United States*, 377 F.2d 469 (1st Cir. 1967), the defendant argued that § 7206(1) was not a perjury statute, because perjury requires false affirmative statements and the omission of income is not a false affirmative statement. The Court held that the language of the jurat did cover such omissions because the jurat states that it is signed under penalty of perjury and the taxpayer attests under penalty of perjury that the return is true and correct so that omitted income was clearly within the scope of the statement made under penalty of perjury (the Court treated the word “complete” in the jurat as superfluous to “true and correct”). “Therefore, the government has made out a violation of the section, whether it be labeled a perjury statute or similar in nature,” (Pp. 762-473 (cleaned up). See also *United States v. Cohen*, 544 F. 2d 781, 783 (5th Cir. 1977) (cleaned up) (“The omission of a material fact [assets from the OIC] renders such a statement just as much not ‘true and correct’ within the meaning of § 7206(1), as the inclusion of a materially false fact,” *Siravo v. United States*, 377 F.2d 469 (1st Cir. 1967).

⁵⁵² This means that, for example, the taxpayer can be charged with tax perjury, § 7206(1).

If, for some reason a taxpayer is legally incapable of filing a return, the executor, administrator, guardian, etc. must file the return and sign subject to the jurat.⁵⁵³

Although for joint income tax returns, both spouses normally have to sign the return, sometimes one spouse will sign both spouses' signatures or even file a joint return with only one spouse's signature. If the nonsigning spouse has expressly or tacitly authorized that signing, the return may be treated as a joint return, particularly if the nonsigning spouse does not repudiate or deny actual or tacit consent.⁵⁵⁴

D. What is a Return?

1. General Requirements.

Income tax liability is reported via the income tax return—for individuals, Form 1040 or one of its iterations (e.g., 1040-EZ for simple individual returns, 1040-NR for nonresidents, etc.) and, for corporations, Form 1120 or one of its iterations (such as 1120-S for S Corporations).⁵⁵⁵ Transfer tax liabilities are reported on gift tax returns (Form 709), estate tax returns (Form 706) and generation skipping tax returns (Form 706). There are a host of other forms for particular types of tax and information reporting requirements.

A return has been described by some as a “first offer” to the IRS, which the IRS may accept by receiving the return and doing nothing (i.e., not asserting that the taxpayer’s “offer” is too little). A system of penalties that I discuss later is designed to encourage most taxpayers to make the “first offer” a “fair” offer (within certain reasonable tolerances). Congress revisits periodically the issue of whether penalties sufficiently encourage taxpayers to do right and how the penalties may be fine-tuned to do so.

In considering the role of a return, we must first know what a return is. A frequently cited test for a valid income tax return is the *Beard* test, named after the case in which it appeared (*Beard v. Commissioner*, 82 T.C. 766 (1984)):

First, there must be sufficient data to calculate [the] tax liability; second, the document must purport to be a return; third, there must be an honest and reasonable attempt to satisfy the requirements of the tax law; and fourth, the taxpayer must execute the return under penalties of perjury.⁵⁵⁶

⁵⁵³ § 6012(b).

⁵⁵⁴ See discussion of the tacit consent rule at p. 168 n. 758.

⁵⁵⁵ S Corporations which are normally flow-through entities with taxes generally paid at the shareholder level may actually have tax liability in some rare cases.

⁵⁵⁶ *Beard v. Commissioner*, 82 T.C. 766, 777 (1984), affd. 793 F.2d 139 (6th Cir. 1986).

Generally, the income tax return should be filed on the proper form,⁵⁵⁷ contain information sufficient to calculate a tax liability, and identify the taxpayer (including the taxpayer's identification number).⁵⁵⁸ A return must be signed and verified under penalties of perjury.⁵⁵⁹ The IRS is authorized to allow returns without such signatures or verifications, but the common returns (income tax returns and transfer tax returns) we cover in this course will require signature and verification.

Why must the return be filed on the proper form?

Congress has given discretion to the Commissioner to prescribe by regulation forms of returns and has made it the duty of the taxpayer to comply. It thus implements the system of self-assessment which is so largely the basis of our American scheme of income taxation. The purpose is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished.⁵⁶⁰

I have given you some general rules that assist in determining what is a return. They will work in most cases. However, it has been observed that the term return in the Code can have more than one meaning, with the meaning heavily influenced by context.⁵⁶¹ Still, although you should be

⁵⁵⁷ See Reg. § 1.6011-1(b), although granting the IRS accept statements of the relevant information on a writing which is not the form as a “tentative return” for some purposes. See *Parker v. Commissioner*, 365 F.2d 792, 780 (8th Cir. 1966) (holding that the IRS’s acceptance in prior years of such information not on the form did not preclude the IRS insistence on the required form for the year involved).

⁵⁵⁸ In *Fowler v. Commissioner*, 155 T.C. 106 (2020) (reviewed, no dissents), the Tax Court held that submission on the required form but omitting the “IP-PIN,” a special number the IRS assigns to taxpayers whose identities has been compromised, for use in addition to SSN to prevent ID fraud, did not prevent the document from being a return under the *Beard* test. Where an IP-PIN has been assigned, IRS practice is to reject the return if the IP-PIN is omitted. The Court’s held that, even though the return was rejected by the IRS, it was still a return filed with the IRS and thus started the statute of limitations.

⁵⁵⁹ §§ 6061 and 6065. An unsigned return is not a return, with the consequences for failure to file (specifically the failure to file penalty and the unlimited statute of limitations). *Vaira v. Commissioner*, 52 T.C. 986, 1005 (1969), aff’d on this issue, rev’d and remanded on other grounds, 444 F.2d 770 (3d Cir. 1971) (failure to file penalty); and *Elliott v. Commissioner*, 113 T.C. 125, 128 (1999) (statute of limitations). The Third Circuit in sustaining the failure to file penalty in *Vaira* did affirm despite the Government concession that “it has been the policy of the Commissioner not to assert the delinquency penalty where the prescribed return was timely filed and accompanied by proper payment of the tax.” However, the IRS’s indicated forbearance on asserting the penalty does not mean that the unsigned return is a return.

⁵⁶⁰ *Commissioner v. Lane-Wells Co.*, 321 US 219, 223 (1944) (the taxpayer filed a corporate income tax return rather than the personal holding company tax return it should have filed; the taxpayer argued substantial compliance, so that the corporate income tax return should be treated as the personal holding company tax return for purposes of the statute of limitations and the civil penalty; the Court held that the personal income tax return could not be treated for those purposes as the personal holding company tax return.). For an interesting application of *Lane-Wells*, see *Quezada v. IRS (In re Quezada)*, 982 F.3d 931 (5th Cir. 2020) (holding the combination of Forms 1040 and 1099 were sufficient to constitute a “filing” of the form for backup withholding (normally reported on Form 945 which the taxpayer did not file) because the filed forms contained the information necessary to compute the backup withholding. The IRS nonacquiesced in *Quezada*, stating that the IRS would not follow the decision in other Circuits. Action on Decision, 2022-01, I.R.B. 2022-6.

⁵⁶¹ In *In re Payne*, 431 F.3d 1055, 1059 (7th Cir. 2005), Judge Posner opined: “All the cases cited to us make sense and are consistent if ‘return’ can vary with context; nonsense results if ‘return’ must bear the same meaning (continued...)”

aware that the definition and application of the term can be nuanced, for most purposes and for purposes of this class we will focus on the general definition.

2. Missing Elements.

Let's explore some of the issues raised by the *Beard* summary of a return.

a. Honest and Reasonable Attempt to Satisfy.

The quintessential case where this element is lacking is in a return filed by a person described as a tax protester who fails to provide the information required by the return. (See discussion beginning on p. 846, below.) The protester knows he is required to report and pay the resulting tax, but makes frivolous claims that, under the law or the constitution, he is not required to provide the information or pay tax. The protester may, for example, simply not provide any numbers on the return or may provide all zeros (except as to the tax that was withheld or paid in installments, so that a net refund is due). This empty return is often accompanied by protester statements of claims that the protester is not required to furnish the information or pay tax. With the exception of an older 9th Circuit case, the courts routinely hold that such returns are not returns and the IRS's position is that zero returns are not returns.⁵⁶² If it is not a return, then the taxpayer, a protester in this example, can be subject to (1) the civil and criminal penalties for failure to file a required return and (2) an unlimited civil statute of limitations that applies if no return is filed.⁵⁶³ But a return that looks like a return and has information from which a—not necessarily the correct—tax liability can be derived will likely be treated as a return.⁵⁶⁴

⁵⁶¹(...continued)

everywhere.” See also *Conforte v. Commissioner*, 692 F.2d 587, 591 (9th Cir. 1982) (citing *Payne* and acknowledging “the possibility that the same word could have a different meaning in different parts of the code,” and concluding that “where, as here, a word could well have a different meaning in different statutory contexts, a purpose-oriented approach should be used when interpreting the meaning of the word as it is used in different sections of the Code.” Notwithstanding this, the form should be some type of return form recognizable as such. Other IRS forms will not be treated as returns even when they are signed by the taxpayer and show a tax liability. For example, the Form 870, Waiver of Restrictions on Assessment, can incorporate a tax liability (and will have back-up summarizing how the tax liability was derived), but, even if it is signed by the taxpayer and serves some of the functions of a return, it is not a return form and cannot be treated as a return. *Mohamed v. Commissioner*, T.C. Memo. 2013-255.

⁵⁶² *Cabirac v. Commissioner*, 120 T.C. 163 (2003); ILM 200651015 (11/14/06). The contrary authority is *United States v. Long*, 618 F.2d 74 (9th Cir. 1980).

⁵⁶³ See *United States v. Marston*, 517 F.3d 996 (8th Cir. 2008) (holding that a defendant who files a form that does not rise to the level of a return can be convicted of failure to file a return, citing *United States v. Grabinski*, 727 F.2d 681, 686 (8th Cir. 1984). I discuss penalties and statutes of limitations below.

⁵⁶⁴ See *Sakkis v. Commissioner*, T.C. Memo. 2010-256, at *20-*21, where the Judge Holmes reasoned: Although the Sakkises used a frivolous legal claim to reduce their tax liability to zero, the rest of their return * * * contained complete and accurate information from which the Commissioner could determine their tax liability. With the exception of the frivolous deduction itself and the disappearance of the self-employment tax and alternative minimum tax, the Sakkises made an honest and reasonable attempt to comply with the tax laws. And while the use of that deduction may indicate negligence, it does not nullify their entire tax return. We therefore find that the Sakkises filed a valid 2000 return. In CCA 201640016 (6/7/16), the IRS cited *Sakkis* for the proposition that “rarely, if ever, has a court found a purported return to be invalid solely for failure to satisfy the third prong of the *Beard* test”; in that case, the IRS advised that, from
(continued...)

What if the return is fraudulent? The fraudulent return does not represent “an honest and reasonable attempt to satisfy the requirements of the tax law.” Can a taxpayer facing a tax evasion charge or a civil fraud penalty on the basis of an allegedly fraudulent return (e.g., omitting large amounts of income or claiming false deductions) allege that he or she never made an honest or reasonable attempt to satisfy the law so that what he or she filed was not a return and cannot support a tax evasion or tax perjury charge for filing a false return?⁵⁶⁵

The conventional wisdom is that the return does not have to indicate the correct tax liability or the components (income and deductions) necessary to derive the correct tax liability. For example, if an item of income is omitted from a return that otherwise sets forth information (including other income, deductions, and taxable income so that the return is not facially irregular), the document filed is a return. Civil and criminal penalties may apply to the understatement of tax on the return or the presentation of false information on the return.⁵⁶⁶ For example, if the document meets the minimum requirements of a return, the taxpayer could face possible tax evasion or tax perjury felony charges for deliberate omissions from or misstatements on the return,⁵⁶⁷ whereas if the document does not meet the minimum requirements for a return, the taxpayer would only face a failure to file misdemeanor charge.⁵⁶⁸ Similarly, a fraudulent return is not a nullity so as to avoid the application of the civil fraud penalty or the unlimited statute of limitation for fraud.⁵⁶⁹ In a sense, the return simply has to appear regular on its face and have sufficient components to be processable by the IRS as a return.⁵⁷⁰

⁵⁶⁴(...continued)

a precaution in case the returns were invalid for this reason, a § 6651(f) fraudulent failure to file (“FFTF”) penalty, should be asserted in addition to the civil fraud penalty applying only to returns recognized as valid under *Beard*. Or, as Professor Bryan Camp says, “a frivolous return is still a return.” Bryan Camp (Guest Blogger), Lesson From The Tax Court: The Functional Definition Of 'Return' (Tax Prof Blog 9/23/19).

⁵⁶⁵ Tax crimes purists will see a technical problem in this question. Tax evasion is usually committed by filing a fraudulent return. A return, however, is not required for tax evasion; the conduct criminalized is an attempt “in any manner to evade or defeat any tax.” So, filing a fraudulent return even if the conduct rendered the document not a return would not be a defense to tax evasion. So. I am painting in imprecise strokes in the text. Perhaps a better example would be a tax perjury charge under § 7206(1).

⁵⁶⁶ See *Badaracco, et al. v. Commissioner*, 464 U.S. 386, 396-397 (1984) (which I discuss at p. 143), noting that the return is still a return even if fraudulent, thus invoking the civil and criminal consequences of returns even if a nonfraudulent amended return is thereafter filed. See also *Gaskin v. Commissioner*, T.C. Memo. 2018-89.

⁵⁶⁷ §§ 7201 and 7206(1). Judge Posner, getting to the point as usual, pungently noted (*In re Payne*, 431 F.3d 1055, 1058 (7th Cir. 2005)):

In Case B, the taxpayer mails to the right address a return that appears to comply fully with the requirements for a return but in it he claims a blind and dependent exemption for his pet cat, whom he describes as his mother. This is deemed a return if he is prosecuted for fraud, even though it is again not an honest and reasonable attempt to satisfy his obligations. It is a return because the submission of it is conduct that Congress intended to punish in prohibiting fraudulent tax returns.

⁵⁶⁸ § 7203.

⁵⁶⁹ *Badaracco, et al. v. Commissioner*, 464 U.S. 386, 396-397 (1984).

⁵⁷⁰ As with all such statements, there are exceptions driven by unusual circumstances. See e.g., *Kiselis v. United States*, 2017 U.S. Claims LEXIS 226 (2017) (treating a delinquent return that appears to have been regular on its face and claiming a tax refund despite the omission of significant income that the IRS knew about as not being a return for purposes of constituting a valid claim for refund).

b. Missing Required Schedules.

A return is still a return even if it is missing schedules that are otherwise required. Thus, for example, if the individual taxpayer had significant capital gains during the year, Schedule D is required. If he files his Form 1040 without the Schedule D, it is still a return. Why is that? Because it purports to be a return and is not so irregular on its face (in contrast to a protester facially deficient return) that it should not be a return. The requirement that it be a return is not a requirement that it be a correct return.

c. Disclaimer or Altered Jurat Returns.

If any key element is not present, has the taxpayer filed a return? Let's deal first with a straightforward case -- i.e., the taxpayer attempts to disclaim the return although the return might appear otherwise regular. (This is one form of protester action, but in this form the taxpayer will often set forth numbers that, at one level, make the return appear regular on its face except for an altered jurat.) Please read *Williams v. Commissioner*, 114 T.C. 136 (2000).⁵⁷¹ What are the consequences of a failure to file a return as set out in *Williams*?

d. Fifth Amendment—Omitting Information.

One of the issues that you may face as a practitioner is how to deal with a person who has income from an illegal source or from a legal source that, if disclosed, could lead to conviction of a crime that must be reported on the return. For example, if the taxpayer is an independent illegal drug dealer, he must report the income on the return on Schedule C. The taxpayer has no right to refuse to file a return or, if he files a return, fail to report the income. The problem for the taxpayer in this situation is not the filing of the return or not reporting the income. Rather, the problem is the requirement on the return (here Schedule C) that he or she report the income producing activity. Similarly, a taxpayer may have legal source income from an otherwise secret foreign bank account that he has not previously reported such that the current disclosure might lead to incrimination for tax or FBAR crimes. These examples raise inherent tensions with the Fifth Amendment's privilege not to incriminate oneself.

The parameters of the law in this area are set by Supreme Court cases dealing with the federal wagering tax. In *Marchetti v. United States*, 390 U.S. 39 (1968) and *Grosso v. United States*, 390 U.S. 62 (1968), the Supreme Court found that the pervasive governmental regulation of gambling activities—most states made it illegal to gamble—implicated the Fifth Amendment privilege with respect to the federal requirement that the person engaged in that activity file a special wagering tax return. The mere filing of a federal wagering tax return admitted activity that, at least

⁵⁷¹ See also Rev. Rul. 2005-18, 2005-1 C.B. 798. In *United States v. Davis*, 603 F.3d 303 (5th Cir. 2010), a criminal case, where the taxpayer “added the phrase ‘without prejudice’ near his signature on the jurats.” The preparer who was also convicted of aiding and assisting in the preparation of false returns claimed that the addition prevented the 1040 from being a return and hence from supporting the conviction. The Court that the added language did not defeat return status, giving the IRS considerable leeway as to characterization where the language is ambivalent. (The Court also noted in a footnote that, in any event, even if the Form 1040s were not returns, they were still false documents submitted to the IRS, thus invoking the aiding and assisting criminal statute.)

then, most states declared to be illegal. Moreover, even filing a Fifth Amendment wagering tax return identifying the taxpayer but otherwise claiming the Fifth Amendment effectively admits such conduct. The Court's holdings applied only to wagering tax returns which were required only for the inherently suspect activity of wagering.

The *Grosso* and *Marchetti* holdings do not mean that persons engaged in such activity need not file income tax returns or can leave otherwise required schedules off the income tax return. Unlike wagering tax returns, income tax returns do not require the reporting of only suspect categories of income. Rather, income tax returns require reporting of all income from whatever source derived, and in by far the overwhelming number of cases the income is legal source income under federal and state laws. In an income tax return, the taxpayer's choice generally is to report the income and, if the return asks for information that would be incriminating (e.g., the source from which the income arose), to assert a privilege as to the incriminating information (e.g., assert the privilege as to the source only, but not the amount).⁵⁷² In *Garner v. United States*, 424 U.S. 648 (1976), the Supreme Court held that a taxpayer who reports his illegal activity (there wagering) on the income tax return without asserting a privilege not to disclose, has waived his Fifth Amendment privilege and that admission can be used against him in a criminal trial.

In our drug dealing example, the source of the income is the problem. Schedule C does request information as to the business activity giving rise to the income. Of course, the business activity is relevant to the IRS's need to confirm the accuracy of the income reported on the Schedule C. The taxpayer may provide a false business activity, which would be a crime (tax perjury, at least). The taxpayer may provide no answer for the business activity, and thus at least not commit tax perjury but may invite inquiry from the IRS. The taxpayer may assert the Fifth Amendment privilege to refuse to provide the information as to the business activity, thus waving a red flag in the IRS's face. In all three of these alternatives, the answer or non-answer to the business activity question would not affect whether a return was filed, with the attendant consequences of filing a return.

We see a variation of this concern in the *Gertner* case, discussed beginning p. 431). The lawyer filed a Form 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business, to report cash payments in excess of \$10,000 but failed to identify the individual paying the cash in excess of \$10,000 (on asserted Fifth Amendment privilege grounds).⁵⁷³ The IRS takes the position in such a case that the return filer has not filed a return and can be subject to the penalties for failure to file the return (which in the case of the Form 8300 are substantial, as I discuss below). The Courts generally sustain the IRS position. So, filing a return otherwise true, complete, and correct but not identifying the taxpayer is not the filing of a return.

Focusing on the offshore bank account problem, can the taxpayer file a return in which he assert the Fifth Amendment privilege to (i) avoid disclosing the foreign bank(s) paying the interest and the amount(s) of the interest and (ii) avoid answering the Schedule B question about foreign

⁵⁷² *United States v. Sullivan*, 274 U.S. 259 (1927).

⁵⁷³ In its current iteration, the Form is a join IRS and FinCEN form.

bank accounts.⁵⁷⁴ The authority is scarce, but the theory would suggest that, if the information is potentially incriminating, the taxpayer can assert the Fifth Amendment.⁵⁷⁵

3. Consequences of A Filing Not Treated as a Return.

If whatever the taxpayer signed or filed is not treated as a return under the foregoing rules, it will be treated as if the taxpayer did not file the required return. There are penalties and other consequences for failure to file a return, as we discuss later in this text. But, if the document is not a return, the penalties and other consequences for an incomplete or inaccurate return do not apply.⁵⁷⁶

E. Return Information to Address Noncompliance.

1. General.

Returns require information other than the basic components of tax liability. This is particularly true with respect to income tax returns because of the complexity of the Code and taxpayers' willingness to avoid and evade their tax obligations even when that tax duty is known. Given the nature of this text as an introduction to tax procedure, I cannot deal with all instances of the information required on returns, but I will give several examples that have been prominent in tax administration.

⁵⁷⁴ The same question would arise with respect to filing the related FBAR and asserting the information required for the foreign bank account(s).

⁵⁷⁵ In *Youssefzadeh v. Commissioner* (T.C. No. 13868-14L), unpublished order dated 11/6/15, Judge Holmes held that the taxpayer so asserting the Fifth Amendment to avoid disclosing the foreign bank and answering the foreign bank question could avoid the frivolous return penalty under § 6702 for doing so. (The taxpayer in the case apparently disclosed the amount of the income related to the account.) The reasoning was simply that failing to report the account on the FBAR was a crime and hence failing to disclose information about the bank when no FBAR had been filed would be incriminating. In the context of the holding, Judge Holmes reasoned that failure to supply information by asserting a Fifth Amendment privilege did not make the submission fail the test of a return. The facts are cryptic, but I would think that the assertion of the privilege would have to be based on past year failures to file the FBAR rather than a current year because the tax return was "timely filed" which meant that it was filed before the current year FBAR was even due. Perhaps this fuzziness in the Order was why it was not elevated to a T.C.M. or even a T.C. opinion.

Note that a related question of whether the IRS can assert what has been called continuation penalties where the taxpayer may be subject to a penalty for failure to supply information and then subject to further penalties upon notice requesting the information. For example, § 6038(b)(2) provides such continuation penalties for certain foreign corporations). Can the taxpayer avoid the continuation penalties by supplying the form required but asserting where appropriate the Fifth Amendment privilege? I would think so. See Frank Agostino and Valerie Vlasenko, Fifth Amendment Privilege in Tax: How to Keep the Case Moving While Protecting the Taxpayer (Agostino & Associates Monthly Journal of Tax Controversy December 2010).

⁵⁷⁶ In an interesting case, *Mohamed v. Commissioner*, T.C. Memo. 2013-255, the IRS received a document in the form of a return that had not been properly executed by the taxpayer. The IRS processed it as a return and asserted the § 6663 civil fraud penalty which is applicable only to returns. After trial in the case, sensing that the Tax Court would hold that the document in question was not a return, the IRS asserted that the taxpayer was liable for the § 6651(a) and (f) failure to file penalty, which under (f) increases the penalty from a maximum of 25% to 75% if the failure to file is a fraudulent failure to file. Based on earlier Tax Court authority indicating that the issues were the same for either penalty and hence the taxpayer was not prejudiced by the late assertion of the alternative penalty, the Tax Court considered the penalty but held that the IRS had not established fraud.

Obviously, the general goal of requiring information on the return is to undergird the tax system and assist in its implementation, so logically the information has to be in some way material to tax administration.⁵⁷⁷ Accordingly, the examples I deal with address areas in which the return reporting requirement is designed to address particular areas in which noncompliance is a significant tax administration problem.

2. Information for Special Compliance Initiatives.

a. Offshore Compliance Information.

(1) The General Compliance Problem.

The United States has a worldwide tax system requiring that, generally, its citizens and alien residents report and pay tax on worldwide income.⁵⁷⁸ In some cases, income earned by offshore entities owned by U.S. entities is not taxed in the United States until “repatriated” (generally meaning brought into the U.S.), but in some cases for significant owners of offshore entities investment type of income is taxed immediately whether or not repatriated. The rules are complex.

Income arising outside the United States and income shifted outside the United States is often very difficult for the IRS to detect and thus offers opportunities for significant tax noncompliance. Accordingly, Congress enacted and the IRS has implemented certain return reporting requirements designed to identify and encourage compliance with this worldwide income reporting scheme.

(2) Foreign Entity/Transaction Reporting.

The Code has long had significant reporting requirements for taxpayers to report ownership in foreign entities. Consider four significant examples:

Section 6038, the implementing regulations and Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations, filed annually require U.S. persons meeting certain ownership level requirements as to a foreign corporation to report to the United States certain

⁵⁷⁷ This issue is particularly important for the tax perjury crime, § 7206(1), which requires materiality for the IRS’ purpose to request the information. The courts have applied two tests, only one of which seems satisfactory. The more satisfying test is the so-called *DiVarco* test basing the materiality determination upon whether the false item has a natural tendency to influence or impede the IRS in determining and auditing the taxpayer’s liability. *United States v. DiVarco*, 343 F. Supp. 101, 103 (N.D. Ill. 1972), aff’d, 484 F.2d 670 (7th Cir. 1973), cert. denied, 415 U.S. 916 (1974); see also *United States v. Pirro*, 212 F.3d 86 (2d Cir. 2000), quoting *United States v. Peters*, 153 F.3d 445, 461 (7th Cir. 1998) (citations omitted), cert. denied, 525 U.S. 1070 (1999).

⁵⁷⁸ Sometimes this system is referred to as citizenship-based taxation (“CBT”). For this purpose, at least in our system, alien residents in the U.S. are taxed the same as citizens. The alternative model to CBT is residence-based taxation (“RBT”) where taxation is solely based on residence and not citizenship. In the RBT model, citizen of country X residing in country Y would be taxed only by country Y.

key information about the income and assets of the foreign corporation. Similar reporting requirements exist for partners or beneficiaries in foreign partnerships and foreign trusts.⁵⁷⁹

Section 6038A and the implementing regulations and Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Under §§ 6038A and 6038C of the Internal Revenue Code), filed annually U.S. corporations 25% owned by foreign shareholders to report and maintain records with respect to transactions between the U.S. corporation and the foreign related party.⁵⁸⁰

Section 6038B, the implementing regulations and Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation, and Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships, require reporting of certain transfers to foreign corporations and to foreign partnerships, respectively.

Section 6038C, the implementing regulations and Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business, filed annually requires information parallel to § 6038A for foreign corporations doing business in the U.S.⁵⁸¹

Significant potential penalties are imposed for noncompliance, and in some cases an extended statute of limitations.⁵⁸²

⁵⁷⁹ Sections 6046A and 6048. For certain exemptions or relief from the related § 6677 penalty for § 6048 for tax favored foreign trusts, see Rev. Proc. 2020-17, 2020-12 I.R.B.

⁵⁸⁰ The Form 5472 is titled “Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Under Sections 6038A and 6038C of the Internal Revenue Code), so the form does double duty with § 6038C discussed in the text below. Section 6038A(e) provides enforcement mechanisms through the U.S. corporation obtaining agent authority from the foreign related person and authority to issue a summons to a U.S. corporation, whether designated agent or not, for the records or testimony, with noncompliance with the summons being that the IRS can determine the amounts of deductions and costs in related party transactions in the IRS’s “sole discretion” from information otherwise known to the IRS.

⁵⁸¹ The form does double duty with § 6038A discussed in the text above.

⁵⁸² Examples of such penalties are: For failure to file Forms 5471, § 6038(b) and (c) impose a penalty of \$10,000 for each accounting period and a 10% reduction in foreign tax credit. See the statute of limitations chapter. For failure to file Forms 5472 and maintain the required information, § 6038A(d) provides a \$25,000 penalty, with additional \$25,000 for each 30-day period of noncompliance after notification by the IRS. For understatements attributable to undisclosed assets described to include “any asset with respect to which information was required to be provided under section 6038, 6038B, 6038D, 6046A, or 6048 for such taxable year but was not provided by the taxpayer as required under the provisions of those Sections,” §§ 6662(b)(7) and 6662(j) increases the normal 20% accuracy related penalty to 40%. For failure to furnish the information required by § 6038B for transfers to foreign corporations and partnerships, § 6038B(c) imposes a penalty is 10% of the value of the property or tax on the inherent gain in the property as if it had been sold, subject to a reasonable cause exception.

(3) Foreign Financial Assets Form 8938.

Bank Secrecy Act⁵⁸³ information forms like the FBAR are generally just information forms submitted to Treasury separately from any tax form. Congress sometimes requires information forms (such as Form 5471) be attached to tax returns. Because of major income tax underreporting with respect to foreign assets (particularly bank accounts), in 2010. Congress passed § 6038D requiring an income tax form information report for certain offshore financial assets, effective for the tax year 2011. The report on Form 8938, Statement of Specified Foreign Financial Assets, parallels the type of information included in the FBAR. Individual taxpayers and certain domestic entities with an interest in a “specified foreign financial asset” during the taxable year must attach the Form 8938 to their income tax return for any year in which the aggregate value of all such assets is greater than \$50,000 (or such higher dollar amount prescribed by the IRS).⁵⁸⁴ Since this new reporting requirement is an income tax specific analog to the FBAR reports, I discuss this Form 8938 requirement in more detail below in Chapter 16 on FBARs (beginning on p. 989), and discuss the IRS fine-tuning of the dollar threshold amounts required in specific circumstances to require the Form 8938 be filed with the return (generally, for many types of returns the threshold is higher). At this point suffice it to say, that the requirement for income tax reporting of the assets is specifically directed to a perceived compliance issue with respect to specified foreign financial assets.

b. Uncertain Tax Positions (“UTP”).

The Code is complex. This often means that tax return reporting positions are not certain. The Code’s requirements in terms of certainty may be conceptualized as a spectrum—at one end are positions that are certain to prevail and at the other are positions that are certain to fail. The tax penalty system which I discuss in detail later is designed to encourage compliance and punish, where appropriate, noncompliance. The penalty system has used this spectrum to determine when penalties are appropriate. In discussing the penalty system below, I discuss certain tax concepts such as “frivolous,” “reasonable basis,” “substantial authority,” and “more likely than not” that help locate the position on the spectrum for penalty purposes. I defer further discussion to the penalties chapter but suffice it to say now that financial accounting has developed the related concept of the uncertain tax position that is required to be reported for financial accounting purposes.

Financial accounting, particularly for public companies, seeks to measure income from period to period and produce fair balance sheets for points during the period or periods measured (usually at the beginning and end). To properly measure income and balance sheets, potential liability for aggressive positions that may end up costing the company need to be measured and

⁵⁸³ The Financial Recordkeeping and Reporting of Currency and Foreign Transactions Act of 1970 (31 U.S.C. 5311 et seq.)

⁵⁸⁴ § 6038D(a) & (f) (the latter authorizing regulations to apply the provision “to any domestic entity which is formed or availed of for purposes of holding, directly or indirectly, specified foreign financial assets, in the same manner as if such entity were an individual.”); see also Reg. § 1.6038D-6(b) & (c)). For purposes of the penalty (discussed in the text below), there is a presumption that the \$50,000 threshold is met if the IRS determines that the taxpayer has one or more specific foreign financial assets and does not supply adequate information to determine that the aggregate value of all such assets is below the threshold. § 6038D(e). The Form is due for tax years after 2010.

appropriate reserves created.⁵⁸⁵ There are auditing standards for reporting financial positions for uncertain tax positions. These positions are incorporated mostly in ASC 740-10 (previously known “Fin 48,” and still commonly referred to as Fin 48). At the risk of oversimplifying, assume that a corporation takes a deduction of \$100 and thereby reports \$21 less tax than it otherwise would have. (Note the tax savings is arbitrary to illustrate the concept.) ASC 740-10 demands that the corporation quantify the risk that the \$21 tax it “saved” will not be realized ultimately and reserve for the tax benefit if the risk is above a certain threshold. Tax benefits that are not more likely than not to be sustained if challenged will not achieve a financial statement benefit because the tax expense must be reported on the P&L statement and reflected in a reserve liability on the balance sheet. Tax benefits which are more likely than not to be sustained if challenged may achieve a financial benefit, but the quantum thereof is based upon the level of likelihood in excess of 50%. Obviously, this quantification process must be reflected in the corporation’s and the auditors’ records (often called tax accrual workpapers) and can be the mother lode to the IRS for aggressive tax positions that otherwise might be difficult to detect.⁵⁸⁶

The UTP concept was announced in January 2010⁵⁸⁷ and has been refined through notice and public comment.⁵⁸⁸ The following are the corporations required to file and a brief definition of the UTP positions:

A corporation must file if (**conjunctive requirements**).⁵⁸⁹

1. The corporation files Form 1120, U.S. Corporation Income Tax Return, and certain other types of Forms 1120 (such as foreign corporation Form 1120-F or life insurance corporation Form 1120-L);
2. The corporation has assets that equal or exceed \$10 million;⁵⁹⁰
3. The corporation or a related party issued audited financial statements reporting all or a portion of the corporation’s operations for all or a portion of the corporation’s tax year; and

⁵⁸⁵ In broad strokes, creating reserves will lower income for the period the reserve is created and will reduce net equity for the year or years that that reserve appears as a liability on the balance sheet.

⁵⁸⁶ This is a high-level summary of the process. For a detailed discussion of how one public company implements the process, see *Wells Fargo & Company v. United States*, 2013 U.S. Dist. LEXIS 79814 (D. Minn. 2013). Based on its review of the process and in the facts of the case, the court held that the taxpayer’s initial identification of uncertain tax positions requiring the FIN 48 analysis was not done in anticipation of litigation, but the analysis itself—consisting of recognition and measurement, was done in anticipation of litigation for which the work product privilege applied.

⁵⁸⁷ IRS Announcement 2010-9; 2010-7 I.R.B. 1.

⁵⁸⁸ See generally IRS web page titled “Uncertain Tax Positions - Schedule UTP” (Last Reviewed or Updated 12/6/21, as viewed 7/20/22). The web page has key links for related documents including Forms and Instructions, IRS Pronouncements, IRS and LB&I Guidance Memorandums, and Public Statements and Comments by IRS Executives.

⁵⁸⁹ Schedule UTP Instructions revised December 2022. All of the requirements are drawn from the Instructions.

⁵⁹⁰ The asset threshold in 2010 and 2011 was \$100 million and was scaled down thereafter, reaching \$10 million in 2014.

4. The corporation has one or more tax positions that must be reported on Schedule UTP.

Uncertain tax positions are tax positions reported on the return which meets two conditions:⁵⁹¹

1. The corporation has taken a tax position on its U.S. federal income tax return for the current tax year or for a prior tax year.
2. Either the corporation or a related party has recorded a liability for unrecognized tax benefits with respect to that tax position for U.S. federal income tax in audited financial statements, or the corporation or related party recognized the tax benefit for that tax position because the corporation expects to litigate the position.

Among other items reported on the Schedule UTP are:⁵⁹²

- positions contrary to (i) regulations, (ii) to subregulatory guidance, called rules (such as a Revenue Ruling) and referred to as “authoritative sources,” or court decisions, in each case identifying the regulation, subregulatory guidance or court decision, which, if disclosed, will obviate reporting categories (i) or (ii) on Forms 8275 or 8275-R to avoid certain accuracy related penalties;
- positions that create timing or temporary differences or permanent differences.
- positions that are Major (defined as 10% or more of all reported items);
- whether the positions are (i) transfer pricing or (ii) other, with a rankings in those categories and expectation to litigate;
- location of the tax position on the return; and
- A concise description of the UTPs.

I will not address the Schedule UTP in more detail except to generalize that the goal is to have the taxpayer self-report its uncertain tax positions and, without stating where on the spectrum the taxpayer thinks any particular position lies. I will return in this text to this issue when discussing the IRS use of its information gathering powers—particularly the IDR and IRS summons—to obtain this type of information.⁵⁹³

⁵⁹¹ Schedule UTP Instructions revised December 2022.

⁵⁹² Schedule UTP Instructions revised December 2022.

⁵⁹³ Id.

c. Disclosure of Aggressive Position.

Some of the potential penalties that apply for improper return reporting may be avoided by making disclosures on the return.⁵⁹⁴ From the IRS's perspective, the purpose of the return disclosure forms and provisions is to encourage the taxpayer to disclose aggressive positions so that the IRS may take such action upon audit as may be appropriate. And, of course, a spin-off benefit to the IRS is that some taxpayers might not take the aggressive position at all if they are unwilling to take the position without disclosing it.

Making the decision to disclose and how to disclose -- balancing the need for penalty protection against showing one's hand and inviting IRS scrutiny of the position -- is an art form and requires considerable judgment and objectivity.

The Regulations provide that the disclosure forms for income taxes are Form 8275, Disclosure Statement for disclosures of positions that are not contrary to Regulations, or Form 8275-R, Regulation Disclosure Statement for positions that are contrary to Regulations.⁵⁹⁵ Some practitioners forego these forms and “disclose” on a separate sheet or sheets attached to the return and sometimes even in empty space on another return form such as Schedule C or Schedule D. They often do this because they think the non-form disclosure lowers the audit profile for the disclosure. The more pertinent question, of course, is whether such a non-form disclosure is adequate to achieve the goal of making a disclosure in the first place. I think there is risk in making disclosures that do not meet the Regulations mandate of the proper Form but am aware of no case authority on the subject to date.

Chief Counsel has opined that filing Form 8886, Reportable Transaction Disclosure Statement, if complete, will obviate the need for providing the information on Forms 8275 or 8275-R.⁵⁹⁶

F. How is the Return Actually Filed?

1. Introduction.

Filing means delivery to the IRS location designated either in the form's instructions or the Regulations for filing.⁵⁹⁷

⁵⁹⁴ Form 8275 may generally be used to report such positions. Form 8275-R is used to report positions contrary to IRS Regulations. As noted in the text above, the IRS has launched a new initiative to require reporting of “uncertain tax positions” on Schedule UTP. Proper disclosures on this Schedule UTP will be treated as having filed the Form 8275 or Form 8275-R, as appropriate.

⁵⁹⁵ Reg. § 1.6662-3(c)(2).

⁵⁹⁶ CCA 202244010 (Oct. 3, 2022).

⁵⁹⁷ § 6091(a), generally giving the IRS authority to designate by regulations; Reg. § 1.6091-2 (c) (“whenever instructions applicable to income tax returns provide that the returns be filed with a service center, the returns must be so filed in accordance with the instructions.”); Reg. 1.6091-2(a)(1) (when not provided by instructions, taxpayers may “file with any person assigned the responsibility to receive returns at the local Internal Revenue Service office that serves the legal residence or principal place of business of the person required to make the return”); and *Hotel Equities* (continued...)

The conventional holding was that delivery to the IRS at any other location is not a filing, until the return is forwarded to **and received** by the proper place for filing. Receipt at the proper office to constitute a filing is most important for determining when a statute of limitations commences. This issue comes up when the taxpayer delivers a return to an IRS office which is not the designated office to file a return. In the normal course, a delivery to the wrong office will result in the return being forwarded to the proper office and the return filing date is when the return is received by the proper office.⁵⁹⁸ That makes sense, so that by delivering to the wrong office the taxpayer takes some risk that it will not be forwarded to the proper office and thus may not constitute a filing to start the statute of limitations.

A particular instance of a potential glitch in this system is where, during an audit or collection activity, the IRS agent or revenue officer asks the taxpayer for a copy of the original return the taxpayer claims to have filed or even, believing no return was filed, asks the taxpayer to deliver (perhaps file) a delinquent original return to the revenue agent or revenue officer. This may occur, for example, if the IRS has no record of receiving the return. The question is whether the revenue agent's or revenue officer's receipt of either an original delinquent return or a copy of the return the taxpayer claims to have previously filed constitutes a filing to start the assessment statute of limitations. Obviously, if the taxpayer sends a signed copy of a return the taxpayer claims to have filed previously, the taxpayer has not evidenced an intent that the copy sent to the revenue agent or revenue officer is itself a filing of the return.⁵⁹⁹ What then happens if the agent just includes the copy in the agent's file for the audit without forwarding to the service center for filing? Recently, in the context of a partnership return, the Ninth Circuit held that receipt by the examining agent is not a filing that starts the statute of limitations.⁶⁰⁰

There are many issues with the Ninth Circuit holding, but the holding does not address the issue of whether the partnership intended or the revenue agent understood that the putative copy was a delinquent return filing.⁶⁰¹

And, of course, the issue is a bit different if the revenue agent or revenue officer requests a delinquent return and the taxpayer delivers a return without any indication that it had been previously filed. Then the above quote from the Ninth Circuit and its holding might indicate that the delivery to the revenue agent or revenue officer was a filing, but there is contrary authority.⁶⁰²

⁵⁹⁷(...continued)

Corp. v. Commissioner, 65 T.C. 528, 531 (1975), *aff'd*, 546 F.2d 725, 727 (7th Cir. 1976).

⁵⁹⁸ E.g., *Winnett v. Commissioner*, 96 T.C. 802, 807-808 (1991) (return filed with the wrong service center and forwarded by IRS to correct service center is filed when delivered to and received by the correct service center).

⁵⁹⁹ In *Seaview Trading, LLC v. Commissioner*, 62 F.4th 1131 (9th Cir. 2023) (en banc), the Ninth Circuit held that a supposed copy of an original return that had never been filed sent to the auditing agent was not a return to start the statute of limitations.

This also raises a nuance with respect to the *Beard* issue (p. 126) for what constitutes a return. If whatever is sent to the agent or officer is not a return to start with, then it would not start the running of the statute of limitations.

⁶⁰⁰ *Seaview Trading, LLC v. Commissioner*, 62 F.4th 1131 (9th Cir. 2023)

⁶⁰¹ The "copy" sent to the agent was with a CMRRR that purported to show a timely mailing that would have been a timely filing under § 7502. See [9th Circuit Holds That Copy of Unfiled Return Delivered to Examining Agent is Filing of Return for Statute of Limitations Purposes](#) at ¶3 (Federal Tax Procedure Blog 5/12/22).

⁶⁰² See e.g., *Allnutt v. Commissioner*, 523 F.3d 406 (4th Cir. 2008), where the taxpayer delivered the
(continued...)

As I note below (beginning on p. 150), there is an important provision, § 7502 (commonly known as timely mailing, timely filing) that allows deposit into the USPS or certain commercial delivery services to be treated as the date of the filing and sometimes the fact of the filing even if the IRS does not receive the document.

2. Hard Copy Filing.

Returns may be filed physically through use of the mail or other courier service or by hand delivery to an appropriate local office based on residence or principal place of business or to the Service Center of the IRS covering that area.⁶⁰³ I discuss below special rules that apply when returns are filed by U.S. mail or by authorized courier service. These rules referred to as timely-mailing, timely filing, deem the return filed on the date deposited with the mail or courier service. Returns filed by hand delivery are to be delivered to the proper office designated for receipt and initial processing of the return.⁶⁰⁴

One of the problems that a practitioner will face is that sometimes an IRS revenue agent or revenue officer may request that the taxpayer file the original delinquent return with that person rather than in the manner normally prescribed (by electronic filing, mail or courier service or by hand delivery to the proper office).⁶⁰⁵ I discuss that issue in the preceding section. That may not be a proper filing until and unless it gets to the proper office.⁶⁰⁶ This could be relevant to statute of limitations and penalty issues turning upon the date of filing.

⁶⁰²(...continued)

delinquent returns to the IRS District Counsel's office upon instructions from his attorney. The attorney was wrong. His client arguably may have suffered a huge tax bill as a result of being wrong. But see *Dingman v. Commissioner*, T.C. Memo. 2011-116 (distinguishing *Allnutt* and holding in any event that, on the facts, the inference is drawn that the returns reached the proper office for filing by a date that would make the assessments untimely); and *Goldsmith v. Commissioner* (T.C. Dkt. 21235-16), Designated Order dated 9/29/17, p. 3 n. 4 (Goldsmith argued that his delivery of the returns to the CI agent constituted a "filing," thus triggering the statute of limitations which had, as a result, expired; held, *Dingman* distinguished because there was no evidence to permit the inference in *Dingman* that the returns the CI agent received were forwarded to the correct Service Center). See also *United States v. Boitano*, 796 F.3d 1160 (9th Cir. 2015) (held merely delivering a signed return to an agent during an audit is not a filing; although filing is not an explicit element of the crime of tax perjury, the precedent makes filing an element).

⁶⁰³ See § 6091. For example, for the individual income tax return, Form 1040, the IRS will list the Service Centers to file by geographical area on the instructions. See also IRS web page, "Where to File Addresses for Taxpayers and Tax Professionals Filing Form 1040" (viewed 7/2/17 as last reviewed or updated 11/22/16).

⁶⁰⁴ Regs § 1.6091-2(d).

⁶⁰⁵ Some "revenue officers" (IRS collection personnel) at certain levels have authority to "secure and process delinquent returns" IRS CCA 199933039 (Aug. 20, 1999), at 3 (cleaned up), as discussed at

⁶⁰⁶ See e.g., *Allnutt v. Commissioner*, 523 F.3d 406 (4th Cir. 2008), where the taxpayer delivered the delinquent returns to the IRS District Counsel's office upon instructions from his attorney. The attorney was wrong. His client arguably may have suffered a huge tax bill as a result of being wrong. But see *Dingman v. Commissioner*, T.C. Memo. 2011-116 (distinguishing *Allnutt* and holding in any event that, on the facts, the inference is drawn that the returns reached the proper office for filing by a date that would make the assessments untimely); and *Goldsmith v. Commissioner* (T.C. Dkt. 21235-16), Designated Order dated 9/29/17, p. 3 n. 4 (Goldsmith argued that his delivery of the returns to the CI agent constituted a "filing," thus triggering the statute of limitations which had, as a result, expired; held, *Dingman* distinguished because there was no evidence to permit the inference in *Dingman* that the returns the CI agent received were forwarded to the correct Service Center). See also *United States v. Boitano*, 796 F.3d 1160 (9th Cir. 2015) (held merely delivering a signed return to an agent during an audit is not a filing; although filing is not an explicit element of the crime of tax perjury, the precedent makes filing an element).

3. Computer Filing (E-Filing).

Most returns may be filed electronically or physically, which means that they are delivered to and filed with the IRS virtually instantaneously. Prodded by Congress,⁶⁰⁷ the IRS is pushing taxpayers to file electronically. For example, most tax return preparers are required to file electronically the returns they prepare.⁶⁰⁸ And taxpayers using services such as Turbo Tax are offered the opportunity to file electronically. For the fiscal year 2022, the IRS processed over 269 million tax returns and other forms (excluding information returns), with nearly 213.4 million of that number filed electronically.⁶⁰⁹

The advantage to the IRS of such electronic filing is that the information can be incorporated into the IRS data systems through an algorithm rather than requiring either OCRing or manual input.

4. Filing Generally Requires a Processable Return.

Generally, at least for IRS return processing requirements, a return is not filed until the IRS receives the return, determines that it is processable, and files it.⁶¹⁰ However, the Courts have recognized that some returns otherwise meeting the *Beard* test received by the IRS but not treated as processable may be a return filing for some purposes (such as the statute of limitations on assessments).⁶¹¹

III. Amended Returns.

A. General.

The key return is the original return (whether filed timely or delinquent). Historically, the Code has not specifically authorized amended returns (except by implication in a few passing references).⁶¹² The IRS has long recognized amended returns for some purposes. The Supreme Court has said that this recognition has been said to be “a creature of administrative origin and grace.”⁶¹³ The Code and Regulations do not require that an amended return be filed to correct errors on the original return, and the IRS is not required to accept an amended return (although it does so routinely).⁶¹⁴ Taxpayers thus are under no legal compulsion to file amended returns as they are to

⁶⁰⁷ See *Cantrell v. Commissioner*, T.C. Memo. 2017-170, at *14-*15 for a discussion of Congress' encouragement of electronic filing.

⁶⁰⁸ See IRS web page titled “Most Tax Return Preparers Must Use IRS e-file,” here (last reviewed and updated 5/14/15 and viewed 7/17/15).

⁶⁰⁹ 2022 Data Book Tables 2 and 4.

⁶¹⁰ For the fine distinction between processing and filing, see Bryan Camp, *Lesson From The Tax Court: Taxpayer 'Filed' Return Even Though IRS Could Not Process It* (Tax Prof Blog 12/6/21).

⁶¹¹ *Fowler v. Commissioner*, 155 T.C. 106 (2020) (missing information rendering return unprocessable for IRS purposes still qualified as a return under the *Beard* test); and *Willets v. Commissioner*, T.C. Sum. Op. 2021-39 (Nov. 22, 2021) (same), discussed in Bryan Camp, *Lesson From The Tax Court: Taxpayer 'Filed' Return Even Though IRS Could Not Process It* (Tax Prof Blog 12/6/21).

⁶¹² E.g., §§ 6501(c)(7) and 6213(g)(1); see also e.g., Reg. § 1.6091-2(e).

⁶¹³ *Badaracco v. Commissioner*, 464 U.S. 386, 393 (1984).

⁶¹⁴ Reg. § 1.451-1(a) provides that, if a taxpayer discovers an erroneous exclusion from gross income or
(continued...)

file the original returns.⁶¹⁵ (I should note, however, that tax professionals advising taxpayers whose original returns were materially erroneous have some ethical obligations to advise the taxpayer about correcting the error by filing an amended return; the scope of that advice and whether the tax professional must or should consider withdrawal from representing the taxpayer if he or she does not correct the error is beyond the scope of this book, but I do urge you to consider this issue further and deeper when it arises in your practice.)

Amended returns are generally used in two cases—to report additional taxes due or to claim refunds of taxes paid with original returns. Commonly encountered amended returns are 1040-X, Amended U.S. Individual Income Tax Return, and 1120-X, Amended U.S. Corporation Income Tax Return. (Note the form naming convention to append -X to the form number of the original return.) An amended income tax return reporting overpayments is a claim for refund.⁶¹⁶ Amended returns may also be filed to correct problems on the original return that do not affect the bottom-line tax liability (such as, for example, make certain elections and correcting a false statement as to the Schedule C business activity; consider the discussion regarding voluntary disclosure below).

Amended returns are usually filed after the due date for filing the return (either the original due date or the extended due date). Sometimes, however, a taxpayer will file an original return prior to the original due date of the return or, if the original return was filed during the extension period, prior to the extended due date of the return. If the amended return were not filed, the early filed return is deemed filed on the original due date if the return is filed prior to the original due date or on the date the return is actually filed if prior to the extended due date. However, if an amended return is filed prior to the original due date or, if on extension, the extended due date, then that amended return will be deemed the “return” for **some** purposes, although nominally an amended

⁶¹⁴(...continued)

erroneous inclusion in gross income in a filed return within the statute of limitations for that return, he or she “should” file an amended return reporting the tax or claiming the refund. The key word is “should,” of course. E.g., *Hillsboro Nat'l Bank v. Commissioner*, 460 U.S. 370, 380 n.10 (1983) (acceptance of amended returns is “within the discretion of the Commissioner”); *Evans Cooperage Co. v. United States*, 712 F.2d 199, 204 (5th Cir. 1983) (The Code and Regulations do not “make any provision for the acceptance of an amended return in place of the original return previously filed.”); *Jones v. Commissioner*, 338 F.3d 463, 466 (5th Cir. 2003) (“The IRS has discretion to accept or reject an amended return.”); *Dover Corp. & Subsidiaries v. Commissioner*, 148 F.3d 70, 72-73 (2d Cir. 1998) (“There is simply no statutory provision authorizing the filing of amended tax returns, and while the IRS has, as a matter of internal administration, recognized and accepted such returns for limited purposes, their treatment has not been elevated beyond a matter of internal discretion.”) (internal citations omitted). As a result, until accepted by the IRS, the filing of the return does not change an assessment previously made or a notice of deficiency previously issued. *McCabe v. Commissioner*, 46 T.C.M. (CCH) 390, 391 (1983); cf. *Miskovsky v. United States*, 414 F.2d 954, 956 (3d Cir. 1969) (“[I]t would be utterly disruptive of the administration of the tax laws if a taxpayer could disregard his return and automatically change an assessment based thereon by making an amended return in his favor long after the expiration of the time for filing the original return.”)

⁶¹⁵ Indeed, although this should be logical from the absence of a duty to file an amended return, the failure to file an amended return is not proof of a taxpayer’s intent to evade tax. *Broadhead v. Commissioner*, T.C. Memo. 1955-328.

⁶¹⁶ Reg. § 301.6402-3(a)(1) & (5). For an amended return to constitute a claim for refund, it still has to meet the basic requirements for a return. *Gillespie v. United States*, 2016 U.S. App. LEXIS 19604 (7th Cir. 2016) (unpublished) (held, amended return making frivolous claim is not an amended return and hence not a claim for refund to support jurisdiction in a refund suit).

return.⁶¹⁷ The amended return in that case is referred to as a “superseding return.”⁶¹⁸ Filing a superseding return can have benefits to the taxpayer or the Government, depending upon the context. As noted below, an amended return does not normally cleanse a fraudulent original return, but it can if it qualifies under these rules as a superseding return. Other penalties that might apply to the original return can be avoided by filing a superseding return.⁶¹⁹ Notwithstanding the foregoing, the original return, even if there is a superseding amended return, is the date that starts the key assessment and claim for refund statutes of limitations in §§ 6501 and 6511.⁶²⁰

There is one other type of amended return that I will discuss in more detail later. This is the qualified amended return, a concept that applies in the penalty area. Accuracy related penalties (such as the 20% negligence penalty) apply to a base equaling the tax due less the tax reported on the original return. The qualified amended return concept treats additional taxes reported on the qualifying amended return as if they had been reported on the original return, thus avoiding the accuracy related penalties but not the civil fraud penalty.⁶²¹ I discuss the qualified amended return below (beginning on p. 352) in discussing the accuracy related penalties. For present purposes you just should know that it offers a way to mitigate or avoid penalties that might otherwise apply.

B. Fraudulent Original Returns.

In *Badaracco, v. Commissioner*, 464 U.S. 386 (1984) which you should read now, the Supreme Court addressed the issue of whether the filing of a nonfraudulent amended return to correct a fraudulent original return started the normal three-year civil statute of limitations on assessment running as of the date of filing the nonfraudulent amended return. The civil statute of limitations is the period during which the IRS can assert an additional tax liability (including penalties and interest). The criminal statute of limitations is the period during which the IRS can criminally prosecute. Generally, for the significant tax crimes, the statute of limitations for criminal

⁶¹⁷ SCA 1998-024 (5/12/98), reproduced at 98 TNT 177-60 (containing an excellent compilation of the cases and synthesis); and ILM 200645019 (6/20/06), reproduced at 2006 TNT 219-22.

⁶¹⁸ IRM 21.6.7.4.10 (03-18-2022), Superseding Returns (“An amended (Form 1040-X) or corrected (duplicate) return filed on or before the due date or the extended due date is a superseding return.”) See Keith Fogg, *Superseding Original Returns* (Procedurally Taxing Blog 1/13/17). However, an amended return filed after the original return due date (even during an extension period) is not a superseding return if it purports to change an irrevocable election on the timely filed original return. Reg. § 1.6013-1(a)(1); see [Taxpayers may file a 2020 superseding return changing their joint filing election to receive the third economic impact payment](#) (NTA Blog 4/20/21).

⁶¹⁹ For example, in ILM 200645019 (6/20/06), reproduced at 2006 TNT 219-22, the original return failed to include Forms 5471. That failure could generate a penalty under § 6038(b). The penalty is mooted by the filing of the superseding return within the extension period. Reg. § 1.6013-1(a)(1) (as to election to file joint returns).

⁶²⁰ See ILM 202026002 (6/26/20), analyzing authorities and holding that *Zellerbach Paper Co. v. Helvering*, 293 U.S. 172 (1934) and *National Paper Products Co. v. Helvering*, 293 U.S. 183 (1934) compel the result. In a footnote, the author states (p. 4 n. 2): “*Zellerbach* is cited for the proposition that a second return does not restart the limitations period, despite the fact that the taxpayer in *Zellerbach* did not file a second return. This is because the Court explained its reasoning on this issue in its *Zellerbach* opinion and then just referred back to that reasoning in its *National Paper* opinion.”

⁶²¹ See Regs § 1.6664-2(c)(2).

prosecution is six years.⁶²² The civil statute of limitations is generally three years but, when the return is “false or fraudulent” “with intent to evade,” is always open.⁶²³

The issue in *Badaracco* was whether the filing of the original fraudulent return meant that the civil statute of limitations was open forever even if there were a subsequent nonfraudulent amended return. Certainly, as indicated in the case, policy arguments could be made that the filing of a nonfraudulent amended return gave the IRS the information it needed and in legal contemplation superseded the original fraudulent return. The notion is that the IRS needs the unlimited statute of limitations only when the taxpayer has not provided the IRS a nonfraudulent return. The Supreme Court held, however, that the fraud on the original return was the reference point for the unlimited statute of limitations.

The exception to the rule in *Badaracco* is the one noted above that, if after filing a fraudulent return before the due date or the extended due date for the return, the taxpayer files a nonfraudulent amended return by the due date or extended due date, respectively, the amended return will be treated as the original return, thus cleansing the fraud.⁶²⁴ In the real world, however, amended returns are rarely filed before the due date of the return or extended due date of the return. If you happen, however, to get a client in that window of time, you have an easy fix for his or her criminal exposure—simply file a nonfraudulent return by the due date.

The *Badaracco* rule that a nonfraudulent amended return means that the taxpayer may be subject to the civil fraud penalty under § 6663 even if he or she has filed an amended return corrected the fraud.⁶²⁵

C. Fraudulent Original Returns; Voluntary Disclosure Practice.

In a tax practice, the most sensitive context in which a practitioner will advise a client to file amended returns is when the original return exposes the taxpayer to potential criminal prosecution. As in *Badaracco*, legally, a nonfraudulent amended return will not cause the original fraudulent return problem to disappear. The taxpayer can still legally be prosecuted for fraud on the original return. Worse, in a criminal prosecution, the amended return is an admission of the unreported tax from the original return and thus establish a key element—a tax due and owing—that the Government would otherwise have to prove in a tax evasion case.⁶²⁶ Why then should a taxpayer even consider filing an amended return?

An amended return *generally* cures the criminal problem. The *general* cure comes because of practical phenomena not commanded by the Code. These phenomena are reflected in the IRS

⁶²² § 6531. The statute actually provides a three-year statute of limitations as the general rule for federal tax crimes, but then excepts out from this general rule the significant (i.e., usually prosecuted) tax crimes as to which a six-year statute of limitations applies.

⁶²³ §§ 6501(a) and 6501(c)(1) and (2).

⁶²⁴ SCA 1998-024 (May 12, 1998), reproduced at 98 TNT 177-60 (containing an excellent compilation of the cases and synthesis).

⁶²⁵ *Gaskin v. Commissioner*, T.C. Memo. 2018-89, at *4-*5 (citing *Badaracco* and *Brown v. Commissioner*, T.C. Memo. 1996-416).

⁶²⁶ § 7201.

“voluntary disclosure practice through which the Government exercises its prosecutorial discretion to not prosecute a taxpayer qualifying under the policy or practice. Simply because the Government may prosecute any person who commits a crime does not mean that it will prosecute. In this instance, to encourage taxpayers to get right on their tax liabilities, the Government gives reasonable advance assurance that it will decline to prosecute taxpayers who file amended returns “voluntarily” (i.e., before the Government has started an investigation or before a series of events that will bring the fraud to the Government’s attention has been set in place). I discuss the voluntary disclosure practice in more detail beginning p. 317.

D. Amended Returns Claiming Refunds; Audits.

The odds of meaningful review or audit of an original return are quite low. The conventional wisdom is that the comparable odds for amended return are higher, particularly where the amended return claims a significant refund. Also, there is anecdotal evidence that some types of amended returns are more heavily scrutinized than others. For example, amended returns claiming income tax or gift tax refunds may be scrutinized less than amended returns claiming estate tax refunds.⁶²⁷ I think most practitioners intuit these varying risks of scrutiny, although their intuitions may be based on such limited data that they are speculations or wishful thinking. Should these varying risks of scrutiny affect how the practitioner advises a client to present claims for refund to the IRS? I think the conventional thinking is that it should not.

As noted below in Chapter 6 discussing penalties, Congress has imposed a penalty for aggressive positions on amended returns claiming refunds.⁶²⁸

IV. Time for Filing Returns.

A. General.

Individual and most C Corporation income tax returns are due on the 15th day of the fourth month after the close of the tax year (i.e., April 15 for calendar year returns; virtually all individual returns are calendar year returns, but for taxpayers on a fiscal year, the return is due on the 15th day of the fourth month after the close of the fiscal year).⁶²⁹ This filing date rule does not apply until 2025 to C Corporation taxpayers with a fiscal year of June 30.⁶³⁰ Partnership and S Corporation

⁶²⁷ See e.g., *Lane v. United States*, 286 F.3d 723 (4th Cir. 2002); and Burgess J.W. Raby and William L. Raby, Sentiment or Greed: Gift or Compensation?, 34 Tax Practice (Tax Analysts) 169 (5/24/02) (“the IRS is much more likely to process Form 1040-X income tax refund claims without challenge than it is to issue a gift tax refund without question.”)

⁶²⁸ § 6676, added by the Small Business and Work Opportunity Tax Act of 2007.

⁶²⁹ § 6072(a). The filing date of the 15th day of the fourth month (April 15 for calendar year reporters) for C Corporations is effective for 2016 returns filed in 2017. Prior to that effective date, the due date for C Corporation returns was the 15th day of the third month (March 15 in the case of calendar year reporters).

⁶³⁰ Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, (P.L. 114-41) § 2006(a)(3). I have no idea as to the reason for this exception to the general rule. The net effect of the new rules is that for those corporate taxpayers wanting to file by the pre-change date of 15th day of third month can still do so and can still file by the former extension date of 15th day of the ninth month because the extension date for the new rule will be October 15th. So, I am not sure what was achieved by excepting fiscal year June 30 filers in the real world.

returns are due on the 15th day of the third month after the end of the tax year (March 15 for calendar year returns).⁶³¹

Returns for nonresident alien individuals and certain foreign corporations are due by June 15 for calendar year taxpayers and, for fiscal year taxpayers, on the 15th day of the 6th month following the close of the fiscal year.⁶³² Returns for U.S. citizens and residents with tax homes abroad are granted an automatic extension until June 15 and may then apply for the regular extension until October 15.⁶³³

Estate returns are due nine months after the decedent's death.⁶³⁴ Gift tax returns are due on the same date (including extensions) as the donor's income tax return.⁶³⁵

Returns otherwise due on a Saturday, Sunday or federal holiday⁶³⁶ are “considered timely” if filed on the next succeeding business day.⁶³⁷ Note that the due date remains the same, but returns filed subject to this provision are considered filed on the normal due date; this is not an extension of the due date to the next succeeding business day. Example: Year 01 return is mailed on Monday, April 17 of Year 02. The return is considered timely filed on the return due date of Saturday, April 15 of Year 02.⁶³⁸

Returns filed before the original due date are deemed filed on the original due date of the return both for purposes of the statute of limitations on assessment and on claiming refunds. § 6501(b)(1) and § 6513(a).⁶³⁹ This rule does not apply to returns filed after the original due date during the period of extension (e.g., 1040s filed after April 15 during the period of extension to

⁶³¹ § 6072(b).

⁶³² § 6072(c).

⁶³³ Reg. § 1.6081-5(a)(5).

⁶³⁴ § 6075(a).

⁶³⁵ § 6075(b).

⁶³⁶ Federal holidays are listed at 5 U.S.C. § 6103. For a similar list, see Tax Court Rule 25(a)(5) which governs treatment of holidays for Tax Court filings.

⁶³⁷ § 7503. For some examples of what the “considered timely” construct means, see Bryan Camp, Lesson From The Tax Court: Counting The Days (Tax Prof Blog 5/23/22).

⁶³⁸ Section 7503 does not change the due date for the return, but merely considers the return timely if filed after the prescribed due date but by the next succeeding business day after the weekend or a holiday. See e.g., *United States v. Johnson*, 2015 U.S. App. LEXIS 5446 (6th Cir. 2015) (nonprecedential opinion ordering dismissal of indictment based on Government concession that § 7503 did not extend the due date of the return, thus making the commencement of the statute of limitations the due date and not the § 7503 date); and *Hannahs v. United States*, 1995 U.S. Dist. LEXIS 2117 (W.D. Tenn. 1995) (due date for purposes of commencing the three-year period for claim for refund remains the same even if § 7503 otherwise applied to have the filing considered timely).

⁶³⁹ It is important to distinguish between the due date (which I sometimes call an original due date) and an extended date. For most individual returns, the due date is April 15. Certain nonresident aliens have a due date of June 15 (§ 6072(c)); hence a return for such a taxpayer filed prior to June 15 is deemed filed on June 15. Other U.S. taxpayers with tax homes abroad are granted an automatic extension until June 15 and may then apply for the regular extension until October 15 (Reg. § 1.6081-5(a) & (b)); their returns filed on or before April 15 are deemed filed on April 15 and after April 15 on the date filed.

For the comparable rule in the partnership context, see § 6229(a)(2) which triggers the TEFRA partnership statute from the later of the filing date or the “last day for filing such return for such year (determined without regard to extensions).”

October 15).⁶⁴⁰ This rule is important in calculating the commencement date for the statute of limitations (both civil and criminal).

Care should be taken here, however. An early filed return is filed on the due date prescribed in the Code (April 15 for individual calendar year taxpayers) even where the Code also treats as timely a return filed on the next business day if that original due date falls on a weekend day or a holiday.⁶⁴¹ Consider the following example:

Year 01 return original due date is Sunday, April 15 of year 02. Since the original due date is on a weekend, § 7503 says that the return filed on the next succeeding business day will be considered timely. The next succeeding business day is Tuesday, April 17 of year 02, because Monday, April 16 is a holiday in Washington, D.C. (Emancipation Day in D.C.). So, a taxpayer can file after the original due date of April 15 but on or before April 17 and have the return “considered timely.” § 7503.

Scenario 1: Taxpayer mails return to IRS on February 1 of year 02 and the IRS receives it on February 6 of year 02. The taxpayer’s return will be deemed filed on April 15 of year 02 for purposes of the civil and criminal statutes of limitations. § 6501(b)(1). The reason is that § 7503 does not change the due date but simply treats returns filed on the next succeeding business day as timely filed.⁶⁴²

Scenario 2: Taxpayer mails return to IRS on April 17 of year 02. Under § 7503, the return is “considered timely.” But there is no provision that says that the return is deemed filed on the original due date. So, the filing date is April 17 for purposes of the civil and criminal statutes of limitations.

B. Extensions.

1. Income Tax.

Extensions on the time for filing income tax returns may easily be obtained for up to six months.⁶⁴³ Thus, for individual and most C Corporate income tax returns reporting on a calendar year, an extension can be obtained from the normal due date of April 15 until October 15. The

⁶⁴⁰ Regs § 301.6501(b)-1(a) provides: “Any return* * * filed before the last day prescribed by law or regulations for the filing thereof (**determined without regard to any extension of time for filing**) shall be considered as filed on such last day.” (Emphasis supplied.)

⁶⁴¹ § 7503; Rev. Rul. 81-269, 1981-2 C.B. 243; IRM 9.1.3.6.3 (02-24-2010), Running of the Statute of Limitations; and DOJ CTM DOJ CTM 7.02[1][a] (last updated June 2016).

⁶⁴² This example is patterned on the one in DOJ CTM DOJ CTM 7.02[1][a] (Last updated June 2016). See the related cases of *United States v. Johnson*, 2016 U.S. App. LEXIS 15879 (6th Cir. 2016); and *United States v. Johnson*, 2015 U.S. App. LEXIS 5446 (6th Cir. 2015) (holding § 7503 did not extend the due date of the return, thus making the commencement of the statute of limitations the due date and not the later § 7503 date); and see also *Hannahs v. United States*, 1995 U.S. Dist. LEXIS 2117 (W.D. Tenn. 1995) (due date for purposes of commencing the three-year period for claim for refund remains the same even if § 7503 otherwise applied to have the filing considered timely).

⁶⁴³ § 6081(a).

request for the extension must be filed on or before the original due date of the return. For individuals, the extension request is filed on Form 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return; the extension is automatic (as the form states) and runs through October 15.⁶⁴⁴ It is not unusual for taxpayers with complex individual returns to seek the extension and file as late as October. The busy season for major accounting firms in early September and early October may thus exceed crunch time in March and early April.

Incident to obtaining the extension, the taxpayer is required to estimate and pay his or her ultimate tax liability.⁶⁴⁵ The taxpayer should remit with the extension form the amount of the estimate to avoid the accrual of interest and penalties, since the ultimate tax the taxpayer will owe will be due as of the original unextended due date. In this regard, the extension is just for filing the return, not for paying the tax. The extension thus avoids the penalty for late filing but does not avoid any penalty for late payment. And, if the taxpayer makes a major error in estimating, the IRS cautions that the extension may not be valid.

Filing for the extensions is an annual ritual for many taxpayers and their return preparers. I have heard taxpayers say that, as a matter of principle, they simply do not get it all together until just before October 15 and have even heard others who say that even if they have it together, they extend anyway. (It is unclear exactly what principle they refer to, unless it is the time-honored principle of not doing today what you can put off until tomorrow.)

Certain pass-through entities (such as partnerships) may obtain automatic extensions to file their returns for up to 5 months.⁶⁴⁶ This shorter extension period is designed to ensure that the taxpayers to whom the results apply will have the pass-through amounts by the time of their extended due date (6 months).

2. Return Must Be Filed During the Extension Period.

The return “as complete as possible” must be filed during the extension period.”⁶⁴⁷

C. Military Service and Disaster Relief.

The Code has many action deadlines – dates by which an action must be taken. In the current context in this text, we are discussing deadlines for filing of returns, but there are other deadlines (e.g., paying tax, filing claims for refund, and petitioning the Tax Court). The Code provides relief for such deadlines in the case of military or support service, Presidentially declared disaster actions or terroristic or military actions that might otherwise prevent timely action. §§ 7508 and 7508A. For most taxpayers, this relief applies most commonly with respect to the return filing date which is extended by a disaster. A summary of those provisions is:

⁶⁴⁴ Prior to 2006, the extension was a two phase process—the first extension being through August 15 and the second through October 15. The IRS got this right by moving to one extension, because the second extension was just make-work.

⁶⁴⁵ Reg. § 1.6081-1(a).

⁶⁴⁶ T.D. 9407, Extension of Time for Filing Returns, 73 Fed. Reg. 37362-01 (July 1, 2008).

⁶⁴⁷ Reg. § 20.6081-1(d).

- Certain action dates disregard the period (plus 180 days) that the taxpayer is in the Armed Forces of the U.S. in a designated combat zone or when deployed outside the U.S. away from the taxpayer's permanent duty station related to a contingency operation or is hospitalized as a result of such operation. § 7508. For example, the time for filing returns and paying tax is disregarded during the suspension period, meaning that the taxpayer has an automatic extension of time to perform those acts. Other action dates are affected. There are certain exceptions, for example permitting collection action in case of jeopardy.
- The Secretary may specify a period up to a year that may be disregarded by a taxpayer that the Secretary determines to be affected by a federally declared disaster. § 7508A. The action dates involved are similar to those under the preceding paragraph related to military service. This provision is invoked in cases such as hurricanes or other natural disasters. This provision was invoked for nationwide relief with respect to the coronavirus (COVID-19) pandemic after the President declared an emergency.⁶⁴⁸
- New § 7508A(d), added in 2019,⁶⁴⁹ provides for a qualified taxpayer⁶⁵⁰ (generally those subject to significant disruptions because of a disaster) that filing deadlines may be disregarded under subsection (a) from (i) the earliest incident date for a disaster specified in the disaster area declaration⁶⁵¹ through (ii) 60 days after the latest incident date.⁶⁵² This new provision has been called a “60-day rolling shield” defense for taxpayers subject to declared disasters to tax deadlines for 60 days after the latest incident declared as a disaster area.⁶⁵³ It is important to read the Notices or other pronouncements to determine which action dates are affected and other qualifications for the relief.⁶⁵⁴

These apply to return filing but also to other action requirements.⁶⁵⁵ Some but not all of these action dates are statutes of limitations. For the key instances of such other deadlines for actions, I mention these relief provisions and refer back to this discussion.

⁶⁴⁸ Notice 2020-23, I.R.B. 2020-18 (incorporating and amplifying earlier notices).

⁶⁴⁹ Pub. L. 116–94, div. Q, title II, § 205(a), Dec. 20, 2019, 133 Stat. 3245.

⁶⁵⁰ § 7508A(d)(2). The list of qualified taxpayers includes an individual whose principal residence, principal place of business or place of relevant record maintenance is in the disaster area, a relief worker in the disaster area, or a taxpayer was killed or injured as a result of the disaster, and a spouse of such an individual.

⁶⁵¹ The disaster area declaration is defined by reference to § 165(i)(5)(A) which defines “Federally declared disaster” to mean a disaster declaration under the Robert T. Stafford Disaster Relief and Emergency Assistance Act.

⁶⁵² § 7508A(d)(1).

⁶⁵³ The precise effect of this rolling extension in the time of the coronavirus pandemic is uncertain. See Tom Greenaway (Guest Blogger), When Do We Have to File and Pay Our Federal Taxes This Year? (Procedurally Taxing Blog 7/7/20); and Keith Fogg, Another Look at 7508A(d) – Impact on Tax Court Jurisdiction (Procedurally Taxing Blog 12/11/20).

⁶⁵⁴ The devil is always in the details. Thus, for example, although the time period for taking appeals from Tax Court decisions may be extended because that time period is in the Code, the time for appealing from tax cases (refund, collection or otherwise) in the district courts to the court of appeals is not affected because that time period is not in the Code. Carlton Smith, IRS Finally Extends Judicial and Refund Claim Filing Deadlines Because of COVID-19 (Procedurally Taxing Blog 4/10/20).

⁶⁵⁵ See e.g., PMTA 2021-06 (7/2/21) (discussing application of §§ 7508A and 7508(b) to § 6611(b)(3), 6611(e) and 6611(g).

V. When Returns Are Filed.

A. General Rule - Date of Receipt by IRS.

The general rule is that returns are filed when they are received by the IRS.⁶⁵⁶ This general rule applies for hard copies (permitting in some cases mailed hard copies to be deemed filed when mailed (see discussion of § 7502 in the next section). Returns filed electronically are deemed filed when electronically filed.⁶⁵⁷

B. Exception - Returns Filed Prior to Original Due Date.

Returns filed prior to the original due date are deemed filed on the original due date. § 6501(b)(1). This gives the IRS and taxpayers a consistent starting point for applying the rules based upon the date of filing—at least a consistent starting point for returns filed on or before the original due date. This rule does not apply to returns filed after the original due date during an extension period (e.g., 1040s filed after April 15 during the extension period to October 15).⁶⁵⁸

C. Returns Filed After the Due Date During the Extension Period.

Returns filed during an extension period are generally deemed filed on the date the IRS receives the return.⁶⁵⁹ If a return is filed prior to the extended due date and an amended return is then filed before the extended due date (referred to as a superseding return), the date the superseding return is received by the IRS is the file date for the return.⁶⁶⁰

D. Timely-Mailing, Timely-Filing Rule.

1. The Statutory Rule § 7502.

The general rule is that tax documents are filed when received **by** the IRS or Tax Court. Taxpayers mailing tax documents were thus at risk of the “the vagaries of the postal service;

⁶⁵⁶ *Hotel Equities Corp. v. Commissioner*, 65 T.C. 528, 531 (1975) (noting “the longstanding definition of the word ‘filed’ as used in Federal statutes is ‘delivered’”), *aff’d*, 546 F.2d 725 (7th Cir. 1976); *Miller v. United States*, 784 F.2d 728, 729-30 (6th Cir. 1986) (referring to the “physical delivery rule”); *Phinney v. Bank of the Southwest National Assn., Houston*, 335 F.2d 266, 268 (5th Cir. 1964); see also *United States v. Lombardo*, 241 U.S. 73, 76 (U.S. 1916), a nontax case, but applying a straight-forward etymological interpretation of the concept of filing, concluding that “Filing * * * is not complete until the document is delivered and received.”)

⁶⁵⁷ Reg. § 301-7502-1(d). (A return “filed electronically with an electronic return transmitter . . . in the manner and time prescribed by the Commissioner is deemed to be filed on the date of the electronic postmark . . . given by the authorized electronic return transmitter.”)

⁶⁵⁸ Regs § 301.6501(b)-1(a) provides: “Any return* * * * filed before the last day prescribed by law or regulations for the filing thereof (determined without regard to any extension of time for filing) shall be considered as filed on such last day.” (Emphasis supplied.)

⁶⁵⁹ This rule apparently can create some potentially significant administrative headaches for the IRS. See ECC 201321022 (5/2/13), reproduced at 2013 TNT 102-60 (5/25/13). There are several potential glitches based upon the different limitations on refund claims in § 6511. I will discuss some of the issues in a footnote in discussing § 6511 below.

⁶⁶⁰ ILM 200645019 (6/20/06), reproduced at 2006 TNT 219-22.

documents could be delayed or not delivered at all through no fault of the taxpayer.”⁶⁶¹ Common law rules regarding mailing and receipt (discussed below) could apply but were uncertain in application and proof. Congress enacted § 7502 to provide taxpayers a more certain method to assure that qualifying mailed documents would be timely filed if mailed timely.⁶⁶² Some courts hold that § 7502 is the exclusive procedure to show that a timely mailed tax document received after the due date will be treated as timely received.

Section 7502 provides a “timely-mailing, timely-filing” rule, which treats the mailing date as the filing date for a return (or certain other documents) received by the IRS (or, for other documents, the Tax Court) after the due date (either the original due date where there is no extension or the extended due date if there is an extension) but mailed on or before that due date. The timely-mailing, timely-filing rules (and risks) may be summarized:

1. The document filed must be a “return, claim, statement, or other document required to be filed.” I focus here on the “required to be filed” element. Original tax returns are the quintessential type of document that is required to be filed and thus clearly meets this element of the statute. Tax Court petitions are also required to be filed by the Code to meet the jurisdictional requirements for the Tax Court and, in that sense, are required to be filed and thus meet this element of the statute.⁶⁶³ What about amended returns? The standard conceptualization of the amended return is that the Code itself does not require amended returns to be filed. So, do amended returns qualify? The answer is that some clearly do and some may not. Since, as we see later, the Code requires claims for refunds to be filed within a statute of limitations period, amended returns making refund claims qualify as returns required to be filed thus permitting the taxpayer to meet this element of the timely mailing, timely filing rule. But that analysis may not apply to amended returns reporting additional liability. The IRS earlier ruled that amended returns reporting additional liability are not “required” and thus any tax reported on such returns actually filed after the assessment limitations period but otherwise mailed within the assessment period, do not qualify under § 7502.⁶⁶⁴ In that instance, the conclusion meant that the IRS could not assess and must return any payment remitted with the amended return reporting a liability. However, in a 2015 Chief Counsel Advice, the IRS questioned that conclusion.⁶⁶⁵

2. The mailing must occur within the time otherwise prescribed (either on or before the due date, whether original or extended).

3. The delivery to the IRS (or Tax Court) must occur *after* the time otherwise required for filing (either the original due date or extended due date). If the delivery to the IRS (or Tax Court) occurs within the time otherwise required, the timely-mailing, timely-filing rule is not needed and

⁶⁶¹ *Baldwin v. United States*, 921 F.3d 836, 840 (9th Cir. 2019), cert. den. ___ U.S. ___, 140 S. Ct. 690 (U.S., Feb. 24, 2020).

⁶⁶² See Tax Court Rule 22(c), referencing § 7502.

⁶⁶³ Cf. § 7502(d)(1).

⁶⁶⁴ ILM 201052003, reproduced at 2011 TNT 2-21 (“Thus, the postmark rule of section 7502 does not apply to an amended return that is received after the limitation period and shows additional tax due.”).

⁶⁶⁵ CCA 201545017 p. 3 fn. 1 (7/27/15) (“We question the conclusion reached in SCA 1998-001 that section 7502 does not apply to timely mailed amended returns that show additional tax due because these returns are not required to be filed by any internal revenue law.”) In the CCA, the IRS attorney cites the earlier holding in SCA 1998-001 rather than ILM 201052003, reproduced at 2011 TNT 2-21, but it is basically the same conclusion being questioned.

does not apply.⁶⁶⁶ This aspect of the timely-mailing, timely-filing rule is, of course, subject to the rule that returns filed before the original due date are deemed filed on the original due date (April 15 for individuals). So, an individual return mailed to the IRS on April 1 but received after the original due date of April 15 is deemed filed on the date of mailing (April 1) but is subject to the rule that it is deemed filed on the original due date (April 15). By contrast, an individual return on extension through October 15 is mailed on October 1 but received after October 15 is deemed filed on October 1 (because the timely-mailing, timely-filing rule is needed). To carry this one step further, in the latter example, if the return is received by the IRS on October 5, the return is filed on October 5 (rather than October 1) because the timely-mailing, timely-filing rule only applies if the return is filed after the extended due date (October 15). This latter result can thus give the IRS several days on the statute of limitations for a return that has an extended due date if the IRS receives it before the extended due date.⁶⁶⁷

4. If the U.S. Postal Service (“USPS”) fails to deliver the mailing to the IRS or the Tax Court (or alternatively, the IRS or the Tax Court has lost it and has no record that it was delivered), the taxpayer may be out of luck. There is a critical exception, however. By use of the USPS’s registered mail or certified mail, pursuant to the conditions in the Regulations, the mailing will be prima facie evidence that the IRS received the mailing and the document will be deemed timely filed on the date of mailing.⁶⁶⁸ Indeed, the document will be deemed timely filed even if the IRS has no record of ever receiving the document or it could be affirmatively proved that the IRS did not receive it. This means that the taxpayer (or his practitioner) has it within his or her power to assure timely filing simply by meeting this condition. The taxpayer still must prove that he or she sent the document by registered or certified mail as prescribed in the Regulations; that is done by taking the envelope to the Post Office and having the USPS clerk stamp the retained receipt with a USPS stamp indicating the date and then producing the stamped receipt if timely mailing is ever questioned. A similar guarantee applies to certain authorized private delivery services, which I discuss later.

5. There are risks if the foregoing guaranteed methods are not used. Simply mailing a return using a USPS postage stamp will not work unless the IRS or the Tax Court receives the envelope and, if there is a postmark, the legible postmark establishes that the postmark was within the prescribed period or, if the postmark is, the taxpayer can prove that it was timely and properly mailed.⁶⁶⁹ (There is a split of authority where the envelope is delivered with no postmark.⁶⁷⁰) Similarly, if the USPS is used for the delivery but non-USPS post metering, such as private post

⁶⁶⁶ See Burgess J.W. Raby and William L. Raby, *Return Filing Dates and the Statute of Limitations*, 2003 TNT 89-11 (2003).

⁶⁶⁷ For technical accuracy, a return received by the IRS before the original due date is obviously subject to this rule. And a return deemed filed on the date mailed by the timely-mailing, timely-filing rule (e.g., a return mailed before the original due date but received by the IRS after the original due date) would be deemed filed on the date mailed but, since it was mailed before the original due date, this rule treats the filing as the original due date rather than the date of mailing.

⁶⁶⁸ § 7502(c). See Reg. § 301.7502-1(c)(2) (providing that “the risk that the document or payment will not be postmarked on the day that it is deposited in the mail may be eliminated by the use of registered or certified mail.”)

⁶⁶⁹ § 7502(a)(2).

⁶⁷⁰ The Tax Court held that when the USPS postmark is missing, the postmark is treated as illegible, permitting the taxpayer to prove timely mailing with the USPS by extrinsic evidence. *Sylvan v. Commissioner*, 65 T.C. 548, 553-555 (1975); and *Mason v. Commissioner*, 68 T.C. 354, 356 (1977). However, the holding in *Sylvan* and subsequent cases relying on it has been questioned. *McCaffery v. United States*, 2021 U.S. Claims LEXIS 1566 (CFC 8/29/21) (holding that no postmark is not the same as an illegible postmark, so that extrinsic evidence in the case of no postmark is not permitted).

metering or third party services (e.g., Stamps.com and Endicia.com) are used, the mailing is subject to rules prescribed in Regulations.⁶⁷¹ Because such non-USPS post metering can be manipulated, the Regulations require that the mailing sent by non-USPS post metering actually reach the office to which it is mailed within the normal period (based on USPS statistics) or, if delivered later than that normal period, the taxpayer must persuasively show the following: (i) timely delivery to the USPS, (ii) delay in USPS transmission of the mail, and (iii) the cause of the delay (often an impossible burden while the mailing was within the very large bowels of the USPS).⁶⁷² As you can see there are risks related to the use of simple postage or private post metering.⁶⁷³

6. The foregoing rules apply to mail posted through the USPS. Two key expansions of the rule apply. First, mail sent via private delivery services (“PDS”) that meet certain strict tests prescribed in IRS Regulations and in periodic announcements qualify for the rule.⁶⁷⁴ The usual suspects (Federal Express, United Parcel Service, DHL, etc.) are approved but only as to certain types of delivery service they offer.⁶⁷⁵ These rules permit qualifying private deliveries to guarantee that the timely-mailing, timely-filing rule will apply. Second, mail delivered via foreign country postal services *to the IRS* qualifies for the rule.⁶⁷⁶ Note the underlining carefully, because foreign country postal service mailings do not qualify if sent to the United States Tax Court.⁶⁷⁷ Persons in foreign countries desiring to qualify for the timely-filing, timely-mailing rule for Tax Court petitions

⁶⁷¹ § 7502(b). See *Tilden v. Commissioner*, 846 F.3d 882 (7th Cir. 2017) (Stamps.com); and *Pearson v. Commissioner*, 149 T.C. 424 (2017) (reviewed opinion, adopting the Seventh Circuit’s holding in *Tilden*).

⁶⁷² Reg. 301.7502-1(c)(1)(iii)(B)(2). See *Robinette v. Commissioner*, 123 T.C. 85 (2004), rev’d 439 F.3d 455 (8th Cir. 2006). Some private post meters can be manipulated to permit a stamp to be backdated. Even where a service such as Stamps.com is used which could permit the taxpayer to show with objective evidence when the stamp was purchased, that does not show when the envelope to which it was affixed was actually deposited with the USPS and that could be fatal. If the item is delivered in the normal time period for such documents to be delivered, a presumption will apply that the item was timely deposited with the USPS. *Pearson v. Commissioner*, 149 T.C. 424 (2017) (reviewed opinion). But, if it is delivered outside the normal time frame, showing timely deposit with the USPS may be difficult and even impossible. Having said that, the USPS does have fairly sophisticated tracking systems for mail, so the tracking system may be able to help if indeed the taxpayer did timely deposit the envelope with the USPS. That tracking system does not supply or constitute an IRS postmark (see *Pearson, supra*), but it may be useful in meeting the taxpayer’s burden when the USPS postmark is not used. Finally, if the taxpayer uses private post-metering, the taxpayer can prove timely and proper mailing, and the document arrives within the normal delivery time, the taxpayer is still out of luck if the USPS affixes a post-mark that is outside the date for timely mailing. *Thomas v. Commissioner*, T.C. Memo. 2020-33.

⁶⁷³ In *Tilden v. Commissioner*, T.C. Memo. 2015-188, the Tax Court liberally interpreted these requirements in holding that, although private post metering was used and there was no USPS postmark, some internal USPS record indicating the date the envelope was in the USPS system could suffice. There the USPS Tracking Records (formerly called USPS Track and Confirm) that record USPS first activity within the time deadline would be treated as the equivalent of USPS postmark for purposes of the rule. On appeal, however, although saving the day for the taxpayer for other reasons, the Seventh Circuit rejected that liberal application because the regulation in question requires a USPS postmark and the tracking system is not a postmark. *Tilden v. Commissioner*, 846 F.3d 882 (7th Cir. 2017); see also *Pearson v. Commissioner*, 149 T.C. 424 (2017) (reviewed opinion).

⁶⁷⁴ § 7502(f).

⁶⁷⁵ Notice 2016-30, I.R.B. 2016-18 (May 2, 2016) provides an updated list of qualifying private delivery services. The IRS will periodically provide notices that update the list of such services. It is very important, as Notice 2016-30 notes, that the taxpayer use only the qualifying types of delivery services offered by the provider. In *Guralnik v. Commissioner*, 146 T.C. 230 (2016), the Court held that a type of FedEx service not listed (although faster than the qualifying type) did not invoke the timely mailing, timely-filing rule.

⁶⁷⁶ Rev. Rul. 2002-23, 2002-18 I.R.B. 811.

⁶⁷⁷ *Pekar v. Commissioner*, 113 T.C. 158, 168 (1999).

and notices of appeal must use the designated delivery services.⁶⁷⁸ Finally, the use of such private delivery services does have some risk, for the date of timely-mailing is the date the private delivery services records its acceptance of the document package over which the practitioner or taxpayer using the service has no control.⁶⁷⁹

In considering whether to go to the extra effort and expense required to ensure that a document timely mailed will qualify for the timely-mailing timely-filing rule, a taxpayer and/or practitioner should consider the potential costs if the document is delivered late and the taxpayer is unable to prove entitlement to the rule. For returns, the penalty for late delivery is a late filing and/or late payment penalty and, if the return is lost, potentially a criminal investigation or prosecution for failure to file. For petitions to the Tax Court, the penalty is dismissal of the case, with, in the case of a petition for redetermination of a deficiency, loss of a prepayment remedy. So that the taxpayer takes the risk that the USPS will not deliver the envelope at all, the USPS will not postmark the envelope, that the postmark on the envelope will not be legible, and that, if illegible or late, the taxpayer cannot explain any delays in the USPS delivery. Since timely Tax Court petition filing is jurisdictional and cannot be remedied, it is the better part of wisdom for the taxpayer or practitioner to take the necessary effort and expense to use the registered or certified mail or the qualified private delivery procedure unless there is plenty of time left so that the taxpayer or practitioner can confirm the actual filing within the prescribed period.⁶⁸⁰

How does a taxpayer or practitioner prove that the certified mail receipt (or private delivery) relates to the particular return that the IRS is questioning, particularly if for some reason the IRS did not receive the mailing at all? Be wary of this issue and be prepared to prove, at least by some circumstantial evidence (regular pattern of practice, etc.) enough evidence from which a court may reasonably infer that the certified mail matches up with the return in issue.⁶⁸¹

Finally, the timely-mailing, timely-filing rules only applies to documents “required to be filed ... under the internal revenue laws.”⁶⁸² This covers returns and petitions for redetermination or other petitions filed with the Tax Court. Section 7502 does not apply to filings in tax cases in other courts, where the timing is controlled by (i) non-Title 26 statutes, (ii) the Federal Rules of Criminal, Civil Procedure, Appellate Procedure, Civil Procedure, or (iii) perhaps even local court rules.⁶⁸³

⁶⁷⁸ Id.

⁶⁷⁹ See *Martinez v. Commissioner*, T.C. Summ. Op. 2010-117 denying relief where the taxpayer claimed to have timely delivered the document package containing the Tax Court petition to the private delivery service but the private delivery service did not mark it as received until a date outside the 90 day window.

⁶⁸⁰ In *Tilden v. Commissioner*, 846 F.3d 882 (7th Cir. 2017), the taxpayer’s law firm used a Stamps.com stamp rather than one of the guaranteed delivery methods. Untimely delivery created a problem that the Court solved for the taxpayer. The Court criticized the law firm by name for not using one of the guaranteed timely mailing, timely filing delivery methods.

⁶⁸¹ See for a tale of woe by a less than sympathetic practitioner, *Schultz v. United States*, 92 Fed. Cl. 213 (2010).

⁶⁸² § 7502(a).

⁶⁸³ § 7502(d)(1). See *Patel v. IRS*, Civ. No. 17-13366 (KM/MAH) (D.N.J. July 29, 2019) (D. N.J. 2019) (two year deadline for filing refund suit under § 6532(a)).

2. Common Law Mailbox Rules.

a. General.

The Supreme Court has summarized the common-law mailbox rule:

The rule is well settled that if a letter properly directed is proved to have been either put into the post office or delivered to the postman, it is presumed, from the known course of business in the post office department, that it reached its destination at the regular time, and was received by the person to whom it was addressed.⁶⁸⁴

In a Supreme Court filing in 2019, the Solicitor General described the application of the mailbox rule in a tax context (if it were to apply):

If a taxpayer could persuade the fact-finder that a document had been properly addressed and deposited in the United States mails, with postage thereon duly prepaid, in time for the document to reach the IRS in the ordinary course of mail, the taxpayer was entitled to a rebuttable evidentiary presumption that the document had been physically delivered to the IRS on time—even if the IRS had no record of receiving it.⁶⁸⁵

This rule is called a rebuttable evidentiary presumption. The decisions are varied as to how and if it applies (i.e., some courts hold that § 7502 pre-empts the field, particularly in light of changes to the underlying regulations⁶⁸⁶).

⁶⁸⁴ *Rosenthal v. Walker*, 111 U.S. 185, 193 (1884); see also, in a refund case where such a rule was necessary to make the filing of the refund suit timely, *Charlson Realty Co. v. United States*, 384 F.2d 434 (Ct. Cl. 1967); and *Liu v. United States*, 93 Fed Cl. 184 (2010).

⁶⁸⁵ United States brief in opposition to petition for certiorari in *Baldwin v. United States*, 921 F.3d 836 (9th Cir. 2019), cert. den. ___ U.S. ___, 140 S. Ct. 690 (2020).

⁶⁸⁶ *Baldwin v. United States*, 921 F.3d 836 (9th Cir. 2019), cert. den. ___ U.S. ___, 140 S. Ct. 690 (2020); *Anania v. McDonough*, 1 F.4th 1019, 1026 n.3 (Fed. Cir. 2021) (citing *Baldwin* for proposition that common-law mailbox is no longer available). Reg. § 301.7502-1(e)(2) provides that, if there is no actual delivery (which would set the latest date), proof of proper use of the USPS methods or the designated PDS methods “are the exclusive means to establish prima facie evidence of delivery.” DOJ’s (and thus the IRS’s) position, accepted by the Court in *Baldwin*, is that these regulation makes § 7502 exclusive as the means to create prima facie proof of delivery, as permitted under *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), with the ability to override earlier contrary cases under *Nat’l Cable & Telecomms. Ass’n v. Brand X Internet Servs.*, 545 U.S. 967 (2005) (which hold that *Chevron* qualified interpretive regulations can pre-empt judicial authority except where the judicial authority precludes the interpretation). In *Pond v. Commissioner*, 69 F.4th 155 (2023), the Court held that holding that the statute is plain on the issue and supplants the mailbox, hence no need to rely on the Regulations.)

For prior precedent, see *Philadelphia Marine Trade Ass’n v. Commissioner*, 523 F.3d 140 (3d Cir. 2008) (discussing the conflicts among the circuits and holding that the mailbox rule survives § 7502’s enactment); and *Sorrentino v. IRS*, 383 F.3d 1187 (10th Cir. 2004). In *Stocker v. United States*, 705 F.3d 225, 232, n. 5 (6th Cir. 2013), the Court applied its precedent holding the statutory rule is exclusive but, in a footnote, cited a case that expressed reservations about that precedent. Some courts say that, even if the common law mailbox rule survives the enactment of § 7502, the taxpayer’s self-serving uncorroborated testimony is insufficient under any of the interpretations of the common law mailbox rule. *Sorrentino*, at 1195; and see *Boudreau v. United States (In re Boudreau)*, 622 B.R. 817, 828 (B.A.P. 1st Cir. 2020) (summarizing cases). Thus, the rule has applied where there was some third party testimony confirming the delivery to the USPS or a mailbox. *Wood v. Commissioner*, 909 F.2d 1155, 1157, 1161 (8th Cir. 1990);

(continued...)

Let's first illustrate the differences between the common law rule and § 7502 by some examples in two scenarios involving only slight variations in the fact pattern. In both cases, the IRS denies having received the return or claim for refund.

Example 1: The taxpayer allegedly mailed the return or claim for refund with postage paid (but not in the guaranteed formats of § 7502) on the last day in which the return or claim for refund could have been filed, let's say a return for Year 01 on April 15 of Year 02. If the IRS had received it at all, it would have been after the due date of April 15 of Year 02. The common law mailbox rule does not supply timeliness because the IRS received the document, if at all, too late.⁶⁸⁷ This, of course, is the phenomenon for which § 7502 was enacted to take the vagaries out of times for delivery and provide a certain method to make timely mailing a timely filing.⁶⁸⁸

Example 2: The taxpayer allegedly mailed the return or claim for refund in the same manner, except the taxpayer allegedly mailed it on February 1 of Year 02. The due date is April 15 of Year 02, so the mailing should easily be delivered to the IRS within the normal time and, if it had been so delivered, § 7502 would have no operation (remember that § 7502 only applied to documents delivered to the IRS *after* the due date). Even if § 7502 might arguably pre-empt the field in the Example 1 situation, one court suggested that it cannot in this Example 2 and the mailbox rule can apply.⁶⁸⁹ Readers should, however, note the regulations change discussed in the next paragraph.

Prior to 2011, courts were divided as to whether § 7502 provides the exclusive exception for documents or whether the common law mailbox rule can still apply.⁶⁹⁰ In 2011, the IRS amended the regulation to resolve the circuit split by providing that § 7502 provides the exclusive exceptions, thus denying the application of the common law mailbox rule.⁶⁹¹ Some courts have agreed that, pursuant to the regulation, § 7502 is exclusive, thus not allowing a common law mailbox rule.⁶⁹² The Tax Court, however, applies its variant of the common law mailbox rule in certain cases.⁶⁹³

⁶⁸⁶(...continued)

Anderson v. United States, 966 F.2d 487, 489, 491 (9th Cir. 1992).

⁶⁸⁷ See *Maine Medical Center v. United States*, 675 F.3d 110 (1st Cir. 2012) (same day delivery to the addressee is not encompassed by the common law mailbox rule and, further, if redundantly, that a taxpayer could not rely on the common law mailbox rule by mailing too late for the document to be delivered in time in the ordinary course of post office business, citing *Philadelphia Marine Trade Ass'n v. Commissioner*, 523 F.3d 140, 148 (3d Cir. 2008)).

⁶⁸⁸ *Maine Medical Center v. United States*, *supra*.

⁶⁸⁹ *Philadelphia Marine Trade Ass'n — Int'l Longshoremen's Ass'n Pension Fund v. Commissioner*, 523 F.3d 140, 150 (3d Cir. 2008).

⁶⁹⁰ Cases holding that § 7502 is exclusive: *Deutsch v. Commissioner*, 599 F.2d 44, 46 (2d Cir. 1979); *Miller v. United States*, 784 F.2d 728, 730-31 (6th Cir. 1986). Cases holding that common law mailbox rule still applies despite § 7502: *Philadelphia Marine Trade Assoc.-Int'l Longshoremen's Ass'n Pension Fund v. Commissioner*, 523 F.3d 140, 147 & n.5, 148-153 (3d Cir. 2008); *Estate of Wood v. Commissioner*, 909 F.2d 1155, 1160-62 (8th Cir. 1990); *Anderson v. United States*, 966 F.2d 487, 490-91 (9th Cir. 1992).

⁶⁹¹ Reg. 301.7502-1(c)(2) as amended in 2011.

⁶⁹² In *Baldwin v. United States*, 921 F.3d 836, 839-40 (9th Cir. 2019), cert. denied, 140 S. Ct. 690 (2020), the Court agreed that the amended regulation superseded the prior cases.

⁶⁹³ *Spain v. Commissioner*, T.C. Memo. 2021-58; and Bryan Camp, [Lesson From The Tax Court: A Timely Lesson For Filing Returns](#) (Tax Prof Blog 5/17/21) (discussing *Spain* and the Tax Court rule).

Courts which earlier permitted some continued application for the mailbox rule in either type of case where the IRS has no record of receipt usually will want more evidence than the taxpayer's own self-serving testimony that he mailed it.⁶⁹⁴

Consider another example to illustrate the limitations of the mailbox rule. Assume that the USPS has a two day delivery from the taxpayer's hometown where she deposits the return in the mail and the IRS Service Center to which the return is addressed. If the taxpayer, an individual, deposits a Year 01 return in the mail on April 15 of Year 02, the original due date, § 7502 treats the return as timely filed on April 15 of Year 02, but the common-law mailbox rule would treat the return as filed on April 17, the date the IRS is deemed under that rule to have received it. Consider a similar example, with the taxpayer having timely filed his Year 01 return by mail on April 15 of Year 02 and then mails the IRS a claim for refund for Year 01 on April 15 of Year 05. Under § 7502, the claim for refund will be timely filed but under the common-law mailbox rule it would not because the IRS would not be deemed to have received it until April 17 of Year 05. And in both of these cases, if the IRS actually receives the document, then the date of receipt is that date of filing, regardless of the mailbox rule, so if the received document meets the requirements of § 7502, then it will be deemed filed on the date of mailing.

b. The Prison Mailbox Rule.

The "prison mailbox" rule is a special variant of the mailbox rule that may apply in some cases to persons who are incarcerated in the United States. A prisoner rarely has unfettered access to a mailbox and, hence, the rule developed that delivery to prison officials will be treated as a mailing so as to invoke the mailbox rule.⁶⁹⁵ A taxpayer seeking to rely on this rule (even if ever was or still is viable) bears the burden of proving timely delivery to prison officials for filing.⁶⁹⁶ And, as articulated by some courts, the rule is like Section 7502's timely-mailing, timely filing rule—delivery to the prison official is deemed filed on that date regardless of when thereafter it should have been delivered to the court or agency, when it was actually delivered to the court or agency or whether it was ever delivered to the court or agency.⁶⁹⁷

E. Review.

For a review of these rules, consider the following examples and the dates the return is deemed filed in each. All examples deal with an individual tax return for Year 01 due on April 15 of Year 02.

⁶⁹⁴ E.g., *Philadelphia Marine Trade Association v. Commissioner*, 523 F.3d 140 (3d Cir. 2008)

⁶⁹⁵ *Houston v. Lack*, 487 U.S. 266 (1988); see also *Stoot v. Cain*, 570 F.3d 669 (5th Cir. 2009).

⁶⁹⁶ See *Hatch v. Commissioner*, 364 Fed. Appx. 401, 2010 U.S. App. LEXIS 5889 (10th Cir. 2010). There is a nuance here. As generally worded, the prison mailbox rule treats the date of delivery as the filing date. See collection of cases at 38 Geo. L. J. Ann. Rev. Crim. Proc. 976, 971 fn. 2905 (2009). The general mailbox rule, by contrast, treats the date that the mail would have been delivered in due course as the filing date. *Hatch* mentions that it has not been definitely decided whether § 7502 displaces the general mailbox rule or co-exists with it, and of course it is conceivable that the prison mailbox rule could still exist for mailings otherwise subject to § 7502 even if the general mailbox rule were displaced by § 7502.

⁶⁹⁷ See *Stoot v. Cain*, 570 F.3d 669, 672 (5th Cir. 2009).

Example 1: The Year 01 return is mailed on February 1 of Year 02 and received by the IRS on February 6 of Year 02. The return is timely filed, so the timely-mailing, timely-filing rule does not apply or need to apply. The return is deemed filed on the due date of April 15 of Year 02.⁶⁹⁸

Example 2: The Year 01 return is mailed on Monday, April 13 of Year 02 and received by the IRS on Thursday, April 16 of Year 02. Normally, the timely-mailing, timely-filing rule would make the filing date April 13 of Year 02, the date of mailing. But, you will recall, § 6501(b)(1) requires that returns filed before the due date are deemed filed on the due date, here April 15 of Year 02. Note that, but for the application of the timely-mailing, timely-filing rule, the return would have been delinquent.

Example 3: Same as Example 2 except that the original due date is Sunday, April 15 of year 02, the taxpayer mails the return on Saturday, April 13 of year 02, and the IRS receives it on Wednesday, April 18 of year 02. Since it arrives late, the taxpayer qualifies for the timely mailing, timely filing rule of § 7502; the return is timely filed. Note that the original due date is on a weekend, so that, under § 7503, the taxpayer could have filed the return after the original due date and on or before April 17 of year 02 because the original due date, April 15, is a Sunday and the next day is not a business day (it is a holiday in the District of Columbia). The return is still deemed filed on the original due date of Sunday, April 15 of year 02 because § 7503 does not extend the original due date.⁶⁹⁹ For this reason, if the taxpayer had mailed the return after April 15 of year 02 and on or before April 17 of year 02, the return would have been “considered timely” but the date for the start of the statute of limitations is the date the taxpayer mailed the return. (Note that accurately identifying the date of the start of the statute of limitations is very important in the tax practice.)

Example 4: Consider the same example, except that the IRS either never received the return or has no record that it received the return. The taxpayer is protected only if she used a protected means of delivery.⁷⁰⁰

Example 5: After receiving extensions through October 15 of Year 02, the taxpayer mails the return on October 1 of Year 02 and the IRS receives it on October 03 of Year 02. The return is filed on October 3 of Year 02. This is true even though the extension gave the taxpayer through October 15 of Year 02 to file. Note that the rule of § 6501(b)(1) does not apply to filings after the original due date.

Example 6: After receiving extensions through October 15 of Year 02, the taxpayer mails the return on October 10 of Year 02 and the IRS receives it on November 15 of Year 2. The return is deemed filed on October 10 of Year 02 under the timely-mailing, timely-filing rule. Note,

⁶⁹⁸ § 6501(b)(1).

⁶⁹⁹ Rev. Rul. 81-269, 1981-2 C.B. 243; IRM 9.1.3.6.3 (02-24-2010), Running of the Statute of Limitations; and DOJ CTM 7.02[1][a] (last updated June 2016). This example is patterned on the one in DOJ CTM 7.02[1][a] (Last updated June 2016). See the related cases of *United States v. Johnson*, 2016 U.S. App. LEXIS 15879 (6th Cir. 2016); and *United States v. Johnson*, 2015 U.S. App. LEXIS 5446 (6th Cir. 2015) (holding § 7503 did not extend the due date of the return, thus making the commencement of the statute of limitations the due date and not the later § 7503 date); and see also *Hannahs v. United States*, 1995 U.S. Dist. LEXIS 2117 (W.D. Tenn. 1995) (due date for purposes of commencing the three-year period for claim for refund remains the same even if § 7503 otherwise applied to have the filing considered timely).

⁷⁰⁰ § 7502(c).

however, that the timely-mailing, timely-filing rule applies only if the taxpayer establishes the elements of the timely-mailing, timely-filing rule. Hence, if a postal stamp was used, the envelope must bear a USPS postmark within the prescribed period (on or before October 15 of Year 02), and if the postmark is illegible, the taxpayer must prove that it was postmarked within that period. Similarly, if private post metering was used, the delivery was outside the normal delivery period and the taxpayer must show why the delivery was delayed, perhaps an impossible burden.

Example 7: The taxpayer mails on October 10 of Year 02 using registered mail or certified mail as prescribed by the Regulations and the IRS receives the return on November 15 of Year 02 or, alternatively, never receives it at all. The taxpayer wins.

Consider the foregoing examples with respect to the filing of a Tax Court petition that is due, at the latest, by October 15 of Year 02.

F. Timely-Mailing Timely-Filing Rule for Delinquent Original Returns Claiming Refunds.

I discussed above § 7502 as it applies to the filing of returns. Section 7502 also applies to claims and other documents required to be filed with the IRS to establish a timely date if the IRS receives the claim or document after the due date but it was mailed on or before the due date. A special issue is presented by a return that is both a return and, because it reports an overpayment, is also a claim for refund. I discuss below statutes of limitations applying to claims for refund. In part here pertinent, however, a claim for refund of, for example, taxes that are overpaid because of withholding or estimated tax payments must be claimed within three years of the return filing date for the year involved (April 15 of Year 02 for an individual overpayment from such taxes paid by withholding or estimated taxes in Year 01). The timely-mailing, timely-filing rule applies to that delinquent original return treated as a claim for refund.⁷⁰¹

VI. Assessment of Tax.

The IRS is authorized to assess immediately the amount of tax due as shown on a return. § 6201(a)(1).⁷⁰² Assessment is an important event and will be discussed in more detail throughout the book. At this point, the importance of assessment is that it entitles the IRS to pursue administrative and judicial remedies to collect if the assessed tax is not paid. I discuss those remedies in Chapter 12, Collection Procedures.

Where the taxpayer admits on the return that he or she owes the tax, there is no need for procedural actions prior to assessing the tax. As I develop later in this text, where the taxpayer does not admit liability for the tax on a filed return, for some types of taxes (such as income tax and estate and gift tax), the IRS generally has to take certain actions prior to assessment -- to wit, first send the taxpayer a notice of deficiency (also called a statutory notice of deficiency and sometimes initialized to NOD or SNOD) which permits the taxpayer to have a pre-assessment, pre-payment remedy in the

⁷⁰¹ Reg. § 301.7502-1(f).

⁷⁰² Although the IRS is authorized to assess immediately, the actual assessment may be delayed so that the date of assessment is not the date the return was filed. *United States v. Bishop*, 2014 U.S. App. LEXIS 11861 (3d Cir. 2014), unpublished (citing prominently *Remington v. United States*, 210 F.3d 281, 284 (5th Cir. 2000)).

U.S. Tax Court. (In this text, I will use both notice of deficiency and the initialism NOD.) The IRS may assess some types of taxes and penalties immediately without those predicate steps. But, even for taxes that would otherwise require predicate steps, if the taxpayer reports the liability on a return, the IRS may assess the reported tax without those predicate steps.

VII. Payment of Tax.

A. General.

Payment is generally due upon the original due date of the return. § 6151(a).⁷⁰³ Payment may be made in cash⁷⁰⁴ or by any commercially effective means such as check or credit or debit card the IRS deems appropriate as provided in regulations.⁷⁰⁵

In many cases, advance payment will have been required through, for example, withholding in the case of wages or salaries and estimated tax payments in the case of other types of income;⁷⁰⁶ those advance payments, along with payments with an early filed return, are deemed paid on the due date of the return.⁷⁰⁷ If the taxpayer obtains an extension of time for filing past the original due date, he or she is still required to estimate and pay the ultimate tax liability by the original due date. If she underpays, interest will run from the original due date; and if she did not reasonably calculate the ultimate liability, she may be subject to penalties.

The prepayments (by withholding or estimated taxes discussed below), plus the payments made with the return will be applied against the tax assessed as reported on the return or as otherwise assessed. If there is a shortfall between the amount assessed and the amounts paid, the IRS will undertake collection measures for the difference. If there is an overpayment indicated on the return, the IRS will consider the return to be a claim for refund and process it accordingly.

B. Prepayments of Taxes.

1. Introduction.

The Code requires certain types of prepayments of tax otherwise due on the last day prescribed to file the related return. I discuss some of those prepayment requirements in this section. Prepayments may be justified as a way of ensuring that the resources will be there when the tax is due (on April 15 of the succeeding year for individuals). Another reason for prepayments is that they

⁷⁰³ The statute says the payment is required “without assessment or notice and demand from the Secretary.” Remember that the assessment occurs after the IRS receipt of the return.

⁷⁰⁴ Payments of cash can be made to the IRS at a Taxpayer Assistance Center or to a retail partner. See IRS web page titled “Pay Your Taxes With Cash” (last reviewed or updated 4/6/22 and viewed 7/20/22). Large cash payments (exceeding \$10,000) require special procedures. SBSE-05-0421-0016 (4/8/21).

⁷⁰⁵ § 6311(a) and Regs. § 301.6311-1 and § 301.6311-2.

⁷⁰⁶ See *Baral v. United States*, 528 U.S. 431, 436-437 (2000) (“Withholding and estimated tax remittances are not taxes in their own right, but methods for collecting the income tax.”)

⁷⁰⁷ § 6531(a) and (b).

help the cash flow of the fisc (hence it is not surprising that the significant prepayments were first enacted during World War II when the need for revenue was very great).⁷⁰⁸

For prepayments of tax, in general, as well as advance filing of returns, the prepayment is deemed made on the last day prescribed to file the return. § 6513. This deemed payment date can affect the date from which the payment will bear interest if it represents an overpayment and the date for the commencement of the refund statute of limitations under the lookback rules of § 6511(b), discussed below beginning on p.225. The deemed payment date will also affect the time during which the taxpayer must file a refund claim if the deemed payment.⁷⁰⁹ Although there is no express interest required for a taxpayer's failure to make prepayments, there may be penalties that function like interest during the period from the date of the prepayment to date the tax is actually due under these rules.

2. Withholding of Tax on Employees.

Taxpayers often prepay their tax liabilities by withholding by the person making payments to the person whose tax is being prepaid (e.g., employers withhold on wages payable to employees). The most common instance of the withholding system is for compensation an employer pays to employees. The employer withholds taxes with respect to the compensation and pays the amounts withheld over to the Government with the employees then claiming credit for the tax payment on their respective federal income tax returns.⁷¹⁰ This employee "pay as you go" system, originally enacted in 1943, serves several important functions in the system: (i) it mitigates the burden on employees of a large tax liability on the due date (April 15 of the following year); (ii) provides a steadier stream of federal revenue; and (iii) protects against tax disruptions due to deaths, disappearances, and mere dropping of taxpayers from sight.⁷¹¹ Similar withholding mechanisms are in place in other situations (e.g., withholding with respect to certain payments made to foreign persons, etc.)

In the case of withholdings on employee compensation, the amount the employer is required to withhold is based on the employee's compensation, the information on the employee's Form W-4, Employee's Withholding Allowance Certificate, in the employer's possession, and an IRS table designed, very roughly, to approximate the taxpayer's tax liability with respect to the compensation upon which the withholding is based. For some types of withholding, the system permits taxpayers to adjust the amounts otherwise required to be withheld order to account for their unique tax situations that would lower their tax liabilities.⁷¹² Where the IRS determines that the taxpayer has

⁷⁰⁸ Current Tax Payment Act of 1943, Pub. L. No. 78-68, 57 Stat. 126.

⁷⁰⁹ CCA 201825031 (6/8/2018), concluding that, under § 6513(b), the withholding payment and any resulting overpayment is deemed paid on the due date of the employee's return, thus starting the statute of limitations to claim a refund, even if the actual payment by the employer is later. See the next section in the text.

⁷¹⁰ § 31(a)(1). Section 6513(b)(1) provides that the employee is deemed to have paid the amount actually withheld during the calendar year on the due date of the employee's return. If this deemed payment results in an overpayment entitling the taxpayer to a refund, the deemed payment date determines the starting date for interest on a refund and for filing a claim for refund. See CCA 201825031 (6/8/18).

⁷¹¹ *Davis v. Commissioner*, T.C. Memo. 2008-238, citing 13 Mertens, Law of Federal Income Taxation, sec. 47A.02, at 47A-8 (2005 rev.).

⁷¹² Historically, this was usually done by increasing the number of personal exemptions on the Form W-4. (continued...)

a pattern of tax noncompliance, the IRS can direct the employer via a “lock-in letter” that the employer withhold more than would be otherwise required by the information on Form W-4 and the table.⁷¹³ It is important to understand that the lock-in letter is not a levy for past due tax but simply a means to ensure that the withholding will be sufficient for the current year’s tax which is the purpose of withholding.

One of the major issues that is encountered in tax practice is the trust fund recovery penalty (“TFRP,” also called the responsible person penalty) that, in the case of an employer’s failure to withhold from employees and remit the withholdings to the IRS, imposes liability upon persons within the employer’s organization who caused the failure.⁷¹⁴ (The withheld tax is deemed held in trust; hence the liability is called the term trust fund recovery penalty.) This circumstance often occurs when the employer is in financial difficulty and chooses to allocate its resources elsewhere than paying the deemed withheld amount to the IRS; in effect, the employer uses the employees’ withholding taxes to fund the operations of the employer’s business. The IRS and Social Security system credit the employee for the withheld taxes anyway, even if the employer never actually pays the withheld amount to the IRS.⁷¹⁵ The trust fund recovery penalty is designed to give persons within the employer organization the incentive to do their duty and, if they do not, give the IRS some recourse to recover the taxes for which it must credit the employees. I cover this liability in more detail below (beginning on p. 793.).

3. Estimated Taxes.

a. Individuals.

Individuals who receive significant income that is not otherwise subject to the withholding system are required to pay quarterly estimated taxes.⁷¹⁶ Estimated taxes typically apply to individuals who have income that is not subject to withholding—such as the receipt of non-employee compensation (i.e., earnings as an independent contractor (such as a lawyer)), and the receipt of income from investment sources such as interest, dividends, capital gains, etc. They may apply,

⁷¹²(...continued)

However, personal exemptions were eliminated for the years 2018 through 2025. § 151(d)(5)(A), as amended by § 11041(a)(2), P.L. 115-97, 131 Stat. 2054 (Dec. 22, 2017) (often referred to as the Tax Cuts and Jobs Act (TCJA)).

⁷¹³ See IRS web site titled “Withholding Compliance Questions & Answers (Last Reviewed or Updated 12/3/19 and viewed on 7/11/21); For a general discussion of this program, see *Cleveland v. Commissioner*, 600 F.3d 739 (7th Cir. 2010) (noting the importance of the letters to the Withholding Compliance Program and holding that the letter is not a levy under § 6331(b) that requires a notice of determination and right to CDP Proceeding). For a discussion of this program and its effectiveness on systemic compliance, see TIGTA Report titled “The Withholding Compliance Program Is Improving Taxpayer Compliance; However, Additional Enforcement Actions Are Needed” (Ref. No. 2008-40-167 8/29/08), and TIGTA Report titled “Improvements Are Needed in the Withholding Compliance Program (Ref. No. 2018-30-072 9/20/18).

⁷¹⁴ § 6672.

⁷¹⁵ See Reg. § 1.31-1(a) (“If the tax has actually been withheld at the source, credit or refund shall be made to the recipient of the income even though such tax has not been paid over to the Government by the employer.”); *Emshwiller v. United States*, 565 F.2d 1042, 1044 (8th Cir. 1977) (“any failure by the employer to pay withheld taxes results in a loss to the government in that amount”).

⁷¹⁶ § 6654. Estimated tax payments are like deposits toward the tax that will be due for the year. Therefore, the IRS cannot assess estimated tax. § 6201(b)(1). The assessment, if any, comes at the end of the tax period for the tax due for the entire period.

however, to employees otherwise subject to withholding but who do not have sufficient withholding during the year.

Individual estimated taxes are due on April 15, June 15, September 15 and January 15.⁷¹⁷ The estimated tax amount required to be paid on each date is 25% of the required annual payment which is the lesser of (1) 90% of the tax shown on the return for the year or, if no return is filed, the tax due for the year or (2) if a return covering 12 months was filed for the prior year, 100% of the tax due for the prior year (110% in the case of high income taxpayers).⁷¹⁸ For this purpose, tax withheld on wages is deemed to be estimated taxes, so that the estimated tax payment is the total tax due net of the expected withholding on wages.⁷¹⁹ Estimated tax payments may be less for taxpayers who have relatively more income later in the year under a special annualized income calculation.⁷²⁰

There are exceptions to the estimated tax requirement. If the tax net of withholding is less than \$1,000, no estimated tax is due.⁷²¹ If the taxpayer is a citizen or resident of the U.S. and reported no tax liability for the preceding tax year including 12 months, no estimated tax is due.⁷²²

These individual estimated tax provisions also apply to estates and trusts, except in certain circumstances.⁷²³

b. Corporations.

Corporations are subject to a similar estimated tax regime.⁷²⁴ Corporate estimated taxes are due on the 15th of the 4th, 6th, 9th and 12th months of the corporation's fiscal year.⁷²⁵ The amount of estimated tax is the "required annual payment," payable in four equal installments on those dates.⁷²⁶ The required annual payment is the lesser of (i) 100% of the tax shown on the return for the year (or the tax due if no return filed) or (ii) if the corporation is not a large corporation, 100% of the tax shown on the preceding year return.⁷²⁷ There is also a provision for lower installments based on annualized income.⁷²⁸

c. Payment by Application of Overpayment.

A taxpayer may elect to apply an overpayment from one year as "a credit against estimated tax for the succeeding taxable year."⁷²⁹ For example, if my 2004 return shows \$1,000 overpayment which I am entitled to have refunded, I may instead elect to have it applied to the estimated tax for

⁷¹⁷ § 6654(c)(2).

⁷¹⁸ § 6654(d).

⁷¹⁹ § 6654(g).

⁷²⁰ § 6654(d)(2).

⁷²¹ § 6654(e)(1).

⁷²² § 6654(e)(2).

⁷²³ § 6654(l).

⁷²⁴ § 6655.

⁷²⁵ § 6655(c).

⁷²⁶ § 6655(d)(1)(A).

⁷²⁷ § 6655(d)(1)(B).

⁷²⁸ § 6655(e).

⁷²⁹ § 6513(d).

2005 rather than having it refunded. This is the equivalent of receiving the refund and paying an estimated tax in the same amount. For that reason, the statute makes the election binding, so that the taxpayer may not thereafter seek to reverse the application and have the amount applied to a subsequently determined deficiency for the year of overpayment (2004 in the example).⁷³⁰

d. Penalties.

As with other payment obligations in the Code, there is a penalty if the taxpayer fails to make those payments.⁷³¹ The penalty is a time based, nondeductible interest-like penalty that runs to the due date of the return, which for individuals is April 15. I cover the penalty and the possibilities of avoiding the penalty in the penalties section below.

4. Withholding on Certain Payments.

a. Backup Withholding.

The IRS can require “backup withholding” by certain payors of “reportable payments”—generally interest or dividends and certain other payments.⁷³² The following are the general categories in which backup withholding applies: (i) the payee is required to furnish his TIN to the payor and does not; (ii) the IRS notifies the payor that the TIN supplied by the payee is incorrect; (iii) the IRS notifies the payor of “payee underreporting;” and (iv) payee certification failure.⁷³³

The first two categories are obvious. Let’s focus on the third—notice of “payee underreporting” described in § 3406(c). The underreporting includes both failure to include reportable interest or dividends on the payee’s filed return(s) or the payee may be required to file and has not filed (thus, necessarily underreporting income required to be reported). The IRS notice is to the payee but must be preceded by an IRS determination of underreporting and at least 4 notices to the payee over a period of at least 120 days.⁷³⁴ The notice to the payor is commonly referred to as a C-Notice (or some variant in reference to the cited Code section). The notice to the payor requires the payor to withhold at the current rate of 24%.⁷³⁵ Once the IRS issues a C-Notice to the payor, the withholding is stopped after the IRS makes a favorable determination and then: (1) provides the payee with a written certification that withholding is to stop and (2) directly notifies the payor to stop the withholding.

⁷³⁰ Id. See also Rev. Rul. 77-339, 1977-2 C.B. 475.

⁷³¹ § 6654(a).

⁷³² § 3406(a).

⁷³³ § 3406(a)(1).

⁷³⁴ § 3406(c)(1); See IRS page titled “Backup Withholding “C” Program” (Last Reviewed or Updated 6/26/22 and viewed 1/29/23).

⁷³⁵ The IRS web page titled Topic No. 307 Backup Withholding (Last Reviewed or Updated 1/4/23 and viewed 1/19/23) states that the withholding rate is 24%. The statute, § 3406(a)(1) (flush language) says that the withholding rate is “the fourth lowest rate of tax applicable under section 1(c)” which sets for the rates schedule for unmarried individuals (other than surviving spouses and heads of households). (It is not clear to me how that web page’s statement of the current rate conforms with the reference to §1(c), but I have not dug into that question further.)

b. Miscellaneous.

The Code has a host of other withholding requirements for payments to persons who are otherwise subject to tax. The payor is required to withhold in such cases, although exemptions may be available. For example, although tax is not normally withheld on corporate dividends, for such dividends paid to foreign persons, the payor corporation must withhold at 30% unless the shareholder payee qualifies for a lesser withholding rate or exemption from withholding under a treaty.⁷³⁶ Similarly, a payer of certain wagering winnings must withhold.⁷³⁷

I will not expect you to know all of the myriad withholding requirements for this course. But I do encourage you to think of the reason for the withholding requirement and you will be able to intuit when there may be a withholding requirement. Think about the employee withholding and the estimated tax system for prepaying taxes. Frequently, without such a “pay as you go system,” taxpayers would not otherwise be able to pay their taxes when they are due. In short, the system addresses a significant potential for noncompliance. Think also about the example I just gave for withholding on dividend payments to foreign persons. If the dividends were paid without withholding, do you think the IRS would have a significant compliance problem with respect to those foreign persons? Do you think that, absent withholding, many foreign persons would report and pay the taxes? Thus, it is quite frequent that, for payments of U.S. income items attributable to foreign persons, there will be some type of withholding mechanism. Similarly, in other areas, such as the employment winnings where there is significant potential for noncompliance, there will often -- but not always -- be a withholding requirement imposed on the U.S. payor.

The significant exception to this is for payments made by taxpayers to persons in a trade or business, often referred to as independent contractors. There is a compliance problem among some classes of independent contractors (such as small operators in the services field, such as gardeners, painters, etc.), but Congress has never had the political will to impose a withholding requirement on such payments to independent contractors. Congress, however, requires that certain payors of payments to nonemployees report the payments to the nonemployee and the IRS (e.g., Forms 1099), which the IRS can then use its computers to match with the returns to see if the income was reported.

C. Extensions of Time to Pay Tax.

The IRS generally can extend payment of income tax shown or required to be shown on a return for six months and may extend payment of estate tax for 12 months.⁷³⁸

Upon determining undue hardship, the IRS can extend payment of (i) income tax determined as a deficiency for a period of 18 months and for a further period not to exceed 12 months⁷³⁹ or (ii) estate tax determined as a deficiency for up to 4 years.⁷⁴⁰ These deficiency extensions are not

⁷³⁶ § 1441.
⁷³⁷ § 3402(q).
⁷³⁸ § 6161(a).
⁷³⁹ § 6161(b)(1).
⁷⁴⁰ § 6161(b)(2).

available if “the deficiency is due to negligence, to intentional disregard of rules and regulations, or to fraud with intent to evade tax.”⁷⁴¹

The IRS may also extend for reasonable cause the payment of estate taxes for up to 10 years.⁷⁴² The reason for this discretionary authority is that estates may be insufficiently liquid to pay the tax when due. The IRS may require the taxpayer to post a bond to protect the Government’s interest.⁷⁴³

In addition, estates having a large percentage of assets in one or more closely held businesses may elect a 15-year deferral (five year interest only and then in ten annual installments) of estate tax attributable to the closely held business.⁷⁴⁴ A special beneficial interest rate applies to some portion of the deferred payments.⁷⁴⁵ The IRS may require the taxpayer to post a bond for the extension or, in lieu of the bond, a special extended estate tax lien for the deferred amount (including penalty and interest).⁷⁴⁶ The statute of limitations on collection is suspended during the period of the extension of time to pay.⁷⁴⁷ And the interested parties may enter an agreement for a special lien on the property subject to the election which is in lieu of the general § 6324 estate tax lien.⁷⁴⁸

The IRS may enter into installment agreements that have the effect of extending the time for payment. Installment agreements are usually not reached, however, at the return filing stage. I cover installment agreements beginning p. 705).

D. Extensions of Time to Pay Tax.

As discussed above (p. 149), the Code provides relief with respect to deadlines in certain cases of military or support service and disasters. §§ 7508 & 7508(a). These provisions apply to the deadline for tax payments.

⁷⁴¹ § 6161(b)(3).

⁷⁴² § 6161(a)(2). In *Baccei v. United States*, 732 F.3d 1140 (9th Cir. 2011), the taxpayer had filed an extension request for estate tax without stating the date to which the extension was requested. The Court held that the extension request was fatally defective so that the failure to pay penalty applied. The Court also found that the reasonable cause exception to the failure to pay penalty did not apply because the taxpayer should have ascertained the payment date and could not rely upon an accountant. The Court relied principally upon *United States v. Boyle* 469 U.S. 241 (1985), rejecting reliance on an accountant as to the filing date for the estate tax return.

⁷⁴³ § 6165.

⁷⁴⁴ § 6166. This election to defer tax “shall be made not later than the time prescribed by section 6075(a) for filing the return of tax imposed by section 2001 (including extensions thereof).” § 6166(d). Consistent with the plain text requirement, the IRS interprets this to preclude the election on a late filed estate tax return. ILM 200628042 (reproduced at 2006 TNT 152-16).

⁷⁴⁵ § 6601(j).

⁷⁴⁶ § 6165 (see § 6166(k)(1) cross referencing to § 6165) and § 6324A (see § 6166(k)(2) cross referencing § 6324A). In *Estate of Roski v. Commissioner*, 128 T.C. 113 (2007), the Court rejected the IRS rule requiring a bond for the election virtually in every case, holding that the IRS was imposing what is a substantive requirement to relief that the Congress did not provide in the statute. In Notice 2007-90, 2007-46 I.R.B., the IRS responded to *Estate of Roski* by establishing procedures to make the case by case determination. See also PMTA 2009-046, reproduced at 2009 TNT 129-21 (discussing procedures with respect to bonds and liens) and ILM 200803016 (discussing use of interest in an LLC as collateral for the special estate tax lien under § 6324A that secures the tax deferred under § 6166).

⁷⁴⁷ § 6503(d) (see § 6166(k)(3) cross referencing § 6503(d)).

⁷⁴⁸ § 6324A.

VIII. Return Reporting in the Marital Relationship.

A. Community Property States v. Separate Property States.

Each taxpayer having income is required to file a return. In community property states such as Texas where each spouse is generally deemed to earn one-half the community income, each spouse is required to report one-half the income earned or received by the other spouse.⁷⁴⁹ By contrast, in separate property states prior to the advent of the joint return, the earner of the income or owner thereof (in the case of income derived from property) had to report all of the income.

Prior to the introduction of the joint return, this disparate property system created two significant glitches.

First, all other things being equal, spouses in community property states with disparate levels of income owed less aggregate income tax than spouses in the same economic circumstance but residing in separate property states. By operation of law, spouses in community property states split their income which gave them rate benefits under the income tax's graduated rate schedules. Spouses in separate property states did not get the income splitting tax rate benefits. This glitch presented an issue of fairness as among citizens of the various states.

Second, on the downside in community property states, because each spouse owed tax on his or her ½ share of the community income, it did not matter whether the spouse in fact received the actual benefit of the community income. I hope you quickly spot that this rule, if applied full bore, can have inequitable consequences in a myriad of situations. For example, assume that husband abandons wife and wife does not know where he is and does not benefit from any share of his income. Wife is nevertheless, in theory, required to report and pay tax on one-half his income.

B. Joint Returns and Joint Liability.

1. The Concept.

In response to the first glitch noted above, Congress enacted the joint return provision of the Code.⁷⁵⁰ This permits married persons to file a joint return⁷⁵¹ combining their income and deductions and applying for a tax table with lesser rates than the individual rate table. Generally, this produced significantly lower taxes for married couples with disparate incomes than if they filed separate returns. Couples in community property states can file joint return and, by an overwhelming

⁷⁴⁹ *Poe v. Seaborn*, 282 U.S. 101 (1930).

⁷⁵⁰ § 6013(a). For a good summary of the history of the joint return provision, see Bryan Camp, Lesson From The Tax Court: The Tacit Consent Rule (Tax Prof Blog 1/18/22) The original version of § 6013(a) was enacted in the Revenue Act of 1918, § 223, 40 Stat. 1057, 1074.

⁷⁵¹ A joint return for this purpose includes the Form 1040 but may also include § 6020(a) returns prepared by IRS if they are signed by the taxpayer under penalties of perjury. Rev. Rul. 2005-59, 2005-37 I.R.B. 505.

majority, most do.⁷⁵² Hence the joint return scheme will apply to most cases even in community property states.

As the cost of this tax rate relief, however, Congress imposed on both spouses joint and several liability for the entire tax due.⁷⁵³ Although the beneficial rate applicable for the joint return did mitigate the discrepancy in overall tax (the first glitch noted above), it imposed this cost (joint liability) that was not the inevitable consequence of the solution of the first glitch (the beneficial rate table for the combined income) and really did not address the second glitch, except to expand the problems inherent in any system in which a spouse may be held liable for tax in inequitable circumstances. The second glitch and related problems arising from joint and several liability were ultimately addressed by Congress in the so-called innocent spouse provisions which, in parallel fashion based on equitable principles, relieve one spouse of liability for tax he or she would otherwise owe with respect to the other spouse's income as a result of filing a joint return or filing a separate return in a community property state. I discuss these innocent spouse provisions below (beginning on p. 758).

2. Couples Eligible to File Joint Returns.

The determination of marital status qualifying to file a joint return is made as of yearend for the tax year. Thus, persons married during the year but divorced by yearend do not qualify.⁷⁵⁴ However, a spouse not married because his or her spouse died during the year may file a joint return).⁷⁵⁵ Spouses who are legally separated at yearend may not file a joint return.⁷⁵⁶

3. Requirements for a Joint Return.

Obviously, for a joint return, the two parties must be married under state law. The joint return they file must be a return under the rules previously discussed. And the couple must intend to file that return as a joint return.⁷⁵⁷ Their signatures on the return is the normal requirement to reflect and implement that intent, but where one of the spouse's signatures does not appear on the return, the return may still qualify if the facts and circumstance show that the couple intended to file a joint return (a "tacit consent" rule).⁷⁵⁸

⁷⁵² Couples with disparate incomes in community property states generally receive less benefit from the joint return than do similarly situated couples in separate property states, but generally these couples do not undertake any type of cost-benefit analysis of using the joint return, the cost being the joint and several liability noted in the text.

⁷⁵³ § 6013(d)(3).

⁷⁵⁴ § 6013(d)(1)(A).

⁷⁵⁵ § 6013(d)(1)(B).

⁷⁵⁶ § 6013(d)(2).

⁷⁵⁷ *Ziegler v. Commissioner*, T.C. Memo. 2003-282, at *8 n.4 (citing *Stone v. Commissioner*, 22 T.C. 893 (1954)).

⁷⁵⁸ *O'Connor v. Commissioner*, 412 F.2d 304, 309 (2d Cir. 1969), cert. denied 397 U.S. 921 (1970); *Shea v. Commissioner*, 780 F.2d 561, 567 (6th Cir. 1986). *Estate of Campbell v. Commissioner*, 56 T.C. 1, 12 (1971); *Okorogu v. Commissioner*, T.C. Memo. 2017-53, at *19 (discussing the "tacit consent rule" where "the intent to file a joint return may be inferred from facts demonstrating that a nonsigning spouse tacitly approved or acquiesced in the other spouse's filing of the joint return."); and *Soni v. Commissioner*, T.C. Memo. 2021-137, at *14-20 (same). For an excellent discussion of the tacit consent rule generally and its application in *Soni*, see Bryan Camp, [Lesson From The Tax Court](#):

(continued...)

4. Joint Returns Filed After Separate Returns.

Spouses may file a joint return after filing separate returns, subject to the following limitations.⁷⁵⁹ First, the joint return must be filed within three years of the date prescribed by law for filing the return for the year.⁷⁶⁰ This means, for example, that, if husband and wife file separately for Year 01, the latest they can file an amended joint return to elect joint return treatment is April 15 of Year 05. Second, a joint return cannot be filed after (a) a notice of deficiency has been sent to either spouse who then petitioned the Tax Court for redetermination, (b) either spouse has filed a refund suit, or (c) either spouse has entered into a closing agreement.⁷⁶¹ The foregoing limitations, by statute, apply only where the married taxpayers have filed a “separate return.” There seems to be a conflict in the circuits over what separate return means for the limitations to apply: Does separate return mean only married filing separate (so that the limitations apply only to returns filed in that category and not, for example, to a return filed as head of household or single, neither of which a married person is eligible to file) or does it mean any non-joint return (such as married filing head of household or single)? The trend seems to be that a disqualifying separate return is only one filed claiming the status married filing separately.⁷⁶²

The filing date for the joint return is normally the date of filing but an earlier deemed filing date is provided under either of these two scenarios: (1) if both spouses previously filed separate returns, the deemed filing date is the date the last of the two separate returns was filed or (2) if only one spouse filed a separate return, the deemed filing date is the date of that separate return if the other spouse was not required to file a return.⁷⁶³ Further, if a delinquent joint return is filed, the statute of limitations on assessment and collection will include at least the one year period from the date of actually filing the return.⁷⁶⁴

⁷⁵⁸(...continued)

The Tacit Consent Rule (Tax Prof Blog 1/18/22). In considering the tacit consent rule, readers should consider which party (the IRS or the taxpayer) is trying to invoke the rule and what proof is required to invoke the rule. For example, the IRS might want to invoke the rule if it seeks joint and several liability for the nonsigning spouse. Similarly, the taxpayer may want to invoke the rule if the taxpayer seeks the benefits of a joint return where only one spouse signed. In *Hennen v. Commissioner*, 35 T.C. 747, 749 (1961), the Court said in the context of the IRS invoking the tacit consent rule that “The tacit consent presumption is nothing more or less than the presumption of correctness attaching to respondent's determination that a joint return was in fact intended. If no contrary evidence appears, his determination will be sustained, whether called a presumption of tacit consent or the regular presumption of correctness.” Of course, if there is contrary evidence (the spouse testifies that he or she did not consent to a joint return), then the party asserting there was a joint return (usually the IRS) will have to prove tacit consent based on the adduced facts and circumstances.

⁷⁵⁹ § 6013(b).

⁷⁶⁰ § 6013(b)(2)(A). Equitable tolling does not apply to this statutory time limitation. *Huff-Rousselle v. United States*, 560 F. Supp. 3d 480 (D. Mass. 9/16/21).

⁷⁶¹ § 6013(b)(2)(B)-(D).

⁷⁶² *Ibrahim v. Commissioner*, 788 F.3d 834 (8th Cir. 2015); and *Glaze v. United States*, 641 F.2d 339 (5th Cir. 1981), holding that the separate return does not include filing as head of household; see also *Camara v. Commissioner*, 149 T.C. 317 (2017) (erroneously filing single return is not a disqualified separate return); and *Knez v. Commissioner*, T.C. Memo. 2017-205 (extending *Camara* to head of household filing is not a disqualified separate return). Although that appears to be the consistent holding of the Courts of Appeals, it is not yet clear whether the IRS will accept the holding or will attempt to raise it in other courts of appeals.

⁷⁶³ § 6013(b)(3).

⁷⁶⁴ § 6013(b)(4).

To preserve the integrity of the penalty provisions, if an originally filed separate return was subject to the negligence or fraud civil penalties, the filing of a joint return will not cleanse the originally filed separate return and will be deemed to be penalizable conduct with respect to the joint return.⁷⁶⁵ Further, if the originally filed separate return was subject to criminal penalties, the original separate return is subject to criminal prosecution.⁷⁶⁶

C. Relief from Joint Tax Liability; Innocent Spouse Relief.

I hope that you understood from the foregoing discussion that there are inherent potential inequities in the system. In separate and community property states, spouses signing joint returns can be subject to all unreported tax whether or not they knew of or benefitted from the omitted income or overstated deductions. In community property states, even where separate returns are filed, spouses will be subject to liability on one-half the community income whether or not they knew of or benefitted from it.

Not only is omitted income a potential inequity, but improperly claimed deductions can be equally unfair to a spouse who did not know that the claim on the return was wrongful.

The Code provides potential so-called innocent spouse relief. I defer discussion until later when addressing collection issues (beginning on p. 758). I cover it there because it usually arises in a collection context and it often comes down to whether the husband or the wife or both will be subject to collection.

IX. Returns to Report Withholding and Related Obligations.

The foregoing discussion has dealt principally with income returns filed by individuals or entities. Other common returns in tax practice deal with returns filed by individuals or entities having the duty to withhold on payments they make to other persons. The most commonly encountered such returns related to payments made to employees. These forms are Form 940, Employer's Annual Federal Unemployment (FUTA) Tax Return, Form 941, Employer's Quarterly Federal Tax Return, and Form W-3, Transmittal of Wage and Tax Statements (attaching Forms W-2 sent to employees). Analogous returns are filed whenever, as with employee's wages, there is a payor withholding obligation. Since there is a withholding obligation, those returns requirement payments of the withheld amounts to the IRS. And, since there is a reporting and payment required, there are penalties for failure to meet those obligations. I do not deal separately with those penalties here.

It is not uncommon for employers to outsource their obligation for reporting and paying for these obligations. The outsourcing may include responsibilities for employment taxes, including the withholding and pay over obligation for trust fund taxes, while the contracting employer remains the employer liable for those taxes. The IRS identifies the following types of such outsourcing:⁷⁶⁷

⁷⁶⁵ § 6013(b)(5)(A).

⁷⁶⁶ § 6013(b)(5)(B).

⁷⁶⁷ See IRS web page titled "Outsourcing Payroll and Third Party Payers" (last reviewed or updated (continued...))

- Payroll Service Provider (PSP). The PSP performs withholding and related compliance for employers. They do not become the employer for purposes of these obligations. Thus, the employer is still responsible, even for noncompliance of the PSPs.
- Reporting Agent (RAF). The RAF originates the electronic submission of certain returns for its clients, and/or transmits the returns to the IRS. The RAF must comply with Revenue Procedure 2012-32.
- Section 3504 Agent. The Section 3504 Agent is appointed under § 3504 to perform the employer's obligations for withholding, reporting, and paying the employment obligations (both withholding and employer tax). The IRS can collect the tax involved from both the employer and the Section 3504 Agent. The Section 3504 agent must follow the procedures set forth in Rev. Proc. 2013-39.
- Certified Professional Employer Organization (CPEO). Pursuant to §§ 3511 and 7794,⁷⁶⁸ the CPEO program permits the CPEO to be treated as the only employer for these employment tax purposes, thus relieving the common law employer and its responsible persons from that liability. To become and remain certified under the program, CPEOs must meet tax compliance, background, experience, business location, financial reporting, bonding, and other requirements.⁷⁶⁹ Of course, as the statutory deemed employers, the CPEOs are liable directly and their responsible persons under § 6672 can be liable if the CPEOs fail to pay.

X. Expatriation or Termination of Long-Term U.S. Residence.

U.S. citizens may renounce their citizenship;⁷⁷⁰ U.S. residents (non-citizens) may also terminate their residency.⁷⁷¹ Some do so for tax reasons, with the expectation or hope that, by escaping the U.S. tax regime, they can reduce their tax liabilities and thus retain more of their wealth. One setting for tax-motivated expatriation arose recently after the IRS started its offshore account initiative in 2009 starting with UBS and then expanding to other Swiss and other foreign financial institutions and, the resulting enactment of the Foreign Account Tax Compliance Act ("FATCA," discussed beginning on p. 991), but the general problem of a U.S. tax accounting and settling of the U.S. tax matters with a U.S. citizen renouncing U.S. citizenship has existed for some time.

⁷⁶⁷(...continued)

9/19/21 and viewed on 7/24/21; and "Third Party Arrangement Chart" (Page Last Reviewed or Updated 6/9/22 and viewed 7/20/22).

⁷⁶⁸ Added by Tax Increase Prevention Act of 2014, P.L. 113-295, §206(a)). The IRS summarizes the requirements for a CPEO (IRS web site titled "Voluntary Certification Program for Professional Employer Organizations (CPEOs)" (last reviewed or updated 7/11/22 and viewed on 7/20/22); and IRS web site titled "Certified Professional Employer Organization Application" ((last reviewed or updated 5/6/22 and viewed on 7/20/22). The requirements include: (i) have at least one physical business location within the United States at which PEO functions are carried on, (ii) provide a Surety Letter at the time of application, (iii) provide financial information, including annual audited financial statements prepared by a CPA, (iv) provide an assertion and CPA examination level attestation regarding federal employment tax compliance; and (v) pay a user fee of \$1,000.00.

⁷⁶⁹ Id.

⁷⁷⁰ 8 U.S.C. § 1481. For a general discussion of the law summarized in this section, see Gary Forster and J. Brian Page, Expatriation From the United States: The Exit Tax, 94 Fla. Bar J. 60 (2020).

⁷⁷¹ § 877(e) (comparable treatment).

Under the current regime,⁷⁷² § 877A imposes a mark-to-market tax on assets in the year of expatriation⁷⁷³ if the following characteristics are met:

- (1) average income tax liability test (average U.S. tax liability for five years preceding year of expatriation exceeding \$190,000⁷⁷⁴ for 2023 (adjusted for inflation));
- (2) net worth test (\$2 million or more on the expatriation date); or
- (3) certification test (taxpayer fails to certify on Form 8854, Initial and Annual Expatriation Statement, U.S. tax compliance for preceding five years including the expatriation date).⁷⁷⁵

A U.S. citizen as so described is called a “covered expatriate.”⁷⁷⁶ A similar regime applies to an alien (not U.S. citizen) who is long-term residents of the U.S. Certain rules designed to avoid gaming the system are provided, and the taxpayer may elect to defer the tax attributable to the property deemed sold.

XI. Return Preparer Regulation and Penalties.

A. Introduction.

The tax return—the self-assessment mechanism—is the foundation of our tax system. Many taxpayers do not prepare their own returns. Rather, they rely upon tax return preparers to prepare the returns. Tax return preparers thus play a critical role in the self-assessment system.

Because of the complexity of the Code, in many cases there is no (or at least no easily ascertainable) finite tax liability, so that correct reporting in many instances is just to ensure that the taxpayer gets within the right range. In this regard, Money Magazine used to present to various well-regarded return preparers throughout the country a set of facts, only moderately complex, for the preparers to prepare returns. Rarely were these preparers in agreement as to the same bottom-line tax liability on the same set of facts. Hence, the penalty regime both for preparers and taxpayers must take this phenomenon into consideration, and only punish conduct that the preparers and taxpayers really knew was wrong or sufficiently risky for the civil or criminal penalty in issue.

If, even given this latitude, tax return preparers fail in their responsibility to prepare reasonably correct returns, there can be serious ramifications both to the taxpayer and to the system, since most incorrect reporting is probably never caught. Accordingly, Congress built in a series of incentives—penalties—to encourage preparers to get it right within some reasonable parameters. Thus, just as there are penalties (that I discuss later) to encourage taxpayers to do it right, there are also

⁷⁷² A prior regime was under § 877 which does not apply to expatriation or termination of residence after July 17, 2008. § 877(h). That regime is described in Gary Forster and J. Brian Page. Expatriation From the United States: The Exit Tax, 94 Fla. Bar J. 60 (2020).

⁷⁷³ The date of expatriation is the earliest of the dates specified in § 877A(g)(2) & (3).

⁷⁷⁴ Rev. Proc. 2022-38; 2022-45 I.R.B. 1, Section 3.37.

⁷⁷⁵ § 877A; and § 6039(g) for the reporting requirement. The discussion in this section is drawn principally from the two IRS web pages: (i) “Expatriation Tax” (last reviewed or updated 7/22/21 and viewed 7/24/21); and (ii) “Relief Procedures for Certain Former Citizens” (last reviewed or updated 7/19/21 and viewed 7/24/21).

⁷⁷⁶ § 877A(g)(1), defined by reference to § 877(a)(2)(A)-(C).

penalties to encourage tax return preparers to do it right. The topic of the present discussion is the tax return preparer penalties.

B. Who is a Tax Return Preparer?

A tax return preparer is a person who prepares a return or substantial portion of a return) or who employs a person who prepares a return or substantial portion for compensation.⁷⁷⁷ Returns include claims for refund.⁷⁷⁸ Persons who perform ministerial tasks such as typing or photocopying are excluded.⁷⁷⁹ A person is a preparer if he or she prepares a substantial portion even though someone else is a signing preparer.

First, consider a case where the preparer compiling and signing the return relies upon a lawyer's opinion as to the reporting of a transaction on the return. Is or should the signing preparer be the preparer as to that item, or should the lawyer giving the opinion be the preparer? I dare say that most of you who enter a tax law practice will have occasion to advise a taxpayer and his return preparer as to how an item should be reported on this return, so this question is not just one of academic interest. The short answer is that the lawyer giving the opinion as to the return reporting can be the preparer as to that item even though that lawyer does not sign the return as preparer.⁷⁸⁰

Second, consider return preparer A who is asked to prepare an individual income tax return (Form 1040) for individual B. Among the items B delivers to A is a K-1 prepared by another return preparer that reports B's share of a partnership's very substantial losses. (These loss characteristics might suggest that the partnership is a tax shelter, but it also may be a real partnership with real losses.) The K-1 reports a single line item for B's share of partnership loss of, say, \$1,000,000. Normally, that amount is then reported as a single entry on B's Form 1040. If A makes that single entry on the return A prepares, is A the return preparer as to that partnership item? Certainly, the partnership return preparer who prepares both the partnership return and the K-1s distributed to the partners is the return preparer for that portion of the partner's return.⁷⁸¹

But what responsibility does the return preparer for B have to go behind the lawyer's opinion or the K-1 in reporting on the return he or she prepares for B? In each case, if the return preparer has facts which should alert a reasonable person that there is a problem with respect to the opinion or the K-1, the return preparer is at risk of being the return preparer as to that item. But even beyond that, what responsibility does the return preparer have?

⁷⁷⁷ § 7701(a)(36)(A). "Substantial portion" is defined in Reg. § 301.7701-15(a)(1) and (b).

⁷⁷⁸ § 7701(a). What is a return or claim for refund for this definition is addressed in Reg. § 301.7701-15. Most of the time a return or claim will be obvious, but there may be some nonobvious cases. For example, if information or a form included with a return does not affect the calculation of tax liability on the return, a person providing that information or preparing that form is not a return preparer. See Reg. § 301.7701-15(b)(iv) (Examples 1 and 2).

⁷⁷⁹ § 7701(a)(36)(B)(i).

⁷⁸⁰ Reg. § 301.7701-15(b)(2) (although excluding lawyers rendering advice only as to contemplated transactions and not specific advice as to how the transaction should be reported on the return).

⁷⁸¹ Reg. § 301.7701-15(b)(iii); *Adler & Drobny, Ltd. v. United States*, 9 F.3d 627 (7th Cir. 1993); and *Goulding v. United States*, 957 F.2d 1420 (7th Cir. 1992) (in which the partnership return preparer drawing a penalty attempted to pass the responsibility to the lawyers who rendered tax shelter opinions to the partnership).

C. Basic Preparer Responsibilities and Penalties (§ 6695).

A return preparer is “any person who prepares for compensation, or who employs one or more persons to prepare for compensation,” any tax return or any claim for refund of tax.”⁷⁸² There are two types of return preparer – the signing return preparer and the nonsigning return preparer.⁷⁸³ The signing preparer is the one with overall responsibility for the return or claim for refund. The nonsigning preparer is the person other than the signing preparer who prepares all or a substantial portion of the return or claim for refund. Nonsigning preparers can include a person rendering advice to a taxpayer or another return preparer when the advice results in a substantial position on the return.⁷⁸⁴

There is a plethora of penalties either targeted to the return preparer or to which the preparer could be subject in the course of preparing returns. These are helpfully listed on an IRS web site titled IRS titled “Summary of Return Preparer Penalties under Title 26.”⁷⁸⁵ I deal here just with the § 6695 penalties for positions taken on returns or related preparer responsibilities.

D. Penalties for Unreasonable Positions, Negligence and Fraud.

1. Unreasonable Positions.

Section 6694(a) imposes a penalty of the greater of \$1,000 or 50% of the preparer’s income with respect to a return or claim for refund prepared by the preparer having an understatement or excessive claim attributable to an “unreasonable position” that was known or reasonably should have been known to the preparer.⁷⁸⁶ An unreasonable position is one where

- either (i) if not disclosed, the position did not have at least substantial authority or (ii) if disclosed, the position did not have at least reasonable basis;⁷⁸⁷ or
- if a tax shelter or reportable transaction, the position is unreasonable “unless it is reasonable to believe that the position would more likely than not be sustained on its merits.”⁷⁸⁸ Note that this is not the preparer’s subjective belief, but some objectively reasonable belief.

Each of the key words—substantial authority, reasonable basis and reasonable to believe more likely than not—are terms of art in the penalty area that have been more fully developed for the taxpayer accuracy related penalties that are discussed in more detail below (beginning on p. 349).⁷⁸⁹ Suffice

⁷⁸² § 7701(a)(36).

⁷⁸³ Reg. § 301.7701-15(b).

⁷⁸⁴ Reg. § 301.7701-15(b)(2)(i).

⁷⁸⁵ (Last Reviewed or Updated 2/7/20 and viewed 7/26/20).

⁷⁸⁶ This section was amended in 2007 and then again in 2008. The discussion above is of the statute as amended in 2008.

⁷⁸⁷ § 6694(a)(2)(A) & (B). See Rev Proc 2020-54 § 3.05, 2020-53 I.R.B. 1806 for guidance on disclosures under § 6694(a)(2)(B).

⁷⁸⁸ § 6694(a)(2)(C).

⁷⁸⁹ See e.g., Notice 2009-5; 2009-3 I.R.B. 309 providing that, until further guidance, the definition of (continued...)

it to say here, one of the common methodologies for conceptualizing a meaningful construct for these key words is:

- reasonable basis - at least a 20% likelihood of prevailing;⁷⁹⁰
- substantial authority - at least a 35-40% likelihood of prevailing;
- more likely than not—at least a 51% likelihood of prevailing.⁷⁹¹

Stating the rules in the affirmative, the preparer can avoid the penalty for a position that is not a tax shelter or reportable transaction position by disclosing the position if there is only reasonable basis for the position or assuring at least substantial authority if not disclosed. Since there is no clear litmus test for differentiating between substantial authority and reasonable basis, the cautious preparer will be inclined to err on the side of disclosure. (By the same token, since there is no clear litmus test for reasonable basis (20%) which is the minimum standard, below which there would have to be the potential for criminal prosecution, those trying to play too close to that line might be taking risks they might regret.)

The foregoing deals with unreasonable positions as to the application of the law to the facts. What responsibility does the preparer have to verify the facts? Generally, the preparer may rely upon the facts presented by the taxpayer so long as the proffered facts are not, based on the factual circumstances known or reasonably knowable to the preparer, incomplete or incorrect. Further, the preparer may rely upon facts from third parties (such as through W-2s, 1099s or others such as other tax advisors or tax preparers), again subject to the preparer not having facts indicating that the facts are incomplete or incorrect. Of course, in those circumstances where the Code requires that the taxpayer have contemporaneous documentation to claim the tax benefit, the preparer must make appropriate inquiry as to the existence of the documents. The Regulations indicate, for example, that where the Code requires a contemporaneous qualified appraisal to support a charitable contribution, the preparer should inquire about the existence of the appraisal.⁷⁹²

The penalty is not imposed if there is reasonable cause for the understatement and the tax return preparer acted in good faith.⁷⁹³

The penalty applies if the preparer “prepares any return or claim of refund” with the understatement.⁷⁹⁴ It does not require that the return or claim have been filed with the IRS.⁷⁹⁵ The Regulations provide that, for this purpose, the return or claim for refund “is deemed prepared on the

⁷⁸⁹(...continued)

“substantial authority” is the same as in Reg. § 1.6662-4(d)(2).

⁷⁹⁰ The IRM says “Reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper. See 26 CFR 1.6662-3(b)(3).” IRM 20.1.5.3.1 (08-31-2021), Definitions. I will address reasonable basis positions later in the discussion of the accuracy related penalties applying to taxpayers for their return reporting positions.

⁷⁹¹ Michelle M. Kwon, Dysfunction Junction: Reasonable Cause and Good Faith Reliance on Tax Advisors with Conflicts of Interest, 67 Tax Law. 403, 407 (2014).

⁷⁹² Reg. § 1.6694-1(e)(3).

⁷⁹³ § 6694(a)(3).

⁷⁹⁴ § 6694(a)(1)(A).

⁷⁹⁵ See ILM 201519029 (3/25/15).

date it is signed by the tax return preparer,” but if the preparer does not sign the return or claim, it is deemed prepared on the date filed.⁷⁹⁶

2. Willful or Reckless Conduct.

Section 6694(b) imposes a penalty of the greater of \$5,000 or 75% of the preparer’s income from the return for a position resulting in an understatement that is due to “a willful attempt in any manner to understate the liability for tax” or “a reckless or intentional disregard of rules or regulations.”⁷⁹⁷ Willful is a term of art in the tax law. It is used in most of the criminal tax provisions to mean the intentional, voluntary violation of known legal duty.⁷⁹⁸ That is the meaning that courts apply here.⁷⁹⁹ It is a significantly higher element of consciousness than simply negligence. Reckless conduct may be viewed as just slightly less culpable conduct than willful conduct, but more culpable than negligent conduct. This penalty is thus intended to apply even if the preparer could not be convicted of a crime requiring willfulness which is the usual requirement for tax crimes.

3. Assessing and Contesting Preparer Penalties.

The statutes of limitations for assessment are:

- § 6694(a) penalty, “within 3 years after the return or claim for refund with respect to which the penalty is assessed was filed.”⁸⁰⁰
- § 6694(b) penalty, “at any time.”⁸⁰¹

The preparer may sue for refund within 3 years of the date the penalty was paid.⁸⁰²

The preparer can pay the penalty assessed and contest liability by the usual procedures of filing a claim for refund and, if denied, a suit for refund. To avoid the *Flora* full payment rule for refund suits, the preparer can (i) within 30 days of the assessment’s notice and demand, pay 15% of the penalty and file a claim for refund and (ii) then file the refund suit in district court by the earlier of (a) 30 days from the denial of the claim or (b) 6 months and 30 days from the date the refund claim was filed.⁸⁰³ Under this special *Flora* avoidance rule, while the claim for refund or the

⁷⁹⁶ Reg. § 1.6694-1(a)(2).

⁷⁹⁷ Prior to 2016, the percentage was 50%.

⁷⁹⁸ See e.g., *United States v. Bishop*, 412 U.S. 346, 361 (1973) (The Court interpreted “willfully” to require an element of *mens rea* and formulated the term willfully to require “a voluntary, intentional violation of a known legal duty.”) See also *Cheek v. United States*, 498 U.S. 192 (1991).

⁷⁹⁹ *Richey v. IRS*, 9 F.3d 1407, 1411 (9th Cir. 1993) (willfulness under § 6694(b)(2)(A) requires “a conscious act or omission made in the knowledge that a duty is therefore not being met,” quoting *Pickering v. United States*, 691 F.2d 853, 855 (8th Cir. 1982)). In *Rodgers v. United States*, 857 Fed. Appx. 959 (9th Cir. 7/6/21) (unpublished and nonprecedential), the Court held that the willful was the *Cheek*-type willfulness under § 7206).

⁸⁰⁰ § 6696(d)(1).

⁸⁰¹ § 6696(d)(1).

⁸⁰² § 6696(d)(2).

⁸⁰³ § 6694(c); see also § 6696(c); Reg. § 1.6696-1. For an application of this rule, see, *Taylor v. Commissioner*, 2016 U.S. Dist. LEXIS 122216 (E.D. Wash 2016), aff’d 731 Fed. Appx. 599 (9th Cir. 2018) (unpublished), noting the compliance with the time limits of this rule is required for this special refund procedure, but

(continued...)

refund suit is pending, the IRS may not levy or bring a court proceeding for collection, but the statute of limitations on collection is suspended.⁸⁰⁴

4. Abatement of Penalty If No Understatement of Tax.

If, at any time, there is a final administrative or judicial determination that there is no taxpayer understatement for which the preparer has been assessed or has paid this preparer penalty, the assessment shall be abated and any payment refunded.⁸⁰⁵

E. Other § 6695 Penalties.

Section 6695 provides for other targeted preparer penalties. These penalties are, with amounts adjusted for inflation, are (all for calendar year 2023).⁸⁰⁶

- Failure to furnish the taxpayer a copy of a return or claim for refund (\$60 per failure up to maximum of \$30,000);⁸⁰⁷
- Failure to sign a return as preparer (\$60 per failure up to \$30,000 maximum per year);⁸⁰⁸
- Failure to furnish the preparer identifying number (\$60 per failure up to \$30,000 maximum per year);⁸⁰⁹
- Failure to retain copies of returns or a list of those prepared and make the returns or list available (\$60 per failure up to \$30,000 maximum per year);⁸¹⁰
- Failure to file a correct information return (\$60 per failure up to \$30,000 maximum per year);⁸¹¹
- Negotiation of a check to the taxpayer (\$600 per check);⁸¹² and
- Failure to exercise diligence for certain taxpayer tax benefits (such as the EITC) (\$600 for each failure on each return).⁸¹³

⁸⁰³(...continued)

denying an alternative request by the taxpayer to assert *Flora's* divisible tax rule because raised too late.

⁸⁰⁴ § 6694(c)(1) & (2).

⁸⁰⁵ The statute does not contemplate no statute of limitations for the abatement or refund.

⁸⁰⁶ The penalty amounts are taken from the IRS web page titled "Tax Preparer Penalties Under Title 26" (Last Reviewed or Updated 7/1/21 and viewed 7/24/21). Some of the penalties are adjusted for inflation. For example, the maximum for the failure to sign return is \$25,000 but as adjusted for inflation is \$30,000 for 2023. I state in the text the maximum amounts adjusted for inflation for 2023. There is an annual Revenue Procedure that lists inflation adjusted amounts. The current one is Rev. Proc. 2022-38, 2022-45 I.R.B. 1.

⁸⁰⁷ § 6695(a).

⁸⁰⁸ § 6695(b).

⁸⁰⁹ § 6695(c), by reference to the requirement in § 6109(a)(4).

⁸¹⁰ § 6695(d), by reference to the requirements in § 6107(b).

⁸¹¹ § 6695(e).

⁸¹² § 6695(f).

⁸¹³ § 6695(g), by reference to head of household (§ 2(b)) and certain tax credits (§§ 24, 25A(g)(1) or 32).

F. Injunctions.

Section 7407 authorizes injunctions against tax return preparers who are subject to the foregoing penalties or violated other duties and limitations as a preparer. The court must find that the return preparer “continually or repeatedly engaged in” the conduct. Hence, the isolated return preparer penalty should not attract the injunction.

G. Criminal Penalties.

The following are the significant or more common criminal penalties to which return preparers are potentially subject:

1. Section 7206(2), a felony, for willfully aiding or assisting in the preparation which is fraudulent or false, whether or not the fraud or falsity is known to the taxpayer.
2. Section 7216, a misdemeanor, for knowingly or recklessly disclosing or using confidential taxpayer information supplied to the preparer for return preparation.⁸¹⁴
3. 18 U.S.C. § 371, conspiracy, particularly the defraud conspiracy (in a tax setting often called a *Klein* conspiracy after *United States v. Klein*, 247 F.2d 908 (2d Cir. 1957), cert. denied, 355 U.S. 924 (1958)).
4. If multiple false returns claiming refunds are prepared, false claims or conspiracy to file false claims, 18 U.S.C. §§ 286 and 287.

H. Practice Penalties.

As noted above, the IRS through the Office of Professional Responsibility, regulates tax practitioners' ability to practice before the IRS. The types of conduct that can attract penalties can also result in disbarment from practice before the IRS. Isolated negligence penalties are not serious enough to result in disbarment, but willful misstatement may and certainly a criminal conviction may. Disbarment from practice can seriously limit a tax practitioner's ability to practice and, moreover, there is the threat that inappropriate conduct by one practitioner can result in disbarment from practice of the whole firm with which he or she is associated. I do not expect you to know the rules of practice before the IRS, but you should be aware that there can be serious economic consequences from inappropriate return positions.

XII. Appraiser Penalties.

The fundamental flaw in many abusive tax schemes – whether one-off or promoted to many – is an improper valuation. Section 6695A imposes a civil penalty upon appraisers if the appraiser

⁸¹⁴ As you might suspect, this crime, which has been in the Code since 1971, is probably committed often, given the sweeping definition of return information, but rarely, if ever, prosecuted. On April 27, 2005, I searched two court opinion databases (LEXIS and Tax Notes Court Opinions) for § 7216 cases and found no reported criminal case involving a prosecution under § 7216.

knows or should have known that the appraisal would be used in conjunction with a tax return or refund claim and the claimed value results in a valuation misstatement or gross valuation misstatement as defined in § 6662(e) or (h). The latter provisions impose an accuracy related penalty on taxpayers for valuation or gross valuation misstatements. I defer further discussion to the portion of the book that discusses such misstatements (beginning on p. 360). Suffice it to say here that the valuation error must be significant (e.g., at least 150% of the correct value). The appraiser penalty is the lesser of (i) \$1,000 or 10% of the tax underpayment, whichever of the two is greater or (ii) 125% of the gross income received by the appraiser for preparing the appraisal. The appraiser may avoid the penalty by showing that the appraisal was more likely than not the proper valuation, although making that showing may be a difficult to do after the IRS or the court has found a substantial or **gross** valuation misstatement.⁸¹⁵

XIII. Tax Compliance and the Tax Gap.

I started this chapter with the concept of our tax system being a voluntary compliance system. I noted that there are a number of penalty provisions that incentivize taxpayers to voluntarily comply. We will study those penalties later in the text. I want to conclude the chapter on returns by talking a little about actual compliance rates. Compliance with the tax laws usually is done by filing the various tax returns and paying any tax reported due (either by prepayment or at the time of filing the return). There are other compliance duties as well, but usually when we talk about compliance and compliance rates we are talking about the bottom line—payment of tax that the taxpayers of the country owe. There is a related concept called the “tax gap” that is the underpayment of tax that results from noncompliance with the Code’s duties.

The overall voluntary compliance rate, according to the IRS’s most recent data for 2014-2016, is estimated to be around 85%, which means that that percentage of tax due is timely reported and paid; the obverse noncompliance rate is around 15.0%.⁸¹⁶ After factoring in IRS enforcement and late payments, the compliance rate is 87%, with the obverse noncompliance rate of 15%.⁸¹⁷

⁸¹⁵ § 6659A(c). This defense is an affirmative defense which means that, if the IRS establishes the predicate conditions for liability, it is the appraiser’s responsibility to assert and establish the defense; in the examination, the IRS is not required to inquire into or develop the issue before asserting the penalty. CCA 202129009 (4/4/20).

⁸¹⁶ See IRS web page “Tax Gap Estimates for Tax Years 2014-2016,” Last Reviewed or Updated: 28-Oct-2022, viewed 8/18/23.

⁸¹⁷ Id.

Noncompliance technically arises from three principal phenomena—(i) taxpayers fail to file returns reporting the tax liabilities (so that, perforce, they are not paid); (ii) taxpayers filing returns fail to report all of the tax they owe (so that, perforce, the shortfall is not paid); and (iii) taxpayers report or are otherwise assessed taxes they owe and do not pay the tax.⁸¹⁸ The IRS gives these estimates of the Tax Gap (for the period 2014-2016):⁸¹⁹

- Gross Tax Gap (after eventual collections): \$496 billion.
- Gross Tax Gap by Category
 - Non-filing Gross Tax Gap - \$39 billion
 - Underreporting Gross Tax Gap - \$398 billion
 - Underpayment Gross Tax Gap - \$5 billion

Compliance is more robust where the taxpayer is subject to third party reporting (e.g., W-2s for wages, Forms 1099 for other types of income) and tax withholding, where the compliance rates rise to above 95%. By contrast, where not subject to third-party reporting or withholding, compliance is as low as 45%.⁸²⁰

The precise reasons for the noncompliance are beyond the scope of the book, but I do sometimes address in this text some of the underlying themes. Where the noncompliance is intentional, the bottom-line is that the taxpayer just does not want to pay the tax he or she owes. The rationale, if there is one, for such behavior may include disagreement with how the public revenue is used by the federal government or just an unwillingness to pay that cost of a civilized society, thereby shifting the burden of tax to other taxpayers. Basically, such intentional conduct is anti-social behavior. Where less intentional conduct is involved, the shortfall can be attributed to the complexity of the tax laws and mere procrastination, among other reasons.

From the perspective of managing a tax system, there are key issues related to compliance and the tax gap.⁸²¹ What is the optimal level of noncompliance we will accept, given our other priorities? Increasing the enforcement budget of the IRS would, at least theoretically, increase compliance, but at what cost? Most immediately, increasing the enforcement budget would at some point be subject to the law of diminishing returns—that the collections from more enforcement dollars will curve down in terms of benefit relative to cost. And giving the IRS a larger presence in our everyday lives might be intolerable for a host of real and imagined social and political reasons. These tensions between the levels of enforcement and the levels of compliance are at the heart of much of the political debate that touches on the revenue raising side of the fisc. Practitioners need to be sensitive to those tensions and the debate because they will result in an ebb and flow in the tax practice that includes tax procedure.

⁸¹⁸ See Statement of Chuck Rettig (IRS Commissioner) titled “A Closer Look: Impacting the Tax Gap” (undated but linked through the IRS web page titled “Impacting the Tax Gap” p. 1 (viewed on 4/28/21).

⁸¹⁹ Tax Gap Estimates for Tax Years 2014-2016, above.

⁸²⁰ Id.

⁸²¹ See TIGTA Report titled “Trends in Compliance Activities Through Fiscal Year 2017” pp. 3-4 (Ref. No. 2018-30-069 9/13/18).

Ch. 4. Statutes of Limitations.

I. Introduction (Including Jurisdictional/Nonjurisdictional Time Limits).

A statute of limitations, in its traditional meaning, is a time-delimited bar to a judicial remedy for a claim. Statutes of limitation grant repose. The Supreme Court observed that “a statute of limitations is an almost indispensable element of fairness as well as of practical administration of income tax policy.”⁸²² This is certainly true, as a good general observation, but there are instances where an unlimited statute of limitation applies. (The saving grace when an unlimited statute of limitations might otherwise apply is that old can be cold, so that the person trying to assert an unlimited statute (in the context of this course, usually the IRS) has significant burdens to satisfying a right to relief in a distant year.) In addition, we will see several instances in which the statute of limitations may be suspended, either by express statutory provision or, in some cases, by the application of equitable principles.⁸²³

Statutes of limitations are affirmative defenses.⁸²⁴ The practical effects of characterizing statutes of limitations as affirmative defenses relate to litigation where (1) the defenses must be affirmatively pled by the party asserting the bar of the statute of limitations,⁸²⁵ (2) the defenses may be waived if not asserted timely, and (3) the defenses may not apply in certain equitable circumstances.⁸²⁶ However, in some cases, the period during which the claim must be judicially pursued is part of the right to sue which means that suit within the prescribed period may be jurisdictional, is non-waivable, is not subject to equitable tolling, and may be raised at any time.⁸²⁷

In federal tax procedure, the distinction between jurisdictional time limits and statutes of limitations (sometimes called claims processing rules) comes up most commonly in situations where the Code requires the taxpayer to perform some act (usually some claim requiring a “filing”) within a certain stated period (e.g., 90 days for deficiency redetermination petitions to the Tax Court, 30

⁸²² *Rothensies v. Electric Storage Battery Co.*, 329 U.S. 296, 301 (1946). The Supreme Court expands on this repose notion in the context of penalties: “Statutes of limitations set a fixed date when exposure to the specified Government enforcement efforts end”; “such limits are vital to the welfare of society and rest on the principle that even wrongdoers are entitled to assume that their sins may be forgotten.” *Kokesh v. SEC*, 581 U.S. ___, ___, 137 S. Ct. 1635, 1641 (2017) (quoting *Gabelli v. SEC*, 568 U.S. 442, 448-449 (2013) and with internal quotation marks omitted).

⁸²³ See the discussion of equitable suspension beginning on p. 253.

⁸²⁴ See e.g., Rule 8(c), Fed. R. Civ. Proc. and Tax Court Rule 39; and *Amesbury Apartments, Ltd. v. Commissioner*, 95 T.C. 227, 240 (1990). General civil procedure concepts treat a statute of limitations defense as barring a remedy but not extinguishing the liability. One author believes that the history of the current statute of limitations regime supports treating the statute of limitations as extinguishing the liability. See Bryan T. Camp, Tax Return Preparer Fraud and the Assessment Limitation Period, 116 Tax Notes 687 (Aug. 20, 2007); accord, *Diamond Gardner v. Commissioner*, 38 T.C. 875, 881 (1962) (noting that the practical effect of the bar of the statute of limitations is to extinguish a tax liability that is barred by the statute of limitations.)

⁸²⁵ *Woods v. Commissioner*, 92 T.C. 776, 779 (1989). This is usually the defendant but may be the plaintiff where the defendant is seeking a judgment against the opponent of the claim asserted by the defendant. The latter phenomenon applies to Tax Court proceedings where the taxpayer is nominally in the plaintiff position (designated petitioner) and the defendant (designated respondent) seeks a decision from the Tax Court that the taxpayer owes some amount of tax.

⁸²⁶ *Bruce v. Commissioner*, T.C. Memo. 2014-178, citing *Genesis Oil & Gas, Ltd. v. Commissioner*, 93 T.C. 562, 564-565 (1989) and T.C. Rule 39).

⁸²⁷ See *United States v. Dalm*, 494 U.S. 596, 608 (1990).

days for CDP petitions in the Tax Court, and two or three-year periods for refund claims and refund suits) or lose the right to pursue the matter (claim). If the time limit is deemed “jurisdictional,” compliance (filing) in the time period is required, is nonwaivable and may be raised at any time; if the time limit is not jurisdictional, then, although compliance within the time period is generally required, compliance within the time period may be waived by the IRS or subject to certain equitable defenses (such as suspensions of the time period based on equitable factors). Beginning in 1990, the Supreme Court developed a line of authority in nontax cases that holds certain statutory time limits for certain agency related actions such as filings may not be jurisdictional and, if not, may be waivable and subject to equitable defenses.⁸²⁸

In a tax case in 2019 involving a statutory deadline for Tax Court jurisdiction, The D.C. Circuit explained:

The Supreme Court in recent years has pressed a stricter distinction between truly jurisdictional rules, which govern a court's adjudicatory authority, and nonjurisdictional claim-processing rules, which do not. Key to our present decision, the Court has made plain that most time bars are nonjurisdictional; they are quintessential claim-processing rules which seek to promote the orderly progress of litigation, but do not deprive a court of authority to hear a case. Therefore, although the Congress is free to attach the jurisdictional label to a rule that we would prefer to call a claim-processing rule, we treat a time bar as jurisdictional only if Congress has clearly stated as much. The Supreme Court has explained that this clear statement requirement is satisfied only if the statute expressly refers to subject-matter jurisdiction or speaks in jurisdictional terms. It is not enough, for instance, that a statute uses mandatory language.⁸²⁹

In *Boechler, P.C. v. Commissioner*, 596 U.S. ___, 142 S. Ct. 1493 (2022), the Supreme Court considered whether the statutory 30-day period for filing a petition for Tax Court review of a Collection Due Process (“CDP”) determination was jurisdictional not permitting equitable tolling or was, instead, nonjurisdictional permitting equitable tolling. The Court held that § 6330(d)(1)’s 30-day time limit was nonjurisdictional and subject to equitable tolling for the following reasons:

(i) time limits are jurisdictional and not subject to equitable relief only if the statute “clearly states” that result was intended; (ii) § 6330(d)(1) did not so “clearly state” in text or context, making it nonjurisdictional; (iii) nonjurisdictional limitations periods are presumptively subject to equitable tolling; and (iv) nothing rebuts the presumption with respect to § 6330(d)(1)’s 30-day time limit.

The language and analysis makes the holding potentially applicable to other time limitations in the IRC.

⁸²⁸ *Irwin v. Dep't of Veterans Affairs*, 498 U.S. 89 (1990); *Henderson v. Shinseki*, 562 U.S. 428 (2011); and *United States v. Kwai Fun Wong*, 575 U.S. 402 (2015).

⁸²⁹ *Myers v. Commissioner*, 928 F.3d 1025, 1034 (D.C. Cir. 2019) (cleaned up).

Consider this example. Section 6213(a) provides that the taxpayer has 90 days in which to petition the Tax Court for redetermination of a deficiency after the IRS issues the notice of deficiency. (The period is 150 days if addressed to a person outside the U.S., but for this example assume that the 90 day period applies; the analysis would be the same for the 150-day period.) The context for that time limit involves the following: (i) the IRS must assess additional tax within a time limit, generally 3-years which, generally is rigid subject to specific statutory exceptions;⁸³⁰ (ii) the taxpayer may file a petition within 90-days for redetermination with the Tax Court;⁸³¹ (iii) the IRS may not assess the tax during that 90-day period or, if the taxpayer files a petition, during the period the case is pending (at least at the Tax Court level),⁸³² (iv) the IRS must assess the tax after the period of prohibition expires, so the IRS will generally assess sometime shortly after the 90-day period if a petition is not filed;⁸³³ and (v) during the period the IRS is prohibited from assessing plus 60 days, the statute of limitations on assessment is suspended.⁸³⁴ There is no clear statement in the text of § 6213(a)'s or any Supreme Court case that the § 6213(a)'s 90-day limitation is jurisdictional or not subject to equitable tolling. For these and other contextual reasons, before *Boechler*, although Congress did not say that the 90-day period (and similar periods) is jurisdictional, the Tax Court and the courts of appeals have treated the period as jurisdictional with no equitable relief for out of time petitions. *Boechler*, although technically applicable only to § 6330(d)(1) might signal a dramatic shift in treatment of other Code time limits, such as § 6213(a).⁸³⁵ In a 2022 unanimous reviewed decision, the Tax Court held that the 90-day period for petition for jurisdiction is jurisdictional;⁸³⁶ but in a July 2023 opinion, the Third Circuit held that the 90-day period is not jurisdictional, thus permitting equitable tolling.⁸³⁷ Under its construction of its Golsen rule, the Tax Court is not bound by that Third Circuit holding in other Circuits where it may continue to apply its own best judgment; the Tax Court thus continues to treat the 90-day period as jurisdictional.⁸³⁸

A statute of limitation for a debt generally does not extinguish the debt; it simply bars a judicial remedy to obtain judgment on the debt. In practical effect, the debt becomes uncollectible, but it continues to exist. Thus, the federal tax assessment statutes of limitation we discuss in this section has “for all **practical** purposes” extinguishes the debt.⁸³⁹

⁸³⁰ See the discussion in the next section in this chapter.

⁸³¹ § 6213(a).

⁸³² Id.

⁸³³ Reg. § 301.6213(c).

⁸³⁴ § 6503(a)(1).

⁸³⁵ Keith Fogg, *What Happens After Boechler – Part 1: The IRS Argues IRC 6330 is Unique* (Procedurally Taxing Blog 4/25/22); and Carlton Smith, *Another Update on Boechler Follow-on Litigation – Part 1* (Procedurally Taxing Blog 8/1/22). For discussion of the general issue of jurisdictional or not, see Camp, Bryan T., *New Thinking About Jurisdictional Time Periods in the Tax Code* (January 21, 2019). Available at SSRN: <https://ssrn.com/abstract=3320040>.

⁸³⁶ *Hallmark Research Collective v. Commissioner*, 159 T.C. ___ No. 6 (2022).

⁸³⁷ *Culp v. Commissioner*, ___ F.4th ___, 2023 U.S. App. LEXIS 18287 (3rd Cir. 2023).

⁸³⁸ *Sanders v. Commissioner*, 161 T.C. ___ No. 8 (2023) (reviewed opinion).

⁸³⁹ *Diamond Gardner v. Commissioner*, 38 T.C. 875, 881 (1962); see Bryan Camp, *Presumptions and Tax Return Preparer Fraud*, 120 Tax Notes 167 (2008) (citing *Gardner*). Professor Camp states boldly that the tax statute of limitations on assessment not only bars the act of assessment but “extinguishes the tax liability itself.” If that were the case it would be different, in theory, than the normal application of statutes of limitation which does not extinguish the debt. No one questions that the tax assessment statute of limitations bars the remedies the IRS may have to collect the (continued...)

II. Assessment.

A. Introduction.

The return filed by the taxpayer is the general starting point for the processes in the system. The IRS can assess immediately tax reported due on the return. § 6201(a)(1). From the date the return is filed, the IRS generally has a time critical period in which to assert claims for tax liabilities in excess of the tax liabilities reported. Correspondingly, the taxpayer generally has a time critical period to claim refunds. These are statutes of limitation.

I discuss at this point only the statute of limitations on assessment. The IRS term for the assessment statute of limitations expiration “assessment statute expiration date,” and the resulting acronym used in IRS internal documents, such as the IRM, is “ASED.”⁸⁴⁰

Payment—or collection, from the IRS perspective—is a different event than assessment. There is a separate statute of limitations on collection after assessment. It is critical to distinguish between assessment and collection. Assessment is only the event that establishes that the taxpayer owes the Government so that the Government then can use its formidable array of administrative collection tools (such as lien and levy) to collect that debt. I deal with collection later in a separate chapter (Chapter 12), but until then we will be principally concerned with the processes that lead to an assessment.

B. The General Rule - Three Years.

⁸³⁹(...continued)

liability, but I am not sure that anything in the statute actually bars the liability. Section 6401(a) treats a payment of a barred year tax as an overpayment; that section may imply that the debt does not exist or it may simply be a procedural mechanism to assure the IRS does not collect the barred year tax. By analogy to normal statutes of limitations, if the debtor pays the debt beyond the period of the statute, the creditor with the money does not have to return it (i.e., the law does not command that it is an overpayment of the liability), so this suggests that the taxpayer does not owe the tax foreclosed by the assessment statute of limitations. The quote from *Gardner* says that the tax assessment statute of limitations extinguishes the liability “for all practical purposes.” True enough. Most would think that the discussion of liability/no liability is dancing on the head of a pin for no practical purpose. One possible area—although it too is theoretical—relates to the provision in § 6501(c)(4) that requires that consents to extend the assessment statute of limitations must be signed before the statute lapses. The statutory text is explicit. But Professor Camp has argued elsewhere that, even without that express statutory requirement, it would exist anyway because, as noted, he believes that the expiration of the statute of limitations bars the debt so that, even if the taxpayer were thereafter to execute a consent to extend, it would be meaningless because the debt has been extinguished. But the statutory requirement exists, so I don’t go into that swamp.

⁸⁴⁰ E.g., IRM 25.6.1.2.2 (01-16-2009), Statute Function Establishment. The ASED is the date that the IRS computer system logs as the assessment statute expiration date. Usually, that is the three-year period from the date of filing the return. The IRS will usually not have any idea that the § 6501(e)(1)(A) omissions or the § 6501(c)(1) unlimited statute for fraud applies. And, as I discuss, various events can cause the assessment statute to be extended. As the IRS becomes aware of factors that establish a longer assessment period, the IRS computers may be updated with the extended ASED. For example, if the taxpayer enters a Form 872 to extend the statute of limitations, the computer ASED will be updated to show the extended statute expiration date. And, presumably, where the IRS sends a notice of deficiency, which suspends the statute as will be noted, the IRS computer ASED will be adjusted automatically through algorithms. The point simply is that the ASED in the IRS computer modules acts sort of like a drop dead date reminding the IRS of the last **known** date to make an assessment, even though if the IRS were to investigate further it might find that an extended statute expiration date actually applies.

The general rule is that the IRS may assess additional taxes (or sue to collect without assessment) within 3 years of the date the return is filed. § 6501(a).⁸⁴¹ Return for this purpose and elsewhere in the statute of limitations provisions means: “the return required to be filed by the taxpayer (and does not include a return of any person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit).”⁸⁴² Hence, this rule applies to a partner’s or S Corporation shareholder’s individual return with respect to his share of items from the partnership or S Corporation.

The starting point for the running of the statute of limitations is the date the return is filed or deemed filed. The key rules on filing are: (1) returns received by the IRS on or prior to the normal, unextended due date are deemed filed on the normal due date,⁸⁴³ and (2) returns received by the IRS after the normal due date (even during an extension period) are filed on the date the IRS actually receives the return. The key exception to these rules is the timely-mailing, timely-filing rule which, if applicable, establishes a deemed date for filing on the date the taxpayer mails or, in some cases, delivers the document (here return) to a qualified private delivery service (such as FedEx), but it is not received timely by the IRS.⁸⁴⁴ The calculation of the normal three-year period starts on the day following the filing date under the foregoing rules.

For example, if the taxpayer files his individual return for Year 01 on the due date (April 15 of Year 02), the statute of limitations begins to run one day thereafter (April 16 of Year 02) and the normal statute of limitations expires on April 15 of Year 05. The same result applies if the return is filed on February 1 of Year 02 because of the rule that returns filed before the original due date of the return are deemed filed on the original due date.

The assessment period rules are statutory and, except as specifically provided by statute, the IRS cannot assess beyond the three-year period. I discuss the statutory exceptions below but note here that the IRS cannot raise general equitable factors that might, in other contexts, permit a tolling of the statute of limitations.⁸⁴⁵

⁸⁴¹ The three-year statute applies even if the return is filed late. § 6501(a) (“3 years after the return was filed (whether or not such return was filed on or after the date prescribed)”).

Note that § 6501 expressly contemplates that, as an alternative to assessment, the Government can sue to collect tax within the 3-year period. Similar authority for suits without assessment relating the limitations period to the assessment period is found in other Code sections, such as: §§ 6215(a) (taxes determined by the Tax Court), 6232(f)(6) (partnership rules related to assessment and collection), 6696(d) (preparer penalties); and 7611(d)(2)(A)(i) (certain church tax),

⁸⁴² § 6501(a) (last sentence, codifying the holding of *Bufferd v. Commissioner*, 506 U.S. 523 (1993)).

⁸⁴³ § 6501(b)(1).

⁸⁴⁴ § 7502.

⁸⁴⁵ *Doe v. KPMG*, 398 F.3d 686 (5th Cir. 2005).

C. Exceptions to the General Three-year Statute.

The exceptions to assessment statutes of limitations are in the statute.⁸⁴⁶ The key exceptions to the general 3-year rule are:

1. False Return or Attempted Evasion.

There is no statute of limitations if the taxpayer either files a false return with the intent to evade tax or, in the case of tax other than income tax or estate tax, willfully attempts in any other manner to defeat or evade tax. §§ 6501(c)(1) and (c)(2).⁸⁴⁷ We encountered this rule in *Badaracco* (p. 143) where the Supreme Court held that a subsequently filed nonfraudulent amended return does not avoid the unlimited statute of limitations for an original fraudulent return. Fraud for this purpose is the same as the definition for fraud for purposes of the civil fraud penalty under § 6663.⁸⁴⁸

Badaracco addressed a potential anomaly between a failure to file a return and filing a fraudulent return. The anomaly is this: A person who fails to file a timely return with the intent to evade tax can get the benefit of the three-year statute of limitations by simply filing a delinquent nonfraudulent original return.⁸⁴⁹ Yet, a person who files a fraudulent original return but then files an amended nonfraudulent return cannot achieve the benefit of the statute of limitations. That is the holding of *Badaracco*. Consider the following examples:

Example 1. Assume the taxpayer files a Year 01 original fraudulent return on April 1 of Year 02 and then files a nonfraudulent amended return on January 1 of Year 03. Under *Badaracco's* holding, there is no statute of limitations because his original return was fraudulent.

Example 2. Same example, except that instead of filing an original fraudulent return, the taxpayer files no return timely and then on January 1 of Year 03 files a nonfraudulent delinquent original return. Section 6501(c)(3), which provides an unlimited statute in case of failure to file, does not apply because the taxpayer filed a nonfraudulent original return, albeit delinquent. Accordingly, there is an original return filing date to anchor the § 6501(a) statute of limitations and it will be three years from the date the delinquent nonfraudulent return is filed (except, in the case of a 25% omission, the statute is six years).

Example 3. Same as Example 2, except that, under the facts, the taxpayer's failure to file a timely return for Year 01 was fraudulent, meaning that by failing to file the taxpayer intended to

⁸⁴⁶ The Fifth Circuit rejected nonstatutory equitable tolling of the assessment statute of limitations in *John Doe 1, et al. v. United States*, 398 F.3d 686 (5th Cir. 2005).

⁸⁴⁷ An interesting point of construction for § 6501 is that a false return is simply an incorrect return, hence the limiting text—"with intent to evade tax"—was needed to make sure that the provision applied in cases of fraud and not to mistake. See Bryan T. Camp, Presumptions and Tax Return Preparer Fraud, 120 Tax Notes 167 at n. 29 (2008)

⁸⁴⁸ *Rhone-Poulenc Surfactants & Specialties, L.P. v. Commissioner*, 114 T.C. 533, 548 (2000), rev'd on other grounds 249 F.3d 175 (3d Cir. 2001); and *Neely v. Commissioner*, 116 T.C. 78, 85 (2001).

⁸⁴⁹ *Bennett v. Commissioner*, 30 T.C. 114 (1958); see also Rev. Rul. 79-178, 1979-1 C.B. 435. It is possible that the Government could show that the failure to file the original return was a willful attempt to defeat or evade tax, so that the subsequent filing of the delinquent original return would not start the shorter three-year statute of limitations.

evade the tax. Certainly, the Code contemplates that a failure to file may be fraudulent.⁸⁵⁰ Section 6501(c)(3) can't apply because a return, albeit delinquent was filed. As the Court noted in Badaracco,⁸⁵¹ § 6501(c)(1) can't apply because it requires a false return and here the return, albeit delinquent, was not false. Section 6501(c)(2) which speaks of a willful attempt in any manner to evade tax does not apply to income tax. (Note that, for penalty purposes a fraudulent failure to file including an affirmative attempt to evade can be § 6501 tax evasion⁸⁵² and can be subject to the § 6651(f) fraudulent failure to file ("FFTF") penalty which, after 5 months, can equal the § 6663 civil fraud penalty applicable to fraudulent returns.)

Whose fraud does it have to be to keep the statute of limitations open? Of course, if the taxpayer had a fraudulent intent in signing the return, that will be sufficient; in the context of a joint return, if one of the taxpayers had the fraudulent intent, that will be sufficient.⁸⁵³ Moreover, the Tax Court held in *Allen v. Commissioner*, 128 T.C. 37 (2007) that even if no taxpayer signing the return had the fraudulent intent, the return preparer's fraudulent intent will suffice to warrant the unlimited statute of limitations.⁸⁵⁴ The opinion appears correct from a literal interpretation of the statute (the statute text requires only that the return be fraudulent) and rests on a policy notion that the IRS needs more time to audit a fraudulent return whether taxpayer fraud is involved or preparer fraud is involved.⁸⁵⁵ But the opinion has been criticized because it is cryptic and does not even consider, much less properly consider, history and context.⁸⁵⁶ Subsequently, the Second Circuit held, consistent with *Allen*, that the unlimited statute applies if fraud is on the return even if not the taxpayer's fraud.⁸⁵⁷ The Court of Appeals for the Federal Circuit then held that the taxpayer's fraud

⁸⁵⁰ See § 6651(f) imposing a higher penalty for a fraudulent failure to file.

⁸⁵¹ At p. 401.

⁸⁵² See *Spies v. United States*, 317 U.S. 492 (1943) requiring some affirmative act of evasion other than failing to file a return.

⁸⁵³ § 6501(c)(1), providing an unlimited statute of limitations for fraud, has no relief provision comparable to § 6663(c) which relieves a spouse from joint liability for the civil fraud penalty in the case of the other spouse's fraud. Accordingly, the statute of limitations for an innocent taxpayer signing the fraudulent joint return is open by virtue of the other spouse's fraud. For a discussion of the interrelationship between the unlimited statute of limitations and the civil fraud penalty, see FSA 200126019, reprinted at 2001 TNT 127-25 (reasoning that the fraud penalty is personal and thus, as § 6663(c) commands, is not applicable to an innocent spouse, but that the unlimited statutes of limitation for fraud is remedial and hence applies to an innocent spouse and indeed will apply if the fraud is that of the preparer even if both spouses are not liable for the civil fraud penalty).

⁸⁵⁴ For the IRS's earlier positions, see FSA 200126019 (Release Date 6/29/01); but see FSA 20010406 (Release Date 1/26/2001) (holding the contrary). FSA 200126019, however, seems to rely in part upon agency principles to attribute the preparer's fraud to the taxpayer and the facts indicate that the taxpayer may not have been wholly innocent. In some cases, however, the taxpayer is innocent.

⁸⁵⁵ The text reasoning relies significantly on an email of Professor Al Lauber on a Tax Prof list serve on 4/22/10. Others argue, however, that the reasoning is flawed. See Bryan T. Camp, Presumptions and Tax Return Preparer Fraud, 120 Tax Notes 167 (2008) and Bryan T. Camp, Tax Return Preparer Fraud and the Assessment Limitation Period, 116 Tax Notes 687 (Aug. 20, 2007). I also have questioned the validity of *Allen* in several blog entries on my Federal Tax Crimes Blog. See *IRS Queasiness Over the Reaches of Allen* (Federal Tax Crimes Blog 9/22/12), which has links for earlier blog entries.

⁸⁵⁶ Bryan T. Camp, Tax Return Preparer Fraud and the Assessment Limitation Period, 116 Tax Notes 687 (Aug. 20, 2007); and Bryan T. Camp, Presumptions and Tax Return Preparer Fraud, 120 Tax Notes 167 (2008).

⁸⁵⁷ *City Wide Transit, Inc. v. Commissioner*, 709 F.3d 102 (2d Cir. 2013); for a discussion of the issue, see my blog *Second Circuit Holds That Fraud on the Return -- Even If Not the Taxpayer's -- Causes an Unlimited Civil* (continued...)

is required, thus rejecting the reasoning of *Allen* and its progeny.⁸⁵⁸ This issue is not finally resolved, for one Tax Court judge indicated that *Allen* stands in the Tax Court and, at that time, would not be reviewed by the full Tax Court which would be required to reverse *Allen*.⁸⁵⁹

One consequence of the *Allen* holding, if correct, would permit an unlimited statute of limitations period in an abusive tax shelter case where the enablers were guilty of fraud, particularly in those cases where they became signing or even unsigned return preparers as to the item. In a series of major tax shelter promoter prosecutions involving variations of Son-of-Boss and related tax shelters, some promoters were convicted of tax evasion with respect to shelters reported on taxpayers' returns (meaning the returns were fraudulent) regardless of whether the taxpayers themselves participated in the fraud (i.e., were guilty of tax evasion).⁸⁶⁰ Under the *Allen* reasoning, all of the returns that thus reflected fraud would have open statutes of limitation forever. And this would be true of similar shelters even where the promoters have not been prosecuted, for the IRS would need to prove only in the civil case that the returns were fraudulent by clear and convincing evidence. Finally, even if the year in which such fraud occurred has otherwise been closed out by court case or administrative action (such as Form 870-AD or Closing Agreement), the presence of fraud on the return would permit the matter to be opened up and a new notice of deficiency issued based on the unlimited statute of limitations.⁸⁶¹

If the taxpayer has been convicted of criminal tax evasion under § 7201, the conviction will be preclusive on the issue of fraud to establish the unlimited statute of limitations in § 6501(c)(1) (as well as the civil fraud penalty in § 6663). For issue preclusion (collateral estoppel)⁸⁶² to apply, the issue in the earlier criminal proceeding must have been tax evasion. Tax evasion requires

⁸⁵⁷(...continued)

Assessment Statute of Limitations to Apply (Federal Tax Crimes Blog 2/4/13).

⁸⁵⁸ *BASR Partnership et al. v. United States*, 795 F.3d 1338 (Fed. Cir. 2015).

⁸⁵⁹ *Finnegan v. Commissioner*, T.C. Memo. 2016-118, aff'd on other grounds 926 F.3d 1261 (11th Cir. 2019). The Government defended the *Allen* holding on Appeal in *Finnegan* which suggests that the issue should arise again in the near future.

⁸⁶⁰ *United States v. Pfaff*, 2010 U.S. App. LEXIS 26854 (2d Cir. 2010) (the "KPMG Related Criminal Case"); *United States v. Coplan*, et al. (SDNY No. (S1) 07 Cr. 453 (SHS)), on appeal (the Ernst & Young Related Criminal Case); and (3) *United States v. Daugerdas*, et al. (SDNY S3 09 Cr. 581 (WHP)) (the Jenkens & Gilchrist / BDO Seidman Related Criminal Case).

⁸⁶¹ See Section 6212(c)(1) which allows a notice of deficiency at any time "in the case of fraud" even if the case has otherwise been closed. See *Zackim v. Commissioner*, 887 F.2d 455 (3d Cir. 1989); and *Burke v. Commissioner*, 105 T.C. 41, 47 (1995); see also *Hemmings v. Commissioner*, 104 T.C. 221 (1995) (re nonpreclusive effect of refund suits). One issue in the way I have stated the proposition in the text is whether the taxpayer's fraud is required § 6212(c)(1) to apply. That section is worded similarly to § 6201(c)(1) which provides an unlimited statute of limitations in the case of fraud. The text of both sections does not require the taxpayer's fraud. As of this writing, it has not definitively been determined whether the taxpayer's personal fraud is required for § 6501(c)(1) to apply. *Allen v. Commissioner*, 128 T.C. 37 (2007) (taxpayer's fraud not required); *City Wide Transit, Inc. v. Commissioner*, 709 F.3d 102, 107 (2d Cir. 2013) (*Allen* makes "intuitive sense"); and *BASR Partnership et al. v. United States*, 795 F.3d 1338 (Fed. Cir. 2015) (taxpayer's fraud required). I believe that the two sections would be interpreted the same, whichever way it ultimately goes.

⁸⁶² See discussion of claim preclusion (*res judicata*) and issue preclusion (collateral estoppel) below beginning on p. 648.

underpayment of tax. Conviction of the taxpayer for tax evasion⁸⁶³ will preclude the convicted taxpayer from contesting fraud in the civil tax case for the same year.⁸⁶⁴ Yet, a major tax crime can exist where the taxpayer has simply filed a false return⁸⁶⁵ without fraudulent underpayment of tax as an element of the crime (this is commonly referred to as tax perjury); for a tax perjury conviction, the taxpayer will not be collaterally estopped from contesting civilly whether the return or any portion of the deficiency was due to fraud.⁸⁶⁶

In addition to denial of repose of the statute of limitations based on a fraudulent return, there are criminal and civil penalties applicable to filing a false return. I discuss these in more detail below (p. 307, criminal penalty) and (p. 341 civil penalty)), but note here that, as to a taxpayer having the fraudulent intent, the fraudulent return will also subject the taxpayer to the civil fraud penalty under § 6663. Accordingly, in a tax case where the assessment would be beyond the normal statute of limitations, the civil issues normally riding on fraud will be (1) the IRS's ability to assess any tax and interest (i.e., the statute of limitations issue) and (2) the taxpayer's liability for the fraud penalty under § 6663 which I discuss below beginning on p. 341. Note, however, that if the statute of limitations is kept open only by virtue of the tax preparer's fraud in which the taxpayer or taxpayers did not participate, the taxpayer or taxpayers will not be subject to the civil fraud penalty.

Even if there is fraud, the unlimited statute of limitations is subject to practical limitations. The difficulty in obtaining information about really old years may make it impossible or impractical for the IRS to pursue unpaid taxes. This practical limitation often comes into play when a taxpayer is considering filing amended returns or delinquent original returns to correct prior years. The number of years that the taxpayer will correct is influenced principally by the 6 year criminal statute of limitations but also by this phenomenon of records and information being unavailable. Thus, although in the case of fraud, the IRS can go back forever, it simply will not do so. Hence, in advising the taxpayer that there is an unlimited statute of limitations for fraud, the practitioner should also try to advise as to the practical reality that the IRS will do so.

⁸⁶³ § 7201.

⁸⁶⁴ *Commissioner v. Sunnen*, 333 U.S. 591 (1948).

⁸⁶⁵ § 7206(1).

⁸⁶⁶ *McGowan v. Commissioner*, T.C. Memo. 2004-146. For a discussion of these concepts, see John A. Townsend, Collateral Estoppel in Civil Cases Following Criminal Convictions, 2005 TNT 4-28.

2. No Return.

There is no statute of limitations where no return is filed. § 6501(c)(3).⁸⁶⁷ A key issue raised with respect to this exception is whether a document filed by a taxpayer is a return. I have discussed the requirements for a return above (beginning p. 114.). There are also civil and criminal penalties for failure to file a return. I discuss these below.

Of course, the same practical problem of developing information for older years operates in the case of delinquent returns.

3. Personal Holding Company Tax - 6 Years.

Section 6501(f) provides a six-year statute of limitations if the personal holding company fails to file with its return a schedule setting forth certain information relevant to the personal holding company tax, including the names and addresses of certain individuals owning stock in the company.

4. Tax Credit Claimed and Thereafter Reduced.

The IRS may assess at any time excess credits claimed on the U.S. return for foreign tax that is reduced in amount by the jurisdiction to which the tax was paid or accrued.⁸⁶⁸

5. Extension by Agreement.

a. General.

Except in the case of the estate tax, the statute of limitations on assessment may be extended by written agreement between the taxpayer and the IRS entered while the statute is still otherwise

⁸⁶⁷ In an interesting interpretation of this provision, the Tax Court held in *Appleton v. Commissioner*, 140 T.C. 273 (2013) that, although the taxpayers who were permanent residents of the U.S. Virgin Islands, had filed no return with the IRS, their filing with the Virgin Islands tax authority pursuant to the “mirror code” constituted a filing that would prevent the application of § 6501(c)(3) with respect to a U.S. return. I discuss the mirror code system below beginning on p. 882, but in summary the mirror code is the treatment of a territory or other non-U.S. jurisdiction affiliated with the U.S. (the Virgin Islands here) as having an internal revenue code mirrored to work like the Internal Revenue Code as to that jurisdiction (here the Virgin Islands) and treating the U.S., as to that jurisdiction as a foreign country. Thus, for example, all references to the United States or Treasury would be deemed to refer to the other jurisdiction. A related feature is that a citizen of one jurisdiction is resident (in some cases, bona fide resident) in the other (e.g., a U.S. citizen resident in the Virgin Islands) has a single filing requirement with the jurisdiction of residence than of citizenship (e.g., in the case of a U.S. citizen resident in the Virgin Islands, the single filing is made to the tax authority for the Virgin Islands). A related holding is that, for a person who may not be a resident of the Virgin Islands and thus should file with the U.S. IRS will be deemed to have filed a U.S. return if he files a single return with the Virgin Islands and the Virgin Islands shares that information with the IRS, thus starting the statute of limitations to run. *Hulett v. Commissioner*, 150 T.C. 60 (2018) (held the shared information constitutes a U.S. return).

⁸⁶⁸ § 6501(c)(5), referring to § 905(c) (requiring taxpayer to notify the IRS of adjustments to taxes claimed on return, with payment of tax due upon notice and demand per 26 CFR § 1.905-4T(d)) and § 2016 (foreign countries, States, etc., death or related taxes credited, to be paid on notice and demand). Note that § 6501(c)(5) also refers to state tax, but the federal credit for state death taxes in § 2011 was repealed.

open. § 6501(c)(4)(A).⁸⁶⁹ Reflecting Congress' views that statutes of limitations should be meaningful and respected, the IRM provides that:

It is the policy of the IRS to secure consents to extend the period to assess tax only in cases involving unusual circumstances. See Rev. Proc. 57-6, 1957-1 C.B. 729. Every attempt will be made to resolve cases before it is necessary to extend the statute of limitations. If it is necessary to extend the statute, the period of extension must be no longer than is necessary to complete the examination and other administrative actions.⁸⁷⁰

The IRM lists circumstances in which a consent may properly be requested.⁸⁷¹ The circumstances include:

(a) Where the limitations period expires within 180 days and there is insufficient time to complete the audit in an orderly manner.

(b) Where the case may go to Appeals to allow sufficient time (at least 395 days on the assessment statute when case is received by Technical Services and at least 365 days when the case is received by Appeals.

(c) Where the case has been suspended by Form 1254, which is a suspense "pending a court decision or final action by national office or chief counsel."⁸⁷²

(d) Where the case is in fraud suspense and the statute expires in 365 days or, in a joint investigation with CI, there is a likelihood that the work cannot be completed before the assessment period statute.

In addition, the IRM notes the IRS practice to keep assessment statutes open for years under Joint Committee on Taxation ("JCT") consideration of large refunds (see discussion beginning at p. 838).

The consent must have been voluntary, meaning that the taxpayer or representative signing the consent must have signed without fraud, trickery or duress.⁸⁷³ But merely signing under

⁸⁶⁹ Similar statutory provisions for agreement to extension of the statute of limitations by agreement are: (i) § 6901(d) (extension of time to assess tax against a transferee); and (ii) § 6229(b) (extension for (a) partnership items or affected items and (b) for taxable periods beginning before 1/1/97, extensions for Subchapter S items (or affected items) for TEFRA S corporations,

⁸⁷⁰ IRM 25.6.22.2.1(1) (11-17-2021), Assessment Statute Extension.

⁸⁷¹ IRM 25.6.22.2.1(3) (11-17-2021), Assessment Statute Extension.

⁸⁷² IRM 4.8.2.11.1 (06-27-2013), Form 1254 Suspense.

⁸⁷³ *Diescher v. Commissioner*, 18 B.T.A. 353, 358 (1929) ("It is now well settled that if an act of one party deprives another of his freedom of will to do or not to do a specific act the party so coerced becomes subject to the will of the other, there is duress, and in such a situation no act of the coerced person is voluntary and contracts made in such circumstances are void because there has been no voluntary meeting of the minds of the parties."); see also *Zapara v. Commissioner*, 124 T.C. 223, 229 (2005) ("This Court has defined duress as actions by one party which deprive another
(continued...)

threat—real or perceived—that the IRS may take some lawful action to protect its interests (such as prompt assessments taking protective positions) is not duress that will avoid an otherwise validly executed consent.⁸⁷⁴

Finally, the representative should be careful to insure that there is a clear record showing the taxpayer was properly advised of the risks and benefits of signing a consent and voluntarily signed it or authorized his representative to sign it.

There is an academic issue as to whether consents to extend the statute of limitations are contracts or unilateral waivers. The courts unfailingly pronounce the consent a waiver, often with the adjective unilateral, of the statute of limitations (meaning, so that notion goes, that the consent is a taxpayer gift—using the euphemism, waiver—to the IRS without return consideration from the IRS), rather than a contract (for which there must be mutual consideration). This sloppy thinking about the nature of the consent is usually not important but could be in certain cases. Since my view of the consent as a contract is a contrarian view, I relegate further discussion to the footnote, but encourage my readers not to accept too easily the notion that the consent is a waiver.⁸⁷⁵

b. Forms for Extensions - 872 and 872-A.

The forms for extension agreement in income tax cases are (1) Form 872, Consent to Extend the Time to Assess Tax, and (2) Form 872-A, Special Consent to Extend the Time to Assess Tax. Similar forms exist in the case of other taxes (e.g., partnership items (Form 872-P (TEFRA

⁸⁷³(...continued)

of his or her freedom of will to do or not to do a specific act,” citing *Diescher*); and *Evert v. Commissioner*, T.C. Memo. 2022-48, at *6, citing *Diescher*.

⁸⁷⁴ *Price v. Commissioner*, 43 T.C.M. 18 (T.C. 1981) (duress is depriving one party of freedom of will to do or not do the act), aff’d, 742 F.2d 1460 (7th Cir. 1984). *Twenty-Two Strategic Investment Funds v. United States*, 859 F.3d 684 (9th Cir. 2017) (citing *Price*; case involved prior Form 872-I, partner level consent for partnership items).

⁸⁷⁵ Basically, the statute requires a written “agreement” which normally connotes more mutuality than suggested by the concept of waiver. Taxpayers usually will not enter a consent unless they perceive some real or perceived benefit conferred by the IRS, particularly if they are informed (as the law requires, § 6501(c)(4)(B)) that they are not required to sign a consent. My former partner and I discuss this issue in John A. Townsend & Lawrence R. Jones, Interpreting Consents to Extend the Statute of Limitations, 78 Tax Notes 459 (1998). Cases addressing different provisions of the prior internal revenue acts referred to the analogous form as a unilateral waiver of the statute of limitations. E.g., *Stange v. United States*, 282 U.S. 270, 276 (1931). Some courts even now—mindlessly, I think—carry forward those case holdings without realizing that the statute is different. The key difference that treating it as a contract makes is in interpreting the benefits and burdens of the form. If it is a contract, it is interpreted and applied like a contract. If it is not a contract, as some even latter day cases suggest (e.g., *Piarulle v. Commissioner*, 80 T.C. 1035, 1042 (1983)), then how is it to be interpreted? Well, the courts tell us cryptically, by using contract-like interpretive techniques (see *Kunkel v. Commissioner*, 821 F.3d 908 (7th Cir. 2016) (using the waive label but permitting reformation for mutual mistake under contract interpretive techniques)), so the difference seems to be a tempest in a teapot in most cases but might affect some cases. The difference was important in *Greenfield v. Commissioner*, T.C. Memo. 2008-16, aff’d by unpublished decision (11th Cir. 10/23/08), in which the taxpayer sought to avoid the 872-A as an executory contract in bankruptcy. The lower and appellate courts held that, since the 872-A was a waiver rather than a contract, the issue as to whether it was a voided executory contract under the bankruptcy rules was not reached. I think both courts’ reasoning was superficial, but superficial reasoning has reigned supreme in this area.

partnerships) or Form 872-M for BBA partnerships) or responsible person penalty taxes).⁸⁷⁶ There are other forms for consents as to other taxes or in other contexts (often bearing an 872+letter form number), but I discuss here the Forms 872 and 872-A to develop the concepts applicable to forms consenting to extended statutes of limitations.⁸⁷⁷

The Form 872 extends the statute to a date certain stated in the Form itself. The IRS must assess on or before that stated date. However, the stated date may be suspended (e.g., by the issuance of a notice of deficiency by the stated date, which will suspend the statute of limitations as I discuss further below in discussing notices of deficiency).

The Form 872-A, called an open-ended consent,⁸⁷⁸ is an indefinite extension which may be terminated upon any one of the following events: (a) 90 days after the taxpayer files Form 872-T, Notice of Termination of Special Consent to Extend the Time to Assess Tax (a pink form to alert the IRS as to its importance);⁸⁷⁹ (b) 90 days after the IRS mails the taxpayer a Form 872-T; (c) the IRS's issuance of a notice of deficiency to the taxpayer, plus 60 days after the period the IRS is prohibited from assessing, or (d), in no event later than the date of assessment or overassessment of tax that reflects a final determination of tax and administrative Appeals consideration.⁸⁸⁰ These are the only ways that the Form 872-A may be terminated. Thus, for example, if after an audit, the taxpayer agrees to a tax liability (on Form 870 or equivalent form which waives the issuance of a notice of deficiency pursuant to § 6213(d)) or issues a no change letter, the Form 872-A will remain in effect until the taxpayer files a termination.⁸⁸¹ A court will not generally be sympathetic regardless of the lapse of time, but might in an extreme case.⁸⁸² The lesson from the Form 872-A rules is that a taxpayer and/or his representative must keep ongoing reminders of the existence of a Form 872-A

⁸⁷⁶ Other extensions often carry an 872 designation. E.g., Form 872-P: Consent to Extend Time to Assess Tax Attributable to Items of Partnership.

⁸⁷⁷ For example, there are consents for partnership items and for partnership audits. Form 872-O, Special Consent to Extend the Time to Assess Tax Attributable to Partnership Items; and Form 872-P, Consent to Extend the Time to Assess Tax Attributable to Partnership Items. See also Form 872-B, Consent to Extend the Time to Assess Miscellaneous Excise Taxes; Form 872-D, Consent to Extend the Time on Assessment of Tax Return Preparer Penalties.

⁸⁷⁸ See Rev. Proc. 79-22, 1979-1 C.B. 563. Rev. Proc. 79-22 (requiring use of Form 872-T); IRM 25.6.22.7 (08-26-2011), Open-ended Consents; and IRM 25.6.22.7.1 (11-17-2021), Form 872-A Special Consent to Extend the Time to Assess Tax

⁸⁷⁹ The IRS provides procedures for prompt consideration of the status of a matter when a Form 872 is received. As to a Form 872-T received in Appeals, see IRM 8.21.2.8 (10-15-2014), Receipt of Consent Termination (Form 872-T or 872-N) (and its subparts)

⁸⁸⁰ These are printed on the Form 872-A. IRM 25.6.22.7.1 (11-17-2021), Form 872-A Special Consent to Extend the Time to Assess Tax. Note that the (d) termination is in a separate paragraph on the form. The IRM explains that some assessments do not reflect a final determination and Appeals consideration and therefore will not terminate the Form 872-A agreement. IRM 25.6.22.7.1(3) (11-17-2021), Form 872-A Special Consent to Extend the Time to Assess Tax.

⁸⁸¹ IRM 25.6.22.7.1(3) (11-17-2021) Form 872-A Special Consent to Extend the Time to Assess Tax

⁸⁸² E.g., *Greenfield v. Commissioner*, T.C. Memo. 2008-16, aff'd by unpublished decision (11th Cir. 10/23/08). *Fredericks v. Commissioner*, 126 F.3d 433 (3d Cir. 1997) is a rare case of estoppel against the Government on the ongoing effect of an unterminated Form 872-A., The IRS had denied that a Form 872-A was outstanding (without which assurance the taxpayer would have or at least could have filed a Form 872-T) and had indeed sought several Forms 872 which, of course, would be meaningless if the Form 872-A were outstanding. The Court held that the taxpayer had reasonably and detrimentally relied upon the IRS's statement that no Form 872-A was outstanding and hence invoked estoppel against the IRS claim that Form 872-A kept the statute of limitations open.

and revoke it explicitly by filing form 872-T if it is otherwise not revoked by the IRS's issuing a notice of deficiency or making an assessment reflecting a final determination.

Examination may be interrupted if the statute of limitations date is approaching and the taxpayer does not give a Form 872, Consent to Extend the Statute of Limitations. In that case, the IRS may “dispatch a statutory notice of deficiency” based on the information it has already developed.⁸⁸³

c. Restricted Consents.

The consents may be restricted with conditions and limitations on adjustments that may be made during the extended consent period.⁸⁸⁴ Restricted consents may extend the assessment statute for one or more issues only.⁸⁸⁵ The IRS must advise the taxpayer of the right to request a restricted consent, but the IRS is not compelled to execute such a restricted consent.⁸⁸⁶ Generally, the IRS will not seek a restricted consent.⁸⁸⁷

The terms of the restricted consent are negotiated between the IRS and the taxpayer, but two key usual provisions are:

The amount of any deficiency assessment is to be limited to that resulting from any adjustment to (description of the area(s) of consideration), any penalties and additions to tax attributable thereto, and any consequential changes to other items based on such adjustment.⁸⁸⁸

The provisions of IRC 6511(c) [relating to limitations on time for filing for refund and the amount of the refund] are limited to any refund or credit resulting from an adjustment for which the period for assessment is extended under this agreement.⁸⁸⁹

For issues not covered by the restricted consent, any adjustments must be made within the otherwise applicable statute of limitations.⁸⁹⁰

⁸⁸³ Reg. § 601.105(f).
⁸⁸⁴ IRM 25.6.22.3(9) & (10) (03-26-2019), Notification of Taxpayer's Rights.
⁸⁸⁵ IRM 25.6.22.8 (08-26-2011), Restricted Consents.
⁸⁸⁶ § 6501(c)(4); see IRM 25.6.22.8.1 (08-26-2011), Taxpayer's Rights Concerning Restricted Consents.
⁸⁸⁷ IRM 25.6.22.8.3 (08-26-2011), Situations when the IRS may Request Restricted Consents (noting exceptions).
⁸⁸⁸ IRM 25.6.22.8.12(1) (08-26-2011), Basic Restrictive Statement.
⁸⁸⁹ IRM 25.6.22.8.12(2) (08-26-2011), Basic Restrictive Statement (for Forms 872 and 872-A).
⁸⁹⁰ IRM 25.6.22.8.4 (08-26-2011), Issues Not Subject to Restricted Consent.

d. Procedures for Consents.

The IRM requires that the agent outline in the file the need for the consent, obtain the group manager's approval before seeking the consent, and ensure that the group manager's approval is documented in the file.⁸⁹¹

Taxpayers are not obligated to enter an extension agreement. The IRS is required to notify taxpayers that they have a right to refuse to enter such an agreement with the IRS each time the IRS requests such an extension.⁸⁹² The IRS has standard forms for advising taxpayers of their right to refuse,⁸⁹³ but what happens if the IRS fails to advise the taxpayer? The IRS takes the position that, if the taxpayer is otherwise aware of his right to refuse to consent, the IRS's failure to meet this statutory mandate to notify the taxpayer will not defeat the validity of the consent.⁸⁹⁴ Whether courts will agree is an open issue.

e. Proof Issues Regarding Consents.

The Tax Court has outlined the procedural steps required where the existence or validity of a consent is in issue: (i) a taxpayer seeking to rely on the bar of the statute of limitations on assessment must affirmatively plead the bar and must bear the burden of persuasion on the issue, (ii) the taxpayer must make a prima facie showing that the assessment was outside the normal period of assessment (i.e., the three year general statutory period for assessments); (iii), if the taxpayer meets the burden in (ii), the IRS then bears the burden of production by introducing evidence that, if believed, proves the existence and validity of the consent that would justify the assessment; and (iv) the taxpayer then bears the burden of persuasion as to the nonexistence or nonvalidity of the consent.⁸⁹⁵ This procedural routine seems also to apply when, in the absence of a consent, the IRS is relying upon some other exception to the normal three-year statute of limitations.⁸⁹⁶ Where, however, the IRS is relying upon fraud to justify the timeliness of an assessment, the IRS bears the persuasion burden (step 5) to prove fraud by clear and convincing evidence.⁸⁹⁷

⁸⁹¹ IRM 25.6.22.2.1(2) (11-17-2021), Assessment Statute Extension.

⁸⁹² § 6501(c)(4)(B). TIGTA must annually report on compliance with this requirement. The most recent report is TIGTA Report Titled "Fiscal Year 2019 Statutory Audit of Compliance With Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute (Ref. Num. 2019-30-054 8/7/19). The report indicates that the IRS generally complies, but some audit files lacked appropriate documentation.

⁸⁹³ See Publication 1035, titled "Extending the Tax Assessment Period" (Rev 06-2007).

⁸⁹⁴ ILM 200221006 (2/6/02), reprinted at 2002 TNT 102-76 (5/28/02).

⁸⁹⁵ *Jordan v. Commissioner*, 134 T.C. 1, 5 (2010), applying *Adler v. Commissioner*, 85 T.C. 535, 541 (T.C. 1985).

⁸⁹⁶ See *Adler v. Commissioner*, 85 T.C. 535, 540 (1985). *Adler* does not say that specifically with respect to the six-year extended limitations period in § 6501(e), but the wording suggests that. I have not had the opportunity to research that issue, but I suspect that there may be authority out there that the IRS (or United States in courts other than the Tax Court) has the burden to establish the application of the six-year statute of limitations. *Adler* may thus be limited to just consents and may only be applicable in the Tax Court. Of course, as I note in the text, the language is tempered in the case of assessments justifiable only by the presence of fraud; in that case, the IRS clearly has the burden of proving fraud.

⁸⁹⁷ Tax Court Rule 142(b).

f. Extension Strategies.

The fact that a taxpayer and the IRS can agree to an extension does not mean that the taxpayer should agree to an extension requested by the IRS. There is no patriotic, moral or other duty to agree to an extension, and the IRS is supposed to advise the taxpayer of that upon requesting an extension. My view is that, generally, a taxpayer should not agree to any extension.

If unusual circumstances exist that might motivate the taxpayer to agree to an extension, the taxpayer should keep a tight leash on the extensions, agreeing to only such extensions as absolutely needed. For example, in one large corporate audit where the IRS requested a Form 872-A and the client reluctantly agreed, the client contemporaneously and unilaterally set a time schedule for the events that needed to happen and advised the IRS in writing that if these events did not happen as scheduled, the taxpayer would pull the plug (i.e., file a Form 872-T) by a date certain. Various other solutions could meet particular needs, but the taxpayer must keep in mind that he controls the extension decision.

In the past, to obtain an extension, the IRS has sometimes threatened and, in some cases, carried out threats to take arbitrary action (such as denying all deductions or denying all deductions of a certain category such as travel and entertainment (“T&E”)) and then forcing the taxpayer to go to court to justify the denied deductions.⁸⁹⁸ Courts and Congress are not happy with such arbitrary action, and the IRS does not do it anymore. In short, there should be no direct penalty from refusal to execute a consent. Taxpayers in ongoing audits (such as large corporate taxpayers) may, however, fear that they may be subject to audit activity in a later audit cycle that could have been avoided by “cooperating” in this fashion in the earlier cycle. That is a judgment call that should be made at the time the IRS requests an extension, but, in all events, in my judgment, the right tone is set by notifying the IRS at the beginning of the audit that extensions will not be granted.

6. Failure to Disclose Listed Transaction.

Congress’ concern for abusive tax shelters hawked to high income or net worth individuals and corporations has led to a series of initiatives (discussed below beginning p. 848)). Among the initiatives is a special statute of limitations for failure to disclose on a return a listed transaction.⁸⁹⁹ Taxpayers are required to report certain information regarding their participation in a listed transaction.⁹⁰⁰ The limitations period on assessment with respect to such a failure shall not expire before one year after the **earlier** of (A) “the date on which the Secretary is furnished the information

⁸⁹⁸ Publication 1035, titled “Extending the Tax Assessment Period” (Rev 06-2007) is more circumspect if the taxpayer refuses to sign: “ If you choose not to sign the consent, we will usually take steps that may ultimately allow us to assess any tax we determine to be due. These steps begin with the issuance of a notice of deficiency.”

⁸⁹⁹ § 6501(c)(10), as added by § 814 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004). The Tax Court has held that this special limitations suspension applies at the partnership level for adjustment of partnership items. *Blak Investments v. Commissioner*, 133 T.C. 431 (2009).

⁹⁰⁰ The reporting requirements include both a disclosure on a particular form with the relevant income tax return(s) and a separate filing with the Office of Tax Shelter Analysis. Reg. § 1.6011-4(d). See IRS web page titled “Recognized Abusive and Listed Transactions” (Last Reviewed or Updated 5/5/17 and viewed on 7/24/17).

so required,”⁹⁰¹ or (B) the date that a material advisor meets disclosure requirements pursuant to an IRS request relating to the undisclosed listed transaction.⁹⁰²

7. Significant Omissions of Income.

a. Six-Year Statute for 25% Omissions.

(1) The Exception to the General Rule.

Section 6501(e)(1)(A) provides a six-year statute for a “substantial omission”—defined as an

- (1) omission from “gross income” in an amount exceeding 25% of the amount of gross income stated in the return (25% Omission”);⁹⁰³ or
- (2) an amount of gross income in excess of \$5,000 attributable to assets required to be reported under § 6038D (IRS Form 8938, Statement of Specified Foreign Financial Assets) or would have been required applied without the dollar thresholds in § 6038D(a) or (h).⁹⁰⁴

An exception to this extended statute of limitations is provided “is disclosed in the return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature and amount of such item.”⁹⁰⁵

The key in applying the formula is the definition of gross income. Gross income means (i) gross proceeds or revenue without reduction by cost of goods or service in a trade or business;⁹⁰⁶ and (ii), in the case of sale of an asset, the gross amount realized without reduction for **overstated** cost or other basis.⁹⁰⁷ The latter provision was designed to reverse the holding in *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958), which interpreted the then 25% omission to include net proceeds after recovery or cost. The Colony holding was abused in tax shelters overstating basis for which the taxpayer never paid.

Exception (i) above permitting a six-year statute turns upon a fraction. The result of the fraction must exceed 25%; the numerator (omitted gross income) over the denominator (the reported

⁹⁰¹ The statute does not require that the person potentially subject to the penalty and extended statute of limitations actually supply the information or that the information be on any particular form, although the Regulations and procedures require that that person supply the information on Form 8886. Reg. § 1.6011-4(a). The Ninth Circuit held in a nonprecedential decision that, based on statutory interpretation in connection with § 6011 to which § 6501(c)(10) refers, the Regulations requirement for furnishing the information on Form 8886 was appropriate; hence, merely because the IRS may have had the information in some other format is not sufficient. *May v. United States*, 2017 U.S. App. LEXIS 8602 (9th Cir. 2017) (unpublished).

⁹⁰² § 6501(c)(10). For an application of the (B) alternative, see *Bemont Investments, LLC v. United States*, 679 F.3d 339 (5th Cir. 2012) (holding that the disclosure must contain the information required by Reg. § 301.6112-1T (2002), Q&A 17 and 18 and that, in this case, that requirement was not met).

⁹⁰³ § 6501(e)(1)(A)(i). An analogous 25% omission rule is provided for partnerships (§ 6229(c)(2)) and for estate, gift and excise taxes (§ 6501(e)(2) & (3)).

⁹⁰⁴ § 6501(e)(1)(A)(ii).

⁹⁰⁵ § 6501(e)(1)(B)(iii).

⁹⁰⁶ § 6501(e)(1)(B)(i).

⁹⁰⁷ § 6501(e)(1)(B)(ii).

gross income) must exceed 25%. Anything increasing the numerator increases the result and anything increasing the denominator decreases the result. Hence, when representing a taxpayer seeking to avoid application of the six-year statute of limitations, you will look for ways to avoid or decrease the amount of inclusion in the numerator and include or increase the amount of the inclusion in the denominator. An expansive interpretation of a particular item of gross income is good for the taxpayer if the taxpayer reported that item of gross income (because it then is included in the denominator) but is bad for the taxpayer if the taxpayer did not report the item (because it is included in the numerator).

Other nuances of the critical definition will be developed in the examples below, which are intended to be illustrative rather than exhaustive.

(2) Examples Illustrating 25% Omission.

Example 1: On Schedule C, the taxpayer, a lawyer, reports \$200,000 of income (all fee income) and claims \$150,000 of deductions, for net Schedule C income of \$50,000. The taxpayer reports no other income on the return. The taxpayer, however, failed to include \$20,000 of interest income. The six-year statute does not apply. Although the omitted \$20,000 exceeds 25% of the taxpayer's taxable income (\$50,000), it does not exceed 25% of the gross income reported on the return (the Schedule C gross receipts of \$200,000). If the amount of interest income omitted were \$60,000, then the omission would exceed the 25% threshold and the six-year statute of limitations would apply.

Example 2: Assume the same facts, except that the interest income is \$300,000 and that the interest income is reported, but the taxpayer fails to include the Schedule C income by omitting the Schedule C. The net unreported taxable income (\$50,000) is about 16% (\$50,000 divided by \$300,000). However, the benchmark omitted gross income is not the schedule C net income (taxable income) but the Schedule C gross income. The omitted gross income clearly exceeds 25% of the reported gross income. This variation from example 1 shows a truism of the critical fraction—interpretations of the term gross income that help the taxpayer when calculating the denominator may hurt the taxpayer when calculating the numerator, and vice-versa.

Example 3: On Schedule C, the taxpayer reports \$200,000 of gross sales income and \$140,000 cost of goods sold (“COGS”) for net income before ordinary deductions of \$60,000. The taxpayer reports \$10,000 of Schedule C ordinary deductions, for a net Schedule C income of \$50,000 (i.e., \$200,000 gross sales income less \$140,000 COGS and \$10,000 of ordinary deductions). The taxpayer reports no other income, and as in Example 1 fails to report \$20,000 of interest income. The issue raised by this slight variation is whether the benchmark denominator figure in the critical calculation includes the \$200,000 gross sales revenue or only the net \$60,000 (i.e., gross revenue less COGS). Gross revenue is the benchmark, so the six-year statute does not apply.⁹⁰⁸

Example 4: The taxpayer reports \$100,000 of salary income and a sale of property. He sold the property for \$100,000. On his return, he reported the \$100,000 as the amount realized on the sale, claimed a basis of \$80,000, and reported taxable gain of \$20,000. Assume that the taxpayer

⁹⁰⁸ § 6501(e)(1)(B)(i).

omitted an item of dividend income of \$40,000 and that omission was not fraudulent. The question is whether, in computing the denominator of the key fraction, the reported amount realized is used or the reported gain is used. The calculations are:

| | If amount realized | If net gain only |
|-------------------------------|---------------------------|-------------------------|
| Income Reported on Return | | |
| Salary | \$100,000 | \$100,000 |
| Sale of Property | \$100,000 | \$20,000 |
| Income Reported (Denominator) | \$200,000 | \$120,000 |
| Unreported Income (Dividend) | \$40,000 | \$40,000 |
| % of Unreported Income | 20% | 33% |

Thus, the taxpayer with this profile would avoid the 6-year statute of limitations. (Readers who find joy in math calculations should also quickly perceive that, where the sale transaction is omitted from the return, the use of the amount realized for the calculations can have the reverse effect in calculating the numerator of the fraction, thus imposing a 6-year statute of limitations where using the gain realized would not.)

Example 5: Now for a variation of Example 4. Assume that (i) the taxpayer had only two components of income (salary income of \$100,000 and the property sale transaction) and (ii) the real basis in the property sale was \$0 but, on the return, the taxpayer claims an improper (but arguably not fraudulent) basis of \$80,000, thus reporting \$20,000 of income. Here are the calculations:

| | If amount realized | If gain only |
|-------------------------------|---------------------------|---------------------|
| Income Reported on Return | | |
| Salary | \$100,000 | \$100,000 |
| Sale of Property | \$100,000 | \$20,000 |
| Income Reported (Denominator) | \$200,000 | \$120,000 |
| Unreported Income | \$0 | \$80,000 |
| % of Unreported Income | 0% | 67% |

Colony seemed to require the amount realized computation, resulting in no 6-year statute of limitations. The Supreme Court so held in this precise type of circumstance (artificially created basis

resulting in a reduction of net gain). *United States v. Home Concrete*, 566 U.S. 478 (2012).⁹⁰⁹ However, Congress legislatively overruled *Home Concrete* by amending § 6501(e)(1)(B) to provide that “An understatement of gross income by reason of an overstatement of unrecovered cost or other basis is an omission from gross income.”⁹¹⁰ This means that, in the foregoing calculation, the \$80,000 overstatement of basis is treated as an omission of gross income, so that the omitted income is \$80,000 with a resulting gross income omission of 67% and a resulting 6-year statute of limitations.

(3) \$5,000+ Omission of 6038D (Form 8938) Assets.

The (2) exception above is for \$5,000 income omissions of assets required to be reported under § 6038D (Form 8938 Assets) or would have been required without consideration of the dollar threshold or exceptions.

Example 1: Taxpayer has a single asset, stock in a foreign corporation, that meets the Form 8938 reporting requirement and is reported on Form 8938. But taxpayer omits \$10,000 in dividends from the foreign corporation. The omission is not fraudulent (which would invoke the unlimited statute of limitations). The six-year statute of limitations applies.

Example 2: Same example, except that the reportable § 6038D asset was not reported on Form 8938. The omission is not fraudulent. Same result as Example 1: The six-year statute of limitations applies. Also, note

- if the taxpayer fails to provide disclosures required by § 6038D on the Form 8938, unless due to reasonable cause, the statute of limitations will not begin to run until the information required is provided to the IRS (§ 6051(c)(8)); and this is true even if the taxpayer reports the income from the foreign financial assets required to be reported; and
- These results would apply even if the taxpayer otherwise reported any amount of other gross income --- say \$1 billion gross income from dividends from a domestic company and \$1 billion gross wages (with W-2).

(4) Disclosure to Avoid 6-Year Statute.

As noted above, even if income is omitted from the calculations on the return, the omission will be disregarded if an adequate disclosure of the omitted income is provided on the return. What

⁹⁰⁹ The context of *Home Concrete* and the flurry of cases that produced the inconsistent courts of appeals decisions leading to Supreme Court review was the widespread proliferation of tax shelters creating artificial basis. In the late 1990s and early 2000s, there were a number of so-called basis enhancement shelters—the most notorious being so-called Son-of-Boss shelters. Some of these shelters (a limited number but representative of the class) were subsequently held to be fraudulent in criminal prosecutions of the promoters. The IRS’s first line of attack in trying to get to these shelters where the three-year statute was closed was to assert the six-year statute in § 6501(e) but needed an interpretation of that exception different than *Colony*’s holding that overstatement of basis was not an omission of income. In *Home Concrete*, the court rejected the IRS’s interpretation of § 6501(e), holding that it was foreclosed by *Colony*.

⁹¹⁰ § 2005(a), the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (P.L. 114-41). The effective date for the enactment is for “the period specified in section 6501 of the Internal Revenue Code of 1986 (determined without regard to such amendments) for assessment of the taxes with respect to which such return relates has not expired as of such date.”

is adequate disclosure? The statute requires disclosure “in a manner adequate to apprise the Secretary of the nature and amount of such item.”⁹¹¹ Some have read the Supreme Court’s decision in *The Colony*, interpreting a pre-1954 Code version of the 6 year exception, to bless disclosure of a mere clue as a way to avoid application of the 6 year exception. The language of the 1954 Code version (the current version), however, requires adequate notice⁹¹² and not just a “a mere clue that might intrigue Sherlock Holmes.”⁹¹³ Indeed, the disclosure must generally appear on the face of the return or an attached statement and “be apparent * * * to the elusive ‘reasonable man.’”⁹¹⁴

The disclosure contemplated is one filed on or with the taxpayer’s own original return which contains the substantial omission.⁹¹⁵ For this reason, the filing of an amended return will not cure the original return failure to disclose that caused the extended statute of limitations.⁹¹⁶ (Students will recall that the same concept applies with respect to the filing of a nonfraudulent amended return where the original return was fraudulent; the amended return does not cure the fraud that triggers the unlimited statute of limitations.) Where, however, the taxpayer’s original return provides a reference to another return that has been filed on or before the date the taxpayer’s return is filed, the references can constitute adequate notice.⁹¹⁷ For example, where a taxpayer reports on his return items from a flow-through entity such as a partnership or an S-corporation, the information on the referenced entity return filed on or before the filing of the taxpayer’s return can be considered in assessing whether the taxpayer has made adequate disclosure.⁹¹⁸

The disclosure escape from the six-year statute of limitations is not a license for a taxpayer to omit income that is clearly taxable and attempt to provide some obtuse disclosure so as to avoid

⁹¹¹ *CC&F Western Operations Limited Partnership v. Commissioner*, 273 F.3d 402, 407 (1st Cir. 2001), citing *George Edward Quick Trust v. Commissioner*, 54 T.C. 1336, 1347 (1970), aff’d per curiam, 444 F.2d 90 (8th Cir. 1971).

⁹¹² *Estate of Fry v. Commissioner*, 88 T.C. 1020, 1023 (1987) (“The statement must be sufficiently detailed to alert the Commissioner and his agents as to the nature of the transaction so that the decision as to whether to select the return for audit may be a reasonably informed one.”).

⁹¹³ *George Edward Quick Trust v. Commissioner*, 54 T.C. 1336, 1347 (1970), aff’d per curiam, 444 F.2d 90 (8th Cir. 1971). In *Benson v. Commissioner*, 560 F.3d 1133, 1136-1137 (9th Cir. 2009), the Court rejected the argument that, since the IRS ultimately found the putatively omitted item, the IRS was not at a special disadvantage requiring a six-year period. The taxpayer’s argument was, of course, circular. If the IRS did not discover the omission, then the statute was six years but would be meaningless because the IRS did not discover the omission even in the six years. If the IRS did discover it in the six-year period, then the six-year period would not apply because the IRS discovered it.

⁹¹⁴ *Univ. Country Club, Inc. v. Commissioner*, 64 T.C. 460, 468 (1975).

⁹¹⁵ *Colony* did note the reason for the extended statute being that Congress deemed the IRS to be “at a special disadvantage” with respect to omitted income. That does not mean that, if for some other reason, the IRS may not in fact be at a special disadvantage, the 6-year statute does not apply; the sole focus is on the omission rather than the special disadvantage. See *Heckman v. Commissioner*, 788 F.3d 845 (8th Cir. 2015).

⁹¹⁶ *Houston v. Commissioner*, 38 T.C. 486, 489 (1962) (stating that this is “settled law,” citing *Goldring v. Commissioner*, 20 T.C. 79 (1953)).

⁹¹⁷ E.g., *Benson v. Commissioner*, T.C. Memo. 2006-55.

⁹¹⁸ E.g., *White v. Commissioner*, 991 F.2d 657, 661 (10th Cir.1993), affg. T.C. Memo.1991-552 (partnership); and *Benderoff v. United States*, 398 F.2d 132 (8th Cir. 1968). The notion is that, if the entity return is filed later than the taxpayer’s original substantial omission return, then the subsequent filing of the entity return is like the filing of an amended return by the taxpayer which, as noted in the text, does not qualify. See CCM 201333008 (6/27/13); for a deeper discussion of this IRS pronouncement, see Leslie Book, [Disclosure and the 6-Year Statute of Limitation: S Corp Issues](#) (Procedurally Taxing Blog 11/13/13). For the limits of these types of disclosures outside the taxpayer’s own return, see *Heckman v. Commissioner*, 788 F.3d 845(8th Cir. 2015).

§ 6501(e). Gamesmanship via an erroneous or misleading disclosure could result in criminal prosecution and/or the civil fraud penalty. Rather, it seems that such disclosure is most effectively employed where the taxpayer has some reasonable argument that the income may not be taxable and desires to achieve two goals by a reasonable disclosure -- first the avoidance of criminal and civil penalties and second the application of the normal three-year limitations period.

For taxpayers who pay close attention to odds and are risk takers, disclosing solely to avoid a six-year limitations period is not generally a recommended option. Providing that the taxpayer is reasonably certain he or she can avoid civil and criminal penalties for the omission, the taxpayer may want to take the risks involved in having a six-year rather than a three-year statute of limitations. The IRS hardly ever commences audits of returns that are over 2 ½ years old anyway, so that the additional three year risk may not be that great. Thus, for each year during the first three years when the statute is open under the general rule, the odds of an IRS audit of the return are far greater than in the succeeding three years (Years 04 through 06). Nevertheless, even with the decreased odds in the “out years,” the IRS will sometimes stumble upon an out year problem while auditing years within the normal statute of limitations and will seek to invoke § 6501(e). And, of course, a disclosure will likely eliminate the far worse risk than a 6 year statute of limitations—a criminal investigation and prosecution. (I do not discuss here but urge readers to consider whether the odds of audit is a proper consideration in advising clients with regard to return filings.)

(5) Burdens of Proof.

In litigation, the burdens will shift: First, the taxpayer makes a prima facie case that the normal three-year statute of limitations has expired. If the three-year statute is open, whether there is a six-year statute is irrelevant. The taxpayer makes a prima facie case that the three-year statute is closed by proving the date of filing and the lapse of three years. That burden is relatively easy. Second, if the taxpayer meets that burden, the IRS must then establish the 25% omission of gross income. Third, if the IRS meets that burden, the taxpayer must then establish the affirmative defense of adequate disclosure.⁹¹⁹

b. Income Omissions Foreign Financial Assets.

I discuss (beginning p.989) a new special income tax disclosure requirement on Form 8938 required by § 6038D for foreign financial assets.⁹²⁰ If a taxpayer omits gross income from foreign financial assets in an amount that exceeds \$5,000, the statute of limitations on the return is six years rather than three years.⁹²¹ It is important to distinguish for this purpose between (i) the information about the foreign financial asset subject to § 6038D’s disclosure regime and (ii) the income from the assets subject to the disclosure regime. Thus, even if a taxpayer actually discloses the assets in the

⁹¹⁹ See *Hoffman v. Commissioner*, 119 T.C.1 40, 146 (2002).

⁹²⁰ § 6038D, added by the § 511 of HIRE Act (FATCA provisions).

⁹²¹ § 6501(e)(1)(A)(ii), as added by § 513(a) of the HIRE Act (FATCA provisions). The determination of the dollar amount is made without regard to the § 6038D’s dollar threshold, the statutory exception for nonresident aliens and any exceptions provided by regulation which might make the foreign financial assets otherwise not subject to actually being reported on the return. Also, the provision does not apply to years before the date of enactment when there was no reporting requirement for the specified foreign financial assets. *Rafizadeh v. Commissioner*, 150 T.C.1, No. 1 (2018) (rejecting the IRS’s argument that such pre-enactment years were included if there was an omission with respect to specified foreign financial assets although there was no reporting requirement).

manner required on Form 8938, but omits income from those reported assets, the taxpayer's return will be subject to this 6 year statute of limitations. (As discussed below, if the taxpayer fails to provide disclosures required by § 6038D on the Form 8938, the statute of limitations will not begin to run until the information required is provided to the IRS; and this is true even if the taxpayer reports the income from the foreign financial assets required to be reported.)

8. Special Rules for Transfer Tax Returns.

a. Gift Tax Returns.

Gift tax returns pose special statute of limitations problems. The gift tax returns are subject to the normal statutes of limitations—generally three years—as noted above. Because of the unified estate and gift tax system, even if the gift tax statute of limitations otherwise closed, the amount of the gifts (not just the amount reported on the gift tax returns) must be included in the estate tax calculation at death. This gave the IRS a second opportunity, outside the normal gift tax statute of limitations, to increase the reported value and collect an estate tax at the highest marginal estate tax rate on the increase.⁹²² In effect, this circumvents the finality otherwise offered by the normal application of the statute of limitations to the gift tax return. To offer some possibility for closure of old and cold transactions, special rules are provided that will lock in the gift tax consequences and their effect on the ultimate transfer tax at death, provided adequate disclosure is made on the gift tax return.

The gift tax statute of limitations will commence only for gifts “disclosed in such [the gift tax or amended gift tax] return, or in a statement attached to the return, in a manner adequate to apprise the Secretary of the nature of such item.”⁹²³ And, in computing the prior taxable gifts for purposes of the unified estate tax calculation, the values of the prior gifts reported on the prior gift tax returns will control only if they met that same standard.⁹²⁴

In addition, there is a 25% omission six-year statute of limitations paralleling § 6501(e)'s 6-year statute for income tax purposes.⁹²⁵ This 6-year gift tax statute applies where the taxpayer omits from the total amount of gifts made during the period for which the gift tax return was filed an amount which exceeds 25% of the total amount of gifts stated on the return. As with the income tax six-year statute, gifts are not included if they are adequately disclosed on the return.

Example: A taxpayer undertakes classic family partnership planning in which the taxpayer creates a limited partnership (“FLP”) and gifts limited partnership interests to his son. The taxpayer

⁹²² See *Estate of Smith v. Commissioner*, 94 T.C. 872, 878 (1990).

⁹²³ § 6501(c)(9); see Reg. § 301.6501(c)-1(f)(2) (requiring, inter alia, description of property, relationship of transferor and transferee, detailed description of the method for determining fair market value (with financial data such as balance sheets and explanations of adjustments, restrictions on property, discounts and basis for discounts). In CCA 201643020 (6/4/15), the IRS concluded that § 6501(c)(9) only requires that the gifts in the period be reported and that omission of prior years' gifts, although important for the calculation of the gift tax, need not be reported to avoid the extended period of limitations. In Rev. Proc. 2000-34, 2000-2 C.B. 186, the IRS concludes that properly reporting the gift on an amended return will start the running of the statute of limitations with respect to the gift.

⁹²⁴ § 2001(f)(2)(a). See *Estate of Hicks v. Commissioner*, T.C. Memo. 2014-100.

⁹²⁵ § 6501(e)(2). The Tax Court has said that this statute is in pari materia with the income tax 6-year statute (§ 6501(e)) and can be interpreted by reference to that statute. *Estate of Williamson v. Commissioner*, T.C. Memo. 1996-426.

files a gift tax return reporting only the gifts to his son. The description on the return is: “FLP Limited Partnership Units acquired by the taxpayer on January 1 of Year 1 for \$200,000 cash with an adjusted basis of \$200,000 and having a value of \$200,000.” The date of the transfer is January 2 of Year 1. Assume that the actual value is \$1,000,000. Is the quoted disclosure adequate to avoid the two special statutes noted above? The Regulations indicate that that would not be an adequate disclosure because it does not contain information about the methodology for valuation of the interest.⁹²⁶ Moreover, if (as is assumed) the actual value of the gift exceeds the 25% threshold, the IRS will have at least the six-year statute of limitations because the return did not make an adequate disclosure.

b. Estate Tax Returns.

If the estate tax return is not filed or, if filed, is fraudulent, the statute of limitations is open forever under the general rules.⁹²⁷ There is also a six-year statute of limitations for substantial omissions which is the same as applies for gift tax returns.⁹²⁸

9. Requests for Prompt Assessment.

A decedent's estate may request prompt assessment with respect to income tax returns.⁹²⁹ The assessment must then be made within 18 months of the date of the request. A similar rule applies for liquidating corporations.⁹³⁰ This shorter statute of limitations does not eliminate the requirement that the IRS send a predicate notice of deficiency; the timely sending of the notice of deficiency will, of course, invoke the suspension of the statute of limitations as discussed elsewhere.

10. Minimum Statute to Assess Tax Reported on Amended Return.

Where there is a statute of limitations that applies, if, within the 60 days before the expiration of the statute, the taxpayer files an amended return reporting additional tax due, the IRS will have at least 60 days to assess the reported tax liability.⁹³¹

11. Other Statutes.

The foregoing are the general statutes of limitations on assessment that you will encounter as a tax practitioner. There is, however, a plethora of other special statutes of limitations to address particular tax imperatives. In this section, I will summarize two examples of these other statutes of limitation to give a general idea of the type of special tax needs that spawn special statutes of limitations.

⁹²⁶ Reg. 301.6501(c)-1(f)(2)(iv).

⁹²⁷ § 6501(c)(1)-(3).

⁹²⁸ § 6501(e)(2).

⁹²⁹ § 6501(d). The request is made on Form 4810, Request for Prompt Assessment Under Internal Revenue Code Section 6501(d).

⁹³⁰ Id.

⁹³¹ § 6501(c)(7).

First, the U.S. Code allows a U.S. taxpayer certain tax credits for income taxes paid to foreign jurisdictions. It may be many years before the final amount of the foreign tax liabilities may be determined. A special statute of limitations applies for foreign tax credits.⁹³²

Second, certain Code provisions require the taxpayer to disclose certain transfers and transactions with foreign entities. For example, a U.S. taxpayer discloses relationships with foreign entities and transactions with those related foreign entities on Form 5471 which is attached to the return. If the taxpayer fails to report the information either altogether or the information is not substantially complete, the assessment statute of limitations on the entire tax return stays open unless the failure to report is due to reasonable cause and not willful neglect in which case the statute is open only with respect to tax relating to the failure.⁹³³

I hope that this gives you a sense that there are special statutes of limitations that meet perceived special tax imperatives. For this class, I do not expect you to scour the Code or other laws for these special statutes but will expect you to know for this class the ones discussed above.

D. Suspensions of the Statute of Limitations.

1. General.

Section 6503(a)(1) provides that the statutes of limitations on assessment and collection in respect of any “deficiency as defined in section 6211” is suspended during the period that the IRS is “prohibited from making the assessment or from collecting by levy or a proceeding in court.” I discuss in the next section the most prominent instance of such suspensions, found in § 6213(a), which prohibits further assessment and collection activity after a notice of deficiency through the expiration of 90 days without a Tax Court petition having been filed or, if filed, the Tax Court decision becomes final. I devote significant attention to the notice of deficiency and Tax Court petition for redetermination because they are ubiquitous in tax practice. But there are other suspensions, so practitioners should be alert to the effect of suspensions on assessment or collection activity.⁹³⁴ Generally speaking, if some statute prohibits the IRS from making an assessment or taking collection action, there is likely to be a suspension of the statute on assessment or collection.

⁹³² § 6501(c)(5).

⁹³³ § 6501(c)(8), as amended by the HIRE Act and then by Pub. L. 111-226 (124 Stat. 2403), § 218 (8/10/10). One question that has been raised but not yet definitively answered is whether a taxpayer disclosing somewhere (e.g. in an audit) the information required by the particular form prescribed the suspension ends upon such disclosure. See *Fairbank v. Commissioner*, T.C. Memo. 2023-19, at *22-*25, particularly at nn.30-33. For a robust discussion of this issue, see Bryan Camp, Lesson From The Tax Court: Fill Out The Damn Form (Tax Prof Blog 3/6/23).

⁹³⁴ There are other suspension of the statute of limitations less frequently encountered. Section 6331(i) suspends the statute of limitations during the period that a refund proceeding for a divisible tax is pending because of a similar prohibition on levies while the suit is pending. This provision can apply to any divisible tax (a concept discussed elsewhere in the text). The most frequently encountered divisible tax is the Trust Fund Recovery Penalty in § 6672. Section 6331(k) had the effect of suspending the statute under § 6503(a)(1) by prohibiting levies while offers-in-compromise are pending or installment agreements are in effect. Section 6502(a) (flush language) extends the collection by levy statute “until the liability for the tax (or a judgment against the taxpayer arising from such liability) is satisfied or becomes unenforceable.” (I have not dug into precisely what this means, but assuming that it means something, it is likely suspended during the time the case is pending, so that if the case ends in a judgment for the tax liability, a new judgment collection statute starts and the old tax collection statute is rendered moot.)

2. Deficiency Notice and Tax Court Petition Suspensions.

a. Suspensions to Ensure Prepayment Remedy.

If the IRS timely (i.e., within the limitations period for assessment) issues a notice of deficiency, the statute of limitations is suspended to ensure that the taxpayer is given an effective prepayment remedy in the United States Tax Court. The notice of deficiency, also called a “ticket to the Tax Court,”⁹³⁵ gives the taxpayer the right to litigate in the Tax Court **before** the tax is assessed and the taxpayer is required to pay. To ensure this prepayment right, Section 6213(a) prohibits the IRS from making an assessment for 90 days after the notice of deficiency is issued and, if the taxpayer petitions the Tax Court, until the decision of the Tax Court becomes final.⁹³⁶ Section 6213(c) requires assessment if the taxpayer does not file the Tax Court petition for redetermination within that 90 day period. To give the IRS some period to assess after the period of prohibition prescribed in § 6213(a), § 6503(a)(1) suspends the period of limitations to take account of § 6213(a)’s period of prohibition on assessments.

There has recently been some concern about “premature assessments” – those made during the prohibition period after a valid Tax Court petition was filed – because of delays in Tax Court notification to the IRS of the petition filing or problems in the IRS after receiving notice. The Tax court and the IRS has processes to correct premature assessments.⁹³⁷

Parsing the text of § 6503(a)(1), the assessment statute of limitations is suspended until 60 days beyond whichever of the following dates applies (depending upon whether the taxpayer petitions the Tax Court):

- if the taxpayer does not petition the Tax Court, the end of the 90-day period during which the IRS was prohibited from making the assessment (the same 90 period during which the taxpayer could have petitioned the Tax Court but did not), and
- if the taxpayer does petition (or, more technically, if “a proceeding in respect of the deficiency is placed on the docket of the Tax Court,”⁹³⁸ the date the Tax Court decision becomes final.

⁹³⁵ *McKay v. Commissioner*, 89 T.C. 1063, 1067 (1987).

⁹³⁶ If the IRS erroneously assesses during this prohibition period, upon notice of the error, it will abate the assessment so that, effectively, the assessment is ignored. See Keith Fogg, [Premature Assessments](#) (Procedurally Taxing 6/10/20); and Keith Fogg, [Collection Issues Discussed at Recent ABA Meeting](#) (Procedurally Taxing Blog 10/7/20). The assessment which has been abated is a nullity and does not prevent re-assessment of the deficiency determined by the Tax Court. Cf. *Connell Bus. Co. v. Commissioner*, T.C. Memo. 2004-131 (“While the abatements might be construed to constitute an admission that the prior assessments were premature, they in no way constitute admissions as to the proper amount of the deficiencies.”); see also *Mackey v. Commissioner*, T.C. Memo. 2004-70.

⁹³⁷ See Tax Court Press Release dated 7/23/21 and [NTA Blog: Have you Recently Filed a Petition with the U.S. Tax Court?](#) (8/10/21) (both noting that taxpayers suffering premature assessments “can email the IRS at taxcourt.petitioner.premature.assessment@irs.gov”).

⁹³⁸ Recognizing the text’s substantial meaning, see *Shockley v. Commissioner*, 686 F.3d 1228 (11th Cir. 2012) (holding that the filing of a Tax Court petition invoked the suspension even if the notice of deficiency was invalid or the filing was not by the proper person; per § 6503(a), the suspension occurs “if a proceeding in respect of the deficiency is placed on the docket of the Tax Court”). For a discussion of this and related issues, see Robert W. Wood and Dashiell C. Shapiro, [For Whom the Statute Tolls](#), 140 Tax Notes 1035 (Sept. 2, 2013).

b. Notice of Deficiency and No Tax Court Petition.

As noted, § 6503(a)(1) suspends the period for assessment when no Tax Court petition is filed for the period during which the IRS is prohibited from making an assessment plus 60 days or, if a Tax Court petition is filed, until the Tax Court case is finalized. We consider here a situation where the taxpayer does not file a petition for redetermination. Section 6503(a) suspends the statute of limitations for the 90 day period of prohibition of assessment provided in § 6213(a), 60 days, for a total suspension period of 150 days from the date of the notice of deficiency. The IRS may assess from the 90th day after the notice through the 150th day after the notice, plus any additional time on the statute when the notice was issued.⁹³⁹

There are some exceptions to § 6213(a)'s prohibition on assessment in cases requiring a notice of deficiency.⁹⁴⁰ The principal such exceptions permitting immediate assessment (called "summary assessment") are:

- Jeopardy assessment if collection of the tax is in jeopardy as determined under jeopardy assessment procedures discuss later in this text. § 6861.⁹⁴¹
- Tax reported on a return (including an amended return). § 6201(a)(1).⁹⁴²
- Tax paid. § 6213(b)(4).
- To correct a mathematical or clerical error. § 6213(b)(1) and (2).⁹⁴³

What happens if, during the 90 day period of the assessment prohibition under § 6213(a), the taxpayer makes a tax payment for the tax in the notice of deficiency, thus permitting the IRS to assess under § 6213(b)(4) notwithstanding § 6213(a). The technical legal question is whether, since the prohibition on assessment during the 90 day period does not apply, the suspension in § 6503(a) for the period of prohibition continues to apply. In a fascinating decision covering the interface of these rules, Court of Federal Claims Judge Allegra concluded that the 150 day suspension period applied even if there were some exception otherwise applicable that permitted an assessment during the period of prohibition stated in § 6213(a).⁹⁴⁴

⁹³⁹ § 6213(c).

⁹⁴⁰ Some tax (including penalties) is not subject to the prohibition on assessment because they do not require a notice of deficiency. This includes certain penalties. See § 6665(b) (re failure to pay and failure to file) and § 6682(c) re false information on withholding forms.

⁹⁴¹ See discussion of jeopardy and termination assessments beginning on p. 523.

⁹⁴² For an interesting application of this rule, see *MEI Productions v. Commissioner*, T.C. Memo. 2020-11 (where, after receiving a notice of deficiency and filing a Tax Court petition, the taxpayer filed an amended return which the IRS assessed immediately without awaiting the outcome of the Tax Court proceeding or incorporating the tax assessed on the amended return into the deficiency calculation in the Tax Court case).

⁹⁴³ See p. 659.

⁹⁴⁴ *Principal Life Insurance Co. v. United States*, 95 Fed. Cl. 786 (2010). Thus, § 6213(b) contains exceptions to the prohibition in § 6213(a). The exception to § 6213(a) in play was § 6213(b)(4). The taxpayer argued that, since it had fully paid the tax, penalties and interest by application of a deposit during the period assessment was otherwise prohibited by § 6213(a), the IRS was not prohibited from making the assessment and, therefore, the suspension provided in § 6503(a) ceased. The consequence, the taxpayer urged, was that the suspension period ended upon the date of payment, thereby making the delayed assessment in that case untimely. Judge Allegra deftly weaves the Code sections and legislative history to conclude that, properly interpreted, § 6503(a) suspends for a flat 150 days once a notice of deficiency is issued regardless of any exception to the prohibition on assessment that might apply and lift the prohibition on assessment in the interim. Judge Allegra's conclusion is, I think, right, but I note that it is dicta in the case. If Judge

(continued...)

c. Notice of Deficiency and Tax Court Petition.

If a Tax Court petition is filed, the IRS is prohibited from making the assessment and thus the statute is suspended until the Tax Court decision becomes final.⁹⁴⁵ That is a flat suspension of the statute that is not dependent upon any period during which the IRS is prohibited from making an assessment (although, in theory, it is somewhat related to that period).⁹⁴⁶

Normally, we would think that finality is not achieved until all appeals (including petitions to the Supreme Court for writ of certiorari) have been concluded in the case. Indeed, the statute says that Tax Court decisions are not final while such further proceedings are pending. § 7481(a).⁹⁴⁷ However, § 7485(a) lifts the prohibition on assessment when the taxpayer appeals from the Tax Court unless the taxpayer posts bond.⁹⁴⁸ Without a bond, the IRS can assess despite the pendency of an appeal. But does that mean that the suspension on the statute of limitations is then lifted, so that the IRS must make the assessment within 60 days plus whatever period remained on the statute when it was suspended? No. Why? Because § 6503(a)(1) states that the suspension occurs while the IRS is prohibited from assessing **but** in any event, if a Tax Court petition is filed, until the decision of the Tax Court becomes final and for 60 days thereafter. Thus, even though § 7485(a) lifts the prohibition on assessment, the Tax Court decision will still not be final under the rule stated in § 7481(a) and the suspension of the period of limitations continues until the Tax Court decision becomes final. Section 7485(a) does not affect the rules as to when the Tax Court decision becomes final; all it does is to lift the prohibition on assessment. Piecing together these rules, even if the taxpayer appeals (provided he does not post bond), the IRS will be able to assess from a date 90 days after the Tax Court decision is rendered through a date which is the number of days after all appeals

⁹⁴⁴(...continued)

Allegra is not correct, however, it would appear that the 150 day period might be shortened by a payment on the tax, penalties and interest during the interim. But query in any event whether, since the tax was paid during the period the IRS could have assessed, the taxpayer nevertheless cannot obtain a refund when the IRS failed to assess timely.

⁹⁴⁵ Once a petition is filed purporting to respond to a notice of deficiency, the statute is suspended even if it is determined thereafter that the person other than the taxpayer actually filing the petition (someone otherwise authorized to practice before the Tax Court) did not have authority to file the petition. See *Eversole v. Commissioner*, 46 T.C. 56 (1966) and *Martin v. Commissioner*, T.C. Memo. 2003-288, aff'd 436 F.3d 1216 (8th Cir. 2006).

⁹⁴⁶ One issue is whether the filing of a Tax Court petition that successfully challenges the validity of the notice of deficiency will result in a tolling of the statute of limitations under § 6501(a)(1), which requires tolling "if a proceeding in respect of the deficiency is placed on the docket of the Tax Court." I don't know that that has been definitively answered. It might depend upon whether the IRS reasonably did not know that the notice of deficiency was invalid, although the statutory text does not require that nuance. See Robert W. Wood and Dashiell C. Shapiro, For Whom the Statute Tolls, 140 Tax Notes 1035 (Sept. 2, 2013).

⁹⁴⁷ The § 7481 concept of finality sounds like a jurisdictional-type bar to further consideration of the matter resolved in the Tax Court proceeding. Some courts, including the Tax Court, have recognized some narrow circumstances in which an otherwise final decision may be subject to revision. See *Kirik v. Commissioner*, 2021 U.S. App. LEXIS 16815 (2d Cir. 2021) (identifying certain exceptions although not yet adopted by the Second Circuit but holding that the circumstances with equitable factors did not apply, thus not requiring the Court to opine on whether such factors may apply to a decision otherwise final). See also Keith Fogg, Finality of a Tax Court Decision (Procedurally Taxing Blog 6/15/21) (discussing *Kirik*).

⁹⁴⁸ See also Tax Court Rule 192 reminding parties that the prohibition on assessment will be lifted if bond is not filed. The amount of the bond is determined by the Tax Court to cover the deficiency and penalties as determined by the Tax Court, plus interest through 2 ½ years after the notice of appeal, with a cap of double the amount of the deficiency. *Poinier v. Commissioner*, 90 T.C. 63 (1988). The posting of the bond does not stop the running of interest on the deficiency, penalties (if any) and interest finally determined. Until the notice of appeal, the IRS has had no assurance that the taxpayer will be able to pay the tax and generally will proceed with collection unless the bond is filed. Approved sureties are listed in Treasury Circular 570.

have been taken and become final determined by adding the number of days remaining on the statute when the notice was issued plus 60 days.

Let's illustrate these rules. The examples I use do not include a notice addressed to a taxpayer outside the United States.

Example 1: The IRS issues a notice of deficiency to T on the last date that the IRS could make an assessment. The IRS cannot make the assessment in the 90 day period during which the taxpayer may file a petition in the Tax Court. § 6213(a) (second sentence). The statute of limitations on assessment is suspended during the period that the IRS is prohibited from making the assessment. § 6503(a)(1). If the taxpayer fails to file a petition, the IRS can make the assessment on the 91st day (the prohibition on assessment being lifted on the last day the taxpayer could have filed a petition in the Tax Court) through the 150th day (the special 60 day extension period provided in § 6503(a)(1)). Note that, in this example, there is no additional time remaining on the statute of limitations at the time the notice of deficiency was issued, but if there had been that number of days would be added to the 60 day extension period. If the taxpayer petitions the Tax Court, the statute continues to be suspended, and the IRS can make the assessment at the earliest 90 days after the Tax Court decision is entered (§ 7485(a)), regardless of whether the taxpayer takes an appeal. And the IRS will then have a minimum of 60 days to make the assessment (if the taxpayer does not appeal) or until 60 days after all appeals are final under § 7481.

Example 2:

Year 01 Return Actually Filed by Mail: 10/01 of Year 2 Saturday
Return Filing Extension Date: 10/15 of Year 02 Thursday
Date Return Received by IRS: 10/14 of Year 02 Wednesday
Notice of Deficiency Date: 10/01 of Year 05 Wednesday
No Forms 872 or 872-A

1. If the taxpayer does nothing, Section 6213(a) prohibits the IRS from assessing during the 90 day period that the taxpayer can go to the Tax Court. The earliest the IRS may assess is 91 days after 10/01 of Year 05.⁹⁴⁹ The latest the IRS may assess is the sum of (i) 150 days⁹⁵⁰ after 10/01 or Year 05 (remember § 6503(a)(1) provides an automatic 60 day extension) and (ii), the number of days remaining on the statute when the notice was issued. Fourteen days remained on the statute when the notice was issued. You will remember that, since the return was actually filed within the extension period on 10/14 of Year 02, the timely-mailing, timely-filing rule does not apply and the filing date for the return is 10/14 of Year 02. So, the IRS may assess no later than the 164th day after 10/01 of year 05.

2. If T files a Tax Court petition on 12/1 of Year 5. Focusing solely on § 6213(a) and § 7481, one would conclude the earliest the assessment may be made is when the Tax Court decision becomes final after all appeals become final. For further consideration, assume the following:

⁹⁴⁹ § 6213(c).

⁹⁵⁰ See the discussion of Principal Life above.

Tax Court decision entered: 6/1 of Year 07
T appeals to Fifth Circuit: 8/1 of Year 07
Fifth Circuit Decision Judgment entered: 6/1 of Year 08
Fifth Circuit Judgment Becomes Final: 9/29 of Year 08
No Petition for Certiorari is Filed

When is the earliest the IRS can assess? Keep in mind § 7481 says that the decision does not become final until 9/29 of Year 08, so is that the earliest the IRS can assess? No. If all we had was § 7481, then the answer would clearly be yes, because there would be no provision lifting § 6213(a)'s prohibition on assessment prior to the date of ultimate case finality. But § 7485(a) provides that, if the taxpayer appeals a Tax Court decision, the prohibition on assessment is lifted as of the date of appeal unless the taxpayer files a bond. Does this mean that, once there is an appeal and the prohibition on assessment lifted, the IRS must assess within 74 days from the date of appeal (the § 6503(a) 60-day grace period plus 14 days)? No, for § 6503(a)(1) suspends the period for assessment if a Tax Court petition is filed (see the parenthetical) until the decision becomes final as defined in § 7481, so that the IRS would have 74 days after that date to assess at the latest. So, the IRS may make the assessment anytime from the date of the appeal, assuming no bond, through 74 days after 9/29 of Year 08, the date of case finality.

d. No Notice of Deficiency and Tax Court Petition.

There are times when the taxpayer files a Tax Court petition but there has been no predicate notice of deficiency. The best example is when the IRS did not properly send the notice of deficiency to the taxpayer's last known address and the taxpayer files a Tax Court petition to void the notice and assessment based on the notice. The Tax Court has jurisdiction to determine that it lacks jurisdiction to redetermine a notice of deficiency void ab initio for failure to properly mail the notice. Is the statute of limitations on assessment is suspended under § 6503(a) as a result of the docketing of the case in the Tax Court for that limited purpose? The answer is that § 6503(a) applies to suspend the statute because of the following parenthetical: "(and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court until the decision of the Tax Court becomes final)."⁹⁵¹

e. Waiver of Prohibitions on Assessment.

I noted earlier that § 6213(d) authorizes a taxpayer, "at any time," to waive the prohibitions on assessment in § 6213(a) (which requires a notice of deficiency and allows the taxpayer time to petition the Tax Court). The suspension period in § 6503(a) discussed above can be shortened by the taxpayer filed a waiver of the restrictions on assessment (such as by Form 870 or Form 4549). The filing of the waiver "filed within the 90-day period of suspension provided by sections 6213(a) and 6503(a)(1) of the Code, has the effect of terminating the running of such 90-day period and starting the running of the 60-day period provided by section 6503(a) of the Code on the date it is filed."⁹⁵² Thus, if the notice is sent 4 days before the normal statute of limitations period expires, and

⁹⁵¹ CCA 201644020 (10/28/16) (advising that the contrary provision in 8.20.7.21.2 (10-03-2014), Dismissed for Lack of Jurisdiction Case Closing (8.4.1.30.4) is incorrect). The CCA seems to be a correct literal reading of the provision, but it is odd that the IRS would have gotten that wrong in the IRM.

⁹⁵² Rev. Rul. 66-17, 1966-1 C.B. 272.

the taxpayer files the waiver a week after the notice is issued, the prohibitions on assessment are lifted and the IRS has 4-days plus the § 6503(a) 60-day suspension period in which to assess.⁹⁵³

E. Other Suspensions of the Assessment Statute.

Section 6503 provides other suspensions of the assessment statute of limitations. More commonly encountered examples are:

- Suspension during bankruptcy while the IRS is prohibited from making an assessment and for a period of 60 days thereafter.⁹⁵⁴
- Suspension with respect to judicial enforcement period for a designated summons (discussed at p. 433 below).⁹⁵⁵

F. Exceptions—No Statute of Limitations for Some Assessments.

Although, as noted above, tax statutes of limitations reflect a general policy that statutes of limitations are an essential element of fairness, there are some instances in which tax claims may be made forever, with no statute of limitations. There is no statute of limitations if taxpayer fails to file the return with respect to which the assessment may be made or files a fraudulent return with respect to which the assessment may be made.⁹⁵⁶ In those cases, Congress determined that countervailing policies outweigh the need for repose.

Still, in Anglo-American jurisprudence, there is a bias toward statutes of limitation even where the statute may seem to provide none. Consider the following from the estimable Judge Posner in a case where the IRS, by regulation, provided the equivalent of a statute of limitations for an administrative claim:

[T]he 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. Courts “borrow” a statute of limitations from some other statute in order to avoid the absurdity of allowing suits to be filed centuries after the claim on which the suit was based arose. They borrow an existing statute of limitations rather than create one because “the length of a limitations period is arbitrary -- you can't reason your way to it -- and courts are supposed not to be arbitrary; when they are, they get criticized for it.” Courts even say that in borrowing a statute of limitations from one statute for use in another they are doing Congress's will: “Given our longstanding practice of borrowing state law, and the congressional awareness of this practice, we can generally assume that Congress intends by its silence that we borrow state law.”⁹⁵⁷

⁹⁵³ ECC 201518015 (2/2/2015), published at 2015 TNT 85-38, citing Rev. Rul. 66-17, 1966-1 C.B. 272.

⁹⁵⁴ § 6503(h).

⁹⁵⁵ § 6503(i)

⁹⁵⁶ § 6501(c)(1)-(3).

⁹⁵⁷ *Lantz v. Commissioner*, 607 F.3d 479, 481-82 (7th Cir. 2010) (case citations omitted).

As in other areas of the law adverted to by Judge Posner, there are situations in which the Code just does not address the issue of a statute of limitations for assessment. Given the Anglo-American predilection for repose, courts will look for some related statute of limitations to borrow. Let's consider, by way of example, the trust fund recovery penalty ("TFRP") which I discuss in more detail below beginning on p. 793). For present purposes, I will just summarize the nature of the penalty. As you know, an employer is required to withhold from employees and pay over to the Government an amount for income tax with regard to compensation paid and the amount of the employee's share (½) of the FICA obligation. The employer is said to hold these amounts in trust between the time they are withheld from the employee and the time they are paid over to the Government; hence the taxes are often referred to as trust fund taxes. As a mechanism to collect the amounts that should have been withheld and paid over, § 6672 imposes a penalty in the amount of the unpaid trust fund tax on the person or persons in the employer's organization who had the responsibility and authority to ensure that the taxes were withheld and paid over. The § 6672 penalty applies only in the amount of the withheld taxes not actually paid over to the Government and, although each responsible person is subject to the tax not paid over, in the aggregate the IRS collects only the amount of the tax not paid over by the employer. As such, the § 6672 penalty is just a collection mechanism for the underlying tax not paid over. Now, as you may already know, the employer's liability for the tax not paid over is subject to a limitations period under the general rules noted above. So, if the employer files a nonfraudulent employment tax return reporting trust fund tax liability, the statute of limitations is generally three years from the date of filing to assess additional tax trust fund tax liability against the employer. What is the limitations period for the trust fund penalty against the responsible person?

There is no requirement of a return for the trust fund tax penalty (i.e., the putative responsible person does not voluntarily report trust fund tax liability on an IRS form). So, the general rules, technically applied, are not applicable to commence and end a statute of limitations on the trust fund penalty. Is there a statute of limitations on assessment of the trust fund penalty?

The answer is yes. The courts have held -- and the IRS has acquiesced in the holding -- that the § 6501 statute of limitations applies by reference to the employer's return. The theory is that, because the penalty is not a real penalty but a collection mechanism (via an alternative source to collect the employee's withheld taxes), the statute should not be longer than the period allowed to assess the tax from the person directly liable (the employer).⁹⁵⁸ Thus, although responsible persons are not required to file returns reporting the penalty, the penalty does relate to the return that the employer is required to file and the liability related to that return and the statute is the same as for the employer on trust fund taxes.

Still, there will be cases where the courts may not be willing to stretch to borrow and grant repose when the statute is silent. For example, § 6111 requires that persons involved in the promotion of certain tax shelters must register the tax shelter with the IRS. Section 6707 imposes a penalty for failure to register. There is no Code provision for a statute of limitations during which the IRS must assess these penalties. The IRS takes the position that the § 6707 penalty has no statute of limitations, relying on cases holding that other penalties not linked to a return filing

⁹⁵⁸ *Lauckner v. United States*, 68 F.3d 69 (3d Cir. 1995), aff'g No. 93-1594 (D.N.J. 1994), A.O.D. 1996-006, 1996-2 C.B. 1.

requirement⁹⁵⁹ have no statute of limitations;⁹⁶⁰ courts agree.⁹⁶¹ Another example is § 905(c) which requires taxpayers to notify the IRS if foreign tax credits differ from the foreign tax accrued. The IRS appears to have an unlimited statute of limitations to assess any tax related to those differences.⁹⁶² Still another is the § 6702 penalty for frivolous returns which, as the Tax Court observed, has no “readily observable statute of limitations.”⁹⁶³

These are the tools for analysis. If the Code provides that a tax liability or a penalty may be assessed, but provides no statute of limitations upon assessment, the assessment may be made at any time, unless liability is somehow related to some other tax obligation for which there is a statute of limitations.⁹⁶⁴ The practitioner will want to think creatively about how these equitable arguments can be marshaled to support a statute of limitations (in the case of desiring the avoid an open-ended assessment period) or support an argument that a limitation period should not apply.

G. IRS Erroneous Abatements.

The IRS may abate an unpaid assessment that is “(1) is excessive in amount, or (2) is assessed after the expiration of the period of limitation properly applicable thereto, or (3) is erroneously or illegally assessed.” § 6404(a). The IRS may also abate for collection factors (e.g., the

⁹⁵⁹ E.g., §§ 6700 and 6701. See, as to § 6700, *Sage v. United States*, 908 F.2d 18, 24-25 (5th Cir. 1990); *Emanuel v. United States*, 705 F. Supp. 434, 436 (N.D. Ill. 1989); and *Agbanc, Ltd. v. United States*, 707 F. Supp. 423, 426-27 (D. Ariz. 1988); and, as to § 6701, see *Kuchan v. United States*, 679 F. Supp. 764, 768 (N.D. Ill. 1988); and *Armstrong v. United States*, 2019 U.S. Dist. LEXIS 103604 (N.D. Cal. 2019).

⁹⁶⁰ See ILM 200112003 (11/28/2000), reprinted in 2001 TNT 58-74 (3/26/01), citing *Mullikin v. U.S.*, 952 F.2d 920 (6th Cir. 1991); *Lamb v. U.S.*, 977 F.2d 1296 (8th Cir. 1992); *Capozzi v. U.S.*, 980 F.2d 872 (2d Cir. 1992); and *Sage v. U.S.*, 908 F.2d 18 (5th Cir. 1990). For an example where the IRS asserted the penalty some 13+ years after the failure to register, see *Diversified Group, Inc. v. United States*, 123 Fed. Cl. 442 (2015), aff’d 841 F.3d 975 (Fed. Cir. 2016).

⁹⁶¹ See *Goddard v. Commissioner*, T.C. Memo. 2022-96, *27-*30 (holding as to § 6707 prior to its amendment in 2004 by the American Jobs Creation Act, Pub. L. No. 108-357, 118 Stat. 1418; however the AJCA made no relevant change and there is no other statute of limitations; the court reasoned that without an express statute of limitations, there is none; citing inter alia *Capozzi v. United States*, 980 F.3d 872 (2d Cir. 1992)).

⁹⁶² By contrast, a U.S. taxpayer accruing foreign taxes for a year (say Year 01) and thereafter paying more taxes than accrued has only a 10 year window in which to claim the resulting tax refund for Year 01 under § 6501(c)(5). See Neal M. Kochman and H. David Rosenbloom, Deconstructing Section 905(c): An Examination of the Redetermination Rules after TRA 1997, 2002 WTD 77-20 (4/22/02).

⁹⁶³ *Crites v. Commissioner*, T.C. Memo. 2012-267 (the Tax Court, however, said that, even if the three-year statute could be borrowed, since the penalty was based upon the amended return and was assessed less than 3 years of the amended return, the assessment was timely). If the assessment had been over 3 years from the date of the penalized amended return, then the Court might or might not have been willing to borrow the 3 year statute and hold for the taxpayer.

⁹⁶⁴ See, e.g., ILM 200142021 (10/22/01), reprinted in 2001 TNT 204-25 and PMTA 2013-004 (4/3/13), reproduced at 2013 TNT 206-19, using this analysis for the §§ 6721 and 6722 penalties for failure to file certain information returns and differentiating between § 6721 and 6722 in this regard. See also CCA 201916006 (3/6/19), concluding that, for the § 6707A failure to disclose a reportable transaction on a return, the statute of limitations for the penalty is the same as the statute of limitations for assessments on the return (i.e., normally the three-year period under § 6501(a) subject to such extended periods as the Code allows) and noting that when disclosure is not required on the return, no limitations period applies.

size of the unpaid assessment makes collection action inappropriate or the IRS compromises the assessment for less than the amount paid).⁹⁶⁵

An abatement may occur simply from administrative mistake. What is the effect of an abatement caused by mistake? Can the IRS simply reverse the abatement, thereby reinstating the pre-abatement assessment amount? Or must the IRS make a new assessment which may then be prohibited because outside the statute of limitations for assessment?

The law is not clear. The line that seems to be drawn is: If the abatement was just an administrative error (e.g., in the case of posting another taxpayer's payment), then the error can be corrected without a reassessment.⁹⁶⁶ If, however, the abatement was affirmatively intended by the IRS as a substantive redetermination of the taxpayer's liability (even if the IRS's determination is wrong), the abatement wipes out the predicate assessment, the wiped-out assessment cannot be revived, and a new timely assessment (with the predicate notice of deficiency) must be made if the statute of limitations on assessment remains open.⁹⁶⁷

Finally, it is important to differentiate between a **claim for refund** and a **request for abatement**. A claim for refund is a claim that the IRS owes a refund of tax paid. A request for abatement asks that the IRS reduce an outstanding unpaid tax assessment. For certain types of taxes, a claim for refund may be made on the "X" series (such as 1040-X, Amended US Individual Income Tax Return), although the X series may be a claim for abatement to the extent that there is unpaid assessed tax due. For other types of tax, the claim for refund is made on Form 843, Claim for Refund and Request for Abatement. Note that the Form includes "Request for Abatement." That is because § 6404 does not confer a right to abatement but simply gives the IRS permissive authority to abate. Thus, if the IRS does not abate on a request for abatement, the taxpayer has no mandatory remedy short of the traditional remedies to contest tax liability – claim and suit for refund (requiring full payment and claim for refund) and in the various collection suits where liability may be contested.⁹⁶⁸

H. Special Rule for Assessment of Interest.

We covered in Chapter 5 the rules for determining interest on taxes that are assessed. The rules we have discussed in the foregoing section determine the statute of limitations on assessment of tax. Normally, accumulated interest is assessed at the same time the underlying tax is assessed and, if the underlying tax is timely, that assessment of interest is timely. However, if the tax and

⁹⁶⁵ E.g., § 6404(c) & (d).

⁹⁶⁶ See e.g., *Bugge v. United States*, 99 F.3d 740 (5th Cir. 1996); and *Crompton-Richmond Co. v. United States*, 311 F. Supp. 1184 (S.D.N.Y. 1970); and Rev. Rul. 74-580, 1974-2 C.B. 400, distinguished by Rev. Rul. 85-67, 1985-1 C.B. 364; but see *In re Becker*, 407 F.3d 89 (2d Cir. 2005), questionably analyzing the *Bugge* and *Crompton-Richmond*.

⁹⁶⁷ See generally Bryan T. Camp, *The Mysteries of Erroneous Tax Refunds*, 114 Tax Notes 231 (Jan. 15, 2007) & 2007 TNT 11-55 (1/16/07).

⁹⁶⁸ *Poretto v. Usry*, 295 F.2d. 499, 501 (5th Cir. 1961) ("Section 6404 does not impose a duty . . . to abate improper assessments, thereby providing a basis for a taxpayer's summary action challenging the . . . refusal to abate an allegedly incorrect assessment."); *Etheridge v. United States*, 300 F.2d 906, 909 (D.C. Cir. 1962) (court unaware of any statute allowing the government to be sued for the abatement of an unpaid tax assessment); *Kang v. Shulman*, No. AW-09-1561, 2010 WL 11556596, at *2 (D. Md. May 20, 2010) ("there is no cause of action for abatement under any Internal Revenue Code provision" and that the IRS's discretion under Section 6404 "is not subject to judicial review.").

assessed interest remain unpaid after the initial assessment of tax and interest, interest will continue to accrue until the tax is paid. That means that, since the statute of limitations on the assessment of tax will likely expire, there needs to be a special extension of the statute of limitations to permit the additional assessment of interest on timely assessed tax and interest. Section 6601(g) provides such an extended period to assess interest during the period within which the assessed underlying tax may be collected.

III. Collections.

A. Collections on Assessments

Collection is different from assessment. Businessmen—including lawyers—know that collecting is quite different than sending a bill. Assessment is the act permitting the IRS to “send the bill.” Collecting the amount assessed is another matter. I now turn to the statute of limitations on collection.

The statute on collection is ten years from the date of assessment. § 6502(a).⁹⁶⁹ The IRS calls this the collection statute expiration date, acronymed to “CSED.”⁹⁷⁰ This statute of limitations is not subject to defenses such as laches.⁹⁷¹

Piecing assessment and collection statutes together, you can see that normally the IRS has three years to make an assessment and ten years to collect the assessment, for a maximum of thirteen years. If the assessment is made before the end of the three-year period, then the maximum thirteen years will be shortened accordingly.

In considering these maximum periods, you must also factor in those circumstances which might cause a valid assessment to be made beyond the three-year period. These include an extended or no statute of limitations on assessment (e.g., failure to file, fraud and six-year statute), suspensions of the statute of limitations on assessment when the IRS issues a notice of deficiency, and extensions of the statute of limitations upon mutual written consent. Thus, it is not unusual for the assessments (even where there is no substantial omission or fraud) to be made five or six years or even longer after the return was filed. Then, upon assessment, the IRS will have ten years after assessment to collect the tax.

⁹⁶⁹ The ten year period to collect, measured from the date of assessment, applies with respect to assessments arising from a substitutes for return (“SFR”) under § 6020(b). The IRS interprets the unlimited statute for collection in § 6501(b)(3) as applying only to § 6501 and not to the collection statute of limitations under § 6502 which is ten years from the date of the assessment. See IRS CCA 200149032 (10/22/01), republished in 2001 IRS CCA LEXIS 222; see also ILM 201238028 (6/19/12), republished in 2012 TNT 185-28.

The 10 year collection statute was enacted in 1990; prior to that, it had been 6 years. Omnibus Budget Reconciliation Act of 1990, Pub. L. No. 101-508, § 11317(a)(1), amending IRC §§ 6502(a)(1), 6502(a)(2).

⁹⁷⁰ E.g., IRM 5.1.19.1.1 (02-07-2020), Background.

⁹⁷¹ E.g., *United States v. Summerlin*, 310 U.S. 414, 416 (1940); *Hatchett v. United States*, 330 F.3d 875, 887 (6th Cir. 2003).

As with the statute of limitations on assessment, historically, the IRS and a taxpayer could extend the collection statute by agreement.⁹⁷² That general authority has been taken away, except where (1) the extension is agreed to at the same time as an installment agreement between the taxpayer and the Service, or (2) the extension is agreed to prior to a release of levy under § 6343 which occurs after the expiration of the statutory ten-year period for collection.⁹⁷³

There are events that will suspend the collection statute of limitations and thus effectively give the IRS more than ten years to collect. Some common examples of such suspensions are (using terms that will be discussed in more detail later in this text):

- Bankruptcy: From the date of filing the bankruptcy petition, (i) suspending the assessment period under § 6501 during the period assessment is prohibited plus 60 days and (ii) suspending the collection period under § 6502 during the period collection is prohibited plus 6 months. § 6503(h).
- Assets in control or custody of court. § 6503(d).
- Outside U.S.: if the taxpayer is outside the U.S. for a continuous 6-month period, the statute is suspended during the period and the statute will then not expire before 6 months after his return to the U.S. § 6503(c).
- Extended Estate Tax Payment: The statute is suspended during the period that the estate has the extended period for payment in § 6161(a)(2) or (b)(2), § 6163 or § 6166.⁹⁷⁴
- Pending Installment Agreement: From the date of the request for an installment agreement, plus appeals, plus 30 days. § 6331(k)(3).⁹⁷⁵
- Termination of Installment Agreement: 30 days from the date of termination, plus appeals. § 6331(k)(3).
- Pending Offer in Compromise: From the date of acceptance for processing of the OIC plus appeals after rejection, plus 30 days. § 6331(k)(3).
- CDP Hearings: From the date of a timely request until final disposition. § 6330(e). Additionally, if it is less than 90 days from the CSED, the CSED is reset to 90 days from the date of final disposition. Reg. § 301.6330-1(g)(3).
- Military-related Service in a Combat Zone: The length of service, plus 180 days. § 7508(a)(1)(i).⁹⁷⁶

The general basis for extending the collection statute of limitations is that there is some reason that the IRS is prohibited or impaired from exercising its collection remedies.⁹⁷⁷ So, students and

⁹⁷² See § 6502(a)(2) (prior to amendment by the 1998 Restructuring Act).

⁹⁷³ § 6502(a) (after amendment). In *Jordan v. Commissioner*, 134 T.C. 1 (2010), the Tax Court held that the taxpayer seeking to assert the bar on collection bears the ultimate burden of persuasion as to the nonexistence or non-validity of a consent, but affirmed the procedural rules in *Adler v. Commissioner*, 85 T.C. 535, 541 (T.C. 1985) as to the procedural and production burdens encountered at trial where the issue of the bar on collection is in play.

⁹⁷⁴ § 6503(d).

⁹⁷⁵ The taxpayer also may contractually agree to extend if he obtains an acceptable installment agreement.

⁹⁷⁶ This list is from Patrick Thomas (Guest Blogger), *Inability to Correctly Calculate CSED—Confusion Leads to Unlawful Results* (Procedurally Taxing Blog 3/6/15), ((viewed 3/7/15 and as modified to eliminate the IRC before the Code Sections).

⁹⁷⁷ Recall that § 6503(a)(1) generally provides for suspensions during the period of prohibition of
(continued...)

practitioners when considering the general 10 year collection statute of limitations should be aware of any factors that might suspend the statute of limitations.

If the Government files a timely collection suit or other proceeding in court to collect the tax, the assessment will be merged into a judgment and the period of limitations will be extended until the judgment against the taxpayer is satisfied or becomes unenforceable.⁹⁷⁸ Less well known is that, if the Government has remedies against third parties as to the taxpayer's tax liability (e.g., transferee liability, alter ego, etc.), the Government's filing of a collection suit against the taxpayer will extend the statute of limitations for the IRS to collect by levy as to its remedies against the third parties.⁹⁷⁹

B. State Law Remedies to Collect Tax.

The Government may invoke state law remedies to collect tax. For example, transferee liability under § 6901 may invoke state fraudulent conveyance remedies such as the Uniform Fraudulent Transfers Act. Such state laws generally have statutes of limitations. In a tax collection suit invoking the state law remedies, the United States is not bound by those state statutes of limitations if its own statute of limitations for collection is still open.⁹⁸⁰ Thus, for example, if the Government sues in federal court to collect on an assessment on the basis of the state UFTA remedy, the 10 year collection statute (subject to the various suspension periods allowed) applies.⁹⁸¹

⁹⁷⁷(...continued)

assessment or collection, but some of the cited Code sections provide specifically for suspension.

⁹⁷⁸ § 6502(a); Reg. § 301.6502-1(c). In *United States v. Ligas*, 549 F.3d 497 (7th Cir. 2008), the IRS timely filed such a collection suit within the ten year statute of limitations but, in an incredible set of facts, failed to properly serve the defendant, thus preventing the IRS from extending the statute of limitations on collection.

In *United States v. Estate of Chicorel*, 907 F.3d 896 (6th Cir. 2018), the IRS assessed the tax and, within the 10 year period, filed a proof of claim in the taxpayer's bankruptcy estate. It is not clear what happened on the proof of claim, but over ten years from the date of assessment, the Government filed a collection suit. The Court held that (i) under § 6502(a) and Michigan law, the proof of claim was a proceeding and (ii) "the statute of limitations in § 6502(a) is satisfied once the government commences any timely proceeding in court." The Court said that the latter holding harmonized the provision which, in the flush language, permitted collection by levy at any time once a proceeding is filed.

⁹⁷⁹ § 6502(a) ("If a timely proceeding in court for the collection of a tax is commenced, the period during which such tax may be collected by levy shall be extended and shall not expire until the liability for the tax (or a judgment against the taxpayer arising from such liability) is satisfied or becomes unenforceable."). *United States v. Anderson*, 2013 U.S. Dist. LEXIS 102086 (M.D. Fla. 2013).

⁹⁸⁰ *United States v. Henco Holding Corp.*, 985 F.3d 129 (11th Cir. 2021) (citing *United States v. Summerlin*, 310 U.S. 414, 416 (1940)).

⁹⁸¹ *Id.* *Henco* is a good illustration. Section 6901 gives the IRS a way to assess liability against the taxpayer and then a special one-year statute of limitations to assess a transferee. With an assessment against the transferee, the IRS can use its collection tools (lien and levy) and ultimately sue to reduce the assessment to judgment. In *Henco*, however, the IRS did not make an assessment against the transferees, but rather invoked its general creditor state law remedy under a state fraudulent conveyance statute to enforce the assessment against the original taxpayer against the transferees. The Court held that the special one-year assessment in § 6901 was not required.

IV. Overpayments.

A. What Are Overpayments?

1. Actual Overpayments (Refunds and Credits; Setoffs).

Overpayments are taxes paid in excess of taxes owed or any interest or penalties paid in excess of interest or penalties owed.⁹⁸² Overpayments must be refunded or credited against other tax, penalties or interest due from the taxpayer and, in some cases, against a debt due other federal, state agencies and even child-support payments certified by the state. § 6402.

Where the taxpayer has overpaid for a year, the IRS may refund the overpayment. Resolving the overpayment by refund is probably done in most cases, except, perhaps, where the taxpayer files a timely return showing an overpayment and elects to apply the overpayment to the following year's tax liability. Conceptually, of course, crediting the overpayment against the following year's tax liability is the equivalent of refunding the overpayment and contemporaneously, at the taxpayer's direction, applying it as an advance payment to the next year's tax liability.⁹⁸³

The IRS's unilateral crediting of a refund otherwise due against a liability otherwise owed by the taxpayer is the equivalent of a refund. This crediting is called a setoff (also called offset) and may be viewed as a collection procedure for the unpaid tax. Take the simplest of situations—a taxpayer is determined to have overpaid his tax liability for Year 03 when he has an outstanding liability for Year 01. Section 6402(a) gives the IRS authority to credit the tax overpayment against the Year 01 tax liability. All of this is effected through IRS's authority and systems. I discuss setoffs further in Chapter 12 on Collection Procedures, beginning on p. 678.

Overpayments may not be refunded or credited after expiration of the statute of limitations for refund, unless the taxpayer filed a timely claim for refund and, if the claim is denied, filed a

⁹⁸² In *Jones v. Liberty Glass Co.*, 332 U.S. 524, 531 (1947), the Court said:

* * * we read the word "overpayment" in its usual sense, as meaning any payment in excess of that which is properly due. Such an excess payment may be traced to an error in mathematics or in judgment or in interpretation of facts or law. And the error may be committed by the taxpayer or by the revenue agents. Whatever the reason, the payment of more than is rightfully due is what characterizes an overpayment.

See also *United States v. Dalm*, 494 U.S. 596, 609 n. 6 (1990) ("The commonsense interpretation is that a tax is overpaid when a taxpayer pays more than is owed, for whatever reason or no reason at all.")

In *Sunoco v. Commissioner*, 663 F.3d 181 (3d Cir. 2011), the Court addressed the jurisdiction of the Tax Court with regard to quantifying overpayment interest where the overpayment was refunded before the Tax Court case was commenced. Section 6512(b)(1) gives the Tax Court jurisdiction to determine an overpayment of tax but overpayment of interest is not itself an overpayment of tax and thus a suit to dispute the IRS's calculation of overpayment interest is outside the Tax Court's jurisdiction and must be pursued as a general monetary claim against the United States in the district court or Court of Federal Claims within the general six-year statutes of limitations in 28 U.S.C. §§ 2401 and 2501. See also *Ford Motor Co. v. United States*, 132 Fed. Cl. 104, 110 (2017), aff'd 908 F.3d 805 (Fed. Cir. 2018); and *Coca-Cola Co. v. United States*, 87 Fed. Cl. 253, 255-256 (2009); and *Exxon Mobil Corporation v. United States*, 2018 U.S. Dist. LEXIS 149760 (N. D. Tex. 2018) (summarily adopting *Sunoco's* reasoning and granting summary judgment on the issue).

⁹⁸³ Refunding a claimed overpayment (e.g., by original return) or crediting it to another year's liability does not prevent the IRS from examining and determining a deficiency with respect to the year of the putative overpayment. *Savage v. Commissioner*, 112 T.C. 46, 48-49 (1999).

timely suit for refund.⁹⁸⁴ The IRS calls the statute of limitations for filing a claim for refund the “refund statute expiration date,” acronymed “RSED.”⁹⁸⁵

Generally, overpayments may only be refunded or credited to the taxpayer suffering the economic burden of the tax paid.⁹⁸⁶ One specific application of this principle is that refunds arising from a joint return are the separate properties of the respective spouses as determined under state law.⁹⁸⁷

The IRS may credit refunds otherwise due against tax debts and for nontax debts other federal, state agencies and even child-support payments certified by the state. This creates a problem when the refund is for a joint return and is being credited against a liability of the sole liability of the other spouse. Example, husband has tax debt for year 01, husband then marries wife in year 04, husband and wife file joint return for year 05 claiming a refund in which, under state law, each has a 50% interest. The IRS applies the entire refund to husband’s year 01 tax debt. Wife is an “injured spouse” because her asset – her share of the 05 refund has been applied to a debt she did not owe. She can seek injured spouse relief to have her share of the refund refunded to her.⁹⁸⁸ Injured spouse relief is sometimes confused with innocent spouse relief which relieves a spouse – the “innocent” spouse – from a tax liability the innocent spouse would otherwise have for joint return liability or under the community property laws.⁹⁸⁹ (The innocent spouse provisions are discussed below

⁹⁸⁴ §§ 6411(a) and 6532(a)(1).

⁹⁸⁵ E.g., IRM 25.6.1.2.2 (01-16-2009), Statute Function Establishment.

⁹⁸⁶ Generally, is the key qualification. Section 6415(a), titled “Credits or refunds to persons who collected certain taxes,” and implementing regulations permit nontaxpayers collecting and remitting the tax to the Government to have the tax refunded to the collector if the collector “has repaid the amount of such tax to the person from whom he collected it, or obtains the consent of such person to the allowance of such credit or refund.” Whether a person paying a tax has collected it from others, and thus subject to § 6415, or has incurred the tax itself and thus may seek the refund is an interesting factual and economic issue. See *8x8, Inc. v. United States*, 854 F.3d 1376 (Fed. Cir. 2017).

Where a nontaxpayer’s assets are seized to apply to another taxpayer’s tax, the nontaxpayer may bring a wrongful levy suit under § 7426, titled “Civil actions by persons other than taxpayers.” In addition, in rare circumstances, a court might allow a nontaxpayer to pursue a refund where the nontaxpayer bore the economic burden of the tax applied to another’s tax liability. See e.g., *United States v. Williams*, 514 U.S. 527 (1995), discussed elsewhere in this text; cf. *Rothkamm v. United States*, 802 F.3d 699 (5th Cir. 2015), acq 2020-03 released 4/20/20. ; and *Garlovsky v. United States*, 211 F. Supp. 3d 1084 (N.D. Ill. 2016) (citing both *Williams* and *Rothkamm*). Of course, if a nontaxpayer voluntarily pays the tax of the taxpayer, the taxpayer may not be viewed as having suffered the economic burden, but in that case the amount paid is properly viewed as a gift or compensation to the taxpayer who, then, economically does suffer the burden at least for these purposes.

⁹⁸⁷ See Rev. Rul. 74-611, 74-2 Cum. Bull. 399. Generally, the allocation is made based on the contributions of each to the tax being refunded. Rev. Rul. 74-611; *United States v. Elam*, 112 F.3d 1036 (9th Cir. 1997).

⁹⁸⁸ See generally IRM 25.18.5 Injured Spouse. IRM 25.18.5.1 (03-07-2017), Background - IRC 6402 Offsets, subpar. 3 which is captioned “How Offset Issues Arise.”

The relief is requested by Form 8379, titled Injured Spouse Allocation, which can be filed (i) with the return if the taxpayers know of the § 6502 creditable debt of the liable spouse and (ii) after notice of the credit to obtain the benefit for the injured spouse. For more on the relief, see Keith Fogg, Special Statute of Limitations for Injured Spouse Relief (Procedurally Taxing Blog 9/2/16), discussing the TIGTA report titled Injured Spouse Cases Were Not Always Timely Resolved, Resulting in the Unnecessary Payment of Interest (Ref. No. 2016-40-042 5/19/16). Professor Fogg notes that the statute of limitations for claiming injured spouse relief for credits to the liable spouse’s federal tax debts is three years whereas the statute of limitations for such relief for nontax debts is six years. He also notes that one solution where a potential injured spouse knows of the creditable debt in advance is for the potential injured spouse to not file a joint return; the downside to that solution is that the joint return may reduce the aggregate net tax liability.

⁹⁸⁹ IRM 25.18.5.1 (03-07-2017), Background - IRC 6402 Offsets, subpar. 3. The IRM also notes that some (continued...)

beginning p. 758.) The injured spouse's share of the credited refund is determined under general state law.⁹⁹⁰

2. Constructive Overpayments.

Overpayments may also include taxes paid that the taxpayer actually owed (at least in theory at one time). Section 6401(a) provides that “the term overpayment” includes “tax . . . assessed or collected after the expiration of the period of limitation properly applicable thereto.”

The following examples will illustrate the normal operation of this rule and how it preserves the integrity of the statutes of limitation on assessment and collection.

Example 1: On April 15 of Year 02, T timely files his tax return for Year 01 showing a tax liability of \$1,000. T has, however, really owed tax of \$1,100 and thus underreported and underpaid his tax liability by \$100. As you know from the discussion above, the statute of limitations for the IRS to assess the additional tax liability expires on April 15 of Year 05. (Assume no exception to the three-year statute on assessment applies.) The IRS timely audits the taxpayer but does not send the notice of deficiency until February 1 of Year 06. The taxpayer does not file a timely petition in the Tax Court to have the notice of deficiency declared invalid because outside the assessment statute of limitations. On June 1 of Year 06, the IRS assesses the tax. Based on the rules for assessment, I hope you easily see that the assessment is untimely. The taxpayer pays on July 1 of Year 06. Two related questions: (1) has the taxpayer made an overpayment and (2) can the taxpayer now claim a refund of the taxes paid pursuant to the assessment? The answer is yes to both questions, for they are in a tax procedure sense the same question. It may seem counterintuitive to say that the taxpayer has made an overpayment of taxes he admittedly owed. The statute creates a constructive overpayment as the mechanism to ensure that the statute of limitations on assessments works; the constructive overpayment thus gives the taxpayer the refund mechanism to get the untimely assessed taxes back. A refund requires that the taxpayer have overpaid his tax; this constructive overpayment permits the tax payment to be refunded.

Example 2: Assume the same facts, except that the IRS makes a timely assessment on April 1 of Year 05. The IRS has a ten year statute of limitations in which to collect taxes that have been assessed. § 6502. This statute runs from the date of assessment. In this example, the IRS would have until April 1 of Year 15 to collect the tax. Suppose that the taxpayer does not pay within the ten year collection period and instead pays in the eleventh year (Year 16 in this example). This statute again creates a constructive overpayment to preserve the statute of limitations on collection by using the real overpayment procedures (i.e., refund procedures) for the taxpayer to have the constructive overpayment refunded.

⁹⁸⁹(...continued)

spouses entitled or potentially entitled to injured spouse relief filed mistakenly for innocent spouse relief. Where that occurs, the IRS is instructed to notify the spouse of the difference via a specific form letter and provide a copy of Form 8379, titled Injured Spouse Allocation. See *Palomares v. Commissioner*, T.C. Memo. 2014-243, rev'd on other grounds, 2017 U.S. App. LEXIS 9565 (9th Cir. 2017).

⁹⁹⁰ IRM 25.18.5.3 (03-04-2011), Calculating the Injured Spouse's Share of the Overpayment; IRM 25.18.5.4 (02-15-2005), Allocating Items in Community Property States. See Rev. Rul. 74-611, 1974-2 C.B. 399 (noting that each spouse has a separate interest in an overpayment on the joint return; the filing of the joint return does not affect their separate interest rights under state law).

Example 3. Using the same facts as Example 2, assume that the taxpayer in anticipation of the final outcome of the audit realizes that he owes an additional \$100 of tax and sends it in to the IRS as a payment on the Year 01 tax liability. For some reason, the IRS does not assess that tax liability until June 1 of Year 06, well outside the statute of limitations. Must the IRS refund the payment? A literal reading of the Code section (quoted above) is that an overpayment is any amount assessed outside the applicable statute of limitations. In this example, the assessment was outside the applicable statute of limitations. Nevertheless, the IRS may retain payments made before the applicable assessment period expires which do not represent actual overpayments of the tax liability.⁹⁹¹

What happens where the IRS does not sua sponte return the money even though it has not determined that an extended statute of limitations might apply? This circumstance often happens when the taxpayer files an amended return for a year that is beyond the normal three-year statute of limitations. I will give you a real-world example. Suppose a taxpayer comes to you in June of Year 07 for your advice about potential criminal fraud for returns for Years 01-06. The criminal statute of limitations is 6 years, so each of these returns, the earliest of which was filed on April 15 of Year 02, could be a criminal problem. Standard advice in this area is to file nonfraudulent amended returns correcting the matters that might be considered fraudulent. The more conservative approach is to file amended returns for all six years. If the normal civil statute of limitations applied, the assessments for returns for Years 01-03 would be barred (assume April 15 filing for all years). So, when the IRS receives the amended returns for Years 01-03 (filed only to mitigate a potential criminal problem), its records will show no reason for the civil statute of limitations to exceed 3 years (assuming the corrections on the amended returns will not show on their face that the six-year statute of limitations (25% omission) applies). The IRS often responds in this circumstance with a letter to the taxpayer advising that the payment appears to be outside the statute of limitations and, if that is true, the taxpayer might consider filing a claim for refund. If the taxpayer, being somewhat greedy, files a claim for refund, the claim will usually receive at least some level of review. The IRS may then do whatever work is necessary to determine whether an extended statute applies. Specifically, although the taxpayer may have solved his criminal problem by filing the amended returns and paying the tax, the IRS may conclude that the original returns were fraudulent and assert that there is no constructive overpayment because the payment and assessment were made within the unlimited civil statute of limitations for fraud. Even worse, that might trigger the IRS to assert the civil fraud penalty. (See the discussion of qualified amended returns (“QARs”) beginning p. 352.)

⁹⁹¹ See *Ewing v. United States*, 914 F.2d 499 at 503 (4th Cir. 1990); *Williams-Russell & Johnson, Inc. v. United States*, 371 F.3d 1350 (11th Cir. 2004), cert. denied 125 S.Ct. 676 (2004); *Crompton & Knowles Loom Works v. White*, 65 F.2d 132, 134 (1st Cir. 1933); and Rev. Rul. 85-67, 1985-1 C.B. 364 (“Where taxes and interest legally due have been paid before the expiration of the period of limitations for assessment . . . they cannot be recovered by the taxpayer merely because they have not been formally assessed.”). See also *Principal Life Insurance Co. v. United States*, 95 Fed. Cl. 786 (2010) for an exhaustive, highly recommended analysis of the principle illustrative in the example in the text.

This may explain why the taxpayer in *New York Life Insurance Company v. United States*, 118 F.3d 1553 (Fed. Cir. 1997), cert. denied 523 U.S. 1094 (1998) argued that an advance remittance when the IRS thereafter failed to assess timely was a deposit which does not draw interest rather than a payment which would draw interest. If the mere untimely assessment would entitle the taxpayer to a refund, then the taxpayer in *New York Life* would have been better off arguing that the remittance was a payment. However, if the taxpayer were concerned that the IRS could retain a timely payment even though the assessment was untimely, the taxpayer would be better off arguing that the remittance was a deposit. In that case, the taxpayer so argued and prevailed.

3. Determination of Overpayment.

Before the IRS makes a refund or credit, the IRS must determine that there is an overpayment. There are two key exceptions to the requirement that the IRS determine the existence of the overpayment. First, if the taxpayer claims on his or her return that amounts paid in advance (e.g., withholding taxes on wages or estimated taxes during the year) are in excess of the tax due,⁹⁹² the IRS may refund or credit the amount of the indicated overpayment without first making a determination (via audit) that there is an overpayment.⁹⁹³ Second, under § 6411, a taxpayer may apply for a tentative carryback refund for a prior year based on the carryback of tax attributes earned in a later year (see p. 836). In both cases, the IRS may subsequently audit the claim for refund and invoke the deficiency procedures to assess and collect the tax refunded or sue for erroneous refund.

4. Overpayment of Installments.

If a tax is payable in installments, an overpayment of an installment is credited against unpaid installments and only when the aggregate installment payments exceed the tax due is the amount treated as an overpayment subject to the foregoing rules.⁹⁹⁴

5. IRS Refund of Claimed Overpayments.

An overpayment is the amount the taxpayer paid in excess of the amount the taxpayer owed. What happens if the taxpayer pays all the tax he is assessed, files claim for refund on basis that he not owe all the tax, and the IRS refunds the amount claimed. For most taxpayers that would be sufficient (in legal limbo, moot the case) because the taxpayer got what he claimed—refund of the overpayment.

But what if the taxpayer wants to use a refund suit as a fulcrum to litigate the issue the IRS abandoned as to him by refunding the tax in question? For example, there may be some incentive to press for a legal decision on the merits that the IRS moots by refunding the allegedly overpaid tax.⁹⁹⁵ The general rule is that by refunding the IRS refund moots the refund suit. There are claims that the IRS may use the refund to moot the case and avoid the taxpayer's choice of venue even

⁹⁹² The income tax return itself constitutes a claim for refund if it indicates an overpayment to be due. Reg. § 301.6402-3(a)(5).

⁹⁹³ Reg. § 301.6402-4.

⁹⁹⁴ § 6403. For this reason, overpaying installments effectively is a prepayment of the amount applied to later installments—i.e., the taxpayer has accelerated the time of payment. A dramatic instance of this might occur where, with the favorable installment of estate tax permitted for estate attributable to closely held business, the taxpayer overpays the portion not attributable to the closely held business which is not deferred will mean that the amount thus overpaid is applied to the deferred portion, thus denying pro tanto the benefit of the installment method. See *Estate of McNeely v. United States*, 2014 U.S. Dist. LEXIS 80000 (D. Minn. 2014)

⁹⁹⁵ There may be any number of reasons a taxpayer would do this—he might just be deranged and just wants to root around in the courts, he might believe that the IRS is behaving badly and just wants to strike back in a neutral forum. More often, it may be some taxpayer (or person behind the taxpayer such as an industry group) that wants to get a particular issue litigated and, through the refund fora choices, choose the most favorable venue. That venue does not include the Tax Court because it only has overpayment jurisdiction to compel a refund in a case that has otherwise met the predicate requirements (in most cases, a deficiency notice).

where the IRS does not really believe the taxpayer is entitled to a refund. Can the IRS do that?⁹⁹⁶
Does the IRS do that?⁹⁹⁷

B. The Claim for Refund.

1. The Role and Nature of the Claim.

To recover a tax overpayment, the taxpayer must first file a claim for refund with the IRS. We will deal with the quantum of tax later in this section, but at a minimum the taxpayer must have paid the tax for which refund is sought.⁹⁹⁸

Another predicate requirement is familiar administrative law: the taxpayer will not be denied her right ultimately to a judicial remedy, but she is required first to pursue reasonably available administrative remedies. Section 7422(a) prohibits suit for tax refund before “a claim for refund or credit has been duly filed with the Secretary, according to the provisions of law in that regard, and the regulations of the Secretary established in pursuance thereof.” See for some requirements of a claim for refund beginning p. 835, but let's turn now to statute of limitations issues.

I said that the claim for refund must be filed before the taxpayer may recover the claim for refund. The IRS may voluntarily make a refund payment without a claim for refund,⁹⁹⁹ and often

⁹⁹⁶ One problem for the IRS is that, if it believes the taxpayer does not have an overpayment and thus is not entitled to a refund but refunds it for some other reason such as its own advantage, can the IRS make the refund? I am not so sure the statute includes the power to make a refund for any reason other than the taxpayer does not owe the tax. Of course, the Code contemplates that the IRS and a taxpayer can compromise a tax liability (most often for litigating hazards) but that is a compromise and not a full payment of the amount in dispute. So I question whether the grant of the refund for pure strategic value to the IRS of paying an overpayment that is not due. Having said that, it is reported that this is a concern. Stephen J. Olsen, [Sixth Circuit: Payment of Crypto Staking Refund Moots Suit, Part 1](#) (Procedurally Taxing Blog 10/10/23); Stephen J. Olsen, [Sixth Circuit: Payment of Crypto Staking Refund Moots Suit, Part 2](#) (Procedurally Taxing Blog 10/11/23).

⁹⁹⁷ Allegedly. See authorities in the immediately preceding footnote.

⁹⁹⁸ There are some subtleties here that are implicit in the statement in the text. If a father writes a check to the IRS designated for application toward the son's tax liability, the father may have formally “paid” the tax but, not being a person liable for the tax that was paid, the father cannot claim a refund of that tax. Rather, the son may file a claim for refund and is deemed to have paid the tax advanced by the father. (In tax ways of thinking, the father's advance of the amount paid is either a gift or loan to the son.) Similarly, in some situations where one person has the obligation to collect and pay over to the IRS taxes owed by another person (employment taxes are the most ubiquitous example), the person entitled to file a claim for refund is the person from whom the tax was withheld. This is all sensible. However, there is yet another situation involving certain retail excise taxes on transactions which a party must pay where the burden is which the party may collect from its customers. Section 6416(a)(1) provides that the person (the party paying the tax in this case) cannot be refunded or credited the retail excise tax unless the person remitting the tax to the IRS (“the remitter”) establishes, pursuant to Regulations, that (i) the remitter has not collected the tax from his customer (meaning that the customer effectively paid the tax making the customer the party entitled to claim the refund), (ii) the remitter has repaid the amount to the customer, or (iii) the remitter has obtained the customer's written consent to pursue refund of the tax. See *United States v. Jefferson Electric Manufacturing Co.*, 291 U.S. 386 (1934) (which held that the effect of this requirement is to add an additional element for a refund claim that the person making the claim “had not shifted the burden of the excise tax to another”); *United States v. Standard Oil Co.*, 158 F.2d 126 (6th Cir. 1946) (same); and *Worldwide Equipment of TN, Inc v. United States*, 876 F.3d 172 (6th Cir. 2017) (holding that the customer consent in (iii) must be filed with the administrative claim for refund in order for a district court to have jurisdiction in a refund suit).

⁹⁹⁹ E.g., Reg. § 601.105(d)(1)(iii) (report of examiner after audit may allow overassessment or abatement (continued...))

does in a situation where it conducts an audit and determines an overpayment.¹⁰⁰⁰ But a taxpayer wanting to preserve her right to force the IRS to refund must make sure that a timely claim for refund is filed because timely filing of the claim is jurisdictional.¹⁰⁰¹ As discussed below, there is a two-year statute of limitations for filing suit for refund after the claim for refund is denied. These claim and suit time limits, generally referred to as statutes of limitations, are jurisdictional, thus requiring compliance (for discussion of difference between jurisdictional and nonjurisdictional above beginning on p. 181).

2. Statute of Limitations for Filing Claim for Refund.

a. General.

There are two statutes of limitation on taxpayers claiming tax refunds.¹⁰⁰²

First, there is a statute of limitations for filing the claim for refund. A claim for refund must be filed within three years from the date the return was filed or two years from the date the tax was paid, whichever is later, and, if no return is filed, within two years from the date of payment. § 6511(a).¹⁰⁰³ This statute of limitations has traditionally been read literally, requiring filing within the

⁹⁹⁹(...continued)

“with or without a claim for refund.”)

¹⁰⁰⁰ One of the documents the IRS asks the taxpayer to sign at the conclusion of an audit is a form essentially accepting for administrative purposes the results of the investigation. The two forms commonly used for this purpose are the Form 870 Waiver of the Restrictions on Assessment and Collection of Deficiency or Acceptance of Overassessment, and the Form 4549, titled Income Tax Examination Changes. If the examination concludes there is prior overassessment or overpayment, the respective Form can constitute a claim for refund or abatement. Rev. Rul. 68-65, 1968-1 C.B. 555.

¹⁰⁰¹ *United States v. Dalm*, 494 U.S. 596, 609–10 (1990); and *Brown v. United States*, 22 F.4th 1008, 1012 2022 U.S. App. LEXIS 263 (Fed. Cir. 1/5/22) (in a case where the claim for refund form was filed timely but had the representative’s signature rather than the taxpayer’s, the court cited *Dalm* for the proposition that a timely filed claim is jurisdictional but noted that “the adequacy of the filing is different from the fact of filing” and the “the ‘duly filed’ requirement in § 7422(a) is more akin to a claims-processing rule than a jurisdictional requirement.”). Because of the substantial judicial relaxing of which timelines are jurisdictional (mandatory) or simply claims processing (may be subject to equitable arguments), the claim for refund timelines may also not be jurisdictional. See *Dixon v. United States*, 67 F.4th 1156, 1161 n. 3 (Fed. Cir. 2023) (“We need not address the effect of *Wilkins* [143 S. Ct. 870, 879 (2023)] on the jurisdictional characterization [for refund claims] adopted by the Supreme Court in *Dalm*. That characterization is immaterial here, as Mr. Dixon has not raised any issue about equitable or comparable bases for excusing noncompliance that are unavailable for jurisdictional rules (but may be available for “nonjurisdictional claims-processing rule[s],” (cleaned up)).

¹⁰⁰² Whether these statutes of limitation are jurisdictional or simply bars to recovery is a question sometimes, but not always, without practical consequence. See the jurisdictional/nonjurisdictional discussion of time limits on p. 181. The most obvious practical consequence in this context is that, for failing to meet the tests, the taxpayer cannot recover the refund. However, another practical consequence is the potential for application of res judicata (claim preclusion) or collateral estoppel (issue preclusion). See *Ebeyer v. United States*, 2013 U.S. Claims LEXIS 1291 (Fed. Cl. 2013) (holding not jurisdictional); and *Gillespie v. United States*, 670 Fed. Appx. 393, 394-395 (7th Cir. 2016) (suggesting that there may be doubt as to § 7422(a)’s requirement that filing a timely claim for refund and exhausting the claim remedy is jurisdictional); see Carl Smith (Guest Blogger, [Is the Requirement to File a Refund Claim Before Bringing Suit Waivable?](#) (Procedurally Taxing Blog 1/18/19) (citing *Gillespie*).

¹⁰⁰³ A refund suit may not be brought unless the taxpayer has filed a claim for refund or credit pursuant to the regulations. § 7422(a). Actually, the statute is a little more nuanced than the general statement in the text which is likely to address most of the situations you will find in practice (hence its generality). The claim for refund limitation period applies to taxes “imposed by this title in respect of which tax the taxpayer is required to file a return.” Suppose

(continued...)

stated periods with no equitable relief; so read literally, the statute of limitations is said to be **jurisdictional** for the predicate condition in § 7422(a) to file a suit for refund.¹⁰⁰⁴ Also, if read literally, the statute means that a taxpayer can file a return 40 years late and qualify under this first rule.¹⁰⁰⁵ I hope readers will instinctively say something must be missing here, for statutes of limitations do not normally allow such lengthy lapses before the claim must be pursued. The answer to that concern is in the second rule to which I now turn.

Second, there is a statute of limitations on the amount of tax that can be refunded if the claim is timely under the first rule.¹⁰⁰⁶ The IRS may only refund the amount of tax paid either (i) within

¹⁰⁰³(...continued)

the taxpayer was not required to file a return (e.g., because it was tax exempt) but in error did file one? Does the three-year limitations period apply? See *Little People's School, Inc. v. United States*, 842 F.2d 570 (1st Cir. 1988) and *Wachovia Bank, N.A. v. United States*, 455 F.3d 1261 (11th Cir. 2006) (both answering yes by rejecting a literal interpretation of the status in favor of a contextual meaning).

¹⁰⁰⁴ See *Walby v. United States*, 957 F.3d 1295 (Fed. Cir. 2020) (discussing and applying the traditional interpretation as jurisdictional, thus not permitting exceptions, but noting that, for purposes of the predicate for a refund suit in § 7422(a), in light of Supreme Court authority in other areas of the law with strictly stated time periods, the panel (i) thought it was time to reconsider whether § 6511(a)'s time requirements may be subject to equitable relief in some cases where the taxpayer filed the claim for refund outside the period and (ii) stated its opinion that the court below "likely did not lack subject matter jurisdiction over this claim."). This area of the tax law where some time periods in the Code for certain actions may be strictly applied (jurisdictional if in the context of a court's jurisdiction) or subject to equitable relief for late filing is in a state of flux as courts, based on Supreme Court authority in other areas, treat time limits as subject to equitable relief rather than immutable jurisdictional requirements. Some of that authority is summarized in *Walby*.

¹⁰⁰⁵ *Omohundro v. United States*, 300 F.3d 1065 (9th Cir. 2002); *Weisbart v. Treasury*, 222 F.3d 93 (2d Cir. 2000); and Rev. Rul. 76-511, 1976-2 C.B. 428. The 40 years late example is inspired by *Oropallo v. United States*, 994 F.2d 25, 30 (1st Cir. 1993) (under this interpretation a taxpayer could "file a tax return 40 years late and still have 3 additional years in which to file a claim for refund; the Second Circuit in *Weisbart* said that "Nevertheless" this construction makes sense.)

¹⁰⁰⁶ This may be better described as a limit on the amount of the refund, but since it is based on action within a designated period, it functions much like a statute of limitations and is commonly referred to as such. It is said that the limitations period is jurisdictional. *Zeier v. United States Internal Revenue Service*, 80 F.3d 1360, 1364 (9th Cir. 1996). In a practical sense, I think this may mean that the statute is not subject to equitable tolling and that compliance with the limitations period may not be waived. In cases where the limitations period has arguably expired, taxpayers may want to see if there is some basis for urging that a timely informal claim was filed. *Libitzky v. United States*, 2021 U.S. Dist. LEXIS 148037 (N.D. Cal. 2021) (citing and quoting *Stevens v. United States*, No. 05-03967 SC, 2006 WL 1766794, at *3 n.3 (N.D. Cal. June 26, 2006) ("accepting that Section 6511(b)(2)(A) creates a jurisdictional bar to Plaintiff's case, Plaintiff may clear that bar with proof that the estate submitted an adequate informal claim, the same thing it will need to prevail on the merits.").

three years plus the period of any extension,¹⁰⁰⁷ or (ii) within two years immediately preceding the date of the claim. § 6511(b)(2).¹⁰⁰⁸ This is called the “lookback” rule.¹⁰⁰⁹

This may be a bit confusing. I provide examples to illustrate.

Example 1: The taxpayer files his Year 01 tax return on 4/15/02 and pays the indicated tax of \$100. In January of Year 05, the taxpayer discovers he overpaid the Year 01 tax by \$50. He may file a timely claim for refund any time on or prior to 4/15/05 and receive a full refund. He satisfies both rules.

Example 2: Assume the same facts, except for some reason, the taxpayer does not file the claim for refund until 6/01/05. Both of the rules would prohibit the IRS from granting the claim. First, he has not filed a claim for refund within the period provided in the first rule. Second, the amount he seeks to have refunded was paid beyond the three-year period before the filing of the claim, as provided in the second rule, the lookback rule.

Example 3: Assume the same facts except that the taxpayer received an extension to file the Year 01 return and files the return on 10/15/02. Under the first rule, the taxpayer will have until

¹⁰⁰⁷ Facially, if the taxpayer filed for and received the requested extension, § 6511(b)(2)(A) applies to make the 3 year period apply from the extended due date even if (i) the taxpayer filed before the extended due date (e.g., for individual return extension, say he received the extension to file the Year 01 return by 10/15/02 and filed it on 9/1/02) or (ii) the taxpayer filed after the extended due date (e.g., the taxpayer filed the original delinquent return claiming the refund in the preceding example on 10/15/05 (3 years after the extended due date). For the latter, Reg. § 301.7502-1(f) and see CC-2000-09 (11/13/2000) (discussing *Weisbart v. Treasury*, 222 F.3d 93 (2d Cir. 2000) where the facts were: (i) extension for 2001 return from 4/15/92 to 8/17/92; and (ii) delinquent original return claiming refund mailed on 8/17/95); this CC, technically addressing the timely mailing, timely filing rule is based on the notion that, had the taxpayer actually filed on 8/17/05—three years from the extended due date—the filing would have been timely; the only issue being whether the timely mailing, timely filing rule applied to a delinquent original return mailed on the last day of the three-year period calculated from the extended due date.

¹⁰⁰⁸ For the esoteric application of these rules in the context of jurisdiction for a refund court (a district court or the Court of Federal Claims) to the issue of whether these rules are jurisdictional or just bases upon which to deny a refund with a court otherwise having jurisdiction, see *Murdock v. United States*, 103 Fed. Cl. 389 (2012). It is not clear to me whether, from a real world perspective, it makes any difference whether a refund claimant loses his or her suit for refund because of jurisdiction or on the merits of whether it has met these rules, which in any event result in the case being dismissed. But the *Murdock* court thought it important to struggle with these concepts, all the while pouring the refund claimant out. The Supreme Court has struggled with the distinction between jurisdictional and statutory time limit requirements in *Henderson v. Shinseki*, 562 U.S. 428 (U.S. 2011), the Court noted important consequences in the distinction, including that jurisdictional rules must be applied by the courts even if not asserted by the parties and other consequences. The Court offers no clear guidance except that (i) a rule should not be treated as jurisdictional unless it governs the court’s adjudicatory capacity and (ii) so-called “claim-processing rules” requiring procedural steps at specific times should generally not be considered jurisdictional. I don’t know if this will change the historical perception of the refund timing rules as not being jurisdictional, but I don’t dwell on it further now because I don’t think it makes a lot of difference in the tax universe. I do note one prominent instance where, over the parties’ objection, a court did invoke what it perceived to be a jurisdictional rule—the full payment rule of *Flora v. United States*, 362 U.S. 145 (1960)—to dismiss a case. *Shore v. United States*, 26 Cl. Ct. 829 (Cl. Ct. 1992). The dismissal turned upon the proper interpretation of the jurisdictional rule. On appeal, the holding was reversed, because the court of appeals interpreted the rule differently, but did not quarrel with the rule as being jurisdictional. *Shore v. United States*, 9 F.3d 1524 (Fed. Cir. 1993).

¹⁰⁰⁹ *Commissioner v. Lundy*, 516 U.S. 235, 240 (1996).

10/15/05 to file a claim for refund and, under the second rule, he may recover the full refund because extension periods are added to the three-year lookback rule.¹⁰¹⁰

Example 4: Assume the same facts as Example 3 (most prominently a requested extension to 10/15/02 for the Year 01 return), but the taxpayer files his original 01 return on 7/1/02 (that is the actual date the IRS receives it and files the Year 01 return). As noted elsewhere in the text the filing date for this return is 7/1/02. The three-year claim for refund period would normally end on 7/1/05. However, the wording of § 6511(b)(2)(A)—“3 years plus the period of any extension of time for filing the return”—permits the refund claim to be filed as late as 10/15/05¹⁰¹¹

Example 5: Assume the same facts as Example 3 (extension to 10/15/02 and actual filing on 10/15/02) except that the IRS issues a notice of deficiency for an additional \$100 tax on the last day of the three-year period (10/15/05), the taxpayer does not petition the Tax Court, and the IRS assesses the \$100 tax and interest on February 1 of Year 06. The taxpayer pays the assessed amounts on February 8 of Year 06. Then, on January 1 of Year 07, the taxpayer files a claim for refund for the taxes and interest he paid on February 8 of Year 6 plus \$50 of the tax he paid on October 15 of Year 2 with the original return. The taxpayer is timely with respect to the taxes paid on February 8 of Year 06 but is not timely with respect to the taxes paid on October 15 of Year 02. Why? Because the taxpayer failed to file a claim within three years from the date the return was filed but did file the claim within two years from the date the additional assessed taxes were paid.

Example 6: Assume the same facts as Example 5 except that, in response to the notice of deficiency, on December 15 of Year 05, the taxpayer filed a timely petition in the Tax Court, and, on June 1 of Year 07, the Tax Court determines that the taxpayer overpaid the taxes he paid on October 15 of Year 02. Can the taxpayer get a refund? Yes, the Tax Court can determine the overpayment and order a refund if on the date the Tax Court notice of deficiency was issued the taxpayer could have filed a timely claim for refund, provided that the Tax Court makes explicit findings in its decision that the period of limitation in § 6511(b)(2) was open on the date the petition was filed. § 6512(b)(3). Can you articulate the reason for this rule?

Example 7: This example will illustrate some of the more byzantine possible constructions of these rules. Assume that the taxpayer has paid more tax than he really owes through one of the prepayment mechanisms (either withholding or estimated taxes). Despite owing no additional tax and even being entitled to a refund, the taxpayer fails to file a tax return on the regular due date of April 15 of Year 02. Can the taxpayer file the required return claiming the refund on October 15 of Year 04, 2 ½ years after the due date of April 15? One possible interpretation of § 6511(a) is that

¹⁰¹⁰ § 6511(b)(2)(A).

¹⁰¹¹ Mimicking the statute, the 2020 Form 1040-X instructions say: “Generally, for a credit or refund, you must file Form 1040-X within 3 years (including extensions) after the date you filed your original return or within 2 years after the date you paid the tax, whichever is later.” This language is not as clear as it could be because it does not clearly differentiate the date of filing and the extension. The date of filing in the example is clear. Nevertheless, the IRS interprets the statute to include the extension period in the time for filing the claim for refund, IRS Field Service Advice (FSA 1998-24 (6/24/93), reproduced at 98 TNT 98-23 (4/30/98)) (stating the “short conclusion” that “Pursuant to the plain meaning of I.R.C. section 6511(b)(2)(A), a taxpayer who properly files for an automatic extension of time to file a return receives the benefit of the extension period in determining the amount of a refund allowable, regardless of whether he or she files the return within the extension period.” So, based on this analysis, the taxpayer in the example would get the benefit of the extension period even if the taxpayer does not file in the extension period. For example, if the taxpayer filed the original Form 1040 on 11/1/02, he would have until 10/15/02 to file a claim for refund.

a timely filed return is required for the three-year period to operate, so that the taxpayer loses because he did not file the refund claim within two years of payment. Section 6511(a) does not expressly require a timely return, but one can construct a contextual argument that § 6511(a) only makes sense if it refers to a timely filed return. Nevertheless, the courts and the IRS, although flirting with that notion and even imposing it in at least one case, seem now to embrace a three-year period for a taxpayer in this situation.¹⁰¹² But that does not get the taxpayer his refund because that only clears the first rule. Fortunately for the taxpayer, he can clear the second rule because his claim is still within the three-year period of § 6511(b)(2)(A).¹⁰¹³

Example 8: Taxpayer prepays Year 01 taxes in the amount of \$100,000 by combination of estimated tax and withholding tax, but then fails to file the return timely on 4/15/02 and does not request an extension. Those prepayments are deemed paid on 4/15/02. The taxpayer thereafter files a delinquent original Year 01 return on 7/15/05 on which he reports a tax liability of \$50,000, claims credit for the prepaid tax of \$100,000, and claims a resulting Year 01 refund of \$50,000. The taxpayer meets the three-year requirement of § 6511(a) because the claim for refund is filed contemporaneously with the return. However, he flunks § 6511(b)(2)(A)'s look-back period requirement because the refund cannot exceed the taxes paid in the preceding three-year period.¹⁰¹⁴ Strangely, if the taxpayer had originally timely received an extension of the Year 01 return which would have permitted him to file a timely Year 01 return by 10/15/02, then the taxpayer will have met the § 6511(b)(2)(A) 3-year lookback requirement because extensions are counted even if not used.¹⁰¹⁵

Example 9: Same Example 8, except assume (i) the taxpayer does not apply for an extension, (ii) for some reason, the IRS treats the prepayment of \$100,000 not as a payment of tax deemed paid on 4/15/02 but as a deposit or cash bond and (iii) the IRS applies the cash bond as a payment on 9/1/02. The refund claim is then timely because the 7/15/05 filing is within 3 years of the date of payment.

I have noted above several special rules like the timely-mailing, timely-filing rule and the holiday rule (making timely a return due on a holiday or weekend if filed the day after a holiday or weekend). Practitioners must pay careful attention to these intersection of these rules with the claim for refund requirement. For example, assume that a return is due on April 15 of Year 02 which is

¹⁰¹² I will not go through the Code gyrations to get you there, but for further reading, see Leandra Lederman, *Late Returns Claiming Refunds: Negotiating the "Fantastic Labyrinth"*, 2000 TNT 224-67 (11/20/2000); see also *Weisbart v. United States*, 222 F.3d 93 (2d Cir. 2000); and *Omohundro v. United States*, 300 F.3d 1065 (9th Cir. 2002); and CC-2003-021, reproduced at 2003 TNT 126-13. See also § 6512(b)(3) which now permits the Tax Court to award an overpayment in such a case.

¹⁰¹³ But see *Dickow v. United States*, 654 F.3d 144 (1st Cir. 2011) denying the claim for refund because the original delinquent return (an estate tax return) was filed over three years after the taxes were paid.

¹⁰¹⁴ *Reynoso v. United States*, 692 F.3d 973 (9th Cir. 2012). The case also discusses the taxpayer's arguments that, because the IRS inappropriately credited the amount involved to another year's return, he should escape the prohibition of § 6511(b)(2)(A)'s look-back period and move it forward to the year the improper credit occurred. That is esoterica which can be consulted in the opinion.

¹⁰¹⁵ FSA 1998-24 (6/24/93), reproduced at 98 TNT 98-23 (4/30/98) with the "Short Conclusion" (emphasis supplied):

Pursuant to the plain meaning of I.R.C. section 6511(b)(2)(A), a taxpayer who properly files for an automatic extension of time to file a return receives the benefit of the extension period in determining the amount of a refund allowable, **regardless of whether he or she files the return within the extension period.**

a Saturday, so that the return will be deemed timely if filed on April 17 of Year 02. The taxpayer mails the return on March 1 of Year 02 and the IRS receives it on March 5 of Year 02. The return is deemed filed on the original due date of April 15 of Year 02 and not the statutorily extended date of April 17 of Year 02. The three-year period for filing a timely claim for refund expires April 15 of Year 05, not April 17 of Year 05.¹⁰¹⁶

I noted above that, in certain special situations, Congress has provided an extended statute of limitations on assessment. So, too, there are special situations that Congress feels justify extended periods for claiming refunds. For example, § 6511(d) provides the following exceptions

- A special seven year statute of limitations for claims for refund related to bad debts and worthless securities.
- a ten year period for claiming refunds related to foreign tax credits.¹⁰¹⁷
- the carryback of net operating losses (NOLs) and capital loss carrybacks in which case the three-year period is measured not from the year to which the losses are carried but from the year that generated the losses that are carried back.¹⁰¹⁸

Finally, § 6511(h) provides that the period for filing a refund claim is suspended during any period that the taxpayer is “financially disabled”—“unable to manage his financial affairs by reason of a medically determinable physical or mental impairment” expected to last 12 months or more and is without a guardian. (For further discussion of § 6511(h), see p. 254.)

b. Interest Claims.

Usually, a taxpayer files a claim for refund claiming that he overpaid his tax liability for the year. As we learn elsewhere, if a taxpayer overpays his tax, he will be entitled to recover interest at the statutory rate (just as when he owes a tax, he will owe interest for the period of the underpayment). To illustrate, when the taxpayer files a claim for \$100 overpayment on his or her Year 01 return that was due and filed on April 15 of Year 02, the taxpayer will be entitled to interest after April 15 of Year 02 until the overpayment is refunded. For this reason, in filing a claim for refund, tax practitioners often include a statement that the refund request includes interest¹⁰¹⁹ but, since the amount of the interest is a moving target, a specific statement of the amount of the interest

¹⁰¹⁶ See Burgess J.W. Raby and William L. Raby, Return Filing Dates and the Statute of Limitations, 2003 TNT 89-11 (2003). The authors also note other examples of problems in the interface of the three-year refund claim rule and other rules.

For examples of potential glitches and fixes when the original filing date is otherwise postponed, see NTA Blog: Refund Statutes and the Lookback Rule Make Taxpayer and Tax Professionals’ Eyes Glaze Over (5/4/23)

¹⁰¹⁷ § 6511(d)(3)(A). Although a taxpayer may elect to take a credit or a deduction for foreign taxes paid, this special limitations period only applies if the credit is taken. *Trusted Media Brands, Inc. v. United States*, 899 F.3d 175 (2d Cir. 2018) (where the taxpayer originally claimed the credit and then sought, within the extended special limitations period, to switch to claim a deduction rather than a credit; held the extended period applies only if the taxpayer is claiming the credit).

¹⁰¹⁸ § 6511(d)(2); see also § 6501(k). For an application of this rule, see *Electrolux Holdings, Inc. v. United States*, 491 F.3d 1327 (Fed Cir. 2007); and ILM 202023006 (3/6/20) (for a particularly good discussion of the application of this rule to generate refunds in years other than the carryback year if the refunds are “attributable to” the loss carried to the carryback year, based on a change of causation concept).

¹⁰¹⁹ The statement will often be as simple as “plus interest as allowed by law.” More pontifically, the statement may be “plus interest on such amount or such greater amount of tax and interest as may be legally refundable on such taxes and interest.” *Mobil Corp. v. United States*, 2002 U.S. Claims LEXIS 92 (Fed. Cl. 2002).

requested is often not included in the claim for refund. In this example, no separate claim for refund of interest is required.¹⁰²⁰ So, the general rule is that, if you have made a valid claim for principal tax liability overpayment, interest on the overpayment will be automatic.

Now, let's vary the example slightly. Assume that the taxpayer filed his Year 01 tax return on April 15 of Year 02, reporting \$0 tax liability and paying no tax. Then on April 15 of Year 03, the IRS asserts a deficiency of \$100 and \$8 of underpayment interest, which the taxpayer promptly pays the same date by cutting a check for \$108. The taxpayer then files a claim for refund of the tax and interest paid on the ground that the \$100 deficiency determined by the IRS was not owed. Does the taxpayer have to claim refund of the deficiency interest of \$8 paid? The answer is yes.¹⁰²¹ The deficiency interest paid (\$8) is not a moving target and can be easily stated on the claim. Of course, if the taxpayer prevails on the claim that the \$100 deficiency and \$8 deficiency interest were not owed, the taxpayer will automatically recover interest on the \$108 from April 15 of Year 03. Arguably in this case, a general claim for interest as allowed by law might suffice, but the cautious practitioner will specifically include in the requested refund the \$8 deficiency interest paid on April 15 of Year 03.

Now, let's vary the example and say that the taxpayer does not contest the \$100 deficiency, but does contest the computation of the interest by the IRS. Let's say that the taxpayer believes that the interest, properly calculated, should have been \$7.50 rather than \$8.00. So, the taxpayer will desire to claim \$.50 refund.¹⁰²² In the claim for refund, the taxpayer should state his basis for calculating interest differently than the IRS did in computing the deficiency interest.¹⁰²³

¹⁰²⁰ § 6611(a) provides that interest "shall be allowed and paid upon any overpayment." The instructions on the claims for refund generally state that the "IRS will figure any interest due or owed and will either include it in [the] refund or bill [the taxpayer] for the interest." E.g., Form 1120-X Instructions. The latter calculation—deficiency interest—provides an apt analogy. In a notice of deficiency, the IRS does not assert the general interest calculation since that is automatically provided by law.

¹⁰²¹ *Alexander Proudfoot Co. v. United States*, 454 F. 2d 1379 (Ct. Cl. 1972). The Court there illustrated this holding (p. 1383, n. 10):

Plaintiff suggest that, if the Service happened to impose deficiency interest at 9% rather than the allowable 6%. . . the taxpayer could bring an independent action not subject to the requirements of a tax refund claim to recover the excess. We agree, however, with the Government that this is precisely one situation in which Congress would want the Service to have an opportunity to correct its mistake before litigation was begun.

¹⁰²² When large numbers are involved, the amounts involved in disputed interest calculations can be quite large and can thus make the claim for refund and refund suit quite cost effective.

¹⁰²³ See *Mobil Corporation v. United States*, 52 Fed. Cl. 327 (2002). In this case, the taxpayer filed a claim for deficiency interest which it had paid but did not include an explanation as to one component (because it did not know of its entitlement to refund on that basis at the time). Years later, the taxpayer sought to expand the scope of the claim on the basis of this new component. The Court applied the doctrine of variance to deny the claim.

c. Adequacy of the Claim; Variance.

The claim for refund must state the basis for the refund in such detail as “sufficient to apprise the Commissioner of the exact basis thereof.”¹⁰²⁴ The claim for refund is analogous to a pleading -- it must timely and fairly put the IRS on notice of the factual and legal basis for the refund. That does not mean that a lengthy brief need be filed -- but the essential facts and summary of the legal position should be provided in the claim. More detail cannot hurt -- hence detailed statements of the claims are often provided. But too little detail can mean that the IRS has not been put on fair notice of the claim and that the claim will be defective. The consequence of a defective claim--i.e., not fairly putting the IRS on notice of the claim--is that the taxpayer may forfeit any right to a refund in a later refund suit through the application of the doctrine of variance unless the defective claim is clarified within the statute of limitations.¹⁰²⁵ The doctrine of variance is not a technical rule, but a rule of fair notice to the IRS. Hence, the variance must be a “substantial variance,” meaning that the claim pursued in the refund suit must “substantially vary the legal theories and factual bases set forth in the tax refund claim presented to the IRS.”¹⁰²⁶

The requirement that a claim be adequately stated to give the IRS a fair opportunity to act on the claim has both factual and legal facets. The claim should fairly put the IRS on notice of the facts. The claim should also fairly put the IRS on notice of the legal claim asserted on the basis of the facts presented. But, you may say, the IRS should be presumed to know the law, so that setting forth facts which entitle the taxpayer to a refund should be sufficient. Wrong, or at least risky.¹⁰²⁷

The disastrous consequence of the doctrine of variance in an ensuing refund suit means that the taxpayer and his practitioner must be very careful in drafting claims for refund. Taxpayers may be tempted to state claims very generally, thinking that they can later make them more specific, thus merely refining the general claim without varying from it. The problem, of course, that, if the claim

¹⁰²⁴ Reg. § 301.6402-2(b)(1); See p. 835. For this reason, the taxpayer and the practitioner will recognize from the amended return form that an explanation must be given. However, the original return can serve as a claim for refund also, but it will often be less evident that the taxpayer must state the basis for the claim. See *Waltner v. United States*, 679 F.3d 1329, 1333 n. 2, 2012 U.S. App. LEXIS 7956 (Fed. Cir. 2012) (stating both that the specificity requirement for original and amended returns). For this reason, if a claim for refund with an original return has not been granted in a reasonable time or at least by the time the refund statute of limitations approaches (generally 3 years from the date of the return or 2 years from the date of payment), the taxpayer and practitioner should consider filing an explanation is sufficient detail to establish the specificity requirement.

¹⁰²⁵ The variance doctrine is described: “a ground for a refund that is neither specifically raised by a timely claim for a refund, nor comprised within the general language of the claim, cannot be considered by a court in a subsequent suit for a refund.” *Ottawa Silica Co. v. United States*, 699 F.2d 1124, 1138 (Fed. Cir. 1983) (citations omitted). For a good discussion of the doctrine, see Margaret C. Wilson, The Variance Doctrine: No Forks in the Road to Refunds, 55 Tax Law. 605 (Winter 2002), and Burgess J.W. Raby and William L. Raby, Full Disclosure and Adequacy of Refund Claims, 2004 TNT 10-51 (1/15/04); see also Burgess J.W. Raby and William L. Raby, Refund Claim Defects and the Tax Practitioner, 2005 TNT 51-105.

One author claims that the *Chevron* line of cases (particularly *Mayo*) at least curbs some of the Government’s ability to claim fatal variance. Patrick J. Smith, Life After Mayo: Silver Linings, 131 Tax Notes 1251 (June 20, 2011).

¹⁰²⁶ *Lockheed Martin Corp. v. United States*, 210 F.3d 1366, 1371 (Fed. Cir. 2000) (internal quotation marks omitted); and *Computervision Corp. v. United States*, 445 F.3d 1355, 1363-64 (Fed. Cir. 2006).

¹⁰²⁷ *Lockheed Martin Corp. v. United States*, 210 F.3d 1366, 1371 (Fed. Cir. 2000) (“With regard to the legal component of the substantial variance rule, any legal theory not expressly or impliedly contained in the application for refund cannot be considered by a court in which a suit for refund is subsequently initiated. The taxpayer similarly may not substantially vary at trial the factual bases raised in the refund claims presented to the IRS.”) (internal quotation marks and citations omitted).

is too generally stated, it may be defective on its face because it does not fairly put the IRS on notice of the specific nature of the claim.¹⁰²⁸

When faced with a Government variance claim in litigation to avoid the refund, taxpayers and their counsel must think creatively of equitable arguments that may defeat the variance claim. For example, the variance doctrine, although “expressed in uncompromising terms,” permits “an exception in cases where the Government’s unilateral action itself creates the substantial variance.”¹⁰²⁹ In one case, the taxpayer urged that, at least with respect to any counterclaim for unpaid assessed taxes that the Government asserts in the refund suit, the variance doctrine will not apply with respect to the counterclaim because it is not suit for refund based on a claim for refund.¹⁰³⁰ Note that this can occur where there is a common issue on the refund claim and on the counterclaim (e.g., the type of issue involved with so-called divisible taxes where the taxpayer is permitted to pay the minimal amount to file and sue for refund).

d. Form for Claims.

Given the disastrous consequences of variance—i.e., the loss of the right to the refund—practitioners must know the rules for what constitutes a claim in addition to the specificity required.

(1) IRS Prescribed Forms.

A formal claim for refund is a request made on a proper form that the IRS refund the tax allegedly overpaid. The individual income tax claim for refund can be either on the original return by claiming a refund (Form 1040) or on an amended return (Form 1040-X, Amended U.S. Individual Income Tax Return) claiming a refund.¹⁰³¹ In the case of corporate income taxes, the claim for refund is the 1120 if the refund is claimed on the original return or the 1120-X, Amended U.S. Corporation

¹⁰²⁸ We see a similar phenomenon of the tension between general statements and specific statements and variance play out in the notice of deficiency area. In a Tax Court proceeding, the taxpayer bears the burden of proof as to claims the IRS makes in the notice of deficiency which is the jurisdictional prerequisite to Tax Court suits but the IRS bears the burden of proof as to new matter—matter outside the scope of the notice of deficiency. Tax Court Rule 142(a)(1). Hence the risk to the IRS in too general a notice is generally that it may have to bear the burden of proof to sustain a deficiency. Note that this remedy of shifting the burden of proof is a significant but still less drastic remedy than barring the claim altogether, which is the result of variance in a claim for refund setting.

¹⁰²⁹ *El Paso CGP Co. v. United States*, 748 F.3d 225, 229 (5th Cir. 2014) (citing “e.g., *Shore v. United States*, 26 Cl.Ct. 826, 828–29 (1992) (rejecting a variance doctrine argument where the Government created the substantial variance from the initial claim); *Brown v. United States*, 427 F.2d 57, 62 (9th Cir.1970) (holding that taxpayers ‘cannot be foreclosed from responding’ to new issues created by the Government after the filing of the initial refund claim).”). The *El Paso* court further explained that “[i]n allowing the taxpayer flexibility to respond, courts recognize that the Government cannot use the variance doctrine to straitjacket the taxpayer when the Government unexpectedly changes its litigation strategy. For an application of this exception to variance, see *Keefer v. United States*, No. 3:20-CV-0836-B, 2022 U.S. Dist. LEXIS 118271 (N.D. Tex. July 6, 2022).

¹⁰³⁰ *Cencast Services, L.P. v. United States*, 729 F.3d 1352 (Fed. Cir. 2013).

¹⁰³¹ Reg. 301.6402-3(a)(5). The original or amended return must meet the requirements for a return (discussed earlier in the text). For a particular example of a taxpayer’s submission of an incomplete return (some information but other significant amounts omitted) not being treated as a return sufficient to claim a refund, see *Kiselis v. United States*, 2017 U.S. Claims LEXIS 226 (2017).

Income Tax Return, when claimed after filing the original return. The Form 843, Claim for Refund and Request for Abatement, is the general form used for requesting refunds of other taxes.¹⁰³²

Other forms may serve as claims for refund. Common examples are: (1) Two forms often signed by a taxpayer after an audit, Forms 870, Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment, and Form 4549, Income Tax Examination Changes, will be treated claims for refund as to any overpayment resulting from the adjustments;¹⁰³³ and (2) for refund of income tax involved with claims for innocent spouse relief, Form 8857, Request for Innocent Spouse Relief, is “[G]enerally ... treated as the filing of a claim for credit or refund even if the requesting spouse does not specifically request a credit or refund.”¹⁰³⁴ (I cover the innocent spouse provisions later in the text beginning on p. 758)

An issue with respect to use of the Forms is that some of the Forms (e.g., an original Form 1040 showing a refund due) may not ask for the type of explanation and support that a separate claim for refund (such as a Form 1040-X) would require to put the IRS on notice as to the nature of the claim. This raises the issue as to a requirement that the taxpayer put the IRS on notice of the basis for the claim for refund which then sets the parameters for applying potential variance from the claim raised. I am not sure that a court would hold a refund claim inadequate if it complies with the instructions on the Form.¹⁰³⁵ However, taxpayers and practitioners might want to consider protective filings if there is any doubt.¹⁰³⁶

(2) Exceptions to Formal Claim for Refund.

(a) General.

The statute requires a claim for refund. Administrative necessity reflected in the regulations requires that the claim be formally presented. Accordingly, claims should be presented with the proper forms (discussed above) and, where required by procedures, with any required accompanying information.¹⁰³⁷ However, from time to time, courts will recognize that the requirement of a claim

¹⁰³² There are other forms. For example, Form 1310, Statement of Person Claiming Refund Due a Deceased Taxpayer and Form 8849, Claim for Refund of Excise Taxes.

¹⁰³³ See Form 870 instructions. Rev. Rul. 68-65, 1968-1 C.B. 555. These forms are used at the end of an audit and indicate the IRS’ and taxpayers’ agreement that a deficiency is due or a refund is due. Relative to the text above, the form would indicate that a refund is due, hence the taxpayer need not be concerned about variance because the IRS is conceding the refund.

¹⁰³⁴ Prop. Reg. § 1.6015-1(k)(4) (Nov. 19, 2015).

¹⁰³⁵ Keith Fogg, Refund Claims and the Specificity Requirement (Procedurally Taxing Blog 9/2/21) (discussing *Intermountain Elecs., Inc. v. United States*, No. 2:20-cv-00501-JNP, 2021 U.S. Dist. LEXIS 133349, at *12-14 (D. Utah July 16, 2021) where the judge was skeptical that submitting the information required by a Form 6765, Credit for Increasing Research Activities, was not sufficient and noting that, if the IRS actually considers the claim, it may have waived any deficiency in the explanation).

¹⁰³⁶ For example, if the refund claim is via a timely filed Form 1040 (including underlying Form attachments) with limited explanation of the basis for the refund, the taxpayer might tickler the latest date for filing a claim for refund under the § 6211 requirements (usually 3 years for a timely filed return) to make sure there is some written submission of the basis of the claim. Same for a delinquent original Form 1040. The refund claim via a Form 1040-X should have the basis for the refund.

¹⁰³⁷ 26 C.F.R. § 301.6402-2(b)(1); See *Abston v. Commissioner*, 691 F.3d 992 (8th Cir. 2012) (denying a timely claim for refund seeking to invoke the suspension of the statute of limitations under § 6511(h) (i) because the

(continued...)

for refund has been met without the filing of a formal claim. The circumstances for such recognition have been catalogued: “(1) the informal claim doctrine; (2) the general-claim doctrine; (3) the germaneness doctrine; and (4) the waiver doctrine.”¹⁰³⁸ These exceptions are rarely applied and are driven by unusual facts and equities.

(b) Informal Claim Doctrine.

Broadly speaking, the components of an informal claim are: (1) the IRS was on actual or constructive notice that the taxpayer was making a claim; (2) just as with a formal claim, the claim must adequately advise the IRS of the legal and factual basis for the claim; (3) the informal claim must have a written component; and (4) the taxpayer filed a formal claim, albeit late, before initiating litigation.¹⁰³⁹ Some courts add the requirement that the IRS have either considered the informal claim or otherwise lead the taxpayer to believe that the claim was sufficient.¹⁰⁴⁰ Simply because the IRS may have had somewhere in the system information indicating that the taxpayer might claim a refund does not meet the requirement for a claim.¹⁰⁴¹ The taxpayer must make the claim, even if informal, and there must be no doubt that he or she is making a claim.¹⁰⁴² And, finally,

¹⁰³⁷(...continued)

taxpayer did not provide with the claim “proof of [a disabling impairment] is furnished in such form and manner as the Secretary may require” and (ii) the IRS required by Revenue Procedure a particular format for such proof, which the taxpayer did not submit; held there was no compliance, hence the issue of substantial compliance was not reached.

¹⁰³⁸ *Green v. United States*, 2016 U.S. App. LEXIS 2948, at *3-4 (10th Cir. 2016) (nonpublished), citing *Blue v. United States*, 108 Fed. Cl. 61, 68 (2012). ; and *Martti v. United States*, 121 Fed. Cl. 87, 101 (2015). See also *Computervision Corp. v. United States*, 445 F.3d 1355 (Fed. Cir. 2006).

¹⁰³⁹ The IRM recognizes informal claims. See particularly IRM 25.6.1.10.2.6.1 (05-17-2004), Background on the Acceptability of Claims Failing to Comply with Prescribed Requirements for the Content and Form and IRM 25.6.1.10.2.6.3 (09-29-2015), Informal Claims. For discussions and applications of these informal claim requirements, see e.g., *United States v. Kales*, 314 U.S. 186 (1941); *BNSF Railway Company v. United States*, 775 F.3d 743 (5th Cir. 2015); *Kaffenberger v. United States*, 314 F.3d 944 (8th Cir. 2003) and *Mobil Corporation v. United States*, 67 Fed. Cl. 708 (2005). The Court in *Kaffenberger* found, inter alia, that the written component of the requirements was imbedded in Form 4868 which included application of the amounts of the claimed refund toward the following year’s taxes. The IRS has acquiesced in the portion of the opinion applying the informal claim for refund requirements. See acquiescence on this issue in 2004-35 I.R.B. The Court in *Mobil Corporation*, found a viable informal claim as to some but not all claims. See also *Greene-Thapedi v. United States*, 549 F.3d 530 (7th Cir. 2008), as to the written component; and *Goldberg v. United States*, 881 F.3d 529, 533 (7th Cir. 2018) (quoting *Green-Thapedi*, “informal claim doctrine is predicated on the expectation that any formal deficiency will at some point be corrected” and rejected the notion that the taxpayer could perfect the claim at any time (there after filing the refund suit)); author’s note: logically, that point must be before the IRS has completed its consideration of the informal claim, usually indicated by a denial of the claim if the IRS recognizes the informal action as a claim for refund.)

¹⁰⁴⁰ *Nick’s Cigarette City, Inc. v. United States*, 531 F.3d 516 (7th Cir. 2008), citing *Kikalos v. United States*, 479 F.3d 522, 525 (7th Cir. 2007).

¹⁰⁴¹ *BCS Financial Corporation v. United States*, 118 F.3d 522, 524-5 (7th Cir. 1997) (citing *Miller v. United States*, 949 F.2d 708, 712 (4th Cir. 1991)).

¹⁰⁴² *Bauer v. United States*, 594 F.2d 44, 47 (5th Cir. 1979). The Court of Federal Claims expounded in *Mobil Corporation v. United States*, 67 Fed. Cl. 708, 717 (2005) (citations omitted and quotations omitted for readability):

It is well-established that the basic underlying principle [of an informal claim] is the necessity to put the [IRS] on notice of what the taxpayer is claiming and that he is in fact making a claim for refund. It is not enough that the Internal Revenue Service have in its possession information from which it might deduce that the taxpayer is entitled to, or might desire, a refund; nor is it sufficient that a claim involving the same ground has been filed for another year or by a different taxpayer.

the informal claim must be “filed” within the applicable statute of limitations.¹⁰⁴³ These are often fact intensive inquiries, ultimately resolved by common sense and fairness.¹⁰⁴⁴ However, the IRS has internally concluded that a Form 4549, Income Tax Examination Changes, which reflects an overpayment “likely” an informal claim for this purpose even though technically it is not prepared or filed by the taxpayer.¹⁰⁴⁵

For present purposes, I expect you to know two things: (1) you should always present your claims on a proper form for claiming the refund your client seeks and (2) if for some reason your client did not so present the claim, you should review the facts, with particular attention to whether the claim was informally presented to and considered by the IRS and the cases dealing with informal claims, to see if you can extract victory from the jaws of defeat.

While the informal claim process is based on facts and circumstances, there is one procedure that formally adopts the informal claim process. In LB&I examinations, the IRS encourages taxpayer communication at the commencement of the audit. Informal claims made within the 30 days of the first audit conference will be accepted and processed without having to file a formal claim for refund.¹⁰⁴⁶

(c) General Claim Doctrine.

The general claim doctrine applies where the taxpayer has filed a claim that, because it is too general, would not be a sufficient claim for refund but, before the IRS denies the claim, the taxpayer supplements the claim outside the refund statute of limitations to provide the necessary specificity.¹⁰⁴⁷ The out of time specificity must be within the scope of the general claim that was timely made. If the timely claim was specific, the out of time supplement cannot be different from the timely specific claim.¹⁰⁴⁸ (This appears to be a variation of the informal claim doctrine noted above.)

¹⁰⁴³ *Furst v. United States*, 678 F.2d 147, 151 (Ct. Cl. 1982).

¹⁰⁴⁴ See e.g., *Mobil Corporation v. United States*, 67 Fed. Cl. 708 (2005); and *Pala Emples. Profit Sharing Plan v. United States*, 234 F.3d 873, 877 (5th Cir. La. 2000) (“There are no ‘hard and fast rules’ for determining the sufficiency of an informal claim, and each case must be decided on its own facts with a view towards determining whether under those facts the Commissioner knew, or should have known, that a claim was being made.”).

¹⁰⁴⁵ CCA 201921013 (12/20/18). The key point is that the IRS was on written notice that a refund was due.

¹⁰⁴⁶ IRS Publication 5125 Publication, Large Business & International Examination Process (February 2016) provides that: “LB&I will only accept informal claims that are provided to the exam team within 30 calendar days of the opening conference. * * * After the 30-day window, claims for refund for issues not identified for examination must be filed using Form 1120-X, Form 1040-X or Form 843 as required by Treasury Regulations. In limited circumstances exceptions to the formal claims process may be granted by LB&I senior management. * * *.”

¹⁰⁴⁷ See *Computervision Corp. v. United States*, 445 F.3d 1355, 1368 (Fed. Cir. 2006), citing *United States v. Andrews*, 302 U.S. 517, 524 (1938).

¹⁰⁴⁸ *Computervision Corp. v. United States*, 445 F.3d 1355, 1368-69 (Fed. Cir. 2006).

(d) Germaneness Doctrine.

The germaneness doctrine may apply where the taxpayer:

(1) files a formal claim within the limitations period making a specific claim; and (2) after the limitations period but, while the IRS still has jurisdiction over the claim, files a formal amendment raising a new legal theory -- not specifically raised in the original claim -- that is “germane” to the original claim, that is, it depends upon facts that the IRS examined or should have examined within the statutory period while determining the merits of the original claim. Unlike the waiver doctrine, the inquiry here is not whether the particular legal theory for recovery has been considered by the IRS during the limitations period but whether the underlying facts supporting that legal theory were discovered or should have been discovered by the IRS in considering the original claim during the limitations period.¹⁰⁴⁹

(e) Waiver.

The IRS’s actual consideration of a claim not formally stated may waive whatever defense the IRS might otherwise have that the claim was not properly made.¹⁰⁵⁰ Logically, for this argument to be pressed, the IRS’s actual consideration must have occurred within the time otherwise available to file a claim for refund.¹⁰⁵¹

If, in the refund suit, the Government asserts a new defense which it is entitled to do, it may be deemed to have waived variance, at least to the extent equitably required to permit the taxpayer to respond to the new defense.¹⁰⁵²

e. Claims After Consent to Extend Statute.

I discussed above the use of a written agreement, called a consent, to extend the statute of limitations on assessment. The IRS form for such a consent with respect to income tax is either Form 872, Consent to Extend the Time to Assess Tax, or Form 872-A, Special Consent to Extend the Time to Assess Tax. Where such a consent is entered, the statute of limitations for filing a claim for refund

¹⁰⁴⁹ *Computervision Corp. v. United States*, 445 F.3d 1355, 1370 (Fed. Cir. 2006) (citing *Bemis Brothers Bag Co. v. United States*, 289 U.S. 28, 53 S. Ct. 454 (1933) and *United States v. Andrews*, 302 U.S. 517, 524 (1938)). In *Computervision*, the Federal Circuit rejected the holding of two other courts that the more specific formal claim could be filed after the IRS has completed consideration of the inadequate original claim by granting the original claim, by denying the original claim or by the taxpayer having filed a suit for refund without IRS formal action on the claim. The cases rejected in *Computervision* are: *Mutual Assurance Inc. v. United States*, 56 F.3d 1353 (11th Cir. 1995); *St. Joseph's Lead Co. v. United States*, 299 F.2d 348 (2d Cir. 1962).

¹⁰⁵⁰ *Angelus Milling Co. v. Commissioner*, 325 U.S. 293, 297 (1945); see also *Cencast Servs., L.P. v. United States*, 729 F.3d 1352, 1368 (Fed. Cir. 2013) (citing *Computervision Corp. v. United States*, 445 F.3d 1355, 1365 (Fed. Cir. 2006)).

¹⁰⁵¹ *Mobil Corporation v. United States*, 2002 U.S. Claims LEXIS 92 (Fed. Cl. 2002).

¹⁰⁵² *Bowles v. United States*, 820 F.2d 647, 649 (4th Cir. 1987); *Brown v. United States*, 427 F.2d 57, 62 (9th Cir. 1970); *Computervision Corp. v. United States*, 445 F.3d 1355, 1372 (Fed. Cir. 2006). These cases would seemingly not apply if the taxpayer should have anticipated the new defense and thus addressed it in the claim for refund. For a dramatic instance involving a lot of money where the Court held that the taxpayer there should have anticipated the new defense and thus poured it out, see *The Proctor & Gamble Company v. United States*, 570 F. Supp. 2d 972 (S.D. Ohio 2008).

does not expire prior to six months after the extended period for assessment expires. § 6511(c). The amount that may be refunded, however, is the amount of tax paid after the consent was filed plus the amount that could have been refunded under the foregoing rules if the taxpayer had filed a claim for refund on the date the consent was executed.¹⁰⁵³

Normally, a consent to extend the statute of limitations is sought by the IRS to prolong the period for assessment. Can the taxpayer obtain a consent to prolong the period of time for filing a claim for refund? A taxpayer in this position who can adequately frame the claim for refund should do so and that will solve the problem. But what if, for some reason, the taxpayer believes he or she may be entitled to a refund but cannot adequately frame the claim within the period required? The answer is that, generally, the IRS will not enter a consent for the purpose of allowing additional time to file a claim for refund; however, this is not an iron-clad rule and the IRS may make an exception. I have, however, been able to obtain a consent in a very unique case with facts and general issues I am sure I will not encounter again.

The downside to protecting the refund statute via a consent is that it also prolongs the period of time that the IRS may assess. A taxpayer may believe that, if any adjustment is appropriate, it will result in a refund rather than a deficiency and thus be willing to take this risk inherent in a consent to obtain additional time to develop the right to a refund. What should the taxpayer do if the IRS refuses to enter a consent for this purpose? The answer is to assess the cost/benefit, devote the appropriate resources based on that analysis, and frame the best claim for refund in the period allowed. You should consider asking in the cover letter and refund claim that the IRS not act promptly on the claim to allow time for the taxpayer to resolve the uncertainties that do not permit the framing of a proper claim at that time.

There is yet another potential work-around to an expiring refund statute that you should consider. File a protective claim for refund stating as much about the claim as you can and ask the IRS to postpone action on the claim for some period of time when you expect the facts and circumstances to firm up to amend the timely filed but otherwise deficient claim.¹⁰⁵⁴ You will have to tell the IRS a good story as to why it should postpone action and give them a reasonable time frame to postpone action. Upon being presented with a good story and reasonable time period request, the IRS will likely postpone action and the amended claim will cure the problems in the original deficient claim.

f. Effect of IRS Granting a Claim for Refund.

The IRS's grant of a claim for refund:

¹⁰⁵³ For a very practical application of this rule in the case of multiple consents, see IRS CCA 201349014 (9/20/13) (applying the rule in the case of multiple consents, looking to the date of the first consent rather than the last so that the taxpayer is not disadvantaged from filing multiple consents rather than one for the period of the multiple consents).

¹⁰⁵⁴ The protective claim is recognized in 1.5.3.4.7.3 (10-01-2018), Protective Claims.

- does not preclude the IRS from seeking a return for refund (see the discussion of erroneous refund procedures below beginning at p. 248) or even asserting a deficiency in excess of the erroneously awarded refund.¹⁰⁵⁵
- can moot a refund suit brought by the taxpayer and thus require dismissal of the suit, even if the IRS might claim tax on the same basis in another open year.¹⁰⁵⁶

3. Overpayments in Tax Court Litigation.

We learned earlier that a central feature of our tax system (at least for income tax and estate and gift tax) that the IRS may determine that the taxpayer owes additional tax—referred to as a deficiency—and the taxpayer can litigate whether he or she owes the deficiency in the U.S. Tax Court. However, in some cases, the IRS may erroneously determine a deficiency in a situation where the taxpayer does not owe any deficiency and is entitled to a refund. In those cases, if the taxpayer files a petition in the Tax Court to contest the deficiency determination, the Tax Court has jurisdiction to determine an overpayment (as opposed to a deficiency) and order a refund of tax paid under **any** of the following conditions which must be determined in the decision document¹⁰⁵⁷ (equivalent of judgment in district courts) per § 6512(b)(1) & (3):

- the tax was paid after the notice of deficiency was mailed.¹⁰⁵⁸
- the tax could have been refunded under the general refund statute of limitations in § 6511(b)(2), (c) or (d) had the taxpayer filed a hypothetical claim for refund on the date the notice of deficiency was mailed.¹⁰⁵⁹ This hypothetical claim for refund requires that the right to a refund be tested under the refund “lookback” periods under § 6511(b)(2)(A), with the exception that a notice of deficiency mailed during the third year after the due date (with extensions) for a person who has not filed a return prior to that third year gets the benefit of a three-year lookback period from the date the tax was paid.¹⁰⁶⁰

¹⁰⁵⁵ See *Meridian Mut. Ins. Co. v. Commissioner*, 44 T.C. 375, 379 (1965), *aff'd*, 369 F.2d 508 (7th Cir. 1966); *Beer v. Commissioner*, 733 F.2d 435, 437 (6th Cir. 1984); *Warner v. Commissioner*, 526 F.2d 1, 2 (9th Cir. 1975) and *Clark v. Commissioner*, 158 F.2d 851 (6th Cir. 1946).

¹⁰⁵⁶ E.g., *Dr. Hill & Thomas Co. v. United States*, 392 F.2d 204, 205 (6th Cir. 1968) (refund suit only has the objective of recovery of money and the payment of the refund moots the objective and thus the suit); *Christian Coalition, Inc. v. United States*, 662 F.3d 1182, 1192 (11th Cir. 2011) (refund claim moot where “IRS returned all of the disputed taxes shortly after this litigation began.”)

¹⁰⁵⁷ For some of the nuances as to overpayments determined in a decision document, see *Hill v. Commissioner*, T.C. Memo 2021-121 (discussing potential overpayments determined by the Tax Court above the Tax Court judge’s signature and those not determined by the Tax Court but appearing as the parties’ stipulations below the judge’s signature. See Bob Probasco (Guest Blogger), [Overpayment, or Not?](#) (Procedurally Taxing Blog 11/29/21).

¹⁰⁵⁸ § 6512(b)(3)(A).

¹⁰⁵⁹ § 6512(b)(3)(B). See generally *Commissioner v. Lundy*, 516 U.S. 235 (1996). By amendment to § 6512(b)(3), Congress overruled the *Lundy* holding. Taxpayer Relief Act of 1997, Pub. L. No. 105-34, sec. 1282(a) and (b), 111 Stat. at 1037-1038. See *Brosi v. Commissioner*, 120 T.C. 5, 9 (2003). The amendment is not without its complications.

¹⁰⁶⁰ See the flush language in § 6512(b)(3) applying to the exception in § 6512(b)(3)(B). For an application of this exception, see *Borenstein v. Commissioner*, 919 F.3d 746 (2d Cir. 2019), reversing *Borenstein v. Commissioner*, 149 T.C. 263 (2017). By finding the statutory text ambiguous, the Second Circuit found some leeway to interpret the statute so that a clear anomaly created by the Tax Court decision was avoided. The problem, referred to as a donut hole period during which a refund could not be granted but could on either side of the donut hole, is explained in [The Second](#) (continued...)

- if, on the date the notice of deficiency was mailed, the taxpayer had filed a timely claim which (i) had not been disallowed, (ii) which, if disallowed, still permitted a timely suit for refund, or (iii) a timely suit for refund under § 6532 had been commenced.¹⁰⁶¹

A General Rule Summary: Under the foregoing rules, the Tax Court will have jurisdiction to order a refund in a timely filed petition for redetermination in the Tax Court in the following circumstances:

- The taxpayer timely files his income tax return, paying the indicated tax, and the IRS issues the notice of deficiency within the normal three-year limitations period in § 6501(a).
- The taxpayer did not timely file a return but timely paid the tax (e.g., by withholding or estimated tax) and the IRS issues the notice of deficiency within three years of the date the return was due.¹⁰⁶²
- The taxpayer pays the tax within two years prior to the date the IRS issues the notice of deficiency (this is needed only when the IRS issues the notice relying upon one of the extended periods allowed in § 6501 (e.g., one of the exceptions in § 6501(c) or the substantial omission 6-year period in § 6501(e)).

I think it will be helpful for students to consider how these rules protect the integrity of the refund statutes of limitation.

Finally, § 6512's rules for overpayments applies only with respect to the Tax Court's deficiency jurisdiction. The Tax Court has a number of other specific jurisdictions (such as Collection Due Process ("CDP") jurisdiction to review certain IRS determination on collection processes. The Tax Court has no jurisdiction to order refunds in such non-deficiency proceedings.¹⁰⁶³

4. The Payment/Deposit Distinction.

a. The Distinction.

In *Rosenman v. United States*, 323 U.S. 658 (1945), the Supreme Court made the critical distinction between a payment toward a tax liability and a deposit against any tax liability that may be due. This distinction is important in several contexts. In the current context of the statute of

¹⁰⁶⁰(...continued)

Circuit in Borenstein Helped to Close the Gap in the Tax Court's Refund Jurisdiction, but Only for Taxpayers in that Circuit (NTA Blog 4/24/19). The NTA is concerned that the *Borenstein* result might not obtain in other circuits and asked the IRS to acquiesce in the Second Circuit opinion to "signal to the Tax Court that the IRS accepts the Second Circuit's reasoning and will follow it in other docketed cases." Of course, the Tax Court is not bound to accept that "signal" if it were made, so there continues to be uncertainty in this area until the Tax Court addresses the issues and (hopefully) adopts the Second Circuit reasoning. See also Keith Fogg, Second Circuit Reverses Tax Court in Borenstein (Procedurally Taxing Blog 10/11/19).

¹⁰⁶¹ § 6512(b)(3)(C).

¹⁰⁶² See *Zarky v. Commissioner*, 123 T.C. 132 (2004).

¹⁰⁶³ *Brown v. Commissioner*, T.C. Memo. 2021-112.

limitations for refunds, it is important because the refund statute of limitations applies to payments and not to deposits.

In *Rosenman*, the taxpayer (an estate acting through its executors) was under audit, but before assessment remitted a then large sum of money to the IRS. The cover letter stated that the remittance was “a payment on account of Federal estate tax. . . . made under protest and duress, and solely for purposes of avoiding penalties and interest, since it is contended by the executors that not all of this sum is legally and lawfully owed.” The Court held that, because the taxpayer made clear that he did not agree to the taxes and none had been assessed, the remittance was a deposit rather than a refund and therefore the taxpayer's right to recover the amount was not subject to the limitation periods set forth in the predecessor to § 6511.

Rosenman established an important and enduring principle of tax law that a taxpayer may advance a remittance to the IRS and, at the taxpayer's option, have it treated as either a payment or a deposit. Taxpayers and their advisors usually considered remittances in advance of an assessment for the same reason as the taxpayer in *Rosenman* did -- i.e., to stop the running of interest on the underlying deficiency and on penalties that bear interest.

Congress codified the *Rosenman* rule permitting a deposit with some modifications. § 6603. Since the primary application of the distinction relates to interest, I defer more detailed discussion of this codification to p. 281.

What are other practical differences between a deposit and a payment in the current refund context? Here are the more obvious:

First, a deposit, not being a payment, is simply held by the IRS pending assessment and must be returned to the taxpayer upon the taxpayer's request. The request for return of the deposit is not a claim for refund.

Second, if the amount were a payment, of course, the taxpayer must file a claim for refund and pay careful attention to the refund statutes of limitation. If it is a deposit, there is no statute of limitations.

Third, if the IRS were to erroneously return to the taxpayer an amount remitted as a payment, it would have to follow the erroneous refund procedure to recover the amount, which allows a general two year statute of limitations, with a five year statute if the refund were caused by the taxpayer's fraud or misrepresentation.¹⁰⁶⁴ By contrast, if the IRS were to erroneously return to the

¹⁰⁶⁴ §§ 6532(b) and 7405(d). **Caveat as to misrepresentation:** The IRC contains provisions, variously worded, that provide exceptions to a prescribed result when certain conditions, including misrepresentation, are present. The ones relevant to this course are: §§ 6231(b) (if FPAA issued and petition filed, no more FPAA's permitted “in the absence of a showing of fraud, malfeasance, or misrepresentation of a material fact”); 6532(b) (statute of limitations on erroneous refund suit is 2 years except extended to 5 years if “any part of the refund was induced by fraud or misrepresentation of a material fact”); and 7121(b) (closing agreement final except for “fraud or malfeasance, or misrepresentation of a material fact” (Note, § 6231(b) is the successor to repealed TEFRA § 6223(f) similarly worded.) Depending upon context, the word “misrepresentation” may mean either an innocent misrepresentation of fact or requires some level of culpability (at least negligence, but usual intent to deceive). E.g., *Halpern v. Commissioner*, T.C. Memo. (continued...)

taxpayer an amount the taxpayer had remitted as a deposit, the Government must seek recovery under a general cause of action for return of money either without a statute of limitations or subject to the general Government claim six-year statute of limitations.¹⁰⁶⁵ Alternatively, of course, if the underlying statute of limitations is still open on the underlying tax liability, the IRS could proceed through the normal procedures to obtain an assessment.

b. Examples and Strategies.

Seeking to avoid the period of limitations on claims for refund, taxpayers may argue that amounts remitted to the IRS are deposits rather than payments. If the remittance to the IRS is treated as a deposit, there is no statute of limitations on recovering the remittance.

A quintessential case of this sort is a taxpayer who is overpaid via withholding or estimated taxes but who does not file a return until long past any possibly applicable refund statute of limitations. That taxpayer would prefer that the IRS treat the withholdings and estimated taxes as deposits rather than payments. In *Baral v. United States*, 528 U.S. 431 (2000), the Supreme Court held that those remittances (by the employer as to withholding and by the taxpayer as to estimated taxes) were payments made on April 15 of the tax year involved and were not deposits. The same rule has been applied to estimated payments made with extension requests.¹⁰⁶⁶

Consider the following not untypical setting presenting the issue of whether a remittance to the IRS should be treated as a cash deposit or a payment. Assume that the IRS is conducting an audit and has preliminarily determined that the taxpayer, a large corporation, has a deficiency of \$1,000,000, but has not yet issued a notice of deficiency. Assume that the corporation will be subject to the “hot interest” penalty of § 6621(c). (We have not covered interest yet; suffice it to say for present purposes that this increases the deficiency interest rate by 2% for large corporate underpayments for some of the period there was an underpayment (p. 276).) The taxpayer should think seriously about remitting the \$1,000,000 and accumulated interest to the IRS. But how should the taxpayer characterize the remittance—payment or deposit? If the taxpayer wants to contest liability or even just hold open the opportunity to litigate it in the Tax Court, the taxpayer should designate the remittance (or some portion of it) as a deposit, for if the taxpayer paid the entire amount of the deficiency, the taxpayer would lose the opportunity to litigate in the Tax Court because, with no deficiency, the IRS will not send a notice of deficiency.¹⁰⁶⁷ But, as should be

¹⁰⁶⁴(...continued)

2000-151 (“For purposes of section 7121, a misrepresentation is not synonymous with a mistake: It denotes something more deliberate or more conscious than mere error or mistake.” (Internal quotations omitted)); and *NPR Invs., L.L.C. v. United States*, 740 F.3d 998 (5th Cir. Tex. 2014) (§ 6223(f), barring a second FPAA notice except for “fraud, malfeasance, or misrepresentation of a material fact,” does not require intent to deceive for misrepresentation and even innocent misrepresentations can apply).

¹⁰⁶⁵ See 28 U.S.C. § 2415; and *United States v. Domino Sugar Corp.*, 349 F.3d 84 (2d Cir. 2003).

¹⁰⁶⁶ *Deaton v. Commissioner*, 440 F.3d 223 (5th Cir. 2006); *Ertman v. United States*, 165 F.3d 204 (2d Cir. 1999) (noting some earlier contrary authority in other circuits and the trend toward this holding as a better analysis); and *Vancanagan v. United States*, 231 F.3d 349 (Fed. Cir. 2000).

¹⁰⁶⁷ *Baral v. United States*, 528 U.S. 431, 439 n.2 (2000). And, even if the taxpayer were to send a notice of deficiency after full payment, the notice of deficiency would be invalid and thus could not be used as a “ticket” to invoke the jurisdiction of the Tax Court. *Conklin v. Commissioner*, 897 F.2d 1027 (10th Cir. 1990); and Patrick Thomas, Losing Jurisdiction through Excessive Payments – Designated Orders: May 27 – 31, 2019 (Procedurally Taxing (continued...))

obvious, by designating the remittance as a deposit, in the event for any reason that the IRS does not assert the deficiency or, alternatively some court ultimately holds that the taxpayer does not owe the additional \$1,000,000, the deposit will be returned with a lower rate of interest than the taxpayer could have obtained if it were a payment. Taxpayers in this situation might consider remitting \$950,000 designated as a payment of tax and \$50,000 designated as a deposit. Then, the IRS will have to issue a notice of deficiency for \$50,000.¹⁰⁶⁸

In this example the taxpayer will make the remittance before the IRS has actually made a determination of additional tax due. What happens if the taxpayer were to simply send a remittance to the IRS with the year properly designated but with no indication as to whether it is a payment or deposit? The IRS's records, of course, will not show a tax due against which to apply the remittance. If the IRS treats it as a payment on its records, it will show as an amount due the taxpayer (i.e., an overpayment). If the IRS treats it as a deposit, it will be placed in a suspense account designated as such and the taxpayer's account for the tax year will show a zero balance due to and from the taxpayer. In such a situation, some courts adopt a per se rule which treats as a deposit an undesignated remittance before the IRS records shows a tax due.¹⁰⁶⁹ Other courts adopt a "facts and circumstances" test.¹⁰⁷⁰ The better part of wisdom on a remittance is to state the nature of the remittance with specificity.

Taxpayers will sometimes seek to avoid their own designation of the remittance as a payment or deposit and may even succeed in doing so.¹⁰⁷¹ These adventures are risky, and the arguments were posited ex post facto after there was nothing to lose. The careful taxpayer and its practitioner will determine in advance the treatment—payment or deposit—it needs and so designate and even follow-through to ensure that the remittance was treated as designated.

¹⁰⁶⁷(...continued)

Blog 7/29/19) (this blog entry offers a nice statutory analysis, particularly focusing on the definition of deficiency in § 6211.

¹⁰⁶⁸ Obviously, the taxpayer might cut the margin thinner, depending upon the facts of the case.

¹⁰⁶⁹ *United States v. Dubuque Packing Co.*, 233 F.2d 453, 460 (8th Cir. 1956); *Thomas v. Merchantile Nat'l Bank*, 204 F.2d 943, 944 (5th Cir. 1953).

¹⁰⁷⁰ *Ertman v. United States*, 165 F.3d 204, 208-09 (2d Cir. 1999).

¹⁰⁷¹ *New York Life Insurance Company v. United States*, 118 F.3d 1553 (Fed. Cir. 1997), cert. denied 523 U.S. 1094 (1998) (taxpayer successfully argued that a remittance designated in the cover letter as a payment was a deposit with the result that the recovery was not subject to the refund limitations periods); and *United States v. Tate & Lyle North American Sugars, Inc.*, 162 F. Supp. 2d 236 (S.D. N.Y. 2001) (taxpayer arguing that a remittance designated in the cover letter as a deposit was a payment to assert the two year limitations period for erroneous refunds), an argument that the taxpayer ultimately lost in *United States v. Tate & Lyle North American Sugars, Inc.*, 228 F. Supp. 2d 308 (S.D. N.Y. 2002).

Note, for review, that, in *New York Life*, the remittance to the IRS was before the expiration of the statute but the assessment was after the expiration of the statute. The taxpayer wanted to avoid having the remittance treated as a payment because the rule of *Lewis v. Reynolds* would permit the Government to retain all of it. *Lewis v. Reynolds*, 284 U.S. 281, 283 (1932), modified by 284 U.S. 599 (1932) (while the statute barred a new assessment, taxpayer is still not entitled to a refund unless he overpaid his taxes). The taxpayer opted instead to argue that it was a deposit and therefore that the Government's assessment outside the period coupled with the converting the deposit to an assessment outside the assessment limitations period required that it be treated as an overpayment. § 6401(a). Normally, the taxpayer would prefer to have a remittance treated as a payment because, if it is entitled to receive the principal back, at the time of *New York Life*, a taxpayer would get full interest on a refund of a payment but got no interest on a return of a deposit. (Under the later enacted § 6603, the taxpayer does get some interest on a deposit but less than if it were a payment.) But treating the remittance as a payment would have precluded the taxpayer from getting the principal or any interest related thereto. By successfully urging that it was a deposit, the taxpayer in *New York Life* at least got the principal back.

Sometimes the IRS with a little nudging will make a taxpayer-friendly blurring of the distinctions between a payment and a deposit. Consider the following from an IRS legal memorandum.¹⁰⁷² The IRS levied upon and sold the taxpayer's real property. The net sales proceeds exceeded the taxes, penalties and interest, so the net was credited on the taxpayer's account as an overpayment and the taxpayer was entitled to a refund. The IRS so notified the taxpayer that he should file a claim for refund. The taxpayer nevertheless failed to make a timely claim for refund, apparently because he was suffering under the delusion that the proceeds were the work of the devil. The equities only generally favored the taxpayer but, as you know by now, the application of the refund statute of limitations does not consider the equities. (In this regard, the special statute of limitations under § 6511(h) for disability did not apply in this case.) The author nevertheless reasoned that the taxpayer's failure to claim a refund that was due transformed the payment into a deposit and, therefore, the deposit could be returned to the taxpayer because there is no statute of limitations on deposits. The cost to the taxpayer of procrastinating, of course, was that he lost interest on the amount during the period the IRS held it. However, by treating what appeared to be a payment as a deposit, the IRS was at least able to do some good for the taxpayer.

Strategically, on the front end, is it wise to remit as a deposit rather than a payment? The only advantage of the deposit is the right to request the payment back without going through the elaborate refund procedures. There is a cost to exercising the right to request the deposit back—i.e., if the taxpayer is ultimately held liable for the deficiency, then the return of the money will result in the accrual of deficiency interest. Further, if the remittance is a deposit rather than a payment and it is ultimately determined that the remittance exceeded the amount of the tax and interest due, the taxpayer will get a lower interest rate on the excess than the taxpayer would have received if it were a payment.¹⁰⁷³ For these reasons, I have never seen a case where, on the front end, the mere right to request immediate return of the money was so important as to outweigh the benefits of the straight payment of tax. That is not to say that I cannot imagine a case where a bond would be preferable; I just haven't seen one.¹⁰⁷⁴ And, because of the downsides of bonds, I recommend that practitioners be able to articulate a clear affirmative reason for remitting as a bond before recommending that to the client.

¹⁰⁷² ILM 200237001, reproduced at 2002 TNT 180-27 (9/17/02).

¹⁰⁷³ A good example of this phenomenon is *United States v. Domino Sugar Corporation*, cited above. There, although the taxpayer remitted as a bond, the IRS erroneously paid \$1,512,100 interest on the bond and then successfully sued to recover the interest erroneously paid. If the remittance had been a payment, the taxpayer would have been entitled to that interest.

¹⁰⁷⁴ To illustrate with a real example, some lawyers have used the "bond" remittance where the strategy was to avoid identifying the taxpayer to the IRS. The scenario involves a taxpayer who feels that he has committed an act of evasion and desires to get right with the IRS but fears that admitting the fraud will result in prosecution. The taxpayer's lawyer (or even a third lawyer, depending upon the number of layers the taxpayer wants to create) will send in an anonymous remittance for deposit with the IRS. Obviously, to have it treated as a payment, the taxpayer would have to identify himself so that the payment could be posted to his account. Taxpayers using this stratagem hope that, in the event they are discovered by the IRS, the anonymous payment will mitigate the IRS's incentive to prosecute or ability to convict, if prosecuted. Of course, as we will see, the voluntary disclosure program will achieve this effect for the taxpayer, so the continuing benefit of this strategy is doubtful. Nevertheless, one court faced with the strategy rejected an IRS attempt to force the lawyer to identify the taxpayer. The court held that, although the attorney-client privilege does not normally protect client identity, it could where it could be used as a last link in a chain to incriminate the taxpayer. *Baird v. Koerner*, 279 F.2d 623 (9th Cir. 1960) (but apparently reaching that conclusion under state law of California which it felt controlled); but see *In re Shargel*, 742 F.2d 61, 62 n. 2 (2d Cir. 1984). I discuss the so-called identity privilege further below in discussing privileges in tax investigations.

5. Related Party Transactions.

Many related party transactions involve transactions where one of the related parties makes payments that would otherwise be deductible to another related party who treats it as income. If, for some reason, the expense claimed is denied to the payor, thus resulting in a deficiency, the consequence to the related payee may be that its income should be reduced accordingly. The classic case for this situation is a § 482 adjustment. Let's use an example, USCO1 is related to USCO2 (both are U.S. taxpayers, hence their names in this example) but they do not file consolidated returns. They have a related party transaction where USCO1 pays USCO2 \$100 for services. (This is often called “transfer pricing”—the price at which goods and services are transferred between related parties.) Upon audit, the IRS focuses on the transfer pricing on the related party transaction and obtains a consent to extend the statute of limitations from USCO1. The IRS then determines that the proper transfer price for the services was \$50 and asserts a timely deficiency accordingly. By that time, assume that the USCO2's statute of limitations for claiming refunds has expired. Without anything further, USCO2 would be out of luck. However, the Regulations under § 482 may impose a requirement for a refund even if the statute has expired.¹⁰⁷⁵ The more prudent course would be for USCO2 to file a protective claim for refund when it first becomes aware that the IRS may make a § 482 transfer pricing adjustment to USCO1.

What happens, however, if the IRS obtained the consent to extend before the IRS has focused on the possibility of a § 482 adjustment and focuses on it only after the USCO2 claim for refund statute of limitations has expired. In that case, the relief implied in § 482 and the underlying regulations may be what the taxpayer has to rely upon.¹⁰⁷⁶ Alternatively, the taxpayer may have to rely upon equitable arguments (unlikely but worth a shot) or see if it can shoehorn relief into the mitigation provisions of the Code (highly unlikely).

But what if you have a situation where the related party adjustment is not made under § 482? Take the USCO1 and USCO2 example described. What if the IRS asserted its authority under § 162 to deny a portion of the overpaid expense because it was not ordinary and necessary? Just as with § 482, that adjustment would result in a deficiency to USCO1, but there would be no § 482 correlative adjustment to USCO2 and the regulations under § 482 would offer no possible relief. The necessary consequence of the adjustment to USCO1, however, is that USCO2 did not have income to the extent of the adjustment and may just be out of luck, subject to such relief as equitable principles or mitigation may apply. The practitioner must be diligent to file protective claims for refund, but there is obviously some risk in this situation. This, of course, is another reason not to sign consents to extend the statute of limitations.

Section 482 adjustments usually are made where one or more of the parties is a foreign taxpayer.¹⁰⁷⁷ The IRS would assert a § 482 adjustment to adjust the transfer pricing to tax the U.S. taxpayer on income previously reported by the related foreign taxpayer to a foreign jurisdiction. If

¹⁰⁷⁵ See *Collins Elec. Co. v. Commissioner*, 67 T.C. 911 (1977).

¹⁰⁷⁶ See *Collins Elec. Co. v. Commissioner*, *supra*.

¹⁰⁷⁷ This is because, in many related party transactions involving only U.S. companies, there is no net tax dollars at issue for the IRS because the parties are in the same tax brackets. Where one or more of the related parties are foreign taxpayers, however, the related party transactions may be used to push taxable income out of the U.S. tax regime and into the foreign tax regime. In those cases, there can be quite large U.S. tax dollars affected by § 482 adjustments.

the U.S. taxpayer(s) underpaid its (their) U.S. tax, it is typical that the related foreign taxpayer(s) overpaid its (their) foreign country tax liabilities. Obviously, there will be no U.S. tax rules that can hold open the foreign country refund statute of limitations. So, the taxpayer must pay careful attention to those foreign country refund statutes of limitation in order not to be whipsawed into double taxation. The principal treaties under the U.S. tax treaty network—with many but not all countries—deal with this possibility of double taxation as a result of transfer pricing adjustments by one of the treaty partners.¹⁰⁷⁸ Under the treaties, the treaty partners commit to consult under a Mutual Agreement Procedure (“MAP”) to reach a consistent transfer price for their respective tax purposes. The treaties have language which arguably requires the treaty partner not initiating a transfer pricing adjustment in a MAP to open an otherwise closed statute of limitations for refunds.¹⁰⁷⁹ The language is somewhat uncertain, so U.S. taxpayers subject to potential U.S. transfer pricing adjustments involving foreign related taxpayers are cautioned to take measures under foreign country law to protect the foreign country refund statute of limitations.¹⁰⁸⁰

C. The Refund Suit.

There is still another key statute of limitations that relates to refunds—the period during which a taxpayer must institute a suit for refund. The suit for refund may be brought only **after** the taxpayer has filed a claim for refund or credit under the regulations and the IRS has denied the claim for refund or the claim for refund has been filed for six months without IRS action. § 6532(a)(1); and § 7422(a).¹⁰⁸¹ Then, if the claim is actually denied, the suit for refund must be actually filed—timely mailing will not work—within two years from the date of the notice of disallowance of the claim. § 6532(a)(1).¹⁰⁸² If, in some rare cases of additional consideration after a notice of

¹⁰⁷⁸ The U.S. treaties are often called “Double Tax Treaties” as a short form reference to the usual formal title an example of which is: “The Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains.” Transfer pricing adjustments are not the only form of potential double taxation dealt with in the treaties.

¹⁰⁷⁹ See paragraph 2 of Article 25 of the Model Treaty; and Treasury Explanation Article 9, paragraph 2 (re waiver of procedural barriers).

¹⁰⁸⁰ Rev. Proc. 96-13, 1996-1 C.B. 616 (a taxpayer facing a U.S. initiated adjustment must take protective steps in the treaty country to protect the statute of limitations so that the competent authority process can be effective).

¹⁰⁸¹ As to whether § 7422(a)’s claim filing and exhaustion requirements are jurisdictional, see *Gillespie v. United States*, 670 Fed. Appx. 393, 394-395 (7th Cir. 2016) (suggesting that there may be doubt as to § 7422(a)’s requirement that filing a timely claim for refund and exhausting the claim remedy is jurisdictional); see Carl Smith (Guest Blogger, [Is the Requirement to File a Refund Claim Before Bringing Suit Waivable?](#)) (Procedurally Taxing Blog 1/18/19) (citing *Gillespie*).

¹⁰⁸² Like the notice of deficiency, the notice of disallowance of the claim for refund need only be mailed by certified or registered mail; there is no requirement that the taxpayer receive the notice of disallowance. *Id.*; see *Rosser v. United States*, 9 F.3d 1519 (11th Cir. 1993). Another formality for the notice of disallowance is that the IRS “provide the taxpayer with an explanation for such disallowance.” § 6402(l).

To state the obvious, where the 2-year statute of limitations applies, the suit has to be actually filed in the court within that 2-year period. There is the potential for limited relief from a late filing in the Court of Federal Claims, but that potential is so narrow as to be almost nonexistent. See *Langan v. United States*, 2013 U.S. Claims LEXIS 740 (2013) (possibility that mailed complaint when it could, in normal course, have timely arrived at court will be deemed timely filed even if untimely received and filed by the court; not applied in case because taxpayer’s lawyer placed in mail so late that its timely delivery was not assured). I hope everyone reading about or reading the *Langan* case will do better. There is no timely-mailing, timely-filing for refund suits.

There is still a further qualification on the statement that there is no timely-mailing, timely-filing for refund (continued...)

disallowance, that first notice starts the two year period even if there is a later notice erroneously stating that it is the notice of disallowance.¹⁰⁸³ And the taxpayer cannot obtain a new refund suit statute of limitations by filing a second claim for refund asserting the same claim as in the first.¹⁰⁸⁴

This means that the key statute of limitations—beyond which the taxpayer is prohibited from filing a suit for refund—is based on the date of denial of the claim. But can a taxpayer tarry indefinitely if the denial of the claim is overly extended? Maybe, maybe not. 28 U.S.C. § 2401(a) 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.” The courts are in conflict as to whether § 2401 applies to close the statute after 6 years from accrual (presumably the accrual being 6 months after the refund claim is filed, because that is the earliest date the taxpayer may file a suit for refund).¹⁰⁸⁵ The IRS, however, published an informal Chief Counsel Notice reiterating its long-standing position that § 2401(a) does not apply and hence the taxpayer who has not received notice has an indefinite period in which to file suit for refund.¹⁰⁸⁶

As with the assessment statute of limitations, the IRS and the taxpayer may extend this two year period by written agreement.¹⁰⁸⁷ Also, another way to achieve the same thing (extension of the

¹⁰⁸²(...continued)

suits. The Tax Court has jurisdiction to determine a refund, and petitions for redetermination are subject to the timely-mailing, timely-filing rule.

¹⁰⁸³ § 6532(a)(4); see *Palm v. United States*, 2014 U.S. Claims LEXIS 500 (2014).

¹⁰⁸⁴ *Haber v. United States*, 17 Cl. Ct. 496, 509 (1989); *Jones v. United States*, 26 Cl. Ct. 424, 425 (1992), aff'd, 988 F.2d 131 (Fed. Cir. 1993)).

¹⁰⁸⁵ See *Detroit Trust Co. v. United States*, 131 Ct. Cl. 223 (Ct. Cl. 1955) (the principal case cited for the proposition that § 2401(a) does not apply, so that the tax refund suit statute of limitations extends indefinitely) with *Wagenet v. United States*, 2009 U.S. Dist. LEXIS 115547 (C.D. Cal. Sept. 14, 2009) (holding that § 2401(a) does apply so that the taxpayer must sue within 6 years and pronouncing that *Detroit Trust* was wrongly decided); and *Hale v. United States*, 143 Fed. Cl. 180, 188 n.5 (Fed. Cl. 2019) (holding consistent with *Wagenet* but the precedential authority of the *Hale* comments may be questionable. See Ct Fed Cl. General Order No. 1(1) providing “(1) All published decisions of the United States Court of Claims are accepted as binding precedent for the United States Claims Court, unless and until modified by decisions of the United States Court of Appeals for the Federal Circuit or the United States Supreme Court.” Discussions of this issue continued viability of § 2401(a)’s six-year limitations period may be found in: John Kendrick, Note, (Un)Limiting Administrative Review: Wind River, Section 2401(a) and the Right to Challenge Federal Agencies, 103 VA. L. REV. 157, 191, 208-209 (2017) (arguing that Wind River would preclude injured plaintiffs simply because they did not have standing within six years of the agency final action, and that instead the right of action should accrue when a particular plaintiff exists and suffers a legal wrong); and Susan C. Morse, Out of Time? APA Challenges to Old Tax Guidance and the Six-Year Default Limitations Period (SSRN Available at SSRN: <https://ssrn.com/abstract=4191798> 1/10/23 draft) (arguing application of § 2401(a)’s six-year statute for the outside limit for refund claims once they have accrued (meaning upon the later of two years after the claim denied or six-years after the claim for refund was filed).

¹⁰⁸⁶ CCN 2012-012 (6/1/12), reproduced at 2012 TNT 108-12, citing Rev. Rul. 56-581, 1956-2 C.B. 953.

¹⁰⁸⁷ § 6532(a)(2). The Form 907 is used for this extension. There is a subtlety here in comparing this extension to the assessment extension in § 6501(c)(4)(A). By its express terms, the latter extension must be executed before the statute otherwise expires but that express language does not appear in § 6532(a)(2). The IRS ruled in Rev. Rul. 71-57, 1971-1 C.B. 405, that § 6532(a)(2) nevertheless should be interpreted to include that requirement. In *Kaffenberger v. United States*, 314 F.3d 944 (8th Cir. 2003), the court held contrary to the Rev. Rul. The IRS has indicated that, in other circuits, it will continue to apply the rule of the Rev. Rul. In a nonacquiescence in *Kaffenberger* at 2004-35 I.R.B. 1, reproduced at 2004 TNT 171-4, the IRS noted that it “disagree[s] with the court’s refusal to follow a published ruling,” which seems to suggest that the IRS believes the court should have deferred to the interpretation in the ruling. This notion hearkens back to the issue discussed earlier in Chapter 2 regarding deference for IRS

(continued...)

statute of limitations) is to have the IRS withdraw the notice of disallowance, but getting the IRS's action—here withdrawal—in writing is the better part of wisdom rather than relying upon informal understandings.¹⁰⁸⁸

This two year statute in which a refund suit must be filed is not a prohibition upon the IRS allowing a refund after that two year period provided that the taxpayer asked for reconsideration during the two year period.¹⁰⁸⁹

Finally, I have stated the two year limitations period as if it is absolute. If the two-year period is deemed jurisdictional, the limitations period is absolute.¹⁰⁹⁰ If, however, the two-year period is not jurisdictional, it may be subject to equitable tolling.¹⁰⁹¹ In 2018, a district court held the two-year period to be nonjurisdictional.¹⁰⁹²

V. Abatements of Erroneous Assessments.

Section 6404(a) authorizes the IRS to abate an assessment of tax (or liability) which is “(1) is excessive in amount, or (2) is assessed after the expiration of the period of limitation properly applicable thereto, or (3) is erroneously or illegally assessed.” All of these alternatives seem straight-forward. For example, if the taxpayer has been assessed \$100 in tax or interest but shows that the correct tax or interest liability is \$50 rather than the \$100 assessed, under subparagraph (1), the IRS can abate the excessive \$50 amount assessed.¹⁰⁹³

¹⁰⁸⁷(...continued)

administrative interpretations of the Code, although it does not mention the word deference or cite the deference cases.

¹⁰⁸⁸ Section 6532(a)(4) provides that IRS reconsideration after issuing a notice of disallowance “shall not operate to extend the period within which suit may be begun.” See *Cadreja v. United States*, 104 Fed. Cl. 296 (2012) (discussing and limiting cases where an IRS orally withdrew the notice of disallowance to situations where the withdrawal was specifically discussed between the taxpayer or the representative and the IRS and agreed orally.)

¹⁰⁸⁹ Section 6532(a)(4) allows such requests for reconsideration of the notice of disallowance but prevents the 2 year statute of limitations for filing the refund suit on the original notice of disallowance from being suspended. The Internal Revenue Manual permits Appeals to consider such and allow, if appropriate, a request for reconsideration even after the 2 year refund suit statute of limitations provided that the request was filed during the period. See ILM 201048030 (8/5/10), reproduced at 2010 TNT 233-34. However, I am not sure the reasoning which says that there is no prohibition on a post 2 year period allowance of a refund compels the conclusion that the taxpayer must request reconsideration in the 2 year period. The IRS in the administration of the Code might place that requirement as a practical way to make the 2 year statute for refund suits meaningful, but it certainly is not a compelled one.

¹⁰⁹⁰ *Kaffenberger v. United States*, 314 F.3d 944 (8th Cir. 2003); and *RHI Holdings, Inc. v. United States*, 142 F.3d 1459 (Fed. Cir. 1998).

¹⁰⁹¹ The leading authority is a nontax case, *Irwin v. Dep't of Veterans Affairs*, 498 U.S. 89 (1990). More recent nontax cases evidencing some more permissiveness for equitable tolling are *Henderson v. Shinseki*, 562 U.S. 428 (2011); and *United States v. Kwai Fun Wong*, 575 U.S. 402 (2015). As I noted earlier, the period for filing a claim for refund is considered jurisdictional thus requiring Congress to provide statutorily for any period of tolling for filing a claim for refund.

¹⁰⁹² *Wagner v. United States*, 353 F. Supp. 3d 1062 (E.D. Wash. 2018) (relying significantly on the more recent Supreme Court nontax cases and on *Volpicelli v. United States*, 777 F.3d 1042 (9th Cir. 2015), tolling the wrongful levy suit period in § 6532(c) (which has been revised since *Volpicelli* but not affecting this issue)).

¹⁰⁹³ In *King v. Commissioner*, 829 F.3d 795 (7th Cir. 2016), dealing with abatement of interest rather than tax, the Seventh Circuit reversed the Tax Court's holding that “excessive” could mean “unfair.” The Court cited several reasons, including the indeterminacy of the concept of “unfair” and the *Chevron* appropriate regulation saying that, in the context of tax, “excessive” means “in excess of the correct tax liability,” with the conclusion that, as to interest, it must mean in excess of the correct interest. See Reg. § 301.6404-1(a).

As noted above, however, the taxpayer still must claim his right to a refund timely, and, if he fails to do so, the statute of limitations on refunds will prevent the IRS from refunding the tax. If for some reason, after the statute of limitations for refund has closed, the taxpayer establishes his or her right to an abatement, the IRS may make the abatement because there is no statute of limitations on abatement.¹⁰⁹⁴ The problem, of course, is that the IRS cannot refund or credit the abated tax liability, if paid, to the taxpayer and, instead, the payments will be posted internally by the IRS to the Excess Collections File.

VI. Erroneous Refund Remedies.

A. Introduction; Rebate Refunds and Nonrebate Refunds.

If the IRS makes an erroneous refund, may the IRS recover the erroneous refund (or does the taxpayer get to keep the refund)?¹⁰⁹⁵ The IRS does have remedies to recover the erroneous refund. However, to understand the availability of the remedies we must divide erroneous refunds into two categories.¹⁰⁹⁶

First, there are erroneous refunds that the IRS affirmatively intended to make because it erroneously determined that the taxpayer was entitled to the refund based on a mistake as to the merits of the taxpayer's tax liability. An example of this first category of erroneous refund is: the taxpayer files a claim for refund and, upon review, the IRS improvidently but intentionally grants the refund. This first category of erroneous refund is a "rebate refund." Rebate refunds are refunds the IRS intends to make based on substantive calculation of the taxpayer's liability.¹⁰⁹⁷ These refunds are the IRS's substantive determination that less tax is due than has been paid in. Second, there are other refunds that do not reflect a redetermination of tax liability. An example of this category is the IRS's improvident double crediting of a single payment to the taxpayer so that the taxpayer's account shows a credit that is then refunded. This second category of erroneous refund is a "nonrebate refund."¹⁰⁹⁸

¹⁰⁹⁴ ILM 200915034 (3/2/2009), published at 2009 TNT 68-16.

¹⁰⁹⁵ An erroneous refund includes any refund after the period for filing a claim for refund has expired or the period for filing a suit for refund has expired. § 6514(a).

¹⁰⁹⁶ See Bryan T. Camp, The Mysteries of Erroneous Tax Refunds, 114 Tax Notes 231 (Jan. 15, 2007).

¹⁰⁹⁷ § 6211(a)(2) and (b)(2); *Acme Steel Co. v. Commissioner*, T.C. Memo. 2003-118.

¹⁰⁹⁸ See *Acme Steel Co., Inc. v. Commissioner*, T.C. Memo. 2003-118 for a good discussion of the differences between the rebate and nonrebate refund. *Acme Steel* discusses the key cases, including *O'Bryant v. United States*, 49 F.3d 340 (7th Cir. 1995). See also Bryan T. Camp, The Mysteries of Erroneous Tax Refunds, 114 Tax Notes 231 (Jan. 15, 2007) & 2007 TNT 11-55 (1/16/07).

B. Rebate Refunds.

1. Deficiency Procedures.

Rebate refunds require a new assessment which can be made only if the statute of limitations for assessment is still open.¹⁰⁹⁹ For income and estate and gift taxes, this requires the ubiquitous predicate notice of deficiency.¹¹⁰⁰ The taxpayer is then accorded a Tax Court prepayment remedy to contest whether the refund was erroneous and will also have available a traditional refund remedy if he pays the erroneous refund amount asserted by the IRS.

2. Erroneous Refund Suits.

The IRS may also recover erroneous rebate refunds through the erroneous refund suit. § 7405(a) & (b).¹¹⁰¹ The statute of limitations for the erroneous refund suit is two years from the date of the refund, except that it is extended to five years if the erroneous refund was induced by fraud or misrepresentation of a material fact. § 6532(b).¹¹⁰² Note that the predicate for the extended period is in the disjunctive. Is there a difference between fraud and misrepresentation? Obviously, in terms of reprehensible behavior, fraud is a stronger word. Does the term misrepresentation include innocent misrepresentations (no culpability or even negligence in the speaker, just error)? Or does it at least require some negligence? That is not yet definitively decided.¹¹⁰³

¹⁰⁹⁹ See *In re Becker*, 407 F.3d 89, 97 (2d Cir. 2005); and §§ 6211-6215. For the types of taxes requiring a predicate deficiency notice before assessment, the deficiency notice for the amount of the erroneous refund must be issued within the applicable assessment period of limitations. I have assumed in the text that the taxpayer really owed the tax that the IRS erroneously refunded. The Tax Court noted in *Allcorn v. Commissioner*, 139 T.C. 53, 60 n. 5 (2012) that an erroneous refund can be made to a taxpayer who actually has no liability, so the deficiency notice is not a tool that can be used to reinstate an assessment for the amount of the erroneous refund; in that case the IRS must pursue the erroneous refund by suit as an erroneous refund.

¹¹⁰⁰ Section 6211(a) defines the deficiency in relevant part as the amount of tax due, *less* the tax reported and assessed and *plus* the amount rebated. So, if the taxpayer owed \$200 and reported \$100 and the IRS subsequently made a rebate refund (intended, erroneously, to make the refund) of \$50, the deficiency would be \$150 (tax due of \$200 *less* amount reported and assessed of \$100 and *plus* the \$50 rebate refund). See *United States v. Frontone*, 383 F.3d 656, 661 (7th Cir. 2004) (“A deficiency can * * * arise as a result of a determination that the rebate * * * was in error.”).

¹¹⁰¹ Section 7405 is a codification of the United States right to recover “money wrongfully or erroneously paid from the public treasury.” *United States v. Wurts*, 303 U.S. 414, 416, 58 S. Ct. 637, 82 L. Ed. 932 (1938).

¹¹⁰² The courts have held that the statute starts running when the taxpayer, having deposited the erroneous refund check, the erroneous refund check then clears the Federal Reserve and payment is actually made by the IRS. *O’Gilvie v. United States*, 519 U.S. 79, 91 (1996); *United States v. Commonwealth Energy Sys. and Subsidiary Cos.*, 235 F.3d 11, 14 (1st Cir. 2000); and *United States v. Greene-Thapedi*, 398 F.3d 635 (7th Cir. 2005). See When Does the Statute of Limitations Start on the Erroneous Refund Suit? (Federal Tax Procedure Blog 4/29/21).

¹¹⁰³ See e.g., *Lane v. United States*, 286 F.3d 723 (4th Cir. 2002), discussing the cases and noting the Government’s position that even innocent misrepresentations trigger the extended statute but not deciding the issue because the facts showed gross negligence. In *United States v. Northern Trust Company*, 372 F.3d 886 (7th Cir. 2004), the Court observed pithily: “‘Misrepresentation’ differs from ‘fraud;’ otherwise § 6532(b) would be redundant.” The court noted the Government’s position that even innocent misrepresentations trigger the longer statute of limitations. But, beyond observing that misrepresentation is less than fraud, the court did not resolve the issue of whether the misrepresentation must be grossly negligent, simply negligent or not negligent at all, so long as it was a misrepresentation.

Caveat as to misrepresentation: The IRC contains provisions, variously worded, that provide exceptions to a prescribed result when certain conditions, including misrepresentation, are present. The ones relevant to this course are: §§ 6231(b) (if FPAAs issued and petition filed, no more FPAAs permitted “in the absence of a showing of fraud,
(continued...)

In an erroneous refund suit, the Government bears the burden of proving both that some amount has been erroneously refunded and what the amount is.¹¹⁰⁴

Can the Government use its common law offset authority or its § 6402(a) offset authority to collect an erroneous refund? The answer to that is probably yes as to the common law authority but no under § 6402.¹¹⁰⁵ But can the IRS use that offset authority after the period of limitations that it is permitted to file an erroneous refunds suit? The answer to that is uncertain, but the IRS has interpreted its general offset authority to expire when the erroneous refund suit limitations period expires.¹¹⁰⁶

3. Offsets to Claims for Refund.

I discuss below the equitable doctrine of offsets, but note here that, under that doctrine, the Government may assert in defense of a refund claim that the taxpayer owed more tax for the year based on a previously unconsidered item, even if the statute of limitations is not otherwise open for the year. So too may the Government assert an erroneous refund as a basis for offsetting an otherwise valid refund claim, even if the time to assess or sue for the erroneous refund is past.¹¹⁰⁷ In the refund matter, the issue is still whether the taxpayer is entitled to a refund for the year and he may not be to the extent that he has previously received an erroneous refund for the year.

C. Nonrebate Refunds.

The IRS may not use the deficiency procedures to pursue erroneous nonrebate refunds. Nonrebate refunds do not require a new assessment. The old assessment improperly abated can be

¹¹⁰³(...continued)

malfeasance, or misrepresentation of a material fact); 6532(b) (statute of limitations on erroneous refund suit is 2 years except extended to 5 years if “any part of the refund was induced by fraud or misrepresentation of a material fact”); and 7121(b) (closing agreement final except for “fraud or malfeasance, or misrepresentation of a material fact” (Note, § 6231(b) is the successor to repealed TEFRA § 6223(f) similarly worded.) Depending upon context, the word “misrepresentation” may mean either an innocent misrepresentation of fact or requires some level of culpability (at least negligence, but usual intent to deceive). E.g., *Halpern v. Commissioner*, T.C. Memo. 2000-151 (“For purposes of section 7121, a misrepresentation is not synonymous with a mistake: It denotes something more deliberate or more conscious than mere error or mistake.” (Internal quotations omitted)); and *NPR Invs., L.L.C. v. United States*, 740 F.3d 998 (5th Cir. Tex. 2014) (§ 6223(f), barring a second FPAA notice except for “fraud, malfeasance, or misrepresentation of a material fact,” does not require intent to deceive for misrepresentation and even innocent misrepresentations can apply).

¹¹⁰⁴ *United States v. McFerrin*, 570 F.3d 672, 675 (5th Cir. 2009) (quoting *Soltermann v. United States*, 272 F.2d 387, 387 (9th Cir. 1959)); see also 26 U.S.C. § 7405. In this sense, it resembles a suit for money suit, like the refund suit, where the taxpayer as plaintiff claiming a refund must prove that he is entitled both to a refund and the amount he is entitled to.

¹¹⁰⁵ PMTA 2011-035 (8/8/11), reprinted at 2012 TNT 18-23. I think the reason under §6402 is that the tax in question must be assessed, assessable or subject to a pending notice of deficiency. Erroneous refunds of income tax would not generally satisfy these conditions.

¹¹⁰⁶ PMTA 2011-035 (8/8/11), reprinted at 2012 TNT 18-23.

¹¹⁰⁷ For an interesting application of this concept, see *United States v. Peterson*, 738 F. Supp. 2d 869 (CD IL 2010). In *Pacific Gas and Electric Co. v. United States*, 417 F.3d 1375 (Fed. Cir. 2005), rehearing and rehearing en banc denied, 2006 U.S. App. LEXIS 1632 (Fed. Cir. 2006), the court recognized the principle stated in the text, but found that, for technical reasons, it did not apply to refund interest overpaid by the IRS on an earlier refund. The IRS has non-acquiesced in the Federal Circuit’s decision at AOD 2006-02; 2006-26 I.R.B. 1.

reinstated by eliminating the improper abatement.¹¹⁰⁸ The IRS can then pursue administrative collection measures based on the revised assessment and/or pursue the erroneous refund suit discussed above.¹¹⁰⁹

VII. The Catch-All Civil Penalty Statute of Limitations - 28 U.S.C. § 2462.

28 U.S.C. § 2462 provides (in part here relevant):

Except as otherwise provided by Act of Congress, an action, suit or proceeding for the enforcement of any civil fine, penalty, or forfeiture, pecuniary or otherwise, shall not be entertained unless commenced within five years from the date when the claim first accrued * * *.

In the IRS procedural universe, this statute applies to collection actions rather than the assessment of a penalty (which for IRC penalties do not accrue until assessed¹¹¹⁰). Section 6502(a)(1) does otherwise provide a 10 year collection period after assessment.¹¹¹¹ A recent case held that § 6038(b) penalties for failure to file Form 5471 cannot be “assessed” because there was no statutory authority to assess, thus limiting collection measures to a collection suit in district court.¹¹¹²

VIII. Smoothing the Harsh Effects of Statutes of Limitation.

A. The Problem - Statutes of Limitation Can Be Harsh.

Statutes of limitations are designed to draw objective finality to potential disputes. Mere unfairness in denying a remedy for a valid claim is generally not enough to pre-empt the intended operation of statutes of limitation. Congress and the courts have, however, recoiled in some cases where a party—a taxpayer or the IRS—tries to take advantage of the statute of limitations by claiming a double benefit. A double benefit is a benefit in the year that is closed by the statute of limitations and another benefit in an open year which is not consistent with having claimed the benefit in the closed year.

¹¹⁰⁸ In *Schuster v. Commissioner*, T.C. Memo. 2017-15, the IRS had erroneously credited an amount against a tax liability for a year but later, upon discovering the error, reversed the credit, thereby causing the unpaid assessed liability to return to the amount prior to the erroneous credit. The IRS did not refund any money in the process to the taxpayer. The Court held that the reversal was proper and that neither an erroneous refund suit nor a new assessment was required.

¹¹⁰⁹ See *Acme Steel Co., Inc. v. Commissioner*, *supra*.

¹¹¹⁰ *Crim v. Commissioner*, T.C. Memo. 2021-117, at *16-18, *aff'd* 66 F. 4th 999 (D.C. Cir. 2023) (both citing *Mullikin v. United States*, 952 F.2d 920, 928 (6th Cir. 1991)); and *Sage v. United States*, 908 F.2d 18, 25 (5th Cir. 1990)). Both the Tax Court opinion and the D.C. Cir. panel opinions in *Crim* note that this is consistent with the unlimited statute of limitations to assess regular tax in cases of fraud because fraud is required by the § 6700 penalty.

¹¹¹¹ *Crim v. Commissioner*, T.C. Memo. 2021-117, at *14-18, *aff'd* 66 F. 4th 999 (D.C. Cir. 2023)

¹¹¹² *Fahry v. Commissioner*, 160 T.C. ___, No. 6 (2023). I am not sure that *Fahry* was correctly decided. Assuming that *Fahry* was correctly decided, § 2462 would apply to the § 6038(b) penalties. The issue then would be to determine correctly the starting date for the 5-year limitations period—i.e., according to the statute the date the liability “accrues.” That date is apparently the date of the delinquency penalized rather than when the delinquency was or should have been discovered. See [Tax Court Holds that IRS Has No Authority to Assess § 6038\(b\) Penalties for Form 5471 Penalties](#) (Federal Tax Procedure Blog 4/3/23; 4/4/23) (citing *Gabelli v. S.E.C.*, 568 U.S. 442 (2013) reasoning that a discovery date rule which applies to actions for compensation but not for government penalties).

In this section we will explore some limited contexts in which Congress and the courts have seen fit to provide relief from the statute of limitations, particularly in the context of some double benefit. These contexts are limited, so that you should be aware that Congress and the courts have limited tolerance for overriding tax statutes of limitations because, from an overall policy and tax administration perspective, statutes of limitations are necessary.

B. The Protective Claim for Refund.

A taxpayer may file a timely protective claim for refund to deal with a refund statute of limitations that is about to expire.¹¹¹³ Such a protective claim for refund may be desirable in several circumstances.

First, the taxpayer may be aware that a refund is due but cannot complete a proper claim for refund within the statutory period. A timely **protective** claim (stating as much of the nature and amount of the claim as reasonable with a statement that it is protective with the reason more definitive claim cannot be made and with the expectation of further refinement by amended claim) followed up by a more detailed amended claim even if outside the refund claim period will usually do the trick.¹¹¹⁴ The risk, as noted above, is that the IRS may deny the deficient protective claim before a proper amended claim can be filed, but that risk is usually solved by advising the IRS on the protective claim or the cover letter for the protective claim what the problem is, so that the IRS can defer action to give the taxpayer time to prepare a proper amended claim. I have found in my practice that the IRS is willing to work with taxpayers to give them the time that they need.

Second, as discussed above, where the IRS (or even a foreign tax authority) proposes adjustments that, if made, would mean that a related U.S. taxpayer's taxes have been overpaid, a timely protective claim can be made to protect against the expiration of the refund statute of limitations. This situation is frequently encountered in cross-border transfer pricing adjustments.¹¹¹⁵ It may also be encountered in more common situations illustrated by leading cases where a protective claim was not filed (as discussed later in this section) such as:

- A decedent's estate makes a payment to an individual and reports the payment as a bequest (hence no deduction in computing estate tax), and the IRS subsequently determines that the recipient received taxable income because the payment was received in consideration for services rendered decedent prior to death (which would mean that the estate should have deducted the payment in computing the estate tax). The refund statute of limitations for estate may have closed before the matter is resolved with the individual.

¹¹¹³ The protective claim is recognized in 1.5.3.4.7.3 (10-01-2018), Protective Claims; see also ILM 200547011 (8/5/05). In the ILM, the IRS stretched a bit to reach a taxpayer favorable and just result.

¹¹¹⁴ *United States v. Kales*, 314 U.S. 186 (1941). The IRS has indicated that de minimis refund claims such as \$1 stripped of detail may not be treated as a valid refund claim that will hold open the refund statute of limitations that can later be refreshed with an amended claim for refund. Keith Fogg, [Nominal Refund Claims \(Procedurally Taxing Blog 3/28/23\)](#) (discussing Program Manger Technical Assistance (PMTA) 2023-001).

¹¹¹⁵ Similarly, the IRS encourages taxpayers subject to IRS proposed adjustments that, if sustained, would mean that a related foreign taxpayer's taxes were overpaid to a foreign country to protect the refund statute of limitations in the foreign country via filing a protective claim or similar device in the foreign country.

- A decedent's estate reports on the estate tax return a low value for property that is left to an individual who sells the property upon receipt claiming as his or her basis the estate tax return value and the IRS later determines in an audit of the estate tax return that the property was valued too low. The refund statute of limitations for the individual may have closed before the matter is resolved with the estate.

Third, there may be circumstances where there is some event that is not known that might justify a refund but there is some reasonable expectation that it may become known after the normal expiration of the statute of limitations. A protective refund may be appropriate in such cases.¹¹¹⁶

I do not attempt to catalogue here all of the circumstances in which a timely protective claim might be used. Even in the absence of a timely protective claim for refund, some of these problems are resolved through application of principles and rules discussed later in this section. Nevertheless, because of some of the uncertainty and hassle of invoking these potential remedies, the timely protective claim is the best insurance and usually has no downside.¹¹¹⁷

C. General Equitable Principles.

The Code's time limits (often called statutes of limitations) are classified for some purposes as either jurisdictional or nonjurisdictional. (See the discussion starting p. 181, above.) The question is how rigid the time limits are. If the time limits are rigid time limits that must be met without exception, they are called jurisdictional because failure to meet the time limit will deprive a court or an agency of "jurisdiction" to grant the relief requested. By contrast, if a time limit is nonjurisdictional, it may not be quite so rigid, and may permit relief by way of "tolling" or suspending the time limit in certain cases. Ultimately, the question the distinction is based upon the court's interpretation of the time limit (both the text and the context) as evidencing Congress's choice that the time limit be rigid or, alternatively, permit some tolling or suspension of the time limit based on traditional equitable considerations.

Consider the time limits on filing a claim for refund and then suing for refund. In *United States v. Brockamp*, 519 U.S. 347 (1997), the taxpayers filed claims for refund beyond the normal statute of limitations for claims for refund. The taxpayers' disabilities rendered them unable to file their claims within the times prescribed. The issue was whether, under general equitable principles applicable with respect to some other types of claims against the Government, the statute of limitations could be equitably tolled by disability. In an earlier case¹¹¹⁸ involving a nontax statute of limitations, the Court had held that statutes of limitation may be equitably tolled, framing the inquiry to be whether there was good reason to believe that Congress intended strict compliance

¹¹¹⁶ Rev. Proc. 2011-48, 2011-42 I.R.B. 527 deals with such a situation where amounts otherwise deductible against the gross estate that would be deductible if paid but payment is deferred beyond the normal refund filing date. In those cases, a protective claim for refund is allowed; the Rev. Proc. sets forth the procedures for filing the protective claim.

¹¹¹⁷ For this reason, some authorities advise with respect to protective claims: "File them early; file them often." Burgess J.W. Raby and William L. Raby, Protecting the Protective Refund Claim, 2003 TNT 79-4 (4/24/03) (quoting an earlier article).

¹¹¹⁸ *Irwin v. Department of Veterans Affairs*, 498 U.S. 89 (1990).

with the statute of limitations. In *Brockamp*, the Court held that textually and in context § 6511 indicated a Congressional intent that there should be no equitable tolling.¹¹¹⁹

After *Brockamp*, Congress provided for limited equitable tolling in § 6511(h) which now permits a suspension of the statute of limitations on claiming refunds during the period that an individual taxpayer is “financially disabled,” defined to mean the “individual is unable to manage his financial affairs by reason of a medically determinable physical or mental impairment of the individual which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months.”¹¹²⁰ The relief does not apply during any period that the individual spouse or any other person (e.g., a guardian or person acting under a power of attorney) is authorized to handle the individual’s affairs.¹¹²¹ Further, the relief is not available if the taxpayer is distracted from his personal affairs while caring for someone who is disabled.¹¹²² Finally, the relief is only available to an “individual,” so that it is not available to any entity (such as a corporation or estate) which necessarily operates through individuals who may be financially disabled.¹¹²³

Brockamp dealt only with the refund statute of limitations in § 6511. The Court found support for not permitting tolling in the detailed statutory scheme itself. This reasoning did not foreclose the inquiry as to other time limitations in the Code where the time imperative may not be so clearly pronounced.¹¹²⁴

¹¹¹⁹ Although not dealing with equitable principles per se, the Supreme rejected a taxpayer’s attempt to end run the refund claim statute of limitations by dressing the refund suit up as a Tucker Act suit. In *United States v. Clintwood Elkhorn Mining Co.*, 553 U.S. 1, 128 S.Ct. 1511 (2008), the taxpayer paid a coal excise tax that was subsequently invalidated as violating the Constitution’s Export Clause. The general 2/3 year statute for filing claims for refund limited the taxpayer’s ability to obtain a refund of tax. The Tucker Act is the general jurisdictional act for claims against the Government and has a 6 year statute of limitations, hence the taxpayer sought to characterize its claim as a general claim rather than a tax claim. As in *Brockamp*, the Court said that the refund statute was straight-forward and emphatic in limiting tax claims to the prescribed period. And, if it looks and acts like a tax, that is what it is and the taxpayer must meet the prescribed statute of limitations. It just does not matter that, when paid, albeit then unbeknownst to the taxpayer, the tax was unconstitutional.

¹¹²⁰ § 6511(h)(2)(A). The statute requires that the taxpayer be an individual. Hence, a corporate taxpayer’s statute of limitations is not affected even though its responsible corporate officer is financially disabled. *Alternative Entertainment Enterprises, Inc. v. United States*, 2008 U.S. App. LEXIS 13997 (6th Cir. 2008) (unpublished opinion). For the procedure for making the claim for relief under § 6511(h), see Rev Proc 99-21, 1999-1 C.B. 960 and *Estate of Rubinstein v. United States*, 95 Fed. Cl. 460 (2011) (holding that following the procedures merely protects the claim procedurally but the taxpayer must also satisfy the underlying requirements for relief); see also *Stauffer, Administrator v. IRS*, 285 F. Supp. 3d 474 (D. Mass. 2017) (holding that the Government has not established the *State Farm* requirement of reasonableness in Rev. Proc. 99-21’s requirement that the proof of financial disability include a written statement of a “physician” as defined in the Social Security Act which excludes psychologists. See *Motor Vehicle Mfrs. Ass’n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (commonly referred to as *State Farm*)). See also *Stauffer v. IRS*, 939 F.3d 1 (1st Cir. 2019) (holding that authority to handle financial matters is the key rather than duty to handle financial matters).

¹¹²¹ See *Stauffer v. IRS*, 939 F.3d 1 (1st Cir. 2019); and *Bova v. United States*, 80 Fed. Cl. 449 (Fed. Cl. 2008). These cases note that it is mere authority to act rather than the actual exercise of the authority.

¹¹²² *Brosi v. Commissioner*, 120 T.C. 5 (2003).

¹¹²³ *Carter v. United States*, No. 5:18-cv-01380-HNJ (N.D. Ala. Aug. 9, 2019) (estate not individual qualifying for relief).

¹¹²⁴ See Bryan T. Camp, *Equitable Principles and Jurisdictional Time Periods, Part 1*, 1397 (Tax Notes, September 11, 2017) (arguing for more flexibility to apply equitable tolling than courts have evidenced to date but expressing hope for the future).

It is important to distinguish between a time period that is a true statute of limitations and a time period that is a jurisdictional prerequisite to the action. A true statute of limitations merely bars judicial enforcement of a remedy that was available before the statute of limitations expired; the claim survives the bar of the statute of limitations but cannot be judicially enforced; and the bar of the statute of limitations “may be subject to waiver, forfeiture and equitable tolling.”¹¹²⁵ A time period that is a jurisdictional prerequisite to consideration of a claim requires timely action, and is not subject to waiver, forfeiture and equitable tolling; failure to timely bring the claim is fatal even if equitable considerations would support extending the period.¹¹²⁶ You may think the difference semantical, but one instance in which it might be important is where the defendant in an action was willing to or inadvertently did waive the bar of the statute of limitations (e.g., by not timely asserting it). If the time period is a jurisdictional requirement, it cannot be waived.¹¹²⁷ More to the point of the application of *Brockamp*, a nonjurisdictional statute of limitations may avoid *Brockamp*’s rejection of equitable tolling.¹¹²⁸ That does not resolve the semantical issues to help you distinguish between the two, but it does tell you of the consequences depending upon how the issue is resolved.

This jurisdictional/nonjurisdictional issue usually arises in a context where the taxpayer seeks equitable relief via tolling of a time limit the taxpayer failed to meet. But equitable tolling is similarly available to the Government. *Young v. United States*, 535 U.S. 43 (2002), involved the discharge of taxes in bankruptcy. The general rule is that taxes for which the return was due within three years of the date the petition for bankruptcy is filed are given a priority in bankruptcy and, most importantly, are not discharged. The taxpayers filed their 1992 income tax return on October 15, 1993, reporting a net tax liability due but did not pay the amount due. On May 1, 1996, within the three-year period, the taxpayers filed a Chapter 13 bankruptcy proceeding. The filing of a bankruptcy proceeding stays the IRS’s collection actions, so after May 1, 1996, the IRS could not use its collection tools to try to collect the tax. Chapter 13 is a reorganization provision for wage earners and requires the approval of a plan which must include provision for the tax due. The taxpayers thereafter moved to dismiss the Chapter 13 proceeding and, on March 12, 1997, the day before the bankruptcy court entered its order of dismissal, the taxpayers filed for Chapter 7 liquidating bankruptcy. Taxes may be discharged in a Chapter 7 proceeding. The taxpayers urged that the 1992 tax liability was discharged in the Chapter 7 bankruptcy proceeding because it had been filed more than three years from date the return was due. The IRS urged, on the other hand, that the three-year period had been tolled during the pendency of the Chapter 13 proceeding and therefore that the three-year period, as thus tolled, had not lapsed upon the filing of the Chapter 7 proceeding. Taxpayers throughout the country were exploiting this “back-to-back” Chapter 13/Chapter 7 bankruptcy gambit to attempt to achieve discharge of their tax liabilities where a

¹¹²⁵ *Rubel v. Commissioner*, 856 F.3d 301 (3d Cir. 2017); *Matuszak v. Commissioner*, 862 F.3d 192 (2d Cir. 2017).

¹¹²⁶ *Id.*

¹¹²⁷ For example, the assessment statutes of limitations may be jurisdictional in the sense that, failure to meet the time limit, extinguishes the tax debt unlike normal statutes of limitations which merely deny a judicial enforcement remedy for the debt.

¹¹²⁸ In *Volpicelli v. United States*, 777 F.3d 1042 (9th Cir. 2015), the Ninth Circuit held that the § 6532(c)(1)’s then nine month period for pursuing wrongful levy suits was not jurisdictional and thus subject to equitable tolling despite *Brockamp*. (Section 6532(c) has been revised but not in ways material to whether equitable tolling might apply.) The Ninth Circuit rejected an earlier contrary precedent in another Circuit, *Becton Dickinson & Co. v. Wolckenhauer*, 215 F.2d 340 (3d Cir. 2000).

straight Chapter 7 proceeding could not have achieved it unless instituted after the three-year period during which the IRS would have had unfettered power to collect.

The Courts of Appeals had reached conflicting conclusions. Some read the statute literally and held for the taxpayers. Some applied equitable tolling. The Supreme Court resolved the conflicts in *Young*. A unanimous Supreme Court, speaking through Justice Scalia, accepted the IRS's argument that the three-year period had tolled during the pendency of the Chapter 13 proceeding so that the hapless taxpayers in *Young* (for whom I feel no sympathy since they were clearly trying to game the system) were not discharged.

In the opinion, the Court said that the lookback period for dischargeability was a limitations period subject to “traditional equitable tolling principles.” The Court cited as “hornbook law” that limitations periods are subject to equitable tolling unless such tolling is inconsistent with the statute. The Court said that Congress enacted these limitations with the understanding that tolling might apply, and this reasoning would be particularly true in bankruptcy, itself an equitable court. The taxpayers attempted to construct an argument, as the Government had in *Brockamp*, that the statute evidenced Congress’ intent not to allow equitable tolling, but the Court rejected the argument.

Can you articulate a principled distinction between *Brockamp* and *Young*? In *Brockamp*, of course, the IRS—the party asserting the benefit of the statute—was not trying to game the system; it was simply responding to the statute. In *Young*, although the Supreme Court said it was not necessary to look at the taxpayers’ intent in the back-to-back filings, it was clear that the taxpayers were gaming the system.

As I discuss time limits in this book, I will note any case authority dealing with whether equitable factors affect the time limits. But, for any time limits where there is no controlling authority, practitioners must look for equitable opportunities to avoid time periods that work against a taxpayer and must also consider the possibility that the same equitable opportunity may be available to the Government.

D. Equitable Recoupment.

In *Bull v. United States*, 295 U.S. 247 (1935) and subsequent cases, the Supreme Court developed and applied the doctrine of equitable recoupment in tax cases which mitigates some harsh effects of the statute of limitations. The Ninth Circuit in *Estate of Branson v. Commissioner*, 264 F.3d 904 (9th Cir. 2001), which is assigned reading for this class, described the doctrine:

Equitable recoupment arises when a single “transaction, item or taxable event” is subject to two inconsistent taxes. *United States v. Dalm*, 494 U.S. 596, 608 n.5 (1990); *Boyle v. United States*, 355 F.2d 233, 236 (3rd Cir. 1965). The doctrine permits a party to a tax dispute to raise a time barred claim in order to reduce or eliminate the money owed on the timely claim. *Rothensies v. Elec. Storage Battery Co.*, 329 U.S. 296, 300 (1946) (“amount of [the] tax collected on the wrong theory should be allowed in recoupment against an assessment on the correct theory”). Equitable recoupment cannot be used offensively to seek a money payment, only defensively to offset an adjudicated deficiency. *Dalm*, 494 U.S. at 611.

Estate of Branson illustrates the potential application of equitable recoupment. Please read that case now and be prepared to discuss the doctrine of equitable recoupment.

In addition to considering whether the circumstances for equitable recoupment existed, the *Estate of Branson* Court also addressed the threshold issue of whether the Tax Court has jurisdiction to entertain equitable recoupment issues ab initio. Historically, the Tax Court had taken the position that its jurisdiction was statutorily limited to determining the amount of a deficiency or overpayment. That has nothing to do, it was thought, with whether the taxpayer (or a related taxpayer) over or underpaid in an earlier year not before the Court and as to which the normal statute of limitations would prevent any relief. The district courts had reached a different result based on Supreme Court cases under their general equitable jurisdiction (which the Tax Court does not have). The historical view that the Tax Court and the District Courts would thus decide the same tax case differently is disquieting for there is no indication that Congress intended that difference in result. Indeed, Congress's clear purpose was to funnel as much tax litigation as possible into the Tax Court and certainly there was no evidence that Congress intended this disincentive to Tax Court litigation. Perhaps to resolve that anomaly, in *Estate of Mueller*, which shortly preceded *Estate of Branson*, the Tax Court suddenly discovered that it indeed does have jurisdiction to apply equitable recoupment.

As noted in *Estate of Branson*, the Sixth Circuit in an earlier case had rejected the Tax Court's new found position about its jurisdiction, but the Tax Court stuck to its guns in *Estate of Branson* and has now been affirmed by the Ninth Circuit. Congress has finally settled the uncertainty by legislating that the Tax Court may apply equitable recoupment principles to the same extent as District Courts and the Court of Federal Claims.¹¹²⁹

Keep in mind what equitable recoupment does. It reduces the open year tax deficiency or refund by the principal amount of tax from the erroneous treatment in the barred year.¹¹³⁰ There is no allowance for interest from the barred year to the year in which recoupment applies.¹¹³¹ For example, if the taxpayer saved \$100 in now barred Year 01 and then, in the current open Year 04, claims a \$120 refund related to the erroneous treatment in the barred year, recoupment would reduce the Year 04 refund by \$100. There would be no further offset by the amount of the interest from April 15 of Year 02 (the date the tax was due for Year 01) to April 15 of Year 05. What if, in the same example, the taxpayer were to claim only a \$50 refund in Year 04? The recoupment would be \$50 in Year 04. Why?

¹¹²⁹ Pension Protection Act of 2006, Public Law 109-280, 120 Stat. 780, effective as to Tax Court cases that are not final as of August 17, 2006.

¹¹³⁰ See *Estate of Buder v. United States*, 372 F. Supp.2d 1145 (E.D. Mo. 2005), aff'd 436 F.3d 936 (8th Cir. 2006) (applying an equitable reduction of an equitable recoupment offset in favor of the Government). The language of some cases suggests that the statute of limitations for the barred year is opened. E.g., *Minskoff v. United States*, 490 F.2d 1283, 1285 (2d Cir. 1974) ("The theory of the doctrine of equitable recoupment is that one taxable event should not be taxed twice, once on a correct theory and once on an incorrect theory, and that to avoid this happening the statute of limitations will be deemed waived."). The theory, however, does not waive the statute of limitations for an otherwise barred year, but permits the party claiming equitable recoupment to reduce a cost in an open year.

¹¹³¹ See *Estate of Buder, supra* (justifying the denial of interest on the amount of the recoupment as exercise of equity and fairness).

I have given you a simplified example. Keep in mind that equitable recoupment is, as the name implies, an equitable remedy. Equities, if present, may favor some adjustments. Vary the initial example above (\$120 refund in Year 04 and \$100 unpaid tax in Year 01), by the fact that only one-half of the tax underpaid in Year 01 (\$50, being ½ of \$100) actually benefitted the related party who now seeks the refund. A court considering these facts may hold that the equities justify equitable recoupment in favor of the Government by one \$25.¹¹³² Other fact variations may present similar equities that the taxpayer or the Government may exploit.

Branson and *Dalm*, the Supreme Court case cited in *Branson*, involved two different but related taxpayers.¹¹³³ Equitable recoupment may apply also when only a single taxpayer is involved. In *IES Industries, Inc. v. United States*,¹¹³⁴ the taxpayer brought a refund suit and succeeded in having the court of appeals reach a decision justifying a refund of about \$25,000,000 for each of Years 01 and 02 and about \$5,000,000 for Year 05. Years 03 and 04 were otherwise closed, but the Government asserted equitable recoupment on the theory that consistent application of the basis upon which the taxpayer was entitled to the refunds in Years 01, 02 and 05 would mean that the taxpayer had underpaid its tax in Years 03 and 04 by about \$14,000,000, thus entitling the Government to recoup this amount against the refunds due for Years 01, 02 and 05. The district court and the circuit court agreed with the Government.¹¹³⁵

Equitable recoupment is not the same as offset or setoff in a refund suit. In a refund suit, the Government may assert an offset as a defense that the taxpayer filing a claim for refund or filing a suit for refund is not entitled to a refund for reasons not previously asserted. For example, if the taxpayer sues for refund for year 01 based on taxes he paid for reasons asserted in a notice of deficiency on the basis that those reasons are incorrect and he does not therefore owe the tax, the Government can assert in defense to his entitlement to a refund that there are other reasons, not previously asserted, that the taxpayer did not overpay his tax for the year and is not entitled to a refund. This right to offset was established in *Lewis v. Reynolds*, 284 U.S. 281 (1932), as modified in 284 U.S. 599 (1932). Equitable recoupment, by contrast, involves using equitable principles to allow some tax paid or not paid for another year or even another type of tax to affect the amount of tax due or refund due in the case before the court.

E. Duty of Consistency.

Sometimes the Courts will apply a “duty of consistency” to prevent the taxpayer or, less frequently, the IRS from claiming a benefit in an open year that is inconsistent with some position,

¹¹³² In *Estate of Buder*, *supra*, the estate of the husband claimed a marital QTIP deduction improperly, thus not paying estate tax that was due. After the wife’s later death, the wife’s estate initially included the property in her estate, but thereafter sought a refund after the statute of limitations had closed on the husband’s estate. The IRS sought to equitably recoup the unpaid estate tax from the husband’s estate against the refund due the wife’s estate. The court sustained equitable recoupment but reduced the amount the IRS could recoup because all of the assets did not go to the wife (e.g., there had been a charitable beneficiary also in the husband’s estate). Wendy C. Gerzog, Buder: The Extent of Equitable Recoupment, 110 Tax Notes 1361 (Mar. 20, 2006).

¹¹³³ *Buder*, discussed above in the footnotes, also involved two different but related taxpayers.

¹¹³⁴ 349 F.3d. 574 (8th Cir. 2003).

¹¹³⁵ For students who really want to understand why the courts strained to apply equitable recoupment, one way of looking at it is that the Eighth Circuit gave the taxpayer an outrageous result on the underlying ADR transaction itself and, thus, were susceptible to some opportunity to mitigate the benefit of its extravagant largesse to the taxpayer.

amounting to a representation, in a barred year.¹¹³⁶ The reason the duty is more commonly invoked against taxpayers is that taxpayers are more commonly in the position of making a “representation” in a barred year than is the IRS. So, the core of the court decisions and development of the concepts discussed relate to application of the duty against the taxpayer.

The Tax Court has described the duty of consistency:

The “duty of consistency”, sometimes referred to as quasi-estoppel, is an equitable doctrine that Federal courts historically have applied in appropriate cases to prevent unfair tax gamesmanship. The duty of consistency doctrine “is based on the theory that the taxpayer owes the Commissioner the duty to be consistent in the tax treatment of items and will not be permitted to benefit from the taxpayer's own prior error or omission.” It prevents a taxpayer from taking one position on one tax return and a contrary position on a subsequent return after the limitations period has run for the earlier year. If the duty of consistency applies, a taxpayer who is gaining Federal tax benefits on the basis of a representation is estopped from taking a contrary return position in order to avoid taxes.¹¹³⁷

The Ninth Circuit has expressed the concept more pungently:

When all is said and done, we are of the opinion that the duty of consistency not only reflects basic fairness, but also shows a proper regard for the administration of justice and the dignity of the law. The law should not be such a idiot n3 that it cannot prevent a taxpayer from changing the historical facts from year to year in order to escape a fair share of the burdens of maintaining our government. Our tax system depends upon self assessment and honesty, rather than upon hiding of the pea or forgetful tergiversation.¹¹³⁸

n3 Charles Dickens, *Oliver Twist* 439 (Pocket Library ed., Pocket Books, Inc. 1959) (1837).

¹¹³⁶ See *Herrington v. Commissioner*, 854 F.2d 755, 758 (5th Cir. 1988), cert. denied, 490 U.S. 1065 (1989); *Estate of Letts v. Commissioner*, 109 T.C. 290 (1997), aff'd 212 F.3d 600 (11th Cir. 2000). As to IRS inconsistency, see generally 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).

¹¹³⁷ *Blonien v. Commissioner*, 118 T.C. 541 (2002), quoting *Hollen v. Commissioner*, T.C. Memo. 2000-99, aff'd. 25 Fed. Appx. 484 (8th Cir. 2002). For good articles discussing some aspects of the duty of consistency, see Burgess J.S. Raby and William L. Raby, A Foolish Consistency in Filing Positions, 2004 TNT 52-8 (3/17/04); and Burgess J.S. Raby and William L. Raby, Duty of Consistency: Facts vs. Law, 2004 TNT 103-27 (5/26/04).

¹¹³⁸ *Estate of Ashman v. Commissioner*, 231 F.3d 541, 544 (9th Cir.2000) (footnote omitted). I did not know what tergiversation means (although I inferred its general sense from the context). So, for more accuracy, I consulted a dictionary which defines it as: “1. evasion of straightforward action or clear-cut statement: equivocation; 2. desertion of a cause, position, party, or faith” Merriam Webster online edition (viewed 5/3/17) (noting also that tergiversation was the “Word of the Day” on 9/22/2013. There now, at least some of you inveterate readers of footnotes will also have learned a new word. *Estate of Ashman* also offered another word that I had not yet encountered. It described the taxpayer argument that the IRS should have discovered the inconsistent representation in the now barred year as “wallydraigle.” (231 F.3d at 546.) My same dictionary source defines wallydraigle as: “a feeble, imperfectly developed, or slovenly creature.” Id.

The duty of consistency has the following formal elements:¹¹³⁹

1. Representation of Fact in the Closed Year. The taxpayer represents a fact in the now closed year. Usually this will be a return reporting fact and the nature of the factual representation can be quite subtle. For example, a failure to report income in the closed year may be a factual representation that the timing of the receipt of the income did not occur in that year or, alternatively, may even be a representation that the receipt was a loan repayment rather than income. Thus, for example, a taxpayer who benefitted from a representation in one tax year may not reduce his tax in a subsequent tax year by arguing, after the statute of limitations has expired on the earlier year, that the taxpayer's original representation was incorrect, and that more tax was due in the now-closed year.¹¹⁴⁰ Note that it must be a representation of fact and not a spin on facts that are correctly presented.¹¹⁴¹ The actual taxpayer making the representation need not be the taxpayer against whom the duty of consistency is invoked, so long as there is sufficient relationship that the two taxpayers. The duty is thus often invoked against an estate beneficiary to compute gain on inherited property after it was valued too low for estate tax purposes.¹¹⁴²

2. IRS Reliance on the Representation of Fact. This element is present if the IRS grants or even acquiesces in the tax benefit achieved by the factual representation in the closed year (e.g., by not auditing or accepting the return treatment on audit).¹¹⁴³ However, if the IRS was aware or put on notice that the representation was not correct in time to correct the treatment in the year as to which the representation was made, then the IRS has not relied to its detriment and the duty of consistency does not apply.¹¹⁴⁴

3. The Taxpayer Claims Inconsistent Tax Benefits in an Open Year. This element is self-evident, for the taxpayer must be claiming some tax benefit in the open year in order for the IRS to assert the preclusive effect of the duty of consistency.

There is also a less formal element which is inherent in the formal element: that the taxpayer's claiming of the inconsistent benefit in the open year be unfair.¹¹⁴⁵

¹¹³⁹ These elements set forth basically the standard formulation of the duty of consistency. See *Blonien v. Commissioner*, 118 T.C. 541, 555 at n. 9 (2002) (and cases there cited); see also *Estate of Ashman v. Commissioner*, 231 F.3d 541, 545 (9th Cir. 2000).

¹¹⁴⁰ See *Portland Oil Co. v. Commissioner*, 109 F.2d 479, 485-486 (1st Cir. 1940), aff'g. 38 B.T.A. 757 (1938) (not reporting a sale in 1929 was a representation that the sale did not occur in 1929); *Wentworth v. Commissioner*, 244 F.2d 874, 875 (9th Cir. 1957), aff'g. 25 T.C. 1210 (1956); (not reporting the receipt of funds on an income tax return was a representation that the funds were a loan repayment).

¹¹⁴¹ *Estate of Rose B. Posner, deceased, et al. v. Commissioner*, T.C. Memo. 2004-112.

¹¹⁴² E.g., *Janis v. Commissioner*, 461 F.3d 1080, 1085 (9th Cir. 2006) (covers "both the taxpayer and parties with sufficiently identical economic interests": this includes an estate where the taxpayer beneficiary makes the representation as executor on the estate tax return and then seeks to avoid the representation on his personal return as beneficiary). Based on the facts, other situations can invoke the duty because of sufficient identify of interest. See *Van Alen v. Commissioner*, T.C. Memo. 2013-235 (involving an estate's § 2032A special valuation election with the beneficiaries trying to claim a higher valuation on sale who had consented to the original election and benefitting from it; § 1014(a)(3) seems to compel that result but the duty of consistency was applied in the alternative).

¹¹⁴³ *Herrington, supra*.

¹¹⁴⁴ *Mayfair Minerals, Inc. v. Commissioner*, 56 T.C. 82, 91 (1971), aff'd per curiam, 456 F.2d 622 (5th Cir. 1972).

¹¹⁴⁵ See the Ninth Circuit quote in the text above from *Estate of Ashman v. Commissioner*, 231 F.3d 541, (continued...)

If these elements are present, the application of the duty of consistency will prevent the taxpayer from claiming the tax benefit in the open year, even if the true facts means that the taxpayer is entitled to that benefit in the open year and, correspondingly, was not entitled to the benefit in the closed year where the misrepresentation was made. In this way, the duty of consistency acts like estoppel in the open year. It does not technically affect the statute of limitations for the closed year, but the imperative to apply the doctrine of consistency is caused by the fact that the statute is closed for the earlier year.

A real world application of the duty of consistency is presented in *Blonien v. Commissioner*,¹¹⁴⁶ where the taxpayer, a nominal partner in a high-flying national law firm (Finley Kumble) that imploded in Enron-like extravagance, took the position that he was not a partner in the firm at all, but was instead an employee of the firm. The tax result he desired was to avoid the cancellation of debt (COD) distributive income that arose when the firm imploded and the creditors walked away with large claims unsatisfied. Those of you who have taken partnership taxation will recall that the partners get outside basis in their partnership interests from both their distributive share of partnership income and inside partnership borrowing. They are of course taxed on partnership income as the partnership reports it (through their distributive shares), but they are not taxed on partnership borrowings even though the partnership may have used such borrowings to make distributions to the partners. In this case, the taxpayer was distributed far more cash than he reported as his distributive share of income, but only reported his share of partnership income. The excess was funded effectively from borrowings that increased the partners basis, thus permitting the tax-free excess distribution. The tax piper must be paid, however, and that occurs when the partnership pays the debt from earnings that are taxed to the partners (not the case here) or, if the borrowings are not paid, the phantom COD income flows through to the partners to impose tax without cash flow (because they had their cash flow earlier in tax-free distributions). So, the Tax Court looked back to the fat year when this partner took received distributions in excess of his distributive income (obviously funded by debt). The Tax Court found that the taxpayer then took the return reporting position that he was indeed a partner, thus getting the benefit of the increase in basis for inside partnership borrowings allowed only to one who is a partner and thus sheltering his distributions in excess of partnership income and actual contributions. Thus, the taxpayer benefitted in the earlier years by taking the return reporting position that he was a partner and, the Tax Court held, will not now be heard to urge that he was not a partner.¹¹⁴⁷

It is important to notice the close parallel to the statutory mitigation provisions which I discuss next. If the mitigation provisions apply, the proper treatment will be allowed in the correct

¹¹⁴⁵(...continued)

544 (9th Cir.2000); and *Musa v. Commissioner*, 854 F.3d 934 (7th Cir. 2017) (noting, in affirming the Tax Court's application of the duty of consistency, that (i) the taxpayer's arguments against its application "are heavy on chutzpah but light on reasoning or any sense of basic fairness" and (ii) that one of the arguments was "disconnected from any sense of basic fairness."

¹¹⁴⁶ 118 T.C. 541 (2002). The setting for *Blonien* was an interesting procedural question dealing with the partnership unified audit and litigation rules that discussed below.

¹¹⁴⁷ Those of you who do not have more than a passing acquaintance with the partnership tax rules might ask why he could not have changed his status from partner to employee by the year in issue before the Court. The answer is that the partnership tax rules would have caught him at the point of change by treating his share of the inside partnership debt as a distribution to him thus capturing the income that had previously been sheltered by distributions in excess of his actual contributions to the partnership. Needless to say, the taxpayer did not take that position on his prior year return and pay the tax at that time.

open year regardless of whether any misrepresentation was made in a closed year and the closed year will be opened up for the limited purpose of correcting the error in the closed year. By contrast, if mitigation does not apply and the duty of consistency does apply, the taxpayer will be denied the tax benefit in the correct open year but will be allowed to keep the tax benefit in the closed year. In terms of priority, where the mitigation provisions apply, they will apply in preference to the duty of consistency.

As I said at the beginning, the IRS too can be subject to the duty of consistency, although the circumstances in which it would have made a representation in a barred year are less frequently encountered.¹¹⁴⁸ Essentially the same elements will apply.

There may be other themes and holdings in the tax law that deal with denying a taxpayer an inconsistent benefit, but I don't treat them further since this is an introductory text.¹¹⁴⁹

F. Claim of Right Relief - § 1341.

In a practical application of the annual accounting principle, the tax law developed the "claim of right doctrine" that says that income received under claim of right is included in gross income and subject to tax¹¹⁵⁰ even if there is some contingency that might take the income away in a later year.¹¹⁵¹ The original safeguard for unfairness was that the taxpayer could or at least might claim a deduction in the year of repayment. That is a rough and ready fix subject to variances in effective rates in the two years. In some cases, those variances could be harsh. For example, if the taxpayer receives \$10,000 taxed at a 35% rate in year 01 and then must return it in year 05 (after Year 01 is closed), the taxpayer could claim a deduction but that deduction might achieve only, say, 5% tax savings.

Section 1341 was enacted to mitigate some of this harsh effect of having to include the income, subsequently determined not be economic income, in a closed year under the claim of right doctrine. Section 1341 provides that, if, in a closed year, a taxpayer included in income an item of income because he subjectively believed that he had a claim of right to the income and, after the close of that year, the taxpayer is entitled in an open year to a deduction exceeding \$3,000 for

¹¹⁴⁸ See 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); and Stephanie Hoffer, Hobgoblin of Little Minds No More: Justice Requires IRS Duty of Consistency, 2006 Utah L. Rev. 317 (2006), citing inter alia Alamo National Bank of San Antonio v. Commissioner, 95 F.2d 622 (5th Cir. 1938).

¹¹⁴⁹ An illustration is the theme in Charles Ifeld Co. v. Hernandez, 292 U.S. 62 (1934) and its progeny that double deductions are disfavored and may be corrected by denying the second deduction on the notion that, deduction of the same economic loss twice is not to be accepted unless there is a clear congressional mandate for the double deductions. This notion is called the Ifeld doctrine. The Ifeld doctrine arose and continues to be applied in consolidated return cases (e.g., Duquesne Light Holdings, Inc. v. Commissioner, 861 F.3d 396 (3rd Cir. 2017) (3rd Cir. 2017)) but probably has traction in other areas of the law as well. And it does not require that the claiming of the original or the double deduction have been in error if considered in isolation; obviously, the deduction in the current year must be in issue, but if it is otherwise proper and, considered in isolation, the original deduction is otherwise proper, the deduction in the current year will nonetheless be disallowed without a clear congressional mandate not only for the current year deduction but for the duplicated deduction.

¹¹⁵⁰ Tax exempt income, for example, is not taxable even if received under a claim of right.

¹¹⁵¹ North American Oil Consolidated Co. v. Burnet, 287 U.S. 417 (1932).

returning the income¹¹⁵² because, as it turns out, he did not have a claim of right in the earlier closed year, then the taxpayer can claim (i) a deduction for the amount returned in the later open year or (ii) a tax for the current open year calculated without the deduction but with a reduction in tax for the tax paid on the item in the closed year.¹¹⁵³ In the example cited above, the taxpayer would have paid a tax on the item in the closed year (Year 01) of \$3,500, so if he returns it in Year 05, he will claim either a \$10,000 deduction or a \$3,500 tax reduction in the open year (Year 05). If the tax reduction exceeds the tax otherwise due, the excess is refundable.¹¹⁵⁴

Perhaps to state the obvious, although illegal income is income that is taxed, it is not income including by claim of right; therefore, illegal income does not qualify for this relief.¹¹⁵⁵

G. Mitigation Provisions of the Code.

1. Introduction.

The mitigation provisions (§§ 1311 - 1314) of the Code mitigate the effect of the statute of limitations and some other provisions of law, except § 7122, that might preclude correction of errors. I deal here with the principal mitigation provisions most practitioners encounter in their practice and deal with these provisions principally where the correction of the error is barred by the statute of limitations for the year in which the error occurred.¹¹⁵⁶ These mitigation provisions parallel the equitable recoupment doctrine and the doctrine of consistency in the sense that they seek to prevent a party from getting a double benefit. The legislative history of these provisions states the case for their need:

The purpose of the statute of limitations to prevent the litigation of stale claims is fully recognized and approved. But it was never intended to sanction active exploitation by the beneficiary of the statutory bar, of opportunities only open to him if he assumes a position diametrically opposed to that taken prior to the running of

¹¹⁵² See *Mihelick v. United States*, 927 F.3d 1138 (11th Cir. 2019) (holding that the return does not have to be to the person from whom the original amount was received under claim of right in circumstances where the taxpayer bore the burden of the cost).

¹¹⁵³ The second option “more or less puts the taxpayer in the position that she would have occupied had she never reported the income.” *Robb Evans & Associates, LLC v. United States*, 850 F.3d 24 (1st Cir. 2017). The key financial cost to the taxpayer is the interim interest on the payment of tax in the closed year that is not returned until the filing of the return for the later open year. Still, the second option takes away any cost attributable to a lower effective tax rate for the deduction under the first option in the later open year.

¹¹⁵⁴ § 1341(b)(1).

¹¹⁵⁵ *Culley v. United States*, 222 F.3d 1331, 1335-36 (Fed. Cir. 2000); *Kraft v. United States*, 991 F.2d 292, 299 (6th Cir. 1993); *McKinney v. United States*, 574 F.2d 1240, 1243 (5th Cir. 1978). Thus, the taxpayer failing relief for illegal income may still claim a deduction if otherwise entitled to claim the deduction. In net, where a deduction is otherwise available for illegal income, what the taxpayer loses by not qualifying for § 1341 relief is the benefit of any higher rate applicable to the illegal income in the closed year.

¹¹⁵⁶ For example, the error may be barred by principles of res judicata [in this case in the broader sense, either claim preclusion or issue preclusion] or the prohibition upon notices of deficiency once a tax court petition for redetermination has been filed, so that the bar to correcting the error may not be a statute of limitations bar. So long as correction of the error is “prevented by the operation of any law or rule of law, other than this part and other than section 7122” it may be corrected.

I do not deal with other mitigation provisions. For example, § 6521 provides mitigation via reduction of an open year tax (similar to equitable recoupment as discussed above) in the case of the FICA and SECA requirements.

the statute. Legislation has long been needed to supplement equitable principles applied by the courts and to check the growing volume of litigation by taking the profit out of inconsistency, whether exhibited by taxpayers or revenue officials and whether fortuitous or the result of design.¹¹⁵⁷

These provisions deny the double benefit if a party (the IRS or the taxpayer) actively (generally) seeks and obtains a benefit in the correct open year which means, perforce, that the party should not have obtained the benefit in the barred year. Unlike the doctrines discussed above, the correction is made by allowing the correct treatment in the open year and opening up the otherwise barred year solely to correct the erroneous benefit. I review here only some of the simpler examples so that you can get a feel for how the mitigation provisions operate.

Readers should keep in mind that the mitigation provisions are tightly written to provide relief in certain specified equitable circumstances; they do not provide general equitable relief for all taxpayer or Government tax claims barred by statutes of limitations.¹¹⁵⁸ Therefore, meeting the requirements of the statute is critical.

Note to students, although I think every tax lawyer should read the mitigation provisions “cover to cover,” you should for this class read only the specific sections cited in the text below.

2. Examples of Double Benefits Covered.

a. Double Inclusion of Income.

The classic case is where a taxpayer includes income on a tax return for Year 01, paying the resulting Year 1 tax. Then, after the statute of limitations for Year 01 has closed but the Year 05 statute is still open, the IRS insists that the same item of income be included in Year 05. Obviously, if the IRS succeeds in forcing the taxpayer to include the item in income in Year 05, the IRS will have realized a double benefit—a tax on the same item of income in both years. In that case, the mitigation provisions will operate to force open the Year 01 statute of limitations solely to allow the taxpayer to obtain a refund plus interest since Year 01. Keep in mind the key elements of this example: the party who benefits insists on the treatment in the correct open year after having benefitted from the same item in an incorrect but now barred year. Relief is available by lifting the bar of the statute of limitations but only to correct that item.

Let's walk through the statute to see how mitigation works in this example. Section 1311(a) provides that, if a “determination” (as described in § 1313(a)) is made that creates a double benefit to the IRS (as described in § 1312, subsection (1) of which includes the double inclusion of income) and, on the date of the determination the correction of the error in the erroneous year (Year 01 in the example) is barred, the error can be corrected (as described in § 1314) by allowing the taxpayer to file a claim for refund for Year 01. Let's focus on some technical issues.

¹¹⁵⁷ S. Rep. No. 1567, 75th Cong., 3d Sess. 49 (1938).

¹¹⁵⁸ *Olin Mathieson Chemical Corp. v. United States*, 265 F.2d 293, 296 (7th Cir. 1959) (“Congress did not intend by [the provisions] to provide relief in all situations in which just claims are precluded by statutes of limitations.”); *Longiotti v. United States*, 819 F.2d 65, 68 (4th Cir. 1987).

First, a determination is required. Section 1313(a) defines determination. A determination is a final court decision,¹¹⁵⁹ a closing agreement under § 7121,¹¹⁶⁰ IRS final action denying a claim for refund, or an agreement as permitted by regulations.¹¹⁶¹ Any other disposition allowing a double benefit is not a determination. The party who will benefit from opening the otherwise closed year must take care not to dispose of the correct open year (Year 05 in the example) without forcing a determination as defined. The party who is hurt by the other side achieving a double benefit—either the taxpayer or the IRS—will have the ability to force a determination. For example, if the taxpayer in filing his Year 5 return includes the item in income on the Year 05 return, there will be no determination. (Note also that, in this example, the IRS did not maintain a position that it be included in Year 05, but we will get to that issue below.) Moreover, if the taxpayer does not include the item in the Year 05 return and then only pays the tax upon the IRS's issuance of a notice of deficiency and assessment, there will be no determination. How can the taxpayer force a determination to meet this prerequisite for mitigation? The taxpayer can include it on his Year 05 return (either the original return or an amended return) and file a claim for refund for the tax paid for Year 05. If the IRS denies the claim (as it is entitled to do because the item is properly includable in year 05), § 1313(a)(3)(B) will treat the denial as a determination. (Note that this will also force the IRS to maintain a position inconsistent with the inclusion of the item in Year 01.) There are other ways to force the event of determination, but for now you must know that you have to have an event of determination and it is your job as a practitioner to get your client there if he or she needs to avoid the IRS getting a double benefit. By the same token, it is your duty to avoid a determination, if possible, if your client is the beneficiary of the double benefit.

One issue that I hope you have spotted is how a taxpayer can file a legitimate claim for refund for Year 05 when the item is properly included in Year 05? Stated otherwise, how can the taxpayer claim under penalty of perjury on the claim for refund that he or she is entitled to a refund for the correct open year? The taxpayer can, but I ask you now to hold that thought and we will return to it. There is a further related question. I said that the IRS is entitled to deny the claim because the item of income is properly included in Year 05. The question I want you also to hold in your mind is whether the IRS can grant the claim and refund the tax for the correct open year so as to avoid opening up the barred year (no double tax)? The IRS can; we will come back to why.

Second, there must be a “circumstance of adjustment” giving rise to a double dip with respect to the same item. In this case, § 1312(1) describes a double inclusion of income as a circumstance of adjustment that can be corrected. In this example, taxing the items in Year 05 would be a double dip for the IRS.

Third, correction of the error must be barred at the time of the determination. Obviously, as with recoupment, a party on notice that the other party is claiming or even might claim a double dip should protect the statute of limitations if the earlier year might become barred is still open. In our

¹¹⁵⁹ In Chief Counsel Advice 201622032 (1/22/16), the IRS ruled that even a Tax Court decision was not the required determination unless it resolved the merits. The parties to the Tax Court proceeding resolved the case by settlement that was then entered into the Tax Court decision. Thus, there was no substantive decision on the merits of the inconsistent position in open year.

¹¹⁶⁰ A Form 870-AD, used by the Appeals Office to settle issues, is not a closing agreement under § 7121.

¹¹⁶¹ Reg. § 1.1313(a)-4. Form 2259, Agreement as Determination Pursuant to IRC 1313(a)(4), is used by Appeals Office and Compliance employees in executing informal agreements. IRM 8.6.4.8.2 (10-15-2005), Form 2259 Agreement - Mitigation and Correction of Errors under IRC 1311.

example, therefore, if for some reason the refund statute of limitations on Year 01 is still open, the taxpayer should file a protective claim for refund. Nevertheless, if such a protective move is not made, the mitigation provisions pull the fat out of the fire by permitting relief so long as the incorrect year (Year 01) is barred at the time of the determination.¹¹⁶²

Fourth, if the above requirements are met, a correction adjustment may be made under § 1314. In our example, the correction is made by opening up the statute of limitations for Year 01 to exclude the income and compute a refund accordingly. Note the critical difference in the relief afforded between mitigation and equitable recoupment. Mitigation opens up the closed year to allow a refund for that otherwise closed year. Equitable recoupment offsets a tax otherwise due in the open year by the amount of tax overpaid in the closed year (i.e., it does not open up the closed year). Further, mitigation requires essentially two proceedings—one to determine the tax treatment in the correct open year and a second one to correct the incorrect treatment in the closed year; equitable recoupment, by contrast, through netting in the correct open year, makes the correction in a single proceeding.

b. Double Deductions.

Mitigation, like equitable recoupment, is a two way street—it can benefit the IRS as well as the taxpayer. Thus, if the taxpayer seeks a deduction in a correct open year (e.g., Year 05 in our example) but has also claimed the deduction erroneously in a barred year (Year 1 in our example), the IRS may open up Year 01 to assess and collect additional tax for Year 01. Let's walk through the elements of mitigation because some may not be intuitive.

First, a determination is required. Just as the taxpayer must force a determination in the double inclusion circumstance of adjustment, so the IRS must force a determination in the double deduction circumstance. How does the IRS do that? Well, if the taxpayer claims the deduction on the Year 05 return (either the original or the amended return) the IRS must deny the deduction by notice of deficiency which alone is not a determination, which will force the taxpayer to either (i) forego the deduction in the correct open year so as not to open up the barred incorrect year (Year 01 in the example) or (ii) force a determination by either pursuing a Tax Court proceeding or paying the tax and filing a claim for refund. Under § 1313(a), either of the events in (ii) will lead to a determination. You will recall that in discussing the determination in the double inclusion circumstance, I asked how the taxpayer could file a claim for refund for Year 05 when the income item is properly included in Year 05? So, here, in the double deduction situation, I ask you how the IRS can deny a deduction in Year 05 when the deduction is properly claimed in Year 05? Hold on to that thought.

Second, there must be a circumstance of adjustment. Section 1312(2) provides that the double allowance of a deduction or credit is a circumstance of adjustment.

Third, correction of the error must be barred at the time of the determination. If Year 01 is not barred, the IRS should simply correct the error by deficiency determination for Year 01.

¹¹⁶² § 1311(a).

Fourth, if the foregoing requirements are met, the error is corrected under the mechanism in § 1314.

3. Maintenance of an Inconsistent Position.

As to most of the circumstances of adjustment, the party in whose favor the bar of the statute of limitations operates must have maintained an inconsistent position in the correct open year. § 1311(b)(1). This effects the statutory policy to take the double benefit out when a party actively exploits the statute of limitations by actively asserting the benefit in the correct open year. In the above examples, I assumed that Year 01 is the incorrect barred year and Year 05 is the correct open year. Accordingly, as to a double inclusion of income, the IRS must be the party successfully maintaining the position that the income item be included in the correct open year (Year 05). Correspondingly, as to the double deduction, the taxpayer must be the party successfully maintaining the position that the deduction be included in the correct open year (Year 05).

Example 1. Assume that the taxpayer erroneously claims a deduction in Year 01 that becomes time-barred from correction by the IRS. The deduction is properly allowable in Year 05 but the taxpayer does not claim it on his Year 05 tax return. If nothing else happens, the taxpayer has received the benefit of the deduction in Year 01 (the improper year) but not in Year 05 (the proper year). The taxpayer has not received a double benefit. That is the end of the matter.¹¹⁶³

Example 2. Same facts except, at a time when the statute for Year 01 assessment is closed, that taxpayer files an original or an amended return for Year 05, claiming the benefit of the deduction. The taxpayer has now maintained an inconsistent position, thus meeting this requirement for the mitigation provisions to apply. The IRS must allow the deduction because the taxpayer so insists—Year 05 is, after all, the proper year for the deduction. The taxpayer has maintained an inconsistent position. Assuming that the other requirements for mitigation exist, the IRS can open up the closed year (Year 01) to deny the benefit of the deduction.¹¹⁶⁴

Example 3. Same facts except that, for Year 05, the taxpayer does claim the deduction on an original or amended return. Rather, the IRS sent the taxpayer a notice of deficiency proposing other adjustments for Year 05 and the taxpayer files a petition in the Tax Court. In preparing the answer, the IRS attorney determines from a review of the file that the taxpayer was entitled to the deduction in Year 05 and, without any prompting from the taxpayer, concedes in the IRS's answer in the Tax Court that the taxpayer is entitled to the deduction. Upon settlement of the other issues, the IRS and the taxpayer submit to the Court an agreed decision document which states a tax liability

¹¹⁶³ One question is whether the taxpayer, knowing that the deduction is properly allowable in Year 05, can properly sign the jurat which says, in effect, that the return is true, correct, and complete? The answer is yes, but perhaps the better part of wisdom would be to identify in a disclosure attachment that the taxpayer is omitting the deduction in the correct open year.

¹¹⁶⁴ One issue you should think about in this context is how the IRS would discover the incorrect claim in the now barred year. Obviously, if the IRS does not know that a double benefit has been achieved, the IRS will not exercise its rights to take away the double benefit under the mitigation provisions. I dare say that, in many perhaps most cases where this is done, the IRS will not learn of the double benefit, so the taxpayer keeps the double benefit. What are the ethics of this? Would a taxpayer be subject to criminal prosecution for claiming the benefit in the correct open year although he had also claimed it in the incorrect open year? Is the taxpayer obligated to tell the IRS so that the IRS can exercise its rights under these mitigation provisions? I think these are good questions (and posit them as such because this is, after all, my book). Think about the questions and your answers.

determined with the deduction. The Tax Court dutifully enters the decision. In this case, the taxpayer never insisted on the deduction and thus never sought a double benefit. Instead, the IRS foisted the double benefit upon the taxpayer by simply allowing the deduction. The taxpayer has not maintained an inconsistent position, so this requirement of mitigation is absent.¹¹⁶⁵

Basically, what this illustrates is that the IRS cannot force on the taxpayer the double benefit, thus opening up the closed year. Logically, this would mean that, even if the IRS is aware of the deduction, the IRS can choose not to volunteer the benefit of the deduction to the taxpayer in Year 05, the correct year for the deduction, so as to force upon the taxpayer the choice of (1) insisting upon the benefit in Year 05, thus maintaining an inconsistent position or (2) declining the benefit in Year 05, thus keeping the benefit for Year 01.¹¹⁶⁶

Similarly, in the case of a double inclusion of income, the taxpayer cannot invoke mitigation simply by including the income on his original or amended return for the correct open year. Simply by accepting the return, the IRS has not maintained an inconsistent position; if anything, the taxpayer has maintained the inconsistent position. As I noted above, with regard to the determination requirement, the taxpayer could include the item on the Year 05 return and file a claim for refund to force a determination which will force the IRS to adopt the position of inclusion in Year 05 or forego its inclusion in Year 05 by granting the claim for refund; alternatively, if the taxpayer excludes the item from his or her Year 05 return, the IRS will get the double benefit only by asserting a deficiency in Year 05. In either event, if the IRS insists on inclusion in Year 05, the IRS's action will meet two requirements for mitigation -- i.e., it will be a maintenance of a position in the correct open year (Year 05) that is inconsistent with the position in the barred year (Year 01) and it will be a determination as required by § 1313(a).

I now return to the questions I asked earlier as to how either party can take a position in the correct open year (Year 05) that the item should not be properly treated in computing the tax for the correct open year (Year 05)? You remember that, in a double inclusion of income situation, I asked how the taxpayer could file a tax return or a claim for refund for the open year that fails to include an income item properly includable in the open year (Year 05 in the example). Similarly, can the IRS grant the claim for refund in Year 05 even though the income item is properly includable in Year 05? Can the party who would get the double benefit by its correct treatment in the open year decide not to claim that double benefit in the correct open year and thus avoid opening up the statute for the barred year? In the case of a potential double deduction, this would require the taxpayer to forego claiming a deduction in the correct open year, thus avoiding a double benefit and thus avoiding opening up Year 01 for a correction. Similarly, in a potential double inclusion of income situation, can the IRS not insist that the taxpayer include the income in the correct open year (i.e., Year 05), to avoid opening up the statute for the taxpayer to get a refund in the incorrect barred year (Year 01)? That is the nub of the issue and the role of the requirement that the claiming of the benefit in the correct open year be at the insistence of the party getting the benefit in the correct open.

¹¹⁶⁵ Reg. § 1.1311(b)-1(c)(1).

¹¹⁶⁶ The IRS attorney, before volunteering a benefit in an open year, would be well advised to at least inquire whether the taxpayer claimed the benefit in another year.

Let's take an example. If the income has been improperly reported in Year 01, the Year 01 tax has been paid, and the Year 01 statute on claims for refund has closed. In year 05, the taxpayer discovers that the income was properly reported in Year 05. The taxpayer then reports the income in Year 05 without the IRS insisting that he do so. Providing the taxpayer can meet the other requirements of the statute (e.g., determination), can the taxpayer unilaterally force open Year 01? And, conversely, in a potential double deduction situation, can the IRS force the taxpayer to get the benefit of the deduction in the correct open year (Year 05) even though the taxpayer does not want to claim the double benefit and thus does not want to exploit the closed statute of limitations?

What the maintenance of an inconsistent position requirement does is to give the party in whose favor the bar of the statute potentially operates (the taxpayer in a double income inclusion case and the IRS in a double deduction case) authority to not insist that the item be properly treated in the correct open year. Thus, in the double income inclusion case, the IRS must actively insist that the income item be included in the correct open year, otherwise the double benefit is not at the IRS's insistence. The mitigation provisions are not designed just to prevent double benefits -- but to prevent double benefits where a party seeks to exploit the bar of the statute of limitations by insisting on the double benefit in the correct open year. Thus, in a double inclusion case, if the taxpayer in the correct open year (Year 05) simply includes the item on his or her return without the insistence of the IRS, the IRS has not maintained an inconsistent position. Only if the taxpayer then files a claim for refund for the correct open year (Year 05) and the IRS denies the claim, will the IRS have maintained an inconsistent position. But, in acting on the claim for refund, the IRS can grant the refund for the correct open year and thereby avoid maintaining an inconsistent position, solely to avoid opening up the barred year. Similarly, in the double deduction situation noted above (see Example 5), the IRS attorney could have not allowed the deduction in Year 05 and thus it would be allowed only if the taxpayer insisted on the deduction.

How, courts ask, can either the IRS or the taxpayer treat the item improperly in the correct open year? Isn't the taxpayer required to report and pay his tax correctly based on what occurred in the open year? Isn't the IRS required to assess and collect the correct amount of tax due for the open year? The answer is that a party (either the IRS or the taxpayer) can avoid the double benefit by foregoing the benefit in the correct open year to avoid the application of the mitigation provisions. If that were not the case, the maintenance of an inconsistent position requirement would be a nullity—either party could force open the statute simply by claiming the correct treatment in the open year. The statute expressly requires that the party receiving the double benefit be the one maintaining the inconsistent position in the correct open year. Moreover, the whole purpose of the provisions would be defeated for it is only the claiming of the double benefit to which the statute is directed. If there is only one benefit in a barred year, there is no reason to lift the statute of limitations.

4. Other Circumstances of Adjustment; Complications.

a. Double Exclusions of Income.

Now we get into more complex territory. There are two possible scenarios here. In Scenario 1, the taxpayer (i) excludes the item from income in Year 01 when he or she should have included it in that year, (ii) includes the item in income on his or her return in Year 03, and (iii) files a claim

for refund for Year 03. In Scenario 2, same facts except the taxpayer does not include the item in Year 03 but the IRS insists that he include it. In either case, the taxpayer can prevail in Year 03 by showing that the item was properly taxed in Year 01 when it was erroneously excluded from income, but the year is now barred except for the operation of the mitigation provisions. I go through the elements, as before, but I first ask you to think about the equities.

Let's take Scenario 2 first. Has the taxpayer actively sought a double benefit? He or she did not include the item in the now barred closed year (Year 01). That is a single benefit, not a double benefit. The exclusion of the item from the Year 03 return is totally consistent with the proper treatment of the item—i.e., it was taxable in Year 01 not Year 03. Can or should the IRS be able to force open the now barred year (Year 01) simply by making a bogus claim that it should be included in an open year -- Year 03 of the example? Similarly, in the Scenario 1, the taxpayer just made a mistake by including it erroneously on the return for Year 03; should he or she be able to avoid mitigation by just correcting the mistake in the incorrect open year? If you think deeply about these scenarios, you will see factors that might justify different treatment. I will develop these factors by addressing the elements of the statute.

First, there must be a determination. I have noted above that the IRS can force a determination -- in the Scenario 1 by denying the claim for refund and in Scenario 2 by issuing a notice of deficiency for Year 03 which will force the taxpayer to pursue litigation in the Tax Court or pay the tax and file a claim for refund.

Second, there must be a circumstance of adjustment. The first scenario is addressed in § 1312(3)(A) and the second is addressed in § 1312(3)(B). So far so good.

Third, correction in the barred year is now closed. Here, a critical distinction is made between the two scenarios. In both Scenarios, the barred correct year (Year 01) is closed at the time of the determination. Section 1311(b)(2), however, creates a special additional requirement for Scenario 2 (where the taxpayer excluded the item in the incorrect open year). As I noted above, in this circumstance there is a single benefit -- erroneous exclusion in the barred year -- and the taxpayer does not seek to exploit a double benefit. If the IRS could force mitigation simply by making a wild assertion in an incorrect open year, the IRS could open up any such barred year. Section 1311(b)(2) requires in the second scenario (taxpayer exclusion on the return in the incorrect open year, also referred to as the § 1312(3)(B) scenario) that the statute of limitations in the correct barred year be open at the time the IRS first maintains the position in the incorrect open year. Thus, the IRS cannot force open a barred year simply by taking a position in an incorrect open year after the correct year is barred. Now, I ask you why the drafters of the mitigation provisions permit the statute of limitations to be opened up when the statute of limitations for the correct, now barred year was open when the IRS first maintained the position as to the open year? The reason is that it is often not clear when income should be included. Obviously, in that circumstance, the IRS could have taken inconsistent positions -- that it was includable also in the earlier year for which the statute of limitations was still open at the time it adopted the position that it was includable in the later year. So, to take the gamesmanship out of that by forcing the adoption of inconsistent positions, the bar on the closed year will be lifted if the IRS could have taken that position for the correct barred year when it first took the position as to the incorrect open year. You should also note that, in this second scenario, there is no requirement that the IRS maintain an inconsistent position in the

later year. § 1311(b)(1). Why suspend this requirement here? Simple, to take the uncertainty in picking the correct year.

That resolves the issue for the second scenario (where the taxpayer excluded it from income in the later incorrect year). What about the first scenario where the taxpayer included it (albeit erroneously) in the later incorrect year? If you understood why there was an exception in Scenario 2, permitting lifting the bar where the IRS first takes the position when the statute on the now barred correct year is still open, you should understand why the bar is lifted in the Scenario 1. As noted above, it is often ambiguous as to which year an item should be included in income. Many times, that is controlled by the taxpayer and, in all cases, the taxpayer is usually more aware of the factors that bear on the resolution of the proper year than is the IRS. If the taxpayer voluntarily and without coaxing by the IRS includes the item in income for the incorrect open year, an argument can be made that the taxpayer should not be heard to later assert that the item should be excluded from income in the incorrect open year without allowing the IRS to open up the correct closed year.

Fourth, if the elements are met, the IRS can obtain relief in the manner prescribed in § 1314.

b. Double Disallowance of a Deduction or Credit.

Let's assume that the taxpayer does not claim a deduction in Year 01, the correct year for the deduction, and then either does not claim it in Year 03 or, if claimed, the IRS disallows the deduction in Year 03. In either event, there is only one benefit to the IRS -- the tax wrongfully collected in Year 01. What ought the result be, realizing that you are essentially dealing with the same circumstance in reverse that we dealt with immediately above on the double exclusion? Think about it, and the answer will be a parallel answer.

The same equitable factor exists. Should the taxpayer be able to force open a barred correct closed year simply by incorrectly claiming a deduction in an open year? Now let's go through the elements.

First, there must be a determination. OK, you must know by now how a taxpayer can force a determination.

Second, there must be a circumstance of adjustment. There is. § 1312(4).

Third, correction in the barred year is closed at the time of the determination. As in the reverse situation, however, there is special relief if, at the time the taxpayer first took the position in the later year (Year 03 in the example), the statute of limitations was still open on Year 01. § 1311(b)(2)(B). I hope you see the reason. The taxpayer could, of course, file a protective claim for refund for the earlier year (just as in the reverse situation the IRS could issue a protective notice of deficiency). But to take the gamesmanship out, the provisions will operate if the statute was open when the taxpayer first maintained the position before the IRS or the Tax Court. Here, too, there is no requirement that the party in whose favor the statute operates has maintained an inconsistent position. § 1311(b)(1).

c. Other.

There are still other circumstances of adjustment, but they are basically variations on the theme in more complicated tax situations. For all of these, you should go through the drill of satisfying the statutory elements. You should, however, be able to intuit when the mitigation provisions might potentially be applicable from the foregoing.

The mitigation provisions are exceedingly complex in more complicated fact patterns and are truly one of the wonders of the Internal Revenue Code. You could spend several classes just on the topic, but what I want you to have is a general understanding of when they might apply. Anytime the IRS or the taxpayer has a double benefit, you should spend the time necessary to see if they apply.

5. Supplementary Reading for Mitigation Enthusiasts.

I commend to your further study on mitigation the best (in my judgment) tax procedure law review article ever written: John M. Maguire, Stanley S. Surrey and Roger John Traynor, Section 820 of the Revenue Act of 1938, 48 Yale L. J. 509 (Part 1) and 719 (Part 2) (1939). Students using this book may not recognize the authors, but they are a team of all-time legal “superstars.” The authors were young “brain trusters” lured to Washington by Franklin Delano Roosevelt's “New Deal.” They assisted in the drafting and enactment of the mitigation provisions of the Code in the late ‘30s.¹¹⁶⁷ Maguire and Surrey rose to the heights of tax academia with distinguished private and public careers. Traynor became one of this country's most respected jurists as a Justice on the California Supreme Court where he shaped the debate of thoughtful discussion in many legal areas. All law students and lawyers should at least know who Traynor is. The ultimate contributions to American jurisprudence by each of these authors in their own way was foreshadowed by this article. They wrote the article to respond to certain concerns by the ABA’s then Standing Committee on Federal Jurisprudence.

H. Accounting Method Adjustments.

In the context of the date for filing tax returns, I covered special provisions that relieve a taxpayer with respect to the filing date deadline. (See p. 149, above.) This relief applies in other contexts where the filing deadline acts as a statute of limitations where the relief sought is not available except that action by a certain date is required. For example, the taxpayer receiving a notice of deficiency has 90 days to petition the Tax Court and, as noted above, has a certain period

¹¹⁶⁷ Mirit Eyal-Cohen, Preventive Tax Policy: Chief Justice Roger J. Traynor's Tax Philosophy, 59 Hastings L.J. 877, 893 (2008):

Traynor and Surrey worked together at the Treasury Department, and shared a passion for tax law. In 1937, Traynor became a consultant expert to the Treasury and chose Surrey, then a young assistant legislative counsel at the Treasury, as a reliable co-author and collaborator. One of their mutual projects was to review the effort to prevent taxpayers' misuse of the statute of limitations on deficiencies and refunds. Their recommendations were incorporated into section 820 of the 1938 Revenue Act.

By the time the law review article appeared in the Yale Law Journal, Maguire was a Professor at Harvard Law School, Surrey was Assistant Legislative Counsel at Treasury, and Traynor was Professor of Law at the University of California School of Jurisprudence.

in which to file claims for refund. These provisions apply to mitigate those deadline requirements as well. I refer readers back to the earlier discussion.

Section 481 requires that, in computing taxable income for a taxable year of an accounting method change, “there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change to prevent amounts from being duplicated or omitted * * *.” Section 481 is not easily deciphered (except in some cases discussed below) and has been described as an example of “codified confusion.”¹¹⁶⁸

I think the basic contours of § 481 can be understood relatively easily. Section 481 can require inclusion in the current year of items that were, under the new method, improperly deducted in a prior year had the new method applied if, as a consequence of the new method, items will be duplicated or omitted. This can have the practical effect of requiring adjustments for items treated improperly in an otherwise closed year, albeit those adjustments are made in the open year of the accounting method adjustment.¹¹⁶⁹

I illustrate with an example.¹¹⁷⁰ The taxpayer improperly deducts \$100 in Year 01 but it is an isolated improper deduction and not part of an accounting method of the taxpayer in Year 01. The taxpayer has an accounting method in year 01, but this deduction is just erroneous and not related to the accounting method. The taxpayer should properly deduct the item in year 10. In an audit for year 05 after Year 01 has closed, the IRS determines that the taxpayer’s accounting method is incorrect and forces the taxpayer to change the method. In the process, the IRS spots the erroneous \$100 deduction in Year 01. Section 481 would not apply because the \$100 erroneous deduction in Year 01 is not related to the accounting method change. Of course, should the taxpayer claim the deduction in Year 10 when he is entitled to, the IRS can invoke the mitigation provisions or the other equitable doctrines to mitigate the double benefit for the taxpayer.

But take the same example and assume that the erroneous \$100 deduction claimed in Year 01 was pursuant to the taxpayer’s method of accounting, albeit an erroneous method of accounting. This would mean that, pursuant to that method which should allow a deduction only once, the taxpayer would not be entitled to the deduction in Year 10. Then, if the IRS requires an accounting method change in Year 05, that, if applicable in Year 01 would have deferred the deduction to Year 10, then the IRS can require that the income in the year of change (05) be adjusted to include the \$100 erroneous deduction. In effect, the IRS has corrected the erroneous deduction in Year 01 in year 05. The taxpayer in this instance can still deduct the item under the now correct method in Year 10.

¹¹⁶⁸ See *Pinkston v. Commissioner*, T.C. Memo. 2020-44, at *9 (citing *Grogan v. United States*, 475 F.2d 15, 16 (5th Cir. 1973) (which quoted William H. Fletcher, Section 481: Changes in Accounting methods, N.Y.U. 18th Inst. on Fed. Tax 161 (1960)).

¹¹⁶⁹ *Mingo v. Commissioner*, 773 F.3d 629, 635-636 (5th Cir. 2014) (quoting *Graff v. Chevrolet Co. v. Campbell*, 343 F.2d 568, 572 (5th Cir. 1965) noting that the § 482 adjustment does not happen until the open year and that section 481 would be virtually useless if it did not affect closed years.).

¹¹⁷⁰ This example is inspired by *Bosamia v. Commissioner*, 661 F.3d 250 (5th Cir. 2011). For an excellent discussion of § 481 in a slightly more complex situation, see Judge Lauber’s discussion in *Pinkston v. Commissioner*, T.C. Memo. 2020-44; *Pinkston* is discussed in Bryan Camp, Lesson From The Tax Court: How Evil §481 Forces Income Recapture (Tax Prof Blog 7/20/20).

Ch. 5. Interest.

I. Introduction.

Interest is compensation for the use of money. A taxpayer can use the Government's money by failing to pay taxes due; correspondingly, the Government can use the taxpayer's money by collecting more than the taxpayer owes. The right to compensation for the use of money in the tax context is strictly statutory and is not based upon any equitable or economic notions merely because the taxpayer or the Government benefitted from the interim use of the other's money (which, of course, is the basis for the statute, but in the absence of the statute there would be no right to interest). The Code provides interest in many, but not all, situations in which the Government or the taxpayer uses the other's money.

II. When the Taxpayer Owes the Government.

A. General.

1. Interest on Underpayments.

The taxpayer uses the Government's money as a result of underpaying tax. The general rule is that interest is due on tax due but not paid from the last date required for the payment through the date it is paid. § 6601(a).¹¹⁷¹ Interest compensates the Government's for the taxpayer's use of the tax beyond the date that it was due and unpaid.¹¹⁷²

The last date required for payment is generally the last date for filing the return, determined without regard to extensions. § 6151(a).¹¹⁷³ As discussed above, for individuals, that date is April 15, and that is the date payment is due. Individual tax payments not made by April 15 bear interest from April 15. For a corporation, the last date prescribed for payment is 2 ½ months after the end

¹¹⁷¹ Certain interest-free adjustments are allowed in the employment tax area. See Rev. Rul. 2009-39, I.R.B. 2009-52, illustrating the application of the interest-free adjustment and claim for refund processes under the final regulations for making interest-free adjustments of employment taxes under §§ 6205 and 6413, and claiming refunds of employment taxes under §§ 6402 and 6414.

¹¹⁷² Interest on an underpayment is "not a penalty but is intended only to compensate the Government for delay in the payment of a tax." *Avon Prods., Inc. v. United States*, 588 F.2d 342, 343 (2d Cir. 1978). The same is true in reverse—interest on an overpayment is intended to compensate the taxpayer for the Government's interim use of the taxpayer's funds which the funds represent an overpayment. This notion that interest is not a penalty but simply compensation for the use of funds may drive how the courts interpret the scope of the statutory interest provisions. For example, focusing on underpaid tax meaning that the taxpayer has interim use of the Government's money from the due date, courts have noted "the traditional rule that one who possesses funds of the government must pay interest for the period that person enjoys the benefit of [the] same." See *Baptiste v. Commissioner*, 29 F.3d 1533, 1542 (11th Cir. 1994). Although interest, in this view, is not a penalty, it does encourage a person owing the liability subject to interest to pay the liability and interest to avoid the continuing cost of nonpayment and thus avoids rewarding those who delay payment. *Baptiste v. Commissioner*, 100 T.C. 252, 259 (1993) (Ruwe, concurring).

¹¹⁷³ But see *Avon Products, Inc. v. United States*, 588 F.2d 342 (2d Cir. 1978) (where the actual deficiency or tax due arose only later in an unusual fact pattern, so that the taxpayer was not charged interest because the tax was not due). The point is to focus on whether the taxpayer in effect has the Government's money and should be charged with the interest. See *Goldring v. United States*, 15 F.4th 639 (5th Cir. 10/4/21) (applying use of money to avoid interest on tax deficiency during period taxpayer had overpaid enough to cover the deficiency).

of the tax year—in the case of a calendar year corporation, the payment is due March 15—and interest will accrue thereafter to the extent of underpayment.¹¹⁷⁴

2. Underpayments of Required Prepayments.

The Code provides mechanisms for prepaying the tax. Thus, an individual employee is subject to withholding against his compensation that effectively prepays the tax prior to the April 15 due date. Similarly, an individual may be required to pay estimated tax prior to the April 15 due date. Does the individual owe the Government interest if he or she does not prepay the tax either by withholding or estimated tax? The technical answer is no.¹¹⁷⁵ What, then, is the taxpayer's incentive to pre-pay via withholding and estimated tax payments? Can the taxpayer achieve an interest-free loan from the Government by not making prepayment until the actual due date? No. Although no "interest" accrues, the cost of paying later rather than as required for withholding or estimated tax is a penalty which is calculated like interest by reference to the underpayment interest rate. §§ 6654 & 6655, referring to § 6621 (the interest provision).

3. Erroneous Refunds.

The taxpayer also uses the Government's money as a result of an erroneous refund of tax. During the period, the taxpayer has the money, the taxpayer is required to pay interest on the erroneous refund. However, under a special rule, the interest may be abated if the amount of the refund is \$50,000 or less and the refund was not caused in any way by the taxpayer.¹¹⁷⁶

B. Underpayment Interest Rates.

1. General.

The underpayment interest rate is the federal short-term borrowing rate plus 3 percentage points. § 6621(a)(2). The interest rate is reset quarterly and announced in a Revenue Ruling issued quarterly. For the third quarter 2023, this interest rate is 7%.¹¹⁷⁷ Interest is compounded daily.¹¹⁷⁸ Since the interest rate may vary from quarter to quarter, to compute the interest due on an underpayment, it is necessary to consider all the interim quarterly rates from the due date of the underpayment. The Revenue Ruling announcing the interest rate for the upcoming quarter includes

¹¹⁷⁴ The last date for payment is the statutorily prescribed date rather than, if later, when the taxpayer first had reason to believe that a payment was due. In *CreditGuard of America, Inc. v. Commissioner*, 149 T.C. 370 (2017), the taxpayer had qualified for tax exempt status in an earlier year and therefore had not filed Form 1120 for 2002. In February 2012, the IRS issued a final determination letter revoking tax-exempt status retroactively to January 1, 2002. The taxpayer thus owed a substantial tax liability for 2002. The Court held that interest began running on the due date of the 2002 return (March 17, 2003), rejecting the taxpayer's equitable sounding argument that it should not have to pay interest during the period it had no reason to believe that it owed the tax.

¹¹⁷⁵ § 6622(b).

¹¹⁷⁶ § 6404(e)(2). In *Allcorn v. Commissioner*, 139 T.C. 53 (2012), the Court held that, even if an erroneous refund is collected by assessment and levy procedures rather than an erroneous refund suit under § 7405, if it could have been collected by erroneous refund suit, the test for abatement of interest is under § 6404(e)(2).

¹¹⁷⁷ Rev. Rul. 2023-11, IRB 2023-23; IR-2023-104, May 22, 2023.

¹¹⁷⁸ § 6622. The exception is for the calculation of the addition to tax for underpayments of estimated tax. § 6622(b).

a table of the interest rates for the periods from 1975 forward. (The same is true for other interest rates discussed in this section, so I won't repeat the availability of that table.)

2. Large Corporate Underpayments (“Hot Interest”).

Section 6621(c) imposes a higher rate for large corporate underpayments defined as a C corporation underpayment exceeding \$100,000. The interest rate is 2 percentage points above the normal rate. For the third quarter of 2023, this interest rate is 9%.¹¹⁷⁹ This interest rate also is re-set quarterly in the same manner as the regular underpayment interest rate. For the period to which the additional rate applies, the base to which the rate applies is the same base as the underlying tax liability base.¹¹⁸⁰ Practitioners often refer to this additional interest as “hot interest.”¹¹⁸¹

The hot interest rate applies from the earlier of (1) the first letter of proposed deficiency or (2) the notice of deficiency. § 6621(c)(2)(A). Thus, the higher rate does not apply from the due date of the return, but only from the first date that the taxpayer is advised that deficiencies will be asserted.¹¹⁸²

This hot interest rate does not apply to the extent that the taxpayer pays during the 30 day period from the starting date. The higher rate encourages large corporations to borrow from others rather than the Government, by giving them the incentive to pay the Government earlier than they would otherwise have paid. Bottom-line, if the corporation can borrow for a lesser interest rate than the large corporate underpayment rate, it will have an incentive to pre-pay the Government. In practice, many corporations will estimate the amount they expect to pay when the audit is finally concluded and litigated, so that they can pay the amount of the estimate to stop the accrual of this higher interest. Of course, to the extent that they underestimate, the hot interest will apply.

3. Deferred Estate Tax on Closely Held Business.

A special low interest rate applies to estate taxes attributable to closely held businesses (including farms) that are deferred under § 6166. § 6601(j). That provision permits deferral for up to 15 years -- with payments of interest for up to five years and with equal principal payments and accrued interest at the special rate for the next ten years. The interest rate is 2% on a portion and 45% of the regular interest rate on the balance. The complex computations are basically designed

¹¹⁷⁹ Rev. Rul. 2023-11, IRB 2023-23; IR-2023-104, May 22, 2023.

¹¹⁸⁰ See *Med James, Inc. v. Commissioner*, 121 T.C. 147 (2003) where the taxpayer had understated its tax liability by \$255,753 in Year 1 but had a net operating loss in Year 2 which it carried back to Year 1 to bring the Year 1 understatement to \$63,573, easily under the \$100,000 threshold for hot interest. Under the rules for calculating regular interest, the base for calculating interest is \$255,753 until the Year 2 tax return is due but then, because of the effect of the NOL carryback, the base is reduced for subsequent period interest calculations. The IRS argued that the threshold \$100,000 determination is made without regard to the effect of the NOL. The taxpayer argued otherwise. The Tax Court held for the taxpayer.

¹¹⁸¹ See *RHI Holdings, Inc. v. United States*, 142 F.3d 1459 (Fed Cir. 1998).

¹¹⁸² A functionally equivalent starting point applies to interest on taxes not subject to the deficiency procedures. § 6621(c)(2)(B)(i).

For an interesting application of the starting date rule where the taxpayer in a large underpayment case got a notice of deficiency and thereafter got a notice of computational adjustment in a partnership subject to the TEFRA rules (now repealed). *General Mills, Inc. v. United States*, 957 F.3d 1275 (Fed. Cir. 2020); see Bob Probasco, [TEFRA + LCU = Confusion, Part 3](#) (Tax Procedure Blog 4/29/21).

to give a 2% interest rate on \$1,000,000 and 45% of the regular rate on the balance attributable to small business. Under time value of money principles, these favorable rates have the effect of significantly lowering the effective estate tax. (Example: if I owe \$1 which I can either pay today or defer for 10 years at an annual interest cost of 1%, the effective current economic cost of the deferred payout today is substantially less than \$1; economically, of course, I will choose the deferred payout.) Thus, estates with closely held businesses as a major part of the estate pay a significantly less estate tax than estates of equal net value with liquid assets such as stocks and bonds.¹¹⁸³ The “cost” of this very significant benefit is that the interest is not deductible for estate tax purposes.¹¹⁸⁴

C. Relief from the Accrual of Interest.

1. General.

Since interest on an underpayment is simply compensation for the taxpayer’s interim use of the Government’s money, there is generally no equitable reason for the Government to waive the interest. The taxpayer owed the Government and, because he did not pay, had the use of the money after the due date and should pay interest on it. Accordingly, the general rule is that there is no relief from interest on an underpayment.¹¹⁸⁵

2. Abatement of Interest Otherwise Due.

The Code allows abatement of interest on income tax otherwise due in certain limited situations “where failure to abate interest would be widely perceived as grossly unfair.”¹¹⁸⁶ I discuss here the ones that are most important in terms of your practice.

a. Delays for Ministerial or Managerial Acts.

Section 6404(e)(1) permits the IRS to abate interest for certain types of taxes (most prominently those to which the deficiency procedure applies)¹¹⁸⁷ for the period during which there were unreasonable errors or delays attributable to the IRS's failure to perform ministerial or managerial acts and no significant aspect of the delay was caused by the taxpayer. The period for which interest may be abated starts only after the IRS has contacted the taxpayer in writing with

¹¹⁸³ Estates with closely held businesses also usually qualify for beneficial valuation reductions that have the further effect of reducing the effective tax rate as compared to estates with more liquid assets.

¹¹⁸⁴ § 2053(c)(1)(D). Foregoing the interest as a deduction against the estate tax eliminates one of the significant procedural problems of deferred estate tax payments -- the periodic reduction of the taxable estate and estate tax as interest is accrued and paid.

¹¹⁸⁵ *Johnson v. United States*, 602 F.2d 734, 738 (6th Cir. 1979) (without a specific statutory exception, neither the IRS nor the courts have the authority to excuse a taxpayer from interest); *Suffness v. United States*, 974 F.2d 608, 610 (5th Cir. 1993) (interest compensates for the Government's loss of use of the money, regardless of the reason for the late payment).

¹¹⁸⁶ *Krugman v. Commissioner*, 112 T.C. 230, 238-239 (1999) (quoting H.R. Rept. No. 99-426, at 844 (1985), 1986-3 C.B. (Vol. 2) 1, 844; S. Rept. No. 99-313, at 208 (1986), 1986-3 C.B. (Vol. 3) 1, 208).

¹¹⁸⁷ You will recall that the deficiency procedure applies principally to income and estate and gift taxes. Thus, for example, employment tax is not subject to deficiency procedure and does not qualify for the interest abatement. *Woodral v. Commissioner*, 112 T.C. 19 (1999); *Miller v. Commissioner*, 310 F.3d 640, 644 (9th Cir. 2002); and *Scanlon White, Inc. v. Commissioner*, 472 F.3d 1173 (2006).

respect to the deficiency in issue, meaning when the IRS notifies the taxpayer that it has started an audit.¹¹⁸⁸ The statute does not define ministerial or managerial acts, but the regulations do and the case authority fleshes out the interpretation.¹¹⁸⁹

This relief is discretionary—the statute says the IRS “may abate.” As interpreted for the original enactment, this gave the IRS unreviewable discretion to abate or not to abate.¹¹⁹⁰ In 1996, § 6404(h) was added to allow limited judicial review in the Tax Court for abuse of the IRS’s discretion not to grant relief by interest waive.¹¹⁹¹ If the taxpayer is not a large taxpayer (defined in the same way that disqualifies a large taxpayer from obtaining attorneys’ fees if he prevails in tax litigation), the taxpayer may litigate the IRS’s denial of relief in the Tax Court. § 6404(h).¹¹⁹² The Tax Court remedy must be brought “any time after by the earlier of” (i) the date the IRS notifies the taxpayer of the determination not to abate but no later than 180 days after the date of the notification of the determination, **or** (ii) 180 days after the filing of the claim for abatement.¹¹⁹³ This Tax Court relief to the so-limited class of relief is exclusive for waiver of interest under § 6404(e)(1).¹¹⁹⁴

Assuming the taxpayer is within the limited class for relief, to prevail on Tax Court review, the taxpayer must:

- (1) identify an error or delay by the IRS in performing a ministerial or managerial act;
- (2) establish a correlation between the error or delay by the IRS and a specific period for which interest should be abated; * * *
- (3) show that he or she would have paid the tax liability earlier but for such error or delay” and [(4)] “in denying the taxpayer’s interest abatement request, the Secretary abused his discretion (i.e., acted arbitrarily, capriciously, or without sound basis in fact or law.”¹¹⁹⁵

¹¹⁸⁸ §6404(e)(1) (flush language); *Allcorn v. Commissioner*, 139 T.C. 53, 57 (2012). It is not uncommon for the IRS to start an audit and then, after a referral to IRS CI for criminal investigations based on discovering, in the audit, firm indications of fraud, suspend the audit until the investigation and any resulting prosecution are resolved. The suspension period for the audit can be substantial. I have not researched the issue, but I don’t think the IRS would exercise its discretionary authority to abate the interest during that suspension period, or that the Tax Court would hold that that denial of interest was an arbitrary decision. Similarly, if the IRS starts a criminal investigation and in some way notifies the target taxpayer, and then after all investigation and resulting prosecutions has ceased, undertakes a civil audit the notice of the civil audit will be the first day that interest may be abated for lapses in the civil audit. See *Adams v. Commissioner*, T.C. Memo. 2019-99.

¹¹⁸⁹ Reg. § 301.6404-2(b)(1) (managerial act is “administrative act that occurs during the processing of a taxpayer’s case involving the temporary or permanent loss of records or the exercise of judgment or discretion relating to management of personnel”); and Reg. § 301.6404-2(b)(2) (ministerial act is “a procedural or mechanical act that does not involve the exercise of judgment or discretion and that occurs during the processing of a taxpayer’s case after all prerequisites to the act, such as conferences and review by supervisors, have taken place.”). Those wanting to drill down further must research the judicial interpretations.

¹¹⁹⁰ *Hinck v. United States*, 550 U.S. 501 (2007).

¹¹⁹¹ *Woodral v. Commissioner*, 112 T.C. 19, 23 (1999).

¹¹⁹² As to the small taxpayer limitation, see § 7430(c)(4)(A)(ii) which refers to 28 U.S.C. § 2412(d)(2)(B) which denies relief to certain taxpayers as therein defined.

¹¹⁹³ § 6404(h)(1)(A) & (B).

¹¹⁹⁴ *Hinck v. United States*, 550 U.S. 501 (2007) (holding that, under § 6404(e)(1) as originally written without the § 6404(h) relief, there was no review of the IRS’s discretion under § 6404(e)(1), but the subsequent enactment of § 6404(h) gave the limited class of taxpayers Tax Court judicial review).

¹¹⁹⁵ *Santana v. Commissioner*, T.C. Memo. 2017-14 , at *18-*19 (and cases there cited). The same formulation appears in one of the cases cited: *Paneque v. Commissioner*, T.C. Memo. 2013-48, at *18-*19. This seems (continued...)

Obviously, under these strict standards, relief is rarely granted in the Tax Court cases.

b. Reliance on Written IRS Advice.

Section 6404(f) requires the IRS to abate interest attributable to erroneous written advice given to a taxpayer by the IRS if (1) the taxpayer reasonably relied on the written advice given in response to a written request and (2) the taxpayer did not provide inadequate or inaccurate information. This relief is not discretionary if the factual requirements are met—the statute says that the IRS “shall abate.” Courts may thus review *de novo* the presence of the facts that require the relief. The statute does not provide a special Tax Court remedy, and hence the taxpayer will normally be able to litigate the issue only in a refund forum.

c. Delay in Notification of Tax Liability.

If an individual taxpayer (not a corporate taxpayer) is not notified of the asserted tax liability within 3 years¹¹⁹⁶ after the later of the original due date of the return (April 15 for individuals on the calendar year) and the actual filing date if within an extension period, accrual of interest on tax and certain other time based penalties functioning like interest¹¹⁹⁷ is suspended from the end of the 3-year period until 21 days after the taxpayer is so notified. § 6404(g)(1) & (3).¹¹⁹⁸ Notice includes both a notice of deficiency and, if earlier, a notice of proposed adjustment. A timely return (either by the original due date or the extended due date) is required.¹¹⁹⁹ An amended return will generally not affect the running of this period; however, if an amended return or other signed document is filed showing an increase in tax liability, the 3-year period does not begin to run with respect to the items that gave rise to the additional tax liability until that amended return or other signed written document is provided to the IRS.¹²⁰⁰ This suspension of interest gives the IRS an incentive to audit and complete the audit earlier rather than later in the normal statute of limitations period.

The interest exemption does not apply in certain cases. The more commonly encountered exceptions are: (i) § 6651 (failure to pay penalties), (ii) any tax, penalty or interest attributable to fraud, (iii) any interest or penalty with respect to tax shown on the return, and (iv) any “reportable transaction with respect to which the requirement of section 6664(d)(2)(A) is not met and any listed transaction (as defined in 6707A(c)).” § 6404(g)(2). Why do you think Congress exempted these categories?

¹¹⁹⁵(...continued)

to be almost a formulaic recital of the requirements the taxpayer must meet under § 6404(e)(1) to obtain judicial relief from the IRS’s denial of relief.

¹¹⁹⁶ The period that must elapse before interest is suspended was increased to 3 years for notices after November 25, 2007. Previously, that period was 18 months.

¹¹⁹⁷ Interest-like additions—“addition[s] to tax and additional amount[s]”—are also suspended. These interest like additions are such additions “computed by reference to the period of time the failure continues to exist and which is properly allocable to the suspension period.” § 6404(g)(1).

¹¹⁹⁸ This Code section has been amended several times. On June 20, 2007, the IRS issued proposed and temporary regulations consolidating the guidance for the amendments. As usual, the Regulations should be consulted.

¹¹⁹⁹ § 6404(g)(1).

¹²⁰⁰ § 6404(g)(1) (flush language). See ILM 200815034, published at 2008 TNT 72-14 (citing Prop. Treas. Reg. 301.6404-4(a)(2)(i) and applying the concept to returns filed under the LCCI initiative with regard to offshore bank accounts and credit cards).

The suspension of interest does not affect the running of the statute of limitations on assessment.

3. Delay in Assessment After Waiver of Restrictions.

If, in response to proposed deficiency assessment by the IRS, the taxpayer signs a waiver of restrictions on assessment (Form 870, Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment, or Form 4549, Income Tax Examination Changes), authorized by § 6213(d), and the IRS fails to assess within 30 days, interest on the deficiency will be suspended.¹²⁰¹ The suspension period is through the date the assessment is made. § 6601(c).

As I note elsewhere, the purpose of the waiver of restrictions on assessment is to waive § 6213(a)'s prohibition on assessment on assessment. You will recall from the statute of limitations chapter that § 6213(a) prohibits the IRS from making an assessment unless the IRS first issues a notice of deficiency and then waits at least 90 days thereafter to give the taxpayer time to file a petition in the Tax Court; the Form 870 waiver or Form 4549 (and its counterparts for taxes other than income taxes) waives the requirement of a notice of deficiency and permits immediate assessment.¹²⁰²

The rationale for this suspension of interest if the tax is not assessed within 30 days of the waiver is that, without the predicate requirement of a notice of deficiency, the IRS should set about making the assessment promptly and, if it fails to do so within 30 days, it is fair to suspend interest. As noted above, at one level, since the taxpayer continues to use the money even if the IRS delays the assessment beyond 30 days, it would not be inequitable to charge rent on that use. However, the policy decision here is not that the taxpayer has not benefitted by the use of money during the period, but that the IRS must be encouraged to move promptly to make the assessment. The suspension of interest gives the IRS the incentive to get its processes in order.

4. Prompt Payment Grace.

There is still one other interest-free period, although it is quite brief. If the deficiency is under \$100,000, no interest accrues from the date of notice and demand for payment for 21 days if the taxpayer pays during that period; if the deficiency is over \$100,000 that grace period is 10 days.¹²⁰³

D. Making and Contesting IRS Interest Calculations.

Interest calculations can be exceedingly complex. I do not introduce those complexities here. I generally have an accountant involved in my representations and rely upon the accountant for

¹²⁰¹ The Form 870 is used for income tax. A parallel form is used for transfer tax: Form 890, Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment - Estate, Gift and Generation - Skipping Transfer Tax

¹²⁰² Both forms indicate in clear language that the taxpayer consents to the immediate assessment of the indicated deficiency without predicate Tax Court review afforded by a notice of deficiency.

¹²⁰³ § 6601(e)(3). This relief period correlates to the period that the taxpayer can pay without incurring the § 6663(a)(3) late payment penalty if the assessed tax is not paid in the relief period.

detailed calculations. For purposes of getting ballpark interest numbers for assisting most taxpayers in making strategy decisions, there are computer programs to calculate interest that work well. I use a program called TaxInterest software, authored by Time Value Software, that has served me and my client's purposes to get a pretty good idea of what the interest and penalties will cost.

For situations requiring a more precise calculation in really complex situations involving (for example, restricted interest), large accounting firms have staffs that calculate deficiency or refund interest more precisely. The need for that level of calculation and specificity usually arises when the IRS has made or proposes to assess and the interest the IRS calculated is sufficiently large that it is worth checking. The IRS does make mistakes in its calculations. Large taxpayers have found it in their interest to pay substantial fees—often contingency fees—to accounting firms and other interest specialists to check up on the IRS on the calculations.

Interest, however calculated, is generally assessed automatically at the same time that the tax is assessed (and then periodically after the tax is assessed as to any portions of the tax and interest that remain unpaid). Thus, for example, in a Tax Court case, the Court will determine the deficiency for the year and will not determine the interest, at least in its initial consideration of a case. The IRS, in making the assessment of the deficiency determined by the Tax Court, will calculate the interest and assess it at the same time as it assesses the underlying deficiency determined by the Tax Court. A deficiency notice is not required for assessment of the interest. If the interest is improperly calculated or the taxpayer may be entitled to waiver of interest, the taxpayer may then (after the original Tax Court decision) file a supplemental proceeding in the Tax Court to have the Court determine the correct amount of interest. § 7481(c).

If an improper calculation of interest occurs outside the context of a predicate Tax Court proceeding, the taxpayer may have to pay the interest and sue for refund if the taxpayer is unable to get the IRS to abate the assessment.

E. Payments or Deposits to Stop the Running of Interest.

The issue addressed here is how the taxpayer can mitigate the running of interest on a deficiency. As noted above, interest is rent for the use of money. If the taxpayer owes a deficiency, the taxpayer has use of the IRS's money and interest will accrue. The taxpayer can avoid the accrual of interest by prepaying the ultimate tax liability. The taxpayer may also use the bond procedure to suspend the accrual of interest. The bond is simply a deposit toward ultimate payment. In either case, the taxpayer has surrendered control of the money to the IRS, the taxpayer is not earning interest on the money, the IRS via the federal fisc is earning interest on the money, and the taxpayer is therefore not liable to the IRS for interest. Under *Rosenman*, the case establishing the bond procedure (p. 239), the deposit did not accrue interest in favor of the taxpayer if it turned out the bond amount paid exceeded the tax deficiency finally determined.¹²⁰⁴ So, if the amount remitted to the IRS exceeded

¹²⁰⁴ The administrative round rules for the bond procedure under *Rosenman* were set forth in Rev. Proc. 84-58, 1984-2 C.B. 501, which has now been superseded by Section 6603 and the IRS guidance issued under that Section, Rev. Proc. 2005-18, 2005-13 I.R.B. 798.

the amount of the deficiency finally determined, there was a real economic difference between the payment and the bond procedure.¹²⁰⁵

Under § 6603, the bond / payment distinction is retained but the economic difference is mitigated somewhat. Section 6603 now codifies and modifies the bond procedure:¹²⁰⁶

(1) The taxpayer may make a cash deposit with respect to any tax that has not been assessed at the time of the deposit.¹²⁰⁷ This is a codification of practice under *Rosenman*.

(2) When and to the extent that the deposit is applied against a tax liability of the taxpayer,¹²⁰⁸ the amount is deemed a payment at the time of the original deposit.¹²⁰⁹ Under the interest accrual rules discussed above, this will suspend the running of interest on the amount of the deposit just as if it had been designated a payment at the time. This is a codification of practice under *Rosenman*.

(3) To the extent not yet applied in payment of a tax or the collection of tax is not in jeopardy, the IRS will return the amount of the deposit.¹²¹⁰ This is a codification of practice under *Rosenman*.

(4) Any deposit returned under (3) will carry interest to the extent attributable to a “disputable tax” during the period of the deposit.¹²¹¹ The interest rate is the federal short term rate

¹²⁰⁵ For a costly example, see *Ford Motor Co. v. United States*, 768 F.3d 580 (6th Cir. 2014), cert. denied 135 S. Ct. 2858 (2015). The Sixth Circuit summarized the tradeoffs between the two procedures (p. 588):

So when Ford sent its remittances, it faced a tradeoff: If a taxpayer remitted a cash-bond deposit but subsequently demanded the deposit's return, the IRS would not pay the taxpayer any interest for the period during which the government held the funds. When a taxpayer demanded a refund of an excessive advance tax payment, by contrast, the IRS allowed the taxpayer to recoup interest. Thus the revenue procedures forced taxpayers to choose: immediate access without interest, or interest without immediate access.

To Ford's credit, it made a creative, if ultimately unavailing, argument. The argument was that, under § 6601, interest accrues on underpayments, so prepayments reduce the amount of underpayments and logically reduce interest on the underpayment. By the IRS concession that a deposit also reduces interest on the interest for § 6601 purposes, the IRS must be saying that a deposit is a payment (because, under the statute, only payments reduce the underpayment subject to interest). If it is a payment for purposes of the interest reduction under § 6601, Ford argued, it must also be interest for purposes of § 6611 which allows interest to accrue in favor of the taxpayer over-depositing. The Court rejected the argument. Ford is a knowledgeable taxpayer which knew precisely how to get interest from the date of payment but chose instead to deposit. (In rejecting the argument, the Court said that the claimed inconsistency might be resolved by not allowing the deficiency interest reduction in § 6601.)

¹²⁰⁶ For a good discussion of the differences for interest between deposits under § 6603 and interest on overpayments, see Judge Lauber's decision in *Hill v. Commissioner*, T.C. Memo. 2021-121.

¹²⁰⁷ § 6603(a).

¹²⁰⁸ The IRS will not apply a deposit to a person other than the taxpayer for whom the deposit was made. *Dillon Trust Company LLC v. United States*, 162 Fed. Cl. 708 (2023).

¹²⁰⁹ § 6603(b). Since deemed a payment at the time applied to the tax, the statute of limitations for refunds will be calculated from that date. See ECC 201316015 (2/14/13), reproduced at 2013 TNT 77-45. Note that the interest suspension benefits accrue only if the deposit is applied by the IRS to the underlying liability,

¹²¹⁰ § 6603(c). In PMTA 2010-067 (12/16/10), reproduced at 2011 TNT 78-14, the IRS concluded that it had no authority to apply any excess § 6603 payment to other taxes under either its statutory authority in § 6402(a) or its general offset authority.

¹²¹¹ § 6603(d)(1). See CC-2010-002, reproduced at 2009 TNT 232-18.

(i.e., 3% less than the overpayment / refund rate for individuals).¹²¹² For the third quarter of 2023, this interest rate is 4%.¹²¹³ Generally, though when the overpayment rate is above 3%, this is a taxpayer favorable modification of practice under the *Rosenman* rule which did not allow interest on any portion of a deposit that is returned to the taxpayer (and correspondingly did not suspend the running of interest on any underlying tax). In effect, under the prior *Rosenman* practice, the Government had use of the taxpayer's money for a period for which it did not pay rent via interest. Now, at least to the extent of a disputable tax, the taxpayer can get interest on return of the deposit. The taxpayer is allowed to make a reasonable estimate as to the maximum tax on disputable items.¹²¹⁴ Disputable items, in turn, are defined as items as to which the taxpayer has both a reasonable basis and a reasonable belief that the IRS could have a reasonable basis to disallow the taxpayer's position.¹²¹⁵ The reasonable estimate is at least the amount the IRS has claimed in a 30-day letter.¹²¹⁶

As indicated, the key modification to the practice under the *Rosenman* rule is the provision for interest on reasonable estimates as to disputable items. This substantially increases the benefit of the use of the bond as opposed to prepayment of the tax.¹²¹⁷ The practice under § 6603 is set forth in a Revenue Procedure,¹²¹⁸ and Regulations will undoubtedly be issued in the future. The Rev. Proc. addresses a number of key practices that will be observed in applying § 6603 and thus is a must read for those considering making a deposit or a payment during the course of an audit, but the following points should give you a sampling of some of the ground rules:

(1) Sets the procedure for a taxpayer to lay the foundation for a taxpayer establishing the disputable tax requirement (via a statement sent with the deposit).¹²¹⁹

(2) Cautions that a deposit made before or during an examination will be applied as payment of the tax if the taxpayer executes a waiver of the restrictions on assessment, so that if the deposit fully covers the amount of the assessment pursuant to the waiver, there will be no deficiency notice issued and the taxpayer will not have a Tax Court remedy.¹²²⁰ The taxpayer can prevent this by asking for and getting refund of some portion of the deposit so that there will be an unpaid amount once the waiver of the restrictions on assessment is signed.

(3) An undesignated remittance received by the IRS when there is no outstanding liability or proposed liability will be treated as a deposit.¹²²¹ If there is no statement of the disputable tax, the taxpayer may forego interest on a deposit that is returned.

¹²¹² § 6603(d)(4).

¹²¹³ Rev. Rul. 2022-11, 2022-23 I.R.B. 1.

¹²¹⁴ § 6603(d)(2)(A).

¹²¹⁵ § 6603(d)(3)(A).

¹²¹⁶ § 6603(d)(2)(B).

¹²¹⁷ See Peter H. Winslow, Samuel A. Mitchell and Joseph A. Sergi, Jobs Act May Change the Economics in Favor of Deposits, 105 Tax Notes 1149 (Nov. 22, 2004).

¹²¹⁸ Rev. Proc. 2005-18, 2005-1 C.B. 798. For example, the Revenue Procedure provides transitional rules for amounts on deposit at the time of enactment.

¹²¹⁹ § 4.01(1). See *Hill v. Commissioner*, T.C. Memo. 2021-121 at *13-*14.

¹²²⁰ § 4.02(1).

¹²²¹ § 4.04(1).

The deposit will serve the function of suspending interest to the extent that it is not returned to the taxpayer but is applied to the payment of a tax liability.

The key contexts in which the bond procedure should be considered are:

First, the deposit can be used to stop the running of interest while preserving the taxpayer's right to litigate in the Tax Court. Thus, assume the taxpayer is in audit and expects significant adjustments, but the audit and appeals processes have not yet been finalized. If the taxpayer were to make a remittance to the IRS as a payment, the amount might fully pay any tax that is subsequently determined to be due and thus the IRS would not issue a notice of deficiency. As I will discuss, the notice of deficiency is generally the ticket to the Tax Court—no notice of deficiency, no Tax Court remedy. To guard against the possibility of wiping out a deficiency, the taxpayer might want initially to designate the remittance as a deposit but ask that the deposit be applied as a payment after the notice of deficiency is issued.¹²²² For optimum funds management, the taxpayer might make a split remittance—i.e., designating one part as a payment in just below the amount that the taxpayer estimates to be an estimate of the amount the IRS may ultimately sustain and the other part designated as a deposit. Then, after the notice of deficiency is issued, the taxpayer could have the deposit amount applied as a payment, so that it can get the maximum possible interest on an amount refunded. In estimating the amount to be applied as a payment either prior to the notice of deficiency or afterwards, the taxpayer of course will want to consider not only interest on a possible refund but also the potential application of “hot interest” as discussed above.

Second, the taxpayer might want to preserve the opportunity to obtain return of the money if doubts are resolved in its favor before the end of the audit and/or litigation process. I illustrate in the following example. Assume that the IRS sends a 30-day letter to a large corporate taxpayer asserting \$1,000,000 in additional tax. The taxpayer assesses its exposure: (1) \$500,000 of the proposed adjustments are good adjustments, so the taxpayer knows that the minimum deficiency and liability is \$500,000; (2) \$250,000 is up in the air -- i.e., the taxpayer might or might not be liable for that amount; and (3) the remaining \$250,000 does not represent good adjustments, so that the taxpayer will not ultimately be liable for that amount. This taxpayer might want to advance \$750,000 to the IRS (plus interest thereon), since that is the maximum reasonable liability. That taxpayer might want to make at least \$250,000 of that advance a deposit, so that if the taxpayer can determine later in the process before assessment (i.e., in IRS appeals or in Tax Court litigation) that the middle \$250,000 or some portion will be resolved in the taxpayer's favor, the taxpayer can ask that the \$250,000 (or some portion) be returned so that the taxpayer can deploy those assets for other more productive uses. In this regard, note that, if that middle \$250,000 were advanced to the IRS as a payment rather than a deposit the interest it might forego on an ultimate refund may not be as

¹²²² *Baral v. United States*, 528 U.S. 431, 439 n.2 (2000) (“[T]he taxpayer will often desire treatment of the remittance as a deposit -- even if this means forfeiting the right to interest on an overpayment -- in order to preserve jurisdiction in the Tax Court, which depends on the existence of a deficiency, 26 U.S.C. § 6213 (1994 ed. and Supp. III), a deficiency that would be wiped out by treatment of the remittance as a payment.”). In *LaRosa Int'l Fuel Co., Inc. v. United States*, 499 F.3d 1324 (Fed. Cir. 2007), cert denied 127 S.Ct. 2871 (2008), the Court held that an amount paid into an escrow was neither fish nor fowl—neither payment nor deposit, so that the taxpayer was subject to interest on the amount ultimately determined to be due. The escrow account was allegedly used to avoid losing Tax Court jurisdiction if the funds were treated as a payment. The problem, of course, is that the use of the escrow account device meant that the funds were not a deposit either thus avoiding interest on the underpayment.

significant a benefit as having the flexibility to force a return of a deposit before the underlying tax liability is finally resolved.

These funds management techniques get more critical as the zeros in the potential liability stack up (i.e., if the proposed adjustment were \$100,000,000 rather than \$1,000,000).

Keep in mind that the amounts designated as a payment will be subject to a statute of limitations on refund. I covered statute of limitations earlier. The taxpayer must pay careful attention to ensure that the right to refund of the principal amount is not foreclosed by the statute of limitations, for the opportunity to recover any interest depends upon the statute being open to recover the principal amount paid. Of course, if the taxpayer prepays during an audit or during a Tax Court proceeding, the refund statute of limitations will almost certainly be open, but you should go through those rules to be sure. Make no assumptions!

F. Time for Assessment of Interest.

The time for assessing interest with respect to the underlying tax is extended to include the period during which the IRS may collect the underlying tax.¹²²³

III. When the Government Owes the Taxpayer.

A. Overpayments.

1. General Rule - Interest is Due.

Interest is generally due where the taxpayer has made an overpayment. In this case, under the use of money construct, the IRS has had the use of the amount of the overpayment during the period that it was not owed and should pay interest.¹²²⁴

Section 6611(b) triggers the interest starting date to the date of the overpayment. Where the taxpayer overpays as of the date of the timely return (whether by withholding, estimated taxes, or taxes paid with the timely return), the interest will accrue from the due date of the return. No interest accrues, however, during the period from the due date to the date that a delinquent return is filed in

¹²²³ § 6601(g).

¹²²⁴ *E.W. Scripps Company v. United States*, 420 F.3d 589, 592-593 (6th Cir. 2005) (§ 6611 is compensation “for the lost time-value of their [taxpayers’] money when they make overpayments of tax”: requiring “statutory interest reflects an attempt to return the taxpayer and the Government to the same positions they would have been in if no overpayment of tax had been made.”)

processable form.¹²²⁵ The IRS may compute the interest through a date preceding the date of the refund by not more than 30 days.¹²²⁶

Keep in mind that we are dealing here with overpayments—when the amount paid exceeds the amount due. We are not dealing with amounts remitted to the IRS under the bond procedure discussed above. Amounts in excess of the tax due under the bond procedure are not overpayments but amounts deposited with the IRS that may be returned to the taxpayer upon request.

2. No Interest Prior to the Tax Due Date.

I cover elsewhere certain payment mechanisms whereby taxpayers pay the tax in advance of the normal due date required for payment. The most frequently encountered examples of such prepayments prior to liability are withholding from employees' compensation and estimated payments of tax made during the year. Another form of such prepayment is to apply a tax refund due for one year to the tax liability of the succeeding year. No interest accrues on such prepayments through the date the tax is deemed paid (April 15 of the following year in the case of an individual).¹²²⁷ Interest will accrue from the date the tax so prepaid is deemed paid (April 15 in the case of an individual) until the refund is made. So, the taxpayer does not get interest for the period

¹²²⁵ § 6611(b)(3) (no interest until delinquent return filed); and § 6611(g) (no interest under (b)(3) until the delinquent return is “processable,” meaning generally on the permitted form, with proper identifying information and information to permit the mathematical verification of the tax liability shown on the return. A return that meets the *Beard* test (p. 126) for a return may not be processable for this purpose. IRM 25.6.1.6.16 (10-03-2022), Processable - Unprocessable Returns (noting that, for example, “a return will be valid even though it is missing Form W-2 or Schedule D, but it will not be processable because the calculations are not verifiable.”) As to the processable requirement, see *Deutsche Bank AG v. United States*, 742 F.3d 1378 (Fed. Cir. 2014). Where, however, the taxpayer is not required to file a return, overpayment interest may accrue from the time of the actual payment. See *MNOPF Trustees, Ltd. v. United States*, 123 F.3d 1460, 1465 (Fed. Cir. 1997) (on overpayment resulting from improper withholding for a tax exempt entity not required to file a return not subject to § 6611(b)(3)); and *Overseas Thread Industries (OTI)*, 48 Fed. Cl. 221, 230 (2000) (same based on whether the taxpayer knew it was entitled to a return on filing date). For the relationship between the *Beard* test and the “processable” requirement, see PMTA 2021-06 (7/2/21) (also noting the consequences of the § 7508A relief (§ 7508 relief is discussed beginning on p. 149)); see also Bob Probasco (Guest Blogger), [Complications from Extensions and Unprocessable Returns](#) (Procedurally Taxing Blog 9/8/21).

¹²²⁶ § 6611(b)(2). The statute keys the cessation of interest accrual to the tendering of the refund check, “whether or not such refund check is accepted by the taxpayer after tender of such refund check to the taxpayer.” An issue has arisen whether the act of the IRS makes a “tender” by mailing the refund check but the check is lost in the mail so that the taxpayer does not receive it. Sometimes, where the mailing is lost or misdirected by the USPS, there is a long period after the mailing before the taxpayer discovers the nondelivery and the IRS thereafter writes a new check and delivers (tenders) the new check to the taxpayer. Should the original mailing of the lost refund check stop interest during the time that the taxpayer had no ability to obtain use of the funds because he did not have and did not even know of the lost refund check? In *Doolin v. United States*, 918 F.2d 15 (2d Cir. 1990), the IRS argued that the § 6611(b)(2) stops interest during that period regardless of whether the refund check is delivered. The Second Circuit held otherwise, keying its analysis to the statutory word “tender.” Large amounts can turn on this issue. For example, in one prominent case involving very large amounts of interest, a taxpayer chose a refund suit in the district court in the Second Circuit because of *Doolin* but failed because the district court did not have jurisdiction over the overpayment interest issue, a matter more properly heard by the Court of Federal Claims. See *Pfizer, Inc. v. United States*, 939 F.3d 173 (2d Cir. 2019) (holding no jurisdiction for overpayment interest under § 1346(a)(1) but reversing for transfer to the Court of Federal Claims under 28 U.S.C. § 1631); accord *Bank of America v. United States*, 964 F.3d 1099 (Fed. Cir. 2020). For a good discussion of this forum shopping ploy for the favorable *Doolin* precedent, see Bob Probasco, [The Tide Keeps Going Out, Carrying Overpayment Interest Suits Away from District Courts](#) (Procedurally Taxing Blog 7/6/20).

¹²²⁷ §§ 6611(d) & 6513.

of the from the date of the remittance until the date the tax is due (i.e., the period prior to April 15 of the succeeding year when the tax becomes technically due).¹²²⁸

3. IRS 45 Day Grace Period on Overpayments.

The IRS has certain grace periods, generally 45 days, during which interest will not accrue if a refund is made in the timely made. These are:

- The IRS has a grace period where no interest is paid if the refund is made within 45 days of (a) the original due date of the return for a return filed on or before the original due date of the return, or (b) the date of filing a return after the original due date (i.e., a delinquent return).¹²²⁹
- If the taxpayer files a claim for refund (i.e., an amended return claiming a refund), the IRS has a grace period of 45 days to pay the refund and interest will not accrue in the 45 day period if it does so.¹²³⁰
- For IRS initiated refunds, the IRS is authorized to subtract 45 days from the date of the refund in calculating the interest on the refund.¹²³¹
- In each of the foregoing instances, the interest-free grace period is extended to 180 days if the overpayment refunded results from withholding tax under Chapters 3 (§§ 1441 - 1464, relating to withholding on payments to nonresident aliens and foreign corporations) or 4 (§§ 1471 to 1474, related to payments to foreign financial institutions and other foreign entities).¹²³²

These grace periods only affect the accrual of interest in the suspension periods—45 or 180 days, respectively.

¹²²⁸ Assume the taxpayer, an individual, is entitled to a refund of \$100 for Year 1 and applies it toward his tax liability for Year 2. This is the functional equivalent of an actual refund to the taxpayer and the taxpayer's payment of an equivalent estimated tax payment for the Year 2 tax liability as of April 15 of Year 2, the date the refund for Year 1 became due. Assume then, at the end of Year 2, the taxpayer has no tax liability for Year 2. The taxpayer then will be entitled to a refund of the Year 2 tax of \$100 that he prepaid by applying the Year 1 refund. Interest on the Year 2 refund will begin accruing as of April 15 of Year 3, the due date of the Year 2 return. The taxpayer will not get interest for the period that the Government held the money from April 15 of Year 2 until April 15 of Year 3. If, however, the taxpayer had taken the Year 1 refund rather than crediting the Year 1 refund against the Year 2 tax, the taxpayer could have earned interest on the \$100 during that period. Variations of this type of interest free loan to the Government are explored in *Marsh & McLennan Cos., Inc. v. United States*, 302 F.3d 1369 (Ct. Fed. Cl. 9/6/02). The same phenomenon of denying interest on prepayments is true for all types of prepayments (including withholding and estimated taxes), so where large numbers are involved (as was the case in *Marsh & McLennan*), taxpayers should take steps to avoid prepaying too much tax.

¹²²⁹ § 6611(e)(1). Note that the loss of interest from the date of the overpayment through the filing of a delinquent original return is a penalty for filing late if the IRS refunds during that 45 day period. A question has arisen whether the

¹²³⁰ § 6611(e)(2). This rule for interest also applies to refunds arising from a net operating loss carryback; the refund in the 45 days from the date of claiming the refund for the carryback avoids the payment of interest. TAM-106302-99/CC:DOM:IT&A:B1 (200002007 released 1/14/2000).

¹²³¹ § 6611(e)(3).

¹²³² § 6611(e)(4).

The IRS's position is that the refund is tendered when the check is mailed to the proper address (the old "it's in the mail" gambit), even if the taxpayer does not receive the check.¹²³³

B. Interest Rate.

1. General Overpayments.

For individuals, the overpayment interest rate is the same as the general underpayment rate—i.e., short-term federal rate plus 3 percentage points. §§ 6611(a) referring to § 6621. For the third quarter of 2022, this interest rate is 6% for individuals and 6% for corporations¹²³⁴

2. Special Reduced Corporate Overpayment Rates.

There are two provisions reducing the rate of interest for refunds paid to corporations. Corporations for this purpose means corporations as the term is generally used in the law and thus includes both for profit and not for profit corporations.¹²³⁵

a. General 1% Reduction.

For corporations, however, the overpayment interest rate is reduced by one percent (i.e., the rate is the short-term federal rate plus 2 percent rather than 3 percent). § 6621(a)(1). For the third quarter of 2022, this interest rate is 6%.¹²³⁶

b. Corporate Overpayments Over \$10,000.

There is a critical exception—for corporate overpayments exceeding \$10,000—the short-term federal rate is only increased by 0.5 percentage points. § 6621(a)(1) (flush language). (This reduced interest rate is often referred to as the "GATT rate"¹²³⁷). Mathematically, the interest rate is 1.5%

¹²³³ FSA 200152001, reprinted at 2001 TNT 251-23.

¹²³⁴ Rev. Rul. 2023-11, IRB 2023-23; IR-2023-104, May 22, 2023.

¹²³⁵ Not for profit corporations argued unsuccessfully that they were not subject to the reduced rates. See *Wichita Ctr. for Graduate Med. Educ., Inc. v. United States*, 917 F.3d 1221 (10th Cir. 2019) (collecting cases from other circuits uniformly rejecting the argument); *Charleston Area Med. Ctr. Inc. v. United States*, 940 F.3d 1362 (Fed. Cir. 2019) (also collecting cases).

¹²³⁶ Rev. Rul. 2022-11, 2022-23 I.R.B. 1.

¹²³⁷ The statutory language in § 6621(a)(1) (flush language) effecting the reduction was added as a result of the Uruguay Round of Multilateral Trade Negotiations conducted under the auspices of the General Agreement on Tariffs and Trade ("GATT"), Pub. L. 103-465, sec. 713(a), 108 Stat. 5001-5002 (1994). For a discussion of the history of this interest rate reduction, see *Gen. Elec. Co. v. United States*, 384 F.3d 1307 (Fed Cir. 2004), *State Farm Mut. Auto. Ins. Co. v. Commissioner*, 126 T.C. 28 (2006), and *ExxonMobil Corporation v. Commissioner*, 126 T.C. 36 (2006), aff'd 484 F.3d 731 (5th Cir. 2007), which involved the effective date of the reduction. For an interesting application of the reduction, see ILM 200951033 (10/13/09), which concluded that the reduction did not apply to interest paid on a refund to a corporate taxpayer on the employee's share of FICA that must be passed on to the employee. ILM 200951033 (10/13/09).

lower than the regular corporate rate discussed above.¹²³⁸ For the third quarter of 2022, this interest rate is 2.5 %.¹²³⁹

As you can see, this low interest rate is a powerful incentive for corporations not to loan money to the Government via overpayment of taxes, because they can likely achieve a better return elsewhere. (By the same token, of course, as noted above, the large corporate underpayment interest premium—the so-called “hot interest” in § 6621(c)—creates a powerful incentive to avoid being a debtor to the Government at least after the IRS makes the critical determinations of additional tax due and owing; in short, there are incentives for corporations to better manage the due tos and due froms in the tax area.) Although S Corporations are normally not subject to tax, sometimes they can be; the court opinions conflict as to whether any overpayment by S Corporations will be subject to this reduced interest rate.¹²⁴⁰ This reduction is also applied to any amounts due by the Government that are treated as a tax for purposes of calculating interest on the amounts due, such as, for example, interest due on wrongful levies.¹²⁴¹

C. Deposits.

I discussed deposits above to illustrate that a deposit stops the running of interest on a deficiency plus accrued interest up to the amount of the deposit. You will also recall that, under *Rosenman*, generally deposits do not accrue interest in favor of the taxpayer if they are returned to the taxpayer because the deposit exceeds the amount due. Section 6603 (p. 282) mitigates this in some cases by providing for interest on a bond but at a lower rate than the normal overpayment rate.

I return here to the deposit concept to remind you of the downside of deposits when the Government ends up owing the taxpayer. To put this in context, let's assume that, on 12/1/XX, the IRS issues a notice of deficiency for \$1,000,000. The corporate taxpayer calculates interest of \$100,000 on the \$1,000,000 deficiency. The corporate taxpayer will file a Tax Court petition to contest the deficiency and believes that it will ultimately prevail on ½ of the asserted deficiency (and, since the interest is just ad valorem based on the deficiency, on ½ of the calculated interest). Accordingly, on 12/31/XX, the day of filing the petition, the taxpayer sends \$550,000 to the IRS. Let's assume then that the taxpayer succeeds spectacularly and eliminates the deficiency altogether. If the taxpayer sent the \$550,000 as a deposit, the taxpayer will be entitled to return of the \$550,000 plus no interest or interest at the reduced § 6603 rate.

Why would a taxpayer direct a remittance to the IRS be treated as a deposit? The advance treated as a deposit will, like a payment, stop the running of interest if there is a deficiency. So, in terms of stopping interest on a deficiency, the deposit acts just like a payment. However, as noted, historically, the deposit did not draw interest if the deposit is in excess of the ultimate deficiency and accrued interest on the deficiency, whereas a payment will draw interest to the extent it exceeds the

¹²³⁸ See e.g., IRM 20.2.4.9.1 (03-05-2015), GATT Credit Interest-Computations on Overpayments (“The GATT rate is one and a half points below the normal corporate credit interest rate for overpayments exceeding \$10,000 for all business taxpayers with a corporate filing requirement.”).

¹²³⁹ Rev. Rul. 2023-11, IRB 2023-23; IR-2023-104, May 22, 2023.

¹²⁴⁰ *Garwood Irrigation Co. v. Commissioner*, 126 T.C. 233 (2006) (holding the reduced interest rate does not apply); and *Eaglehawk Carbon v. United States*, 2015 U.S. Claims LEXIS 862 (2015) (rejecting the holding of *Garwood*).

¹²⁴¹ *Steven N.S. Cheung, Inc. v. United States*, 545 F.3d 695 (9th Cir. 2008).

deficiency plus accrued interest on the deficiency. Under § 6603, the deposit will draw interest at the federal short term rate. An overpayment (as opposed to a deposit) will draw interest under the rules noted above—e.g., for individuals, it is the federal short term rate plus 3%. So, there is still a 3% interest cost to a deposit that is returned to a taxpayer as opposed to a payment that is returned to the taxpayer. The advantage to a taxpayer of making the advance to the IRS as a deposit rather than a payment is that the taxpayer can, upon request, require the IRS to return an amount sent as a deposit. It is a rare case where this advantage will justify giving up the potential right to interest if the taxpayer has overestimated the payment that is required.

D. Interest on Judgment of Refund.

When an overpayment is determined in a tax refund suit and incorporated in a court judgment, the interest on the judgment is the same as the overpayment rate discussed above.¹²⁴²

IV. Miscellaneous Interest Issues.

A. Interest on Penalties.

The penalties that are subject to the deficiency procedures (most prominently the fraud and accuracy related penalties that I discuss below) accrue interest from the due date of return. § 6601(e)(2)(B).¹²⁴³ I hope that you understand why. If interest did not accrue, a taxpayer subject to the penalty could delay the assessment of the penalty and thus mitigate the economic impact of the penalty. So-called assessable penalties (i.e., those not requiring a notice of deficiency)¹²⁴⁴ often do not accrue interest until the notice and demand for payment (with parallel 21/10 day grace periods from the date of notice and demand for payment). § 6601(e)(2)(A).¹²⁴⁵

B. Carrybacks and Carryforwards.

The Code provides for certain carrybacks and carryforwards which have the effect of mitigating some of the harsh consequences of the requirement that taxes be computed annually. For example, a new corporate taxpayer may lose \$1,000,000 in the first year (with the losses achieving no tax benefit) and earn \$1,000,000 in the second year. If there were not a mechanism to consider the losses in the first year, this corporate taxpayer would have a substantial Year 2 tax liability, even though economically it has made no net profit. Thus, the Code permits a taxpayer having certain tax beneficial attributes (e.g., net operating losses or foreign tax credits) that the taxpayer cannot use

¹²⁴² 28 U.S.C. § 2411.

¹²⁴³ The reference to “under part II of subchapter A of chapter 68” includes the accuracy related and civil fraud penalties.

¹²⁴⁴ For example, the penalties under § 6677 for failure to file Forms 3520 and 3520A (relating to foreign trusts required by §§ 6048 and 6038(b)) and § 6707A (failure to disclose participation in certain tax advantaged transactions) are assessable penalties not requiring a predicate notice of deficiency. See, as to § 6707A, *Smith v. Commissioner*, 133 T.C. 424 (2009). (Note however that the Tax Court held in *Fahry v. Commissioner*, 160 T.C. ___, No. 6 (2023) held that § 6038(b) penalties are not assessable penalties, with the result that the IRS has no authority to assess and use the administrative collection tools).

¹²⁴⁵ An example of an assessable penalty that bears interest only from the date of the assessment is the § 6672 trust fund recovery tax penalty. See *Purcell v. United States*, 1 F.3d 932, 942 (9th Cir. 1993). However, interest on the failure to file penalty under § 6651(a)(1) runs from the due date of the return. § 6601(e)(2)(A). The failure to pay penalty (FTP) is an assessable penalty that does not bear interest until assessed.

in the year in which they accrue to carry them back to an earlier year or carry them forward to a later year.¹²⁴⁶ The carrybacks and carryforwards permit the taxpayer to “set off its lean years against its lush years, and to strike something like an average taxable income computed over a period longer than one year.”¹²⁴⁷ The carryback (as opposed to carryforward) period is generally 2 years.¹²⁴⁸

A carryback to an earlier year can create an overpayment and resulting right to a refund in the earlier year. For example, if an individual taxpayer pays \$100 tax for Year 1 and, in Year 2, incurs a net operating loss that can be carried back to Year 1, the loss will create an overpayment of all or a portion of the Year 1 tax paid. For calculating interest on the overpayment, the overpayment is deemed to occur at the earliest on the original due date of the Year 2 return.¹²⁴⁹ However, if the IRS pays the resulting refund within the 45 day grace period after filing the Year 1 refund claim incorporating the NOL carryback, the taxpayer will be entitled to no interest on the overpayment.¹²⁵⁰

What happens in the above example if Year 1 is a deficiency year so that the effect of a carryback from Year 1 is to reduce or eliminate the deficiency? Interest accrues on deficiencies, so the question is what effect the carryback has on the accrual of interest on the deficiency for Year 1. To the extent that the carryback reduces a deficiency for the earlier year, interest still accrues on the deficiency in the prior year until the return is filed for the year of loss.¹²⁵¹ Thus, in this example, interest on the Year 1 underpayment (deficiency) will accrue from the due date of the Year 1 return to the filing date of the Year 2 return claiming the loss giving rise to the carryback.

C. Mutual Indebtedness, Setoffs and Interest Netting.

Frequently, particularly with large corporate taxpayers, there will be years where substantial refunds are due and other years for which substantial deficiencies are due.¹²⁵² A strict application of the interest rate rules noted above could mean that the taxpayer owes the large corporate interest rate (federal short-term rate plus 5 percentage points) on the underpayments and yet is entitled to only the corporate overpayment rate (federal short-term rate plus .05 percentage point) on its contemporaneous overpayments, when in fact there was really no net amount due the Government.

¹²⁴⁶ § 172(b)(1)(A) (NOL deductions). The carryback period has been extended for eligible small businesses pursuant to an amendment to § 162(b)(1)(H) by the American Recovery and Reinvestment Act of 2009. The amendment permits electing small businesses a 3,4 or 5 year carryback for net operating losses, rather than the usual 2 year carryback. The Worker, Home Ownership and Business Assistance Act of November 26, 2009 contained a provision to allow most taxpayers an increased carryback period for losses in 2008 and 2009. This new provision is not limited to small businesses.

¹²⁴⁷ *Libson Shops, Inc. v. Koehler*, 353 U.S. 382, 386 (1957).

¹²⁴⁸ This carryback period was extended up to 5 years for NOL arising in 2008 and 2009. § 172(b)(1)(H). The reason was the drastic downturn in the economy during those years for which Congress felt an extended carryback period was appropriate.

¹²⁴⁹ § 6611(f)(1) and (4) (earliest date for interest is the filing date for the loss year return, but filing date is defined as the original due date).

¹²⁵⁰ This rule may be gathered from the language of § 6611(f)(4)(B). I don't encourage anyone to sort this out unless they have a real need.

¹²⁵¹ § 6601(d) (applying the principle for NOL carrybacks, foreign tax credit carrybacks and certain other credit carrybacks). See also *Manning v. Seeley Tube & Box Co. of N.J.*, 338 U.S. 561 (1950); and *United States v. Beane*, 841 F.3d 1273 (11th Cir. 2016).

¹²⁵² A common instance where this occurs is where the IRS denies the taxpayer deductions in an earlier year that are then allowed in a later year.

Even though there is no net principal amount due, the net interest rate cost (4.5%)¹²⁵³ could be major.¹²⁵⁴ And, even when the large corporate interest rate add-on of 2% doesn't apply, there is still a 2.5% differential¹²⁵⁵ in rates so there can still be net interest due during the period when there is no net debt. On very large overlapping overpayments and underpayments, the differential can be major.

A similar inequity can apply even with same year underpayments and overpayments. This phenomenon has been referred to as "Annual interest netting."¹²⁵⁶ An example: For example, on 3/15/13, corporation files income tax return for 2012, filed on 3/15/2013 showing an overpayment of \$3 million, which the IRS refunds with the lower rate of interest (short term rate plus .5%) on 1/5/2015. After an audit, the IRS assesses additional tax of \$5 million for 2012 (the \$3 million erroneously refunded plus an additional \$2 million). The strict application of the interest rules would require the large corporate rate (short term rate plus 5%) from the date the return was due and filed even though the taxpayer was paid only the refund rate of short term rate plus .5%.

The Code, as interpreted, provides mechanisms for resolving this type of inequity. First, in the Annual interest netting case, the overlapping amounts are netted into a single balance before computing interest so as to eliminate the interest differential.¹²⁵⁷ Second, if the IRS credits an overpayment against an underpayment,¹²⁵⁸ interest does not accrue on the underpayment during any period for which the taxpayer would have been entitled to a refund on the overpayment being credited.¹²⁵⁹ One problem with this relief provision is that the IRS is not required to credit but may actually refund the overpayment and demand the underpayment, thus making the relief unavailable. Third, under a provision commonly referred to as the "global interest netting" the interest rate is zero in such mutual indebtedness situations by the same taxpayer during the period of mutual indebtedness.¹²⁶⁰ This relief is not discretionary.

¹²⁵³ The corporate overpayment rate is the federal short term rate plus .5% for overpayments in excess of \$10,000 (§ 6621(a)(1), flush language). The corporate underpayment rate for large corporate underpayments (in excess of \$100,000) is the federal short term rate plus 5% (§ 6621(a)(2) and (c)). There is thus a 4.5% differential.

¹²⁵⁴ In *Federal National Mortgage Association v. United States*, 379 F.3d 1303 (Fed. Cir. 2004), the Court noted that this disparity generated a net interest cost of over \$10,000,000 for the periods involved. The taxpayer obtained no relief there because the court held that, during the transition period, both the refund and deficiency statutes of limitation need to be open.

¹²⁵⁵ The corporate overpayment rate is the federal short term rate plus .5% for overpayments in excess of 410,000 (§ 6621(a)(1), flush language). The corporate underpayment rate (with no large corporate underpayment add on) is the federal short term rate plus 3% (§ 6621(a)(2)). There is thus a 2.5% differential.

¹²⁵⁶ See Bob Probasco (Guest Blogger), [A Question of Identity– Interest Netting, Part 1](#) (Procedurally Taxing Blog 1/8/19). (The example in the text is copied from that blog entry); and Bob Probasco (Guest Blogger), [A Question of Identity– Interest Netting, Part 2](#) (Procedurally Taxing Blog 1/9/19).

¹²⁵⁷ See *Avon Products Co. v. United States*, 588 F.2d 342 (2d Cir. 1978); acquiesced in Rev. Proc. 94-60, 1994-2 C.B. 774; and PMTA-2008-01850 (6/20/08) explaining: "Rev. Proc. 94-60, 1994-2 C.B. 774, provides, in essence, that when a taxpayer receives an excessive tax refund as defined by Rev. Proc. 94-60 and interest is paid on the refund, interest will be calculated by the Service in a manner that effectively eliminates the interest differential under section 6621" and providing further elaboration on how that elimination occurs). See also *Goldring v. United States*, 15 F.4th 639 (5th Cir. 2021).

¹²⁵⁸ § 6402(a).

¹²⁵⁹ § 6601(f).

¹²⁶⁰ § 6621(d). For a robust discussion of this provision, see Bob Probasco, [A Question of Identity– Interest Netting, Part 1](#) (Procedurally Taxing Blog 1/8/19); and David Berke, [More of the Same: Section 6621\(d\) in the Federal Circuit](#), 72 Tax Lawyer. 201 (2018). Here is the summary of the law, as I understood it, prior to Probasco's and
(continued...)

D. Normal and Restricted Interest.

In the previous discussion, I have focused on the usual rules of interest. The IRM has two categories of interest – “normal interest” and “restricted interest.”

- Normal interest is “interest that is computed based on conventional beginning and ending dates” including (i) for underpayments, interest that “is computed from the date the liability is due to the date the liability is fully paid, taking into account any payments and credits” and (ii) for overpayments,” interest “computed from the availability date of the overpayment to the date the overpayment is offset (credited) and/or refunded.”¹²⁶¹
- Restricted interest is “any interest that is computed from other than the normal interest beginning and ending dates, including statutory exceptions of time (e.g., IRC 6601(c), IRC 6404(g)) or rate (e.g., IRC 6621(c), IRC 6621(d)).”¹²⁶² The key difference between restricted interest and normal interest is “that the computer may not be able to identify all conditions involved in a restricted interest situation,” so the restricted interest calculations cannot be completed by the computer and must be computed by someone familiar with the interest restrictions.¹²⁶³ For example, § 6404(g) provides for interest suspension periods and thus requires special interest calculations taking into account the interest suspension period. Section 6621(c)

¹²⁶⁰(...continued)

Berke’s more robust (and longer) discussions:

In *Energy East Corp. v. United States*, 645 F.3d 1358 (D.C. Cir., 2011), the court held that, really, “the same taxpayer” requirement of the statute means “same taxpayer” when the offsetting overpayment and underpayments existed. Actually, perhaps, the issue was more nuanced than that, but not much. The corporations were separate taxpayers wholly unrelated to the parent corporation when the underpayment was due and the overpayments were made. In *Wells Fargo & Co. v. United States*, 827 F.3d 1026 (Fed. Cir. 2016), the Court dealt with the same taxpayer requirement in the case of three merger situations presenting the issue of whether the surviving corporation in a merger and the disappearing corporations were the same taxpayer so that pre-merger liabilities and overpayments of different disappearing corporations or a disappearing and the surviving corporation could be offset. The Court held the issue was one of timing, and if the corporations were completely separate at the time of the underpayment and overpayment, netting would not be allowed, but if the underpayment and overpayment were successive and one occurred after the merger, netting could be allowed. I won’t get any further into the weeds on this one. See also, though, *Ford Motor Company v. United States*, 132 Fed. Cl. 104 (2017), aff’d 908 F.3d 805 (Fed. Cir. 2018) (U.S. corporation and its Foreign Sales Corporation two separate taxpayers). If you encounter this issue, just be aware that it is an issue and, since lots of money will likely be involved, research further with your client compensating you handsomely.

In *Exxon Mobil Corp. v. Commissioner*, 689 F.3d 191 (2d Cir. 2012), the Second Circuit applied this interest netting rule retrospectively based on its interpretation of special non-codified legislation that permitted such retrospective application prior to the date of enactment of the required interest netting prospectively. This precise holding is probably of no future precedential importance because of its limited nature for the retrospective years, but the Second Circuit does have some interesting analyses of statutory interpretation in reaching the conclusion. Moreover, for procedural reasons, the issue appears to be most often presented in cases that must be pursued in the Court of Federal Claims which has a pro-government interpretation. See Marie Sapirie, [Exxon Mobil Shows Importance of Transition Rules](#), 136 Tax Notes 873 (Aug. 20, 2012).

¹²⁶¹ IRM 20.2.1.4 (01-25-2021), Normal and Restricted Interest.

¹²⁶² Id.

¹²⁶³ IRM 20.2.1.4 (01-25-2021), Normal and Restricted Interest.

provides some cross-references to Code Sections which restrict interest, but the IRM compiles the provisions of the Code restricting interest.¹²⁶⁴

E. Deficiency or Refund Interest Paid or Accrued.

Interest received by the taxpayer on overpayments is taxable income.¹²⁶⁵ Interest paid by the individual taxpayer on deficiencies, however, is personal interest which is not deductible by individuals.¹²⁶⁶ Interest paid by the corporate taxpayer, however, is not personal interest and may be deducted.¹²⁶⁷ In short, the interest deduction mitigates the corporate taxpayer's cost for borrowing from the Government via underpaid taxes.

F. Contesting Interest Calculations.

Interest is a function of the amount of the principal and the length of time involved. Interest on underpayments or overpayments can be significant depending upon the amount of tax and/or time involved. The actual interest calculations can be arcane.¹²⁶⁸ That is why accounting firms and in-house tax departments spend considerable time checking the IRS interest calculations.

The taxpayer may contest the IRS interest calculations if the taxpayer disagrees with the IRS and is unable to resolve the calculation internally. Section 7481(c) gives the Tax Court jurisdiction to redetermine IRS interest calculations which are based on the tax and penalties determined in a Tax Court case.¹²⁶⁹ The taxpayer must fully pay the tax and interest, thus making the procedure in effect a refund procedure. The procedure must be brought within one year of the date the Tax Court decision becomes final.¹²⁷⁰ In other cases, where the taxpayer disagrees with the IRS's interest calculations on a deficiency, the taxpayer may pay the tax and interest, file a claim for refund and bring a refund suit.¹²⁷¹

¹²⁶⁴ IRM Exhibit 20.2.1-1, Provisions Restricting Interest.

¹²⁶⁵ § 61(a)(4).

¹²⁶⁶ § 163(h). See *Robinson v. Commissioner*, 119 T.C. 44 (2002) discussing the cases on this subject.

¹²⁶⁷ § 163(a).

¹²⁶⁸ Thomas Johnston, Ian Friedman, and Richard Gagnon, Jr., Third Circuit Warns in Sunoco: Don't Put Off Interest Issues, 134 Tax Notes 1155 (Feb. 27, 2012).

¹²⁶⁹ Apart from the special grant in § 7481(c), the Tax Court generally lacks jurisdiction to hear disputes about interest. *United States v. Beane*, 841 F.3d 1273, 1283-1284 (11th Cir. 2016); *Bax v. Commissioner*, 13 F.3d 54, 56 (2d Cir. 1993); *ASA Investering Pship. v. Commissioner*, 118 T.C. 423, 424 (2002); *LTV Corp. v. Commissioner*, 64 T.C. 589, 597 (1975). This is because assessment of interest, unlike assessment of the tax, does not require a predicate notice of deficiency. See § 6213(a) requiring a predicate notice of deficiency for the tax; and § 6601 treating interest as tax “except [for purposes of] subchapter B of chapter 63, relating to deficiency procedures.”

¹²⁷⁰ Finality is determined under § 7481(a) and, as you might suspect, the Tax Court decision does not become final until all appeals, including by writ of certiorari to the Supreme Court, have been exhausted. We encountered § 7481(a)'s finality concept above (p. 208.) in discussing the rules for determining the period of suspension of the statute of limitations when a taxpayer pursues a Tax Court petition for redetermination.

¹²⁷¹ Although rare, if a taxpayer contests only the interest the IRS calculates in making an overpayment not resulting from a Tax Court decision, the taxpayer must sue in the Federal Court of Claims pursuant to 28 U.S.C. § 1491(a)(1). *Pfizer, Inc. v. United States*, 939 F.3d 173 (2d Cir. 2019); accord *Bank of America v. United States*, 964 F.3d 1099 (Fed. Cir. 2020). The applicable statute of limitation is 6 years. 28 U.S.C. §§ 2401 and 2501. At least in the Court of Federal Claims, this statute of limitations is subject to the “accrual suspension rule” which suspends the statute if the plaintiff shows the defendant concealed acts so that plaintiff was not aware of the claim or that the claim was “inherently
(continued...)

At least in large dollar tax cases where interest is also large, the interest issues should be addressed and identified early so as to not have a procedural foot fault as the dispute over the correct tax liability grinds along.¹²⁷²

G. Who Really Does This Type of Work?

The procedures for calculating restricted interest, somewhat arcane in application, are beyond the scope of this work.¹²⁷³ Interest calculations (including restricted interest calculations) are for the back room green eye shade guys, and not us lean and mean gregarious tax lawyers, so I recommend that my students pass this work on to guys with the skills and personality to see the calculations through. In this regard, most major accounting firms and any number of boutiques do interest calculations for an appropriate fee, which often is a contingency fee.¹²⁷⁴

However, as I noted above, for purposes of general tax practice, it is often sufficient to have a general ballpark number so that clients can understand the consequences of their decisions and the financial risks that might be involved. In such cases, I use a Tax Interest program authored by Time Value Software. The program is a pretty good interest calculator. A number of return preparers with whom I work use the program, for example, to calculate interest that will be due on amended returns showing a tax due and in other contexts where a good interest calculator is required. For my purposes as a tax controversy attorney, the program gives me a critical tool I need to help my clients make decisions and anticipate results. And this would be true in both small and very large cases.

¹²⁷¹(...continued)

unknowable.” *Paresky v. United States*, 2018 U.S. Claims LEXIS 966 (2018) (citing *Ingrum v. United States*, 560 F.3d 1311, 1314 (Fed. Cir. 2009); and *Young v. United States*, 529 F.3d 1380, 1384 (Fed. Cir. 2008)). In addition, the D.C. Circuit has held that the § 2401 statute of limitations is not jurisdictional, meaning that it might be subject to equitable tolling extending the six-year period for filing suit. *Jackson v. Modly*, 949 F.3d 763 (D.C. Cir. 2020).

¹²⁷² Thomas Johnston, Ian Friedman, and Richard Gagnon, Jr., [Third Circuit Warns in Sunoco: Don't Put Off Interest Issues](#), 134 Tax Notes 1155 (Feb. 27, 2012). I have to say, in candor, that all of this interest nuance makes my head hurt

¹²⁷³ See Rev. Proc. 83-58, 1983-2 C.B. 575 for the procedures.

¹²⁷⁴ Under new Circular 230 rules, practitioners are normally precluded from charging contingency fees, but for interest and penalty calculation work, they can charge contingency fees. Reg. § 10.27; See Jeremiah Coder, [Back-to-Back Circular 230 Changes Reveal Winners, Losers](#), 2007 TNT 187-1 (9/26/07).

Ch. 6. Penalties.

I. Introduction.

It is often claimed that we have a voluntary tax system.¹²⁷⁵ So the myth¹²⁷⁶ goes, U.S. taxpayers voluntarily report and pay their tax liabilities because they are honest and are willing to pay this price for civilized society. The truth is that our tax system is not voluntary. The law commands that taxpayers report and pay their tax liabilities. The law doesn't simply say that they may volunteer to report and pay in whatever amounts they think appropriate. Congress provides penalty inducements to comply with the obligations to report and pay. The IRS has an enforcement program designed to impose these inducements.¹²⁷⁷ I focus here on these penalty inducements.

First, let's make sure that we understand the general legal concept of penalties. The Supreme Court recently synthesized its holdings as to what a penalty is:

A “penalty” is a punishment, whether corporal or pecuniary, imposed and enforced by the State, for a crime or offense against its laws. This definition gives rise to two principles. First, whether a sanction represents a penalty turns in part on whether the wrong sought to be redressed is a wrong to the public, or a wrong to the individual. Although statutes creating private causes of action against wrongdoers may appear—or even be labeled—penal, in many cases neither the liability imposed nor the remedy given is strictly penal. This is because penal laws, strictly and properly, are those imposing punishment for an offense committed against the State. Second, a pecuniary sanction operates as a penalty only if it is sought for the purpose of punishment, and to deter others from offending in like manner—as opposed to compensating a victim for his loss.¹²⁷⁸

For example, we deal in this book later with one provision, § 6672, which nominally imposes a “penalty” often referred to as the Trust Fund Recovery Penalty (“TFRP,” see discussion beginning on p. 793). This “penalty,” as applied, only compensates the Government for tax the employer should have withheld from employees and paid over to the IRS. As thus applied, it is not a penalty in the sense noted above but is designed to compensate the Government for lost revenue.¹²⁷⁹ The balance of this section will deal with statutory provisions that meet the definition of penalty. In Section II, I cover criminal penalties and related matters. In Section III, I cover civil penalties and related matters.

¹²⁷⁵ Bryan T. Camp, *Theory and Practice in Tax Administration*, 29 Va. Tax Rev. 227, 264-265 (2009) (with good quotes from the first Commissioner of Internal Revenue in 1862 through President Kennedy in 1961).

¹²⁷⁶ I use myth in its academic sense to mean a cultural acceptance of something that may or may not be true in an absolute sense.

¹²⁷⁷ IRM 1.2.1.6.1 1 (08-18-1994), Policy Statement 5-1: “A tax system based on voluntary assessment would not be viable without enforcement programs to ensure compliance.”

¹²⁷⁸ *Kokesh v. SEC*, 581 U.S. 455, 461 (2017) (Cleaned up).

¹²⁷⁹ Having said that, as noted later, the TFRP is treated as a penalty for purposes of the requirement for prior supervisory written approval in § 6751(b). And, to be sure, those subject to the TFRP will feel the sting like a penalty for their conduct in failing to exercise responsibility to withhold and pay over. But it is not a penalty in the sense noted above as some additional cost imposed beyond the damage caused by the conduct (which for the TFRP is simply the uncollected tax that they should have withheld and pay over).

The IRS states the overall purpose of tax penalties:¹²⁸⁰

- Penalties are used to enhance voluntary compliance.
- Penalties assist IRS efficiency in collection of tax revenue by encouraging voluntary compliance.
- Penalties encourage voluntary compliance by (a) demonstrating fairness in the tax system and increasing the cost of noncompliance.

Since the goal of the tax system is compliance, the penalties are properly viewed as incentives for compliance or, alternatively, disincentives for noncompliance. The Supreme Court in a famous criminal tax case said that the tax system imposes “a system of sanctions which singly or in combination were calculated to induce prompt and forthright fulfillment of every duty under the income tax law and to provide a penalty suitable to every degree of delinquency.”¹²⁸¹ The criminal penalties are viewed as the punishment for conduct deemed most offensive to the tax system, The panoply of civil penalties applies to the same conduct and to other less system-offensive conduct for which Congress deemed civil penalties appropriate.¹²⁸²

Focusing on the overall goal of compliance, taking the risk of being punished for tax crimes may be viewed from an economic modeling perspective as “a special form of gambling.”¹²⁸³ Using the economic/gambling metaphor, “a rational taxpayer will evade taxes if the expected value of the punishment is lower than the expected gains from evasion.”¹²⁸⁴ Simplified economic modeling would suggest that (i) if detection and properly scaled punishment for noncompliance were certain to occur, taxpayers would not use the tax system as an outlet for their gambling urges, for the odds would be against them and only the very stupid and ill-informed would cheat; but (ii) if detection

¹²⁸⁰ IRM 1.2.1.12.1 (06-29-2004), Policy Statement 20-1 (Formerly P-1-18), Penalties are used to enhance voluntary compliance); see also IRM 20.1.1.2 (11-21-2017) Purpose of Penalties.

¹²⁸¹ *Spies v. United States*, 317 U.S. 492, 497 (1943).

¹²⁸² The criminal sanctions usually have civil penalty parallels to make criminal noncompliance more costly than provided in the criminal statutes. For example, tax evasion is a crime with criminal punishment (§ 7201); the same conduct is subject to a 75% ad valorem civil fraud penalty on the tax evaded (§ 6663).

¹²⁸³ Leandra Lederman, *The Interplay Between Norms and Enforcement in Tax Compliance*, 64 Ohio St. L. J. 1453, 1463 (2003) (quoting Michael W. Spicer, *Civilization at a Discount: The Problem of Tax Evasion*, 39 Nat'l Tax J. 13, 14 (1986) (“The term ‘avoidance’ on occasion has been used to refer to tax avoidance activity of questionable legality.”).) For a good general discussion of these issues by Nobel Prize winning economist (Gary Becker) and an outstanding federal judge (Judge Posner of the Seventh Circuit), see blog entry titled “Why so Little Tax Evasion? Becker” (The Becker Posner Blog 11/07) (viewed 7/22/18).

¹²⁸⁴ Id. Professor Lederman illustrates this in a simple example that I quote in full, without the footnotes that explain some of the subtleties of the simple example (pp. 1464-5):

As a simplified example, assume that a taxpayer is facing a decision whether or not to report \$3,000 of income received in cash. Assume that the applicable tax rate is 33 1/3% so that the tax at stake is \$1,000. Also assume that if the taxpayer is caught, the taxpayer will owe a penalty of \$3,000 plus the tax that was legally due. (Assume for simplicity that all amounts are adjusted to current dollars.) If there is a 2% chance that a taxpayer will be audited and a 100% chance that, if audited, the taxpayer will owe the \$3,000 penalty, the expected penalty for noncompliance is only \$60, while the expected benefit of noncompliance is \$980 (reflecting a 98% chance of retaining the unpaid \$1,000). In other words, the expected value of cheating is \$920, and rationally the taxpayer should cheat whenever the expected value is positive.

This example assumes only dollar penalties (often referred to as civil penalties) for noncompliance. The risk of criminal penalties will increase the risk to reward ratio but in a manner that is less easily quantifiable under economic modeling concepts.

and punishment were certain not to occur or the punishment not properly scaled for the conduct, the tax system would fail, for the odds would be with the gamblers; only the very stupid and ill-informed—or those generous citizens willing to bear a disproportionate share of the cost of government—would not cheat.¹²⁸⁵ Still, traditional ways of modeling taxpayer compliance suggested by the foregoing spectrum does not fully explain the high level of taxpayer compliance in the United States. Consider the following:

This phenomenon [of U.S. taxpayer voluntary compliance] has inspired some scholars to assert that U.S. taxpayers are “pathologically honest,” in the sense that they pay more in taxes than the standard deterrence model would suggest. It is almost as if taxpayers are, in effect, making a “gift” to the government. This argument is often overstated, insofar as it fails to recognize that, with many individual taxpayers (especially those whose primary source of income is in the form of wages), the level of compliance is very high, just as the traditional deterrence model would predict. This fact seems to be due, in large part, to the role of information returns, which the IRS can easily cross reference with tax returns. Still, with respect to the corporate income tax, as well as with respect to some forms of individual income (such as self-employment income), the well-documented opportunities for undetectable evasion are so plentiful that the traditional model, narrowly construed, clearly does not provide the full explanation [for the high level of voluntary compliance].¹²⁸⁶

I have never counted the penalty provisions of the Code, but the IRM indicates that there are over 140 separate penalty provisions.¹²⁸⁷ Most practitioners usually encounter in practice only a small number of the applicable penalty provisions—most importantly, the civil penalties for inaccurate return reporting (the accuracy related and civil fraud penalties) and the delinquency penalties for failure to file, for late filing and for late payment. Practitioners should have a general sense of the range of other penalties, both criminal and civil. Practitioners should assume that for

¹²⁸⁵ This assumption involves two key variables—the certainty of detection and an appropriate penalty to fit the crime—conduct of noncompliance. Given the audit rates Congress has historically authorized (via appropriations that limit audit activity), the real world is that there is no certainty of detection. And, if there were certainty of detection, the penalty rate required to discourage the conduct could be low. But with the audit rates we have, taxpayers applying an expected utility model to their tax behavior should be subject to very high penalty rates to discourage the behavior. For example, one author has concluded that “[I]n the simple case of a risk-neutral taxpayer evading \$ 1 million of taxes with a 20 percent probability of being caught, a penalty of 400 percent . . . would leave both the taxpayer and a risk-neutral government indifferent between evasion and compliance.” Daniel Shavero, Disclosure and Civil Penalty Rules in the U.S. Legal Response to Tax Shelters, in TAX AND CORPORATE GOVERNANCE 229, 239 (Wolfgang Schön ed., 2008), as quoted in Sarah B. Lawsky, How Tax Models Work, 53 B.C. L. Rev. 1657, 1667 (2012). As readers will quickly discern, there are no such penalty structures in the Code—indeed, for conduct that bears a far lesser probability of being caught, the maximum income tax penalty provided by the Code is 75% of the tax attributable to fraud. § 6663.

¹²⁸⁶ Kyle D. Logue, The Problem of Tax Law Uncertainty and the Role of Tax Insurance, Va. Tax Rev. 339, 349, n. 12 (Fall 2005). The indented text above is not an exact quote. I have made some changes for readability, but it is close to an exact quote. The author cites at n. 13 authorities offering some explanation for the phenomenon.

¹²⁸⁷ IRM Penalty Handbook 20.1.1.1.1 (11-25-2011), Overview. (“In 1955 there were approximately 14 penalty provisions in the Internal Revenue Code. There are now more than ten times that number.”) The IRM Penalty Handbook, Chapter 1 of IRM Part 20, is a useful source for study into the penalty provisions. A caveat for this source—the Penalty Handbook is a statement of the IRS’s position with respect to the penalties and is not necessarily the position that a court might adopt.

every command in the Code there is a penalty for failure to meet the command; that assumption will usually be correct and can encourage you to research further when the need arises.

II. Criminal Penalties.

A. Introduction.

I introduce the major tax crimes. They are not a focus of a tax procedure class, but you should have a passing familiarity with them. For a larger discussion, I refer readers to the Saltzman Treatise, Chapter 12, titled “Criminal Penalties and the Investigation Function.” (Disclosure, I am the principal author of that chapter.)

I offer three general caveats to trying to understand tax crimes:

- First, although the Code defines tax crimes, there are other general federal crimes (found in 18 U.S.C., titled Crimes and Criminal Procedure) that can be deployed against people cheating on taxes; these Title 18 crimes can be charged along with or in lieu of a tax crime in the Code. For example, if a taxpayer lies to an agent in an audit, that lie may be an act of tax evasion or tax obstruction (defined in §§ 7201 and 7212(a), respectively) or it may be a false statement usually prosecuted under 18 U.S.C. § 1001. Similarly, tax crimes often involve more than one person, thus potentially constituting a conspiracy crime under 18 U.S.C. § 371.
- Second, even with the tax crimes, the Code words defining the crimes are not plain language, the full meaning of which can be understood by a lay person just reading the law. There is a body of interpretation behind virtually every word in the definition of a tax crime and for federal crimes generally. If you practice in this area, you will need to know that body of interpretation. But, in tax crimes and other criminal contexts, the body of interpretation is necessarily constrained more to the text because these are criminal provisions designed to put the nonspecialist public at risk of criminal conviction and thus the text itself needs to be more understandable to the public than Title 26 provisions that just affect their pocketbooks. Indeed, there is an interpretive doctrine known as the rule of lenity that applies to construe ambiguous criminal statutes in favor of a defendant.¹²⁸⁸ And there is a general notion that lenity covers this field and that agencies such as the IRS cannot, through regulatory interpretation under *Chevron*,¹²⁸⁹ interpret criminal statutes.¹²⁹⁰

¹²⁸⁸ Kristin E. Hickman, *Of Lenity, Chevron and KPMG*, 26 Va. Tax Rev. 905, 909-910 (2007).

¹²⁸⁹ *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984).

¹²⁹⁰ Kristin E. Hickman, *Of Lenity, Chevron and KPMG*, 26 Va. Tax Rev. 905, 918 (2007) (Courts “have clearly rejected the applicability of *Chevron* deference in criminal cases.”); see also the concurring opinion of Judge Sutton in *Carter v. United States*, 736 F.3d 722, 729 (6th Cir. 2013).

I suggest that the notion is not without its conceptual difficulties for tax crimes with an element of willfulness (see below) which require that the taxpayer intend to violate a known legal duty in a substantive statute outside the criminal statute; *Chevron* would permit the IRS to interpret ambiguous substantive statute to set the legal duty which the taxpayer must intend to violate. In other words the criminal statute itself is subject to lenity rather than *Chevron* deference, but the underlying substantive law to which willfulness – the intentional violation of a known legal duty – refers may be subject to *Chevron* deference. I reached this conclusion by logic rather than deep research and thus just
(continued...)

- Third, along with defining the tax crime, the Code states a maximum incarceration period and a maximum fine. Those Code maximums can be misleading to those not familiar with the federal criminal justice system. Monetary criminal penalties are now set under a provision of the general criminal Code (18 U.S.C.), and both sentencing and monetary penalties are ultimately determined at sentencing where the statutory goal is to make the punishment fit the crime.¹²⁹¹ A principal factor—at least a starting point—in the sentencing matrix will be the now advisory Federal Sentencing Guidelines which almost always set incarceration and monetary penalties of less than the maximum provided in the Code or in Title 18.¹²⁹²

I cover here principally the Title 26 criminal provisions and certain other crimes outside Title 26 that are most often deployed for tax crimes.

The Government does not detect most tax crimes; perhaps more counterintuitive, the Government does not prosecute most tax crimes it detects.¹²⁹³ The Government has a limited budget for investigating and prosecuting tax crimes. Throughout the United States, in any given year, on average less than 2,000 tax crimes will be prosecuted. Many of these tax crimes are prosecuted as adjuncts to prosecutions where other crimes (such as drug offenses or money laundering) are the major focus of the prosecutions. So, there will be significantly fewer pure tax prosecutions where tax crime is the focus; the number of such pure tax prosecutions in fiscal year 2022 was 487 with the average during the period 2015-2022 being 904.¹²⁹⁴ As I hope you can appreciate, the number of tax crimes in a system involving hundreds of millions of taxpayers (consisting of individuals and entities such as corporations, partnerships and trusts) is far, far larger than these numbers would indicate. Accordingly, the government uses the limited prosecutions in a manner that will not only punish the particular offender but will send a message to other taxpayers encouraging them to do right. This collateral goal is recognized in the U.S. Sentencing Guidelines (2021 Guidelines Ch. 2, Part T, par. 1, Introductory Comment):

The criminal tax laws are designed to protect the public interest in preserving the integrity of the nation's tax system. Criminal tax prosecutions serve to punish the violator and promote respect for the tax laws. Because of the limited number of criminal tax prosecutions relative to the estimated incidence of such violations, deterring others from violating the tax laws is a primary consideration underlying these guidelines. Recognition that the sentence for a criminal tax case will be

¹²⁹⁰(...continued)

flag it for readers who might want to pursue it.

¹²⁹¹ See 18 U.S.C. § 3553(a).

¹²⁹² The Sentencing Guidelines are not mandatory (*United States v. Booker*, 543 U.S. 200 (2005)), but they may be deemed presumptive as to appropriate sentences. *Rita v. United States*, 127 S. Ct. 2456 (2007).

¹²⁹³ I could chew on that general statement for a long time, but I must forego doing so here. For more discussion of tax and related crimes, I offer two sources: John Townsend, Larry Campagna, Steve Johnson and Scott Schumacher, *Tax Crimes* (LEXIS-NEXIS 2015 2d Ed.), a casebook for law students; and Michael Saltzman and Leslie Book, *IRS Practice and Procedure* (Thomsen Reuters 2015), Chapter 12, Criminal Penalties and the Investigation Function (I was the principal draftsman on this chapter which, as originally published before updates, numbers 311 pages and 1298 footnotes as originally published, probably more with updates).

¹²⁹⁴ These statistics are from the IRS 2022 Data Book, Table 24, and a spreadsheet I maintain showing key statistics for legal source tax crimes since 2005.

commensurate with the gravity of the offense should act as a deterrent to would-be violators.

Because of this collateral goal, criminal tax prosecutions and particularly convictions are often highly publicized by the IRS and DOJ Tax.

The Government perceives that it is very important that it obtain convictions in a very high percentage of the cases that it brings. The goal is a 90+% conviction rate¹²⁹⁵ A significantly lower conviction rate would defeat the collateral goal of encouraging other taxpayers to do right. With a lower conviction rate, taxpayers might perceive the criminal enforcement effort as a paper tiger -- i.e., there is not a very high chance that the taxpayer will be detected in criminal activity in the first instance, but if he or she is detected, there is not a very high likelihood that the government will choose to prosecute, and then, if the government does choose to prosecute, there is a significant chance of acquittal. By choosing its cases carefully and insisting upon pursuing only cases where that are reasonably certain to succeed, the government can publicize the particular convictions and a high conviction rate.¹²⁹⁶ The government feels that, given its resources, that achieves the maximum benefit for the criminal tax enforcement buck.

B. The Sentencing Guidelines.

The statutes defining the Title 26 tax crimes provide the maximum sentence and fine that can be imposed. The actual sentences are determined in 18 U.S.C. § 3553 and the U.S. Sentencing

¹²⁹⁵ DOJ Tax has historically claimed claims a higher goal—95%—and a higher actual success rate—97%. See Prepared Testimony of Acting Assistant Attorney General to House Judiciary Subcommittee (Federal Tax Crimes Blog 6/11/17) (quoting the AAG’s prepared testimony saying: “The conviction rate for cases brought by Division prosecutors generally exceeds 95 percent.”). I am skeptical of the touted success rate. I think the actual success rate is lower than 95%. I cover this in my Federal Tax Crimes Blog. But keep in mind that these are statistics—the worst kind of lies according to the famous saying often attributed to Mark Twain (“There are lies, damn lies and statistics.”). See Wikipedia entry, “Lies, Damned Lies, and Statistics” (last edited 7/9/22 and viewed 7/18/22) (reporting that Twain attributed the saying to Benjamin Disraeli, although not found in his extant works). There is, as usual, a more nuanced aphorism: “It is easy to lie with statistics, but easier to lie without them,” attributed to Fred Mosteller, one of the most eminent statisticians of the 20th Century. Wikiquote entry, “Statistics” (last edited 5/15/22 and viewed 7/18/22),

¹²⁹⁶ High litigation success rates can mean a lot of things to litigators. I explain in the text why the Government’s criminal tax enforcement program needs a high success rate. Hence, the tax prosecutors pick cases that really should be slam dunks for good prosecutors who can prosecute sophisticated cases. Saying that does not demean the quality of those prosecutors; it is just to say systemically prosecutors avoid cases with a high chance of acquittal and thereby are assured high success rates. The DOJ Justice Manual (the guide for prosecutors, formerly the U.S. Attorney Manual, provides the general standard for prosecution: “The attorney for the government should commence or recommend federal prosecution if he/she believes that the person’s conduct constitutes a federal offense, and that the admissible evidence will probably be sufficient to obtain and sustain a conviction,” with certain exceptions. DOJ JM 9-27.220. Even within that potential universe, I believe the DOJ Tax Division is more selective because of the imperative to have a very high conviction rate. Another important factor is that tax cases, with a demanding willful mens rea requirement, are often difficult to prosecute because you need only one juror who has an animus against the IRS to result in a hung jury that might induce acquittal or no retrial. So, I am saying that DOJ Tax prosecutors have a high success rate because of the selectivity demanded by wise use of systemic resources and the quality of the prosecutors. Nevertheless, I am reminded of the quote attributed to James Comey when he became U.S. Attorney for the Southern District of New York, DOJ’s premier prosecution unit with the best litigators in the system. Comey is reported to have advised his AUSAs: “We have a name for prosecutors who have never lost — the ‘Chickenshit Club.’” Jesse Eisinger, The Rise of Corporate Impunity (ProPublica 4/30/14); this quote inspired the title of Eisinger’s subsequent book, The Chickenshit Club: Why the Justice Department Fails to Prosecute Executives (Simon & Schuster 2017).

Commission's Sentencing Guidelines (“Sentencing Guidelines”) which are easily available on the internet.¹²⁹⁷ Before the Sentencing Guidelines, federal judges imposed sentences and fines without any guidelines except the parameters set forth in the criminal statute itself which usually only sets the maximum period of incarceration. Title 26 provides a maximum sentence for tax evasion of up to 5 years. Thus, a judge could sentence from 0 to 5 years’ incarceration, with no guidance, prior to the Guidelines, as to the sentence within that range. Sentencing varied depending upon a specific judge's individual predilections, prejudices, etc. and sometimes upon regional attitudes. The Sentencing Guidelines for tax crimes thus note (2018 Guidelines § 2T1.1, Background):

Under pre-guidelines practice, roughly half of all tax evaders were sentenced to probation without imprisonment, while the other half received sentences that required them to serve an average prison term of twelve months. This guideline is intended to reduce disparity in sentencing for tax offenses and to somewhat increase average sentence length. As a result, the number of purely probationary sentences will be reduced. The Commission believes that any additional costs of imprisonment that may be incurred as a result of the increase in the average term of imprisonment for tax offenses are inconsequential in relation to the potential increase in revenue. According to estimates current at the time this guideline was originally developed (1987), income taxes are underpaid by approximately \$90 billion annually. Guideline sentences should result in small increases in the average length of imprisonment for most tax cases that involve less than \$100,000 in tax loss. The increase is expected to be somewhat larger for cases involving more taxes.

The Sentencing Guidelines create guideline ranges in months (e.g.,27-33 months) for sentencing based upon certain prescribed sentencing factors determined by the drafters, after review of historical sentencing practices, to be relevant to sentencing. The Sentencing Commission annually reviews and revises these factors as appropriate based on experience. In a tax setting, the most important sentencing factor is the intended tax loss from the tax crime.¹²⁹⁸ The tax loss is not the actual tax loss, for once the IRS puts its criminal hair-sights on a taxpayer that taxpayer might well pay up (with penalties)—either before a criminal trial or after—so that there is often no real ultimate tax loss. Rather, the tax loss for sentencing purposes is that tax loss the taxpayer intended from the criminal activity. Generally, that is the portion of the tax underpayment that the taxpayer intended to evade, and the Government must prove the tax loss by a preponderance of the evidence. This is not necessarily the entire underpayment, for the Government may not be able to prove criminal intent as to some portion of an underpayment. And the tax loss can include tax loss—called **relevant conduct**—from unconvicted crimes; unconvicted crimes can include crimes for counts for which the defendant was acquitted or that were dropped incident to a plea agreement on other counts or even counts that were not charged.¹²⁹⁹ Other sentencing factors such as acceptance of responsibility may

¹²⁹⁷ The Sentencing Commission publishes the various annual versions of the Guidelines on its web site titled “2921 Guidelines Manual Annotated” (the one currently applicable, which is a reprint of the 2018 Guidelines Manual).

¹²⁹⁸ S.G. §2T1.1 and §2T4.1 (Tax Table). *See United States v. Upshur*, 67 F.4th 178 (3d Cir. 2023).

¹²⁹⁹ See S.G. §1B1.3. Relevant Conduct (Factors that Determine the Guideline Range). For this reason, the Government will usually drop counts to obtain a plea agreement as to one or two major tax counts, since the unconvicted counts can be included in the tax loss that drives the Guidelines for the count(s) of conviction. In other words, dropping counts often—perhaps usually—does not affect the advisory sentencing range under the Guidelines. And,
(continued...)

also be considered. For tax crimes, unless the tax loss number is truly very large, the incarceration period is significantly less than the maximums for the crimes prescribed in Title 26. Since most tax prosecutions result in plea bargaining and a guilty plea to one or more counts, the major strategy will be to get the tax loss number to a sufficiently low amount that the guideline range will be acceptable to the taxpayer.

The Sentencing Guidelines ranges for incarceration and for fines serve as advisory guides to the sentencing judge. There are two ways the sentence can be outside the calculated guideline range. First, as recognized in the Guidelines, there can be “departures” for factors recognized in the Guidelines as bases for departures. The most prominent is providing significant cooperation to the Government, usually in further criminal investigation of other persons, which are referred to as § 5K1.1 departures. Second, after consideration of the Guidelines (including departures) is fully considered, the judge may consider general sentencing factors in 18 U.S.C. § 3553(a) in setting the final sentence. That final sentence can be outside the Guidelines range (even with a § 5K1.1 departure) and, to that extent, is called a variance. If the judge sentences within the guideline range (with § 5K1.1 departures), the sentence will generally not be reversed upon appeal (unless the judge articulated some improper consideration in setting the sentence or misapplied the guidelines). If, however, the judge chooses to sentence outside the Guideline range (usually below in tax cases), the judge must state the basis for the variance. (In federal criminal practice, the variance process is sometimes called “Booker variance,” named for the Supreme Court case (*United States v. Booker*, 543 U.S. 220 (2005)) recognizing the significant discretion sentencing judges have to vary.)¹³⁰⁰

C. Return Reporting Crimes.

1. Tax Evasion - § 7201.

a. General.

Section 7201 defines the felony commonly referred to as tax evasion—a willful attempt in any manner to defeat or evade tax. Incarceration is up to 5 years per count (per year of tax evasion).

b. Evasion of Assessment; Evasion of Payment.

Tax evasion usually occurs on a false return underreporting and thus underpaying tax liability. This is commonly referred to as evasion of assessment because by failing to report the liability, the taxpayer’s intent is to avoid assessment and payment. Evasion of assessment can also occur by failing to file a return, but that type of evasion is rarely charged since Congress provided a separate criminal penalty for the mere act of failing to file a return (§ 7203); for failure to file to be evasion, the taxpayer must commit some further affirmative act beyond mere nonfiling in furtherance of the evasion.

¹²⁹⁹(...continued)

as noted even counts not charged can be included in relevant conduct.

¹³⁰⁰ For an extreme case showing the wide discretion for variances in a tax crime setting see *United States v. Warner*, 792 F.3d 847 (7th Cir. 2015), which I discuss in a blog, Seventh Circuit Affirms No Incarceration Sentence for Ty Warner (Federal Tax Crimes Blog 7/10/15; 7/14/15).

Tax evasion may also occur through acts to avoid payment of tax after or in anticipation of an assessment of the tax. This is commonly referred to as evasion of payment.

c. Capstone of Tax Penalty System.

The Supreme Court has described tax evasion is the capstone of the federal system of penalties to encourage compliance with the Code. *Spies v. United States*, 317 U.S. 492, 497 (1943). Tax evasion carries the highest nominal sentence (5 years) and monetary fines (\$100,000 for individuals and \$500,000 for corporations). (I say nominal because, as I note above, the fine for tax crimes is higher than stated in Title 26 because of a provision in Title 18 and, in any event, under the Sentencing Guidelines and any *Booker* variance (*United States v. Booker*, 543 U.S. 220 (2005)), the sentence is likely to be a lot less than the Title 26 maximums except where the tax loss is quite large and there is only one or two counts of conviction.)

d. Elements of the Crime.

As interpreted, a traditional formulation of the elements of tax evasion is: (1) a substantial tax evaded (other formulations being tax due and owing and tax deficiency); (2) willfulness (being an intent to evade payment); and (3) some affirmative act (however minimal) in furtherance of the intent. I offer some short comments on the key interpretations of these elements. (For the other crimes discussed below, I will just offer a short statement of the elements, but offer more elaboration for tax evasion to introduce some of the key concepts.)

(1) Substantial Tax Evaded.

Tax¹³⁰¹ must have been evaded¹³⁰² and the amount of evaded tax must be substantial.¹³⁰³

¹³⁰¹ Evasion of assessment includes the principal tax amount evaded; evasion of payment can include tax and related Title 26 liabilities (such as interest and penalties). In addition, some special Title 26 liabilities not technically involving tax or tax add-ons (such as interest and ad valorem penalties) may be included in the term tax that can be subject to tax evasion. Most prominently, the Trust Fund Recovery Penalty (“TFRP”) under § 6672 is treated as a tax that can be subject to an evasion of payment charge. See *United States v. Prelogar*, 2018 U.S. Dist. LEXIS 188305 (D. Mo. 2018), *aff’d* on other grounds 996 F. 3d 526 (8th Cir. 2021). Section 6671 says that the penalties in the subchapter (including § 6672) are treated as tax for all Title 26 purposes. In addition, the TFRP is a collection mechanism for the underlying Trust Fund Tax and thus should fall within the definition of tax for the evasion statute. See Court Holds that the Trust Fund Recovery Penalty is a Tax For Purposes of Tax Evasion, § 7201 (Federal Tax Crimes Blog 11/10/18).

¹³⁰² The precise name for the evaded tax due element varies. Historically, it was “tax due and owing” and later often was “tax deficiency.” John A. Townsend, Tax Evaded in the Federal Tax Crimes Sentencing Process and Beyond, 59 Vill. L. Rev. 599 (2014). Neither formulation captures the evasion element. Thus, for example, tax deficiency is a term of art in the tax law meaning the civil tax deficiency. See § 6211 (Definition of a deficiency). The civil tax deficiency can and often is more than the amount of tax evaded for purposes of tax evasion. For example, the amount proved as evaded in a criminal trial might be \$100,000 and the real ultimate civil tax deficiency can be \$200,000 because of items as that are arguable and thus not willful. I think tax due and owing is also not descriptive. I prefer the term tax evaded but am in the substantial minority on that.

¹³⁰³ The “substantial” modifier is not in the statute. Some courts add the modifier. E.g., *United States v. Helmsley*, 941 F.2d 71, 83-84 (1991), cert. denied, 502 U.S. 1091 (1991) (“We have also required a showing that the deficiency was substantial.”). Other courts reject the modifier. *United States v. Daniels*, 387 F.3d 636 (7th Cir. 2004), cert. denied, 544 U.S. 911 (2005). Courts that reject the modifier have done so only in cases where the tax due was substantial. Moreover, DOJ Tax will prosecute cases only where the tax due is substantial because juries may not convict where the tax due is insubstantial and, under the Sentencing Guidelines, the primary sentencing factor is the tax (continued...)

Note that the tax evaded element incorporates the mens rea element of the crime, although the mens rea element is stated as the separate element of willfulness.

(2) Willfulness.

Willfulness is a term of art and constitutes an element for most Title 26 tax crimes. In tax crimes where willfulness is an element, the thoroughness of the pretrial work will permit the Government to prove the other more objective elements of the crime with relative ease, so that often the issue that controls guilt or innocence is willfulness. Normally, in U.S. law, a defendant can be guilty of a crime simply by intentionally doing the act that constitutes the crime; the defendant need not know that the conduct constitutes a crime and intends to commit that known crime. So, the common saying goes, ignorance of the law is no excuse; at least generally. The Supreme Court has said that this traditional rule does not apply in tax crimes because of the “willfully” element. The standard formulation is that willfully means a “voluntary, intentional violation of a known legal duty.” *Cheek v. United States*, 498 U.S. 192, 201 (1991).¹³⁰⁴

Crimes with this *Cheek* definition of willfulness are specific intent crimes requiring the Government to prove at trial the specific intent to violate a known legal duty. The concept of “willful blindness” may play some role in the Government’s proof of the required specific intent to violate a known legal duty. The jury may be instructed that, if it finds that the defendant acted to avoid the required knowledge of the law and the duty, those actions either

- (i) permit (but does not require) the jury to treat acts of willful blindness as circumstantial evidence from which the jury may infer the specific intent to violate the known legal duty, or
- (ii) require the jury to find that the defendant had the specific intent to violate the known legal duty.

Formulation (ii) substitutes willful blindness for the statutory willful element of the crime. I question whether that substitution is appropriate because it broadens the statutory element of the crime—intent to violate a known legal duty. I believe that formulation (i) is the better formulation because courts are not supposed to broaden the elements of crimes. The courts have not, however, clearly focused on and resolved the precise nature of the willful blindness concept. So, judges in tax crimes

¹³⁰³(...continued)

loss which would likely mean no incarceration, thus minimizing the deterrent effect of the prosecution.

¹³⁰⁴ Students and practitioners should be careful when reading nontax criminal and civil statutes with a willfully element. Willfully can mean something less than intentional violation of a known legal duty in other contexts. See *Bryan v. United States*, 524 U.S. 184 (1998) (a nontax case), where the court said: “The word ‘willfully’ is sometimes said to be ‘a word of many meanings’ whose construction is often dependent on the context in which it appears.’ And even in the strictest sense of the word as in tax crimes, the Court said: “In certain cases involving willful violations of the tax laws, we have concluded that the jury must find that the defendant was aware of the specific provision of the tax code that he was charged with violating,” citing *Cheek*. That statement should not be read too literally, for that is not the requirement. See *United States v. Mousavi*, 604 F.3d 1084, 1092 (9th Cir. 2010); and *United States v. Patridge*, 507 F.3d 1092, 1094 (7th Cir. 2007), cert. den. 552 U.S. 1228 (2008) (noting pungently that “Knowledge of the law’s demands does not depend on knowing the citation any more than ability to watch a program on TV depends on knowing the frequency on which the signal is broadcast.”)

prosecutions will deploy willful blindness instructions that go either or both ways.¹³⁰⁵ The point is that the practitioner must be attuned to the issue particularly when drafting proposed instructions or seeking to mitigate the damage from the Government's proposed instructions. Of course, the difference will only be outcome determinative where the jury would find acts of willful blindness but could not find specific intent to violate a known legal duty. Those cases may not be that common.

Willfulness incorporates the concept that (i) the legal duty be knowable in some objective sense and (ii) that the taxpayer knew the legal duty. The *Cheek* definition certainly incorporates the latter; the jury makes that determination. The first part – that the law be knowable – is a legal determination made by the court rather than the jury. If the court determines that the state of the law at the time of the conduct was sufficiently uncertain that it did not give taxpayers clear instructions as to the legal duty, then the prosecution will be dismissed without ever getting to the second part (the taxpayer's state of mind).¹³⁰⁶

This willfulness element is explicit in most Title 26 crimes and other crimes deployed in the tax area. Even when not explicit, the crimes deployed in the tax area have elements that, as interpreted and applied in a tax setting, approach the willfulness element.¹³⁰⁷ So, willfulness is probably the most critical feature of the crimes deployed in the tax area.

I noted above that the willfulness element, although separately stated, is necessary to determine the evaded tax element. And it is also necessary to determine the affirmative act element to which I now turn.

(3) Affirmative Act of Evasion.

The statute requires “attempts in any manner to evade or defeat any tax.” The Supreme Court held that this requires an affirmative act to evade and provided some illustrations.¹³⁰⁸

By way of illustration, and not by way of limitation, we would think affirmative willful attempt may be inferred from conduct such as keeping a double set of books, making false entries or alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one's affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal. If the tax-evasion motive plays any part in such conduct, the offense may be made out even though the conduct may also serve other purposes such as concealment of other crime.

¹³⁰⁵ See Saltzman Treatise, ¶ 12.05[2][c][ii] Willful blindness and its variations. I have written on this subject often on my Federal Tax Crimes Blog.

¹³⁰⁶ In *James v. United States*, 366 U.S. 213 (1961), the jury convicted thus meaning it found that, factually, the defendant intended to violate a duty he knew. The Supreme Court reversed because the state of the law was such that, from an objective legal viewpoint, the duty was not knowable. The defendant may have intended to violate a duty that he thought he knew, but in fact no such duty existed.

¹³⁰⁷ John A. Townsend, *Tax Obstruction Crimes: Is Making the IRS's Job Harder Enough*, 9 Hous. Bus. & Tax. L.J. 255 (2009).

¹³⁰⁸ *Spies v. United States*, 317 U.S. 492 (1943).

Note the overlap of the willfulness element – “if the affirmative act element is satisfied, there is no question that willfulness is present.”¹³⁰⁹

2. False Return (Tax Perjury) - § 7206(1).

Section 7206(1) imposes a felony criminal penalty for willfully making a material false statement on return or other document filed with the IRS under penalty of perjury. The elements of the crime are: (1) a return signed under penalty of perjury; (2) a false statement in the return; (3) the defendant knew the statement was false; (4) the statement was material; and (5) the defendant made the statement willfully with intent to violate a known legal duty.¹³¹⁰

The commonly encountered tax returns (income and estate and gift) are filed under penalties of perjury;¹³¹¹ as you recall, the jurat on the individual income tax return (Form 1040) is quoted above (p. 124). There is no requirement, as in tax evasion, that there be an understatement of tax liability.¹³¹² Indeed, the tax liability can be correctly stated and even overstated and the tax fully paid or overpaid; the taxpayer can still be guilty of this crime if he or she made material misstatements on the return. For example, a drug dealer improperly stating on his Schedule C that his business is a retail clothing business can be found guilty for that reason alone. Perhaps I overstate the importance of the absence of tax evaded as an element of the crime because, if indeed there is no tax evaded, the IRS will usually not devote the substantial systemic resources (investigation, prosecution, trial, sentencing, incarceration), particularly where for a pure tax crime the Sentencing Guidelines would likely produce no incarceration time (because no tax loss) and thus would send a weak signal (at best) to others about not cheating on their taxes.

A material false statement is basically any statement that could mislead the IRS as to whether it should audit or in the event it did audit, which basically is any statement required by the return.¹³¹³ For example, a taxpayer improperly answering the question on Schedule B of the Form 1040 (individual tax return) as to signatory authority over foreign bank accounts can be found guilty for that reason alone, even though no additional tax is due.¹³¹⁴

Because of the jurat, false statements on a return also are within the ambit of the general federal perjury crime, 18 USC § 1621. Such false statements on tax returns are, however, prosecuted under either § 7201 or § 7206(1) rather than under 18 USC § 1621, because they are the more specific provisions Congress intended to apply to tax return false statements.¹³¹⁵ It is interesting to

¹³⁰⁹ *United States v. Romano*, 938 F.2d 1569, 1572 (2d Cir. 1991); and *United States v. Boisseau*, 841 F.3d 1122, 1127 (10th Cir. 2016) (citing *Romano*).

¹³¹⁰ See e.g., Fifth Circuit pattern jury instruction 2.97.

¹³¹¹ § 6065 requires that, except as otherwise provided by regulations, returns and other documents filed with the Treasury under the internal revenue laws be signed under penalty of perjury.

¹³¹² *Boulware v. United States*, 552 U.S. 421, 432 n. 9, 128 S.Ct. 1168, 1178 n. 9 (2008) (“the Courts of Appeals are unanimous in holding that § 7206(1) ‘does not require the prosecution to prove the existence of a tax deficiency . . .’”).

¹³¹³ See *United States v. Gaudin*, 515 U.S. 506 (1995) (holding that when materiality is an element, that element must be submitted to the jury).

¹³¹⁴ *United States v. Hough*, 803 F.3d 1181 (11th Cir. 2015).

¹³¹⁵ Probably the most practical difference between the two in the context of tax returns is that the general perjury statute of limitations is 5 years, whereas the tax perjury statute of limitations is 6 years. See 18 USC § 3282 (continued...)

note that the general federal perjury statute imposes a 5 year maximum sentence whereas § 7206(1), tax perjury, imposes a 3 year maximum sentence. One could infer that the § 7206(1) evidences a legislative determination that tax perjury is only 60% as damaging to society than is perjury in the setting of other sworn testimony. By similar analysis, tax perjury could be viewed as only 60% as harmful as tax evasion.

Although not a textual element of the crime, the crime only applies to a document signed under penalties of perjury that is actually filed with the IRS.¹³¹⁶

3. Aiding or Assisting - § 7206(2).

Section 7206(2) provides a felony criminal penalty for aiding or assisting in the preparation or presentation of a false return or tax relevant document. The elements of the crime are: (1) the defendant aided or assisted in preparation of a return or other document; (2) the document contains a false statement; (3) the defendant knew the statement in the document was false; (4) the false statement was material; and (5) the defendant aided or assisted in the preparation of or presentation of the document to the IRS.¹³¹⁷

This penalty is aimed primarily at tax return preparers but can hit others such as tax shelter promoters or corporate officers assisting a corporation in filing false returns or documents. There is no requirement that the taxpayer be a co-conspirator or even be aware of the crime. The Code's maximum sentence for aiding and assisting is 3 years.

This felony is not the same as the general aiding and abetting crime under 18 U.S.C. § 2(a). Traditionally, aiding and abetting required a criminally culpable principal offender being aided and abetted; the principal offender was not required to be prosecuted, but there must have been a criminally culpable principal offender.¹³¹⁸ Section 7206(2) permits the prosecution of a return preparer or other persons assisting some way in a false return even if the taxpayer involved is wholly innocent. Although it is not uncommon for courts to refer to § 7206(2) as an aiding and abetting provision, I hope my students will be a little more discriminating in description—aiding and assisting is the proper description.¹³¹⁹

¹³¹⁵(...continued)
(general criminal perjury) and § 6531(5) (tax perjury).

¹³¹⁶ *United States v. Boitano*, 796 F.3d 1160 (9th Cir. 2015) (held merely delivering a signed return to an agent during an audit is not a filing; although filing is not an explicit element of the crime of tax perjury, the precedent makes filing an element).

¹³¹⁷ See Fifth Circuit Pattern Jury Instruction 2.98.

¹³¹⁸ Although not the same, § 7206(2) is said to “effectively incorporate[] * * * the theory behind accomplice liability” under 18 U.S.C. § 2(a). *United States v. Searan*, 259 F.3d 434, 443 (6th Cir. 2001).

Actually, the general aiding and abetting statute has been expanded to make a causer liable even when there is no culpable other offender, so that the causer is not aiding and abetting anyone. 18 U.S.C. § 2(b). See Townsend, John A., Theories of Criminal Liability for Tax Evasion (May 15, 2012). Available at SSRN: <http://ssrn.com/abstract=2060496>. (Noting that, under general tax evasion elements, the acts making a person a causer under § 2(b) would also make that person directly an offender for the crime of tax evasion.)

¹³¹⁹ See The Difference Between § 7206(2) Aiding and Assisting and 18 USC § 2(a) Aiding and Abetting (Federal Tax Crimes Blog 11/22/18).

4. Failure to File Return - § 7203.

Section 7203 provides a misdemeanor criminal penalty (imprisonment up to 1 year) for willful failure to file a return. The elements of the crime are: (1) the defendant was required to file a return; (2) the defendant failed to file a return; and (3) in failing to file, the defendant acted willfully, with intent to violate a known legal duty.¹³²⁰

This act is complete on the date the return is due (either the original due date or the extended due date if an extension was obtained). Filing a delinquent return does not cure the criminal problem from a technical legal standpoint. (From a practical standpoint, filing delinquent returns before the IRS starts its investigation will generally cure the problem under the voluntary disclosure practice discussed beginning p. 317.)

As you can see, the crime of failure to file is significantly less serious in terms of the defined Code penalties than the crimes discussed earlier (tax fraud and tax perjury which are felonies carrying incarceration of up to five and three years, respectively). During the pre-Guidelines period when I first entered private practice, I heard that the difference between a tax-cheat doctor (who presumably was not aware of this difference) and a tax-cheat lawyer (who presumably was aware) was that the doctor filed a fraudulent return and the lawyer filed no return. This is just lore and probably not supported by empirical data, but those who practice in this area do know that there seem to be a lot of lawyers who fail to file returns. (The Sentencing Guidelines now lessen the difference between these crimes significantly, but precisely how that happens is beyond the scope of this course.)

There is one critical deviation in the misdemeanor status for failure to file. Section 6050I requires trades or businesses receiving more than \$10,000 in cash one or a series of related transactions to report the transaction to the IRS on a CTR. The reporting requirement applies to cash and certain types of cash equivalents (such as foreign currency and certain monetary instruments). Please review briefly *Gertner* covered below (p. 431). Willful failure to file the § 6050I return is a felony punishable by 5 years' incarceration.¹³²¹

D. Tax Administration Crimes.

1. Tax Evasion - § 7201.

As noted above, § 7201 is generally applied to fraudulent returns. However, it may apply also to fraudulent attempts to evade assessment or payment during the course of an IRS examination or investigation.

2. Concealing Assets - § 7206(4).

Section 7206(4) imposes a felony penalty upon acts designed to conceal assets upon which levy may be made to pay a tax with intent to evade or defeat payment. The acts covered by this

¹³²⁰ CTM Instruction 26.7203-3.

¹³²¹ § 7203 (last sentence).

provision would commonly be affirmative acts of evasion of payment and thus, are more commonly prosecuted under § 7201, tax evasion.

3. Tax Obstruction - Impeding Administration - § 7212(a).

There are two criminal provisions that are deployed to the crime generally described as impairing or impeding the lawful functions of a government agency, including the IRS. These are § 7212(a) and 18 U.S.C. § 371 (which also describes a specific offense conspiracy in addition to the conspiracy to impair or impede the government agency). I discuss the conspiracy statute below because it includes two types of conspiracies, only one of which is to impair or impede the lawful function of the IRS. Just remember for the present that the defraud conspiracy can substantially overlap the tax obstruction under § 7212, except that tax conspiracy obstruction requires more than one actor.

Section 7212(a) defines as a felony corruptly obstructing or impeding the administration of the tax laws either corruptly or by force or threats. This is often referred to as the “Omnibus Clause.” The conduct potentially within the scope of the provision is limited only by the imaginations of persons having a motive to impede. Some examples are (i) hiding information from the IRS relevant to tax liability, (ii) hiding assets from the IRS to avoid payment of tax, (iii) filing unwarranted liens against IRS agent's homes in the local real property records, (iv) filing unwarranted criminal complaints against IRS officials, and (v) sending phony 1099s to other taxpayers (sometimes even IRS officials) reporting that they received payments that they did not in fact receive.¹³²² Actions within the scope of the Omnibus Clause might otherwise be legal except that they have no basis in fact and are designed to impede or harass the IRS from doing its job or from doing it efficiently. These actions are often employed by tax protesters. (For more on tax protesters, see p. 846) Mere harassment of an agent, if not done to obtain improper advantage, is not within the scope of the provision. One court thus said that:

[T]here is no reason to presume that every annoyance or impeding of an IRS agent is done per se “corruptly.” A disgruntled taxpayer may annoy a revenue agent with no intent to gain any advantage or benefit other than the satisfaction of annoying the agent. Such actions by taxpayers are not to be condoned, but neither are they “corrupt” under Section 7212(a).¹³²³

DOJ policy is to not use this provision where there is a more targeted tax crime for the conduct in question -- such as § 7201 and § 7206(1).¹³²⁴

¹³²² For a more robust discussion, see John A. Townsend, *Tax Obstruction Crimes: Is Making the IRS's Job Harder Enough*, 9 Hous. Bus. & Tax. L.J. 255 (2009) and the companion appendix with examples, *Tax Obstruction Crimes: Is Making the IRS's Job Harder Enough? Online Appendix*, 9 Hous. Bus. & Tax L.J. A-1 (2009). These items will be referred to in this chapter as Townsend, Tax Obstruction Crimes.

¹³²³ *United States v. Reeves*, 752 F.2d 995, 998 (5th Cir.), cert. denied, 474 U.S. 834 (1985).

¹³²⁴ DOJ CTM 17.03 Tax Division Policy (“The omnibus clause generally should not be used as a substitute for a charge directly related to tax liability, such as tax evasion or filing false claims, if such charge is readily provable.”) I have written an article on the tax obstruction crime and its general counterpart, the defraud conspiracy (*Klein* conspiracy in a tax setting) and refer the interested reader to that article. John A. Townsend, *Tax Obstruction Crimes: Is Making the IRS's Job Harder Enough*, 9 Hous. Bus. & Tax. L.J. 255 (2009).

Practitioners and courts have expressed concern regarding the potential sweep of this provision and its potential overlap with more specifically targeted tax crimes.¹³²⁵ In 2018, in *Marinello v. United States*, 584 U.S. ___, 138 S. Ct. 1101 (2018), the Supreme Court reacted to these concerns and held that the tax obstruction crime requires:¹³²⁶

- A nexus to an administrative proceeding: “a ‘nexus’ between the defendant’s conduct and a particular administrative proceeding, such as an investigation, an audit, or other targeted administrative action. That nexus requires a ‘relationship in time, causation, or logic with the [administrative] proceeding.’”¹³²⁷
- A pending or reasonably foreseeable proceeding: “the [administrative] proceeding was pending at the time the defendant engaged in the obstructive conduct or, at the least, was then reasonably foreseeable by the defendant.”¹³²⁸

Those requirements leave open some important issues.¹³²⁹ I just introduce three of those issues: (1) can the Government mitigate the force of the above pending proceeding limitations by charging under another statute?;¹³³⁰ (2) does the interpretation to require a pending or reasonably foreseeable IRS administrative proceeding apply also to the parallel defraud / *Klein* conspiracy under 18 U.S.C. § 371 which defined as a conspiracy to impair or impede the lawful function of the IRS (although the post-*Marinello* cases do not apply the requirement to the defraud conspiracy);¹³³¹ and (3) is the corruptly element for tax obstruction coextensive with the willfulness element for other Title 26 tax crimes.¹³³²

¹³²⁵ For a recent strong statement of concern see particularly *United States v. Marinello*, 839 F.3d 209 (2d Cir. 2016), reh. en banc den. 2017 U.S. App. LEXIS 2686 (2d Cir. 2017), rev’d 584 U.S. ___, 138 S. Ct. 1101 (2018). In his dissent to rehearing en banc, Judge Jacobs forcefully laments the sweeping scope of the section and thinks it should be limited to impeding a pending investigation. Judge Jacobs’ concerns were adopted by the Supreme Court.

¹³²⁶ In the text I provide a high level summary. In the footnotes, I cite to portions of Chapter 12 of the Saltzman Treatise. I prepared that Chapter; those who do not have access to the publication will usually find the discussion in some form on my Federal Tax Crimes Blog.

¹³²⁷ *Marinello v. United States*, 584 U.S. ___, 138 S. Ct. 1101, 1109-1110 (2018), quoting *United States v. Aguilar*, 515 U.S. 593 (1995). *Aguilar* involved the general obstruction of justice statute, 18 U.S.C. §1503, which the Court interpreted to require nexus to a pending judicial proceeding, concluding that the parallel language in § 7212(a) requires a pending IRS administrative proceeding.

¹³²⁸ *Marinello v. United States*, 584 U.S. ___, 138 S. Ct. 1101, 1110 (2018), citing and quoting *Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005) holding for another obstruction statute, 18 U.S.C. § 1512(b), that a reasonably foreseeable would suffice and imposing that requirement upon tax obstruction.

¹³²⁹ In June 2020, DOJ Tax Updated the CTM discussion of the tax obstruction crime in the Omnibus Clause of § 7212(a). CTM § 17.00, titled 26 U.S.C. § 7212(a): “Omnibus Clause.” While the CTM discussion is not the law, it in most instances accurately states the law and, beyond that, shows the DOJ Tax view of the law that practitioners will face.

¹³³⁰ See Saltzman Treatise, ¶ 12.02[5][c][v] Scope — Is an active investigation required? (Suggesting possible charging for tax evasion (§ 7201), tax perjury (§ 7206(1), aiding and assisting (§ 7206(2)), and false statements (18 U.S.C. § 1001)).

¹³³¹ E.g., *United States v. Herman*, 997 F. 3d 251, 273 (5th Cir. 2021).

¹³³² Saltzman Treatise, ¶ 12.02[5][c][ii], The defendant must act corruptly, quoting from *Marinello v. United States*, 584 U.S. ___, 138 S. Ct. 1101, 1108 (2018): “we find unconvincing the dissent’s argument that the distinction between ‘willfully’ and ‘corruptly’—at least as defined by the Government—reflects any meaningful difference in culpability.”

4. Willful Failure to Collect and Pay Over Trust Fund Taxes - § 7202.

The Code imposes a duty on employers to withhold from the pay to employees certain tax that employees are required to pay (withholding on employees' remuneration; employee's share of FICA and the like). These are called "Trust Fund" taxes because the employer becomes the agent of the IRS to collect from the employees' remuneration and pay the withheld amounts over to the IRS. The trust fund taxes and the employers' role in collecting them is critical to the IRS revenue stream. Failure to withhold and pay over can subject those individuals responsible for the failure to both civil and criminal liability. The civil liability is found in § 6672, often referred to as the Trust Fund Recovery Penalty ("TFRP"); I discuss § 6672 elsewhere in the text. (Technically, the civil liability may not be a penalty in the traditional sense of penalty because it is simply a mechanism to collect the Trust Fund taxes.) The criminal liability—clearly a penalty—is found in § 7202, which provides a five year maximum sentence. In this sense, Congress has determined that this penalty is the same in seriousness to tax evasion, also a maximum five year sentence.

The elements of the crime are: (1) failure to collect, account for, or pay over any tax¹³³³ and (2) willfulness with respect to the failure. Prosecutions under this provision have become prominent in the overall prosecutions for tax crimes.

As with most tax crimes, the fact pattern for charging § 7202 would usually support other charges in addition to or in lieu of § 7202, such as §§ 7201 (tax evasion), 7212(a) (tax obstruction) and 18 U.S.C. 371 (conspiracy).

5. Failure to Pay - § 7203.

Section 7203 criminalizes failure to meet several tax duties. I noted above that § 7203 criminalizes failure to file a return. The principal other tax duty criminalized under § 7203 is failure to pay tax. The elements are that the taxpayer failed to pay the tax (or estimated tax) and that the taxpayer acted willfully. The crime is a misdemeanor. Egregious failure to pay will likely be charged under § 7201, evasion of payment,¹³³⁴ or § 7212(a), tax obstruction.¹³³⁵

¹³³³ The statute uses a conjunctive as follows: "fails to collect or truthfully account for **and** pay over such tax." The Courts read that "and" as disjunctive rather than conjunctive, so that the crime is committed for failure to pay over even if the withholdings had been properly accounted for. *United States v. Sertich*, 879 F.3d 558 (5th Cir. 2018) (adopting similar holdings in *United States v. Gilbert*, 266 F.3d 1180, 1183-85 (9th Cir. 2001)); *United States v. Thayer*, 201 F.3d 214, 220-21 (3d Cir. 1999), abrogation on other grounds recognized by *Fahie v. Virgin Islands*, 858 F.3d 162, 66 V.I. 935 (3d Cir. 1999)); and *United States v. Evangelista*, 122 F.3d 112, 120-22 (2d Cir. 1997).

¹³³⁴ In *Sansone v. United States*, 380 U.S. 343, 351 (1965), the Court rejected a § 7203 lesser included offense jury instruction in a § 7201 prosecution because the lesser included offense instruction is applicable only where the jury would be required to find an element for the greater charge that was not required for the lesser included offense, so that the defendant could be convicted of the lesser but not the greater; in the case, the disputed facts the jury did not permit the jury to find that the defendant committed all of the elements of § 7203 without finding that he also committed all of the elements of § 7201.

¹³³⁵ In *United States v. Rankin*, 929 F.3d 399 (6th Cir. 2019), the Court considered whether a defendant charged under § 7202 for failure to collect and pay over withheld taxes, a felony, could obtain a lesser included offense charge for § 7203, failure to pay, a misdemeanor. The Court rejected that attempt because it found that all of the elements of § 7203 were not elements of § 7202. Basically, the Court reasoned that the lesser included offense charge could be given only where there is some extra element in the greater offense (§ 7202) not in the lesser offense (§ 7203), so that the jury could acquit for the greater offense but find guilt for the lesser offense. See *Sansone v. United States*, (continued...)

6. False Claims and False Claims Conspiracies—18 U.S.C. §§ 286 & 287.

False Claims and False Claims Conspiracies (18 U.S.C. § 286 & 287) are crimes generally applicable to claims against federal agencies. The elements of the false claims crime are (1) the knowing presentation of a claim to the agency; (2) knowledge that the claim was false or fraudulent. The false claims conspiracy requires the same elements with the addition of a conspiracy in making the claim. The false claims conspiracy is quite similar to the regular general conspiracy statute, 18 U.S.C. § 371, except that it specifically deals with false claims.

The charges are generally used in a tax setting for filing of tax returns or amended tax returns claiming false refunds as a pattern or scheme by persons other than the taxpayer involved (such as in the case of Stolen Identity Refund Fraud).¹³³⁶ The taxpayer's own filing of returns or amended returns claiming refunds for himself is generally charged under the more specific tax crimes in the Code (tax evasion or tax perjury). Those specific tax crimes and others could be deployed in mass refund fraud cases, but one reason that false claims and false claims conspiracy is generally used is because restitution is available in Title 18 crimes but not for Code crimes (unless agreed to by the defendant in a plea agreement or imposed as a condition of supervised release).¹³³⁷ And, because such mass false claims and false claim conspiracies make more prominent use of mail and wires, prosecutors will more frequently add charges for mail or wire fraud (§§ 1341 and 1343, respectively). Normally, in taxpayer-only fraud through returns and amended returns charged under Title 26, the use of mail and wires is less prominent and DOJ Tax will not approve mail or wire fraud charges.¹³³⁸

7. False Statements - 18 U.S.C. § 1001.

I noted above that the Code itself contains provisions for tax perjury and for aiders and assisters in filing false documents with the IRS. These usually come into play in connection with the filing of a return or submitting documents to the IRS. During the course of an investigation, however, the taxpayer or his representative or even a third party may make misleading oral statements to the IRS.

18 U.S.C., § 1001 punishes any false statement made to a federal officer within the scope of his or her responsibility as a federal officer. This is not a tax specific crime—it can apply to false statements to any federal government officer. The crime is a felony, with up to five years' incarceration. There is no requirement that the person making the statement be under oath (in the

¹³³⁵(...continued)

380 U.S. 343 (1965).

¹³³⁶ DOJ CTM 22.02[1] Policy (2012 ed.) (these charges are used for “fraudulent refund schemes” by “a defendant who filed multiple fictitious income tax returns claiming refunds of income tax in the same year, particularly when the defendant personally received and retained some or all of the proceeds.”

¹³³⁷ DOJ CTM 22.02[1] Policy (2012 ed.):

Many false refund claim cases could also be charged using 26 U.S.C. § 7206(1) or (2) (false returns), Chapter 44 or 18 U.S.C. § 1001 (false statements), § 1341 (mail fraud) or § 1343 (wire fraud). Section 287 is preferred to Section 7206 when the defendant pocketed the refund proceeds, because restitution for Title 18 offenses is more readily available than for Title 26 offenses.

¹³³⁸ DOJ Tax Directive No. 128, titled “Charging Mail Fraud, Wire Fraud or Bank Fraud Alone or as Predicate Offenses in Cases Involving Tax Administration,” included in DOJ CTM 3.00 Tax Division Policy Directives and Memoranda ((2012 ed.).

criminal law parlance, a false statement under oath is not an element of the § 1001 offense). Making false statements under oath is the separate offense of perjury¹³³⁹ and, if made on a tax return, is a separate offense of tax perjury under § 7206(1). The § 1001 offense is basically the same as perjury, but perjury requires that the statement be made under oath whereas § 1001 does not require an oath. Furthermore, whereas literal truth under oath is a defense to perjury even if the testimony is highly misleading, literally true but misleading statements may violate § 1001.¹³⁴⁰ In a tax setting, this offense is often charged for false statements during an IRS audit or IRS collection activity.

In addition to being independently prosecutable, a false statement during an audit can refresh the statute of limitations for tax evasion that otherwise would be triggered by the filing of the fraudulent return or can be charged as an overt act in a conspiracy.

8. FBAR Violations (31 U.S.C. § 5322; 18 U.S.C. § 1001).

I cover the FBAR, FinCEN Form 114, Foreign Bank Account Report, filing requirement, including criminal penalties in Ch. 17, beginning at p. 967. I only cover in summary certain key points of the criminal penalties. Although the FBAR has other law enforcement objectives, one objective is to identify and assure that income arising from or related to foreign accounts (including income activity producing proceeds deposited into foreign accounts) is properly reported and taxed in the U.S. There are civil and criminal penalties for failure to meet the FBAR requirement. The criminal penalty for failure to file an FBAR is 5 years. 31 U.S.C. § 5322.¹³⁴¹ The criminal penalty requires willfulness in the *Cheek* sense noted above. Although not certain, the most likely criminal penalty for filing a false FBAR is 5 years, may be under § 5322 or under some other appropriate statute, most likely, 18 U.S.C. § 1001, false statements, which is discussed above.¹³⁴²

E. Conspiracy - 18 U.S.C. § 371.

Conspiracy is defined in 18 U.S.C. § 371 as two categories of conspiratorial conduct—(i) a conspiracy to commit an offense (the offense conspiracy, such as a conspiracy to commit tax evasion) and (ii) a conspiracy to impair or impede the lawful functioning of a Government agency (a defraud conspiracy, in this context, the IRS, often referred to as a *Klein* conspiracy). Conspiracy is a common charge in federal criminal cases, particularly in tax cases. The *Klein* conspiracy substantially overlaps with the tax obstruction crime, § 7212(a), discussed above, except that the

¹³³⁹ See 18 USC § 1621.

¹³⁴⁰ See *Peterson v. United States*, 344 F.2d 419 (5th Cir. 1965).

¹³⁴¹ See Saltzman Treatise, ¶12.04. Currency Offenses (Bank Secrecy Act and Related) at n.467 (WG&L Online Edition) (viewed 2/20/19).

¹³⁴² See *Ratzlaf v. United States*, 510 U.S. 135 (1994) (involving a related provision for currency transaction reports requiring willfulness).

Klein conspiracy requires more than one culpable actor, whereas tax obstruction does not.¹³⁴³ Conspiracy is a common charge in federal criminal cases, particularly in tax cases.¹³⁴⁴

The *Klein* conspiracy is often charged in tax cases.¹³⁴⁵ The reason is that the proof requirements may be less onerous to the Government than for the offense conspiracy in a tax crimes setting.¹³⁴⁶ Another benefit of the *Klein* conspiracy is that, certainly in the case of larger conspiracies with more tax dollars involved, it offers the Government an opportunity to lard up the indictment with all sorts of salacious conduct (called “overt acts” in conspiracy parlance) and then put on all sorts of evidence at trial that might not be relevant to a more targeted substantive offense. Finally, I mentioned above that the *Klein* conspiracy overlaps the tax obstruction crime under § 7212(a)—acts to impair or impede the IRS. In a 2018 case, *Marinello v. United States*, 584 U.S. ___, 138 S. Ct. 1101 (2018), the Supreme Court held that the tax obstruction crime required that the obstructive acts be intended to impair or impede a known or reasonably foreseeable IRS administrative proceeding and generally expressed some concerns about expansive readings of that crime. Some practitioners thought that the *Marinello* holding and concerns may well curb the expansive interpretation of the *Klein* conspiracy, but so far courts have rejected any application of *Marinello* holdings or concerns to the *Klein* conspiracy.¹³⁴⁷

¹³⁴³ For this reason, § 7212(a) was at one time called a 1-person *Klein* defraud conspiracy. E.g., David F. Axelrod, Larry A. Campagna, James A. Bruton III, The “New” Tax Laws - 26 U.S.C. Section 7212(a) and the One-Person Conspiracy (Paper prepared for ABA National Institute on Criminal Tax Fraud in 1999). That claim is not used any more since the Court has refined the elements of both the *Klein* conspiracy and § 7212(a) obstruction. E.g., *Marinello v. United States*, 584 U.S. ___, 138 S. Ct. 1101 (2018). Still there is substantial overlap, so that conduct that could be charged as a *Klein* conspiracy if conducted by two or more individuals, might be charged as § 7212 obstruction if committed by one person.

¹³⁴⁴ In *United States v. Reynolds*, 919 F.2d 435, 439 (7th Cir. 1990), a tax case, Judge Easterbrook lamented that the conspiracy add-ons are “inevitable because prosecutors seem to have conspiracy on their word processors as Count I; rare is the case omitting such a charge.” See also Kathleen F. Brickey, In Enron's Wake: Corporate Executives on Trial, 96 J. Crim. L. & Criminology 397, 401 & 420-423 (2006) (empirical research that, in federal corporate crime cases during the period 2002 through 2006), over 2/3s of the cases had multiple defendants and all of those had at least one conspiracy count).

¹³⁴⁵ The *Klein* conspiracy is named from the leading case—*United States v. Klein*, 247 F.2d 908 (2d Cir. 1957), cert. denied, 355 U.S. 924 (1958). Actually, *Klein* was just a tax-specific application of the holding in *Hammerschmidt v. United States*, 265 U.S. 182 (1924). See DOJ CTM 23.07[2] [Klein Conspiracy][a] Generally (cleaned up: “The term ‘*Klein* conspiracy’ is in some sense a misnomer, since the primary holding of *Klein* is a quote from *Hammerschmidt*.” *Klein* simply applied *Hammerschmidt v. United States*, 265 U.S. 182 (1924), to a tax case, describing a conspiracy.”). Nevertheless, the term “*Klein* conspiracy” is used in nontax defraud conspiracy cases. I have written an article on the *Klein* conspiracy and its Internal Revenue Code counterpart, tax obstruction in § 7212(a) and refer the interested reader to that article. John A. Townsend, Tax Obstruction Crimes: Is Making the IRS's Job Harder Enough?, 9 Hous. Bus. & Tax. L.J. 255 (2009),

¹³⁴⁶ I avoid getting into a deeper discussion on this issue. Suffice it to say that willfulness, with is a very high mens rea element, is required for Title 26 tax crimes and, because the offense conspiracy requires the same level of mens rea as the substantive offense, that high mens rea is required for conspiracy to commit tax offenses. E.g., *United States v. Pinckney*, 85 F.3d 4, 8 (1996). By contrast, so it is imagined, the defraud or *Klein* conspiracy is not articulated to have such a high mens rea element, although it may have the equivalent meaning. Having baited your curiosity, I do refer you to *United States v. Coplan*, 703 F.3d 46 (2d Cir. 2012), cert. den. 134 S. Ct. 71 (2013) (where majority opinion questions the broad scope of the defraud conspiracy but is bound by the Supreme Court opinion, *Hammerschmidt v. United States*, 265 U.S. 182 (1924), which blessed the broad reading); and John A. Townsend, Is Making the IRS's Job Harder Enough?, 9 Hous. & Bus. Tax L.J. 260 (2009) where I nois about this issue in great volume.

¹³⁴⁷ *United States v. Flynn*, 969 F.3d 873 (8th Cir. 2020); *United States v. Flynn*, 2019 U.S. Dist. LEXIS 36408 (D. Minn. 2019); and *United States v. Herman*, 997 F.3d 251, 273 (5th Cir. 2021).

F. Miscellaneous Tax-Related Crimes.

1. General - Myriad of Other Tax Related Crimes.

The foregoing are the principal tax crimes that you will see in your practice. There are, however, a host of other crimes in the Code and crimes in Title 18 and even other Titles that overlap or are frequent traveling companions with tax crimes. I discuss below only the significant ones you will see.

2. Money Laundering and Wire Fraud.

You will often also see money laundering charges traveling with tax crimes charges. Money laundering is beyond the scope of this book. These provisions are quite sweeping and generally impose stiff penalties on the attempt to use financial institutions or monetary instruments to further serious crimes or cleanse the fruits of serious crimes. The Government usually fields these provisions to attack drug trafficking, organized crime and other major national criminal enforcement priorities. However, because of their sweep, the money laundering laws potentially apply in many other situations of lesser criminality and the Government will use them if it feels that other crimes it might charge are not adequate to punish the gravity of the overall criminal conduct.

Money laundering requires some predicate criminal act producing or related to the proceeds being laundered. Mail fraud or wire fraud (18 U.S.C. §§ 1341 and 1343) can be a predicate act for the money laundering crime. This type of fraud criminalizes use of mail and wires to commit fraud. Mail fraud or wire fraud (or both) is probably present in most tax crimes. Tax evasion or tax perjury by false return certainly will involve mail fraud or wire fraud. Conduct required for tax obstruction or *Klein* conspiracy will almost always in some way implicate mail or wires. Where the gravamen of the criminal conduct is, at core, a tax crime, DOJ Tax will generally approve charging the tax crime only and will not approve charging the mail fraud or wire fraud. The purpose of this discretionary general limitation is to charge the tax specific crime if that is the gravamen of the conduct. One other salutary benefit is that Government attorneys will not bootstrap a money laundering charge from a wire or mail fraud claim for conduct that is essentially a tax crime when Congress chose not to make the tax crime a predicate offense to money laundering.

3. Some Other Representative Crimes.

In the employment context, there are failure to file criminal penalties for employers who fail to file information returns such as W-2's and for employees who claim too many exemptions so as to improperly lower the amount of withholding.

There are numerous other criminal penalties which I cannot cover here. Suffice it to say that wherever you find an important civil tax obligation in the Code there will usually be some type of criminal penalty to give the persons subject to the obligation some incentive to comply "voluntarily."

G. Voluntary Disclosure.

1. The General Voluntary Disclosure Programs.

a. General Description of the Programs.

The Government has historically had voluntary disclosure practices or programs for persons who are at risk of potential criminal prosecution for tax crimes. In general, the practices or programs give some assurance against criminal prosecution to a taxpayer who voluntarily reports his or her wrongdoing before coming into the criminal cross-hairs of the IRS. The IRS and DOJ have each had some form of voluntary disclosure practice or program, which in most respects substantially overlap. The nuances of the programs may change from time to time, but the broad outlines have been relatively stable. However, successful voluntary disclosures under the practices or programs will generally avoid criminal prosecution for tax and tax-related crimes.

The general parameters in various iterations over the years is: where the taxpayer who has committed or has possibly¹³⁴⁸ committed a tax crime or tax-related crime¹³⁴⁹ and the IRS has not yet commenced a criminal investigation or, possibly even a civil tax audit,¹³⁵⁰ the taxpayer may be able to cure the criminal prosecution risk by making a “voluntary disclosure.”¹³⁵¹ When a disclosure qualifies under the policy, the IRS exercises its discretion not to refer the case to DOJ Tax’s Criminal Enforcement Section (“CES”) for further investigation or prosecution. The taxpayer is protected only from criminal problems; the taxpayer is not insulated from civil taxes, penalties and interest.¹³⁵² The policy thus operates as a form of administrative amnesty. If for some reason, CES were to consider prosecuting a taxpayer who made a voluntary disclosure, it will consider the voluntary disclosure and compliance with the IRS program as a significant factor weighing against prosecution. (I discuss this in more detail below.)

These voluntary disclosure programs reflect practical and fiscal imperatives. The practical imperative is that, in tax cases, a jury will often be less likely to convict where the taxpayer has

¹³⁴⁸ Sometimes it is not clear. Even where the taxpayer does not think he has committed a crime which, after all, does require his or her intent to commit, other people—specifically, the IRS, the DOJ, and a judge or jury—might think he committed the crime.

¹³⁴⁹ This includes crimes, such as FBAR crimes, related to tax crimes.

¹³⁵⁰ As will be noted, the current IRS policy treats as untimely a voluntary disclosure attempted after a civil audit of the taxpayer and, in some cases, related parties has commenced. That has not always been the case; and, I suspect, may be honored in the breach even now through general understandings in the process of a voluntary disclosure.

¹³⁵¹ Both the IRS and the DOJ have voluntary disclosure practices or policies. I discuss them in detail later in the text. Some states have from time to time adopted voluntary disclosure practices or policies. Here, we deal only with federal voluntary disclosure—to wit, the IRS and DOJ practices or policies.

¹³⁵² An exception to this might be if, incident to the voluntary disclosure, the taxpayer files amended returns that qualify as Qualified Amended Returns (“QARs”). Reg. § 1.6664-2(c)(2). QARs avoid the accuracy related penalty (generally 20%). The QAR does not apply if the return was fraudulent, in which case the civil fraud penalty would apply to the portion of the understatement attributable to fraud and the accuracy related penalty could apply to some or all of the portion of the understatement not attributable to fraud. However, making a voluntary disclosure is not per se an admission of fraud. The taxpayer will have to disclose the facts that may be an admission of fraud. But often in voluntary disclosures, the facts are still mixed as to fraud and the taxpayer may be seeking just to avoid a misfocused criminal investigation and prosecution. In that type of case, the taxpayer will want to act consistently with qualifying for the QAR relief.

corrected the criminal conduct by voluntarily filing an amended return or delinquent original return. The fiscal imperative—probably more important to the existence of the program—is that it is “win-win” as a revenue measure. A voluntary disclosure policy will generate significant additional revenue for the Government since the IRS would not have discovered or, if discovered, would not have prosecuted most of the taxpayers who voluntarily disclose under the policy. There are still plenty of taxpayers to prosecute who have not gotten right with the Government for the Government to meet its criminal tax enforcement needs, so the additional revenue generated by the voluntary disclosure policy is a “freebie” for the Government. The Government gives up nothing of systemic importance and gets a material amount of revenue that, but for the policy, it would never get.

The key caveat here is that the disclosure must be voluntary and must be complete. To avoid fact intensive queries about what precisely is motivating the taxpayer to make a disclosure, the IRS has some rules that disqualify the taxpayer based on the “timeliness” of the disclosure. The key timeliness condition is that a disclosure after a civil or criminal investigation has started is not timely.

The foregoing are the general rules of the programs over the year. The specific requirements are more detailed, and the nuances with respect to the policy shift from time to time. Still, a taxpayer having a potential criminal problem on the original return or having failed to file a return should consider voluntary disclosure, even if the circumstances might suggest that the disclosure is not really voluntary (e.g., even if the spouse waging a nasty divorce has threatened to turn him in).

Within these broad parameters, there are actually two voluntary disclosure programs. The IRS has one,¹³⁵³ and CES, which prosecutes all tax crimes, has one.¹³⁵⁴ The two substantially overlap, but from time to time there may be differences.¹³⁵⁵ The important point, however, is that if you fail to qualify for the IRS's policy and the IRS forwards the case to CES with a recommendation for criminal prosecution, the taxpayer may have another bite at this apple.

b. IRS Voluntary Disclosure Practice (“VDP”).

(1) General.

The IRM states the IRS’s “voluntary disclosure practice” (“VDP”)¹³⁵⁶ In relevant part, the key features of this practice are:

- “This voluntary disclosure practice creates no substantive or procedural rights for taxpayers,”

¹³⁵³ IRM 9.5.11.9 (09-17-2020), Voluntary Disclosure Practice. See also IRS web page titled “IRS Criminal Investigation Voluntary Disclosure Practice” (Last reviewed or updated 10/20/20 and viewed on 7/24/21).

¹³⁵⁴ The DOJ Tax’s voluntary disclosure policy is reflected in its Criminal Tax Manual, often referred to as the “CTM,” available on the DOJ web site, at ¶ 4.01 Voluntary Disclosure.

¹³⁵⁵ That there may be differences is reflected in DOJ Tax Memorandum from the Acting Assistant Attorney General which is reproduced in the CTM at ¶ 3.00.

¹³⁵⁶ IRM 9.5.11.9 (09-17-2020), Voluntary Disclosure Practice

- “A voluntary disclosure will be considered along with all other factors in determining whether criminal prosecution will be recommended. A voluntary disclosure does not guarantee immunity from prosecution.”
- VDP is “is not available to taxpayers with illegal source income.”
- The disclosure must be “truthful, timely, complete” and include full cooperation and, if possible, payment of the tax, penalties and interest.
- In order to be considered timely, the VDP must be started before the IRS has notified the taxpayer of a civil or criminal investigation or an notified the taxpayer of an intent to start one”: (ii) the IRS has received information from a third-party as to the taxpayer’s noncompliance; and (iii) “the IRS has acquired information directly related to the taxpayer’s noncompliance from an enforcement action (e.g., as search warrant, grand IRS summons, or jury subpoena).”
- IRS-CI’s determinations, including but not limited to determinations concerning timeliness, completeness, truthfulness, rejection, and revocation decisions, are not subject to any administrative or judicial review or appeal process.”

Voluntary disclosure is virtually daily grist of the tax crimes practitioner’s mill. Taxpayers often make mistakes on their returns—mistakes usually in their favor. Those mistakes can be culpable mistakes, involving some risk of potential criminal prosecution and significant civil penalties, or more innocent mistakes, involving at worst some level of negligence. For taxpayers who are culpable in making mistakes, the IRS voluntary disclosure practice should be considered. For taxpayers who are not culpable and thus not at material risk of criminal prosecution, there may be other ways to correct the mistakes short of doing a traditional voluntary disclosure under the voluntary disclosure programs. In making the distinction between the culpable actors and nonculpable actors, tax practitioners should have considerable experience because there is no litmus test, particularly in the middle of the continuum.

(2) Formal VDP (“Noisy Disclosure”).

The culpable actor wanting the benefits of the IRS voluntary disclosure program should follow the procedures the IRS outlines for its voluntary disclosure “practice.”¹³⁵⁷

In the past, the practice was invoked by the taxpayer's counsel first meeting with CI -- IRS's Criminal Investigation division -- to advise of the facts, often on an anonymous basis, to receive some advance assurance from CI that if the facts are as represented, CI will not pursue a criminal investigation or recommendation to CES for prosecution. If the practitioner received that assurance, the taxpayer’s identity would be disclosed and the taxpayer would then cooperate with the IRS with regard to potential tax liabilities.

¹³⁵⁷ IRM 9.5.11.9(1) (09-17-2020), Voluntary Disclosure Process.

The current VDP, announced in 2018, requires a process described in the IRM.¹³⁵⁸ The following are the steps in sequential order:¹³⁵⁹

1. The first step is to file a written preclearance request with the IRS Lead Development Center in Philadelphia.¹³⁶⁰ The request is made on Form 14457, Voluntary Disclosure Practice Preclearance Request and Application. Only the first part of the Form (Part I), called Preclearance Request, is completed. That part of the form only requires limited information identifying the taxpayer and making certain other disclosure.¹³⁶¹

2. Upon receipt of the Form 14457, IRS CI reviews the information and checks IRS and other accessible databases to determine whether the taxpayer is under audit or criminal investigation or there is some other indication that the taxpayer does not qualify to make a voluntary disclosure. If IRS CI finds no disqualifying factor, IRS CI will notify the taxpayer and request that the taxpayer submit the form again with the second part of the Form (Part II), having detailed disclosures regarding the noncompliance. A key part of the disclosures in Part II is a detailed narrative statement, under penalty of perjury, of the “the complete story of the willful noncompliance,”¹³⁶² with favorable and unfavorable facts and including identifying all professionals involved.

3. Upon review and approval of Part II, the IRS provides the taxpayer “a Preliminary Acceptance Letter and forward the Form 14457 to a civil section of the IRS.” A civil agent will then contact the taxpayer.

4. The taxpayer will then submit amended returns for the “covered period,” generally, the most recent 6 years. The taxpayer will pay the required taxes, interest and civil penalties. The civil penalties generally are: (i) a 75% civil fraud penalty under §§ 6663 or 6651(f) for the high tax year in the covered period and (ii) accuracy related penalties or delinquency penalties in the other years. This penalty structure is the general rule. In limited circumstances (including failure to cooperate), the fraud penalty may apply to more than one year and beyond the covered period.¹³⁶³

¹³⁵⁸ IRM 9.5.11.9.1 (09-17-2020), Voluntary Disclosure Process. A good discussion of the VDP as of early 2021 is Scott Michel and Mark Matthews, The 2020 Revision to the Internal Revenue Manual’s Voluntary Disclosure Practice: More Consistency with Greater Risk (Bloomberg Daily Tax Report 1/12/21).

¹³⁵⁹ The steps are described in the IRM provision cited in the previous footnote.

¹³⁶⁰ See IRS web page titled “IRS Criminal Investigation Voluntary Disclosure Practice” (Last reviewed or updated 5/6/22 and viewed on 5/18/22).

¹³⁶¹ Some of the disclosures might be incriminating-type disclosures such disclosures are required to get preclearance. See Scott Michel and Mark Matthews, The 2020 Revision to the Internal Revenue Manual’s Voluntary Disclosure Practice: More Consistency with Greater Risk (Bloomberg Daily Tax Report 1/12/21).

¹³⁶² IRM 9.5.11.9.1(5) (09-17-2020), Voluntary Disclosure Process. As of the date of this revision (1/16/21), the actual quote is: “the complete story of the willful on compliance.” That has to be a typo and I have put in the quote in the text the correct requirement.

¹³⁶³ The financial costs are in a prior memo rather than in the IRM. See IRS Memorandum LB&I-09-1118-014). See Scott Michel and Mark Matthews, The 2020 Revision to the Internal Revenue Manual’s Voluntary Disclosure Practice: More Consistency with Greater Risk (Bloomberg Daily Tax Report 1/12/21).

5. Similarly, if the tax noncompliance is accompanied by FBAR noncompliance, the FBAR civil penalties may apply in accordance with the guidelines in the Internal Revenue Manual.¹³⁶⁴

6. If the taxpayer cannot pay the amounts thus calculated, the taxpayer will have to go through the IRS processes for installment payments or perhaps even compromise.

Taxpayers not having material risk of criminal prosecution should not attempt a voluntary disclosure under this practice. There is **perhaps** one exception to this general statement. If a taxpayer has some special features that would make actual criminal prosecution unlikely but could be at risk of the civil penalties that are analogs of the crimes involved (specifically the civil fraud penalty under § 6663 or the FBAR willful penalty), the taxpayer might want to do a voluntary disclosure to mitigate the civil penalty cost.

Finally, the VDP is contingent upon timely application. A disclosure is timely if the made **before** any of the following:¹³⁶⁵

(a) the IRS has started a civil or criminal investigation of the taxpayer, the taxpayer's spouse or related entities or has been notified of intent to start such an investigation,¹³⁶⁶

(b) the IRS has received information from a third party of the taxpayer's noncompliance; and

(c) the IRS has "acquired information directly related to "the taxpayer's noncompliance from an enforcement action (such as search warrant, summons or grand jury subpoena). In (c) focus on the word "acquired." For example, if the IRS issues a John Doe Summons that compels a third party with records about an unnamed taxpayer or taxpayers, the taxpayer or taxpayers can qualify for VDP by acting before the IRS acquires the records.

(3) Informal ("Quiet Disclosure").

The only IRS formally sanctioned voluntary disclosure is the formal practice ("noisy disclosure") discussed above. Historically, practitioners have felt that simply filing amended returns (often referred to as "quiet disclosure") and full cooperation thereafter could achieve the key benefit of voluntary disclosure practice—no criminal prosecution.¹³⁶⁷ Practitioners had to make judgment

¹³⁶⁴ I discuss those guidelines in Chapter 16 discussing FBARs generally.

¹³⁶⁵ IRM 9.5.11.9(7) (09-17-2020), Voluntary Disclosure Practice; and IRM 9.5.11.9.4 (09-17-2020), Disqualifying Factors.

¹³⁶⁶ IRM 9.5.11.9.4 (09-17-2020), Disqualifying Factors. This was a taxpayer-friendly constriction of the prior breadth of this disqualification from VDP. See Scott Michel and Mark Matthews, The 2020 Revision to the Internal Revenue Manual's Voluntary Disclosure Practice: More Consistency with Greater Risk (Bloomberg Daily Tax Report 1/12/21). In addition, the taxpayer will have to disclose on the initial Form whether under investigation by any law enforcement agency, but I assume that such an investigation, properly disclosed if not related to federal tax noncompliance will be disqualify for the VDP.

¹³⁶⁷ In the "hot" area of offshore accounts, however, the IRS claimed that it was alerting processors of (continued...)

calls as to how many years amended returns should be filed, but generally it was thought that 6 years would suffice for mitigating the criminal risk because the criminal statute of limitations is 6 years.¹³⁶⁸

One of the side benefits of the quiet disclosure is that the amended returns historically have not been audited or have been audited only infrequently.¹³⁶⁹ Indeed, there is a qualified amended return process that says, in effect, that the amended return filed before an audit is started will draw no penalty except in the case of fraud (in which case, of course, the civil fraud penalty would apply).¹³⁷⁰ In other words, unless the amended return is audited and a finding of fraud made, the taxpayer's cost of his type of disclosure is the tax and the interest on the tax. Given the audit capabilities of the IRS and the difficulties the IRS often encounters in asserting and prevailing in the assertion of civil fraud, most amended returns will get through without any penalties.

A major issue is whether the IRS or DOJ Tax would consider a quiet disclosure to be a qualified voluntary disclosure for avoiding criminal prosecution exposure. The IRS has never formally blessed quiet disclosures and has occasionally noised, particularly in the foreign bank account area, that quiet disclosures do not qualify. The IRS formal line has been that only the “noisy disclosure” qualifies. I think that most practitioners believe that, for **typical** tax noncompliance without significant features of egregious culpability, the full and complete quiet disclosure with subsequent full cooperation as requested by the IRS will serve to avoid criminal prosecution. This is based on criminal practitioner understanding of how the IRS and DOJ Tax apply criminal tax enforcement priorities but the risk is that that understanding may not be perfect and certainly does not bind the IRS or DOJ Tax. Given the inherent uncertainty of the quiet disclosure to mitigate the criminal prosecution risk, except in more benign cases of criminal culpability, the noisy disclosure procedure should be followed. (Further mitigating in favor of the noisy disclosure is that the quiet disclosure runs more risk of greater civil penalties than offered under the noisy disclosure.)

c. DOJ Tax Disclosure Policy.

Historically, DOJ Tax has had a voluntary disclosure policy that varied—at least in some of its nuances—from the IRS voluntary disclosure policy. See DOJ Criminal Tax Manual (“CTM”) 4.01[1] Policy Respecting Voluntary Disclosure. Key features of this policy are:

- The voluntary disclosure is considered “along with all other factors in the case in determining whether to pursue criminal prosecution”

¹³⁶⁷(...continued)

amended returns to look for amended returns reporting previously undisclosed foreign account income and the answering the critical foreign account question on Schedule B of Form 1040. This special initiative made the “quiet disclosure” of foreign account income riskier, so with the special voluntary disclosure initiative for foreign accounts most practitioners in most cases where there is serious potential criminal exposure would not recommend quiet disclosure.

¹³⁶⁸ Some practitioners recommended filing fewer than 6 years on the thought that the IRS could not pursue criminal investigation and prosecution for the early years. More cautious practitioners, however, generally recommended 6 years.

¹³⁶⁹ I don't recall any quiet disclosure resulting in an audit. Prior to the implementation of the qualified amended return procedure (discussed below in the text), it was not uncommon for certain penalties to be applied at the Service Center without an investigation.

¹³⁷⁰ Reg. § 1.6664-2(c)(2).

- “If a putative criminal defendant has complied in all respects with all of the requirements of the Internal Revenue Service’s voluntary disclosure practice, the Tax Division may consider that factor in its exercise of prosecutorial discretion. It will consider, inter alia, the timeliness of the voluntary disclosure, what prompted the person to make the disclosure, and whether the person fully and truthfully cooperated with the government by paying past tax liabilities, complying with subsequent tax obligations, and assisting in the prosecution of other persons involved in the crime.”¹³⁷¹

In 2023, DOJ components, including DOJ Tax, have updated their respective corporate voluntary disclosure policies. While an attorney representing corporations having a potential federal criminal problem should familiarize themselves with appropriate DOJ component (e.g., Criminal Division) policies, I focus here on the DOJ Tax voluntary disclosure policy. The DOJ Tax update “supplements” the Tax Division existing policy (described above) by providing much more detail as to the requirements for the policy.¹³⁷² Key features of the “supplement” are:¹³⁷³

- “The terms corporation and company apply to all types of business organizations, including but not limited to partnerships, government entities, and unincorporated associations.”
- “Any voluntary self-disclosure related to matters arising under the internal revenue laws **must** be made to the Tax Division.” **Caveat**, it is not clear whether this “imperative” flanges with the IRS voluntary disclosure practice.
- The detailed requirements of the DOJ Tax voluntary disclosure practice in some respects parallel the IRS disclosure practice but are more detailed and have requirements beyond the IRS disclosure practice. For example, certain key requirements are:
 - “The Tax Division will determine, at **its sole discretion**, whether a disclosure constitutes a voluntary self-disclosure based on a careful, case-by-case assessment.” (Boldface supplied.)
 - Disclosure both before events that would bring the conduct to the government’s attention and “within a reasonably prompt time after the company becomes aware of the criminal misconduct, with the burden being on the company to demonstrate timeliness.”

¹³⁷¹ DOJ Tax CTM 4.01 Voluntary Disclosure (2012 ed.)

¹³⁷² The policy is stated on the Tax Division web site titled “Corporate Voluntary Self-Disclosure Policy,” <https://www.justice.gov/tax/corporate-voluntary-self-disclosure-policy> (updated March 1, 2023 viewed 4/14/23).

¹³⁷³ This is summarized from Updated DOJ Tax Voluntary Disclosure Policy (Federal Tax Crimes Blog 4/14/23).

- Affirmative steps consistent with disclosure and full cooperation, including preservation of documents and consent to government to disclose, etc.

Caveat, anyone wanting to do a corporate disclosure either to DOJ Tax or to the IRS (or even other DOJ components) must thoroughly familiarize themselves with those policies in detail beyond this summary and bring the research up to date. Specifically, the wording of the DOJ Tax voluntary disclosure does suggest that DOJ Tax might prosecute even if the taxpayer has made a voluntary disclosure that the IRS would view as consistent with its practice—which in turn the IRS views as consistent with its mission to enforce and administer the tax laws. This raises the issue of whether DOJ Tax would or could prosecute when the IRS says that prosecution is not consistent with its administration of the tax laws. That is a big and potentially distractive issue, so I forego it now (except in the footnote).¹³⁷⁴

d. Does the VDP Confer Rights?

Both the IRM and the CTM specifically state that the practice or policy confers no rights on taxpayers. What does this mean? Basically, it means that the IRS will not be second-guessed in its application of the practice by a court.¹³⁷⁵ In other words, it serves as a specific caution to taxpayers that the *Caceres* doctrine¹³⁷⁶ applies to the voluntary disclosure practice (which might have been required by *Caceres* even without the specific caution).¹³⁷⁷ So, you might ask, why should a taxpayer do a voluntary disclosure if he or she has no assurance that he or she will not be criminally prosecuted? The answer to that is that the IRS is not stupid, so it does a pretty good job of policing its application of the practice. The voluntary disclosure practice is win-win for the IRS. If it were

¹³⁷⁴ If the IRS views the taxpayer's disclosure as meeting its voluntary disclosure practice, the IRS simply does not refer the taxpayer to DOJ Tax for criminal prosecution, and that is the end of the matter. However, let's say that DOJ Tax or some other DOJ component focuses on the taxpayer for some reason other than a criminal prosecution or grand jury investigation referral from the IRS; the issue raised is whether DOJ Tax can then authorize a prosecution that the IRS insists is inconsistent with its responsibilities because the taxpayer complied with the voluntary disclosure policy and therefore declines to refer to DOJ Tax? There are some big issues here. I would like to go farther with this issue, but I don't want to turn this footnote into a book—or at least a law review article.

¹³⁷⁵ See e.g., E.g., *Crystal v. United States*, 172 F.3d 1141, 1151 (9th Cir. 1999); *United States v. Knottnerus*, 139 F.3d 558, 560, 561 n.5 (7th Cir. 1998) cert. denied, 119 S. Ct. 146 (1998).

¹³⁷⁶ *United States v. Caceres*, 440 U.S. 741 (1979) (holding that IRM does not confer rights on taxpayers; hence, evidence obtained arguably in violation of IRM cannot be excluded).

¹³⁷⁷ The IRM is of course subregulatory guidance and even of lesser dignity in terms of guidance to taxpayers than Revenue Rulings. For violation of regulations guidance see U.S. ex rel. *Accardi v. Shaughnessy*, 347 U.S. 260, 266-67 (1954); and a predecessor case, *Ariz. Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co.*, 284 U.S. 370 (1932), which as currently interpreted and applied (if applied), "Agency violations of their own regulations, whether or not also in violation of the Constitution, may well be inconsistent with the standards of agency action which the APA directs the courts to enforce. Indeed, some of our most important decisions holding agencies bound by their regulations have been in cases originally brought under the APA." *Accardi*, p. 754-754. The Supreme Court guidance is sparse, but "Within the lower courts, there is general (though not universal) agreement that the principle applies only to legislative rules, which have the force of law, and that agencies need not comply with interpretive rules or general statements of policy." (Citing in fn. 249, Stephen G. Breyer et al., *Administrative Law and Regulatory Policy* 420–21 (8th ed. 2017).) See also Thomas W. Merrill, *The Accardi Principle*, 74 Geo. Wash. L. Rev. 569, 600-03 (2006) ("the *Accardi* principle applies only if the agency has been delegated authority to make legislative rules by Congress"); and Cass R. Sunstein & Adrian Vermeule, *The Morality of Administrative Law*, Harv. L. Rev. 1924, 1956- 1961 (2018).

to prosecute one or more taxpayers who actually met or were perceived to have met the conditions for voluntary disclosure, it would cost the IRS far more than it could ever hope to gain, because voluntary disclosures would dry up.

There are cases where taxpayers have asserted that they met the conditions for voluntary disclosure practice and that, therefore, the Government should not be able to prosecute them. What you will find when you scratch the surface of those cases is that the taxpayers involved did not meet the conditions for voluntary disclosure and otherwise behaved in a manner inconsistent with the requirement to cooperate completely.¹³⁷⁸

Practitioners should distinguish the IRS's voluntary disclosure practice from the concept of immunity from prosecution which, in federal criminal law, is generally conferred only by DOJ or the courts.¹³⁷⁹ Specifically, in this context, the IRS has no authority to confer immunity from criminal prosecution. The IRS voluntary disclosure practice may be a form of practical immunity. If the IRS does not refer a case to DOJ Tax for criminal prosecution, except in rare circumstances, DOJ Tax would never have occasion to even consider criminally prosecuting the taxpayer who made a voluntary disclosure to the IRS. And, even in those instances where DOJ Tax were to consider prosecuting without a referral from the IRS, DOJ Tax's own voluntary disclosure policy would mitigate against prosecuting the taxpayer who had made a voluntary disclosure to the IRS. And, finally, since all tax prosecutions by DOJ Tax require that the IRS make a recommendation as to prosecuting, it would be exceedingly rare for DOJ Tax to pursue criminal prosecution where the IRS did not recommend criminal prosecution, which it would not if the taxpayer had made a qualifying voluntary disclosure.

e. Timeliness, Truthfulness and Completeness.

Voluntary disclosure requires timeliness, truthfulness and completeness. When using quiet disclosure, the return will usually not include a complete disclosure of the underlying facts—either as to the nature of the erroneously reported item or the reason it was not included on the original return. Nevertheless, what the amended or delinquent original return should report is all of the information called for by the return instructions, although I think it need not include a detailed *mea culpa*. And the IRS would prefer a cover letter indicating that the quiet disclosure is intended to qualify as a voluntary disclosure under the practice discussed above, but I think most practitioners do not view that as necessary or appropriate, at least in some cases. I am not aware of such a quiet disclosure ever failing (even without a cover letter as described), so long as the amended return or delinquent original return contains the type of information normally required for returns in the type of detail normally required. Of course, if the IRS wants then to ask the taxpayer questions about the amended return or the delinquent original return, the taxpayer's responses will have to be complete and the taxpayer will have to be cooperative. Practitioners concerned about whether the quiet disclosure is adequate without a complete discussion of the facts can simply include that discussion.

¹³⁷⁸ A good example is *United States v. Tenzer*, 213 F.3d 34 (2d Cir. 2000), which I used to include in the text of this book just so that the reader will get an idea for just the quintessential type of taxpayer that asserts the benefits of voluntary disclosure—no prosecution—while not even coming close to meet the conditions of the voluntary disclosure practice. Read it if you are interested, but suffice it to say that, so long as your client meets the conditions of the practice, the chances of his meeting Mr. Tenzer's fate are slim and nonexistent.

¹³⁷⁹ Immunity is a topic for criminal law courses. However, I do provide a brief discussion of immunity in discussing the Fifth Amendment below (beginning on p. 911),

Further, taxpayers and practitioners wanting more certainty than offered by a quiet disclosure can pursue the formal VDP.

For many reasons, the taxpayer will often be unable to file a completely accurate amended return or delinquent original return. The taxpayer may not have kept good records, the taxpayer in furtherance of the original fraud may have destroyed records, the time elapsed may have made some third party sources of relevant information unavailable, etc. Yet, something needs to be done and it needs to be done as accurately as possible, so that the taxpayer does not file a false amended return or false delinquent return, thereby compounding his or her problem.¹³⁸⁰ Good return preparers will know how to undertake the type of due diligence to make the best return reasonably possible, and that should be acceptable. But obviously a good faith, even if expensive, effort must be made to reconstruct the taxpayer's income, deductions, and credits and proper disclosures should be made on the return where estimates and indirect methods of reconstruction are used. In many cases, this will require the return preparer to make judgment calls against the taxpayer to ensure that the tax liability is not under reported. That is just a cost of the original fraud and ensuring that the IRS will bless the voluntary disclosure, a less likely result if the taxpayer's disclosure by amended return is found wanting. Good faith is the key, and good faith will work to ensure the application of the policy so long as the other requirements are met.

f. Taxpayer Cooperation.

The taxpayer is required to be forthcoming and cooperative. Certainly, as to IRS inquiries regarding the taxes or potential penalties, the taxpayer must cooperate. Does it mean more?

For example, does this mean in the case of quiet disclosure that a taxpayer who knows he or she committed a criminal act is required to "self-impose" the appropriate civil penalties that would otherwise apply to the criminal conduct? Thus, if the original return were fraudulent, is the taxpayer required to advise the IRS on or with the amended return that he or she is subject to the civil fraud penalty and pay that penalty if possible? Most practitioners say that such self-imposed penalty assessments are not required to qualify for voluntary disclosure. The assessment of the penalty is not the prerogative of the taxpayer but is instead the prerogative of the IRS. The IRS will often, even usually, assert some penalty upon receiving an amended return reporting substantial additional tax liability or for a delinquent original return, but the taxpayer should await the IRS's call on that one without great concern that he has not been cooperative.

The tougher question will be whether and how hard the taxpayer might want to fight the imposition of any penalty that the IRS imposes upon receipt of the return. For reasons noted above, the IRS may not assert any penalty after either type of disclosure—noisy or quiet. But, if it were to do so, what should be the taxpayer's response, keeping in mind that his conduct may have been subject to the civil fraud penalty. Smart taxpayers, particularly in a fraud situation, might not want to fight for a host of strategic reasons which, in the interest of keeping these materials to an acceptable size, cannot be explored here. Would fighting the penalty be deemed noncooperation?

¹³⁸⁰ See *Blauner v. United States*, 293 F.2d 723, 729-730, 724-735 (8th Cir. 1960), cert. denied 368 U.S. 931 (1961).

Frequently, persons desiring to qualify under this policy will not have the funds to pay the taxes, penalties and interest that are then due. Does this exclude from the policy taxpayers who cannot pay in full? Surely not, but this too is the author's judgment call based on experience and a logical implementation of the policy. Of course, the taxpayer will want to avoid delay and foot-dragging, to meet the cooperation requirement. Accordingly, if the quiet disclosure method is used, where the taxpayer can't fully pay, the taxpayer should include as much payment as possible with the return and a cover letter or a statement attached to the return saying that he or she cannot pay the amount required but desires to cooperate and work with the IRS under existing procedures to resolve the liability. The taxpayer should thereafter cooperate with the IRS collection personnel. Existing collection procedures include installment agreements and offers in compromise. The key, of course, is for the taxpayer to show the good faith that eluded those few who have been prosecuted.¹³⁸¹

If the IRS decides to investigate the circumstances of the original fraud or even the decision to disclose voluntarily, can the IRS require the taxpayer to waive his privileges to meet the cooperation requirement of the policy? Obviously, the taxpayer has disclosed the underlying fraud itself and has thus waived his Fifth Amendment privilege as to that conduct, although if the IRS started a full-blown inquiry and the taxpayer was really concerned, he could reassert that privilege to avoid future disclosures of information privileged under the Fifth Amendment. But what if the taxpayer had other criminal conduct, not necessarily tax criminal conduct, but still related to the tax fraud? Can the taxpayer assert the Fifth Amendment privilege and still qualify? Note that the IRS policy above applies only to legal source income, so this might be a disqualification ab initio if the untaxed income is illegal source income.¹³⁸² Similarly, can the taxpayer assert the attorney-client privilege for advice he or she received in the course of considering and making voluntary disclosure? And can the taxpayer claim the new practitioner privilege, § 7525, to prevent the IRS from learning confidences incident to the original return preparation and still qualify for the privilege? These issues are yet to be decided.

g. Events Preventing Timeliness or Voluntariness.

If the IRS gets on the taxpayer's trail or a series of events is in place that will likely put the IRS on the taxpayer's trail, the policy does not apply. As set forth in the IRM, these events are a civil or criminal investigation, third party information about that taxpayer's noncompliance, another civil or criminal investigation that would likely lead to the taxpayer or information from another criminal enforcement investigation.¹³⁸³ I hope you can see why this limitation on the policy is necessary. If all a taxpayer had to do to solve a criminal problem was to fess up when caught and maybe some civil penalties, the cost-benefit ratio of playing the audit lottery with fraudulent activity would be heavily tilted in the taxpayer's favor.

¹³⁸¹ See e.g., *United States v. Tenzer*, 213 F.3d 34 (2d Cir. 2000), discussed above at p. 325 n. 1378.

¹³⁸² The policies do apply only to legal source income. In appropriate cases, however, a taxpayer with illegal source income might want to try the noisy disclosure route to see if he or she can get the needed assurance from the Chief of CI. If the Chief gives the assurance, it will certainly be honored. That type of advance assurance cannot be achieved via the quiet disclosure route.

¹³⁸³ See 9.5.11.9 Voluntary Disclosure Practice (12-02-2009), at par. (4).

Previously, the IRM suggested that the voluntary disclosure practice was not available if some series of events had transpired which made the IRS's discovery of the taxpayer's malfeasance inevitable. The limitation is not present in the current version of the practice. I urge the reader to go back and read the policy and consider why I say that this limitation is not in the current version. The reader will note that the practice is not available to a taxpayer if the IRS has started an investigation of another taxpayer as to a matter that is "directly related" to the taxpayer's liability. This limitation should be read carefully, and obviously the practitioner should be prepared to mount effective advocacy as to why his client's tax liability in the voluntary disclosure is not directly related to another previously discovered taxpayer's tax liability. I think advocacy, even in a close case, might be effective here because the IRS could lose more than it could gain by applying the voluntary disclosure practice too narrowly. That is to say, that the IRS and DOJ Tax can get plenty of fodder for its criminal tax enforcement priorities without being stingy about voluntary disclosure. Your job may be to help the IRS and / or CES realize that priority in your client's specific case.

2. Special Voluntary Disclosure Initiatives.

In major areas of noncompliance where the IRS's ability to detect noncompliance is limited or other special factors exist, the IRS may offer special "voluntary disclosure" type initiatives to encourage compliance. Some of these voluntary disclosure initiatives that I describe sought to resolve the civil liabilities for mitigation financial costs but without explicit assurance of no criminal prosecution. Some involved more explicit understandings of criminal exposure relief. I mention here three prominent examples.

a. Earlier Offshore Initiatives.

At this point in the book, I think it helpful to describe the term tax haven. I think readers who have gotten this far in the book, probably know what a tax haven is. **The Office of Economic Cooperation and Development ("OECD"), an international organization of countries including the U.S. that deals with economic and fiscal issues,**¹³⁸⁴ offers the following attributes of tax havens (with my nuance added in brackets):

[T]ax havens have the following four attributes: (i) no or low effective tax rates [attributable to the financial activity involved]; (ii) no substantial economic activities [in the tax haven] needed to attract tax benefits; (iii) a lack of transparency of financial and other laws that govern financial dealings; and (iv) a lack of effective exchange of information [with other countries, including the U.S. which is the focus of this text].¹³⁸⁵

Historically, some countries have offered these characteristics to attract capital into their financial institutions and related service industries (such as trust companies and lawyers). Prominent countries serving as tax havens have historically included Switzerland, Panama, and some Caribbean

¹³⁸⁴ **The OECD is a major player in international cooperation and development, particularly in fiscal matters, among its many members, including the United States. Incident to that role, it studies and promotes efficient tax policies that result from international trade. I refer to OECD often in this book.**

¹³⁸⁵ Arthur J. Cockfield, Big Data and Tax Haven Secrecy, 18 Fla. Tax Rev. 483, 489-490 (2016) (quoting the OECD definition, but noting OECD had taken out the second characteristic (no substantial economic activities to attract tax benefits) for reasons not germane to the concept of tax havens in this book.

countries, where reasonably sophisticated financial institutions (often with the complicity of the tax haven governments) developed the business model to permit the secret and relatively safe parking of financial assets. The use of tax havens for tax evasion and avoidance has been known for many years, but the IRS's ability to identify the taxpayers involved except anecdotally if the information surfaces through audits or whistleblowers has been thwarted because the characteristics thwarted systemic attack on the use of tax havens. But, as they say, the sleeping giant awakened and began its attack on tax havens. One of the most prominent tools for doing so was to offer taxpayers using tax havens for tax evasion or avoidance special voluntary disclosure programs.

In the later 1990s, the IRS initiated a major initiative to identify taxpayers using offshore credit cards, and more broadly offshore financial institutions, as a means of implementing tax crimes with minimal (they think) risk of detection. Using so-called John Doe summonses against credit and debit card processors in the U.S. targeting transactions for tax haven foreign bank cards, the IRS began tracing the tax haven bank credit card charges through the vendors where the charges were made and on to the taxpayers; with some Sherlock Holmes techniques and some luck, the IRS could often identify the U.S. taxpayers and start U.S. audits and, where appropriate, criminal investigation processes. As an early part of this initiative, the IRS encouraged taxpayers with this problem to voluntarily disclose and offered reasonable assurance that qualifying taxpayers will not be prosecuted. This initiative was called the Offshore Voluntary Compliance Initiative ("OVCI"). The IRS did not expect all taxpayers to accept this voluntary disclosure offer, and thus still had plenty of taxpayers that it can identify and prosecute. But, for those taxpayers within the scope of the offer, it did offer reasonable assurance that they would not be prosecuted. Still, during audits in which an offshore account was identified or suspected, the IRS usually offered the taxpayers a similar program with stiffened penalties that were still much better than worst case called the Last Chance Compliance Initiative ("LCCI").

b. Tax Shelter Initiatives.

Like tax havens, abusive tax shelters have plagued the tax system for years. I offer the following definition of tax shelters. I offer this definition of abusive tax shelters in a later discussion of tax shelters (p. 850 below) but quote it here without footnotes (which can be accessed in the practitioner edition at the cited page:

Some of the characteristics that I have observed for tax shelters that the Government might perceive as abusive are that (i) the transaction is outside the mainstream activity of the taxpayer, (ii) the transaction is incredibly complex in its structure and steps so that not many (including IRS auditors, if they stumble across the transaction(s) will have the ability, tenacity, time and resources to trace it out to its illogical conclusion (this feature is often included to increase the taxpayer's odds of winning the audit lottery); (iii) the transaction costs of the arrangement and risks involved, even where large relative to the deal, offer a favorable cost benefit/ratio only because of the tax benefits to be offered by the audit lottery, (iv) the promoters of the adventure make a lot more than even an hourly rate even at the high end for professionals (the so-called value added fee, which is often insurance type compensation to mediate potential penalty risks by shifting them to the tax professional or the netherworld between the taxpayer and the tax professional) and

(v) the objective indications as to the taxpayer's purpose for entering the transaction are a tax savings motive rather than any type of purposive business or investment motive.

For many widely promoted tax shelters, the IRS has often had settlement guidelines to permit taxpayers to settle the cases before definitive litigation on a basis less than worst case. Often, some of the penalties otherwise applicable might be reduced or avoided. These initiatives were designed to clear out civil audits or cases otherwise in the pipeline. The IRS then began offering voluntary disclosure initiatives designed to have taxpayers volunteer the tax shelters by offering penalty mitigation without explicit assurance of no prosecution.

In the early 2000s after a wave of abusive tax shelters, the IRS announced initiatives as to particular highly marketed shelters permitting taxpayers to limit their risk by voluntary disclosure. These initiatives usually facially offer relief only with respect to the taxpayer's civil exposure (principally because the complexity of the shelters with "opinions" from major tax firms criminal prosecution would be unlikely). But, in situations where the opinions were mere window dressing which the taxpayer really did not believe (often with the assistance of his own independent counsel), careful practitioners would at least be concerned that there might criminal investigation or prosecution. The general thinking is that, in the unlikely event the taxpayer's conduct might otherwise be potentially subject to criminal prosecution, participation in the program with full disclosure will avoid the criminal problem.

c. 2009 and Later Years Offshore Initiatives.

I discuss in Ch. 17 on FBARs, the IRS's voluntary disclosure initiatives related to FBAR noncompliance and offshore account income tax noncompliance.

H. Statutes of Limitation.

The statutes of limitations for criminal prosecutions for tax crimes (including tax related conspiracies) are provided in § 6531. For the crimes I expect you to know (the crimes discussed in these materials), the statute is 6 years from the last act. For tax evasion and false returns, it is six years from the date the false return was filed, although it is possible some subsequent act in furtherance of the criminal conduct will "refresh" the statute of limitations. For example, if a false return is filed and, during the audit, the taxpayer makes false statements to cover up the fraud, the new false statements will start the statute of limitations on § 7201 running from that date.¹³⁸⁶ Note in this example, that the misrepresentation in the audit could be viewed as tax evasion (covering up the original evasion) or simply as a false statement to a government agent punishable under the false statement provisions of 18 U.S.C. § 1001.

If the crime is tax related, but not defined in the Code (i.e., is prescribed in Title 18 rather than Title 26), the statute of limitations will usually be provided in Title 18. For example, for false

¹³⁸⁶ See *United States v. Beacon Brass Co., Inc.*, 244 U.S. 43 (1952); cf. *United States v. Anderson*, 319 F.3d 1218 (10th Cir. 2003).

statements under 18 U.S.C. § 1001 the statute of limitations is 5 years.¹³⁸⁷ There is one significant exception. Title 18 § 371 defines the conspiracy crime that applies to a plethora of criminal conduct, including tax crimes. Conspiracy generally has a 5 year statute of limitations under Title 18. For tax related conspiracies, however, the Code provides a 6 year statute (i) “for offenses involving the defrauding or attempting to defraud the United States or any agency thereof, whether by conspiracy or not, and in any manner” (covering at least the defraud/*Klein* conspiracy)¹³⁸⁸ or (ii) “where the object of the conspiracy is to attempt in any manner to evade or defeat any tax or the payment thereof” (the offense conspiracy for the tax evasion offense).¹³⁸⁹

There are a number of provisions, beyond the scope of this introduction to tax procedure, that might cause the statute of limitations to postpone the start of the statute of limitations or suspend the running of the statute after it has started. For example:

- Noncompliance with or proceedings to quash IRS summonses (including John Doe Summonses) may suspend the statute of limitations.¹³⁹⁰
- Collection Due Process proceedings suspended the IRS’s ability to investigate or collect may suspend the statute of limitations.
- The statute of limitations for Tax crimes in Title 26 and certain tax related crimes (such as conspiracy) in Title 18 is suspended while the defendant is outside the United States or a fugitive from justice within the meaning of 18 U.S.C. § 3290.¹³⁹¹

A literal application of the Wartime Suspension of Limitations Act (“WSLA”), 18 U.S.C. § 3287, would suspend the statute for any crime “involving fraud or attempted fraud against the United States or any agency thereof in any manner, whether by conspiracy or not.” This provision might apply to the Iraq and Afghanistan engagements, but its application to tax crimes with elements of fraud or attempted fraud is notable only because of the many cases in which it could have been applied but is rarely, very rarely, asserted where statute of limitations defenses are asserted.¹³⁹²

¹³⁸⁷ § 3282.
¹³⁸⁸ § 6531(1).
¹³⁸⁹ § 6531(8).
¹³⁹⁰ § 7609(e).
¹³⁹¹ § 6531 (flush language).

¹³⁹² E.g., Appeals Arguments Over Whether Government Brought Evasion and Tax Conspiracy Charges Within Statute of Limitations With No Mention of WSLA (Federal Tax Crimes Blog 9/19/21). Further, the WSLA is not even mentioned in the DOJ Criminal Tax Manual. SEE DOJ CTM 7.00 Statute of Limitations. Apparently because of its lack of use in tax crimes, the ABA has recommended ;”Guidance making it clear that the Service’s Criminal Investigations division will not recommend prosecution for charges that otherwise would be untimely except through the operation of the Wartime Suspension Limitations Act,” I discuss and link this recommendation in ABA Tax Section Recommendation to IRS for Priority Guidance to Disavow Application of WSLA and Further Comments Re Same (Federal Tax Crimes Blog 7/23/21); and More on the Wartime Suspension of Limitations Act (WSLA) (Federal Tax Crimes Blog 2/20/21). Nevertheless, the WSLA has been applied in some tax offense and defraud conspiracies. E.g., *Daugerdas v. United States*, 2021 WL 603068 (S.D. N.Y. 2/16/21)(noting the Afghanistan and Iraq resolutions and stating: “Accordingly, beginning in September 2001, the WLSA tolled the statute of limitations on the *conspiracy to defraud* the United States [for tax objects of conspiracy] and mail fraud charges. See *Wells Fargo Bank*, 972 F. Supp. 2d 593 at 613–14 (holding that the WSLA suspended the ten-year statute of limitations for certain fraud claims arising prior to June 25, 2002 because hostilities had not ended).”; and *United States v. Wellington*, 2022 WL 3345759 (D. N.M. 2022) (Defendant was charged with “violation of 18 U.S.C. § 371, Conspiracy to Commit Tax Evasion and Defraud the United States;” held WSLA applied based on holding in *United States v. Nishiie*, 996 F.3d 1013, 1028 (9th Cir. 2021),

(continued...)

I. Criminal Investigations and Prosecutions.

1. Introduction.

A prototypical tax criminal investigation and prosecution involves two broad phases. The first phase is an IRS administrative investigation by IRS's Criminal Investigation ("CI"). Upon completion of this phase, CI either (1) decides not to pursue the matter further criminally and releases the matter to the civil branches of the IRS for any further appropriate consideration or (2) sends the case to the Criminal Enforcement Section ("CES") of DOJ Tax. The second phase of the case is then conducted by the CES working with and often through the local United States Attorney which is a branch of DOJ. Government attorneys from the CES and/or the United States Attorney's office conduct all further proceedings through prosecution and sentencing.

2. Special CI Initiatives.

IRS CI has programs and emphasis areas.¹³⁹³ The current list includes the following:

- Abusive Return Preparer Enforcement
- Abusive Tax Schemes
- Bankruptcy Fraud
- Corporate Fraud
- Employment Tax Enforcement
- Financial Institution Fraud
- Gaming
- General Fraud Investigations
- Healthcare Fraud
- Identity Theft Schemes
- International Investigations
- Money Laundering & Bank Secrecy Act (BSA)
- Narcotics-Related Investigations
- Non-filer Enforcement
- Public Corruption Crimes
- Questionable Refund Program (QRP)

I discuss non-filer initiatives in Chapter 15.

3. The Usual Criminal Tax Investigation.

a. Sources for CI Investigation.

The most significant single source for CI's criminal investigations is the IRS through its various civil functions. The IRS has a Fraud Referral Program in each of its operating divisions –

¹³⁹²(...continued)
cert. denied, ___ U.S. ___, 142 S. Ct. 2653 (U.S. Apr. 25, 2022) and also citing *Wells Fargo.*)

¹³⁹³ IRS web page titled "Program and Emphasis Areas for IRS Criminal Investigation" (last updated 2/24/22 and accessed 7/18/22).

Small Business/Self-Employed, Wage and Investment, Large Business & International, and Tax Exempt and Government Entities.¹³⁹⁴ In brief,¹³⁹⁵ this program asks the agents, collection officers and other employees to be alert to “first indicators of fraud” and then, in conjunction with the employee’s manager and with the Fraud Enforcement Advisor (formerly Fraud Technical Advisor), to do such work as necessary to determine whether the matter should be referred to CI. The key point at which significant civil investigative work should cease is when the Examination Division has firm indicators of fraud. Taxpayers sometimes try to suppress the fruits of a civil agent’s interview of the taxpayer on the basis that, by the time of the interview, the agent had firm indicators of fraud without giving the appropriate noncustodial *Miranda* warning. Generally, those attacks fail, but in some rare cases a court may hold that, in the interview, the taxpayer had been affirmatively misled about the nature of the interview and therefore suppress the statements made in the interview.

Other sources for CI investigations include disgruntled business partners, spouses or significant others, unhappy clients who turn on their professionals, publicity such as newspaper articles, etc.

Another source, currently in prominence, is the IRS Whistleblower Program. I discuss that program elsewhere (see discussion in Chapter 18, Whistleblower Rewards, beginning on p. 998). In addition, the IRS encourages U.S. citizens to report other taxpayer noncompliance via Form 3949-A, Information Referral, which reports “alleged tax law violations by an individual, a business, or both.”¹³⁹⁶ A citizen considering reporting other taxpayer noncompliance should seriously first consider the Whistleblower Program before Form 3949-A.

b. CI Investigation.

The general flow of a CI criminal investigation is:

Based on information it receives from whatever sources, CI will start an investigation. Sometimes it is just preliminary testing to see if CI wants to spend its limited resources on the matter. If it determines to open an investigation, the IRS will assign one or more CI Special Agents to the investigation. Sometimes a civil agent will be assigned to assist.

The CI Special Agent will conduct such investigation as necessary using whatever investigative resources are appropriate. Those investigative resources can include the IRS administrative summons.

The CI investigation may be unknown to the taxpayer or his representatives at the inception and in the early stages. At some point, however, the CI investigation will surface. It can surface in several ways, but one of the ways frequently used is with two CI Special Agents showing up at the taxpayer’s home (often in the early morning) to introduce themselves, reading the taxpayer modified *Miranda* warnings advising him of his rights (including right not to answer questions and right to

¹³⁹⁴ See IRM 25.1.2 Recognizing and Developing Fraud.

¹³⁹⁵ I discuss key aspects of this Fraud Referral Program in Ch. 7 dealing with Examinations. See discussion beginning on p. 447.

¹³⁹⁶ See Form 3949-A instructions, which also advise use of other forms for reporting return preparer issues.

consult with an attorney), and ask the taxpayer if he will answer some question. The taxpayer is not in custody and can terminate the interview at any time. The IRS makes this surprise visit to catch the taxpayer off guard and hope that he will talk. Often, he does and what he says often plays prominently in the ultimate prosecution.

At some point, the taxpayer will become aware that a criminal investigation is being pursued. The taxpayer's attorney will want to track the investigation so that, to the extent possible, the taxpayer's attorney knows what IRS CI knows.

Upon conclusion of the CI investigation, if the investigating Special Agent desires to pursue prosecution or further investigation by a grand jury, CI will have several review processes, including a review by a CI attorney (whom the Special Agent would have used as a resource during the investigation). The Special Agent in Charge ("SAC") of the CI district will then decide whether to forward the case to CES. The taxpayer's attorney will usually have the opportunity for a conference with the SAC or deputy and the CI attorney.¹³⁹⁷ The purpose of the conference is to permit the taxpayer's attorney to make any argument he or she desires to make to convince the SAC that the case should not be forwarded to CES.

If the SAC approves the recommendation for referral, the case file (including most prominently the Special Agents Report ("SAR")) will be forwarded to DOJ Tax along with a Criminal Referral Letter providing certain key information including the recommended counts of prosecutor and the tax loss involved.¹³⁹⁸ The taxpayer's representative will also be sent a letter advising of the referral and providing the recommended counts and tax loss involved.¹³⁹⁹

If CI does not recommend criminal prosecution, CI closes the criminal aspect of the case and, if appropriate, sends the case to the examination function for any further civil tax investigation and assessments.

c. DOJ Review Through Prosecution.

If CI recommends that the taxpayer be prosecuted or that the case be further investigated through a grand jury, the case will be referred to CES. The taxpayer and his attorney will be notified that the case is being referred for prosecution, the counts that are being recommended, and the tax loss associated with the recommendation. Taxpayer's counsel should then immediately notify CES that the taxpayer does want a conference before CES makes its decision whether to authorize prosecution.

CES may return the case to the IRS with a final decision of no prosecution or may return the case for the IRS to conduct such further investigation as appropriate and then refer the case again if that is appropriate. Alternatively, CES may forward the case to the local United States Attorney

¹³⁹⁷ IRM 9.5.12.3.1 (07-25-2007), Taxpayer Conference Procedures (taxpayer conference offered as a matter of course after CI administrative investigation, but not offered after a grand jury investigation); IRM 9.5.12.3.3 (07-25-2007), Scheduling the Taxpayer Conference; and IRM 9.5.12.3.4 (02-08-2019), Conducting the Taxpayer Conference.

¹³⁹⁸ IRM 9.5.12.4 (07-25-2007), Processing of Prosecution Recommendations; see also IRM 9.5.12.4.3 (02-08-2019), Prosecution Recommendation Documents.

¹³⁹⁹ IRM 9.5.12.3.5 (07-25-2007). Post Taxpayer Conference.

to either present the case to a grand jury for indictment or, alternatively, to have the grand jury investigate further. In all events, CES retains final authority as to whether a tax crime will be indicted and prosecuted. CES retains this authority because the government systemically has limited resources to investigate and prosecute tax crimes, and CES is charged with the responsibility to ensure that the government's enforcement efforts are consistent with priorities and resources. Technically, CES does not have responsibility over the IRS's CI which generates most tax criminal cases, but CES sends powerful signals to CI by which cases it prosecutes or declines, thus influencing CI's criminal investigations.

If CES forwards the case to the U.S. Attorney for indictment or grand jury investigation, either a local Assistant U.S. Attorney ("AUSA") or a CES attorney will handle such further processes as are required. If the grand jury indicts, the case will proceed to trial. As in the federal criminal system generally, most criminal tax cases are resolved by plea agreement. Indeed, because of the care with which CES picks its cases, the cases are generally stronger than the average criminal case and produce pleas in 95%+ of the cases. That does not mean that the target pleads to the charges as framed by the prosecutor and grand jury; rather, it means that some compromises are made that from the parties' perspectives is better than going to trial.

If a plea does not result, the case goes to trial.

If the taxpayer is convicted either by plea or after trial, the court will sentence under the Sentencing Guidelines noted above.

d. Conferences.

At each critical stage in this process, the taxpayer's attorney will usually have an opportunity for a meeting with decision makers to attempt to influence their decision as to whether to ratchet the case toward criminal prosecution. At the CI level, the taxpayer's attorney will usually interface with the Special Agent and have an opportunity to advance such arguments as appropriate to prevent the Special Agent from recommending prosecution. At the conclusion of the investigation if the Special Agent is recommending referring the case to CES, the taxpayer will have an opportunity for a meeting either with the SAC or a designated management representative to attempt to persuade CI not to forward the case to CES. These opportunities are usually afforded but are not inalienable rights of the taxpayer. (Remember the *Caceres* doctrine (p. 80),)

Similarly, at the CES level, the taxpayer will usually have an opportunity for a meeting to attempt to persuade CES not to pursue the matter.¹⁴⁰⁰ This meeting is also not a matter of right, but a taxpayer request for the meeting will usually be honored.

The taxpayer will have a final opportunity to meet with the local AUSA handling the case. By this time, the wiggle room for the AUSA may not be great because of CES's control. Still, some opportunities may be available.

¹⁴⁰⁰ DOJ Tax Division Directive No. 86-58 (5/14/86) and Memorandum Supplement to Tax Division Directive No. 86-58 (10/1/2013), both of which are included in CTM Chapter 3, titled Tax Division Policy Directives and Memoranda.

4. Unusual Processing of Criminal Tax Investigations.

The foregoing is a general discussion of the flow of a criminal investigation from CI through CES on to the United States Attorney for further investigation or prosecution. Tax criminal cases sometimes take a different route. There are two such routes.

Sometimes CES and CI may determine that a grand jury investigation is the preferred investigation route from or very near the beginning. This happened, for example, in some areas of the country in the fuel tax excise tax scams that were rampant in the late 1980's and early 1990's. This also happened in the investigation of major tax shelter abuses by the large accounting firms, including most prominently KPMG and Ernst & Young which have produced several indictments. The administrative investigation by CI is not used in such cases, but one or more CI Special Agents are assigned to assist the grand jury in its investigation.

The second route involves a grand jury investigating nontax crimes that uncovers evidence also of tax crimes. It is not unusual for tax crimes to accompany other illegal activities that are governmental enforcement priorities, such as mob activity and drug dealing. If the prosecutor (an AUSA or DOJ attorney) leading that nontax investigation discovers tax crimes that he or she wants to pursue, the prosecutor can seek appropriate approvals from CI and CES to pursue the tax crimes via the grand jury investigation and indictment process. In both of these situations, there may be no significant investigative activity conducted by CI as CI (as opposed to CI agents assisting the grand jury).

5. Secrecy Rules in Criminal Tax Investigations.

Two secrecy rules play a prominent role in this division of investigations between CI investigations and grand jury investigations.

First, as I mentioned above, § 6103 generally precludes the IRS from disclosing tax return information. Information developed by CI in a CI investigation is tax return information that cannot even be disclosed to CES attorneys until CI refers the case to CES. This information can be used by the IRS for any purpose, civil or criminal. Once the case is referred to CES, the IRS can no longer use the IRS administrative summons or begin a proceeding to enforce a previously issued summons;¹⁴⁰¹ further compulsory investigative process must be only through the grand jury processes, most significantly the grand jury subpoena.

Second, Rule 6(e), Federal Rules of Criminal Procedure, prohibits disclosure of information developed by the grand jury, so that even tax relevant information developed by the grand jury cannot be shared with the IRS, except for IRS personnel (usually Special Agents) assigned to assist the grand jury.

The combination of these rules requires that the IRS CI investigation be kept distinct from the grand jury investigation. Of course, the fruits of any CI investigation may go to CES when the case is referred, but the fruits of the grand jury investigation can only be shared with the IRS's CI

¹⁴⁰¹ § 7602(d). A summons enforcement proceeding commenced before the referral, however, may be continued after the referral. *Drum v. United States*, 602 F. Supp. 834 (M.D. Pa. 1985).

to the extent necessary to obtain approvals for criminal prosecution. The fruits of the grand jury investigation cannot be used for any other IRS purposes, including civil tax assessment.

To illustrate, I mentioned above that a nontax grand jury may learn of tax crimes and, if CES and the IRS determine that tax indictments would be consistent with tax enforcement priorities, the prosecutor of that grand jury may seek an indictment on the tax crime. The IRS can use that information for the limited purpose of recommending prosecution for the tax crime. The IRS cannot use the information for its own use either civilly or in an IRS administrative investigation. Any of the grand jury information that is subsequently publicly disclosed in the criminal prosecution phase can be available to the IRS for civil tax and other purposes, but often in a plea bargain situation much of the grand jury information will not be disclosed of public record and thus available for general IRS purposes. Thus, the investigative efficiency achieved through using grand jury processes is mitigated by the limitations upon the use of the fruits of the grand jury investigation for civil tax purposes.

6. Sentencing Guidelines Strategy.

I mentioned above that the Government's enforcement priorities for tax crimes is to select the relatively few cases it selects well so that it obtains a 90+⁰% conviction rate. That does not mean conviction as to all counts charged. Most activity that generates a tax crime charge such as evasion (§ 7201) or tax perjury (§ 7206(1)) will be activity that itself can draw other charges (e.g., *Klein* conspiracy) or will be accompanied by activity that can draw other charges (e.g., 18 U.S.C. § 1001). Such separate charges would be separate counts in an indictment. Furthermore, if only evasion or tax perjury is charged, each year involved will be a separate count. So, most tax crimes indicted will involve multiple counts.

In authorizing the indictment, CES will designate a major count or, in more serious cases, perhaps two major counts as to which it desires conviction; the AUSA is then authorized to negotiate a plea as to the major count(s) with the other counts falling by the wayside.¹⁴⁰² For example, in a case I handled, the indictment charged two related defendants with one count each of conspiracy (*Klein* tax conspiracy), two counts of tax perjury for one (one count for each of two years) and two counts of aiding and assisting (§ 7206(2)) for the other (one count for each of the same two years of the returns). The Government's major count was, respectively, the second year tax perjury count for the one and the second year 7206(2) count for the other, thus evidencing a willingness to drop the conspiracy charge, the tax perjury count for the first year and the 7206(2) count for the second year. This may sound like a good deal for the taxpayer, but that can be deceiving or, at least, superficial.

The reason is that the Sentencing Guidelines recognize that the Government plays games with counts. Thus, in tax crimes (as well as other economic crimes), the Guidelines base sentencing principally upon the tax loss numbers rather than the number of counts. The tax loss numbers will include all relevant conduct, including the tax loss in the counts that were acquitted, dropped (usually incident to plea) or not included in the indictment at all. Hence, to obtain a plea, the

¹⁴⁰² DOJ CTM 5.01[1] Offense of Conviction — The Major Count Policy; see also U.S. Justice Manual (successor to USAM) 6-4.310 Major Count Policy in Plea Agreements.
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Government is really not giving up anything substantial by dropping the non-major counts so long as it obtains a plea to the major counts.

Why then, you have surely questioned by now if you understood what I just said, does the Government charge multiple tax related counts in the first place? I can't crawl into the Government's collective mind, but certainly multiple counts give the Government a chip to play (or give up) without really giving up anything material. An unsophisticated defendant or worse, lazy or incompetent counsel, might think that requiring a plea to only one major count is one hell of a deal, when four or five or 20 other counts are dismissed. Moreover, I suspect, the Government feels that it is sometimes helpful to have multiple counts to charge the atmosphere before the jury in the Government's favor if it is unable to force a plea. The more counts may project to the jury that the defendant is a really bad character. If the Government can coax out several different law violations and package them as separate counts from the same basic tax misconduct, it will have achieved an advantage at trial—if nothing else it gives the jury some room to compromise and still obtain a felony conviction. (It may also, of course, have an opposite effect if the jury or the judge were to believe that the Government were just piling on counts for one basic crime.) Also, by charging *Klein* conspiracy, a frequent traveling companion for tax crimes, the Government can better shape the evidence that it may get admitted at trial. There are thus reasons for the Government to allege several or even many counts even though they will not affect sentencing.

Also, based on personal anecdotal experience, prosecutors and the IRS during the administrative experience may respond to arguments to get the tax loss, the principal driver for Guidelines calculations, reduced. While prosecutors are discouraged from “bargaining” the loss, they will consider appropriate arguments and facts to reduce the tax loss.¹⁴⁰³

III. Civil Penalties.

A. Introduction.

I deal in this section with civil penalties which now number over 140.¹⁴⁰⁴ I discuss here and expect you to know for the examination only the more frequently encountered civil penalties. I work from the heaviest civil penalty to the lightest.

The IRM states that the purpose of penalties is “to encourage voluntary compliance by supporting the standards of behavior expected by the Internal Revenue Code” and states that penalties do that by:

- Defining standards of compliant behavior,
- Defining remedial consequences for noncompliance, and
- Providing monetary sanctions against taxpayers who do not meet the standard.¹⁴⁰⁵

¹⁴⁰³ DOJ CTM 5.01[2] Relevant Conduct and Tax Loss (2012 ed.).

¹⁴⁰⁴ The Penalty Handbook says that there are more than 140 penalties. Penalty Handbook IRM 20.1.1.1.1 (11-25-2011), Background (14 civil penalties in 1955; “now more than ten times that number”).

¹⁴⁰⁵ Penalty Handbook, IRM 20.1.1.2 (11-21-2017), Purpose of Penalties.

I present in this section the significant civil penalties you will encounter in a tax practice. First, however, I address burden of proof.

Most of the penalties I discuss here are ad valorem penalties scaling the penalty according to the amount of tax involved. For example, the first penalty I discuss is the civil fraud penalty which is 75% of the tax attributable to the fraud. The more tax attributable to fraud, the higher the penalty. Similarly, the accuracy related penalties applying to underreporting of tax liability for less egregious conduct is 20% or 40% of the tax attributable to the punishable conduct. Other civil penalties can be set amounts, which are sometimes adjusted for inflation.¹⁴⁰⁶ For example, certain returns filed with the IRS are information returns reporting no tax liability; in such cases, the penalties are often set amounts (often adjusted for inflation).¹⁴⁰⁷ Such penalties can be scalable, not based on tax, but based on the number of taxpayers for whom the information is reported (such as the number of partners in a partnership for failure to file a partnership return).¹⁴⁰⁸ Students should know the reporting obligation and consider the type of civil penalty that might be appropriate to give the proper incentive for compliance with the obligation.

This section only deals only with penalties in the traditional sense in the Code. It does not deal with other Code provisions that, depending upon perspective, may function like a penalty. For example, in *King v. Burwell*, 576 U.S. 473 (2015). Obamacare imposed an individual mandate to purchase health insurance and, failure to do so, resulted in what the Code called a penalty. The Court nevertheless concluded that it was a tax. *King* was an outlier setting. Perhaps a better illustration is Section 280E which prohibits any “deduction or credit” for any business that “consists of trafficking in controlled substances (within the meaning of . . . the Controlled Substances Act).” The IRS takes the position that, although marijuana may be legally sold in under state law in some states (Colorado in this case), § 280E can deny deductions related to a marijuana business such as medical marijuana business because of federal prohibitions. Is the denial of the deduction a penalty? Since it targets illegal or potentially illegal conduct, it may be viewed as punishment for the conduct. It is, however, not called a penalty in the Code, and courts have concluded that it is not a penalty for purposes of the Eighth Amendment’s excessive fines prohibition.¹⁴⁰⁹ Also, the Trust Fund Recovery Penalty

¹⁴⁰⁶ The IRS provides the inflation adjustments in an annual Rev. Proc. See, for 2023, Rev. Proc. 2022-38; 2022-45 I.R.B. 1.

¹⁴⁰⁷ E.g., § 6652, Failure to file certain information returns, registration statements, etc.

¹⁴⁰⁸ § 6698(a) & 6698(b) provide a penalty of \$195 per month times the number of partners for failure to file the partnership return. (The IRS has recognized that partnerships with fewer than 10 partners may be exempt from the partnership return filing requirement and thus this penalty (Rev. Proc. 84-35, 1984-1 C.B. 509); this exemption is not in the statute but is based on the legislative history of § 6698 recognizing that partnerships with 10 or fewer partners often do not file the partnership return and the partners report directly on their returns the results of partnership operations, so that, in the Committee’s view, that partner level reporting is “adequate” and “it is reasonable not to file a partnership return in that instance.” (See CCA 201733013 (7/12/17).) That amount is adjusted for inflation. § 6698(c), For 2023, with the inflation adjustment, the penalty is \$235 per month times the number of partners. § 6698(e); see Rev. Proc. 2022-38; 2022-45 I.R.B. 1, Section 3.55 (inflation adjustment). Similar rules are prescribed for S Corporations in § 6699. See *ATL & Sons v. Commissioner*, 152 T.C. 138(2019) (S Corporation is subject to the penalty even though shareholders received extensions). This pattern may apply to a number of other information reporting obligations where multiple taxpayers are affected by the information reporting. First Time Abate (“FTA”) relief may apply to the penalty. IRM 20.1.1.3.3.2.1 (03-29-2023), First Time Abate (FTA).

¹⁴⁰⁹ *Alpenglow Botanicals, LLC v. United States*, 894 F.3d 1187 (10th Cir. 2018) (holding also in district court); and *N. Cal. Small Bus. Assistants Inc. v. Commissioner*, 153 TC 65 (2019) (reviewed opinion, with some disputing as to whether denial of deductions is a penalty for Eighth Amendment purposes). Thus, when the provision

(continued...)

(“TFRP”) in § 6672 is called a penalty but is often described as a secondary collection mechanism for the Trust Fund Tax rather than a penalty in the traditional sense. I think that the TFRP is not a penalty in the traditional sense and therefore postpone discussion until Chapter 12 on Collection Procedures (see discussion beginning at p. 793).

There are still other Code sections that are not called penalties but function like penalties. For example, there may be extended periods of limitations (discussed in Ch. 4) that may apply for specified conduct, such as fraud, failure to file a return, or failure to provide certain information with a return. Another example: a taxpayer improperly claiming the Earned Income Tax Credit (“EITC”) may be banned from claiming the EITC in future years for a “disallowance period” with the length of the period calibrated to the seriousness of the conduct.¹⁴¹⁰

I discuss some of these provisions that function like penalties in the contexts in which they arise in this book, but do not discuss them further in this Chapter on penalties.

Finally, penalties are punishments for misbehavior. The rule of lenity applicable to statutes imposing criminal liability does not apply for statutes for civil penalties. Nevertheless, some courts strictly construe statutes imposing civil penalties.¹⁴¹¹

B. Burden of Proof - General and § 7491(c).

As I cover in more detail below in discussing burden of proof (beginning p. 616) with respect to fact issues,¹⁴¹² generally in civil tax controversies that taxpayer bears the burden of proof with respect to civil tax liability. The burden of proof has two components—the burden of persuasion (or ultimate burden in the case) and a predicate burden of production historically used for a court to determine if the evidence meets some minimum level that a fact issue should be submitted to a jury. Generally, the taxpayer bears both these burdens. By virtue of being assigned the burden of persuasion, the taxpayer will perforce bear the burden of production. There is considerable logic to this assignment of these burdens as to the underlying tax liability. There is also some logic to this assignment of these burdens as to penalties. As to both aspects of a taxpayer’s potential liability, the taxpayer is usually better in command of the relevant information than is the IRS and better able to persuade on the issue one way or the other.

Nevertheless, in response to expressions of concern that the IRS may be less than even-handed with respect to the assertion of penalties, thereby unfairly imposing burdens on taxpayers and the courts, Congress enacted § 7491(c) to impose upon the IRS the burden of production in any

¹⁴⁰⁹(...continued)

is not characterized as a penalty, the analysis and requirements for penalties do not apply.

¹⁴¹⁰ § 32(k)(1)(A) (disallowance period of two years for reckless or intentional disregard and 10 years for fraud). See Leslie Book, The Ban on Claiming the EITC: A Problematic Penalty (Procedurally Taxing Blog 1/23/14) (calling the ban an “unusual sanction” and “unique because its effect is in future years.”).

¹⁴¹¹ *United States v. Boyd*, 991 F.3d 1077, 1085-1086 (9th Cir. 2021). It is not clear what the practical difference between lenity for criminal penalty statutes and strict construction for civil penalty statutes.

¹⁴¹² The burden of proof does not apply to legal issues. E.g., *Stanojevich v. Commissioner*, 160 T.C. ___, No. 7 (2023) (citing *Pei Fung Guo v. Commissioner*, 149 T.C. 334, 336 (2017)).

court proceeding with respect to “with respect to the liability of any individual for any penalty,¹⁴¹³ addition to tax, or additional amount imposed by this title.”¹⁴¹⁴ I think it is best at this point to merely state the rule in generalities rather than in detail and defer a more detailed discussion until a later point in the text. The burden of production is a fairly minimal burden to show the court that the IRS has some reasonable basis for asserting penalty. Once the IRS makes that minimal reasonable showing, the taxpayer bears the burden of persuading the court that the penalty should not be imposed.¹⁴¹⁵

There is one exception to the foregoing, where the penalty is a civil fraud penalty (fraudulent return or fraudulent failure to file, both of which are civil fraud penalties). As noted in the two succeeding sections, the IRS bears the burden of establishing the fraud predicate to those penalties by clear and convincing evidence. Since the IRS bears the burden of persuasion on that issue, the IRS necessarily bears the burden of production.

C. Fraudulent Return - § 6663.

Section 6663 imposes the civil fraud penalty to underpayments with respect to a filed return “[i]f any part of any underpayment of tax required to be shown on a return is due to fraud.” § 6663(a).¹⁴¹⁶ The civil fraud penalty is “75 percent of the portion of the underpayment which is attributable to fraud.” *Id.* The underpayment is the amount of tax the taxpayer owes over the tax the

¹⁴¹³ Care is required in dealing with Code provisions that call an imposition something other than a penalty but which may be referred to as a penalty. For example, § 72(t) imposes a “10% tax on early distributions” from tax favored retirement plans. This imposition is often referred to as a penalty, but is a tax, so that § 7491(c) does not apply. *El v. Commissioner*, 144 T.C. 140, 148-149 (2015).

¹⁴¹⁴ *NT, Inc. v. Commissioner*, 126 T.C. 191, 195 (2006) (also concluding after noting that § 7491(c) only applies to the liability of an “individual,” cryptically noting in rejecting its application: “Petitioner is not an individual; it is a corporation.”). Note in this regard that, although the definitional provisions in § 7701 do not provide a definitive definition of individual, the inference in the definition of “person”—“The term “person” shall be construed to mean and include an individual, a trust, estate, partnership, association, company or corporation”—is that an individual is not one of the entity types included in the list (otherwise, there would be no need to list the entities). Notwithstanding that this may be an unsettled issue. See Caleb Smith, Designated Orders: Week of 1/1/2018 – 1/5/2018 aka New Year, New Graev III(?) (Procedurally Taxing Blog 1/17/18) (discussing two Tax Court orders raising the issue).

There may be tax that appears to serve as a penalty. For example, § 72(t) imposes an “additional tax” on distributions from qualified with certain exceptions (including most prominently distributions after the age 59 ½) and distributions after separation from service for an employee 55 or older. § 72(t)(f)(2)(A). That may look and operate like a penalty for early distributions, but it is an additional tax that is not a penalty that invokes the requirement that the IRS bear a burden of production for the imposition of the tax. *El v. Commissioner*, 144 T.C. 140 (2015); and see *Grajales v. Commissioner*, 47 F.4th 58 (2d Cir. 2022) (tax for purposes of not implicating the supervisor written approval of § 6751(b)).

¹⁴¹⁵ For some penalties, the IRS has imposed the burden of persuasion on the IRS. E.g., the civil fraud penalty under § 6663 (see § 7454(a)) and the penalties under §§ 6700, 6701, and 6702 (see § 6703(a), presumably under a preponderance of the evidence standard unless fraud is an element of the penalty). See *Stanojevich v. Commissioner*, 160 T.C. ___, No. 7 (2023) (noting “The burden, however, does not come into play to the extent that we decide an issue of law such as the meaning of the statute. See *Pei Fung Guo v. Commissioner*, 149 T.C. 334, 336 (2017).”).

¹⁴¹⁶ For the limitation of the fraud penalty to underpayments on a filed return, see § 6664(b) (providing that the penalties in this “part”—the accuracy related and fraud penalties—apply only in “only in cases where a return of tax is filed (other than a return prepared by the Secretary under the authority of section 6020(b).” Generally, a filed return requires the taxpayer’s signature, but obviously electronically filed returns do not have an actual signature. Those returns are nevertheless returns for purposes of the accuracy related and fraud penalties. See *Cantrell v. Commissioner*, T.C. Memo. 2017-170.

taxpayer reported; some or all of that underpayment may be due to fraud.¹⁴¹⁷ The civil fraud penalty is a civil sanction with a remedial character rather than a punishment in addition to the criminal fraud penalty, so that it is not double jeopardy and will survive the death of the taxpayer subject to the penalty.¹⁴¹⁸

The Code does not define fraud, but it may be viewed as the civil counterpart of criminal tax evasion in § 7201.¹⁴¹⁹ Examples of how courts have stated civil fraud under § 6663 are: (i) civil fraud requires “intentional commission of an act or acts for the specific purpose of evading tax believed to be due and owing”;¹⁴²⁰ and (ii) civil fraud requires that “the taxpayer have intended to evade taxes known to be due and owing by conduct intended to conceal, mislead or otherwise prevent the collection of taxes and that is an underpayment.”¹⁴²¹ In making the determination, as with criminal cases, courts will often look to certain common patterns indicating fraud—referred to as badges of fraud, such as unreported income, failure to keep adequate books, dealing in cash, etc.¹⁴²² The key differences between the two is that § 6663 is a civil penalty and has a lower burden of proof (clear and convincing rather than beyond a reasonable doubt) as I note later.

Because of this commonality between § 7201, tax evasion, and § 6663, civil fraud, the interpretations of willfulness for tax evasion apply to the civil fraud penalty. Thus, just as willful blindness can be considered to establish willfulness for tax evasion, so it may be considered to establish civil fraud for § 6663.¹⁴²³ Also, the so-called “*Cheek*” defense to criminal tax evasion—a subjective good faith misunderstanding of the law, however objectively unreasonable—is a defense to the § 6663 civil fraud penalty.¹⁴²⁴ This defense is not available if the taxpayer knew the law and

¹⁴¹⁷ In *Feller v. Commissioner*, 135 T.C. 497 (2010), the taxpayer fraudulently overstated withholding tax credits, thereby understating the amount of tax due with the return. The taxpayer argued that, in determining “underpayments” under the statute, withholding tax credits were not considered and therefore the Regulations permitting fraudulent withholding credits to be considered was invalid. In a reviewed decision, the Court determined that, the Regulations adopted under the general authority of § 7805(a), were to be tested under the Chevron analysis and, under that test, were a reasonable construction of the statute.

¹⁴¹⁸ *Helvering v. Mitchell*, 303 U.S. 391, 401 (1938); see *Reiserer v. United States*, 478 F.3d 1160 (9th Cir. 2007) (involving a promoter penalty but with the same analysis as to whether the civil penalty is remedial or punitive and holding that, since remedial rather than punitive, the penalty survives death).

¹⁴¹⁹ *Anderson v. Commissioner*, 698 F.3d 160, 164 (3d Cir. 2012), (“the elements of evasion under 26 U.S.C. § 7201 and fraud under 26 U.S.C. § 6663 are identical.”), cert. denied 569 U.S. 1039 (2013).

¹⁴²⁰ *Erikson v. Commissioner*, T.C. Memo. 2012-194, at *22; and *Neely v. Commissioner*, 116 T.C. 79, 86 (2001).

¹⁴²¹ *Nelon v. Commissioner*, T.C. Memo. 1997-49; *Zell v. Commissioner*, 763 F. 2d 1139, 1142-1143 (3rd Cir. 1985) (“Fraud means “actual, intentional wrongdoing, and the intent required is the specific purpose to evade a tax believed to be owing.”); and *Fiore v. Commissioner*, T.C. Memo. 2013-21, at *15 (“Fraud is the ‘willful attempt to evade tax’” and using the criminal law concept of willful blindness to find the presence of civil fraud; note that, in the criminal law, the concept of willful blindness goes by several names, including conscious avoidance.)

¹⁴²² E.g., *Kosinski v. Commissioner*, 541 F.3d 671, 679-80 (6th Cir. 2008). For use of a negative inference from assertion of the Fifth Amendment privilege in concluding that the IRS had met its burden of proving civil fraud by clear and convincing evidence, see *Loren-Maltese v. Commissioner*, T.C. Memo. 2012-214, at *6,*14-*15, & *24.

¹⁴²³ *Fiore v. Commissioner*, T.C. Memo. 2013-21, at *21-*31. I have discussed the concept of willful blindness and its uses and misuses in my Federal Tax Crimes Blog.

¹⁴²⁴ *Cheek v. United States*, 498 U.S. 192 (1991) (interpreting willfulness under § 7201 as the intentional violation of a known legal duty”); *Niedringhaus v. Commissioner*, 99 T.C. 202, 216-220 (1992) (holding that the *Cheek* defense might apply but did not because the *Cheek* defense does not apply to claims that the legal duty is unconstitutional); *Eriksen v. Commissioner*, T.C. Memo. 2012-194, at *22 (“Fraud [under § 6663] is the intentional

(continued...)

simply disagreed or the taxpayer knew the law and thought it unconstitutional; rather he must have a good faith belief that his actions complied with the law.¹⁴²⁵ And, if he has a good faith belief that his actions complied with the law, then he did not commit fraud—he did not intend to violate the known legal duty—and has no need for a good faith defense. In short, if the Government proves fraud, the Government has negated good faith.¹⁴²⁶

As I discuss below, conviction of tax evasion is preclusive that the taxpayer committed civil fraud for purposes of § 6663.

To prevail on the civil fraud penalty, the IRS is first required to prove by clear and convincing evidence that some portion of the understatement is attributable to fraud. § 7454(a).¹⁴²⁷ Like the criminal standard “beyond a reasonable doubt,” there is no satisfactory language to inform

¹⁴²⁴(...continued)

commission of an act or acts for the specific purpose of evading tax believed to be due and owing.”) and *Pau v. Commissioner*, T.C. Memo. 1997-43 (where the taxpayer argued a good faith misunderstanding of the law, relying on *Cheek*, but the Court held that their own testimony did not support the defense).

¹⁴²⁵ E.g., *Cheek, supra* (§ 7201); *Porter v. Commissioner*, T.C. Memo. 2015-122 (§ 6663).

¹⁴²⁶ Readers of the statute—I hope all readers of this text—may note that § 6664(c)(1) says that “No penalty shall be imposed under section 6662 or **6663** with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion.” (Bold face supplied.) The statutory text appears to be redundant as to § 6663 because reasonable cause and good faith would preclude the application of § 6663 even without § 6664(c)(1). The reason is that the level of intent required for the civil fraud penalty, the same as the criminal evasion statute, cannot co-exist with reasonable cause and good faith as the criminal cases routinely hold in recognizing the *Cheek* defense. Of course, the text is meaningful for the accuracy related penalty in § 6662. That is why the regulations under § 6664(c)(1) only address the § 6662 accuracy related penalty. Reg. § 1.6664-4, titled “Reasonable cause and good faith exception to section 6662 penalties.” Notwithstanding the oxymoron of a finding of civil fraud and “reasonable cause,” courts do sometimes consider reasonable cause after finding civil fraud because it is like a check-list item. See *Purvis v. Commissioner*, T.C. Memo. 2020-13, at *48-*49 (rejecting the reasonable cause defense). I am not aware of a case that the Government proved found civil fraud by clear and convincing evidence and then sustained a reasonable cause defense; having said that, I suspect someone can find one or two.

Although commonly referred to as the “Cheek” Defense, reasonable cause or good faith is not a defense in the traditional meaning that, if the taxpayer proves it, criminal conviction or the civil fraud penalty will be avoided. Rather, the Government must prove in the criminal case beyond a reasonable doubt and in the civil fraud case by clear and convincing evidence that the taxpayer intended to violate a known legal duty (the Cheek standard) which must necessarily negate reasonable cause and good faith. The taxpayer does not have to prove reasonable cause and good faith to avoid the criminal and parallel civil fraud penalty. So, if the taxpayer’s good faith is in issue in either the criminal or civil case, the Government has to negate good faith by proving that the taxpayer intended to violate a known legal duty.

¹⁴²⁷ Section 7454(a) provides that the IRS must prove fraud; that the IRS prove fraud by clear and convincing evidence is nonstatutory but has developed as a consistently applied rule consistent with historic pleading and proof rules. See e.g., Tax Court Rule 142(b). The IRS is also required to prove by clear and convincing evidence that payments are illegal to deny deductions under § 162(c)(1) & (2) (both subsections specifically incorporate the § 7454(a) burden of proof).

Section 7454(a) was initially enacted in a 1928 Revenue Act provision that applied by its terms only in the Tax Court. Revenue Act of 1928, c. 852, § 601, 45 Stat. 791; see *Paddock v. United States*, 280 F.2d 563 (2d Cir. 1960). Indeed, the section refers to “petitioners,” the term used for the taxpayer in Tax Court deficiency proceedings; notwithstanding that reference, however, the few courts addressing the issue say that the burden is on the IRS to prove fraud regardless of the forum that the fraud issue arises. Leo P. Martinez, *Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases*, 39 *Hastings L.J.* 239, 263-264 (1988) (citing *Paddock* and *Carter v. Campbell*, 264 F.2d 930, 937-38 (5th Cir. 1959); *Trainer v. United States*, 145 F. Supp. 786, 787 (E.D. Pa. 1956); see *Lee v. United States*, 466 F.2d 11, 14 (5th Cir. 1972)).

precisely what “clear and convincing” means. The Tax Court says that it is “a stringent and extraordinary burden” that is difficult to sustain.¹⁴²⁸ Perhaps the best that can be said is that clear and convincing lies somewhere on the continuum between “more likely than not” (the usual civil burden) and “beyond a reasonable doubt” (the criminal burden)¹⁴²⁹ If the IRS meets that burden, the entire understatement will be subject to the penalty except to the portion that the taxpayer establishes by a preponderance of the evidence does not arise from fraud. § 6663(b).

A spouse signing a joint return is not subject to the penalty unless he or she participated in the fraud. § 6663(c). Furthermore, a spouse thus “innocent” (meaning nonfraudulent) is also not liable for the accuracy related penalty with respect to that portion of the understatement to which the fraud penalty applies against the other spouse.¹⁴³⁰

The civil fraud penalty may be asserted without the taxpayer having been investigated or prosecuted for tax evasion (§ 7201) or tax perjury (§ 7206(1)). Where there has been a criminal investigation or prosecution under a tax crime, there will often be an unpaid tax liability for which the IRS will assert the civil fraud penalty.¹⁴³¹ If there was a prosecution and the taxpayer was found guilty of tax evasion (§ 7201) with a filed tax return, under issue preclusion,¹⁴³² the conviction will be preclusive on (i) the issue of the taxpayer's civil fraud **but** (ii) usually the amount of the tax

¹⁴²⁸ *Labay v. Commissioner*, 55 T.C. 6, 13 (1979), *aff'd per curiam*, 450 F.2d 280 (5th Cir. 1971); and *Kellett v. Commissioner*, 5 T.C. 608, 616 (1945).

¹⁴²⁹ One author says that “typical jury instructions” require persuasion that the fact is “highly probably true.” Michael S. Pardo, *Second-Order Proof Rules*, 61 Fla. L. Rev. 1083, 1097 n. 80 (2009) (citing 7th Circuit Pattern Jury Instructions and See McCormick on Evidence § 340 (John W. Strong ed., 5th ed. 1999) (1954)). Playing the numbers game, Judge Jack B. Weinstein, certainly one of the deeper thinkers in this area, observed that the lesser clear and convincing standard of proof (the standard applicable in civil fraud matters such as a civil fraud penalty under § 6663) might be quantified as proof above 70%. See *United States v. Copeland*, 379 F. Supp. 2d 275 (E.D. N.Y. 2005), *aff'd United States v. Copeland*, 2007 U.S. App. LEXIS 19794 (2d Cir. 2007), quoting *United States v. Fatico*, 458 F. Supp. 388, 411 (E.D.N.Y. 1978). Other thoughtful observers quantify the proof for “clear and convincing” at 75%. See Lewis Kaplow, *Burden of Proof*, 121 Yale L.J. 738, 779 n. 77 (2012) (citing a survey of federal judges showing a range of 70% to 80%, with an average of 74.99%). See also John Gamino, *Tax Controversy Overburdened: A Critique of Heightened Standards of Proof*, 59 Tax Law. 497 (2006).

Based on empirical studies, some authors suggest that juries actually, and erroneously, perceive the “clear and convincing” standard to be greater than the “beyond a reasonable doubt standard.” See Lawrence Solan, *Refocusing the Burden of Proof in Criminal Cases: Some Doubt about Reasonable Doubt*, 78 Tex L Rev 105, 128-129 (1999); Michael S. Pardo, *Second-Order Proof Rules*, 61 Fla. L. Rev. 1083, 1097 (2009). Bench trials, presumably would not present this logical inconsistency but perhaps suffer from some judges relaxed assessments of the quantum of proof required for proof “beyond a reasonable doubt.”

¹⁴³⁰ § 6662(b) (flush language). The flush language was so interpreted in *Zaban v. Commissioner*, T.C. Memo. 1997-479 (reasoning otherwise impermissible “stacking”); and applied in *Said v. Commissioner*, T.C. Memo. 2003-148, *aff'd* 112 F. App'x 608 (9th Cir. 2004); and *Chico v. Commissioner*, T.C. Memo. 2019-123, at *49. This seems to me to be a permissible interpretation of the flush language but not a compelled interpretation. By doing “what ifs” with various possibilities, strange results could apply, particularly if, for some reason, the fraudulent spouse does not bear any economic burden of the fraud penalty imposed on the fraudulent spouse. But relieving the nonfraudulent spouse appears to be the law, as the flush language is interpreted. See Keith Fogg, *Impact of Fraud Penalty on Only One Spouse* (Procedurally Taxing Blog 10/7/19).

¹⁴³¹ This has been my experience. TIGTA reported that the IRS’ follow-through on the civil side after criminal investigation (whether or not a prosecution results) is not as uniform as my experience. TIGTA, *Improvements Are Needed to Ensure Information Developed During Criminal Investigations Is Referred for Civil Action (Audit # 200310041)*, unofficially reproduced at 2004 TNT 210-4.

¹⁴³² See the discussion of claim preclusion (*res judicata*) and issue preclusion (*collateral estoppel*), see below beginning on p. 648).

evaded is not determined, leaving the amount subject to the civil fraud penalty open for determination in the civil fraud case. Nevertheless, at least conceptually, the tax evasion conviction should be preclusive in the civil fraud case that **some** amount of tax was evaded, so as to invoke § 6663(b)'s burden shifting requirement that the taxpayer then prove the amount of the underpayment that is not subject to the civil fraud penalty.¹⁴³³

If the taxpayer is acquitted of the tax evasion charge, however, the IRS may still assert the civil fraud penalty (the acquittal is not preclusive that there was no civil fraud). Why? A finding of not guilty is not necessarily a finding of innocence; it is only a finding that the Government failed to prove guilt beyond a reasonable doubt.¹⁴³⁴ In an ensuing civil tax case, the Government must establish fraud only by clear and convincing evidence, a substantially lesser burden than the beyond a reasonable doubt requirement for criminal conviction.¹⁴³⁵ Accordingly, the IRS may and usually does assert the civil fraud penalty when the taxpayer has been acquitted.¹⁴³⁶

If, the taxpayer is convicted under § 7206(1), tax perjury, the conviction merely establishes that the taxpayer filed willfully a false return in some respect and thus will not be preclusive on the issue of whether the “underpayment . . . is due to fraud” as required for the civil fraud penalty.¹⁴³⁷

¹⁴³³ Interestingly, though, in a case where the taxpayer convicted of tax evasion proved in the ensuing Tax Court deficiency proceeding that there was no tax due (thus contradicting the tax evasion conviction because the tax due and owing element did not exist), the Court held that this theoretical issue preclusion as to some possible amount did not require it to find that there was some minimal tax due. *Senyszyn v. Commissioner*, 146 T.C. 136 (2016), subsequent confirming T.C. Memo. 2016-137. *Senyszyn* failed in a subsequent attempt to extrapolate his Tax Court win into reversal of his conviction in a post appeal proceeding (coram nobis) related to the criminal case. See *Senyszyn v. United States*, 2016 U.S. Dist. LEXIS 156155 (D. N.J. 2016).

¹⁴³⁴ Of course, the jury could have returned the not guilty verdict based upon their unstated finding that the defendant was innocent. So, a not guilty verdict is consistent with innocence in fact but certainly does not establish innocence in fact because a not guilty verdict is also consistent with a jury unstated finding that guilt was proved by a preponderance of the evidence but not beyond a reasonable doubt. Consider the following quote from *United States v. Gricco*, 277 F.3d 339, 352 n. 4 (3d Cir. 2002):

It has frequently been stated that judgments of acquittal are not even relevant on the issue of guilt because “they do not necessarily prove innocence but may indicate only that the prosecution failed to meet its burden of proof beyond a reasonable doubt as to at least one element of the crime.” [Case citation omitted]

¹⁴³⁵ *United States v. Watts*, 519 U.S. 148, 156 (1997) (“[A]n acquittal in a criminal case does not preclude the Government from relitigating an issue when it is presented in a subsequent action governed by a lower standard of proof.” (citation omitted)).

¹⁴³⁶ *Collins v. Pond Creek Mining Co.*, 468 F.3d 213, 217-218 (4th Cir. 2006) (The doctrine does not apply “where the party against whom the doctrine is invoked had a heavier burden of persuasion on that issue in the first action than he does in the second, or where his adversary has a heavier burden in the second action than he did in the first”), cited and quoted in *McHan v. Commissioner*, 558 F.3d 326, 331 (4th Cir. 2009).

¹⁴³⁷ *Wright v. Commissioner*, 84 T.C. 636, 643 (1985) (reviewed opinion); see also IRM 25.1.6.5 (06-10-2021), Collateral Estoppel. For an interesting discussion of the potential application of issue preclusion from findings made in a sentencing hearing after a § 7206(1) conviction, see FSA 200221002 (dated 2/25/02).

Sentencing in the criminal proceeding raises two issues as to whether determinations may be preclusive in a later civil proceeding. First, to calibrate the Sentencing Guidelines recommended sentencing range, the sentencing court has to determine the tax loss, which is the loss the taxpayer sought to evade. Second, a court may order restitution for tax the taxpayer sought to evade. The trend of the case holdings is that that, as to the tax loss number, the sentencing findings are not preclusive in a later civil case. *Kosinski v. Commissioner*, 541 F.3d 671 (6th Cir. 2008), a well-reasoned and nuanced opinion citing, inter alia, the *Booker* shift in binding effect of the Sentencing Guidelines and *Maciel v. Commissioner*, 489 F.3d 1013 (9th Cir. 2007); but see John A. Townsend, Collateral Estoppel in Civil Cases Following

(continued...)

If, however, the taxpayer admitted fraud in the plea agreement or at sentencing, even though he was not convicted of evasion, that admission may be controlling or persuasive in a civil case where the IRS must establish fraud (such as for the fraud penalty or an unlimited statute of limitations).¹⁴³⁸ Further, if the taxpayer admitted an amount of tax due, such as in the § 7206(1) plea agreement, the conviction plus the admission might be preclusive as to tax due but, in truth, in a § 7206(1) case that is more like an admission than a finding necessary to the criminal conviction entitled to preclusive effect.¹⁴³⁹

In applying issue preclusion (also called collateral estoppel), it is critical to focus on precisely what was determined in the prior criminal case. A § 7201 conviction will, as noted, be on all squares to establish that some portion of the underpayment was due to fraud. That is all that is required to invoke § 6663's burden shifting rules. Although the taxpayer's prior conviction of evasion is preclusive as to civil fraud, it is not preclusive as to the amount of tax or the amount attributable to fraud which is subject to the civil fraud penalty. Although not preclusive, once fraud is established as to some amount (here by issue preclusion),¹⁴⁴⁰ § 6663's burden shifting rules require that the taxpayer show that the amount attributable to fraud and thus the civil fraud penalty is less than the amount asserted by the IRS. A § 7206(1), tax perjury, conviction, however, will not be preclusive on the fraud issue because a fraudulent underpayment is not an element of the crime; rather only a false statement is required.¹⁴⁴¹

¹⁴³⁷(...continued)

Criminal Convictions, 2005 TNT 4-28 (2005) arguing (erroneously) for preclusive effect as to the sentencing tax loss number. Similarly, a sentencing court's imposition of tax restitution is not preclusive in a later civil case involving the amount of tax. *Morse v. Commissioner*, 419 F.3d 829, 833-835 (8th Cir. 2005).

And, to use the old saying that consistency is the hobgoblin of small minds, at the same time as denying preclusive effect to tax loss findings when the taxpayer attempts to invoke the doctrine, courts appear willing to permit the doctrine in other cases. See *Arguelles-Olivares v. Mukasey*, 526 F.3d 171 (5th Cir. 2008) (in an immigration proceeding, accepting the court's sentencing finding (based on the PSR) as to the tax loss for purposes of determining that the tax loss exceeded \$10,000, a key element of the immigration statute).

¹⁴³⁸ See e.g., *Evans v. Commissioner*, T.C. Memo. 2010-199, at *13 ("Although Evans' conviction for subscribing a false Federal tax return does not collaterally estop him from denying that he fraudulently understated petitioners' income tax liability, his conviction is evidence of fraudulent intent").

¹⁴³⁹ There is some loose and facially erroneous language in some cases that a § 7206(1) conviction "estops him or her from contesting that an underpayment exists for the years at issue in the criminal case." *Fabian v. Commissioner*, 2022 T.C. Memo. 94, at *39 (citing *Laciny v. Commissioner*, T.C. Memo. 2013-107, at *15; see also *Seiffert v. Commissioner*, T.C. Memo. 2014-4, at *13, supplemented by T.C. Memo. 2014-61). I think that statement is incorrect. Deeper analysis in the cases shows that the taxpayer usually made admissions of the underpayment in the plea agreement, which might technically be more a taxpayer admission rather than a finding entitled to preclusive effect (collateral estoppel). In this regard, one Tax Court Judge (Holmes) pronounced that "Petitioner's conviction, pursuant to section 7206(1), is a badge of fraud and estops him from contesting that he filed false 1991, 1992, and 1993 returns and that an underpayment exists for these years." *Kemp v. Commissioner*, TC Memo. 2004-153, at *4-*5 (citing *Bradford v. Commissioner*, 796 F.2d 303, 307-308 (9th Cir. 1986); *Considine v. United States*, 683 F.2d 1285, 1287 (9th Cir. 1982); *Wright v. Commissioner*, 84 T.C. 636, 643-644 (1985). **Caution to readers**, read that claim with a dash of salt. The badge of fraud claim is particularly concerning at the outset because a badge of fraud is something the actor does rather than something the court does (conviction).

¹⁴⁴⁰ See discussion of claim preclusion (res judicata) and issue preclusion (collateral estoppel) below beginning at p. 648.

¹⁴⁴¹ *Wright v. Commissioner*, 84 T.C. 636, 643 (1985) (intent to evade tax is not an element of the § 7206(1) offense).

Let's look at another application of issue preclusion (collateral estoppel).¹⁴⁴² For tax Year 01, taxpayer claims large fraudulent deductions, thus wiping out his Year 01 tax liability and creating a net operating loss on the tax Year 01 tax return filed 4/15 of Year 02. Taxpayer elects not to carryback his losses, and therefore carries them forward. He claims some portion of the NOL carryforward in Year 04 on his return filed 4/15 of Year 05. On 2/1 of Year 06, he is indicted for tax evasion for Year 01. He is subsequently convicted of the charge. Based on the foregoing, the conviction of tax evasion for Year 01 precludes the taxpayer from contesting civil fraud in Year 01. But is the Year 01 conviction preclusive on the civil fraud issue as to the Year 04 return? One court has so held, reasoning that the claiming of a fraudulent NOL carryforward perforce renders the later year return fraudulent and, since the claiming of the NOL loss itself has already been litigated between the parties in the NOL year (Year 01 in this example), the conviction is preclusive as to fraud on the subsequent carryforward non-conviction year (Year 04 in the example).¹⁴⁴³ What would you argue in response?

D. Fraudulent Failure to File Return (“FFTF”)- § 6651(f).

I discuss the general civil failure to file penalty below beginning p. 372. If the failure to file is due to fraud, the failure to file penalty is tripled (from 5% per month to 15% per month, up to a 75% maximum). § 6651(f). The base to which the 15% per month fraudulent failure to file penalty rate applies is the same base as the general failure to file 5% per month penalty – the tax due “reduced by the amount of any part of the tax which is paid on or before the date prescribed for payment of the tax and by the amount of any credit against the tax which may be claimed on the return.”¹⁴⁴⁴

Fraud for this purpose is the same as for the civil fraud penalty—a willful attempt to evade tax—except that it occurs in the context of a failure to file rather than a filed return.¹⁴⁴⁵ Essentially, the same fraudulent intent for § 6651(f) is required in a failure to file context as is required for the § 6663 civil fraud penalty in the case of a filed return.¹⁴⁴⁶ (The criminal analog to civil fraudulent failure to file is tax evasion, § 7201, which is not that commonly prosecuted, but requires some affirmative act of evasion in addition to failure to file; applying that concept to civil fraudulent failure to file, the IRS will have to show that the taxpayer did something in the nature of an affirmative act beyond the mere failure to file.)

The critical differences that distinguish the FFTF penalty from the civil fraud penalty are: (1) the FFTF penalty is based upon the net tax due on the due date of the return (i.e., appropriate credits are given for tax payments on or before the date of the return),¹⁴⁴⁷ whereas the civil fraud penalty is based on the underpayment attributable to fraud, which excludes the tax payments and any portion of the tax underpaid not attributable to fraud; and (2) the FFTF penalty is a time based penalty that permits mitigation where the taxpayer acts promptly after the event giving rise to the

¹⁴⁴² See discussion of claim preclusion (res judicata) and issue preclusion (collateral estoppel) below beginning at p. 648.

¹⁴⁴³ *Gandy Nursery, Inc. v. United States*, 318 F.3d 631 (5th Cir. 2002).

¹⁴⁴⁴ § 6651(b)(1).

¹⁴⁴⁵ See *Clayton v. Commissioner*, 102 T.C. 632, 653 (1994); *Mohamed v. Commissioner*, T.C. Memo. 2013-255, at *24 (citing *Clayton*); and *Reynoso v. Commissioner*, T.C. Memo. 2016-185, at *14 (citing *Clayton*).

¹⁴⁴⁶ *Mohamed v. Commissioner*, T.C. Memo. 2013-255.

¹⁴⁴⁷ § 6651(b)(1).

penalty. The latter is illustrated where a taxpayer fails to file a Year 01 return on April 15 of Year 02 with the intent to commit fraud by the failure to file and then, in 4 months or less (before August 15 of Year 02), files a nonfraudulent delinquent return for Year 1. The taxpayer will thus not be subject to the entire 75% penalty but will be subject to some lesser percentage depending upon when in that 4 month period the taxpayer files the delinquent return.

The difference in the amount of the base may be illustrated by a variation of the same example. Let's say that the tax due on a correct return would be \$100, and there is no advance payment of tax. The taxpayer fraudulently fails to file the Year 01 return on April 15 of Year 02, the due date for the Year 01 return. On October 1 of Year 02, the taxpayer files a delinquent return reporting \$20 of tax. Assume that, of the unreported tax of \$80 on the delinquent return, \$50 is attributable to fraud and \$30 is attributable to erroneous but nonfraudulent positions. The FTFF penalty would be \$75. By filing the delinquent but fraudulent return, the taxpayer would have practically avoided the IRS investigating fraud with respect to his original delinquency and will have reduced his civil penalty exposure to the civil fraud penalty of 75% of \$50, or \$37.50. But, by filing a fraudulent delinquent return, the taxpayer will also have raised the potential stakes of criminal prosecution from what would likely be a failure to file misdemeanor prosecution under § 7203 to a felony evasion prosecution under § 7201.¹⁴⁴⁸

The latter point further illustrates that one of the easiest tricks in the lawyer's arsenal for a client who is in the situation of having failed to file a return is to advise the client to promptly file a return (or multiple returns in the case of multiple year delinquencies). The filing of a delinquent return before a criminal investigation starts will usually forestall the institution of a criminal investigation in the first instance and the IRS is not likely to expend resources to determine whether the original failure to file was fraudulent so as to assert the fraudulent failure to file penalty. The IRS will usually automatically assert the general failure to file penalty (5% per month up to 25%) when it receives the delinquent return, but the risk of the IRS's investigation and assertion of the fraudulent failure to file penalty will be practically cured. (See the discussion elsewhere in the text on Voluntary Disclosure.)

By definition, the FTFF penalty applies only if no return is filed. It is not uncommon for a taxpayer to file a document on the reporting form (in the case of income tax, the Form 1040) that appears at least superficially to be a return. As noted earlier in discussing the requirements for a return, a standard test – referred to as the *Beard* test (*Beard v. Commissioner*, 82 T.C. 766 (1984) (see p. 126) – is often applied in determining whether the document is a return. If an original return is fraudulent, the civil fraud penalty, § 6663, can apply and the fraudulent failure to file penalty cannot apply; if it is not a return, the FTFF penalty can apply but the civil fraud penalty cannot. It is not always clear whether a document having some resemblance to a return is a return under the

¹⁴⁴⁸ OK, those of you who have been paying careful attention will recall that, in some cases, a § 7201 evasion case can be made in the absence of filing a fraudulent return and for this example, I assumed a fraudulent failure to file. It would accordingly be possible under these facts for the IRS to investigate and perhaps even pursue and obtain an evasion conviction for the original delinquency in filing the return. Practically speaking, however, if the IRS desired to investigate and DOJ desired to prosecute, they would pursue the § 7203 failure to file misdemeanor charge rather than the evasion charge. First, failure to file cases require less investigative, prosecutive and court resources than evasion cases. Second, the example posits a single year delinquency, and the IRS prefers to charge multiple years in any criminal tax prosecution. The Government's prosecution needs would likely be satisfied with a failure to file prosecution, if it prosecuted at all.

Beard test. Where that is the case, the IRS may assert protectively both the civil fraud penalty applicable if it is a return and a FTFF penalty if it is not a return.¹⁴⁴⁹ And, in those cases where the IRS does not assert alternative positions protectively, an unlimited statute of limitations would probably apply to fraudulent positions (e.g., if the document is a return, the unlimited statute of limitations for fraud would apply and, if the document is not a return, the unlimited statute of limitations for failing to file a return would apply).¹⁴⁵⁰

Finally, the IRS says that, although conceptually both the FTFF penalty and the § 6663 civil fraud penalty can apply where the taxpayer willfully fails to file **and** then files a fraudulent delinquent return, generally only the § 6651(f) penalty should apply.¹⁴⁵¹ The FTFF penalty will not be less than the § 6663 civil fraud penalty and could well be more.

E. Accuracy-Related Penalties - § 6662.

Section 6662 establishes accuracy related penalties designed to penalize certain types of inaccurate return reporting.¹⁴⁵² Professor Bryan Camp says that the penalty is “not a penalty for being bad”: rather it is a “consequence for being inaccurate,” although that may be euphemism rather than most taxpayer’s view.¹⁴⁵³

The penalty in most cases is 20 % of the amount of understatement attributable to the conduct penalized but may be increased to 40% for certain egregious misconduct. This penalty does not apply to any portion of the understatement to which the 75% civil fraud penalty applies.¹⁴⁵⁴ Only one accuracy related penalty applies to each portion of the understatement. In other words, if the taxpayer has an understatement of \$400, it is conceivable that \$100 is subject to no penalty, \$100 is subject to the 20% negligence penalty (one subset of the accuracy penalty), \$100 is subject to the 20% substantial understatement penalty (another subset of the accuracy penalty), and \$100 is subject to the 75% civil fraud penalty.

¹⁴⁴⁹ CCA 201640016 (6/7/2016) (finding that, under the analysis of *Sakkis v. Commissioner*, T.C. Memo. 2010-256, the document under consideration would be treated as a return under *Beard*, “To guard against the possibility that the returns are not valid, the Service should include the section 6651(f) fraudulent failure to file penalty as an alternative position in any statutory notice of deficiency issued to the-----for the years at issue.”).

¹⁴⁵⁰ § 6501(c)(1) and (c)(3).

¹⁴⁵¹ IRM 20.1.5.16.2(8) (08-31-2021), Penalty Assertion, saying “Although there is no specific prohibition against asserting penalties under both IRC 6651(f) and IRC 6663, the examiner should exercise caution. The court is not likely to sustain the assertion of both penalties unless compelling facts support the IRS’s position.” See also IRM 20.1.2.3.7.5.1(6) (07-02-2013), FTFF Penalty Assessment—Procedural Requirements (“The civil fraud penalty should not be proposed in lieu of the FTFF [fraudulent failure to file] penalty in that case.”)

¹⁴⁵² The understatement must be made with respect to a filed return. § 6664(b); Reg. § 1.6662-2(a). If a purported return is filed but does not meet the definition of a return (discussed above), then there is no understatement to which the penalty applies, and the only penalty that can apply is the FTFF penalty. See *Williams v. Commissioner*, 114 T.C. 136, 143 (2000).

¹⁴⁵³ Bryan Camp, [Lesson From The Tax Court: A Reasonable Basis For Deducting Scrubs?](#) (Tax Prof Blog 6/27/22). Interestingly, Professor Camp cites IRM 20.1.1.2 (11-21-2017), Purpose of Penalties, which says in relevant part that “monetary penalties” provide “monetary sanctions against taxpayers who do not meet the standard.” Sanctions to me certainly sounds like penalty punishing misconduct.

¹⁴⁵⁴ § 6662(b) (flush language at end). The Tax Court has held that, in a joint return context, if one spouse is subject to the civil fraud penalty, the indicated flush language prevents the spouse not subject to the fraud penalty to avoid any accuracy related penalty. *Said v. Commissioner*, T.C. Memo. 2003-148, aff’d 112 F. App’x 608 (9th Cir. 2004); and *Chico v. Commissioner*, T.C. Memo. 2019-123, at *49.

1. Introduction to the Concepts.

When should a return reporting position draw a penalty? Keep in mind that this is only a real issue after the IRS and perhaps, ultimately, a court has first determined that the return reporting position was not correct and there is a resulting understatement and underpayment of tax. It is a hindsight look at the taxpayer's reporting of the position in the beginning. As we know from sports, hindsight can be most unforgiving. In a penalty context, it is a search for culpability, and in a tax reporting context culpability has many shades. Consider these shades as illustrated by the tax jargon for confidence in return reporting positions (from least confidence to most confidence):¹⁴⁵⁵

| Confidence Level | Probability of Winning | Probability of Losing |
|----------------------------------|------------------------|-----------------------|
| not frivolous | 10% | 90% |
| reasonable basis | 20% (some say 30%) | 80% (70%) |
| realistic possibility of success | 33 1/3% | 66 2/3% |
| substantial authority | 40% (some say 35%) | 60% (65%) |
| more likely than not | >50% (more than 50%) | 50% or < 50% |

¹⁴⁵⁵ The regulations define certain of the terms in words rather than percentages (Reg. §§ 1.6662-3(b)(3) (reasonable basis), 1.6662-4(d) (substantial authority), and 1.6664-4(f)(2)(i)(B) (more likely than not), but observes have derived, intuited, extrapolated or interpolated the percentages set forth above. This list with the percentages is my own compilation and synthesis from a number of sources. Heather M. Field, Aggressive Tax Planning and the Ethical Tax Lawyer, 36 Virginia Tax Rev. 261, 271 (2017); Heather Field, Tax Opinions & Probability Theory: Lessons From Donald Trump, 156 Tax Notes 61 (7/3/17); Dennis J. Ventry, Jr. & Bradley T. Borden, Probability, Professionalism, and Protecting Taxpayers, 68 Tax Law. 83, 84 (2014); Michelle M. Kwon, Dysfunction Junction: Reasonable Cause and Good Faith Reliance on Tax Advisors with Conflicts of Interest, 67 Tax Law. 403, 407 (2014); David Weisbach and Brian Gale, The Regulation of Tax Advice and Tax Advisors, 130 Tax Notes 1279, 1283-1284 (Mar. 14, 2011) (citing at n. 25 Jasper L. Cummings, Jr., The Range of Legal Tax Opinions, With Emphasis on the "Should" Opinion, Tax Notes, Feb. 17, 2003)); and Robert R. Rothman, Tax Opinion Practice, 64 The Tax Law. 301, 327 (Winter 2011); and Joint Comm. on Taxation, Comparison of Recommendations of the Joint Committee on Taxation Staff and the Treasury Relating to Interest and Penalties 13 (JCX-79-99 1999). The regulations define certain of the terms in words rather than percentages (Reg. §§ 1.6662-3(b)(3) (reasonable basis), 1.6662-4(d) (substantial authority), and 1.6664-4(f)(2)(i)(B) (more likely than not), but observes have derived, intuited, extrapolated or interpolated the percentages set forth above. Townsend FTP 2023.2 Practitioner Edition 350 January 1, 2024

There are still higher levels of confidence expressed as to tax positions,¹⁴⁵⁶ but the foregoing ones are the ones relevant to the current penalty discussion. I provide more discussion below of the ones principally encountered in § 6662 – reasonable basis, substantial authority and more likely than not.

One issue the student and practitioner should think seriously about is whether these percentages are meaningful generally or in the context of any particular tax position.¹⁴⁵⁷ What is the difference between a more likely than not opinion at the 51% confidence level and a not more likely than opinion? That difference could be as low as 1% or even a fraction of 1% if the more likely than not opinion were, say, 50.05%, which still exceeds 50%. That is not a meaningful difference in trying to determine what a court would do with the claimed tax benefit.¹⁴⁵⁸ Indeed, trying to discern a 50.05% confidence level or even a 55% confidence level is often an exercise that is more driven by the desired result than a thoughtful and objective analysis of the law and a projection for what a court would determine. The major tax shelter prosecutions have involved tax professionals rendering more likely than not opinions which, under any reasonable analysis, could never be more likely than not and indeed were in the frivolous to reasonable basis, at most, range. Usually, those prosecutions were based mostly on other recognizable criminal problems (lying, cheating and

¹⁴⁵⁶ Probability assessments higher than more likely than not may be given or required for SEC purposes or some business deal purposes. Two such assessments are “should” generally considered more than 70% and “will” generally considered from 90 to 95%. Heather M. Field, Aggressive Tax Planning and the Ethical Tax Lawyer, 36 Virginia Tax Rev. 261, 271 (2017); Jasper L. Cummings, Jr., The Range of Legal Tax Opinions, With Emphasis on the 'Should' Opinion, 98 Tax Notes 1125 (2003) ; Jacob L. Todres, Bad Tax Shelters - Accountability or the Lack Thereof: Ten Years of Tax Malpractice, 66 Baylor L. Rev. 602 (2014) (citing Linda Galler & Michael B. Lang, Regulation of Tax Practice, 100-101 (Matthew Bender & Co. 2010)); Kevin A. Diehl, Can the Failure to Obtain a “Should” Tax Opinion from External Attorneys Invalidate a Merger, 36 Tax Times No. 4 (ABA August 2017). In some prominent cases, taxpayers have unsuccessfully sought to rely upon “should” opinions for a reasonable cause defense to the accuracy related penalty, which means that the court did not believe the should opinion or the taxpayer’s alleged reasonable reliance upon the should opinion. See *Long Term Capital Holdings v. United States*, 330 F. Supp. 2d 122, 205-212 (D. Conn. 2004), aff’d, 150 F. App’x 40 (2d Cir. 2005); and *Canal Corp. v. Commissioner*, 135 T.C. 199, 218-222 (2010).

¹⁴⁵⁷ See generally, Dennis J. Ventry, Jr. & Bradley T. Borden, Probability, Professionalism, and Protecting Taxpayers, 68 Tax Law. 83, 84 (2014). The authors (i) apply Bayesian probability analysis to the standard of care for lawyers in dealing with these probabilistic determinations and (ii) assert that this articulation of relationship between a lawyer’s standard of care and Bayesian probability theory is new. It is certainly new to me, although I would have instinctively thought that it applied in assessing probabilities of tax outcomes perhaps along with or by merging fuzzily the alternative theory which the authors call aleatory reasoning (more commonly called objective or frequentist probability).

¹⁴⁵⁸ Fact burden of proof theory has a similar analysis. As I discuss later in the book in discussing burden of proof (starting on p. 616), the preponderance of the evidence as to a fact is often described as more likely than not, which is quantified in percentages as being greater than 50% to find the fact. Conversely, if the trier is either 50-50 (called a state of equipoise) or less as to the fact, the fact cannot be found, meaning that the party bearing the burden of persuasion on the issue loses. That same type of analysis applies to more likely than not legal conclusions for tax opinions. If the adviser is 50-50 (state of equipoise) or less on the legal issue, then the adviser cannot render a more likely than not opinion. If the adviser is more than 50% on the legal issue, the adviser can render a more likely than not opinion. Of course, the difference between 50% or 49% opinion (cannot render the opinion) and a 51% opinion (can render the opinion) is razor thin and probably impossible to quantify with sufficient confidence to render a more likely than not legal opinion. And the potential for error is compounded when subsequent legal conclusions depend upon the correctness of an earlier conclusion that itself may be uncertain. Example: Legal issue 1 is barely more likely than not, say 51%; Legal issue 2, which depends on Legal issue 1 is at 51%. Is the overall opinion that the tax benefits will be achieved at 51% or some lesser number (in this case around 26%). How does the legal adviser render the opinion? Heather Field, Tax Opinions & Probability Theory: Lessons From Donald Trump, 156 Tax Notes 61 (7/3/17).

stealing),¹⁴⁵⁹ but the backdrop for the prosecutions were more likely than not opinions that were just false in some material part.

Moving toward the bottom of the spectrum, the “reasonable basis” position is quantified as only a 20 or 30% probability of success (or 80-70% probability of failing). That does not sound like a very high standard, but the IRM says: “Reasonable basis is a relatively high standard of tax reporting, that is, significantly higher than not frivolous or not patently improper.”¹⁴⁶⁰ Perhaps I quibble with this statement, but I would not characterize “reasonable basis” (70-80% probability of failing) as “a relatively high standard of tax reporting,” although if the comparison is only to frivolous I guess it is relatively high.

2. Penalty Base - Tax Understatement; Qualified Amended Return (“QAR”).

The accuracy related penalties apply a penalty rate (20% or 40%) to a penalty base which is the tax underpayment. If a taxpayer reports \$100 of tax and upon audit is determined to have owed \$150, the underpayment is \$50. Some portion or all of the underpayment may be subject to the accuracy related penalty.

I mentioned earlier in discussing amended returns that there is a special category of amended return called a qualified amended return (“QAR”) The QAR—relief granted by Regulation rather than by statute—permits a taxpayer to treat the amount of tax reported on the QAR as the tax reported on an original return so that the accuracy related penalty will not apply. Reg. § 1.6664-2(c)(2). In the example above, if the taxpayer files a QAR reporting the correct \$150 tax liability after reporting only \$100 on the original return, the reporting of the correct \$150 liability will avoid the accuracy related penalty. QAR relief does not apply, however, as to the amounts originally underreported attributable to fraud.¹⁴⁶¹

What are the circumstances in which the taxpayer may achieve the benefit of the QAR? A QAR is an amended return filed after the original due date of the return (determined with extensions) but before any of the following events: (i) the date the taxpayer is first contacted for examination of the return; (ii) the date any person is contacted for a tax shelter promoter examination under § 6700;¹⁴⁶² (iii) as to a pass-through entity item, the date the entity is first contacted for examination;

¹⁴⁵⁹ Of course, a false more likely than not opinion is a lie thus prosecutable as a tax crime, but if that were the only lie, it might be hard to attack a tax professional’s belief that his opinion really was more likely than not. This gets into an area covered by the analogous so-called *Cheek* defense to tax crimes where a sincerely held belief, however unreasonable cannot be the basis of a tax crime having an element requiring willfulness—intentional violation of a known legal duty. *Cheek v. United States*, 498 U.S. 192 (1991).

¹⁴⁶⁰ IRM 20.1.5.3.1(8) (08-31-2021), Definitions.

¹⁴⁶¹ Reg. § 1.6664-2(c)(2). For an innovative, but ultimately unsuccessful, spin on the QAR and fraud, see *Gaskin v. Commissioner*, T.C. Memo. 2018-89 where the taxpayer having underreported due to fraud, filed what he claimed was a QAR reporting the tax underpayment amount that was due to fraud, the IRS asserted by notice of deficiency a larger nonfraudulent tax deficiency amount on audit and a civil fraud penalty based on the original fraudulently underreported amount; held merely because the notice of deficiency related only to nonfraudulent items did not foreclose the IRS from asserting the civil fraud penalty on the original fraudulently underreported tax that the taxpayer had corrected by amended return.

¹⁴⁶² For an application of this exception to QAR status, see *Bergmann v. Commissioner*, 137 T.C. 136 (continued...)

(iv) the date a John Doe Summons is issued to identify the name of the taxpayer; and (v) as to certain tax shelter items, the dates of certain IRS initiatives published in the Internal Revenue Bulletin.¹⁴⁶³ Undisclosed listed transactions are excluded.¹⁴⁶⁴

The QAR is a formal procedure to achieve a result in the civil penalty arena that a “voluntary disclosure”—often effected by amended return(s)—does in the criminal tax enforcement arena in generally the same relevant equitable circumstance—i.e., the IRS has not yet started a criminal investigation against the taxpayer or a related proceeding (e.g., § 6700 investigation or John Doe Summons) likely to lead to the taxpayer. These programs that permit taxpayers to avoid penalties—civil in the case of a QAR and criminal in the case of the voluntary disclosure practice—are designed to encourage taxpayers to get right voluntarily with the IRS.¹⁴⁶⁵ The programs produce significant additional revenue that might otherwise escape the IRS net; in the circumstances, foregoing the penalties is consistent with overall revenue enforcement policies. I discussed the criminal voluntary disclosure policy earlier in this book.

There is yet another opportunity to avoid the impact of the accuracy related penalties. An IRS Rev. Proc. permits a taxpayer in large case audits to make appropriate disclosures at the commencement of the audit that will then be treated like a QAR, thus avoiding the accuracy related penalty under the concepts noted above.¹⁴⁶⁶ Some practitioners have claimed that the Rev. Proc., although applicable only to certain taxpayers, can be invoked by all large case taxpayers or, indeed, all taxpayers to avoid accuracy related penalties.¹⁴⁶⁷

¹⁴⁶²(...continued)

(2011), aff'd 2014 U.S. App. LEXIS 720 (9th Cir. 2014) (involving the John Doe Summons to KPMG during its foray into criminal tax shelters). See also Hale E. Sheppard, The Parameters of Qualified Amended Returns Examined by Tax Court in Case of First Impression, 116 Journal of Taxation No. 2 (February 2012).

¹⁴⁶³ Regs § 1.6664-2(c)(3)(i).

¹⁴⁶⁴ Reg. § 1.6664-2(c)(3)(ii).

¹⁴⁶⁵ In cases of potential significant noncompliance, the IRS may issue public cautions and advise taxpayers that if they have participated in such noncompliance, they can use the QAR to eliminate their exposure to the accuracy related penalties. E.g., IR-2019-182 (11/12/19) (advising that the IRS will increase enforcement efforts against abusive syndicated conservation easements and that “Taxpayers may avoid the imposition of penalties relating to improper contribution deductions if they fully remove the improper contribution and related tax benefits from their returns by timely filing a qualified amended return or timely administrative adjustment request.”)

¹⁴⁶⁶ Rev. Proc. 94-69, Rev. Proc. 94-69, 1994-2 C.B. 804, § 3; see IRM 20.1.5.8.2.1.1 (08-31-2021), Special Rules for Disclosure

¹⁴⁶⁷ Although the language of Rev. Proc. 94-69 and the IRM states that it applies only to taxpayers in Coordinated Industry cases (successor to the Coordinated Examination Program mentioned in the Rev. Proc.), which are subject to regular and annual audits, practitioners report the potential for having it apply to other taxpayers. IRS Practice and Procedure Deskbook, Chapter 7, Large Case Examinations § 7:5.5 p. 7-58 (Practicing Law Institute 11/10) (all large case taxpayers; my anecdotal experience has been consistent for large case taxpayers); Ryan Lardinois and Mark Heroux, LB&I Directives on Information Document Requests and Rev. Proc. 94-69 (The Tax Advisor 2014) (claiming that it should apply to all taxpayers on the notion that the IRS cannot discriminate among taxpayers, citing *Computer Sciences Corp. v. United States*, 50 Fed. Cl. 388 (2001); *Oshkosh Truck Corp. v. United States*, 123 F.3d 1477 (Fed. Cir. 1997); and *International Business Machines Corp. v. United States*, 343 F.2d 914 (Ct. Cl. 1965); the authors state that, although agents might resist, they will ultimately be convinced of the “universal applicability” of the Rev. Proc.). In 2015, an IRS advisory subgroup recommended that the procedure apply beyond the current scope to CIC taxpayers. See 2015 IRSAC Large Business and International Report (Last Reviewed or Updated: 19-Nov-2015) (“We therefore recommend that the LB&I develop a new procedure to preserve the benefits of Rev. Proc. 94-69 and, indeed, possibly expand them to a broader group of taxpayers.”).

3. Negligence and Disregard of Rules and Regulations.

a. Negligence.

The negligence penalty applies to the portion of the understatement due to negligence or disregard of rules and regulations. § 6662(b)(1).

Negligence includes “any failure to make a reasonable attempt to comply with the provisions of this title.” § 6662(c). In a commonly cited formulation, the Fifth Circuit has said that “Negligence is lack of due care or failure to do what a reasonable and ordinarily prudent person would do under the circumstances.”¹⁴⁶⁸ Courts will subject a taxpayer to the negligence penalty if, under the circumstances and regardless of how elaborate the tax planning, the taxpayer should have known or had reason to believe it was just “too good to be true.”¹⁴⁶⁹ Keep in mind that the court reaches the penalty issue only after it has found or the parties have conceded that the planning was in fact too good to be true.

The portion of the tax underpayment that has a reasonable basis does not draw this penalty, at least if the basis for the penalty is negligence (as opposed to disregard which connotes a deliberate act).¹⁴⁷⁰ Reasonable basis is a higher standard than not frivolous and not patently improper (the latter standards may apply in other situations not here relevant). Reasonable basis is, however, less than the substantial authority standard discussed below in the substantial understatement penalty. In the percentages noted above, reasonable basis is just a 20 to 25% chance of prevailing, so this is not a particularly high standard, because it implies that the position is 75% to 80% wrong. Not only must this objective test of reasonable basis be met, but the taxpayer must have relied upon the authority establishing reasonable basis in taking the return position.¹⁴⁷¹

We observed above that a spouse innocent of fraud but signing a joint return is relieved of the civil fraud penalty arising from the other spouse’s conduct. A spouse innocent of fraud is also relieved of the accuracy related penalties with respect to any portion of the understatement for which a civil fraud penalty is imposed.¹⁴⁷²

You are assigned *Streber v. Commissioner*, 138 F.3d 216 (5th Cir. 1998), involving the application of the negligence penalty. There, the Fifth Circuit said that “the relevant inquiry for the imposition of a negligence penalty is whether the taxpayer acted reasonably” and that good faith reliance on a tax professional is reasonable. (A watershed on this issue was an earlier Fifth Circuit

¹⁴⁶⁸ *Marcello v. Commissioner*, 380 F.2d 499, 506 (5th Cir. 1967).

¹⁴⁶⁹ *Santa Monica Pictures, LLC v. Commissioner*, T.C. Memo. 2005-104, at *278.

¹⁴⁷⁰ IRM 20.1.5.8.1(3) (12-13-2016), Negligence (12-13-2016), Negligence. Note reasonable basis avoids negligence, so that the “good cause” exception in § 6664(c) is irrelevant if there is reasonable basis. But there may be reasonable cause and good faith even if the position does not have a reasonable basis. Regs. § 1.6662-3(b)(3). However, I think there is substantial overlap, and the cited IRM section says: “If a return position is reasonably based on one or more of the authorities in 26 CFR 1.6662-4(d)(3)(iii), the position will generally satisfy the reasonable basis standard even though it does not rise to the level of substantial authority.”

¹⁴⁷¹ *Wells Fargo & Company v. United States*, 957 F.3d 840, 854 (8th Cir. 2020) (“the reasonable-basis defense under 26 C.F.R. § 1.6662-3 requires evidence that a taxpayer actually relied on the relevant legal authorities that form the reasonable basis for its position.”),

¹⁴⁷² See § 6662(b) flush language. See discussion above p. 344 n. 1430. See also the innocent spouse provisions that may permit the qualifying spouse to avoid liability (p. 758.)

decision in *Heasley*,¹⁴⁷³ a case which has been cited with favor by many courts and is cited by the Fifth Circuit in *Streber*.) The *Streber* Court did not distinguish carefully between the elements of the conduct penalized under § 6662(c) and the reasonable cause exception under § 6664(c) which it did not even mention. In other words, a taxpayer can avoid the penalty if the return position is not negligent or, even if negligent, the taxpayer had reasonable cause (discussed in more detail below). The Court held that “Due care does not require young, unsophisticated individuals to independently examine their tax liabilities after taking the reasonably prudent step of securing advice from a tax attorney,” apparently referring to the conduct penalized in § 6662(c) itself.

The *Streber* Court relied also upon language from *United States v. Boyle*, 469 U.S. 241 (1985) which you should read now. In *Boyle*, the issue was whether the taxpayer, an estate, was subject to the § 6651(a)(1) FTF penalty for failing to timely file an estate tax return. Relief from the FTF penalty is available if the failure is due to reasonable cause and not to willful neglect. There, the taxpayer (through the executor) also relied upon a professional (lawyer) to advise as to when the estate tax return was due and to make sure it was timely completed for filing. The Supreme Court held that the estate did not have reasonable cause because reasonable taxpayers, and particularly the taxpayer there involved, certainly knew a return was due and is charged with the responsibility for ascertaining the due date. The Supreme Court distinguished professional advice on return reporting positions because, due to the complexity of the Code, return reporting positions often involve subtleties requiring reliance on professionals. Courts have picked up on this distinction to avoid the application of the accuracy related penalties where a lawyer has been consulted. I discuss *Boyle* and some of its subtleties later in the reasonable cause defense to accuracy related penalties.

b. Disregard of Rules and Regulations.

As noted, this penalty may apply even in the absence of negligence if the taxpayer disregards rules and regulations, which is defined to include “careless, reckless, or intentional disregard.”¹⁴⁷⁴ § 6662(c). Where the disregard of the rule or regulation is intentional, a court might not relieve the taxpayer from the penalty, and it is not clear that it would do so if the taxpayer’s conduct is careless or reckless.¹⁴⁷⁵ This penalty will not be asserted if the return reporting position contrary to the rules or regulations is disclosed on the proper form on the return,¹⁴⁷⁶ but disclosure will not avoid the penalty if “if the position with respect to a rule or regulation does not have a reasonable basis, if the taxpayer fails to keep adequate books and records, or if the taxpayer fails to substantiate records properly.”¹⁴⁷⁷

¹⁴⁷³ *Heasley v. Commissioner*, 902 F.2d 380, 383 (5th Cir. 1990).

¹⁴⁷⁴ If one wants to dance on the head of a pin, one could contemplate whether negligence is different from careless, reckless or intentional disregard of rules and regulations. I don’t do that in the text above and treat them separately. I do note that, in *Palmolive Bldg. Inv’rs, LLC v. Commissioner*, 152 T.C. 75, 87 (2019), the Court said it was doubtful that two different formulations resulted in two different penalties in § 6662(b)(1) for purposes of § 6751(b)’s written approval requirement (so that an approval only for negligence without mentioning the other formulation was sufficient). Whether the two are substantially the same or different, the conduct meeting the definition(s) can be subject to the penalty but practitioners might want to see if there is any opportunity to duck the penalty by differentiating the two for purposes of § 6751(b).

¹⁴⁷⁵ See *Druker v. Commissioner*, 697 F.2d 46 (2d Cir. 1982).

¹⁴⁷⁶ IRM 20.1.5.8.2.1 (01-24-2012), Adequate Disclosure. The proper forms are Form 8275, Disclosure Statement, or Form 8275-R, Regulation Disclosure Statement.

¹⁴⁷⁷ IRM 20.1.5.8.2.1 (01-24-2012), Adequate Disclosure. If the disclosure fails to avoid the penalty
(continued...)

4. Substantial Understatement Penalty.

a. Introduction.

The substantial understatement penalty of § 6662(d) is designed to impose a more objective penalty where the taxpayer knew that **the taxpayer** was taking an aggressive position. I outline here the key elements of the penalty. But you should understand the “evil” to which the provision was directed. Prior to enactment of this penalty, many taxpayers played the audit lottery (betting they will not be audited, as suggested by the low rates of audit), but hedged their bets by taking return reporting positions that skirted the negligence penalty (reasonable basis position, being only a 20 - 25% chance of winning), which prior to the substantial understatement penalty was the only civil penalty for nonfraudulent returns. One such gambit was to “rely” upon questionable opinions from tax professionals engaged by the tax shelter promoter as “insurance” against the IRS assertion of the negligence penalty.¹⁴⁷⁸ Furthermore, they might insert other professionals for the same reason -- to make a facial showing of reasonable cause. Congress reacted to these and related perceived abuses by increasing the negligence penalty from 5% to 20% and by adding other accuracy related penalties that use more objective standards. I expect you to know the substantial understatement penalty I discuss here and the substantial valuation misstatement penalty I discuss in the next subheading.

b. Understatement Thresholds; Penalty Base.

The starting point is the understatement threshold. The following minimum understatement threshold is required.

- For an individual, the understatement must exceed the **greater of** (i) 10% of the tax required to be shown on the return **or** (ii) \$5,000. § 6662(d)(1)(A).¹⁴⁷⁹
- For a corporation, the understatement must exceed the **lesser of** (i) 10% of the tax shown on the return **or**, if greater, \$10,000 **or** (ii) \$10,000,000. § 6662(d)(1)(B).

If the threshold is met, the entire understatement is the penalty base—the amount subject to the penalty. § 6662(d)(2)(A).

¹⁴⁷⁷(...continued)

because of lack of reasonable basis, the taxpayer may still obtain relief for reasonable cause. See Reg. § 1.6662-3 (“the reasonable cause and good faith exception in § 1.6664-4 may provide relief from the penalty for negligence or disregard of rules or regulations, even if a return position does not satisfy the reasonable basis standard.”)

¹⁴⁷⁸ E.g., *Fidelity International Currency Advisor A Fund, LLC v. United States*, 747 F.Supp.2d 49, 69 (D. Mass. 2010), aff’d, 661 F.3d 667 (1st Cir. 2011) “opinions were “stagecraft” and “fraudulent,” known by all to be “false” and “not possibly correct.” “opinions had but one purpose: to serve as a form of insurance against the imposition of penalties if the transactions were ever to come to light.”)

¹⁴⁷⁹ Section 6662(d)(1)(C), added by the Tax Cuts and Jobs Act of 2017 (“TCJA”), P.L. No. 115-97, 131 Stat. 2054 (Dec. 22, 2017), changes the percentage from 10% to 5% if the taxpayer claims the § 199 qualified business income deduction.

c. Reductions to the Penalty Base.

(1) Design of the Statute for Reductions.

Reductions from the entire understatement are provided for the amount attributable to:

- a reporting position that has substantial authority (§ 6662(d)(2)(B)(i)); or
- a reporting position where the two following conditions are met: (i) “the relevant facts affecting the item's tax treatment are adequately disclosed in the return or in a statement attached to the return,” and (ii) “there is a reasonable basis for the tax treatment of such item by the taxpayer” (§ 6662(d)(2)(B)(ii)).¹⁴⁸⁰

As noted above, reductions are also reported with respect to items that are reported on a qualified amended return (“QAR”).

(2) Substantial Authority and Reasonable Basis.

I discussed the reasonable basis standard above in discussing the negligence penalty.¹⁴⁸¹ Reasonable basis alone is not enough for the reduction of the understatement for the substantial understatement penalty. To help bracket these standards for your better understanding, there is a “more likely than not” position that means the position more likely than not will prevail (i.e., more than 50% chance of prevailing). Accordingly, the substantial authority standard lies somewhere between the reasonable basis standard and the more likely than not standard.¹⁴⁸² The substantial authority standard might be a 40% chance of prevailing.

The substantial authority standard is, according to the Regulations, an objective standard involving an analysis of the law and the application of the law to the relevant facts.¹⁴⁸³ Basically, to have substantial authority there must be authority supporting the position even though not rising to the level of more likely than not.

The Regulations provide a list of the types of authorities that may be considered in the mix of determining whether the return reporting position has substantial authority. Basically, they are as you might suspect -- the Code, the Regulations, published rulings, private rulings issued to the taxpayer, etc. Please review *Streber's* discussion of substantial authority at this point.

The substantial authority standard is most frequently considered in the context of a determination of the law relating to the taking of a return position. However, the law is not applied in a vacuum, but is applied to the facts. The facts are not always clear or certain. What is substantial

¹⁴⁸⁰ This reduction will not apply to a corporate return position for “a multiple-party financing transaction if such treatment does not clearly reflect the income of the corporation.” § 6662(d)(2)(B) (flush language).

¹⁴⁸¹ I also discussed a variation of the reasonable basis standard in discussing relief for employee re-characterization for service providers treated as independent contractors (so called § 530 relief). See p. 96.

¹⁴⁸² Reg. 1.6662-4(d)(2). For a good discussion of the substantial authority standard and how tax professionals apply it, see Dennis J. Ventry, Jr. & Bradley T. Borden, *Probability, Professionalism, and Protecting Taxpayers*, 68 Tax Law. 83, 112-116 (2014)

¹⁴⁸³ Reg. 1.6662-4(d)(3).

authority where the facts are not certain? Stated otherwise, even if in hindsight a court were to determine the facts differently than assumed in taking the return position, can it be said that the taxpayer did not have substantial authority for taking the fact position? Stated conversely, does the penalty necessarily apply when the facts are determined inconsistently with the return reporting position? The cases are few in this context but support the position that a return reporting position can have substantial authority even where the facts are different than assumed in taking the return reporting position. Perhaps a quintessential case illustrating this concept involves the issue of whether a taxpayer is in a trade or business as to an activity which has certain “hobby” overtones, such as horse raising or racing. In determining the ultimate issue of whether the taxpayer is entitled to claim losses in excess of income, a court must determine whether or not the taxpayer was in the trade or business. A key factual inquiry is whether the taxpayer had a legitimate profit making intent in conducting the activity. If the court holds otherwise, does that mean that the penalty should apply because the necessary factual underpinning for the return reporting position has been shown to be false? Arguably not, because the key factual determination is a conclusion based on a mixed set of facts, a set of facts which were substantial enough for the taxpayer to have taken a reasonable return reporting position. Hence, the courts have determined that a mixed set of facts may constitute substantial authority for a return reporting position.¹⁴⁸⁴

(3) Disclosure.

The Regulations provide that disclosure is adequate if made on the original return or a qualified amended return¹⁴⁸⁵ via the Form 8275 (Disclosure Statement) or, if the return position is contrary to a regulation, on Form 8275-R (Regulation Disclosure Statement).¹⁴⁸⁶ The IRS publishes periodically a Revenue Procedure to identify the circumstances under which a disclosure on a return may avoid the § 6662(d) substantial understatement penalty (as well as the preparer penalty under § 6694(a)).¹⁴⁸⁷ The Revenue Procedure provides some methods for disclosure that will suffice without Forms 8275 or 8275-R; except as provided those Forms should be used. Taxpayers and their preparers should familiarize themselves with this Revenue Procedure if they are taking positions that are potentially subject to the penalty. Disclosure does not avoid the penalty if the return reporting item is a tax shelter or if the return reporting position lacks reasonable basis.¹⁴⁸⁸

¹⁴⁸⁴ See the *Streber* case cited. Also, see *Estate of Kluener v. Commissioner*, 154 F.3d 630 (6th Cir. 1998); and *Osteen v. Commissioner*, 62 F.3d 356 (11th Cir. 1995); and for a discussion of these cases, Burgess J.W. Raby, and William L. Raby, How Tax Practitioners Provide Taxpayers with Penalty Insurance, 2002 TNT 236-50 (12/9/02).

¹⁴⁸⁵ Qualified amended return is defined in part here pertinent as a return filed before the taxpayer is first contacted by the IRS for examination. Reg. § 1.6664-2(c)(3). A proper qualified amended return essentially is treated as the original return for penalty purposes, so that proper disclosure on the qualified amended return may qualify the taxpayer for penalty relief. The time to file a qualified amended return is terminated once the IRS issues a John Doe summons or contacts a promoter in a tax shelter context. Reg. § 1.6664-2T(c)(3)(i)(D) & (E).

¹⁴⁸⁶ Reg. § 1.6662-4(f)(1).

¹⁴⁸⁷ Reg. § 1.6662-4(f)(2). The current version is Rev. Proc. 2021-52, 2021 I.R.B. 51, updating Rev. Proc. 2020-54, I.R.B. 2020-53, which updated Rev. Proc. 2019-42, 2019-49 I.R.B.

¹⁴⁸⁸ Rev. Proc. 2022-41, § 4.01(5), 2022 I.R.B. 50.

d. No Reduction for Tax Shelter Positions.

Congress has adopted a panoply of provisions to address the problem of tax shelters. I discuss these provisions in the overall context of tax shelters below beginning p. 852. For present purposes, § 6662(d)(2)(C) precludes any reduction in the substantial understatement penalty base for tax shelter items. (Technically, the statute makes the substantial authority reduction unavailable for tax shelters; similarly, disclosure of the tax shelter item or a reportable transaction will not avoid the penalty.)¹⁴⁸⁹ Tax shelters are broadly defined as

- (I) a partnership or other entity,
- (II) any investment plan or arrangement, or
- (III) any other plan or arrangement, if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.¹⁴⁹⁰

These words are hardly self-descriptive, are very broad and are in the disjunctive. Note that the conditional clause at the end of (III)—“significant purpose”—applies to each of (I), (II) and (III). Hence, all partnerships are not tax shelters but only if a “significant purpose . . . is the avoidance or evasions of Federal income tax.” The Regulations flesh this out, although they define a prior statutory iteration which used the term “principal purpose” defining a tax shelter as one of the three types; I think that “a significant purpose” for “the principal purpose) fairly interprets the current statute:

if the principal purpose [a significant purpose] of the entity, plan or arrangement, based on objective evidence, is to avoid or evade Federal income tax. * * * * Typical of tax shelters are transactions structured with little or no motive for the realization of economic gain, and transactions that utilize the mismatching of income and deductions, overvalued assets or assets with values subject to substantial uncertainty, certain nonrecourse financing, financing techniques that do not conform to standard commercial business practices, or the mis-characterization of the substance of the transaction. The existence of economic substance does not of itself establish that a transaction is not a tax shelter if the transaction includes other characteristics that indicate it is a tax shelter.¹⁴⁹¹

Consider the following from a case involving § 7525's federally authorized tax practitioner privilege (often initialized to “FATP”) which relies upon this definition of tax shelter to deny application of the privilege for the promotion of a tax shelter. The Court said, after quoting the broad definition:

Nothing in this definition limits tax shelters to cookie-cutter products peddled by shady practitioners or distinguishes tax shelters from individualized tax advice. Instead, the language is broad and encompasses any plan or arrangement whose

¹⁴⁸⁹ Rev. Proc. 2022-41, I.R.B. 2022-50 § 4.01(6).

¹⁴⁹⁰ § 6662(d)(2)(C)(ii).

¹⁴⁹¹ Reg. § 1.6662-4(g)(i).

significant purpose is to avoid or evade federal taxes. See *BDO III*, 492 F.3d at 823 (noting that the tax shelter exception is broad “but such breadth does not make the text ambiguous”). By advocating such a narrow definition of promotion, Valero is, through the back door, proposing a definition of tax shelters at odds with the text of the statute. We decline to read such a contradiction into the statute. This definition of tax shelter is broad and could, as Valero points out, include some legitimate attempts by a company to reduce its tax burden. But it is not our place to tinker with the unambiguous definition provided by Congress. And even under this definition, tax shelters are not boundless. Only plans and arrangements with a significant--as opposed to an ancillary--goal of avoiding or evading taxes count.¹⁴⁹²

That does not mean that all is lost for taxpayers who lose on the substantive tax merits of the tax shelter. They may still obtain relief under § 6664(c) for reasonable cause and good faith, albeit that safety relief valve is stringently applied for tax shelters (see below).

5. Substantial or Gross Valuation or Basis Misstatement Penalty.

a. Improper Valuation Claims.

Section 6662(e)’s substantial valuation misstatement penalty and § 6662(h)’s gross valuation misstatement penalty are directed to return reporting positions where the reporting position is based on valuation that is at least significantly erroneous, resulting in the substantial understatement of the tax liability.

In many of the abusive tax shelters over the years, the Achilles heel has been and continues to be grossly inflated valuations. The legal superstructure for the tax shelter may have had some facial merit, but it was built on a factual house of cards because of gross overvaluation.¹⁴⁹³ A facet of this problem was that, since tax professionals were not valuation experts, they could render their opinions without taking responsibility for the key valuation facts that supported the whole purported tax shelter superstructure. For example, as to property otherwise qualifying for the old investment tax credit (10% of qualifying investment in property), tax shelter promoters would sometimes inflate the value of property to 10 or 20 times its true value and sell it to investment partnerships (where the partners were tax shelter investors) for the inflated value.¹⁴⁹⁴ Of course, only crazy people would pay the inflated value, so the tax shelter investors paid only a small amount down and “paid” the balance by nonrecourse indebtedness (before the rules related to nonrecourse indebtedness and

¹⁴⁹² *Valero Energy Corp. v. United States*, 569 F.3d 626, 632 (7th Cir. 2009). Query whether the language of the statute is really unambiguous as the Court said in *Valero* and in the predecessor case it cites, *United States v. BDO Seidman, LLP*, 492 F.3d 806, 823 (7th Cir. 2007). At least, I think, it probably is ambiguous in terms of the IRS’s ability under *Chevron* to adopt regulations further defining the terms.

¹⁴⁹³ An example of what appears to be an overvaluation abuse is in a conservation easement case where the LLC purchased the property at \$1,234,597 and, within 16 months, obtained an appraisal to support a claimed deduction valuing the property at \$10,989,000” an appreciation of 890%. *Thompson v. Commissioner*, T.C. Memo. 2022-80 slip op. at *2 and *9 (noting that, with that much of an increase “in just over a year, the IRS did not need a formal appraisal to support its determination that a valuation misstatement likely existed.” Over the years, I have observed in cases that were better or worse in terms of rather obvious overvaluations.

¹⁴⁹⁴ E.g., *In re MDL-731 Tax Refund Litig.*, 989 F.2d 1290 (2d Cir. 1993) (involving the application of the § 6700 penalty for gross valuation overstatements for investment tax credit property.

passive losses). Assuming that the value was correct, the taxpayers would be entitled to the credit; the problem was in the valuation. A similar gross over-valuation phenomenon has recently appeared in the valuation of promoted shelters with gross over-valuations for conservation easements in claiming charitable contribution deductions.¹⁴⁹⁵ Many, many tax issues, not just tax shelter issues, rely upon valuations.¹⁴⁹⁶ Thus, for example, estate and gift tax returns rely upon valuations. The purpose of this penalty is to put some sting in overly aggressive valuations.

One issue that has arisen for this penalty is whether, if the tax underpayment is based on some threshold reason (such as lack of economic substance or, in the case of a charitable deduction, for failure to substantiate), so that the valuation issue is mooted, the penalty can't apply. The notion was that, in that case, the underpayment arose from that threshold reason and was not "attributable to" the substantial or gross overvaluation. Some early cases so held and rejected the penalty. The trend, however, is now to apply the penalty. The Tax Court said:

We conclude that, if a taxpayer claims a deduction that overstates by 200% or 400% the value or basis of property, any underpayment resulting from the disallowance of that deduction on grounds unrelated to valuation is nonetheless "attributable to" the valuation misstatement, within the meaning of section 6662(b)(3) and (h)(1), to the extent that the underpayment relates to the disallowance of that portion of the deduction that exceeds the property's correct value or basis.¹⁴⁹⁷

The penalty applies to the portion of the tax underpayment attributable to the overvaluation. That means that the portion of the underpayment not attributable to an overvaluation may be subject to another accuracy related penalty (e.g., a negligence penalty). Example: T reports a \$1M deduction based upon an overvaluation of \$800K. The portion of the tax underpayment attributable to the

¹⁴⁹⁵ E.g., *PBBM-Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193, 209-212 (5th Cir. 2018) (sustaining the Tax Court's determination of \$100,000 value for an easement that the taxpayer valued at \$15,160,00 in claiming a charitable contribution deduction). The Tax Court has had a flood of such cases, where the claimed contribution deduction fails for other reasons, with the overvaluation issue often present. E.g., *Coal Property Holdings, LLC v. Commissioner*, 153 T.C. 126 (2019); and *Oakhill Woods, LLC v. Commissioner*, T.C. Memo. 2020-24. The resolution of the case turned on other than valuation issues, but it is clear that significant overvaluation was being exploited in the cases. See also Notice 2017-10, 2017-04 I.R.B. (providing that syndicated conservation easement transactions providing pass-through entity investors the possibility of a charitable contribution deduction that equals or exceeds two and one-half times the amount of the investor's investment, and similar transactions, are listed transactions requiring disclosure of those transactions by participants and advisors).

¹⁴⁹⁶ A recent example involves syndication (marketing) of claimed charitable contribution deductions for contributions of conservation easements which have been inflated based on phony valuations. See Notice 2017-10, 2017-4 I.R.B. 1 (Dec 23, 2016) (In the Notice, the IRS alerts taxpayers that such transactions are "listed transactions" which entail certain responsibilities. I discuss listed transactions in the text below at p. 856.); and IR-2019-182 (11/12/19) (notifying of increased enforcement action against abusive conservation easements).

¹⁴⁹⁷ *RERI Holdings I, LLC v. Commissioner*, 149 T.C. 1, 35 (2017), aff'd sub nom. *Blau v. Commissioner*, 924 F.3d 1261 (D.C. Cir. 2019). Both the Tax Court and D.C. Circuit opinions rejected the earlier cases that held otherwise, including *Todd v. Commissioner*, 89 T.C. 912 (1987), aff'd, 862 F.2d 540 (5th Cir. 1988); and *McCrary v. Commissioner*, 92 T.C. 827, 854 (1989). The Tax Court overruled its holdings in *Todd* and *McCrary* in *AHG Invs., LLC v. Commissioner*, 140 T.C. 73 (2013). See *United States v. Woods*, 571 U.S. 31, 47 (2013); *Dow Europe, S.A. v. United States*, 823 F.3d 282, 286 (5th Cir. 2016), cert. denied, 137 S. Ct. 624, 196 L. Ed. 2d 516 (2017); *PBBM-Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193, 209 (5th Cir. 2018); and *Keller v. Commissioner*, 556 F.3d 1056, 1060-61 (9th Cir. 2009).

overvaluation will be subject to the penalty. The balance not attributable to the overvaluation may be subject to another accuracy related penalty for some other reason.¹⁴⁹⁸

b. Improper Basis Claims.

A related problem is improperly inflating basis. This often occurs in the erroneous valuation context just described. By inflating the purported value of property, a taxpayer purporting to purchase at a fair value (i.e., really the improperly inflated value) claims an inflated basis for the property and claims improper tax benefits. But improperly inflated basis claims appear in contexts other than inflated valuations. Hence, the penalty applies in the disjunctive—i.e., inflated basis claims alone can be subject to the penalty.

Of course, if the taxpayer simply artificially inflates a basis claim, he can be subject to the 75% civil fraud penalty. But inflated basis claims can have at least the superficial appearance of a legal basis and/or an improper appraisal, thus precluding application of the civil fraud penalty. In this case, the substantial valuation misstatement penalty can apply. The Supreme Court so held in *United States v. Woods*, 571 U.S. 31 (2013). In that case, a TEFRA proceeding, the issue was whether an artificial/false basis enhancement shelter could avoid the penalty if, by concession or otherwise, the basis overstatement fails the threshold test of economic substance (i.e., was a sham). A couple of courts had held that it could avoid the penalty. Most courts held that it could not. The Supreme Court resolved the issue by holding that the penalty is not avoided just because the tax claim is rejected on some other threshold basis.

c. Valuation Error Thresholds for Penalty.

The valuation claimed in reporting the return position must be 150% or more of the correct valuation of the property and the tax attributable to the incorrect valuation exceeds \$5,000 (\$10,000 if a corporation other than an S corporation). § 6662(e)(1)(A) & (2).¹⁴⁹⁹ The § 6662(a) penalty is increased to 40% if the valuation is 200% or more of the correct valuation. § 6662(h)(2)(A)(i).¹⁵⁰⁰ However, the penalty only applies if the underpayment attributable to the substantial valuation misstatement exceeds \$5,000 (\$10,000 in the case of corporations). § 6662(e)(2).

¹⁴⁹⁸ *Plateau Holdings, LLC v. Commissioner*, T.C. Memo. 2021-133 (holding that, although the portion not attributable to the overvaluation, could be subject to the negligence and substantial understatement accuracy related penalties, the taxpayer had reasonable cause that avoided those penalties).

¹⁴⁹⁹ As amended by the Pension Protection Act of 2006. Prior to the amendment, the threshold was 200%. For math enthusiasts, a lively debate has engaged over the mathematics of the calculation where the originally claimed basis is greater than zero and the correct basis is zero (as in the case of a sham partnership). The statutory interpretation issue is (i) whether the test is to divide the claimed basis by the correct basis to determine the percentage, which can't be done if the correct basis is zero or (ii) multiply the correct basis times the percentage with the penalty applying if the claimed basis exceeds the product of that multiplication. I won't get into the esoterica of that debate, but direct readers to the articles engaging the debate: Andy S. Grewal, *Petaluma and the Limits of Treasury's Authority*, 144 Tax Notes 479 (July 28, 2014); Michael L. Schler, *Dividing by Zero Is Not So Strange*, 144 Tax Notes 627 (Aug. 4, 2014); Andy S. Grewal, *To Undefined . . . and Beyond!*, 144 Tax Notes 865 (Aug. 18, 2014); and Ajay Gupta, *The Tax Lawyer Who Knew Infinity*, 144 Tax Notes 869 (Aug. 18, 2014).

¹⁵⁰⁰ As amended by the Pension Protection Act of 2006. Prior to the amendment, the threshold was 400%.

d. Section 482 Valuation Misstatements.

The substantial valuation misstatement applies in a special way to § 482 (transfer pricing) valuation misstatements if the reporting position value is 200% or more or 50% or less than the correct value. § 6662(e)(1)(B). U.S. tax can be substantially affected by transfer pricing. Thus, for example, a U.S. subsidiary purchasing inventory from a foreign parent corporation can understate its U.S. tax liability by paying too much for the inventory. Similarly, a U.S. subsidiary of a foreign parent selling inventory to a foreign parent corporation can understate its U.S. tax liability by charging too little for the inventory. There are many variations on the transfer pricing theme but they are all valuation issues and this is illustrative. If the valuation is 200% or more or 50% or less, a 20% valuation misstatement penalty may apply. The penalty is increased to 40% if the overstatement is gross (defined as 400% or more or 25% or less). Certain § 482 adjustments are excluded.¹⁵⁰¹ To be excluded several requirements are imposed, one of which is that the taxpayer have contemporaneous documentation as to the transfer pricing methodology.

e. Estate and Gift Tax Understatement Penalty.

Section 6662(g) imposes a substantial estate or gift valuation understatement penalty for substantial understatements of value. The penalty applies if (i) a reported value on the return is 65% or less than the correct amount and (ii) as a result of substantial undervaluations exceeds \$5,000.

f. No Fault.

I hope you get the point of these penalties -- they act as a no-fault penalty for aggressive return reporting positions. Of course, most taxpayers engaged in aggressive valuation or basis claims will have some degree of subjective fault, but by imposing the penalty based solely on the substantiality of the error (200% error required), the issue of fault is irrelevant. Please note, however, that there is a general reasonable cause and good faith exception that I will discuss.

6. Undisclosed Foreign Financial Asset Understatement.

In 2010, Congress included within the accuracy related penalty provisions a penalty for “any undisclosed foreign financial asset understatement. § 6662(j).¹⁵⁰² I discussed above contemporaneous enactment of a requirement that individuals disclose their foreign financial assets on their tax returns, and this requirement somewhat overlaps the information requirement for the FBARs (which are not tax return forms and are not required by the Internal Revenue Code). § 6038D; the reporting form is Form 8938. There is now a separate Code penalty just for failure to provide the information (§ 6038D(d)), regardless of whether there is an understatement related to the foreign financial asset. But, if there is an understatement with respect to “any transaction involving an undisclosed foreign financial asset,” an accuracy related penalty of 40% applies.¹⁵⁰³ This penalty applies not only to Form 8938 for return disclosure for foreign financial assets, but also to certain other information

¹⁵⁰¹ § 6662(e)(3)(B).

¹⁵⁰² § 6662(b)(7) and (j), as added by Section 512 of the HIRE Act (FATCA provisions).

¹⁵⁰³ As added by the HIRE Act (FATCA provisions).

disclosures for foreign activities.¹⁵⁰⁴ The effective date for this provision is for taxable years beginning after the date of enactment (taxable year 2011 for most individuals).¹⁵⁰⁵

7. Other Accuracy Related Penalties.

Section 6662 contains other penalties for substantial errors, applying similar concepts to other types of taxes. In this class, I expect you only to know the ones covered above.

8. Innocent Spouse Relief.

I noted above that a spouse innocent of fraud but signing a joint return is relieved of the fraud penalty arising from the other spouse's conduct, but that such a spouse "innocent" of negligence is not relieved of the negligence penalty arising from the other spouse's conduct if they file a joint return. As with the negligence penalty, there is no relief to such an "innocent" spouse with respect to the other spouse's conduct. However, as noted elsewhere, there is general innocent spouse relief which, if applicable, relieves the innocent spouse of liability for the tax, penalties and interest.

9. Reasonable Cause Exception.

a. General.

Section 6664(c)(1) establishes an exception to the accuracy-related penalty "with respect to any portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith with respect to such portion."¹⁵⁰⁶ Reasonable cause and good faith are traveling companions; thus, in this text, I refer to this defense as a reasonable cause defense, a shorthand convention for both elements. The defense is available only if the taxpayer's claiming of the erroneous position was objectively reasonable under all the circumstances.¹⁵⁰⁷ The reasonable cause defense is an affirmative defense. The taxpayer bears both the burden of production and persuasion with respect to this defense.¹⁵⁰⁸ The regulations contain helpful examples of when the reasonable cause exception applies.¹⁵⁰⁹

¹⁵⁰⁴ § 6662(j)(2), citing Code §§ 6038, 6038B, 6038D, 6046A, or 6048. Section 6038D is the new provision for reporting foreign financial accounts.

¹⁵⁰⁵ § 512(b) of the HIRE Act (FATCA provisions).

¹⁵⁰⁶ The exception does not apply to the noneconomic substance penalty under § 6662(b)(6). See § 6662(c)(2).

¹⁵⁰⁷ Reg. § 1.6664-4(b); *American Boat Co. v. United States*, 583 F.3d 471, 480, 485 (7th Cir. 2009). At least conceptually, since both reasonable cause and good faith are required, even if the claiming of an erroneous position was in good faith, then it might not be reasonable. Of course, the degree of unreasonableness of the position might imply lack of good faith, in the sense that, in the criminal and some civil contexts, willful blindness can impute knowledge of the law.

¹⁵⁰⁸ In meeting the production burden imposed generally with respect to penalties (§ 7491(c)), the IRS need not disprove or even meet a production burden that the reasonable cause defense does not apply. *Wheeler v. Commissioner*, 127 T.C. 200 (2006); *Santa Monica Pictures LLC v. Commissioner*, T.C. Memo. 2005-104, citing *Higbee v. Commissioner*, 116 T.C. 438, 446-447 (2001). For example, once the IRS meets the production burden that a taxpayer has failed to file, the taxpayer then must establish reasonable cause. *Wheeler v. Commissioner*, *supra*.

¹⁵⁰⁹ See Regs § 1.6664-4.

Reasonable cause becomes an issue only if the accuracy-related penalty is first otherwise applicable under § 6662. Thus, it is important to distinguish between those factors which make the conduct not punishable *ab initio*, as opposed to relieving the taxpayer from the punishment. Sometimes that may not be easy. You will recall that the Court in *Streber* blended these two concepts -- liability and relief from liability for reasonable cause -- in its discussion.¹⁵¹⁰

Reasonable cause is a broad concept not defined in the Code. Courts interpret reasonable cause to require the exercise of ordinary business care and prudence under all the facts and circumstances.¹⁵¹¹ The regulations thus provide (cleaned up).¹⁵¹²

The determination of whether a taxpayer acted with reasonable cause and in good faith is made on a case-by-case basis, taking into account all pertinent facts and circumstances. Generally, the most important factor is the extent of the taxpayer's effort to assess the taxpayer's proper tax liability. Circumstances that may indicate reasonable cause and good faith include an honest misunderstanding of fact or law that is reasonable in light of all of the facts and circumstances, including the experience, knowledge, and education of the taxpayer. Reliance on an information return, professional advice, or other facts, however, constitutes reasonable cause and good faith if, under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith. A taxpayer's reliance on erroneous information reported on a Form W-2, Form 1099, or other information return indicates reasonable cause and good faith, provided the taxpayer did not know or have reason to know that the information was incorrect. Generally, a taxpayer knows, or has reason to know, that the information on an information return is incorrect if such information is inconsistent with other information reported or otherwise furnished to the taxpayer, or with the taxpayer's knowledge of the transaction.

If the law's command is objectively uncertain or ambiguous, the courts will find reasonable cause and good faith even without inquiry into the taxpayer's actions.¹⁵¹³

Given the facts and circumstances nature of the reasonable cause relief, I think the Regulations quote above adequately introduces the nature of the relief, so that it would not be helpful to readers to go into the details in particular cases. I will, however, address certain themes that arise often in the reasonable cause relief context below.

¹⁵¹⁰ See also *Stobie Creek Investments, LLC v. United States*, 82 Fed. Cl. 636, 708 (Fed. Cl. 2008), *aff'd*, 608 F.3d 1366 (Fed. Cir. 2010). Consider also *Roco v. Commissioner*, 121 T.C. 160 (2003)

¹⁵¹¹ E.g., *United States v. Boyle*, 469 US 241 (1985) (interpreting reasonable cause for the FTF penalty).

¹⁵¹² Reg. § 1.6664-4(b).

¹⁵¹³ *Galloway v. Commissioner*, 149 T.C. 407 (2017) (citing *Stromme v. Commissioner*, 138 T.C. 213, 222 (2012) (“Given the ambiguity in this area of the law, we find the Strommes' confusion reasonable and honest.”); and *Rolfs v. Commissioner*, 135 T.C. 471, 496 (2010) (“[G]iven all the facts and circumstances, including the uncertain state of the law, we find that petitioners acted with reasonable cause and in good faith.”), *aff'd* on other grounds, 668 F.3d 888 (7th Cir. 2012). This concept of rejecting the type of mens rea required for a penalty to apply is the analog to the willfulness requirement for tax crimes that precludes a finding of willfulness where the law is objectively uncertain or ambiguous. See *James v. United States*, 366 U.S. 213, 81 S. Ct. 1052, 6 L. Ed. 2d 246, 1961-2 C.B. 9 (1961) and its progeny. And, since the definition of civil fraud is the same as for tax crime, this concept provides relief from the civil fraud penalty in § 6663.

In 2021, the IRS announced a revision to its process for certain FAQs and announced that good faith and reasonable reliance on FAQs that later prove wrong as to the advice in the FAQs may qualify for the reasonable cause exception.¹⁵¹⁴

b. Reasonable Reliance on Tax Advisor.

Reasonable reliance on a qualified tax professional should permit this defense.¹⁵¹⁵ The emphasis is on reasonable. The emphasis on reasonable is my own. Other's state the defense differently.

Bryan Camp has synthesized the holdings of the Tax Court into a useful 3-part test as follows:

(1) was the adviser a competent professional who had sufficient expertise to justify reliance, (2) did the taxpayer give the advisor accurate relevant information, and (3) did the taxpayer actually rely in good faith on the adviser's judgment? This last test is where the Tax Court takes into account the taxpayer's education, sophistication, and business experience.¹⁵¹⁶

Let's move back to my emphasis on reasonable. Reasonable reliance is not determined in a vacuum—i.e., it does not apply simply because a qualified tax professional was involved.¹⁵¹⁷ Rather, it applies only if, under all the circumstances, reliance upon the qualified tax professional was reasonable. The Regulations thus caution:

All facts and circumstances must be taken into account in determining whether a taxpayer has reasonably relied in good faith on advice (including the opinion of a professional tax advisor) as to the treatment of the taxpayer (or any entity, plan, or arrangement) under Federal tax law. For example, the taxpayer's education, sophistication and business experience will be relevant in determining whether the taxpayer's reliance on tax advice was reasonable and made in good faith. In no event will a taxpayer be considered to have reasonably relied in good faith on advice (including an opinion) unless the requirements of this paragraph (c)(1) are satisfied. The fact that these requirements are satisfied, however, will not necessarily establish that the taxpayer reasonably relied on the advice (including the opinion of

¹⁵¹⁴ IR-2021-202 (10/15/21), discussed in the section on FAQs beginning on p. 78.

¹⁵¹⁵ Reg. 1.6664-4(c).

¹⁵¹⁶ Bryan Camp, Lesson From The Tax Court: Blind Reliance Is Not Reasonable Reliance (Tax Prof Blog 4/19/21) (citing Neonatology Associates, P.A. v. Commissioner, 115 T.C. 43 (2000), aff'd 299 F.3d 221 (3rd Cir. 2002)); and Bryan Camp, Lesson From The Tax Court: When 'My CPA Did It' Is No Defense To Penalties (Tax Prof Blog 9/18/23) (discussing Johnson v. Commissioner, T.C. Memo. 2023-116, holding that reasonable reliance requires the tax preparer's "advice" to the taxpayer and mere preparation may not be advice, so the taxpayer cannot claim to have relied upon it; "The mere fact that their CPA prepared the returns "does not mean that...she has opined on any or all of the items reported therein;" in this regard, reliance for may turn on a sliding scale depending upon the sophistication of the taxpayer).

¹⁵¹⁷ The mere existence of legal advice does not immunize taxpayers from penalties in blatant tax schemes. See Nicole Rose Corp. v. Commissioner, 320 F.3d 282, 284-285 (2d Cir. 2002). Moreover, the Tax Court held that a taxpayer did not realize when his tax return preparer omitted such a large amount of income that the taxpayer should have spotted with minimal review of the return. Woodsum v. Commissioner, 136 T.C. 585, No. 29 (2011).

a tax advisor) in good faith. For example, reliance may not be reasonable or in good faith if the taxpayer knew, or reasonably should have known, that the advisor lacked knowledge in the relevant aspects of Federal tax law.¹⁵¹⁸

The reliance on the advisor must be objectively reasonable. You should now read *Addington v. Commissioner*, 205 F.3d 54 (2d. Cir. 2000). By way of background, the taxpayers were lawyers who invested in a hokey tax shelter which had substantially overvalued machines used in producing recycling plastic. The value of a recycler did not exceed \$50,000. But the taxpayers through a partnership (a favored abusive tax shelter vehicle) based investment tax credit based on an estimated value of \$1,162,666. They sought to rely upon their hired tax specialists, “Guy Maxfield, a professor of tax law at New York University School of Law,” and conferred with “John Y. Taggart,” also at one time a professor of tax law at NYU Law who had helped prepare the offering documents for the shelter. Those tax specialists knew nothing about the plastic recycling business or machines. Well, you can read the opinion as to whether that worked.¹⁵¹⁹

The taxpayer may reasonably rely upon an opinion, if the circumstances justify doing so, without having to seek a “second opinion.” The Tax Court has explained: “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.”¹⁵²⁰

The relief does require that the taxpayer rely upon an independent tax advisor—i.e., one who is not conflicted.¹⁵²¹ There are, of course, myriad of possibilities as to independence. Perhaps the most obvious case of lack of independence is where a taxpayer claims to rely upon an ostensibly independent tax advisor who was referred to the taxpayer by the promoter of an abusive tax shelter scheme.¹⁵²² The fact that the such a promoter-affiliated tax advisor is not really independent bears

¹⁵¹⁸ Reg. § 1.6664-4(c)(1).

¹⁵¹⁹ For a more recent application of the reasonableness test, see *Exelon Corp. v. Commissioner*, 147 T.C. 230, 307 ff. (2016), aff’d 906 F.3d 513 (7th Cir. 2018), reh. denied, U.S. App. LEXIS 34293 (where in a complex deferral tax shelter with paperwork of smoke and mirrors with many tax advisors, internal and external, and an opinion from a prominent national law firm, the Court rejected reliance on the law firm opinion and underlying major accounting firm appraisal on which the opinion was based because the law firm “interfered with the appraisal process’ integrity and independence by providing Deloitte with the wording of the conclusions it expected to see in the final appraisal reports.”

¹⁵²⁰ *Exelon Corp. v. Commissioner*, 147 T.C. 230, 333 (2016), aff’d 906 F.3d 513 (7th Cir. 2018), reh. denied, U.S. App. LEXIS 34293 (cleaned up).

¹⁵²¹ E.g., *Gustashaw v. Commissioner*, 696 F.3d 1124, 1134 (11th Cir. 2012) (attorney’s inherent conflict of interest because the promoter “referred Gustashaw to Brown & Wood and supplied him with the firm’s model opinion letter”); and *Mortenson v. Commissioner*, 440 F.3d 375, 387 (6th Cir. 2006) (“In order for reliance on professional tax advice to be reasonable, however, the advice must generally be from a competent and independent advisor unburdened with a conflict of interest and not from promoters of the investment.”)

¹⁵²² The following was typical for abusive tax shelter schemes. The tax shelter promoter would develop a complex (almost incomprehensibly complex) tax scheme that, if properly analyzed, was unlikely to work and find one or more lawyers willing to advise taxpayers buying the scheme that the tax benefits would more likely than not prevail. E.g., Mortimer M. Caplin, *The Tax Lawyer’s Role in the Way the American Tax System Works* (13th Annual Erwin N. Griswold Lecture Before The American College of Tax Counsel 1/22/05) (quoting Senator Grassley: ““At the heart of every abusive tax shelter is a tax lawyer or accountant.”) Even where the lawyer or accountant was not being directly paid by the promoter, the fee the lawyer would charge would be outsize and, economically, was an excess premium being
(continued...)

on the reasonableness of the taxpayer's reliance on the tax advisor, particularly where the tax benefits are so outsized that even the taxpayer should have realized that they were "too good to be true."

For this defense, the taxpayer must show that he actually relied on the advice.¹⁵²³ Is the professional's preparation of the return sufficient for that showing? Probably not unless the preparer did more than simply report the position without any independent investigation into the factual and legal propriety of the position.¹⁵²⁴

One of the dangers in a taxpayer asserting this defense is that the taxpayer thereby waives the attorney-client privilege or the Federally Authorized Tax Practitioner privilege which parallels the attorney-client privilege for non-lawyer practitioners.¹⁵²⁵ Since many counsel realizing the dangers lurking in high risk planning tend to hedge their opinions, the actual underlying opinion may do more harm than good for the defense.

c. Tax Shelters.

Taxpayers playing the abusive tax shelter game often claim reasonable cause relief. The foregoing discussion relies significantly upon courts' discussion of those claims in the context of abusive tax shelters. I provide more focus on abusive tax shelters.

The Regulations address reasonable cause for tax shelter items of corporations,¹⁵²⁶ hearkening back to the time when § 6662 effectively excluded corporate tax shelters from the reduction for the substantial understatement penalty. Now that all tax shelters are excluded from that

¹⁵²²(...continued)

charged for offering the taxpayers an opportunity to avoid the criminal and civil penalties because they can claim to have "relied" on the lawyer's or accountant's opinion. The problem, though, is that, in an environment where the tax benefits were even facially "too good to be true" (as some courts have concluded) relying upon a lawyer or accountant with whom the taxpayer had no relationship and delivered to the taxpayer by the promoter is not reasonable. See e.g., *Gustashaw v. Commissioner*, 696 F.3d 1124, 1142 (11th Cir. 2012) ("As the Tax Court concluded, such a scenario, especially in light of Gustashaw's personal financial history and business sophistication, was plainly 'too good to be true,")

¹⁵²³ Of course, where the taxpayer could not have reasonably relied upon the advice, the facts will likely show that the taxpayer did not rely upon the advice.

¹⁵²⁴ *Russian Recovery Fund Limited v. United States*, 851 F.3d 1253 (Fed. Cir. 2017) (where Ernst & Young simply reported on the return the position based on facts orchestrated by a promoter and which it assumed for purposes of the opinion; it is probably important that this was a too good to be true tax shelter); and *Makric Enterprises Inc. v. Commissioner*, T.C. Memo. 2016-44, at *66 n. 38 noting that the preparer "did not give formal advice to" the taxpayer; rather "[h]e only prepared Makric's return," with the result that "one might question whether Harper provided 'advice' to" the taxpayer; citing Reg. § 1.6664-4(c)(2) (defining advice for this purpose as a communication setting forth the "analysis" and "conclusion" of the professional tax adviser), aff'd 2017 U.S. App. LEXIS 5301 (5th Cir. 2017) (unpublished).

¹⁵²⁵ *In re G-I Holdings, Inc.*, 218 F.R.D. 428 (D. N.J. 2003) (taxpayer asserted "reasonable basis" and "reasonable cause" based upon consultation with "outside legal counsel and others" as a defense to the accuracy related penalties; held this defense waived the privilege); and *AD Investment 2000 Fund LLC et al. v. Commissioner*, 142 T.C. 248, 254-6 (2014) ("When a person puts into issue his subjective intent in deciding how to comply with the law, he may forfeit the privilege afforded attorney-client communications.").

¹⁵²⁶ Reg. § 1.6664-4(f).

reduction,¹⁵²⁷ this discussion in the regulations is instructive as to reasonable cause and good faith in the case of all tax shelters.¹⁵²⁸ Those regulations provide (I substitute taxpayer for corporation):

- A general rule that it is a facts and circumstances inquiry, considering the taxpayer's efforts to assess the taxpayer's proper tax liability and the reasonableness of the taxpayer's misunderstanding of fact and law.¹⁵²⁹
- At a minimum, the position must have "substantial authority" and the taxpayer "reasonably believed that the position was more likely than not the proper treatment."¹⁵³⁰
- A reasonable belief exists only if, independent of the possibility that the position will not be audited, the taxpayer either analyzes the facts and authorities and concludes in good faith that a greater than 50% likelihood of prevailing exists or relies in good faith on the opinion of a professional tax advisor which makes a similar analysis.¹⁵³¹
- The foregoing are just the minimum requirements and may not be enough to qualify for relief.¹⁵³² Thus, depending upon the facts, the following are negative factors for the taxpayer: "the taxpayer's participation in the tax shelter lacked significant business purpose, if the taxpayer claimed tax benefits that are unreasonable in comparison to the taxpayer's investment in the tax shelter, or if the taxpayer agreed with the organizer or promoter of the tax shelter that the taxpayer would protect the confidentiality of the tax aspects of the structure of the tax shelter."¹⁵³³

I think that practical planning should require the taxpayer and his advisor(s) to assume that a planning arrangement that has some odor piscatorial to is going to be subject to the penalty. You will know it when you see it.

d. The Software Did It.

Given the popularity of tax software, some taxpayers have tried to blame the software for the problem, thus constituting reasonable cause. This defense became more popular after, in his confirmation hearings for Secretary of Treasury, Timothy Geithner alleged that a substantial tax underpayment was the result of a TurboTax error. Geithner was confirmed as Secretary of the Treasury, and I do not know whether the IRS asserted and prevailed on an accuracy related penalty for him. But Geithner's claim of good faith in his hearings has been cited and rejected in criminal¹⁵³⁴

¹⁵²⁷ § 6662(d)(2)(C) which excludes tax shelter items from the reduction in § 6662(d)(2)(B) for "any item attributable to a tax shelter." This exclusion from the reduction applies to all taxpayers subject to the § 6662 penalties.

¹⁵²⁸ Marie Sapirie, *Revised Guidance on Tax Shelter Definition on the Way*, 2013 TNT 42-9 (3/4/13) (An IRS official said that, although these regulations mention only corporations, "the IRS's position is that reg. section 1.6664-4(f) applies to both corporate and noncorporate taxpayers. Saying that the statute's legislative history suggests its purpose was to end abusive transactions, he argued that its language makes sense only if it applies to noncorporate taxpayers.")

¹⁵²⁹ Reg. § 1.6664-4(b)(1).

¹⁵³⁰ Reg. § 1.6664-4(f)(2)(i).

¹⁵³¹ Reg. § 1.6664-4(f)(2)(i)(B).

¹⁵³² Reg. § 1.6664-4(f)(3).

¹⁵³³ Reg. § 1.6664-4(f)(3).

¹⁵³⁴ E.g., *United States v. Hendrickson*, 664 F. Supp. 2d 793, 806 n. 16 (E.D. Mich. 2009) (making the (continued...))

and civil¹⁵³⁵ tax cases where it was clear that the problem was in the operator / taxpayer and not the software. If indeed the problem were in the software or its instructions, the defense should succeed.¹⁵³⁶

e. Other.

There are exceptions to the reasonable cause defense:

- the defense is not applicable to underpayments from a transaction lacking economic substance under § 7701(o) or “failing to meet the requirements of any similar rule of law.”¹⁵³⁷
- the defense is not applicable to underpayments from charitable contributions attributable to substantial or gross valuation overstatements or understatement, unless (i) “the claimed value of the property was based on a qualified appraisal made by a qualified appraiser” and (ii) the taxpayer made “a good faith investigation of the value of the contributed property.”¹⁵³⁸

10. Penalties and Carryovers.

Certain tax attributes unused in one year may be “carried” to another year to reduce tax liability in the year (the carryover year). For example, net operating losses in one year (let's assume Year 03, the source year) do not reduce tax liability in the source year but may be carried backwards or forwards to reduce liability in another year. In this example, let's say that they are carried back to Year 01 and reduce liability in Year 01. The penalties may be applied to the carryover year (in this case Year 01, a carryback year).¹⁵³⁹

11. No “Stacking” of Certain Accuracy and Civil Fraud Penalties.

Section 6662(b)(flush language) provides that the accuracy related penalties and the civil fraud penalty will not be “stacked” so as to have two penalties apply to the same underpayment of

¹⁵³⁴(...continued)

argument generally and specifically with respect to Geithner but turning the argument against the taxpayer’s selective prosecution argument). The Geithner phenomenon could even give rise to a variant that I call the tax software or, more narrowly, a TurboTax defense. Geithner testified that he used TurboTax and, while saying the problem was his rather than his TurboTax software’s problem, did say that TurboTax did not bring to his attention that he should pay more tax.

¹⁵³⁵ *Lam v. Commissioner*, T.C. Memo. 2010-82, *6-8.

¹⁵³⁶ See *Thompson v. Commissioner*, T.C. Memo. 2007-174, at *9 (finding that, “on the entire record,” the taxpayer acted reasonably in obtaining and using the software).

¹⁵³⁷ § 6664(c)(2), referring to § 6662(b)(6). Presumably any other similar rule of law would include the common law doctrines such as the nonstatutory economic substance doctrine, the business purpose doctrine and substance over form.

¹⁵³⁸ § 6664(c)(3); see *RERI Holdings I, LLC v. Commissioner*, 149 T.C. 1 (2017), aff’d sub nom. *Blau v. Commissioner*, 924 F.3d 1261 (D.C. Cir. 2019). For a case holding that the taxpayer had met these requirements for the reasonable cause defense, see *Chandler v. Commissioner*, 142 T.C. 279 (2014).

¹⁵³⁹ Regs. § 1.6662-3(d) (negligence penalty); § 1.6662-4(c) (substantial understatement penalty); § 1.6662-5(c) (substantial and gross valuation misstatements); and § 1.6662-6(e) and (f) (§ 482 adjustments, but quantifying whether there an adjustment is done in the source year).

tax.¹⁵⁴⁰ This is referred to as the anti-stacking provision.¹⁵⁴¹ Thus, the portion of the underpayment that could be subject to both the civil fraud penalty (§ 6663) and one or more accuracy related penalties, will only have one penalty apply, so that application of the civil fraud penalty will preclude application of the accuracy related penalty.¹⁵⁴² Similarly, an application of a 40% accuracy related penalty to a portion of an underpayment will preclude application of one of the 20% accuracy related penalties the same portion of the underpayment.¹⁵⁴³

The anti-stacking provision applies only to the portion of the understatement involved with two potential penalties. This means that as to an aggregate understatement (deficiency), some portion could be subject to no penalty, some portion could be subject to a 20 or 40% accuracy related penalty and some portion could be subject to the 75% civil fraud penalty. But the penalties will not overlap as to a portion of the understatement.¹⁵⁴⁴

Although the penalties will not overlap, in the notice of deficiency, the IRS may assert penalties in the alternative – e.g., assert the civil fraud penalty with a lesser accuracy related penalty as an alternative position if the fraud penalty is not sustained or assert a higher accuracy related penalty with a lesser accuracy related penalty if the higher penalty is not sustained.¹⁵⁴⁵ In that case, the bottom line amount of deficiency determined in the notice of deficiency will only include the higher penalty and the lesser, alternative penalty, although asserted, will not be in the bottom-line deficiency determination.¹⁵⁴⁶ And, in the final Tax Court decision document, only the higher applicable penalty to the particular understatement will be determined.

¹⁵⁴⁰ See Reg. § 1.6662-2(a).

¹⁵⁴¹ *Heller v. Commissioner*, T.C. Memo. 2008-232, at * 15.

¹⁵⁴² § 6662(b)(flush language); Reg. § 1.6662-2(a).

¹⁵⁴³ § 6662(b)(flush language); Reg. § 1.6662-2(c).

¹⁵⁴⁴ *Graev v. Commissioner*, 147 T.C. 460 (2016) (reviewed opinion, often referred to as *Graev II*) (in the case of the 40% and 20% accuracy related penalties, “Only one of these penalties can apply to a given portion of a deficiency; they cannot be stacked.”). *Graev II* was reversed on other grounds in *Graev v. Commissioner*, 149 T.C. 485 (2017) (reviewed opinion, often referred to as *Graev III*). At this point, I should also introduce *Graev I*, *Graev v. Commissioner*, 140 T.C. 377 (2013). The *Graev* case (as opposed to the opinions it has generated) has produced three precedential opinions, two of which were the relatively rare reviewed opinions. I don’t think it is important at this point to do a history of the twists and turns along the way. It is important, however, to establish the reference points for *Graev II* and *Graev III*, the most important of which, as of this writing, is *Graev III* which essentially reversed key aspects of *Graev II*.

¹⁵⁴⁵ An illustration of how this works in conjunction with other Code requirements is *Graev v. Commissioner*, 147 T.C. 460 (2016) (reviewed opinion, *Graev II*). In *Graev II*, the IRS asserted the 40% gross valuation misstatement penalty and, in the alternative, asserted the 20% accuracy related penalty. Both of those penalties could not apply. Accordingly, in the notice of deficiency, although asserting the 40% penalty and stating the 20% penalty as an alternative, the deficiency number for the deficiency included only the 40% penalty. The IRS conceded the 40% penalty and the Court sustained the 20% penalty. In doing so, the Tax Court rejected the taxpayer’s claim that stating the 20% penalty in the alternative without including the calculation of the 20% penalty (because the 40% penalty was calculated) violated § 6751(a)’s requirement that the penalty calculation be included in the notice. The point illustrated here was not reversed in the subsequent *Graev III* holding, *Graev v. Commissioner*, 149 T.C. 485 (2017) (reviewed opinion).

¹⁵⁴⁶ See *Graev v. Commissioner*, 147 T.C. 460 (2016) (reviewed opinion, *Graev II*). *Graev II* was reversed on other grounds in a second opinion, *Graev v. Commissioner*, 149 T.C. 485 (2017) (reviewed opinion, *Graev III*).

Finally, I noted above that the anti-stacking rule may apply, in conjunction with the nonfraudulent spouse exemption from the civil fraud penalty, to exempt the nonfraudulent spouse from the accuracy related penalty if a culpable spouse is liable for the civil fraud penalty.¹⁵⁴⁷

F. Failure to File (“FTF”) Penalty.

1. Most Returns with Tax Due.

I mentioned general failure to file penalty (§ 6651(a)(1)) above in discussing the Fraudulent Failure to File Penalty. I discuss here the requirements for the failure to file penalty.

The failure to file (“FTF”) penalty is a penalty for failure to file the return by the due date. For individuals, the due date for income tax returns is April 15 of the following year (i.e., year 01 returns are due 4/15/02). The due date for income tax returns may be extended for six months (10/02 in the example). If the income tax return is not filed by the due date or extended due date, the penalty may apply. Other returns may be subject to the FTF penalty, but I focus here principally on income tax returns.

The penalty base is the amount required to be shown on the return less any tax paid on or before the due date of the return (e.g., paid by withholding or estimated tax payments) or any credits that could be claimed. § 6651(a)(1) and (b)(1). Basically, the base is the unpaid tax liability on the due date.¹⁵⁴⁸ The penalty rate when fraud is not present, is 5% per month up to a maximum of 25%. Thus, failing to file or filing over 4 months (partial months are treated as full months) late can draw the maximum 25% FTF penalty.¹⁵⁴⁹ If the failure to file is due to fraud, the penalty rate is tripled—i.e., 15% per month with a maximum of 75%. § 6551(f).

If the return otherwise subject to the penalty is filed more than 60 days after the due date, the minimum penalty is the **lesser** of \$485 (as inflation adjusted for 2023) or 100% of the tax required to be shown on the return. § 6651(a), flush language.¹⁵⁵⁰

The penalty is not applicable if the taxpayer's failure to file is due to reasonable cause and not to willful neglect.¹⁵⁵¹ Where, as with the § 6651 penalties, relief is provided when the noncompliance is “due to reasonable cause and not due to willful neglect,” it is common to refer to the relief as reasonable cause relief, because reasonable cause assumes the absence of willful

¹⁵⁴⁷ See discussion on p. 344.

¹⁵⁴⁸ In a notice a client received, the IRS explained the penalty: “The penalty for filing late is based on the tax ultimately due, which was not paid by the original return due date without regard to extensions.”

¹⁵⁴⁹ In the unlikely event the IRS were to prepare a § 6020(b) substitute for return (“SFR”) for the taxpayer in the 4+ month period, the SFR would not be a return for purposes of stopping the accrual of the FTF penalty. § 6651(g)(1).

¹⁵⁵⁰ As amended by the Trade Facilitation and Trade Enforcement Act of 2015, Pub. L. No. 114-125, 130 Stat. 122. The statute says the penalty is \$435 as of 2020 but the penalty is inflation indexed for years after 2020. The 2023 inflation adjustment is in Rev. Proc. 2022-38; 2022-45 I.R.B. 1 Section 3.52.

¹⁵⁵¹ The fact that the taxpayer expects a refund is not reasonable cause for failure to file. *Parekh v. Commissioner*, T.C. Memo. 2017-227.

neglect;¹⁵⁵² I will use that convention of identifying the relief as “reasonable cause” relief in discussing penalties with relief for noncompliance due to reasonable cause and not willful neglect or to similar formulations (such as reasonable cause and good faith).¹⁵⁵³

Please re-read *United States v. Boyle*, 469 U.S. 241 (1985). Basically, *Boyle* established a “bright line” rule that timely filing of a return is nondelegable taxpayer responsibility so that alleged reliance on a tax professional is not reasonable cause for failure to file.¹⁵⁵⁴ *Boyle* has been easily extended to failure to pay and failure to file an extension of time to file a return.¹⁵⁵⁵ Beyond that, it gets murky.

Taxpayer mental impairment would constitute reasonable cause. The executor in *Boyle* was not mentally impaired. What about financial hardship? Can a taxpayer urge that, because of financial hardship, he could not pay the taxes and, for that reason, did not file the return? The answer is that inability to pay does not excuse failure to file and report the liability. Filing and paying are two different things. I cover below the failure to pay penalty which also has reasonable cause relief.

Does *Boyle* mean that there is no reasonable cause when a failure to file timely results from erroneous legal advice upon which the taxpayer relied? No. The result in *Boyle* was driven by the fact that the particular event—a time limit in which to file—should have been known and put a reasonable executor upon inquiry. What about some more esoteric legal rule relating to the time during which a return must be filed?¹⁵⁵⁶ The cases are not clear on this issue, but the issue may turn upon the complexity of the legal rule and the objective reasonableness of the assumptions the lawyer made in rendering the advice.¹⁵⁵⁷

¹⁵⁵² E.g., IRS Web Page titled : IRS Tax Tips Important Facts about Filing Late and Paying Penalties” (last reviewed or updated 4/5/18 and accessed 12/8/18) (“8. No penalty if reasonable cause. Taxpayers will not have to pay a failure-to-file or failure-to-pay penalty if they can show reasonable cause for not filing or paying on time.”)

¹⁵⁵³ Other Code relief formulations use “reasonable cause,” often with some additional qualifier such as not due to willful neglect or due to good faith . A sampling are: § 6652 in various subsections (“willful neglect,” also a failure to file returns or other documents), § 6501(c)(8) (“willful neglect,” extension of statute of limitations for failure to file a document); § 6664(c)(1) (reasonable cause and good faith). I will often just refer to the relief as reasonable cause relief, sometimes without noting that the additional qualifier is in the Code although it is redundant.

¹⁵⁵⁴ A logical extension of *Boyle*’s holding that reliance on a professional is not reasonable cause for filing the hard copy of a return is that reliance on a professional is not reasonable if the professional fails to file the return electronically. *Lee v. United States*, 84 F.4th 1271 (11th Cir. 11/24/23). Readers might want also to read Judge Lagoa’s “specially concurring” opinion in *Lee* reciting the risks taxpayers assume in engaging return preparers arising from this bright line rule. Of course, the taxpayer can make as a condition of the engagement that the preparer deliver the hardcopy return to the taxpayer who then can mail the return to the IRS.

¹⁵⁵⁵ E.g., *Knapp v. United States*, 713 F.3d 1164, 1174 (9th Cir. 2013).

¹⁵⁵⁶ A reasonable cause exception to the FBAR Nonwillful Penalty is allowed. Nonwillful FBAR failures to file are not imposed if the failure is due to reasonable cause and the taxpayer reports after failure to file. See discussion of the exception below at p. 971.

¹⁵⁵⁷ *Estate of Liptin v. United States*, 754 F.3d 975 (Fed. Cir. 2014) noting the importance of the filing dates for returns and that an objective reasonableness of the legal advice standard best preserves the competing interests. So, if the advice as to time of filing is erroneous but objectively reasonable, the taxpayer has reasonable cause for late filing, but if the advice is not objectively reasonable, the taxpayer has no reasonable cause (but, of course, does have a malpractice claim against the attorney). See also *Estate of Hake v. United States*, 234 F. Supp. 3d 626 (M.D. Pa. 2017).

What about the taxpayer who relies upon a tax professional not for advice per se but for performing some action such as timely filing the return? A court held that where the tax preparer attempted an e-filing that failed causing the IRS to assert the late filing penalty, the test would be whether the preparer acted negligently because the preparer in so acting was the agent of the taxpayer and thus the preparer's reasonable cause was the proper focus.¹⁵⁵⁸

An administrative relief measure in the IRM, called First Time Abate ("FTA"),¹⁵⁵⁹ may apply even without a showing of reasonable cause for a first time failure to file, failure to pay and/or failure to deposit penalties.¹⁵⁶⁰ The relief is available if the taxpayer has a compliant history for the preceding three years. This type of relief would not apply to a filing of an estate tax return, because it is a one-time event rather than a periodic, repeated event which FTA assumes.¹⁵⁶¹ This relief is only available once.¹⁵⁶² First Time Abate relief may be available for other penalties; I shall mention the relief in discussing the penalties relevant to this book without further discussion of the relief.

There is also another penalty for failure to file U.S. income tax returns due from foreign taxpayers doing business in the United States. Such foreign taxpayers obtain the benefits of deductions and credits only by "filing or causing to be filed" a "true and accurate" return as required by subpart F (the procedure sections) which must include "all the information which the Secretary may deem necessary for the calculation of such deductions and credits."¹⁵⁶³ The Regulations require that the return be "timely" but provide certain extended periods during which a return will be deemed timely filed to avoid this "penalty."¹⁵⁶⁴ The IRS may waive this "penalty" if the taxpayer establishes that he acted "reasonably and in good faith" and then cooperates in determining the tax liability.¹⁵⁶⁵ This "penalty" applies even if a treaty requires that a foreign taxpayer be taxed only on its U.S. source business income attributable to a permanent establishment.¹⁵⁶⁶ The Regulations do allow foreign taxpayers to file protective returns to ensure their ability to claim the deductions and credits.¹⁵⁶⁷

¹⁵⁵⁸ *Haynes v. United States*, 760 Fed. Appx. 324 (5th Cir. 2019).

¹⁵⁵⁹ Some practitioners call this First Time Abatement.

¹⁵⁶⁰ IRM 20.1.1.3.3.2.1 (03-29-2023), First Time Abate (FTA)). For a discussion, see Garrett L. Brodeur, The First-Time Abatement Policy—Harsh Realities and Strategic Considerations (ABA Section of Taxation Practice Point 5/26/22).

¹⁵⁶¹ IRM 20.1.1.3.3.2.1 (03-29-2023), First Time Abate (FTA) (FTA does not apply to, inter alia, "Returns with an event-based filing requirement, generally returns filed once or infrequently such as Form 706, U.S. Estate Tax Return, and Form 709, United States Gift (and Generation-Skipping Transfer) Tax Return."

¹⁵⁶² One concern is that, as applied, the IRS may grant FTA relief even though the taxpayer may qualify for a reasonable cause exception. This would "use up" the taxpayer's one time abate where it is not needed. See The Systemic First Time Abatement Policy Currently Under Consideration by the IRS Would Override Reasonable Cause Relief and Jeopardize Fundamental Taxpayer Rights (NTA Blog 8/29/18).

¹⁵⁶³ See § 874(a)(1) (foreign individual taxpayers) and § 882(c)(2) (foreign corporate taxpayers).

¹⁵⁶⁴ Reg. § 1.874-1(a) & (b)(1) and 1.882-4(a).

¹⁵⁶⁵ Reg. § 1.874-1(b)(2) and 1.882-4(a)(3)(ii).

¹⁵⁶⁶ Reg. § 1.874-1(b)(3). See U.S. Treasury Department Technical Explanation of U.S. Model Treaty 79 (2006), explanation of Article 24 (Nondiscrimination), paragraph 2 (note that there is a subsequent Model Treaty (2016) but it does not have a technical explanation; so the earlier technical explanation likely is a useful for interpretation the 2016 Model Treaty.

¹⁵⁶⁷ § 1.874-1(b)(4).

2. Information Returns.

The § 6651 penalties are ad valorem penalties -- i.e., they are based on the amount that would have been due with the return. If no tax is due, there is no penalty. This has a certain logic as to returns for which tax could be due but has no logic for returns where no tax is due. Information returns such as the various Forms 1099 for interest and dividends have no tax due and therefore an effective penalty system cannot be ad valorem based on the tax due. Section 6721 provides a penalty structure for failure to file information returns. The penalty applies if the return is not filed or if material information is left off the return.¹⁵⁶⁸ For 2023, as inflation adjusted, the penalty is \$310 per return up to a maximum of \$3,783,000.¹⁵⁶⁹ Lower penalties are permitted for smaller taxpayers,¹⁵⁷⁰ and the taxpayer can take prompt corrective measures that will mitigate the amount of the penalty.¹⁵⁷¹ Higher penalties are provided if the failure is due to intentional disregard.¹⁵⁷²

A key exception to this general penalty regime for information returns applies to the § 6050I information returns (CTRs) for trade or business cash receipts exceeding \$10,000. If the nonfiling is the result of “intentional disregard,” the penalty for any transaction is the greater of \$25,000 per return or the amount of cash involved up to \$100,000¹⁵⁷³ and the general limit of \$3,000,000 does not apply.¹⁵⁷⁴

Even when the Code does not impose a monetary penalty, there may be other adverse consequences that may attend failure to file information returns. For example, there is a special relief provision available for a service provider who might otherwise be classified as an employee to be treated as an independent contractor if he or she has been consistently treated as an independent contractor and the person for whom the services were provided filed the appropriate tax forms (in the case of an independent contractor, Forms 1099).¹⁵⁷⁵ As you can see, this relief, usually beneficial to the person to whom the services are provided, is unavailable if the filing requirement has not been met.

Related to the information returns a payor must file with the IRS are requirements that the payor furnish a correct payee statement (W-2, various Forms 1099 and a host of other such statements).¹⁵⁷⁶ The payees use these statements to assist in the meeting their tax return filing and tax payment obligations. Section 6724(a) imposes a penalty of \$250 per statement for failure to furnish the payee the required statement or failure to include all required information on the

¹⁵⁶⁸ § 6721(a)(2).

¹⁵⁶⁹ § 6721(a)(1), as amended by the Trade Preferences Extension Act of 2015, P.L. 114-27. These amounts are adjusted for inflation. § 6721(f). The amounts for 2023 are as indicated in the text. Rev. Proc. 2022-38; 2022-45 I.R.B. 1. Section 3.57

¹⁵⁷⁰ Rev. Proc. 2022-38; 2022-45 I.R.B. 1. § 3.57.

¹⁵⁷¹ § 6721(b)-(d). These too are subject to increase for inflation. Rev. Proc. 2022-38; 2022-45 I.R.B. 1. § 3.57.

¹⁵⁷² § 6721(e).

¹⁵⁷³ § 6721(e)(2)(C).

¹⁵⁷⁴ § 6721(e)(3).

¹⁵⁷⁵ This is known as § 530 relief, referring to that section in the Revenue Act of 1978. I discuss § 530 relief beginning on p. 96.

¹⁵⁷⁶ Payee statement is defined in § 6724(d)(2) to cover many types of payee statements by reference to the Code sections requiring the payee statements.

statement. The cap for such penalties in any calendar year is \$3 million. There is a reasonable cause exception for the penalty.¹⁵⁷⁷

G. Failure to Pay Penalty.

1. Failure to Pay Tax Reported on an Original Return.

Section 6651(a)(2) imposes a penalty for failure to pay an amount reported as tax on the original return.¹⁵⁷⁸ This failure to pay penalty is 0.5% per month up to 25%.¹⁵⁷⁹ The penalty base is the amount shown on the original return less the amount paid by the due date.¹⁵⁸⁰ The penalty commences accruing on the due date for payment (generally the original due date of the return).

Consider these examples to illustrate.

Example 1: Assume that, for year 01, the taxpayer has withheld \$9,000 which is deemed paid on the due date, 4/15/02. The taxpayer files his return on 4/15/02, reporting a tax liability of \$20,000, tax withheld credit of \$9,000 and resulting remaining tax liability due of \$11,000. The taxpayer pays the \$11,000 due on 4/15/02 along with his return. The IRS audits the 01 return in 2003 and, pursuant to the audit in which the tax liability is determined to be \$35,000, on 9/1/03 assesses additional tax of \$15,000 and sends the taxpayer notice and demand for payment. The taxpayer is not subject to a failure to pay penalty on the \$15,000 tax which was actually unpaid for the period from 4/15/02 to the date of the later assessment on 9/1/03.

Example 2: Same facts as Example 1, except that, instead of timely filing the 01 return on 4/15/02, the taxpayer files the year 01 original return on 2/1/03, showing the same tax liability of \$20,000 and net tax due of \$11,000 which he pays contemporaneously with the delinquent original return on 2/1/03. The taxpayer will be subject to the § 6651(a)(2) failure to pay penalty for the period from 4/15/02 to the date of filing the delinquent original return on 2/1/03. The base for the penalty will be \$11,000 (\$20,000 (tax liability reported) less \$9,000 (withheld tax paid by 4/15/02)). The number of months is 10 months, so the failure to pay penalty is 5%.

Example 3. Same facts as Example 1 (timely full paid return) but, instead of a subsequent IRS assessment pursuant to audit, the taxpayer files an amended return reporting the additional \$15,000

¹⁵⁷⁷ § 6724(a).

¹⁵⁷⁸ Where the taxpayer does not file an original return, the IRS may prepare substitute for returns (“SFRs”) under § 6020(b) which are subject to the late payment penalty in § 6651(a)(2) and (3). § 6651(g); see *Cabirac v. Commissioner*, 120 T.C. 163, 170 (2003), aff’d without published opinion, 94 A.F.T.R. 2d (RIA) 2004-5490 (3d Cir. 2004).

¹⁵⁷⁹ The maximum 25% penalty would require the expiration of 50 months. That is one of the reasons given for courts to determine that the normal three-year statute of limitations does not apply. See *United States v. Krasnow*, 548 F. Supp. 686, 689 (S.D.N.Y. 1982); see CCA 201713001 (3/31/17) (articulating and applying the rule in the context of re-assessing the § 6651(a)(2) after it had been erroneously abated under the First Time Abatement program).

¹⁵⁸⁰ § 6651(b)(2). Any tax paid on or before the due date for the return – such as withholding for the tax year – reduces the penalty. However, any income tax paid but refunded before the due date does not reduce the base for the penalty, so that the penalty applies to the net amount paid on the due date. *Crummey v. Commissioner*, 2017 U.S. App. LEXIS 5996 (5th Cir. 2017) (unpublished).

tax liability and pays the \$15,000 additional tax plus interest on the tax from the original due date. The failure to pay penalty will not apply to the period from the original due date for payment to the date of filing the amended return.

These examples illustrate what some people think is an illogical result. In fact, the taxpayer has underpaid his year 01 tax liability by \$15,000 after 4/15/02, the original due date. Why then does not the failure to pay penalty apply to the actual underpayment? The reason is that the § 6651(a)(2) penalty only applies to amounts which are reported on an original return and not paid. In Example 1, involving timely filing and timely payment of the entire tax reported on the return, there is no amount unpaid per the return to which the penalty applies. There is an unpaid amount—the amount ultimately determined to be due in excess of that previously reported—but the § 6651(a)(2) base is only the difference between the amount originally reported and the amount timely paid. Of course, although avoiding the failure to pay penalty, the taxpayer will have to pay the interest on the tax during the period of underpayment. And the taxpayer may be subject to the accuracy related penalty in § 6662 or the civil fraud penalty in § 6663 for the tax underreported on the return. In Example 2, there is a delinquent original return upon which to base the failure to pay penalty. And in Example 3, the amended return will not itself give rise to the failure to pay penalty (thus bringing the result in line with no penalty applying to the additional assessment arising from an IRS audit).

The penalty is not applicable if the taxpayer's failure to pay is due to reasonable cause. What is reasonable cause? A good example is financial hardship. Financial hardship is not an excuse for failing to file. But, if the taxpayer cannot pay because of financial hardship, that may be reasonable cause for failing to pay, at least in most Circuits.¹⁵⁸¹ In addition, applying the reasoning of *Boyle*, reliance on accountant as to the due date for payment will not constitute reasonable cause.¹⁵⁸²

Also, subsequent year events (e.g., NOL or credit carrybacks) that might ex post facto lessen the tax otherwise subject to the failure to pay penalty will not relieve the taxpayer of the failure to pay penalty in the interim.¹⁵⁸³

A taxpayer failing to file and failing to pay may be subject to both the failure to file and failure to pay penalties whereas a taxpayer filing and reporting but not paying will be subject to only the failure to pay penalty. However, during the period that both penalties apply, the failure to pay

¹⁵⁸¹ E.g., *Diamond Plating Co. v. United States*, 390 F.3d 1035, 1038-39 (7th Cir. 2004) (“We agree with the majority of circuit courts that have considered this issue, and recognize that financial hardship may constitute reasonable cause for abatement of penalties for nonpayment of taxes in some circumstances.”) (see cases cited and discussed in *Diamond Plating*); see also *Synergy Staffing, Inc. v. United States*, 323 F.3d 1157, 1160 (9th Cir. 2003) (noting that financial hardship may constitute reasonable cause, but “Evidence of financial trouble, without more, is not enough.”). However, there is a split in the circuits on this issue, with one court holding that financial difficulty not reasonable cause. See *Brewery, Inc. v. United States*, 33 F.3d 589 (6th Cir. 1994); see also *Staff-It, Inc. v. United States*, 482 F.3d 792 (5th Cir. 2007) (acknowledging a split in the circuits but declining to decide the issue for the Fifth Circuit since the taxpayer did not qualify under the facts and circumstances test anyway).

¹⁵⁸² *Baccei v. United States*, 732 F.3d 1140 (9th Cir. 2011).

¹⁵⁸³ *Shafmaster v. United States*, 707 F.3d 130 (1st Cir. 2013) (citing *Simon v. Commissioner*, 248 F.2d 869, 877 (8th Cir. 1957); Rev. Rul. 72-484, 1972-2 C.B. 638; and *Manning v. Seeley Tube & Box Co. of N.J.*, 338 U.S. 561, 565-66 (1950)).

penalty offsets the FTF penalty.¹⁵⁸⁴ This offset means, for example, that where the taxpayer files and pays in the fifth month of delinquency, the combined penalty will be 25% and, if the taxpayer files and pays in the 50th month (the maximum for the failure to pay penalty), the combined penalty will be 47.5%.¹⁵⁸⁵

A taxpayer may be fully paid (e.g., by withholding or estimated tax payments) but fail to file the return. In such cases, the taxpayer will be subject only to the minimum failure to file civil penalty. (The taxpayer, of course, might be subject to criminal prosecution for failure to file, but it would be a rare case indeed that the IRS would exercise its discretion to prosecute where the taxpayer had fully paid his taxes.)

First Time Abate (“FTA”) relief may be available for this penalty.¹⁵⁸⁶

2. Failure to Pay Assessed Tax.

Section 6651(a)(3) imposes a failure to pay penalty for tax that has not been paid within 21 days of notice and demand for assessed taxes¹⁵⁸⁷ unless the failure to pay is based on reasonable cause. For example, in Example 1 above, the IRS assesses the audit generated tax of \$15,000 on 9/1/03 and sends the proper notice and demand. There is a grace period of 21 days (10 days if tax equals or exceeds \$100,000) to pay without this penalty, but if not paid in the period, the penalty applies from the date of the assessment.¹⁵⁸⁸

First Time Abate relief is available for this penalty.¹⁵⁸⁹

3. Failure to Pay Estimated Taxes.

We covered earlier the general concept of the estimated tax system for prepaying tax liability prior to the statutory due date (April 15 of the succeeding year for individuals). Taxpayers failing to pay estimated taxes are subject to the estimated tax penalty.¹⁵⁹⁰ Corporations and individuals are subject to the penalty. We cover the penalty for individuals here since that is the most frequently encountered in practice.

The amount of the penalty is the general underpayment interest rate under § 6621 calculated on the installment amount¹⁵⁹¹ based on the “required annual payment” from the date the estimated

¹⁵⁸⁴ § 6651(c)(1). This offset is not available, however, if the minimum FTF penalty (rather than the percentage ad valorem penalty) applies.

¹⁵⁸⁵ IRS Web Page titled FAQs Collection Procedural Questions 3 (reviewed or last updated 9/6/18 and accessed 12/9/18) (“The maximum total penalty for failure to file and pay is 47.5% (22.5% late filing and 25% late payment) of the tax.”).

¹⁵⁸⁶ IRM 20.1.1.3.3.2.1 (03-29-2023), First Time Abate (FTA).

¹⁵⁸⁷ Tax assessed based on an § 6020(b) SFRs are subject to the late payment penalty. § 6651(g).

¹⁵⁸⁸ Similar grace periods apply for the accrual of interest from the date of assessment in § 6601(e)(3).

¹⁵⁸⁹ IRM 20.1.1.3.3.2.1 (03-29-2023), First Time Abate (FTA)

¹⁵⁹⁰ § 6654 for individuals and § 6655 for corporations.

¹⁵⁹¹ The installment amount is generally 25% for each installment (i.e., there are 4 installments). An annualized method can be used if it produces better results. § 6654(d)(2).

installment is due to the earlier of the date the tax is paid or the original due date of the return.¹⁵⁹² The required annual payment is defined as the lesser of 90% of the tax shown on the return for the year or 100% of the tax shown on the prior year return (subject to increase in the case of taxpayers with gross income over \$150,000).¹⁵⁹³ The penalty does not apply if (i) the tax shown on the return or tax due if no return was filed is less than \$1,000 and (ii) there is no tax due on the prior year return covering a full 12 months and the taxpayer was a citizen or resident of the U.S. for the entire year.¹⁵⁹⁴

The penalty is waivable if the IRS “determines that by reason of casualty, disaster, or other unusual circumstances the imposition of such addition to tax would be against equity and good conscience.”¹⁵⁹⁵ In addition, the penalty is not due if the IRS determines that the underpayment was after the taxpayer retired after age 62 or became disabled.¹⁵⁹⁶ The Code confers no waiver of the corporate penalty otherwise due.

The penalty is, of course, the Code’s incentive for the taxpayer to pay the estimated tax installment when it is due. And the penalty functions more as an interest charge on the amount that should have been paid (i.e., the taxpayer by not paying has the use of the money and is paying a charge for that interim use of the estimated tax amount).

H. Failure to Deposit.

Section 6656 imposes a penalty for failure to deposit as required by the Code. The Code has a number of deposit requirements whereby certain payors making payment to certain payees are required to withhold from the payments and deposit the withheld amounts, not with respect to the payor’s tax liability but with respect to the payee’s tax liability. The classic example is that the payor of wages who is required to withhold income tax and FICA tax from employees and periodically deposit the withheld amount with the IRS or a depository institution.¹⁵⁹⁷ As with the failure to pay penalty discussed above, the penalty can be avoided if the failure to pay is “due to reasonable cause.”¹⁵⁹⁸ In addition, the penalty can be waived in certain cases, generally as to first time smaller taxpayers.¹⁵⁹⁹

The penalty based on the “underpayment,” defined as “the excess of the amount of the tax required to be deposited over the amount, if any, thereof deposited on or before the date prescribed

¹⁵⁹² § 6654(a) & (b) and § 6655(a) & (b).

¹⁵⁹³ § 6654(d)(1)(B) & (C). It is important to note the focus on the current year return and the prior year return. Assuming each of the returns was filed, they may have substantially underreported the actual tax liability, but still the reference point is the return as filed. There are, of course, penalties that may apply if the taxpayer files an inappropriate return. If, of course, the taxpayer files no return for the current year, the reference point will be the tax actually due. See *Mendes v. Commissioner*, 121 T.C. 308 (2003) (rejecting a taxpayer attempt to file a substantially delinquent return showing no tax due as a basis for avoiding the penalty based on a literal reading of the statute).

¹⁵⁹⁴ § 6654(e)(2).

¹⁵⁹⁵ § 6654(e)(3)(A).

¹⁵⁹⁶ § 6654(e)(3)(B).

¹⁵⁹⁷ §§ 3102(a) and 3402(a).

¹⁵⁹⁸ § 6656(a).

¹⁵⁹⁹ § 6656(c).

therefor.”¹⁶⁰⁰ The percentages applied to the underpayment are time-based: (i) 2% for not more than 5 days; (ii) 5% if for 6-15 days; and 10% for more than 15 days.¹⁶⁰¹

First Time Abate relief is available for this penalty.¹⁶⁰²

I. Frivolous Returns.

Section 6702(a) imposes a \$5,000 fine for filing “what purports to be a return of tax”¹⁶⁰³ where both of the following are met: (i) omits information or contains information resulting in a substantially incorrect documents and (ii) is based on a position identified by the IRS as frivolous¹⁶⁰⁴ or “reflects a desire to delay or hinder tax administration.”¹⁶⁰⁵ The IRM provides that the IRS will notify the taxpayer filing a frivolous return and allowed 60 days to file a proper return; if he does so, the penalty will not be assessed.¹⁶⁰⁶ This penalty applies in addition to any other penalty that may apply.

Section 6702(b) imposes a parallel \$5,000 penalty for a “specified frivolous submission.” Such submissions include various forms of relief in IRS collection activity, including applications for compromise or installment agreements and requests for a collection due process hearing.¹⁶⁰⁷ The submission is subject to the penalty if based on a position the IRS “has identified as frivolous” or “reflects a desire to impede the administration of Federal tax laws.”¹⁶⁰⁸ I cover these collection activities below in Ch. 12. The penalty is \$5,000. If the IRS provides notice of the frivolous position and the taxpayer withdraws the submission within 30 days of the notice, the penalty does not apply; however, the statute does not seem to require the IRS to give the notice that is the predicate for the 30 day period.

The § 6702 penalties are not subject to the deficiency procedures.¹⁶⁰⁹ They are assessable without a predicate notice of deficiency. This means that they may not be litigated in the Tax Court,¹⁶¹⁰ which historically meant that they could only be litigated in a refund suit. The taxpayer can pay the penalty assessed and contest liability by the usual procedures of filing a claim for refund and, if denied, a suit for refund. To avoid the *Flora* full payment rule for refund suits, the preparer can (i) within 30 days of the assessment’s notice and demand, pay 15% of the penalty and file a

¹⁶⁰⁰ § 6656(b)(2).

¹⁶⁰¹ § 6656(b)(1)(A).

¹⁶⁰² IRM 20.1.1.3.3.2.1 (03-29-2023), First Time Abate (FTA),

¹⁶⁰³ In the case of multiple filings (via copy) of an original return, only the first filing will be subject to the penalty. *Kestin v. Commissioner*, 153 T.C. 14 (2019)

¹⁶⁰⁴ § 6702(a)(2). For frivolous positions, the provision references § 6702(c) which directs the IRS to “prescribe (and periodically revise) a list of positions which the Secretary has identified as being frivolous for purposes of this subsection.” The IRS has done so by Notice 2010-33, 2010-17 I.R.B. 609.

¹⁶⁰⁵ Filing a correct and complete return without payment of tax indicated due along with a letter making a frivolous claim as to why no payment is enclosed is not subject to this penalty.

¹⁶⁰⁶ IRM 5.20.10.4.3 (10-05-2018), Responding to Frivolous Filings Subject to Penalty Under IRC 6702(a).

¹⁶⁰⁷ § 6702(b)(2)(B).

¹⁶⁰⁸ § 6702(b)(2)(A).

¹⁶⁰⁹ § 6703(b). Penalties or other impositions not subject to the deficiency procedures are often called “assessable penalties.”

¹⁶¹⁰ *Van Es v. Commissioner*, 115 T.C. 324, 328-29 (2000).

claim for refund and (ii) then file the refund suit in district court by the earlier of (a) 30 days from the denial of the claim or (b) 6 months and 30 days from the date the refund claim was filed.¹⁶¹¹ If the taxpayer pursues this special remedy, collection procedures on the balance will be suspended and the statute of limitations on collection will also be suspended. In addition, to the special procedure for partial payment and suit for refund, penalties subject to this rule (i.e., §§ 6701 and 6702) may be litigated in CDP procedures.¹⁶¹²

The Government bears the burden of persuasion on the penalty and, necessarily, the initial burden of production.¹⁶¹³

Section 6702(d) allows the IRS discretionary authority to reduce the § 6702 penalties “if the Secretary determines that such reduction would promote compliance with and administration of the Federal tax laws.” Under this authority, the IRS has prescribed relief on a one-time basis for outstanding unpaid § 6702 penalties upon the party’s request, provided that the party “must abandon any frivolous positions regarding the Federal tax laws” and meet certain specific eligibility requirements.¹⁶¹⁴ The relief is to reduce the penalties to \$500.

Congress enacted Collection Due Process procedures which I discuss later in the Collection Chapter. The Tax Court has held that, in the Collection Due Process cases, amended § 6330(d)(1) gives the Tax Court jurisdiction to decide the merits of the IRS’s assessment of the frivolous return penalties.¹⁶¹⁵

¹⁶¹¹ § 6703(c); compare the same wording for special refund suit for return preparer penalties in § 6694(c). If the person subject to the penalty assessment does pursue this special remedy timely, the full *Flora* prepayment rule will apply for refund jurisdiction. *Karobkin v. United States*, 988 F.3d 975, 976 (9th Cir. 1993) (per curiam); and *Thomas v. United States*, 755 F.2d 728 (9th Cir. 1985).

In a case, such as § 6700, where it is possible that more than one individual or entity can be subject to the same quantum of penalty based on the same underlying transaction, the 15% payment rule requires that each individual or entity assessed pay the 15% to satisfy this payment prerequisite. *DAC Management, LLC v. United States*, 275 F. Supp. 3d 928 (N.D. Ill 2017) (although noting that it may be correct that substantively, asserting “an equal penalty [on multiple actors] based on the same underlying conduct is substantively unlawful,” citing *In re MDL-731 Tax Refund Litig.*, 989 F.2d 1290, 1304-05 (2d Cir. 1993)).

¹⁶¹² *Gardner v. Commissioner*, 145 T.C. 161 (2015), citing *Williams v. Commissioner*, 131 T.C. 54, 58 n.4 (2008); *Harry v. Commissioner*, T.C. Memo. 2009-206; *Callahan v. Commissioner*, 130 T.C. 44 (2008).

¹⁶¹³ § 6703(a). One issue is the magnitude of the burden of persuasion: is it preponderance or clear and convincing. In cases involving the § 6700 penalty, also subject to § 6703(a), courts have applied the preponderance of the evidence standard. See *Davison v. Commissioner*, T.C. Memo. 2020-58, at *49-*50 (2020) (and cases cited). In *Lemay v. Commissioner*, 2021 U.S. App. LEXIS 26557 (10th Cir. 2021) (Nonprecedential), the Tax Court applied the preponderance standard, but the Court of Appeals declined to decide which standard applied in a § 6700 case because, under either standard, the petitioner was liable for the penalty.

¹⁶¹⁴ Rev. Proc. 2012-43, 2012-49 I.R.B. 1. The eligibility requirements include: (i) filing all tax returns and paying all outstanding taxes, penalties (other than § 6702 penalties), and related interest; (ii) filing the reduction request before the government files suit against the individual, either for collection of the penalty or to reduce any assessment of the penalty to judgment; (iii) no prior § 6702 reduction; and (iv) no prior reduction of a § 6702 penalty and an offer in compromise, partial payment installment agreement, or closing agreement that includes any § 6702 penalty.

¹⁶¹⁵ *Callahan v. Commissioner*, 130 T.C. 130(2008)

The Tax Court held that the § 6702 penalty has no “readily observable statute of limitations.”¹⁶¹⁶ We discussed above that courts might “borrow” a statute of limitations from some related provision. For example, returns have a statute of limitations; hence, a court might be willing to borrow that statute for a frivolous return, but has not done so to date.¹⁶¹⁷

J. Refund Claims.

1. Refund Claims Without Reasonable Cause.

Section 6676 imposes a 20% penalty for claims for income tax refund or credit in “an excessive amount, unless it is shown that the claim for such excessive amount is due to reasonable cause.”¹⁶¹⁸ The reasonable cause exception is based on the reasonable cause exception to the accuracy related penalty in § 6664(c), so that the authorities applicable for that exception should apply for the § 6676 exception. Specifically excepted from “reasonable cause” are refunds or credits attributable to noneconomic substance transactions described for the accuracy related penalty,¹⁶¹⁹ The penalty does not apply to any portion of the “excessive amount” that is subject to the other income tax penalties, such as the accuracy related penalty or the civil fraud penalty.¹⁶²⁰

As worded, the penalty applies if the claim is excessive unless the taxpayer affirmatively shows that it has reasonable cause; presumably, however, the IRS will make some attempt to see if the claim has reasonable cause before asserting the penalty and shifting the proof to the taxpayer. Excessive amount is the amount of the claim less the refund allowable. Unlike the accuracy related penalty, this penalty is assessable, meaning that it is not subject to the deficiency procedures allowing a prepayment litigation opportunity.¹⁶²¹ The accuracy related penalties discussed earlier do

¹⁶¹⁶ *Crites v. Commissioner*, T.C. Memo. 2012-267, at *11-*12.

¹⁶¹⁷ In *Crites*, the Tax Court held that, because the penalty was assessed within the three-year period from the date the penalized frivolous amended return was filed, even if the three-year period were borrowed, the assessment was timely. The Tax Court specifically said that it was not deciding that the penalty was subject to the three-year statute of limitations.

¹⁶¹⁸ As originally enacted in 2007, the exception to the penalty was for “reasonable basis.” Pub. L. 110–28, title VIII, § 8247(a), May 25, 2007. The exception was changed to “reasonable cause” in 2018, apparently on the recommendation of the Taxpayer Advocate in her 2014 Report to Congress (Legislative Recommendation #8) so that all the taxpayer’s facts and circumstances could be considered before the penalty is applied. For discussions of the differences in the standards and reasons for the change, see the Taxpayer Advocated recommendation and Michael Saltzman Treatise, ¶ 11.2[3] (Thomsen Reuters 2015).

¹⁶¹⁹ § 6676(c), referred to § 6662(b)(6) which, in turn, refers to incorporates “section 7701(o) or failing to meet the requirements of any similar rule of law.”

¹⁶²⁰ § 6676(d).

¹⁶²¹ The IRS ruled in informal procedural advice that, if the penalty were asserted contemporaneously with a notice of deficiency (rather than just denial of the claim), the § 6676 penalty should be asserted in the notice, thus perhaps giving the Tax Court jurisdiction over the penalty if the taxpayer filed a petition in response to the notice. PMTA 2014-15 (Aug. 6, 2014). Some commentators questioned possible Tax Court jurisdiction over the penalty, and, of course, the IRS can’t create jurisdiction. See Carl Smith, *Kahanyshyn v. Comm’r: Tax Court Rules It Lacks Deficiency Jurisdiction Over Sec. 6676 Excessive Refund Claim Penalty* (Procedurally Taxing 2/11/16). In a nonprecedential order, a Tax Court, the Tax Court rejected Tax Court jurisdiction over the penalty. *Kahanyshyn v. Commissioner*, order dated 2/10/16 (referring to an earlier order dated 9/14/15 which dismissed the penalty issue because it is an assessable penalty not subject to the deficiency procedures; the issue is discussed and linked in the article just cited). The IRS uses the Form 8278, Computation and Assessment of Miscellaneous Procedures, to assess the § 6676 penalty. See IRS Internal (continued...)

not apply because they apply the penalty percentage to the underreported tax liability. Where the tax has been reported and paid and a refund is requested, there is no underreported tax liability, thereby escaping the accuracy related penalties. Accordingly, prior to § 6676, some practitioners felt that it was better to assert aggressive positions on a claim for refund to avoid the accuracy related penalties. The IRS and Congress were concerned that there was significant gaming of the system—specifically, the IRS’s strained resources—by taking this risk-free approach to aggressive refund claims. Section 6676 now imposes risk unless the taxpayer has a reasonable cause for the refund claimed.¹⁶²²

The Code does not provide a statute of limitations for assessment of the erroneous refund penalty, but as I note elsewhere in the textual discussion of statute of limitations, courts will often import a statute from a related provision and it is likely that Congress will amend the Code to provide a statute of limitations.¹⁶²³

The erroneous refund penalty is an assessable penalty that is not subject to the deficiency procedures except in certain limited circumstances.¹⁶²⁴

2. Refund Claims Where No Tax Paid.

If a taxpayer files a fraudulent refund claim to recover tax in an amount that exceeds the tax paid, the taxpayer may be subject to triple forfeiture in the amount of the tax so fraudulently claimed (i.e., the excess claimed over the amount of tax paid).¹⁶²⁵

K. Penalties Applicable to Nontaxpayers (Enablers).

The foregoing penalties apply to taxpayers. However, as we know from the abusive tax shelter arena, other persons are more than willing to aid taxpayers in underpaying their taxes. Their conduct has been the focus of various penalties.¹⁶²⁶

1. Tax Shelter Related Penalties.

The Code provides several penalties targeted to tax shelter activity. I deal in more detail with these penalties later (beginning p. 848).

¹⁶²¹(...continued)

FAQs, at Q 10, reproduced at 2010 TNT 153-24.

¹⁶²² An argument has been made that the penalty may be unconstitutional. Derek T. Ho & Christopher Klimmek, Penalizing Tax Petitions: Why the Erroneous Refund Penalty in Code § 6676 Violates Taxpayers’ First Amendment Rights, 68 Tax Law. 463 (2015). The argument is a long-shot.

¹⁶²³ See IRS Internal FAQs, at Q 12, reproduced at 2010 TNT 153-24, noting the absence of an explicit statute of limitations, recommending a “best practice” of assessing within 3 years, and advising that Chief Counsel has submitted a proposal for a legislative change to provide a statute of limitations.

¹⁶²⁴ IRM 8.11.1.3.7(4) (07-03-2019), IRC 6676; IRM 20.1.5.18.4 (04-22-2019), Case Procedures WITH Deficiency Procedures.

¹⁶²⁵ § 7304.

¹⁶²⁶ See generally Jay A. Soled, Third-Party Civil Tax Penalties and Professional Standards, 2004 Wis. L. Rev. 1611 (2004).

2. Aiding and Assisting Understatement of Tax.

Section 6701 imposes a penalty on any person who (1) aids, assists, procures, or advises with respect to the preparation or presentation of any portion of a return, affidavit, claim, or other document, (2) knows (or has reason to believe) that the document will be used in connection with any material matter arising under the internal revenue laws, and (3) knows that the document would result in an understatement of another person's tax liability.¹⁶²⁷ As stated in the statutory text, the penalty can apply even if the document is not actually submitted to the IRS.¹⁶²⁸

The penalty is \$1,000 (increased to \$10,000 for corporate returns) for each false document for each taxpayer for each tax period affected by the document (but no more than one penalty per period).¹⁶²⁹ This penalty is the civil penalty analog to the tax crime of aiding and assisting, § 7206(2).¹⁶³⁰ The penalty is not related to the amount of understated tax.

This penalty is typically assessed against tax return preparers but may apply to others who meet the elements and contribute to the making of the understatement. For example, an appraiser rendering a materially false valuation opinion that underlies false charitable contribution claims on a return may be subject to the penalty.¹⁶³¹

¹⁶²⁷ The penalty is the civil counterpart of the aiding and assisting crime in § 7206(2). S. Rep. No. 97-494, at 1022 (1982). One key difference is that the criminal penalty requires “willful” conduct (specific intent to violate a known legal duty), whereas the § 6701 penalty requires only that the preparer “know” the document will be used to understate a taxpayer’s tax liability. The knowledge required is only that the preparer know the facts and the ultimate result of the conduct. E.g., *Kapp v. Commissioner*, T.C. Memo. 2019-84, at *101) (citing cases).

¹⁶²⁸ *Kapp v. Commissioner*, T.C. Memo. 2019-84, at *110.

¹⁶²⁹ § 6701(a) and (b)(3) (one penalty per taxpayer per period); *Mitchell v. United States*, 977 F.2d 1318 (9th Cir. 1992); and CCA 201805001 (10/26/17)(overstatement of depreciation in original and subsequent years merely by carrying forward the false and deducting them in later years subject to penalty in each return affected). By contrast, if the original return claimed a credit or deductions that are carried forward rather than “earned” in the later years, the penalty may only apply to the original year of the credit or deduction carried forward. *Mattingly v. United States*, 924 F.2d 785, 792-93 (8th Cir. 1991); and *Emanuel v. United States*, 705 F. Supp. 434 (N.D. Ill. 1989) (distinguished CCA 201805001 (10/26/17).

¹⁶³⁰ Conf. Committee Report 97 H. Rept. 760 (describing current law providing the criminal penalty in § 7206(2) and adopting the civil penalty); S. Rep. No. 97-494, at 1022 (1982). Two points:

First, a key difference is that the criminal penalty requires “willful” conduct (the *Cheek* standard of specific intent to violate a known legal duty), whereas the § 6701 penalty requires only that the preparer “know” the document will be used to understate a taxpayer’s tax liability. E.g., *Kapp v. Commissioner*, T.C. Memo. 2019-84, at *101) (citing cases). A specific intent to violate a known legal duty is not required.

Second, the header for § 6701 uses the term “aiding and abetting.” The term abet is one familiar from the criminal law. 18 U.S.C. § 2 (making a person who “abets” a crime punishable as a principal). The text of § 6701, however, uses the term “aids or assists in” rather than the word abets. As noted, § 6701 thus parallels a related criminal provision. § 7206(2) (“willfully aids or assists in”). There is at least one key difference between 18 U.S.C. § 2 and § 7206(2). The former requires the commission of the underlying offense but the latter does not. *United States v. Griffin*, 814 F.2d 806, 811 (1st Cir. 1987). Section 7206(2) does not require proof of the taxpayer’s or any other person's guilty knowledge or participation in any crime. All it requires proof of is that the defendant (not the taxpayer) committed the crime of aiding and assisting. See *United States v. Motley*, 940 F.2d 1079, 1082 (7th Cir. 1991). Presumably the same concept applies for purposes of § 6701, despite the reference to “abets” in the title.

¹⁶³¹ Reg. § 1.170A-13(c)(5)(D). See also authorities, including legislative history and cases, discussed in CCA 200512016, unofficially reproduced at 2005 TNT 58-24.

The Government, by statute, has the “burden of proof.”¹⁶³² There is an open issue of whether the Government must prove the elements of this penalty by a preponderance of the evidence or by clear and convincing evidence, which is the standard of proof for civil tax penalties involving fraud.¹⁶³³

The § 6701 penalty may be contested in one of the following manners:

- A traditional refund suit in the district court or Court of Federal Claims, which requires full payment under the *Flora* rule (subject to mitigation by the divisible tax concept).
- A special refund suit which mitigates the *Flora* rule by requiring only 15% payment.¹⁶³⁴ This mitigation rule requires that (i) within 30 days of the assessment’s notice and demand, the person assessed the penalty pay 15% of the penalty and file a claim for refund and (ii) then file the refund suit in district court by the earlier of (a) 30 days from the denial of the claim or (b) 6 months and 30 days from the date the refund claim was filed.¹⁶³⁵ If the taxpayer pursues this special district court remedy, collection procedures on the balance will be suspended and the statute of limitations on collection will also be suspended.¹⁶³⁶
- In Tax Court CDP proceedings where the underlying liability is properly at issue.¹⁶³⁷

There is no statute of limitations for this penalty.¹⁶³⁸

I am not certain on this, but I believe interest on the penalty runs from the date of assessment.

L. Penalty Administration.

1. Authority to Assess; Written Approval; Notice.

Penalties are serious business. They should not be lightly asserted nor, on the other hand, should the IRS be reticent to assert penalties in appropriate cases. The IRS has been accused of both

¹⁶³² § 6703(a). Most courts say that the burden is by preponderance rather than clear and convincing, although the issue may not be settled. See p. 381 n. 1613.

¹⁶³³ *United States v. Carlson*, 754 F.3d 1223 (11th Cir. 2014) (holding that clear and convincing evidence standard applies; *Carlson* created a conflict with other Circuits on this issue and has a good discussion of the conflicting positions); see also *Kapp v. Commissioner*, T.C. Memo. 2019-84, at *98) noting the key cases, most of which hold that the preponderance of the evidence standard applies, but not resolving the conflict with *Carlson* because the evidence established liability by clear and convincing evidence.

¹⁶³⁴ For both mitigation rules, see *Humphrey v. United States*, 854 F. Supp. 2d 1301 (N.D. Ga. 2011). The 15% payment opportunity is in § 6703(c).

¹⁶³⁵ § 6703(c).

¹⁶³⁶ § 6703(c).

¹⁶³⁷ *Gardner v. Commissioner*, 145 T.C. 161 (2015), citing inter alia *Williams v. Commissioner*, 131 T.C. 54, 58 n.4 (2008); see also *Kapp v. Commissioner*, T.C. Memo. 2019-84, at *93-*94).

¹⁶³⁸ *Mullikin v. United States*, 952 F.2d 920 (6th Cir. 1991) (no statute, rejecting application of 5-year default statute of limitations in 28 U.S.C. § 2462); *Lamb v. United States*, 977 F.2d 1296 (8th Cir. 1992); and *Armstrong v. United States*, 2019 U.S. Dist. LEXIS 103604 (N.D. Cal. 2019) (collecting cases and discussing the inapplicability of the general penalty catch all five-year statute of limitations under 28 U.S.C. § 2462).

and using the threat or actual assertion of penalties as a bargaining chip to achieve concessions on the underlying tax liability.¹⁶³⁹ Section 6751 imposes certain requirements on the IRS's assertion of penalties.

First, § 6751(a) requires that, in each notice of penalty, the IRS state the name of the penalty, the Code section and the computation of the penalty.¹⁶⁴⁰

Second, § 6751(b)(1) prohibits the assessment of a penalty “unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.”¹⁶⁴¹ Although not stated in the statute, legislative history cited by the courts in interpreting the provision indicates that a purpose of the requirement is to prevent agents from improperly using the threat of a penalty as inappropriate leverage—a “bargaining chip”—to extract concessions when the IRS institutionally had not made a determination to assert a penalty.¹⁶⁴² The wording of the statute, however, is textually nonsensical because there is no such thing in the tax law as the determination of an assessment and, in any event, the assessment comes long after the threat of penalties could have been made to bully taxpayers.¹⁶⁴³ In statutory interpretation lingo, if not nonsensical, the statutory text is “ambiguous,” a characterization which has spawned many opinions as the courts try to deal with the deficiencies in the statutory text through purposive interpretation strategies to apply the text as the courts think or speculate Congress intended but did not say in the statutory text. Section 6751(b) is a quintessential case illustrating this struggle to interpret and apply “ambiguous”

¹⁶³⁹ See *Graev v. Commissioner*, 147 T.C. 460, 512, text and footnote at fn. 11 (2016) (*Graev II*) (Gustafson, J., dissenting, citing the legislative history, S. Rept. No. 105-174, at 65 (1998), 1998-3 C.B. 537, 601, including testimony of a practitioner). *Graev II* was reversed on other grounds in *Graev v. Commissioner*, 149 T.C. 485 (2017) (reviewed opinion, *Graev III*).

¹⁶⁴⁰ In *Graev v. Commissioner*, 147 T.C. 460 (2016) (reviewed opinion, *Graev II*), the notice of deficiency asserted as a principal position a 40% accuracy related penalty and included the calculated 40% amount in the deficiency notice. The notice also asserted, as an alternative, if the 40% penalty did not apply, a 20% accuracy related penalty but did not separately calculate the 20% penalty; indeed the notice showed, although asserting the 20% penalty, calculated it as zero because, since the penalties are not “stackable,” the 20% penalty amount would be subsumed in the 40% penalty calculation. The IRS then conceded the 40% penalty. The taxpayer urged that, since there was no separate calculation and assertion of the 20% penalty, § 6751(a)'s requirements had not been met and therefore no penalty could be considered in the Tax Court proceeding. The Court rejected the claim. The latter holding of *Graev II* was reversed in *Graev v. Commissioner*, 149 T.C. 485 (2017) (reviewed opinion, *Graev III*), although the Court held that, in the *Graev* case, the written approval requirement had been met.

¹⁶⁴¹ The requirement was designed to ensure “that penalties should only be imposed where appropriate and not as a bargaining chip.” S. Rept. No. 105-174, at 65 (1998). Accordingly, since the provision was directed at IRS conduct, it does not apply to penalties imposed initially by the Tax Court, such as the § 6673(a)(1) penalty for delay or frivolous positions in the Tax Court. *Williams v. Commissioner*, 151 T.C. 1 (2018).

The requirement is that written approval be obtained by the initial approval. Preliminary notices that warn of a possible penalty are not initial determinations. *Kestin v. Commissioner*, 153 T.C. 14 (2019).

¹⁶⁴² S. Rept. No. 105-174, at 65 (1998), 1998-3 C.B. 537, 601; *Roth v. Commissioner*, 922 F. 3d 1126, 1133 (10th Cir. 2019); and *Tribune Media Company v. Commissioner*, T.C. Memo. 2020-2, at * 14.

¹⁶⁴³ E.g., *Belair Woods, LLC v. Commissioner*, 154 T.C. 1, 7-15 (2020) (reviewed opinion; plurality opinion by 8 out of 16 judges) (says the phrase has no ordinary meaning in the IRC (calling the statutory phrase a “hapax legomenon, a word or phrase that occurs only once in a document or corpus” (here the IRC) and calling the statutory text ambiguous which permits the creative interpretations that have arisen.) The majority opinion in *Belair Woods* has a good summary of the trajectory.

statutory text on an ad hoc, case by case basis to interpret the “law” that can then be applied in future cases.

I attempt to bullet-point key features of the statutory prohibition under the current state of play. I state the current state of play in general overview, but do not develop many of the nuances, some of which are yet to come.¹⁶⁴⁴ There undoubtedly will be further refinements as the courts address various unique fact patterns, so stay tuned.¹⁶⁴⁵ With those caveats, here is my summary:

- A predicate requirement is that a penalty¹⁶⁴⁶ be involved. If the Code calls the exaction a penalty, it will be treated as a penalty for this purpose even if, as interpreted it may be viewed as serving some other function such as, in the case of the Trust Fund Recovery Penalty, § 6672, which may be called a secondary collection mechanism rather than a penalty.¹⁶⁴⁷ Similarly, if Code calls the exaction

¹⁶⁴⁴ Judge Holmes offered the following in his concurring opinion in *Graev III*, decided in 2017, at p. 503: Section 6751 has been in the Code for nearly twenty years. Adopting this reading as our own, and rolling it out nationwide, amounts to saying that we have been imposing penalties unlawfully on the tens of thousands--perhaps hundreds of thousands--of taxpayers who have appeared before us in that time. It is quite a counterintuitive result to those with a working knowledge of tax vocabulary and procedure; it will have unintended and irrational consequences unless corrected by additional appellate review or clarifying legislation; it is contrary to the text of the Code, whether viewed by itself or in light of a seemingly applicable canon of construction--and I predict it will even end up harming taxpayers unintentionally.

¹⁶⁴⁵ This appears to me to be a classic case where a well-considered statutory amendment or, failing that, comprehensive interpretive regulations could clean up the mess. The courts have already found the statute ambiguous, the condition required for “reasonable” interpretive regulations. *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984). By adopting well-considered interpretive regulations, the IRS could essentially moot out the plethora of prior and future court machinations to deal with the problem. See *National Cable & Telecommunications Assn. v. Brand X Internet Services*, 545 U.S. 967, 981 (2005) (permitting the agency to adopt interpretive regulations contrary to prior judicial interpretations so long as the prior judicial interpretations are not compelled by the text of the statute, which would not be true here because the statute is ambiguous). I don’t think reversal of the court interpretations of § 6751(b) would be foreclosed under *Brand X* by prior judicial precedent that foreclose the agency new interpretation as occurred in *United States v. Home Concrete & Supply, LLC*, 566 U.S. 478 (2012). An interpretive regulation, with notice and comment, by Treasury, the expert on IRS processes and the big picture, would likely produce a more holistic set of interpretations than courts can do anecdotally as unique cases arise. The problem with the regulations approach is that final regulations could take a very long time, perhaps a couple of years. But, since the regulations would be interpretive, Treasury could adopt a Temporary Regulation and, provided that the final Regulation is adopted within three years, the Temporary Regulation could be effective immediately (§ 7805(e)) and the final Regulation could be effective from the date of the Temporary Regulation (§ 7805(b)). And, perhaps even, the Temporary and Final Regulations might be persuasive authority under *Skidmore v. Swift & Co.*, 323 U.S. 134 (1944) for application retroactively to the date of the statute for any case still in pipeline or getting there involving conduct prior to the effective date of the Temporary Regulation. Such retroactive application beyond the limits imposed by § 7805 is a long subject, I think that the interpretation might apply retroactively with the only limit being that the interpretation be within the scope of § 6751(b)’s ambiguity from the enactment of the statute.

¹⁶⁴⁶ Section 6751(c) defines penalty to include “addition to tax or any additional amount.” The courts construe the inclusion language as referring to penalties enumerated as such in chapter 68, subchapter A. *Grajales v. Commissioner*, 156 T.C. 55, 57-59 (2021), aff’d 47 F.4th 58 (2d Cir. 2022) (both holding that the § 6751(b) does not apply to the 10% early withdrawal “cost,” described in § 72(t) as an “additional tax.” Accordingly, in the text I state the requirement as that a penalty be involved.

¹⁶⁴⁷ *Chadwick v. Commissioner*, 154 T.C. 84, 90-94 (2020). Without getting into the weeds on the issue, I think there are arguments that the penalty is a tax or collection mechanism for the tax rather than a penalty that should (continued...)

a tax rather than a penalty, then it will not be treated as a penalty, even if it seems to serve a function like a penalty.¹⁶⁴⁸

- The most significant issue has been the timing of the written approval. Once the courts accepted that timing must be before the assessment despite the statutory text, the issue is to identify the timing of the “initial determination” required for the written approval. The statutory text provides no guide for determining that earlier timing, but by focusing on the requirement for an “initial determination” and the purpose indicated in the legislative history,¹⁶⁴⁹ courts have concluded that, since a determination in the tax law, “denotes a communication with a high degree of concreteness and formality,” the initial determination is “the document by which the Examination Division formally notifies the taxpayer, in writing, that it has completed its work and made an unequivocal decision to assert penalties.”¹⁶⁵⁰ Another general standard recently proposed by the Ninth Circuit is that “§ 6751(b)(1) requires written supervisory approval before the assessment of the penalty or, if earlier, before the relevant supervisor loses discretion whether to approve the penalty assessment.”¹⁶⁵¹ In that case, for an assessable penalty, that point would be immediately before the assessment; in a deficiency case, that would be immediately before the notice of deficiency is sent (or perhaps the 30-day letter).¹⁶⁵² These statements of a standard offer somewhat fuzzy guidance and may not be consistent. So guidance must be found, particularly outside the Ninth Circuit, in the plethora of cases dealing with varying fact patterns. In the context of an income tax audit, the latest date for the initial determination is the 30-day letter (or an equivalent (including the 60-day letter in a TEFRA audit) sent to the taxpayer) stating Examination’s determination to assert one or more penalties and offering the taxpayer a right to contest the determination in Appeals.¹⁶⁵² Even a Form 4549, Income Tax Examination Changes, delivered to

¹⁶⁴⁷(...continued)

be subject to § 6751(b). The IRS may appeal *Chadwick* or continue to litigate in other fora. Readers wanting to pursue the matter may want to consider. Keith Fogg, [Graev and the Trust Fund Recovery Penalty](#) (Procedurally Taxing Blog 2/7/20); Bryan Camp, [Lesson From The Tax Court: §6672 Trust Fund Recovery Penalty Is Really A Penalty ... Sort Of](#) (Tax Prof Blog 1/27/20); and [Tax Court Holds the TFRP is a Penalty Subject to § 6751\(b\) Supervisor Written Approval Requirement](#) (Federal Tax Procedure Blog 1/23/20)

¹⁶⁴⁸ *Grajales v. Commissioner*, 156 T.C. 55 (2021), aff’d 47 F.4th 58(2d Cir. 2022) (treating the § 72(t), labeled an “additional tax” on early withdrawal from tax-deferred retirement plans, as a tax and not a penalty.

¹⁶⁴⁹ *Belair Woods, LLC v. Commissioner*, 154 T.C. 1, 15 (2020) (reviewed opinion, plurality opinion with 8 out of 16 judges). The *Belair* Court worded this alternatively (p. 10): “the “initial determination” of a penalty assessment will be embodied in a formal written communication to the taxpayer, notifying him that the Examination Division has completed its work and has made a definite decision to assert penalties.”

¹⁶⁵⁰ *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner*, 29 F.4th 1066 (9th Cir. Mar. 25, 2022).

¹⁶⁵¹ *Kraske v. Commissioner*, 161 T.C. ___ No. 7 (2023) (based on *Laidlaw*).

¹⁶⁵² *Belair Woods, LLC v. Commissioner*, 154 T.C. 1, 8-9 (2020) (reviewed opinion, plurality opinion with 8 out of 16 judges). Concurring and dissenting judges did not necessarily agree with this line marking the determination and feel that it could occur in some communication prior to the classic points at which the IRS has made a determination. See *Thompson v. Commissioner*, 155 T.C. 87, 92 (2020). A notice of **proposed** adjustment (“NOPA”) standing alone is not a determination requiring written approval. See also *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner*, 154 T.C. 68, 80-83 (2020), rev’d on other grounds, 29 F.4th 1066 (9th Cir. Mar. 25, 2022); and *Tribune Media Company v. Commissioner*, T.C. Memo. 2020-2, at *20. But an RAR with Letter 5153 (sent when there is not time left on the assessment statute of limitations for internal appeal and the taxpayer refuses to consent to extend enclosing the RAR will constitute a determination. *Carter v. Commissioner*, T.C. Memo. 2020-21, at *27-32.

the taxpayer may be the initial determination if the context so indicates.¹⁶⁵³ Mere notice to the taxpayer that the agent is considering asserting penalties and asking the taxpayer to discuss the penalties is not the determination requiring written approval.¹⁶⁵⁴ Further, a communication offering a reduced penalty as part of a campaign to settle issues such as abusive shelters involved many taxpayers which say that, if the settlement is not accepted, an examination will be conducted and may result in penalties is not an initial determination.¹⁶⁵⁵ Similarly a general IRS publication such as a Notice identifying listed transactions that may be subject to penalties is not the initial communication.¹⁶⁵⁶ However, a Revenue Agent’s Report (“RAR”)¹⁶⁵⁷ including penalties delivered to the taxpayer is the written determination requiring written approval.¹⁶⁵⁸ Even a notice that the IRS has preliminarily determined to assert a penalty that the taxpayer can avoid by action on his part is not the initial determination requiring written approval.¹⁶⁵⁹ Cutting through all this, the IRM was revised to guide agents succinctly (perhaps cryptically) that the “written supervisory approval required under IRS 6751(b)(1) must be obtained prior to issuing any written communication of penalties to a taxpayer that offers the taxpayer an opportunity to [i] Sign an agreement, or [ii] Consent to assessment or proposal of the penalty.”¹⁶⁶⁰ While that guidance may not be outcome determinative in cases arising from audits where the operative facts preceded the date of the new IRM, it

¹⁶⁵³ *Beland v. Commissioner*, 156 T.C. __, __ (slip op. at 9-12) (2021).

¹⁶⁵⁴ E.g., *Excelsior Aggregates, LLC v. Commissioner*, T.C. Memo. 2021-125.

¹⁶⁵⁵ *Thompson v. Commissioner*, 155 T.C. 87 (2020).

¹⁶⁵⁶ *Pickens Decorative Stone, LLC v. Commissioner*, T.C. Memo. 2022-22.

¹⁶⁵⁷ The RAR was described in *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner*, 154 T.C. 68, 72 n. 3 (2020) (citing *Branerton Corp. v. Commissioner*, 64 T.C. 191, 194-195 (1975)) as: “a Form 4549-A, “Income Tax Discrepancy Adjustments,” along with a Form 886-A, “Explanation of Items”), rev’d on other grounds 29 F.4th 1066 (9th Cir. Mar. 25, 2022).

¹⁶⁵⁸ *Clay v. Commissioner*, 152 T.C. 223 (2019); and *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner*, 154 T.C. 68, 78-80 (2020) (applying the holding in *Clay* to an assessable penalty), rev’d on other grounds 29 F.4th 1066 (9th Cir. Mar. 25, 2022). In *Roth v. Commissioner*, 922 F.3d 1126 (10th Cir. 2019), the 40% accuracy related penalty for gross valuation misstatement had been determined and properly approved in writing at examination, the taxpayers were notified, the taxpayers appealed to the IRS Appeals Office, the Appeals Officer sustained the imposition of the 40% penalty, but in the calculations mistakenly used the 20% penalty, and the supervisor of the Appeals Officer approved, the taxpayer petitioned for redetermination, and the IRS attorney asserted the 40% penalty in the answer after written approval by her supervisor. So, at each level, the written approval for the 40% penalty was met, but the 20% penalty was mistakenly used for calculation in the notice of deficiency. The Court noted that the initial determination which must be approved by a written supervisor was either the examining agent’s determination where there was approval or the IRS attorney’s determination in the answer which had received written approval. (The Court noted in the latter regard that, without allowing the answer to assert the penalty, the Tax Court would be deprived “of its well-settled jurisdiction to consider claims for new penalties asserted by the IRS in a deficiency proceeding.”)

¹⁶⁵⁹ *Kestin v. Commissioner*, 153 T.C. 14 (2019).

¹⁶⁶⁰ IRM 20.1.1.2.3.1 (10-19-2020), Timing of Supervisory Approval, Note that the IRM says the communication must be to “a taxpayer” which, in context means the taxpayer determined to be subject to the penalty. In *Excelsior Aggregates, LLC v. Commissioner*, T.C. Memo. 2021-125, at *13-*14, the Court held that the IRS’s prior determination to assert at § 6695A penalty against an appraiser for overvaluation misstatements was not an initial determination that the taxpayer relying on the appraisal was subject to the § 6662(e) and § 6662(h) penalties for valuation misstatement. The penalties stand alone even though the predicate conduct might be overlapping.

perhaps might be the solution going forward to render the commotion around timing moot.¹⁶⁶¹

- The written approval requirement must be met for each separate penalty, although the written approval requirement may be met in different documents. In this regard, § 6662 “creates several distinct penalties.”¹⁶⁶² The penalties listed in § 6662(b) are separate penalties, but some of the other penalties in § 6662 are either (i) separate penalties for which standalone approval is necessary or (ii) merely increases to the § 6662(b) penalties for which approval must be had for **both** the base penalty and for the increase.¹⁶⁶³ For example, § 6662(b) imposes a 20% penalty for transactions lacking economic substance and § 6662(i) “increases” the penalty to 40% for “nondisclosed noneconomic substance transactions.” Approval of the § 6662(i) “increase” without approval of the § 6662(b)(6) base penalty being increased will fail the written approval requirement.¹⁶⁶⁴ By contrast, the § 6662(h) penalty for gross valuation misstatement is a separate penalty that must be approved separately without any other predicate penalty being approved.¹⁶⁶⁵ If it is not clear as to which penalty in § 6662 is being approved, the written approval requirement is not met.¹⁶⁶⁶ Extending this logic, necessarily a penalty initial determination with respect to one taxpayer will not be a penalty initial determination with respect to another taxpayer even if the predicate facts are the same. For example, if the IRS makes an initial determination that an appraiser is subject to the valuation misstatement penalty in § 6659A for an appraisal that a taxpayer used in making a tax claim, that is not an initial determination that a taxpayer reporting based on the valuation misstatement subject to the valuation misstatement penalties in § 6662.¹⁶⁶⁷
- Where § 7491(c) imposes the production burden on the IRS to prove written approval; if the taxpayer challenges the penalties, the IRS must meet the production burden that the written approval was obtained and timely.¹⁶⁶⁸ If the IRS meets that

¹⁶⁶¹ The new IRM provision would not be entitled to *Chevron* deference as an interpretation of the cases, but it might be entitled to *Skidmore* deference as a persuasive summary of the case law extant at the date of adoption of the IRM.

¹⁶⁶² *Sells v. Commissioner*, 2021 T.C. Memo. 12, at *28 (citing *Palmolive Bldg. Inv'rs, LLC v. Commissioner*, 152 T.C. 75, 87 (2019)).

¹⁶⁶³ *Oropeza v. Commissioner*, 155 T.C. 132 (2020).

¹⁶⁶⁴ *Id.*

¹⁶⁶⁵ *Palmolive Bldg. Inv'rs, LLC v. Commissioner*, 152 T.C. 75, 79, 83-84 n. 3 (2019).

¹⁶⁶⁶ *Campbell v. Commissioner*, T.C. Memo. 2020-41, at *31-*33.

¹⁶⁶⁷ *Excelsior Aggregates, LLC v. Commissioner*, T.C. Memo. 2021-125, *13-14.

¹⁶⁶⁸ *Chai v. Commissioner*, 851 F.3d 190, 217, 221-222 (2d Cir. 2017); and *Frost v. Commissioner*, 154 T.C. 23, 32-34 (2020). CC 2018-006 (6/6/18) advises IRS attorneys to introduce proof of compliance with § 6751(b)(1) even if the taxpayer does not raise the written approval issue and should concede the issue if there is no proof of compliance.

After the Tax Court held that § 7491(c) required the IRS to meet a production burden on the written approval issue, there were many cases in the pipeline where the record was closed but the case not yet decided. In some of those cases, the IRS requested and the Tax Court permitted the IRS to open the record to make the showing. E.g., *Fiedziuszko v. Commissioner*, T.C. Memo. 2018-75., at *24-*27 In other cases, the IRS did not make the request or the request was denied, and the IRS lost the penalty issue for failure to meet the § 7491(c) burden. E.g., *Guess v. Commissioner*, T.C. Memo. 2018-97 (IRS proved fraud for purpose of the unlimited statute of limitations and, while proof of fraud would then normally require the civil fraud penalty under § 6663, the IRS lost the civil fraud penalty issue because it has not

(continued...)

production burden to show written approval before communication to the taxpayer of the determination of the penalty, the taxpayer then has the burden of production to show an earlier communication of the determination of the penalty before written approval was obtained.¹⁶⁶⁹ If the taxpayer meets that burden of production, the trier of fact will decide based upon the allocation of the persuasion burden.¹⁶⁷⁰

- Where § 7491(c) does not impose the production burden on the IRS (such as in proceedings not involving individuals), the taxpayer must raise and prove the absence of § 6751(b) written approval as a defense.¹⁶⁷¹
- There is no requirement that the supervisor's written approval either reflect or be predicated on **meaningful review** of the determination.¹⁶⁷²
- No particular IRS form is required for the written approval so long as it is clear that the written approval does in fact approve the penalty.¹⁶⁷³ Even the manager's

¹⁶⁶⁸(...continued)

met the burden required by § 7491(c) to prove written supervision approval required by § 6751(b)). In still other cases, the taxpayers did not timely assert the defense. E.g., *Curtis Investment Co., LLC v. Commissioner*, 909 F.3d 1339 (11th Cir. 2018) (in abusive tax shelter case, noting that the taxpayer could have asserted the claim in the Tax Court before or after the proceeding, but chose to delay and assert it in supplemental appellate brief; held, too late); *Baxter v. Commissioner*, 910 F.3d 150 (4th Cir. 2018) (same abusive tax shelter, same lawyers, same gambit; held too late); *Blau v. Commissioner*, 924 F.3d 1261 (D.C. Cir. 2019) (same); and *Ginsburg v. United States*, 123 A.F.T.R.2d 2019-553 (M.D. Fla. 2019), on appeal to the Eleventh Circuit (No. 19-11836-J) (same where the written approval issue was not raised in the claim for refund, the jurisdictional predicate to a suit for refund).

¹⁶⁶⁹ *Frost v. Commissioner*, 154 T.C. 23, 35-36 (2020).

¹⁶⁷⁰ There is an open issue of whether, if the IRS meets its production burden that written approval was obtained before the communication of the penalty determination and the taxpayer meets his resulting production burden showing an earlier communication before the written approval, the IRS or the taxpayer then bears the ultimate burden of persuasion on the issue. The Tax Court has reserved deciding that issue. See *Frost v. Commissioner*, 154 T.C. 23, 34 n. 6 (slip op. at 20 n. 6) (2020). The Tax Court did say that the production burden, if met by the IRS, will serve its classic function of then imposing at least a production burden on the taxpayer, which would then mean that the IRS wins that issue if the taxpayer does nothing.

In *Chai*, the Second Circuit used language that imposed a persuasion burden (which necessarily requires that a production burden has been met). In its subsequent opinion in *Graev III* (*Graev v. Commissioner*, 149 T.C. 485, 493 n. 14 (2017)), the Tax Court questioned whether the Second Circuit “meant to impose upon the Commissioner the burden of proof or just—as provided in sec. 7491(c)—the burden of production.” See also Judge Holmes’ concurring opinion (beginning on p. 502) (articulating the argument that *Chai* was simply wrong in suggesting that § 7491(c) imposed persuasion burden on the written approval requirement). In *Graev III*, the Tax Court did not have to decide that issue because the IRS proved compliance with § 7491(c) by a preponderance of the evidence, which meant that, by satisfying the persuasion burden, the IRS necessarily satisfied the production burden.

¹⁶⁷¹ *Dynamo Holdings, Inc. v. Commissioner*, 150 T.C. 224 (2018). In *Plentywood Drug, Inc. v. Commissioner*, T.C. Memo. 2021-4, at *24, the Court suggested that entity’s burden to prove lack of approval is a “somewhat unusual burden—the burden of producing evidence that no evidence exists of the Commissioner’s compliance with his obligation to show supervisory approval of penalties”: the Court noted that it could do that through discovery. In *Estate of Jackson v. Commissioner*, T.C. Memo. 2021-48, at *248-*249, the Court suggested that, procedurally, an entity must meet a production burden that the supervisor approval was not met in order to require the IRS to prove the required supervisor approval did exist.

¹⁶⁷² *Belair Woods, LLC v. Commissioner*, 154 T.C. 1, 16-17 (2020) (reviewed opinion, plurality opinion with 8 out of 16 judges); and *Raifman v. Commissioner*, T.C. Memo. 2018-101, at *60-*61. See Keith Fogg, [Changing a Penalty – Graev Effect](#) (Procedurally Taxing Blog 1/13/23) (discussing *Castro v. Commissioner*, TC Memo 2022-120 and noting the complications that could occur if the courts, in applying § 6751(b), inquired into the quality of the supervisor’s review in granting approval.)

¹⁶⁷³ *Palmolive Bldg. Inv’rs, LLC v. Commissioner*, 152 T.C. 75, 85 (2019) (“the IRS’s use of a form other
(continued...)”)

signature on the cover letter forwarding the penalty determination has been held to suffice.¹⁶⁷⁴

- Where in the administrative process including Appeals, initial determinations as to alternative penalties may be made by different persons (e.g., Examination agent, Appeals Officer or in a Tax Court case by the attorney), providing that the required immediate supervisor approval is made for each such determination.¹⁶⁷⁵ For example, if the IRS attorney in a Tax Court case asserts a new penalty by answer or amended answer, which the IRS is entitled to do (§ 6214(a)), does the “approval” of the attorney and the attorney’s manager meet the requirement? The IRS’s answer is that that approval suffices.¹⁶⁷⁶
- The exceptions to the written approval requirement are for penalties under §§ 6651, 6654, or 6655 and for ““any other penalty automatically calculated through electronic means.””¹⁶⁷⁷ Although the delinquency penalties in § 6651 are excluded by the statute, the IRM requires written approval for (i) the fraudulent FTFF penalty in 6651(f)¹⁶⁷⁸ and (ii) any failure to file penalty relating to a deficiency asserted in a notice of deficiency.
- The “assessable penalties,” penalties that may be assessed without a predicate notice of deficiency, are subject to § 6751(b)’s written approval requirement.¹⁶⁷⁹
- Some IRS liabilities nominated penalties may not in fact be penalties subject to the requirement. For example, the § 6673(a)(1) penalty that the Tax Court may impose

¹⁶⁷³(...continued)

than the one prescribed by internal administrative regulations does not preclude a finding that the supervisory approval requirement has been satisfied.”); *Tribune Media Company v. Commissioner*, T.C. Memo. 2020-2, at *21 (“Any written manifestation of the supervisor’s intent to approve the penalty is sufficient.”). The supervisor’s written approval need not have the supervisor’s signature; initials will suffice. *Graev v. Commissioner*, 149 T.C. 485, 488-489 (2017). Indeed, even approval expressed in emails will suffice. *Rogers v. Commissioner*, T.C. Memo. 2019-61, at *24-*25.

¹⁶⁷⁴ *PBBM-Rose Hill, Ltd. v. Commissioner*, 900 F.3d 193,213 (5th Cir. 2018).

¹⁶⁷⁵ *Palmolive Bldg. Inv’rs, LLC v. Commissioner*, 152 T.C. 75 (2019). *Sand Investment Co., LLC v. Commissioner*, 157 T.C. ___, No. 11 (2021) (held immediate supervisor was not the supervisor per the organization chart but who was the immediate supervisor for the examination in question).

¹⁶⁷⁶ CCN 2018-006 (6/6/18).

¹⁶⁷⁷ § 6751(b)(2). *Walquist v. Commissioner*, 152 T.C. 619 (2019) (§ 6662 accuracy related penalties automatically calculated by computer without human review are “automatically calculated through electronic means” within the meaning of I.R.C. sec. 6751(b)(2)(B) and exempt from the written supervisory approval requirement of § 6751(b)(1). If, however, the taxpayer responded to the automatic notice to prevent automatic assessment, the penalties must be approved before issuing the notice of deficiency. See also *Piper Truck & Leasing, LLC v. Commissioner*, 161 T.C. ___ No. 3 (2023) (§ 6721(e) penalty assessed through Combined Annual Wage Reporting (CAWR) computer program is not subject to § 6751(b)(1).)

¹⁶⁷⁸ IRM 20.1.5.2.3(4) (08-31-2021), Supervisory Approval of Penalties - IRC 6751 Procedural Requirements; IRM 20.1.2.3.7.5.1(8) (07-02-2013), FTFF Penalty Assessment—Procedural Requirements. One question is whether, since this IRM provision is a matter of IRS largesse and not required by the statute, the IRS’s failure to meet the IRM requirement would result in the penalty being rejected in a court.

¹⁶⁷⁹ *Laidlaw’s Harley Davidson Sales, Inc. v. Commissioner*, 154 T.C. 68, 80 (2020) (applying the requirement to the § 6707A penalty and stating that, in its prior precedent, “we did not intimate that our holding was limited to the deficiency context”: and rejecting the IRS strained notion that, for assessable penalties, the written approval need be met only by the time of assessment.), rev’d on other grounds 29 F.4th 1066 (9th Cir. Mar. 25, 2022)

for proceedings for delay or for frivolous or groundless positions are not subject to the requirement.¹⁶⁸⁰

- If the taxpayer agrees to a penalty by executing a closing agreement with the IRS, § 7121(b)'s finality requirement will foreclose a taxpayer from contesting the issue of whether the § 6751(b) written approval requirement was met.¹⁶⁸¹
- The § 6751(b) written approval requirement may be in play in any judicial proceeding involving penalties subject to the requirement.¹⁶⁸² An exception is where the Government asserts the penalty as an offset in a refund action.¹⁶⁸³ Another exception is in partner litigation after a TEFRA audit; the § 6751(b) issue must be contested at the partnership level rather than at the partner level.¹⁶⁸⁴
- Given the potential to avoid a penalty because of this procedural foot fault and the many nuances, it is important that the taxpayer or taxpayer's representative determine as early as possible whether the IRS has failed to meet the requirement. Prior to litigation (in Tax Court or otherwise), there are three opportunities to obtain the approval. First, the taxpayer or taxpayer representative may request the approval during the audit after the penalty has been "determined" and communicated to the taxpayer.¹⁶⁸⁵ The agent may provide it on request. Second, the internal appeal to the Appeals office, the approval should be available under § 7803(e)(7). Finally, the taxpayer can make a FOIA request.

Finally, in *Kroner v. Commissioner*, 48 F.4th 1272 (11th Cir. 2022), the Court swept past all of these nuanced ad hoc holdings to focus on the statutory text of § 6751(b) and held that (i) the statute does not speak to communications with the taxpayer but to the initial determination by the IRS and (ii) "the IRS satisfies Section 6751(b) so long as a supervisor approves an initial determination of a penalty assessment before it **assesses** those penalties."

¹⁶⁸⁰ The Tax Court may impose a penalty under § 6673(a)(1) for proceedings for delay or asserting frivolous or groundless positions. This penalty is not subject to the written supervisor approval requirement of § 6751(b). *Williams v. Commissioner*, 151 T.C. 1 (2018) (which, although it applies textually to all penalties imposed by the Code, makes sense only in the context of an IRS imposed penalty (where there is an IRS supervisor), not one imposed by the Court under § 6673).

¹⁶⁸¹ *McAvey v. Commissioner*, T.C. Memo. 2018-142 (holding in the CDP case that the AO's failure to verify the § 6751(b) requirement was met was harmless error at best because the finality required for closing agreements made the issue moot).

¹⁶⁸² For example, it is clearly at play in a deficiency proceeding where the taxpayer contests the penalty. It is also at play in a CDP proceeding (discussed beginning p. 733), as a checklist requirement, even in the CDP proceeding where the taxpayer does not affirmatively contest the merits of the penalty. See *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner*, 154 T.C. 68, 78-79 (2020) (quoting the statutory requirement that the verification required in CDP proceedings include the requirements of any applicable law, including § 6751(b), rev'd on other grounds 29 F.4th 1066 (9th Cir. Mar. 25, 2022)). Presumably, the requirement would apply also in collection action where the IRS seeks to reduce an assessment including a penalty assessment to judgment or to enforce the assessment of a penalty, particularly in cases where the IRS bears the burden under § 7491(a).

¹⁶⁸³ *Wells Fargo & Company v. United States*, 957 F.3d 840, 854-855 (8th Cir. 2020) ("[B]ecause the negligence penalty in this case is an offset defense in a refund action—not an "assessment"—the prior-approval requirement in § 6751(b)(1) does not apply.")

¹⁶⁸⁴ *Dynamo Holdings Ltd. P'ship v. Commissioner*, 150 T.C. 224, 234-36 (2018).

¹⁶⁸⁵ The date of the "determination" may not be certain for the reasons noted in the text above, but the taxpayer might want to avoid flagging the issue by raising it prematurely, thus permitting the IRS to make sure the approval is in the file.

2. Assessing Penalties.

a. Penalties Requiring Notice of Deficiency Before Assessment.

Most of the penalties dealt with above are penalties that are assessed like the underlying taxes to which they relate. This means that, as to taxes that require a notice of deficiency (income and estate and gift taxes), the penalties must be asserted first in a notice of deficiency, thereby giving the taxpayer the right to contest them in the Tax Court without having to pay them before they are assessed and must be paid.¹⁶⁸⁶ Thus, if the IRS desires to assert the fraud penalty under § 6663 or the accuracy related penalties under § 6662, the IRS must send a predicate notice of deficiency.¹⁶⁸⁷

b. Assessable Penalties; NonAssessable Penalties.

Some penalties are so-called assessable penalties which means that they can be immediately assessed without a predicate notice of deficiency.¹⁶⁸⁸ Frequently encountered assessable penalties are the failure to file and failure to pay penalties unless attributable to a deficiency in tax.¹⁶⁸⁹ The IRS generally treats most Code penalties not requiring a notice of deficiency or similar pre-assessment procedure (such as the § 6672(b)(1)'s preliminary notice requirement for the Trust Fund Recovery Procedure) as immediately assessable permitting it, for example, to assess late filing penalties immediately upon receipt of a delinquent return and, based on the assessment use IRS liens and levies. The taxpayer may then have such post-assessment remedies such as claim for abatement, CDP proceeding and refund claims and suits.

The problem with assessable penalties that the IRS may assess without some prior opportunity for the taxpayer to contest administratively or judicially is that the automatic assessment can create hardship for taxpayers and squander taxpayer and IRS resources in resolving the liability post-assessment, with relatively high rates of abatement for some of the claimed assessable penalties. The limited prepayment remedies can impose considerable unfairness, particularly where

¹⁶⁸⁶ § 6665(a). For example, the § 6707A penalty for failure to report certain tax advantaged transactions is an assessable penalty. See *Smith v. Commissioner*, 133 T.C. 424, 428-430 (2009).

¹⁶⁸⁷ There can be a glitch if there turns out to be no deficiency

¹⁶⁸⁸ E.g., § 6665(b) (excepting from the notice of deficiency requirement certain additions under § 6651, 6654 and 6655); and § 6682(c) (excepting from the deficiency procedures the § 6682(a) civil penalty for false (no reasonable basis) statements under §§ 3402 or 3506 related to withholding). As to the § 6665(b) exception, see *Meyer v. Commissioner*, 97 T.C. 555 (1991).

I am not aware of a complete catalog of assessable penalties, but a recent article says that Congress enacted over 60 assessable penalties since 1960. Keith Fogg, Access to Judicial Review in Nondeficiency Tax Cases, 73 *Tax Lawyer* 435, 440 (2020) (also describing in n. 10 the procedures for such assessable penalties and providing a list of assessable penalties in an Appendix (pp. 495-499).

¹⁶⁸⁹ § 6655(b)(1). See *Smith v. Commissioner*, 133 T.C. 424, 428-430 (2009) (as to the § 6707A penalty). The Tax Court in *Smith* did note that, if the assessable penalty is related to the deficiency, the Tax Court might have some form of derivative jurisdiction, but held the § 6707A penalty, like most other assessable penalties, does not relate to a deficiency.

the amount is so significant that the person cannot comply with *Flora* prepayment requirements and there is no CDP opportunity available.¹⁶⁹⁰

In addition, some have questioned whether some of the penalties the IRS claims to be assessable penalties really are assessable penalties (meaning that, the penalties are nonassessable penalties so that IRS collection tools are not available and the penalties would require DOJ Tax suit to collect the penalties).¹⁶⁹¹ In the 2020 Taxpayer Advocate report to Congress, the Taxpayer Advocate asserted that two of the claimed assessable penalties (§§ 6038 and 6038A, certain foreign reporting penalties) were possibly nonassessable penalties but recommended legislation to clarify that §§ 6038 and 6038A require predicate notices of deficiency before assessment.¹⁶⁹² The Taxpayer Advocate suggested that similar considerations apply to other claimed assessable penalties but limited the report and recommendation to the indicated penalties.¹⁶⁹³

3. Penalty Handbook.

The IRS has a Penalty Handbook which is part of the IRM.¹⁶⁹⁴ This is the major source for IRS field employees in the application of the penalties. The OPA updates the Penalty Handbook as needed.

¹⁶⁹⁰ Keith Fogg, Access to Judicial Review in Nondeficiency Tax Cases, 73 Tax Lawyer 435 (2020) (proposing (p. 494) that the CDP provisions be broadened to include all taxpayers subject to collection procedures if they did not previously have the opportunity to challenge the merits in a judicial proceeding).

¹⁶⁹¹ E.g., Erin Collins and Garrett Hahn, Foreign Information Reporting Penalties: Assessable or Not? Tax Notes Today 211-213 (July 9, 2018) (the lead author of this article was appointed Taxpayer Advocate after the article was published); Robert Horwitz, Can the IRS Assess or Collect Foreign Information Reporting Penalties? Tax Notes Today 301 (Jan. 31, 2019); and Frank Agostino and Phillip Colasanto, The IRS's Illegal Assessment of International Penalties, Tax Notes Today 261 (Apr. 8, 2019). In an earlier version of this text, I footnoted the following discussion for the point in the text:

I picked this up from a blog—Edward M. Robbins, International Penalties Beware of Modified Form 872, Consent to Extend Time to Assess (Tax Litigator Blog 5/9/18). The reasoning goes: § 6201(a) authorizes assessments only for “taxes (including interest, additional amounts, additions to the tax, and assessable penalties).” The 6038 series (and some others) penalties are not “taxes” (the general category) nor in the “including” parenthetical, since the only penalties mentioned are Code defined category of “assessable penalties.” An assessment simply permits the IRS to use its collection tools. But, if the IRS cannot make a lawful assessment, those administrative collection tools are not available. Assuming this reasoning is correct, then the only collection tool the IRS has is to have the Department of Justice sue to obtain judgment and then collect on the judgment.

Robbins is married to Erin Collins, the lead author of the cited article, who is not the Taxpayer Advocate.

¹⁶⁹² 2020 National Taxpayer Advocate Report to Congress, Most Serious Problem #8: International, titled The IRS's Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS, starting on p. 119. In the IRS Comments (p.129), the IRS stated its disagreement with “the fundamental premise of the MSP that the IRS lacks legal authority to assess Chapter 61 penalties,” stating the assessment authority is implicit in the authority to impose the penalty with no requirement of predicate notice of deficiency or other pre-assessment conditions. Further, the IRS asserted that immediately assessable penalties are appropriate even though in some cases the post-assessment abatement rates are “relatively high” and offered to work with the TAS to determine more efficient administration methods “while maintaining the equitable treatment afforded through systemic assessments.”

¹⁶⁹³ Report, p. 119, n. 2 (“Although we specifically examine the assessability of penalties under IRC §§ 6038 and 6038A, the same arguments are generally applicable to other provisions found in Chapter 61 of the code.”)

¹⁶⁹⁴ IRM 20.1.

For those practicing in the audit and litigation area where penalties and the risk of penalties are frequently encountered, the Penalty Handbook is an essential source.

4. IRS Goals in Penalty Administration.

The Penalty Handbook encouraged IRS employees to:

- treat similar cases and similarly-situated taxpayers alike.
- give each taxpayer the opportunity to have his or her interests heard and considered.
- Strive to make a good decision in the first instance. A wrong decision, even though eventually corrected, has a negative impact on voluntary compliance.
- Provide adequate opportunity for incorrect decisions to be corrected.
- Treat each case in an impartial and honest way (i.e., approach the job, not from the government's or the taxpayer's perspective, but in the interest of fair and impartial enforcement of the tax laws).
- Use each penalty case as an opportunity to educate the taxpayer, help the taxpayer understand their legal obligations and rights, assist the taxpayer in understanding their appeal rights and, in all cases, observe the taxpayer's procedural rights.
- Endeavor to promptly process and resolve each taxpayer's case.
- Resolve each penalty case in a manner which promotes voluntary compliance.¹⁶⁹⁵

Obviously, those are worthy goals. The IRS, however, is a very large organization with many cooks in what are effectively many kitchens in penalty administration. The goals are not always achieved. For example, there are many judgment calls made by the agents, their supervisors, and Appeals Officers in the application or nonapplication of penalties. 100% consistency from agent to agent, supervisor to supervisor, and Appeals Officer to Appeals Officer cannot be expected. But, through the guidance in the Penalty Handbook and the IRS's other efforts at guidance (through various internal publications such as FSAs), the IRS does make the effort at consistency.

5. Deadly Sins and Penalty Administration.

It has been reported that the 1998 Restructuring Act and, in particular, its 10 Deadly Sins (p. 98) have created a climate within the IRS that have caused agents to forego the assertion of penalties in situations where penalties should be asserted.¹⁶⁹⁶ The evidence is anecdotal in specific instances, but the overall statistics suggest that the assertion of penalties is down. Does this mean that the IRS asserted penalties too often before this trend? Does it mean that the IRS is not asserting penalties in many cases where it should do so now? Further study is required.

¹⁶⁹⁵ IRM 20.1.1.1.3 (10-19-2020), Responsibilities. Some items above are verbatim quotes for which I have not provided quotation marks.

¹⁶⁹⁶ E.g., Lee A. Sheppard, The Sixth Deadly Sin, 92 Tax Notes 1018 (8/20/2001) ("Assertion of penalties is thought by IRS executives to be going down because examiners perceive they will be accused of harassment."). The Sixth Deadly Sin is:

violations of the Internal Revenue Code of 1986, Department of Treasury regulations, or policies of the Internal Revenue Service (including the Internal Revenue Manual) for the purpose of retaliating against, or harassing, a taxpayer, taxpayer representative, or other employee of the Internal Revenue Service.

Ch. 7. The IRS Compliance Function - Examination.

I. Introduction.

The IRS compliance function is the backstop to the taxpayer's responsibility to report. The compliance function checks to see whether taxpayers have reported properly and takes remedial action to collect taxes that are underpaid. In the macro sense, the underpaid tax liability is called the tax gap and, as you might suspect, the tax gap is large. The role of the IRS's compliance and collections functions the tax gap as low as possible given the amount of resources that Congress allows for the task. The IRS periodically publishes reasonably current estimates of the tax gap on its web page. The most recent statistics for the period 2014-2016 indicate an average gross annual tax gap is \$496 billion and net annual tax gap (after late payments and enforcement efforts) is \$428 billion (after late payments and enforcement efforts).¹⁶⁹⁷

The IRS's compliance function has two major components—(i) to determine whether taxpayers have met the responsibility to self-assess and take corrective measures to the extent they have not (this is often called the examination function which is carried out by “audits”¹⁶⁹⁸ which are sometimes also called examinations), and (ii) to collect the unpaid taxes that have been self-assessed or assessed by the IRS (this is often called the collection function). I focus in this chapter on the examination component of the compliance function.

II. Types of Examinations.

A. Civil Examinations.¹⁶⁹⁹

1. Correspondence.

The Service Center initiates correspondence inquiries, often called correspondence audits or correspondence examinations, which are written requests for information.¹⁷⁰⁰ The written requests are generated through IRS systemic processes.¹⁷⁰¹ The two principal reasons for such inquiries are (1) facial errors on the return that the IRS believes can usually be answered by correspondence and (2) discrepancies between information returns (such as 1099-INT (for interest paid) or 1099-DIV (for dividends paid) and the tax return. The IRS principally identifies returns for correspondence

¹⁶⁹⁷ IRS web page titled “Tax Gap Estimates for Tax Years 2014-2016” (last reviewed or updated 11/2/21 and viewed on 7/13/22). The web page has estimates also for years 2011-2013, 2008-2010, and 2006.

¹⁶⁹⁸ See IRS web page title “IRS Audits” (last reviewed or updated 10/28/22 and viewed 8/15/23).

¹⁶⁹⁹ The discussion of the types of examinations under this section is based on the sources indicated in the footnotes. However a recent summary was provided in the National Taxpayer Advocate's Annual Report to Congress 2017 under the Most Serious Problems dividing IRS examination activity into real audits (correspondence, field or office audits) and “unreal audits” all those which are not real audits.

¹⁷⁰⁰ See generally GAO Report titled “IRS Correspondence Audits: Better Management Could Improve Tax Compliance and Reduce Taxpayer Burden” (GAO-14-479 June 2014). In this section, the GAO Report is referred to simply as GAO Report.

¹⁷⁰¹ TIGTA Report, Improvements to the Correspondence Examination Process May Increase Taxpayer Compliance and Collection Potential 1 (No. 2021-30-061 9/30/21). In this section, the TIGTA Report is referred to as TIGTA Report.

audits through an automated scoring process, but sometimes through manual review on referral from various office in the IRS.¹⁷⁰²

The principal advantage of correspondence audits is that they capture what colloquially is called low hanging fruit, material revenue in the aggregate for low expenditure of IRS resources. In a 2021 Report,¹⁷⁰³ the following table was provided to show some key numbers for correspondence audits in non-EITC correspondence examinations:

Figure 5: Most Frequently Examined Issues in Non-EITC Correspondence Examinations for FY 2017 Through FY 2019 (on Average)

| Project Code Definition | Average Number Examined | Average Assessment | Average Exam Days | Average Exam Time (in hours) |
|---|-------------------------|--------------------|-------------------|------------------------------|
| 0381 – Form 1040 Schedule A: Employee Business Expense | 55,856 | \$3,688 | 228.63 | 1.58 |
| 0377 – Form 1040 Schedule C Issues | 46,052 | \$4,576 | 239.82 | 1.92 |
| 0277 – Nonfilers | 44,702 | \$28,102 | 186.29 | 0.41 |
| 0453 – Combined Annual Wage Reporting Audits - Employment Tax Nonfiler | 15,921 | \$5,188 | 139.23 | 0.37 |
| 0288 – Questionable Form 1040 Schedule C With Earned Income Tax Credit | 10,868 | \$3,669 | 234.74 | 0.90 |
| 0406 – American Opportunity Tax Credit – Max Years Exceeded | 10,830 | \$2,647 | 179.45 | 2.90 |
| 0133 – Criminal Investigation – Non-Earned Income Tax Credit Referral | 9,383 | \$3,508 | 170.96 | 1.25 |
| 0639 – Medical/Contribution/Miscellaneous Expense on Form 1040 Schedule A | 5,167 | \$5,535 | 269.30 | 2.23 |
| 0231 – Alimony Compliance Project (Payer) | 4,368 | \$4,984 | 194.20 | 3.32 |
| 0000 – Valid Correction – Alternative Minimum Tax | 4,251 | \$3,190 | 136.64 | 1.52 |

Source: TIGTA analysis of Closed Audit Information Management System files for FYs 2017, 2018, and 2019.

There can be correspondence inquiries at the local level also. These are relatively low level inquiries that are not audits at all for purposes of the limitations on second audits,¹⁷⁰⁴ but may escalate into audits. For example, the IRS may also initiate automated matching notices resulting from computer identified mismatches between the taxpayers return reporting and the various forms

¹⁷⁰² Id. The GAO Report has this example:

For example, the main determinant for selecting EITC returns for audit is the score from the Dependent Database (DdB). DdB relies on decision rules applied to tax returns claiming EITC and related tax benefits. Using filters created from various criteria, the DdB creates scores for returns before refunds are disbursed. Returns with the highest scores are selected for audit.

¹⁷⁰³ TIGTA Report, *supra*.

¹⁷⁰⁴ IRM 1.2.13.1.1 (12-21-1984) Policy Statement 4-3, , Cases closed by District Directors or Service Center Directors will not be reopened except under certain circumstances. The prohibition on second audits is in § 7605(b). I discuss that prohibition beginning on p. 400.

of information returns filed by third parties (such as W-2 and various Forms 1099).¹⁷⁰⁵ These Notices are not audits but in some ways function like correspondence audits.

2. Office Audits.

The taxpayer may be invited by letter to the IRS office to address certain issues identified in the letter and produce information or documents about the identified issues.¹⁷⁰⁶ This is the next level. Taxpayers may also raise any issues that would mitigate any adjustment or even result in a refund.¹⁷⁰⁷

Office audits are usually handled by a mid-level Examination person and deal with simpler issues (verification of deductions, etc.). This type of audit might escalate to the next level if a satisfactory resolution is not achieved or the office auditor identifies characteristics that justify more intense audit activity.

3. Field Examinations.

Field examinations or field audits are examinations where a higher grade revenue agent is assigned and may do such field (out of IRS office) work as he or she deems appropriate to the circumstances, including visits to the taxpayer's place of business, taxpayer's home (if an individual taxpayer), or the taxpayer's representative's office.¹⁷⁰⁸ The balance of this chapter deals principally with the field examination.

The larger field examinations handled by the IRS's LB&I division are further divided between those that require multiple examiners operating as a team and those that require only a single examiner. Coordinated Industry Case ("CIC") taxpayers are generally the largest taxpayers, thus requiring a team of examiners on the audit. The CIC designation is being changed to "Large Corporate Compliance," acronymed to "LCC."¹⁷⁰⁹ The LCC program is directed to "a new application of data analytics for determining the population of [the] largest and most complex corporate taxpayers."¹⁷¹⁰

¹⁷⁰⁵ The principal such notices are: CP2000 Notice of Proposed Adjustment for Underpayment or Overpayment, CP2501 Notice, Initial Contact Letter, and CP3219A Notice of Deficiency and Increase in Tax. The CP2000 Notice and CP3219A Notices propose adjustments; the CP2501 Notice requests further information or explanation from the taxpayer.

¹⁷⁰⁶ Reg. 601.105(b)(2)(ii).

¹⁷⁰⁷ Id.

¹⁷⁰⁸ Reg. § 601.105(a)(3).

¹⁷⁰⁹ IRS Publication 5319 (Rev. 2-2019), titled FY2019 LB&I Strategic Goals (Message from the LB&I Commissioner's Office); and IR 2019-95 (5/16/2019), titled "LB&I Announces Large Corporate Compliance Program."

¹⁷¹⁰ In IRS and data analytics jargon, the IRS explains: (IR 2019-95 (5/16/19)

LCC employs automatic application of the large case pointing criteria to determine the LCC population. For example, pointing criteria include such items as gross assets and gross receipts. In the past, this was done on a manual, localized basis. Automated pointing allows a more objective determination of the taxpayers that should be part of the population.

After the population is determined, data analytics is used to identify the returns that pose the highest compliance risk. The LCC program further improves LB&I's ability to efficiently focus its resources

(continued...)

Outside large case examinations (in other IRS divisions, such as SB/SE), usually one auditor will be assigned principal responsibility for the case and the taxpayer and his representative will have principal and often sole contact with that one auditor. As I note below, the auditor may seek assistance from various areas of the IRS to help address issues that arise in the audit, but the taxpayer or his representative will often not be involved significantly in that process.

4. Unnecessary Examinations Prohibition.

a. Unnecessary Examinations.

Section 7605(b) provides that “No taxpayer shall be subjected to unnecessary examination or investigations. . . .” This prohibition prevents unnecessary examinations and harassment of taxpayers. What is an unnecessary examination, however, may be in the eye of the beholder. Many taxpayers, at least while in the surge of the storm, believe that their audits are unnecessary and that they are being harassed. But obviously Congress contemplated ordinary, nonrepetitive, nonharassment audit activity as an essential component of the tax system.

In *United States v. Powell*, 379 U.S. 48 (1964), the taxpayer argued that, given the confluence of the policy evident in § 7605(b) regarding unnecessary examinations and the summons provisions, where the IRS seeks information outside the normal statute of limitations for additional assessments, the IRS must make some predicate showing of probable cause that the statute is open before it may conduct a legitimate audit of the otherwise closed years (and use the summons power during that audit). In that case, depending upon what the examination developed, the IRS could assert fraud to keep the civil statute of limitations open beyond the normal period. The taxpayer therefore urged that the court should require the IRS to make a predicate showing that fraud might be involved. The Court rejected the argument. We deal in more detail with and read *Powell* below in discussing the summons power.

Although the Court dealt directly with the use of the summons and formulated the classic test of a valid summons, presumably the same broad standard for an enforceable summons also applies in determining whether an audit is “unnecessary” for purposes of § 7605(b). I defer further discussion to the discussion of the scope of the summons power later in this chapter.

b. Second “Inspections” of Taxpayer’s Books.

Section 7605(b) also permits “only one inspection of the taxpayer’s books” unless the taxpayer requests it or the IRS makes a specific determination that a second inspection is necessary

¹⁷¹⁰(...continued)

on noncompliance.

LCC works in tandem with LB&I agents and examiners who apply their experience and expertise in undertaking compliance actions and determining compliance treatment streams of the biggest and most-complex corporate taxpayers. Each enhances the other.

The program includes continuous improvement using an agile model principle to continually monitor and improve based on feedback from stakeholders including field teams, practice networks, and data scientists.

and so notifies the taxpayer in writing of the determination.¹⁷¹¹ This is often referred to as the prohibition against second examinations or second audits; but I think the better description would be second inspection of the taxpayer's books because a second examination is not prohibited after a first inspection of the taxpayer's books, so long as the second examination does not require inspection of the taxpayer's books.¹⁷¹²

To apply this limitation, we have to identify an inspection. The focus is on inspection of the taxpayer's books. The IRS has several programs for contacting taxpayers about the accuracy of their returns. The following are the types: (1) Math error program in which the IRS computer catches mathematics or clerical errors;¹⁷¹³ (2) underreporter program in which, via computer, the IRS matches the taxpayer's return with third party information returns (such as W-2's and 1099's), with examination of the taxpayer's books sufficient to resolve the discrepancy;¹⁷¹⁴ (3) so-called "soft" notices asking the taxpayer to review and make adjustments as appropriate, used in the following cases -- (i) one to taxpayers whose return cites a dependent or spouse SSN that has been used on at least one other return and (ii) another to taxpayers who report business-type income but fail to pay self-employment tax; (4) Compliance Checks (discussed at p. 403) which do not investigate tax liability; and (5) audits formally designated and treated as such, which the Tax Advocate has called "real or traditional audits."¹⁷¹⁵ The IRS takes the position that only the 5th category is an inspection (audit) subject to the § 7605(b) prohibition.¹⁷¹⁶

Other actions where the IRS interfaces with the taxpayer are not second inspections. Examples: (i) collection activity for taxes assessed after the first inspection (audit);¹⁷¹⁷ (ii) audit activity for a different year or different taxa than the year or tax previously audited that requires

¹⁷¹¹ The procedures are set forth in IRM 25.5.4.5.3 (07-14-2015), Statutory Restrictions on Unnecessary Examinations

¹⁷¹² *Estate of Sower v. Commissioner*, 149 T.C. 279 (2017) (where the IRS merely reconsiders the information it has and does not obtain new information, there is no prohibited second examination). The IRS discusses in LAFB 20202501F (5/6/20), example of a second inspection where the taxpayer had been previously audited a year with respect to a net operation carryforward from an earlier year but the taxpayer's claim was sustained, then in a later year Examination asked whether it could review the NOL carryforward from the original year. The IRS said re-auditing the NOL carryforward would be a second inspection.

¹⁷¹³ For discussion of the math and clerical errors correction issues, see p. 659.

¹⁷¹⁴ IRM 1.2.1.5.1(4) & (5) (12-21-1984), Policy Statement 4-3, Cases closed by District Directors or Service Center Directors will not be reopened except under certain circumstances.

¹⁷¹⁵ In the National Taxpayer Advocate's Annual Report to Congress 2017, the NTA identifies among the Most Serious Problems the "lesser" IRS activity not rising to an audit (or inspection) as follows (in summary): The IRS has the authority to examine, in what can be termed a "real" or traditional audit, any books, papers, records, or other data that may be relevant to ascertain the correctness of any return. However, the IRS does not consider a significant number of compliance contacts with taxpayers to be "real" audits, including math error corrections, Automated Underreporter (AUR), identity and wage verification, and Automated Substitute for Return (ASFR). Yet these contacts, or "unreal" audits, require taxpayers to provide documentation or information to the IRS, comprise the majority of compliance contacts, and feel very much like a "real" examination to taxpayers. "Unreal" audits lack taxpayer protections typically found in "real" audits.

See also *Essner v. Commissioner*, T.C. Memo. 2020-23, at *8-*11 (holding that the IRS AUR is not an inspection (audit) for this purpose).

¹⁷¹⁶ IRM 1.2.13.1.1 (12-21-1984), Policy Statement 4-3. See also Rev. Proc. 2005-32, 2005-1 C.B. 1206 (listing types of contacts that will not be considered a second examination).

¹⁷¹⁷ IRM 5.17.6.8(2) (08-01-2019), Unnecessary Examinations and Barred Years.

inquiry into the taxpayer's records related to the previously audited year or tax,¹⁷¹⁸ (iii) activity such as issuing an IDR or summons for the taxpayer's records if the taxpayer either did not provide the records or, perhaps, even if he did, the IRS did not assert additional tax on that second inspection;¹⁷¹⁹ (iv) activity to obtain a taxpayer's records relating to another taxpayer being examined;¹⁷²⁰ (v) activity in response to a claim for refund, Form 1040-X, filed after the first inspection, and involving review of only documents already in the IRS's possession;¹⁷²¹ and (vi) assembling and consulting third party records related to the tax liability or even the taxpayer's own returns in the IRS possession.¹⁷²²

Section 7605(b) does not prohibit a second inspection of the taxpayer's books where the IRS makes an appropriate second inspection decision and notifies the taxpayer. The Court in *Powell* stated that this prohibition serves "to emphasize the responsibility of agents to exercise prudent judgment in wielding the extensive powers granted to them by the Internal Revenue Code."¹⁷²³ The minimum conditions for such a second inspection are set forth in an IRS Revenue Procedure.¹⁷²⁴

¹⁷¹⁸ *United States v. Titan Int'l, Inc.*, 811 F.3d 950 (7th Cir. 2016) (interpreting the statutory language "[O]nly one inspection of a taxpayer's books of account shall be made for each taxable year" to mean that the prohibition applies only if the audited year is the same as the first inspection year). An example of (ii) is auditing the propriety of a net operating loss carryover (carryback or carryforward) to a year previously audited may require inspection of the taxpayer's books for the originating year and intervening years (including the previously audited year). See also CCA 20114701F (5/12/11) (holding that examination on a carryback claim to a previously audited year is not a second examination of the year).

¹⁷¹⁹ *Ballantine v. Commissioner*, 74 T.C. 516 (1980) (no second inspection when the taxpayers refused to comply with summons and IRS issued a notice of deficiency without further inspecting the taxpayers' books); *Jackson v. Commissioner*, T.C. Memo. 1982-556 (1982) (IRS did not conduct a second inspection when, although the IRS issued a reopening letter, "all the information needed to redetermine [the taxpayers'] liabilities * * * was available from the prior audit"); see also *Hough v. Commissioner*, 882 F.2d 1271 (7th Cir. 1989), aff'd T.C. Memo. 1986-229; and *Jackson v. Commissioner*, T.C. Memo. 1982-556.

¹⁷²⁰ *In re Rains Petitions to Quash*, 2018 WL 3064342 (CD Cal. 2018) (discussing cases and holding that records of a previously audited corporation can be obtained to determine if the taxpayer committed fraud); *Estate of Sowers v. Commissioner*, 149 TC No. 11 (2017) (examination of records a previously audited predeceased spouse in the audit of the surviving spouse).

¹⁷²¹ Rev. Proc. 2005-32, 2005-1 CB 1206, § 4.02. In *Planty v. Commissioner*, T.C. Memo. 2017-240, at *4-*6, the IRS treated the claim for refund, Form 1040X filed after the first audit as a taxpayer request for audit reconsideration which would permit the second inspection. The IRS asserted more tax after reviewing the Form 1040-X. The *Planty* Court did note that there was no assertion that IRS considered taxpayer's books and records in acting on the claim for refund, Form 1040-X, stating that § 7805 "has no bearing upon the Commissioner's authority to examine tax returns already in his possession," quoting *Pleasanton Gravel Co. v. Commissioner*, 64 T.C. 510, 528 (1975), aff'd per curiam, 578 F.2d 827 (9th Cir. 1978).

¹⁷²² *Hubner v. Tucker*, 245 F.2d 35, 38-39 (9th Cir. 1957); and *Estate of Sower v. Commissioner*, 149 T.C. 279, 289 (2017).

¹⁷²³ *United States v. Powell*, 379 U.S. 48, 56 (1964).

¹⁷²⁴ Rev. Proc. 2005-32, 2005-1 C.B. 1206, § 5. The IRS guidelines for re-opening closed cases require that (a) there be "evidence of fraud, malfeasance, collusion, concealment or misrepresentation of a material fact," (b) "the prior closing involved a clearly defined substantial error based on an established Service position existing at the time of the previous examination" or (c) "other circumstances exist which indicate failure to reopen would be a serious administrative omission." IRM 1.2.1.5.1 (12-21-1984), Policy Statement 4-3, Cases closed by District Directors or Service Center Directors will not be reopened except under certain circumstances.

To apply the limitation, we have to know when the first inspection (audit) closed; otherwise examination activity will be treated as just a continuation of the first inspection (audit).¹⁷²⁵ The circumstances for which an examination is deemed closed are identified in an IRS Revenue Procedure.¹⁷²⁶ I discuss closing examinations below beginning on p. 470.

What is the appropriate remedy if the IRS violates this prohibition? The remedy does not include relief from the tax that the IRS may assert from the second examination.¹⁷²⁷ Perhaps one remedy might be that any evidence obtained in the second inspection would be excluded and the IRS required to prove any tax liability related to the evidence from other sources. And, if the taxpayer does not timely raise this prohibition during the course of the second inspection, he will be deemed to have waived the right conferred by the prohibition.¹⁷²⁸

B. Criminal Investigations.

The IRS's Criminal Investigation ("CI") branch conducts criminal tax investigations. The goal of CI is not to determine the taxpayer's correct tax liability. Determining the correct tax liability is the job of the civil investigative function -- often referred to as the examination function -- discussed above. CI investigates criminal tax conduct and refers cases to DOJ Tax when it concludes that a taxpayer or other target of their investigation (e.g., a return preparer) should be prosecuted. I have summarized the process on beginning p. 332.

C. Compliance Checks.

The IRS may conduct compliance checks which are reviews to "to determine whether a business owner or individual is adhering to record keeping and information reporting requirements."¹⁷²⁹ The compliance check is not an examination of a tax liability, so that the various provisions dealing with examinations is not invoked (e.g., § 7605(b) prohibition on second

¹⁷²⁵ *United States v. Morgan*, 761 F.2d 1009, 1010-1011 (4th Cir. 1985) (suspension of civil audit on referral to CI is not a closing of the audit; hence second inspection of books does not violate § 7605(b) prohibition); *United States v. Lang*, 792 F.2d 1235, 1242 (4th Cir. 1986).

¹⁷²⁶ Rev. Proc. 2005-32, 2005-1 C.B. 1206, § 4.01.

¹⁷²⁷ See *Redstone v. Commissioner*, T.C. Memo. 2015-237, at *26:

To invalidate a notice of deficiency because the IRS neglected to send this explanatory letter would "substantially overshoot the goal which the legislators sought to attain." *United States v. Powell*, 379 U.S. at 55. Accordingly, "[i]t has long been established by this Court and others that failure of the Commissioner to comply with the provisions of section 7605(b) * * * does not invalidate a deficiency determined from information derived from such an examination." *Flynn v. Commissioner*, 40 T.C. 770, 774 (1963). But see *Reineman*, 301 F.2d at 272. If the taxpayer objects to an IRS contact as an impermissible "second examination," he may "refuse to permit the examination and, should the Service seek enforcement of a summons, oppose the application for enforcement." Saltzman, *supra*, para. 13.02[5], Westlaw (2013).

In *Reineman v. United States*, 301 F.2d 267 (7th Cir. 1962), cited in the excerpt above, the Seventh Circuit set aside a deficiency assessment on this basis, but the Tax Court has consistently rejected the reasoning of *Reineman* in cases not appealable to the Seventh Circuit.

¹⁷²⁸ *Redstone v. Commissioner*, T.C. Memo. 2015-247, at *27 (citing *Estate of Barker v. Commissioner*, 13 B.T.A. 562, 566 (1928); *Moloney v. United States*, 521 F.2d 491, 501 (6th Cir. 1975); *United States v. O'Connor*, 237 F.2d 466, 476-477 (2d Cir. 1956); *Credit Bureau of Erie, Inc. v. Commissioner*, 54 T.C. 726, 729 (1970); *Flynn v. Commissioner*, 40 T.C. 770, 774 (1963); and *Philip Mangone Co. v. United States*, 54 F.2d 168, 172 (Ct. Cl. 1931).

¹⁷²⁹ IRM 4.23.3.5 (11-19-2018), Compliance Checks.

inspections).¹⁷³⁰ The taxpayer incurs no penalty for failing to respond to a compliance check, but the IRS may respond by opening an examination.

III. Selection for Audit.

A. General Introduction.

For general use, the IRS explains audit selection as follows:¹⁷³¹

Why am I being selected for an audit?

Selection for an audit does not always suggest there's a problem. The IRS uses several different methods:

- **Random selection and computer screening** - sometimes returns are selected based solely on a statistical formula. We compare your tax return against "norms" for similar returns. We develop these "norms" from audits of a statistically valid random sample of returns, as part of the National Research Program the IRS conducts. The IRS uses this program to update return selection information.
- **Related examinations** – we may select your returns when they involve issues or transactions with other taxpayers, such as business partners or investors, whose returns were selected for audit.

Next, an experienced auditor reviews the return. They may accept it; or if the auditor notes something questionable, they will identify the items noted and forward the return for assignment to an examining group.

As I discuss, this explanation is cryptic and, in some ways, incomplete. Students of tax procedure need a more fleshed explanation of the selection for audit process.

B. Computer Selection, DIF.

Returns are generally selected at the Service Center principally on computer modeling, called Discriminant Function or Discriminant Inventory Function (acronymed to "DIF").¹⁷³² DIF is a computer scoring system, developed from data collected from National Research Program ("NRP") audits (discussed beginning p. 409,) that "assigns a numeric score to *** tax returns after they have

¹⁷³⁰ IRM 4.23.3.5.1(4) (11-19-2018), Guidelines for Compliance Checks prohibits the IRS employee conducting a compliance check from inspecting books and records and otherwise inspecting or asking about particular tax liabilities. The IRS considers compliance checks opportunities to educate taxpayers rather than audits of tax liabilities, so the IRM cautions that (i) the examiner must explain that the check "does not qualify as an inspection under IRC 7605(b) or as an audit for purposes of section 530 of the Revenue Act of 1978."

¹⁷³¹ IRS web page titled "IRS Audits" (last reviewed or updated 7/10/19 and viewed 9/29/19).

¹⁷³² Reg. 601.105(a). IRM 4.1.2.7 (09-21-2020), Discriminant Function (DIF) Overview.

been processed.”¹⁷³³ Returns that are thus scored are individual, some corporate,¹⁷³⁴ S Corporation,¹⁷³⁵ partnership¹⁷³⁶ and fiduciary income tax returns.¹⁷³⁷ The goal of the process is to identify the returns that appear, based on statistical analysis of the information presented in the return as it is processed, to have the most effective audit potential for significant tax change given the IRS's resources.¹⁷³⁸ The IRS advises taxpayers that “If your return is selected because of a high score under the DIF system, the **potential** is high that an examination of your return will result in a change to your income tax liability.”¹⁷³⁹

LB&I uses a computer scoring model, called Discriminant Analysis System (“DAS”), for large case audits (total assets of \$10 million or more).¹⁷⁴⁰ The model scores the audit potential for these taxpayers.

There may be other forms of modeling, computer or otherwise, that the IRS uses but the foregoing appears to be the main ones.

Although the IRS does not publish its scoring techniques except in broad concepts,¹⁷⁴¹ the process is easy to illustrate in broad concepts. For example, the DIF undoubtedly scores high charitable contributions relative to income negatively in terms of at least justifying a look at the return. Thus, a return that claims \$50,000 of wage income and no other income, but \$25,000 in charitable contributions is likely to receive a relatively higher DIF score thus increasing its likelihood of audit. By contrast, the same return claiming \$2,000 in charitable contributions would receive a relatively lower score and would likely not be kicked out for audit in the absence of other unusual return characteristics. What this means is that taxpayers who are not pigs may be able to do some level of aggressive reporting (perhaps even cheating) without materially increasing their risk of audit.

To avoid gaming of the system, the IRS does not publicize its DIF scoring techniques, and the courts do not require disclosure of the factors.¹⁷⁴² Still, people do try to game the system in this

¹⁷³³ Publication 556 (09/2013), Examination of Returns, Appeal Rights, and Claims for Refund; and IRM 4.1.2.7 (09-21-2020), Discriminant Function (DIF) Overview (similar, saying that the process score[s] tax returns for examination potential.”).

¹⁷³⁴ IRM 4.1.2.7.3 (10-19-2017), Corporation Returns (although noting that “High asset returns, activity codes 219 through 230, are not DIF scored and are delivered automatically to classification at the Ogden Large Business & International (LB&I) Campus.”).

¹⁷³⁵ IRM 4.1.2.7.4 (10-19-2017), S Corporation Returns.

¹⁷³⁶ IRM 4.1.2.7.5 (10-19-2017), Partnership Returns.

¹⁷³⁷ IRM 4.1.2.7.6 (10-19-2017), Fiduciary Returns.

¹⁷³⁸ Tax Fraud and Noncompliance: IRS Could Further Leverage the Return Review Program to Strengthen Tax Enforcement 27 (GAO-18-544 July 2018). The DIF scored returns are “classified by an experienced examiner to eliminate those returns not worthy of exam.” IRM 4.1.5.3.3.1 (09-21-2020), Standards for Classification.

¹⁷³⁹ Publication 556 (09/2013), Examination of Returns, Appeal Rights, and Claims for Refund; and IRM 4.19.11.2.2(2) (10-11-2017), Sources of Returns for Classification. The IRM says that lower DIF scores have less predictive value. IRM 4.1.2.7.7 (09-21-2020), DIF Cutoff Score,

¹⁷⁴⁰ The discussion of DAS in this paragraph is taken from TIGTA Report The Large Case Examination Selection Method Consistently Results in High No-Change Rates (Ref. No. 2020-30-031 6/22/20).

¹⁷⁴¹ E.g., the DAS model is described in TIGTA Report The Large Case Examination Selection Method Consistently Results in High No-Change Rates 4-5 (Ref. No. 2020-30-031 6/22/20).

¹⁷⁴² See *Goldstein v. IRS*, 174 F. Supp.3d 38, 51 (D.D.C. Mar. 25, 2016) (observing that “Courts have

(continued...)

manner,¹⁷⁴³ but I cannot recommend it because (i) it is wrong, (ii) the taxpayer might be identified for audit in some other way and (iii) the taxpayer may not have accurately guessed the scoring factors relevant to the taxpayers' return.

The IRS has a program titled Return Review Program (“RRP”) designed to prevent issuance of invalid refunds. The RRP uses advanced analytic techniques and various data sources, including prior-year tax returns, to assign multiple scores to individual returns based on characteristics of identity theft and other refund fraud.¹⁷⁴⁴ As of 2018, the DIF and RRP were independent in operations, but the IRS is reported to have plans to better coordinated the RRP and DIF.¹⁷⁴⁵

C. Related Party Audits.

Incident to the audit of one taxpayer's return, the IRS may audit a related party's return. This often happens when there are transactions between the audited taxpayer and the related party. A common example is to audit a foreign sales corporation (“FSC”) at the same time that the U.S. corporation is audited. Also, in the course of auditing a closely held corporation, the IRS may at least take a cursory look at the returns of the shareholder-employees.

D. Mandatory Audits—President and Vice President.

The returns of the President and the Vice President are subject to mandatory audits.¹⁷⁴⁶

E. Return Disclosures.

You will recall that taxpayers may file return disclosures to avoid penalties for return positions or, in some cases, to avoid the applicability of the 6 year period of limitations for 25%

¹⁷⁴²(...continued)

routinely held that DIF scores are exempt from [FOIA] disclosure * * * because such disclosure could allow individuals to manipulate their scores to evade audits”). If the scores are contained in any documents subject to FOIA, they should be redacted.

¹⁷⁴³ Particularly ingenious taxpayers with a motive might try to guess the system to improve their chances. E.g., Amir D. Aczel, How to Beat the I.R.S. at Its Own Game: Strategies to Avoid-And Fight-An Audit (Four Walls Eight Windows 1995); see David Cay Johnston, Your Taxes: Some New Tricks to Help Filers Avoid an Old Audit Trap, NYT (2/25/96).

¹⁷⁴⁴ See Tax Fraud and Noncompliance: IRS Could Further Leverage the Return Review Program to Strengthen Tax Enforcement (GAO-18-544 July 2018).

¹⁷⁴⁵ Id., at p. 27.

¹⁷⁴⁶ IRM 4.8.4.2.5 (03-12-2015), Audit of President and Vice President; and 3.28.3.5.3 (01-01-2020), Mandatory Examination. See Committee on Ways and Means v. United States Dept of Treasury, 45 F.4th 324 (D.C. Cir. 8/9/22) (explaining the history and effect mandatory audit requirement as being an administrative requirement rather than a statutory requirement arising from the Nixon tax return problem). The examination is mandatory, regardless of the DIF scoring or absence of other indicators of audit worthiness. Id. For a discussion of the IRS's policy and practice mandating the audits and how they are conducted, see Background Regarding the Confidentiality and Disclosure of Federal Tax Returns 18-22 (JCX-3-19 (2/4/19), prepared by the JCT Staff for a scheduled public Ways and Means hearing on 2/7/19). Although the IRM says the examination is mandatory, there is no statute mandating the audits; rather, the policy and practice was in “interest of sound tax administration” and to remove “from any particular employee of the IRS the necessity of having to make a decision as to whether to audit the particular returns involved.” Id. at 21.

omissions. I discussed earlier how such disclosures are made.¹⁷⁴⁷ The IRS does from time to time review such disclosures and initiate audits based on the disclosures. (In the case of large corporate taxpayers whose returns are always audited in two or three-year audit cycles, such disclosures may not initiate an audit, but can shape some of the audit activity that will be pursued.)

F. Amended Returns Claiming Refunds.

Amended returns claiming refunds may present a higher profile for audit than original returns filed in the normal filing seasons (on or prior to April 15 and on or prior to October 15).¹⁷⁴⁸ Tax examiners review individually such amended returns and flag some for additional review or audit. Thus, amended returns claiming refunds receive a preliminary level of review that is not accorded to original returns.

G. Initiatives in Areas of Noncompliance.

1. General.

From time to time the IRS will have national or local initiatives in areas where it thinks that compliance is unusually low or at least low enough that the benefit (tax collection) to cost ratio of the initiative is positive and where a higher level of audit activity, particularly if it can receive some publicity, will not only produce audit change dollars but may affect future compliance among other taxpayers similarly situated, thus enhancing the revenue effect. For example, there has been a lot of noncompliance -- and indeed outright fraud -- in the fuel tax and foreign trust and bank account areas, and the IRS has long had major national initiatives -- both civil and criminal -- in those areas.

2. Offshore Initiative.

I discuss elsewhere the IRS's initiatives with regard to offshore banks. (See in Ch. 17 discussion beginning p.987 .)

3. LB&I Compliance Campaigns.

LB&I has special areas of examination interest called Compliance Campaigns.¹⁷⁴⁹ The full list of Compliance Campaigns includes the following (a sample just to show the range):

- FATCA Filing Accuracy
- Forms 1042/1042-S Compliance
- Form 1120-F Chapter 3 and Chapter 4 Withholding Campaign
- Form 1120-F Non-Filer Campaign

¹⁷⁴⁷ Beginning p. 138.

¹⁷⁴⁸ The discussion in this section is from a TIGTA report, Improvements Are Necessary to Ensure That Individual Amended Returns With Claims for Refunds and Abatements of Taxes Are Properly Reviewed (Ref. 2016-30-032 May 17, 2016) and Keith Fogg, How Does the IRS Decide Which Amended Returns to Examine (Procedurally Taxing Blog 3/2/17) (which summarizes some parts of the TIGTA report and offers Fogg's keen insight on the process).

¹⁷⁴⁹ See IRS web page titled "Large Business and International Launches Compliance Campaigns" (last reviewed or updated 6/28/18 and accessed on 11/11/18).

- Micro-Captive Insurance Campaign
- Offshore Service Providers
- OVDP Declines-Withdrawals Campaign
- Post Offshore Voluntary Disclosure Program (OVDP) Compliance
- Partnership Stop Filer
- Related Party Transactions Campaign
- Swiss Bank Program Campaign
- TEFRA Linkage Plan Strategy Campaign
- Virtual Currency

4. Special Enforcement Program.

SB/SE has a Special Enforcement Program (“SEP”) to investigate unreported income, false deductions, etc., through in-depth examinations, with significant fraud potential.¹⁷⁵⁰ The agents conducting the examinations are:

financial investigative specialists and forensic accountants. In addition to general tax law knowledge and auditing skills, SEP agents are experts in the identification and development of cases with fraud potential.¹⁷⁵¹

For example, SEP agents were used in the IRS offshore compliance initiative where the taxpayers were often high wealth individuals with a high potential for fraud.¹⁷⁵²

H. Informants (the Whistleblower Program).

Historically, the IRS has received significant information from whistleblowers that have led to enforcement activity—examinations, collections and criminal investigation.

The IRS often receives tips from disgruntled spouses, ex-spouses, lovers, employees, partners, enemies, etc. Each such tip does not automatically lead to an audit or criminal investigation or indeed any work by the IRS other than receiving the tip. Often, however, if the tip is accompanied by some hard information or reliable indication of significant noncompliance, the IRS will initiate an audit or even a criminal investigation.

Often these tips are made directly to IRS's CI -- the criminal investigation division in the IRS. This type of tip -- particularly if accompanied by good information and/or a good source -- might justify an immediate criminal investigation without prior Examination involvement. On the other hand, if the tip does not a strong criminal indication based on the known evidence or CI is otherwise busy, CI may send the matter to Examination to determine whether an audit is appropriate

¹⁷⁵⁰ IRM 4.16.1.1 (06-14-2011), Overview; and IRM 4.16.1.2 (06-14-2011), Introduction.

¹⁷⁵¹ IRM 4.16.1(3) (06-14-2011), SEP Agent Duties and Responsibilities.

¹⁷⁵² Nathan J. Richman, *OVDP Opt-Outs Subject to Same Audit as Other Offshore Taxpayers*, 2015 TNT 209-7 (10/29/15) (noting that taxpayers who joined the special voluntary disclosure initiative (called Offshore Voluntary Disclosure Program or some variant) could opt out and be audited rather than accept the civil penalty the program offered; these opt outs were offered audited by SEP agents).

with the understanding that if indications of fraud are discovered the case might be referred back to CI.

An incentive to blow the whistle on another taxpayer is the IRS reward system in § 7623. I present the discuss of the reward system in § 7623 in a separate chapter, Ch. 18, Whistleblower Rewards, below beginning p. 998. Suffice it to say at this point that the IRS receives information through the system and deploys some of the information to collect revenue from examinations and collection activity.

I. Information from State Agencies.

Another agency source for information of noncompliance is the state tax agency. We have noted above that the IRS has authority to and does share with state tax agencies vast quantities of data for use by the state tax agencies in their compliance function. Sharing can be a two way street. The IRS can obtain compliance information from the state.¹⁷⁵³

J. Audits to Develop Compliance Initiatives (TCMP, NRP, etc.).

The IRS believes that it needs to conduct detailed audits via a statistical sampling process for the purpose of identifying areas of noncompliance so that its DIF audit scoring—the statistical process whereby returns are scored for potential audit—can better achieve its goal to support voluntary compliance. Historically, a major resource in developing the IRS's audit modeling was the Taxpayer Compliance Measurement Program (“TCMP”). That program used statistical random sampling techniques to identify taxpayers within selected categories and subject them to detailed, line by line audits, to determine where, within each category, there were trends in noncompliance. For those unfortunate taxpayers selected, these audits were “audits from hell.” The last TCMP was conducted in the 1990's as to the tax Year 1988; in the 1990s, when the IRS geared up for another round of these detailed audits, Congress listened to the complaining taxpayers and, in response to Congress’ concerns, the TCMP audits were abandoned.¹⁷⁵⁴

The need for audits to help on audit scoring, however, has not gone away and gets more acute with the passage of time, since the last TCMP audit results are substantially outdated. Accordingly, the IRS adopted and continues to refine random audit techniques referred to as National Research Program (“NRP”) that curb some of the more offensive features of the TCMP audits. The IRS describes the program generally:¹⁷⁵⁵

¹⁷⁵³ See, e.g., TIGTA Final Audit Report -- Information from State Tax Amnesty Programs Could Bolster Compliance Efforts and Ensure Federal Tax Obligations Are Also Met, Reference 2005-30-165 (9/26/05), reproduced at 2005 TNT 197-17 (noting that, although the IRS may obtain information from state tax agencies, information from state tax amnesty programs has not been used by the IRS and concluding that “the State tax amnesty information could be used effectively to bolster IRS efforts for improving compliance.”)

¹⁷⁵⁴ Whether abandoning the TCMP was wise is debatable. See Christopher E. Bergin, TCMP and the Lessons of History, 138 Tax Notes 1011 (Feb. 25, 2013).

¹⁷⁵⁵ IRM 4.22.4.1 (01-28-2021), Program Scope and Objectives; and IRM 4.22.4.1.1 (06-13-2018), Background.

1. The Service needs reliable compliance measures to determine what key areas of noncompliance to address and what treatments to apply to maximize the use of its limited resources. Data to meet these needs are necessary. An innovative and efficient approach that is less burdensome to taxpayers is necessary to measure the extent of noncompliance and to identify factors related to noncompliance. Additionally, it is necessary to identify areas where taxpayer education is needed and clarity of forms, instructions, and publications can be improved.
2. The National Research Program (NRP) approach maximizes use of data available to the IRS and, to the extent possible, minimizes intrusiveness and taxpayer burden while collecting data.

The IRS will design a statistically significant sample of issues and taxpayers that it wants to examine in detail and will then design an audit plan for the audits. The audits are not as onerous to the taxpayers audited as the TCMP, but they are certainly not fun either.¹⁷⁵⁶ The design of the audits is not made public.

K. Audit Priorities.

The IRS has audit priorities in terms of the taxpayer profiles for audits. The IRS set the following audit priorities for individuals, these audit priorities:¹⁷⁵⁷

- Offshore credit card users.
- High-risk, high-income taxpayers.
- Abusive schemes and promoter investigations.
- High-income non-filers.
- Unreported income.
- The National Research Program.

The IRS also has audit priorities for other types of taxpayers—e.g., corporations and nonprofits. It has not publicized those priorities but, from the activity that is visible to the public, it is clear, for example, that corporate tax shelters are a top priority for corporations.

The IRS also has established audit priorities that, in an apt metaphor, encourages its auditors to go after the “low hanging fruit” in an audit so that they can harvest from more “trees” using the descriptive metaphor. As in many endeavors, often the audit-worthy items identified fairly early in

¹⁷⁵⁶ Because NRP audits demand more of taxpayers, the NTA has recommended that the Code be amended to compensate taxpayers for “no change” NRP audits and that Congress “consider waiving the assessment of tax, interest, and penalties resulting from an NRP audit, absent fraud or an intent to evade federal taxes.” See NTA 2019 Purple Book, Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration, Recommendation # 34.

¹⁷⁵⁷ IRS Website titled IRS Fact Sheet FS-2002-12, September 2002 (Page Last Reviewed or Updated: 18-Aug-2012).

the audit will account for the bulk of the potential for adjustment and obtaining the balance will require an inordinate expenditure of resources.¹⁷⁵⁸

L. Collectibility as Factor in Whether to Audit.

IRS examiners “are required to consider the collectibility of potential tax assessments during the pre-contact, audit, and closing phases of an Office or Field examination.”¹⁷⁵⁹ Consideration of collectibility may lead examiners to forego an otherwise indicated audit or to limit the scope of an otherwise indicated audit. Basically, this is an application of not using good audit resources when the collection potential is absent.

M. Repetitive Audits.

The IRS has procedures to limit so-called repetitive audits of individual taxpayers whose returns do not include Schedule C, Profit or Loss from Business (Sole Proprietorship), or Schedule F, Profit or Loss from Farming.¹⁷⁶⁰ These procedures apply when (i) “an examination in one or both of the preceding tax years resulted in no change or small tax change” and (ii) the issues selected for examination in the current year “are the same as the issues examined in either of the two preceding tax years.”¹⁷⁶¹

N. Executive Branch Influence in IRS Investigations.

Section 7217 makes it a 5-year felony for executive branch officials to request, directly or indirectly, “any officer or employee of the Internal Revenue Service to conduct or terminate an audit or other investigation of any particular taxpayer with respect to the tax liability of such taxpayer.”¹⁷⁶² The executive branch personnel within the scope of this prohibition are: (i) the President and Vice President and their respective executive offices; and (ii) persons at level 1 of 5 U.S.C. § 5312 (generally department heads other than the Attorney General and certain branch heads). Any officer or employee of the IRS receiving such a request must report it to TIGTA.¹⁷⁶³ Certain limited exceptions are provided.¹⁷⁶⁴

O. Audit Coverage and the Audit Lottery.

In 2019, the IRS collected total tax revenue of over \$3.564 trillion and net revenue (after refunds) of over \$3,112 trillion.¹⁷⁶⁵ Still, there is a major tax gap—the distance between the tax due and the tax collected. (See the discussion of the Tax Gap beginning p. 179.) That Tax Gap exists,

¹⁷⁵⁸ Dustin Stamper, IRS Audits Touching More Taxpayers, Digging Less Deep, Brown Says, 2006 TNT 217-7.

¹⁷⁵⁹ TIGTA Report titled Examination Collectibility Procedures Need to Be Clarified and Applied Consistently 1 (Ref. No. 2016-30-070 9/7/16), citing IRM 4.20.1.2 (02-26-2013), Examiner’s Responsibilities.

¹⁷⁶⁰ IRM 4.10.2.13 (02-11-2016), Repetitive Audits.

¹⁷⁶¹ Id.

¹⁷⁶² § 7217(a).

¹⁷⁶³ § 7217(b).

¹⁷⁶⁴ § 7217(c).

¹⁷⁶⁵ 2019 Data Book, Table 1.

in part, because of limited IRS resources given the overall population of taxpayers and returns. The following statistics are from the IRS 2019 Data Book reporting the statistics for the 2019 fiscal year (ending 10/31/19).¹⁷⁶⁶

- Number of returns filed in Calendar Year 2019 by type (selective list)¹⁷⁶⁷
 - income tax (1040, 1120, 1065, etc.) - 191.4 million.
 - estate tax (including generation skipping) - 25,742
 - gift tax - 239,618

In the 2019 Data Book, the IRS reports the highlights regarding audit coverage, with the following being key statistics:¹⁷⁶⁸

- For all returns filed for Tax Years 2010 through 2018, the IRS examined 0.60 percent of individual returns filed and 0.97 percent of all corporation returns filed.
- In Fiscal Year (FY) 2019, the IRS audited 771,095 tax returns, resulting in nearly \$17.3 billion in recommended additional tax.
- The IRS examined the returns of 9.26 percent of taxpayers filing individual returns reporting total positive income greater than \$10 million for Tax Years 2010 through 2018.
- The majority of FY 2019 audits, 73.8 percent, were conducted via correspondence. The remaining 26.2 percent were conducted in the field.

Right now, all I want you to focus on is the gross numbers of returns and potential for audit. Don't focus on the audit coverage because most of the audit coverage is not random. That is, within the categories and subcategories of each type of taxpayer and of return, the IRS generally selectively applies its audit resources to the returns with the most potential for compliance issues to exist and revenues to be collected. Thus, individual returns with higher AGI generally have significantly higher percentages of audit coverage.¹⁷⁶⁹

A taxpayer falling in the category of having unidentified tax dollars (because he did not report the liability and it is not identified through the examination function) is said to have played the audit lottery and won. I discuss below the system of penalties that operate as an incentive to not play the audit lottery—to correctly report tax liability. Practitioners and the IRS know, however that the penalty only imperfectly performs its functions, leaving a lot of taxpayers with the incentive to play the audit lottery at a level consistent with their tolerance for risk.¹⁷⁷⁰

¹⁷⁶⁶ 2019 Data Book.

¹⁷⁶⁷ 2019 Data Book, Table 2.

¹⁷⁶⁸ 2019 Data Book, pp. 32-22.

¹⁷⁶⁹ 2019 Data Book, Table 17a.

¹⁷⁷⁰ One could make strong arguments that, considering all taxpayers, the penalty system is not a sufficient incentive because it still leaves the risk / reward ratio tilted in the favor of players of the audit lottery. See generally Leandra Lederman, The Interplay Between Norms and Enforcement in Tax Compliance, 64 Ohio St. L. J. 1453 (2003).
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IV. IRS Players in the Process.

A. Introduction - The Field Audit.

In this chapter, unless otherwise specifically noted, we discuss the field audit, also called field examination. We do not discuss correspondence or office inquiries or audits unless specifically noted.

B. Revenue Agent.

The line-level IRS person in a civil field audit is a revenue agent. Depending upon the size of the examination, there may be only one revenue agent directly involved. For larger audits, there will be a team managed by a manager.

For larger audits with multinational taxpayers (either U.S. companies operating abroad or foreign companies with U.S. operations), the audit team may include specialized international agents as well as managers and counsel. Similarly, as to particular industries particularly those with specialized tax regimes (such as banks and life insurance companies), the team may include revenue agents specialized in the particular industries.

The IRS has other personnel that function like Revenue Agents for some audit activity. These are Tax Examiners (TEs) and Tax Compliance Officers (TCOs) who “conduct audits and related reviews of less complex tax law and account issues.”¹⁷⁷¹ For purposes of other discussions in this book, I will assume that audit level activity is by a Revenue Agent.

C. Other Disciplines.

The IRS has team members other than agents who bring specialized skills. The IRS thus has in-house real estate experts, valuation engineers, economists and the like. Sometimes, during the audit stage where a particularly large adjustment is involved, the IRS may engage an outside expert. This has happened, for example, in transfer pricing cases.

D. Industry Experts.

The IRS is developing expertise in various industries by assigning industry experts whose responsibility is to know the industry. Often these experts produce Audit Technique Guides for specific industries under the so-called Market Segment Specialization Program (“MSSP”) to assist other agents when auditing in that industry.¹⁷⁷² The Audit Technique Guides are audit guidelines or plans for particular industry segments (e.g., lawyers or retail gasoline stores).

In addition, the IRS has for a long time had an Art Advisory Panel of independent art experts to “review and evaluate the acceptability of tangible personal property appraisals taxpayers submit

¹⁷⁷¹ See IRS web page, [How the IRS Ensures Compliance with the Tax Laws](https://www.irs.gov/about-irs/how-the-irs-ensures-compliance-with-the-tax-laws) (Last Reviewed or Updated 20/23/23 and viewed 10/29/23); <https://www.irs.gov/about-irs/how-the-irs-ensures-compliance-with-the-tax-laws>

¹⁷⁷² See IRS web page titled “Audit Techniques Guides (ATGs).”

in support of the fair market value claimed on the wide range of works of art involved in income, estate, and gift tax returns.”¹⁷⁷³

E. Counsel.

Counsel are assigned to the various divisions (LB&I, etc.). Counsel are the in-house lawyers for the division. Personnel within the division may consult with Counsel on any matter they deem appropriate. Specifically, in the present context, agents and other personnel involved in the examination function in the division may consult with and seek the advice of Counsel. Usually, on smaller audits, Counsel has very little involvement. On larger audits, Counsel may have significant involvement, for example, in drafting summonses and the like. The IRS promulgated Regulations providing that Counsel may participate in summons proceedings (discussed below).¹⁷⁷⁴

F. National Office Players.

The National Office rarely gets involved in examinations. However, the agents and supervisors may from time to time seek National Office advice. I have mentioned above that the examination function, with the participation of the taxpayer, may seek Technical Advice from the National Office. In addition, the examination function may seek other types of advice, exemplified by the Field Service Advice procedure, and the taxpayer may not be aware of National Office involvement until after the fact.

G. CI Agent (“Special Agent”).

The focus of this book is IRS civil procedure. I do cover, however, certain points related to the criminal investigation function managed by an IRS branch named Criminal Investigation (“CI”). CI agents are commonly referred to as “Special Agents” and are the tax analogue of FBI Agents. When they show up (either after a civil audit has commenced or, in the absence of a civil audit, as the first indication that the IRS is interested the client), a whole separate set of procedures and considerations kick in. The Special Agent can show up when the taxpayer or his representative thought that only a civil audit was involved. If that happens, the IRS civil audit will generally go quiet while the CI investigation and any further tax criminal enforcement (such as referral to DOJ Tax for prosecution) is in effect. If the Special Agent shows up, the practitioner should immediately refer his client (usually the taxpayer but sometimes another potential criminal target such as a return preparer) to a criminal tax specialist and strongly advise the client not to discuss anything with the Special Agent until he or she has consulted with a criminal tax specialist.

In an audit, of course, the careful practitioner will have done the work necessary to spot criminal tax potential in the case. Sometimes the client will convincingly lie to the practitioner about the facts necessary to assess criminal tax potential or will not allow the practitioner the budget to explore such issues. **Practice Tip:** It is always better practice to document the key facts upon which

¹⁷⁷³ See Art Advisory Panel Annual Report for Fiscal Year 2011, unofficially reproduced at 2012 TNT 140-22.

¹⁷⁷⁴ See Reg. § 301.7602-1(b), promulgated 3/31/05.
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the practitioner relies and/or the limitations that the client imposes upon the engagement, so that it is clear that the client accepts the risks that come with those assumed facts and limitations.

If you become aware that the client you represent in a civil tax investigation really has some underlying criminal tax (or other) exposure, you should immediately assure that someone with criminal tax (or other) experience is on the client's team. This situation is often referred to as an "eggshell audit." Mistakes can be very costly to the client -- both in terms of freedom and assets. Moreover, the practitioner himself or herself can be exposed to malpractice or worse, -- i.e., some potential civil or criminal penalty by blundering in the representation in a way that the Government might perceive as the practitioner's willful conduct. Inexperienced practitioners should not get their experience by handling eggshell audits without a criminal tax expert on the team. The problem, of course, is that their inexperience may cause them not to recognize the eggshell audit.

V. Initiation of the Audit.

Upon initiating the audit, the IRS will advise the taxpayer in writing of the audit and provide an IRS publication regarding the process (IRS Pub. 1). The notice letter will often also enclose an Information Document Request (often acronymed to "IDR") which asks the client to produce certain identified documents as the first salvo in the audit.

VI. Certain Procedures for Field Audits.

At the inception of a field audit, the revenue officer is usually tasked to examine a single tax year. However, revenue agents are directed to at least inspect the returns for other open years to make some preliminary determination as to audit potential, particularly with respect to issues in the initial examination year. The revenue agent may also spot some reason to examine one or more related party returns (such as related party transactions). As a result, the revenue officer may request and receive authority to expand the scope of the audit.¹⁷⁷⁵

VII. IRS Information Gathering Process.

A. Informal Requests.

The agent may make informal requests by telephone, across the table or by correspondence. There is no legal compulsion to respond to the informal request. There may be strategic reasons to responding to the request, but there is no legal compulsion and no statutory penalty for failure to respond to the request.

¹⁷⁷⁵ See TIGTA Report titled "Improvements Are Needed to Ensure Adequate Consideration of the Pickup of Prior and/or Subsequent Returns During Field Examinations 1 (Ref. No. 2018-30-073 9/17/18):

The field examiner's professional judgment is required to determine if potential compliance issues exist warranting expanding the examination. Field examiners are required to review other open tax returns for those cases in which the tax year under examination contains proposed adjustments or there are large, unusual, or questionable (LUQ) items identified on the other returns. If the field examiners do not select other returns for examination, they are required to provide an explanation as to why they did not select these returns. Field examiners should always consider and, if appropriate, pursue prior and/or subsequent year returns containing the same issues as the tax year examined.

B. Information Document Requests (“IDR”s).

The agent may make a request in writing on an Information Document Request (“IDR”), Form 4564, that is a more formal request for information.¹⁷⁷⁶ There is also no legal compulsion to respond to the IDR, but failure to respond, particularly in LB&I examinations, may generate an IRS summons¹⁷⁷⁷ which is compulsory. (I cover the IRS summons below.) I generally require that, whenever the IRS wants information or a document, the agent put the request in an IDR so that, hopefully, it is clear what the agent is asking for and what the agent is not asking for and no misunderstandings can arise later about the propriety of the response. In the larger examinations where the taxpayer and the examiner drafting the IDR have more daily or weekly communications, the taxpayer may be more proactive in shaping the wording of the requests in the IDR.

LB&I may also use the IDR to get an agreed statement of relevant facts – regardless of whether favorable to IRS or the taxpayer – on issues that have been developed in examination but are unagreed between the taxpayer and the IRS.¹⁷⁷⁸ Negotiating this IDR to include all material and relevant facts is important to factual development and processing through appeals and resulting litigation.

C. Third Party Contacts.

The IRS has historically been able to contact third parties who may provide the IRS information either informally without legal compulsion or formally pursuant to the IRS issuance of an administrative summons (which I discuss in the next section).¹⁷⁷⁹ Section 7602(c)(1)¹⁷⁸⁰ provides that IRS personnel may make a third party contact (“TPC”)¹⁷⁸¹ only under the following conditions:

¹⁷⁷⁶ The form used for the IDR is Form 4564. In IRM 4.46.4 Executing the Examination for LB&I agents, Exhibit 4.46.4-1, Requirements for Issuing IDRs lays out the checklist for agents issuing IDRs.

¹⁷⁷⁷ IRM 4.46.4 Executing the Examination for LB&I agents, Exhibit 4.46.4-2, IDR Enforcement Process (describing the steps if the taxpayer does not comply with the IDR, the taxpayer is issued a delinquency notice, then a pre-summons letter, and then a summons; the section also describes the importance of timetables for answering IDRs and granting extensions for answers.)

¹⁷⁷⁸ IRM Exhibit 4.46.4-3, Pro-Forma IDR for Acknowledgment of Facts on Unagreed Issues. The IRM provides a pro forma IDR, Form 4564, for this purpose as the final stage before the Notice of Proposed Adjustment is issued. The pro forma refers to the attached Form 886-A, Explanation of Items. When this process works, the taxpayer’s response to the IDR will permit the Form 886-A to be finalized with as complete a statement of relevant facts as appropriate for the issue.

¹⁷⁷⁹ Informal contacts for information and the compulsory summons are different procedures. The requirements for summonses to third parties are not applicable to informal contacts. Reg. § 301.7609-1(a)(2).

¹⁷⁸⁰ As amended by Taxpayer First Act of 2019, § 1206, P.L. 116-25, 133 Stat 981 (July 1, 2019); see also IRM 4.11.57.2 (07-20-2020), TPC Introduction. Prior to this amendment, the IRS took the position that a generic notice in Publication 1 (Pub 1), Your Rights as a Taxpayer accompanying notice of audit was sufficient under the prior version of the statute. The IRS has recently concluded that, effective August 15, 2019, Publication No. 1 will not be used as notice and more specific notice meeting the requirements of § 1206(c)(2)(i) will be required. Memo to Branch Commissioners from Nikki Johnson, titled Interim Guidance on Third-Party Contact Notification Procedures (7/26/19).

¹⁷⁸¹ See IRM 4.11.57.2 (07-20-2020), TPC Introduction.

(i) the IRS may not contact such third parties with respect to determination or collection of tax unless the IRS first provides the taxpayer “reasonable notice in advance” that such contacts “may be made” during a one year period beginning not later than 45 days before the beginning of the period;¹⁷⁸²

(ii) consecutive notices for a period that, in the aggregate exceeds one year may be issued;¹⁷⁸³

(iii) the notice cannot be issued unless the IRS intends to contact such third persons;¹⁷⁸⁴

(iv) the IRS must keep a record of third party contacts;¹⁷⁸⁵ and

(v) the IRS must provide that record to the taxpayer both periodically and also upon the request of the taxpayer.¹⁷⁸⁶

The IRM says that, because the “intent behind the statute, is to provide the taxpayer, in most cases, with the opportunity to produce the information and documents requested before the IRS must obtain the information from third parties, so that the IRS employee must “generally request the information on a Form 4564, Information Document Request, before making a TPC.”¹⁷⁸⁷

Third party contacts are defined for this purpose as a communication with all of the following elements:

- (i) Is initiated by an IRS employee;
- (ii) Is made to a person other than the taxpayer;

¹⁷⁸² This requirement of advance notice does not apply to contacts made during trial preparation activity after a Tax Court petition is filed. *Seawright v. Commissioner*, 117 T.C. 204 (2001); see also Prop. Reg. § 301.7602-2(f)(7).

¹⁷⁸³ § 7602(c)(1)(flush language).

¹⁷⁸⁴ § 7602(c)(1)(A) and flush language (requiring notice when third party contacts “are intended to be made” and “A notice shall not be issued under this paragraph unless there is an intent at the time such notice is issued to contact persons other than the taxpayer during the period specified in such notice”). This prevents the IRS from including a pro forma general notice with the notice of the IRS examination. Prior to the 2019 amendments to the statute, the IRS provided notice in Publication 1 (Pub 1), Your Rights as a Taxpayer. Courts were not enamored of such a general notice. *J.B. v. United States*, 916 F.3d 1161 (9th Cir. 2019). The revised statute makes it clear that such generic notices will not suffice.

¹⁷⁸⁵ § 7602(c)(2) (requiring that the IRS provided the taxpayer the record “periodically,” meaning that the record should be maintained).

¹⁷⁸⁶ § 7602(c)(2). Although the statutory language expressly requires the IRS to report periodically to the taxpayer and make a report available to the taxpayer upon request, the regulations state simply that “A record of persons so contacted must be made and given to the taxpayer upon the taxpayer’s request.” Reg. § 301.7602-2(a); see also (e)(1). It seems that the IRS is ignoring the mandate of the Code by requiring a predicate request. Moreover, apparently because the IRS was not complying with § 7602(c), a taxpayer tried to blast the list out under FOIA but was unsuccessful because, even though possibly required to be disclosed under § 7602, the list did qualify for a FOIA exemption. *EduCap, Inc. v. IRS*, 2009 U.S. Dist. LEXIS 12339 (D. D.C. 2009).

¹⁷⁸⁷ IRM 4.11.57.2 (07-20-2020), TPC Introduction.

- (iii) Is made with respect to the determination or collection of the tax liability of such taxpayer;
- (iv) Discloses the identity of the taxpayer being investigated; and
- (v) Discloses the association of the IRS employee with the IRS.¹⁷⁸⁸

Although not stated in the statute, a regulation provides that § 7602(c) “does not apply to any contact with any office of any local, state, Federal or foreign governmental entity except for contacts concerning the taxpayer's business with the government office contacted, such as the taxpayer's contracts with or employment by the office.”¹⁷⁸⁹

This third party contact requirement does not apply in the following circumstances: (i) the investigation is criminal;¹⁷⁹⁰ (ii) the IRS determines that notice would jeopardize the collection of the tax or may involve reprisal against the third party;¹⁷⁹¹ (iii) the taxpayer authorizes the contact;¹⁷⁹² (iv) the contact is pursuant to litigation rather than an IRS examination or collection function;¹⁷⁹³ (v) jeopardy situations;¹⁷⁹⁴ (vi) the third party contacts with the IRS unsolicited by the IRS; (vii) information provided under treaty information exchange provisions or Mutual Collections Assistance Agreement;¹⁷⁹⁵ and (viii) information exchange programs with states.¹⁷⁹⁶

There is no requirement that the advance notice include the names of the third party contacts that may be contacted. The IRS is required to “periodically provide” to the taxpayer a “record of persons contacted” and to provide the record upon request of the taxpayer.¹⁷⁹⁷

The IRS takes the position that the third party contact requirement does not apply when, pursuant to a treaty requirement, the IRS is obtaining information for a treaty partner to use in its audit and the IRS is not auditing the taxpayer for U.S. purposes with respect to the matter. This has not yet been litigated, but there is authority for saying that such procedural requirements normally applicable to the use of the IRS summons for U.S. tax purposes do not apply to use of the IRS summons pursuant to a treaty.¹⁷⁹⁸ Now, in the reverse situation when the IRS through the U.S.

¹⁷⁸⁸ Reg. § 301.7602-2.

¹⁷⁸⁹ Reg. § 301.7602-2(f)(5). The IRS has explained that this regulations exception was provided because, based on the legislative history, Congress did not intend to require notice to taxpayers for contacts with government agencies. ILM 202013015 (2/27/29).

¹⁷⁹⁰ § 7602(c)(3)(C). Under the regulations interpretation, this exclusion from the notice requirement applies to contacts “by an IRS employee whose primary duties include either identifying or investigating criminal violations of the law.” Reg. § 301.7602-2(f)(4).

¹⁷⁹¹ § 7602(c)(3)(B). See Reg. § 301.7602-2(f)(2) (jeopardy), (3) (reprisals) & (6) (confidential informant).

¹⁷⁹² § 7602(c)(3)(A). See IRM 25.27.1.3.6 (04-07-2021), Taxpayer Authorizes Contact with a Third Party.

¹⁷⁹³ IRM 25.27.1.2 (04-07-2021), Third-Party Contact (TPC): Definition.

¹⁷⁹⁴ IRM 25.27.1.3.7 (04-07-2021), Jeopardy Situations.

¹⁷⁹⁵ IRM 25.27.1.2 (04-07-2021), Third-Party Contact (TPC): Definition.

¹⁷⁹⁶ Id.

¹⁷⁹⁷ Reg. § 301.7602-2(c)(2).

¹⁷⁹⁸ See *United States v. Stuart*, 489 U.S. 353 (1989) (requirement that IRS summons not be used if case has been referred to DOJ; courts will not look to see whether the foreign country’s examination is criminal in focus or has reached an equivalent stage under its procedures).

competent authority contacts a treaty partner competent authority to make a request for information, the IRS takes the position that is a third party contact subject to this requirement.¹⁷⁹⁹

The third party contact requirements do not apply to investigations that are not IRS investigations.¹⁸⁰⁰ For example, contacts not related to IRS audits or collection matters do not require notice of third party contact. Thus, IRS Chief Counsel attorneys defending in a Tax Court proceeding are not subject to this prohibition and may contact third parties regarding the pending case.¹⁸⁰¹

D. The IRS Administrative Summons.

1. General.

a. The IRS Summons.

Section 7602(a) authorizes the IRS to issue a compulsory summons in an audit or in collections.¹⁸⁰² The summons is an administrative summons, requiring only the action of the IRS; it does not require any action or approval by a court prior to its use, except in the case of a John Doe summons which I discuss below. The summons is comparable to a subpoena (either a trial or a grand jury subpoena) but has certain procedures that are not available for trial subpoenas and certainly not available for grand jury subpoena. As a practical matter, it is relatively easy for the IRS to use the summons if the taxpayer or third party does not respond or does not respond timely to less formal requests for information or documents.

The summons is served by one of the following three methods:

- delivery “in hand” to the summonsee;
- delivery by leaving a copy at the “last and usual place of abode”: or
- if a “third party recordkeeper summons” (discussed below), delivery by certified or registered mail.¹⁸⁰³

Failure of a witness (whether the taxpayer or a third party witness) to appear and/or produce documents pursuant to the summons is a misdemeanor offense, although the practical risk of prosecution appears negligible.¹⁸⁰⁴ In addition, as we learn in *Powell* covered in the next section, a

¹⁷⁹⁹ ITA 200117040 (12/14/99), reproduced at 2001 TNT 83-36 (4/30/01).

¹⁸⁰⁰ Reg. § 301.7602-2(f).

¹⁸⁰¹ Id.

¹⁸⁰² The IRS summons is Form 2039. The summons may also be used in collection matters.

¹⁸⁰³ § 7603(a) & (b). For an example of service abroad where the IRS is unable to rely upon a treaty exchange of information provision (see below, beginning p.458) and must instead rely upon the more general Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters, see ILM 200143032, 2001 WTD 210-29 (10/30/01).

¹⁸⁰⁴ § 7210. The Second Circuit held that the misdemeanor sanction cannot apply unless the Government seeks judicial enforcement of the summons and the witness then refuses to comply with any resulting court order. *Schulz* (continued...)

court may treat a contumacious default as a contempt.¹⁸⁰⁵ Risk of these penalties are mitigated if a witness appears but asserts some semblance of a non-laughable argument that he or she is not required to answer questions or produce the documents requested. If the IRS disagrees with the argument made and desires to pursue the matter further, the IRS will seek judicial enforcement of the summons and, if the court orders enforcement and the taxpayer then fails to comply with the court order, the court may impose appropriate sanctions.

The IRM contains a “Summons Handbook” which practitioners should have available to understand details of IRS procedures for summons.¹⁸⁰⁶ DOJ Tax has a Summons Enforcement Manual on the web.¹⁸⁰⁷

The IRS is not required to use the summons to gather evidence. It may instead use informal requests to gather evidence.¹⁸⁰⁸ The summons is usually employed when informal requests are deemed insufficient.

b. The Summons Power and the *Powell* Standards.

The IRS summons power is broad. *United States v. Powell*, 379 U.S. 48 (1964), which you should read now. I expect you to know for the examination the *Powell* standards and therefore refer you to that case for those standards (although I excerpt them in the next paragraph of this text). The major issue addressed in *Powell* was the taxpayer’s argument that, to inquire into years that are beyond the normal statute of limitations on assessment (recall that, where the taxpayer filed a return, the normal statute of three years is inapplicable in case of a 25 % omission or fraud), the IRS must meet some predicate burden like a production burden to show that the alternative longer statute(s) of limitation might apply. The statute did not require such a predicate showing and the Court declined to read one into the statute. Instead, the Court imposed quite minimal burdens on the IRS for the enforcement of the administrative summons.

Courts and commentators routinely cite *Powell*’s test as the applicable standard in determining whether a summons is valid. *Powell* articulates the test:

that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the Code have been followed * * * .¹⁸⁰⁹

¹⁸⁰⁴(...continued)

v. *I.R.S.*, 395 F.3d 463 (2d Cir. 2005), affirmed and clarified, 413 F.3d 297 (2d Cir. 2005). Even apart from the correctness of *Schulz*, prosecutions under § 7210 are virtually non-existent. The IRS almost certainly would pursue summons enforcement in district court, obtain an order to comply, and then seek contempt for violation of the order.

¹⁸⁰⁵ § 7604(b).

¹⁸⁰⁶ IRM 25.5. This portion of the manual is referred to as the IRS Summons Handbook.

¹⁸⁰⁷ DOJ Tax, Summons Enforcement Manual (updated July 2011)).

¹⁸⁰⁸ *United States v. McLaughlin*, 126 F.3d 130 (3d Cir. 1997), cert. denied, 524 U.S. 951 (1998).

¹⁸⁰⁹ *Powell*, at 57-58.

The standards are quite broad and “designed to ensure only the basic propriety of the investigation.”¹⁸¹⁰

With this broad a standard, I hope you appreciate that the IRS need only make a minimal showing of potential relevance to a tax liability. As the Supreme Court said, the IRS

has a power of inquisition . . . which is not derived from the judicial function. It is more analogous to the Grand Jury, which does not depend on a case or controversy for power to get evidence but can investigate merely on suspicion that the law is being violated, or even just because it wants assurance that it is not.¹⁸¹¹

While *Powell*'s standards are not so elastic as to be illusory, they are very low; thus for example, relevance is simply showing that the information or documents “may be”—not “are”—related to the IRS duty to determine and collect tax.¹⁸¹² The IRS's burden is to establish a “prima facie” *Powell* case, a burden described as minimal.¹⁸¹³ Related to relevance, however, courts may in the exercise of discretion decline to enforce “over-broad and disproportionate to the end sought.”¹⁸¹⁴

How this plays out in the real world is that the IRS's ability to summons tax information has only minimal limits, so long as the IRS can make some showing of a potential revenue function purpose. Rarely does a court quash or substantially limit a summons.¹⁸¹⁵

¹⁸¹⁰ *Mollison v. United States*, 481 F.3d 119, 122 (2d Cir. 2007).

¹⁸¹¹ *Id.*, p. 57 (internal quotes omitted, but quoting *United States v. Morton Salt Co.*, 338 U.S. 632, 642-643 (1948), involving an analogous agency investigation device).

¹⁸¹² *Adamowicz v. United States*, 2008 U.S. App. LEXIS 14323 (2d Cir. 2008). This focus on relevance and proportionality in *Powell* gives meaning to the *Powell* test. For example, the *Powell* test suggests that the summons should not be enforced if the documents or information is otherwise in the possession of the Government or the IRS in particular. This cannot be read literally. Indeed, this spin in the *Powell* test is not in the statute authorizing summonses but is a gloss imputed to the summons procedure from the Code's prohibition on unnecessary examinations. See *Powell*, 379 U.S., at 56-58; and *United States v. Davis*, 636 F.2d 1028, 1037 (5th Cir. 1981) (“[r]ead in context, we construe the ‘already possessed’ principle enunciated by *Powell* as a gloss on § 7605(b)'s prohibition of ‘unnecessary’ summonses”). Accordingly, courts may apply the “already possessed” test in a practical way based on the circumstances.

¹⁸¹³ E.g., *Robert v. United States*, 364 F.3d 988, 996 (8th Cir. 2004). In *Byers v. United States*, 963 F.3d 548, 553-557 (6th Cir. 2020), the taxpayer argued that the third party summons should have a reasonable basis requirement like those statutorily required for John Doe Summonses; the Court held that there is no requirement that the Government show a reasonable basis, noting that Byers' argument “has intuitive appeal—‘Shouldn't the government have to give a reason why it wants my information?’—and merits this fulsome response. In all, Byers has raised a colorable policy argument, but not a legal one.”

¹⁸¹⁴ *Adamowicz v. United States*, 2008 U.S. App. LEXIS 14323 (2d Cir. 2008) (synthesizing case authority and noting that this requirement is rooted in the Fourth Amendment protection against unreasonable searches and seizures). Variations of this theme are addressed in *United States v. Hubbell*, 530 U.S. 27 (2000) (although not mentioning the Fourth Amendment, noted that overbroad subpoena subject to Fifth Amendment privilege where the witnesses' response to the subpoena is inherently testimonial; I discuss *Hubbell* below in discussing the Fifth Amendment).

¹⁸¹⁵ Bryan T. Camp, Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998, 56 Fla. L. Rev. 1, 35 (2004) (citing in fn. 159 LEXIS searches by the author). I have not replicated that research nor attempted any such detailed research, but my experience tells me it is about right and certainly close enough for the point I illustrate in the text. Professor Camp also relates another LEXIS analysis—that, (continued...)

c. Routine for Summonses.

The basic routine for the IRS summons is: The IRS issues the summons, directing the witness (either the taxpayer or a third party witness) to appear at a designated time and place to give testimony, to produce documents, or to do both. Often, there will be some negotiating between the IRS and the summoned witness as to the scope of the summons. For example, sometimes the IRS will have issued the summons before having a full understanding of the witness' ability to respond to the summons as issued or the problems the witness will encounter to respond. Often the witness—particularly third party witnesses—can negotiate the scope of the summoned documents. Then, after negotiations as to scope (if any) have concluded, when the IRS is interested only in document production, the witness can negotiate compliance with the IRS by agreeing to photocopy the required documents and deliver either the originals or copies to the IRS or have the agent pick them up at a mutually convenient place. Otherwise, the witness must appear as required and either respond (i.e., produce documents and/or answer the questions), or, as to any questions or requests for documents, assert any grounds that the witness may have for not responding to any question or request for documents.¹⁸¹⁶ The grounds for not complying are typically privileges such as the Fifth Amendment privilege¹⁸¹⁷ and the attorney client privilege (which I cover separately below beginning p. 443) but may also include other privileges or inability to respond (lack of possession of the documents summoned).¹⁸¹⁸

If the witness complies with the summons by producing the requested documents or giving the testimony, that will be the end of the summons compulsion.

¹⁸¹⁵(...continued)

through 5/22/03, *Powell*, decided 10 years after the major constitutional case of *Brown v. Board of Education*, 347 U.S. 483 (1954), has been cited by courts in decisions in the LEXIS database 1,658 times as compared to 2,096 for *Powell*. I'll let you draw your own conclusions on this statistic.

¹⁸¹⁶ The Q&A at the summons proceeding has historically been performed by the line IRS person (revenue agent or collection officer). That person may have been prepped by counsel, but counsel did not perform the Q&A. In 2019, Congress added § 7602(f) to prohibit the IRS from using outside personnel to conduct examinations and summonses “except when such person requires such information for the sole purpose of providing expert evaluation and assistance to the Internal Revenue Service.” Taxpayer First Act of 2019, § 1208, P.L. 116-25, 133 Stat 981 (July 1, 2019). This provision was prompted by controversy about the IRS engagement of outside attorneys to assist in the examination with respect to summonses and interviews in an apparently contentious examination of Microsoft. *United States v. Microsoft Corporation*, 154 F. Supp. 3d 1134 (W.D. Wash. 2015). In 2020, the IRS issued proposed regulations § 301.7602-1(b)(3) to implement new § 7602(f). The regulations generally permit in appropriate cases such outside experts to be present at the interviews but only in a consulting capacity and not to ask questions or address privileges. See 85 FR 47931 (8/7/20). The IRS may provide return information to such outside experts for “tax administration.” § 6103(n). See IRM 11.3.24.3(3), Note (03-17-2020), Disclosure of Returns and Return Information to Vendors and Expert Services noting that § 7602(f) permits disclosure to such outside contractors only “when such person requires such information for the sole purpose of providing expert evaluation and assistance to the IRS”: the provision “is not intended to restrain the IRS from continuing to use court reporters, translators or interpreters, photocopy services, and other similar ancillary contractors.”)

¹⁸¹⁷ *United States v. Zolin*, 491 U.S. 554, 562 (1989).

¹⁸¹⁸ See *United States v. Malhas*, 2015 U.S. Dist. LEXIS 151990 (N.D. Ill. Nov. 10, 2015) (holding that the summoned taxpayer had failed in the summons enforcement proceeding to establish lack of possession or control with respect to foreign bank account records).

If the witness does not comply, however, then additional processes are required because the summons is not self-enforcing.¹⁸¹⁹ The IRS may seek judicial enforcement in the U.S. district court. See §§ 7402(b) and 7604. In the summons enforcement proceeding, the IRS will introduce an affidavit from the agent that will facially establish the *Powell* standards, including most prominently a good faith reason for the information or documents summonsed.¹⁸²⁰ The summons will be enforced summarily on that showing unless the taxpayer meets the following burden:

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.¹⁸²¹

Provided that the witness has asserted the grounds in good faith, the worst the district court can do is reject the witness's good faith position and order compliance with the summons.¹⁸²² If the district court orders compliance with the summons, it will often do so without giving the witness time to appeal the order, although that is within the discretion of the trial court.¹⁸²³ The witness then must either comply or refuse to comply, which will put the taxpayer at the risk of contempt if, upon the completion of the appeal, the court of appeals sustains the district court.

If the taxpayer fails to comply with the district court's order, the Government may institute a "show cause" proceeding before the same district court to hold the taxpayer in contempt for violation of the order enforcing the summons. In the contempt phase of the case, the taxpayer generally may not relitigate defenses he or she could have argued, but did not, in the summons enforcement phase prior to the issuance of the court's order.¹⁸²⁴

¹⁸¹⁹ Because the summons is not self-enforcing, compliance with the summons may be considered a voluntary act rather than compulsion for purposes of suppression. *United States v. Peters*, 153 F.3d 445 (7th Cir. 1998). A witness really concerned about suppression down the road should consider resisting compliance and force the Government to enforce in the manner noted above in the text. However, this may not be an exercise for the faint hearted, so only do that after obtaining competent counsel.

¹⁸²⁰ *United States v. Dynavac, Inc.*, 6 F.3d 1407, 1414 (9th Cir. 1993) (The *Powell* burden "is a slight one, and may be satisfied by a declaration from the investigating agent").

¹⁸²¹ *United States v. Clarke*, 573 U.S. 248, 254-255 (2014). For an oft-quoted summary of the *Powell* requirements in this context, see *Villarreal v. United States*, 524 Fed. Appx. 419, 422-423 (10th Cir. 2013) (unpublished).

¹⁸²² See *Reisman v. Caplin*, 375 U.S. 440 (1964), cited and discussed briefly in *Powell*.

¹⁸²³ See e.g., *Boyd v. United States*, 2002 U.S. Dist. LEXIS 25425 (E.D. Ky. 2002).

¹⁸²⁴ *Reisman v. Caplin*, 375 U.S. 440, 447 (1964) ("noncompliance is not subject to prosecution thereunder when the summons is attacked in good faith. "); see also *United States v. Rylander*, 460 U.S. 752 (1983).

The witness asserting a good faith ground for failing to comply with a summons is well advised to appear pursuant to the summons and assert the ground(s) at that time, rather than taking the risk that first asserting a ground at some later time (e.g., the summons enforcement proceeding or the show cause hearing) may be held too late or to have shifted some burden to him that he will have difficulty meeting. Practitioners who come in late to the representation after the witness has already failed to assert properly the grounds may find some hope in certain cases that may allow late assertions of the privileges or other grounds involved. But practitioners on the scene from the beginning should always advise that the taxpayer appear pursuant to the summons and assert properly the grounds for noncompliance.

d. Summons for Software Source Code.

Computer software and its source code is within the scope of the IRS's general summons authority under § 7602.¹⁸²⁵ However, concerned that the IRS might abuse this power with respect to source code the disclosure of which might be competitively damaging to the taxpayer, Congress enacted § 7612 to limit and put conditions on the IRS's ability to summons and use taxpayer computer source code. I present here only a very broad overview of the provision.

The IRS may not summons any tax-related software computer code “intended for accounting, tax return preparation or compliance, or tax planning.”¹⁸²⁶ The key exception is that the IRS can summons software code if necessary to ascertain the correctness of an item on a return from other sources (such as books and records).¹⁸²⁷

In addition, significant confidentiality and trade secret protections and limitations on use of other software code that the IRS obtains.¹⁸²⁸

e. Summons in Criminal Investigations.

The IRS has the power to investigate tax crimes and may use the summons power in criminal investigations. However, the IRS cannot prosecute crimes nor use the grand jury process in an IRS investigation. Rather, the Department of Justice has sole authority over criminal prosecutions and grand jury investigations. When the IRS determines that it will recommend a taxpayer to DOJ for criminal prosecution, it will make a “referral” to DOJ. A referral for this purpose is an IRS recommendation to DOJ for grand jury investigation or prosecution or a DOJ request to the IRS for return information.¹⁸²⁹ The IRS cannot issue a summons or begin a summons enforcement proceeding with respect to a person (usually the taxpayer) after the that person has been referred to

¹⁸²⁵ *United States v. Norwest Corporation*, 116 F.3d 1227 (8th Cir. 1997).

¹⁸²⁶ § 7216(a)(1) and § 7216(d)(6).

¹⁸²⁷ § 7216(b)(1).

¹⁸²⁸ § 7216(a)(2) and § 7216(c).

¹⁸²⁹ § 7602(d)(2)(A). The person to whom a summons is issued is not the same as a related person who may be under criminal referral arising from the same set of facts. *Equity Inv. Assocs., LLC v. United States*, 40 F.4th 156 (2022) (administrative summons issued to syndicated easement tax partnership does not violate § 7602(d)(A) even though a principal agent of the partnership has been referred to the DOJ).

DOJ. § 7602(d).¹⁸³⁰(Note, however, that this limitation does not apply to a summons issued to a third party witness who has been referred (say a promoter) where the person being investigated and with respect to whom the summons is issued has not been referred to DOJ.¹⁸³¹)

The reason for limiting the use of the summons after DOJ referral is the dichotomy in the criminal investigation and prosecution functions. The IRS cannot prosecute crimes or conduct grand jury investigations. DOJ Tax can; its Criminal Enforcement Section (“CES”) is charged with the sole responsibility to do both. When the IRS investigation has reached the point of a formal DOJ referral, further investigative work with respect to the person referred should be done by a grand jury rather than by the IRS. That act of referral is simply a bright-line test to differentiate between the critical functions.

Prior to the bright-line test, the courts expressed grave concerns about the IRS continuing to use the administrative summons after the IRS had “institutionally” determined that the taxpayer should be referred to DOJ Tax for criminal prosecution.¹⁸³² The concern was that further investigation after that institutional determination should be made only by the DOJ Tax upon referral through the grand jury process and the IRS should not continue to use the IRS administrative summons. When the critical point of an “institutional” determination had been reached was, however, most unclear and spawned much litigation. Congress adopted the bright-line test to provide certainty as to the point when the IRS should no longer use an administrative summons.

The issue of the IRS's bona fides in the use of the administrative summons is still present, despite the “bright-line” test. The IRS controls the timing of the DOJ Tax referral when it makes the referral and can thus continue an IRS investigation long beyond the time that it should have been referred. There is some continuing uncertainty as to whether the bright-line test pre-empts further litigation over the issue of the IRS's bona fides for continued use of the administrative summons.

2. Third Party Summonses.

a. General -Notice to Investigated Party.

A third party summons is a summons to a person other than the person being investigated (usually the taxpayer whose taxes are being investigated) for the records or information of the person being investigated. The third party summons uses the same form as a regular summons.¹⁸³³ The third party summons will identify the person being investigated (usually the taxpayer but others, such as abusive tax shelter promoters, may be investigated). The general rule is that the investigated party must be notified of all third party summonses in sufficient time (minimum of 23 days’ notice) to

¹⁸³⁰ A summons enforcement proceeding commenced before the referral, however, may be continued after the referral. *Drum v. United States*, 602 F. Supp. 834 (M.D. Pa. 1985).

¹⁸³¹ *Khan v. United States*, 548 F.3d 549 (7th Cir. 2008)

¹⁸³² E.g., *United States v. LaSalle Nat'l Bank*, 437 U.S. 298 (1978).

¹⁸³³ Form 2039.

bring a proceeding to quash the summons. § 7609(a).¹⁸³⁴ The notice is sent to the investigated party's last known address.¹⁸³⁵

¹⁸³⁴ A circuit split has developed on the issue of whether failure to meet this notice requirement is fatal to a summons and summons enforcement or whether failure to meet the requirement can be ignored if the taxpayer was not prejudiced. See *Jewell v. United States*, 2014 U.S. App. LEXIS 7899 (10th Cir. 2014) (holding that because the requirement is stated as “shall” the requirement is mandatory and failure to give the notice if fatal to the validity of the summons; the court discusses the contrary authority from other circuits.

In *United States v. First Bank*, 737 F.2d 269 (2d Cir. 1984), the Court held, under the plain language of § 7609(a)(2), a co-owner of an account not identified in the summons is not entitled to notice of the summons. The notice is, of course, the key practical predicate to a motion to quash under § 7609(b) and, consistently, the courts hold that a co-owner not identified in the summons is not entitled to bring a motion to quash if he or she otherwise learns of the summons. *Stewart v. United States*, 511 F.3d 1251 (9th Cir. 2008).

¹⁸³⁵ § 7609(a)(2).

b. Exceptions to Notice Requirement.

There are three key exceptions you will most frequently be concerned with in practice.¹⁸³⁶

First, a summons issued to the taxpayer (or other liable party) does not require notice.¹⁸³⁷ In that case, notice separate from the summons itself would be redundant.

Second, summonses used in aid of collection of an assessed liability against the taxpayer or a transferee require no notice to the party whose liability is being investigated (again, usually the taxpayer).¹⁸³⁸ This would often be a summons to a person having assets that might be levied to collect the assessed liability. Thus, for example, the requirement for notice of third party record keeper summonses does not apply to such summonses.¹⁸³⁹

Third, summonses issued by an IRS criminal investigator require no notice.¹⁸⁴⁰ Even in a criminal investigation, however, the IRS must always give the taxpayer notice of the third party record-keeper summons.¹⁸⁴¹ A third party record keeper summons is a summons issued to the certain

¹⁸³⁶ I list in the text the key exceptions. There is one other exception for a summons issued based upon a court determination that “there is reasonable cause to believe the giving of notice may lead to attempts to conceal, destroy, or alter records relevant to the examination, to prevent the communication of information from other persons through intimidation, bribery, or collusion, or to flee to avoid prosecution, testifying, or production of records.” § 7609(g), which eliminates the notice requirement via § 7609(c)(3). The court proceeding is, of course, ex parte (§ 7609(h)(2)), meaning that the taxpayer is not notified because that would defeat the purpose of seeking authority to issue a summons without notice to the taxpayer.

¹⁸³⁷ § 7609(c)(2)(A).

¹⁸³⁸ § 7609(c)(2)(D). In *Polselli v. IRS*, 598 U.S. ___, 143 S. Ct. 1231 (2023) the Supreme Court clarified (from syllabus):

- “The Court rejects petitioners’ argument that the exception to the notice requirement in §7609(c)(2)(D)(i) applies only if the delinquent taxpayer has a legal interest in the accounts or records summoned by the IRS;
- Court * * * does not define the precise contours of the phrase “in aid of the collection.” The briefing by the parties and the question presented focus only on whether §7609(c)(2)(D)(i) requires that a taxpayer maintain a legal interest in records summoned by the IRS. The answer is no.”

¹⁸³⁹ The exception excepts such summons from § 7609. So the general requirement within § 7609 that requires notice to such third party record keepers is not applicable. By contrast, as noted below in the text, which excepts summonses in criminal investigations § 7609, by special provision, the requirement for notice for third party recordkeeper summons is made applicable for such summonses in criminal investigations.

¹⁸⁴⁰ § 7609(c)(2)(E)(ii). There is another exception which seems to overlap this exception. Section 7609(c)(2)(F) and (g) permit the IRS to seek court approval to forego notice by establishing reasonable cause to believe that the giving of notice may lead to spoliation of potential evidence relevant to the examination. This would likely occur only in a criminal investigation, so the exception cited in the text would apply without the need for court approval. There nevertheless may be real world circumstances, however rare, to which the court approval exception may apply. Note that in the case of either exception there is not prohibition upon the summoned party itself notifying the taxpayer of the receipt of the summons.

¹⁸⁴¹ § 7609(c)(2)(E)(ii).

types of third parties, including most prominently financial institutions,¹⁸⁴² consumer reporting agencies, attorneys, and accountants.¹⁸⁴³

Of course, a taxpayer and the practitioner will want to know if the case has been referred by the civil agent to CI for criminal investigation. The civil agent is not supposed to announce the referral. If the taxpayer receives a notice of a third party record-keeper summons issued by a CI Special Agent, the taxpayer or at least his or her practitioner will know that a criminal investigation is afoot and will be able to respond accordingly. The risk is that the IRS will first use straight third party summonses in the criminal investigation which requires no notice to the taxpayer and, unless the third party advises the taxpayer, the Special Agent can be out gathering evidence while the taxpayer and his or her practitioner are unaware.

Another exception that readers should be aware of given the offshore account brouhaha involving, in many instances, so-called numbered accounts identified only by the number with the taxpayer owning the account not being identified (except perhaps in deep records of the bank. Section 7609(c)(2) permits a summons “issued solely to determine the identity of person having a numbered account with a bank or financial institution which is a third party recordkeeper defined in section 7603(b)(2)(A).” This “no notice” summons authority reflects the practical reality that all the IRS knows is the account number; the IRS does not know the identity of the owner and therefore can’t give notice.¹⁸⁴⁴ Once the IRS has the name of the owner, it can then issue a regular summons to the financial institution. This “no notice” summons is not the same as a John Doe Summons (“JDS”) where, as to accounts in financial institutions, the IRS may not have any information but by stating characteristics for the accounts compels the financial institution receiving the summons to identify the owner and the bank account numbers and produce other information and documents related to the account(s). (I discuss the JDS in this context in more detail immediately below.)¹⁸⁴⁵

¹⁸⁴² The Right to Financial Privacy Act (“RFPA”), 12 U.S.C. § 3401, requires privacy from government searches except in certain cases. An except is in § 3414(c), which provides “Nothing in this chapter prohibits the disclosure of financial records in accordance with the procedures authorized by Title 26.”

¹⁸⁴³ § 7603(b)(2).

¹⁸⁴⁴ For an example of this type of summons, referred to as a “no notice” summons, see *Charles v. United States*, 2013 U.S. Dist. LEXIS 153586 (W.D. Mich. 2013) (holding that IRS improperly used the “no notice” summons because the account was not a “numbered account.”), reh. den. 2013 U.S. Dist. LEXIS 152715 (W.D. Mich., 2013).

¹⁸⁴⁵ I am not sure how important this “no notice” summons is. I have never seen it used. I suspect that financial institutions within the summons power (most U.S. financial institutions or foreign financial institutions with U.S. presence) have number bank accounts or similar arrangements. Still, I presume that, since foreign banks were subject to the JDS power in some instances, they should be subject to this “no notice” summons power if they have numbered accounts or similar arrangements. But this “no notice” summons would presumably require the number of the account or some other way to identify the account in question, otherwise it would have to identify by characteristics which is the classic JDS requiring court approval.

3. The John Doe Summons (“JDS”).

The “John Doe Summons” (“JDS”) is a summons to a third party who has or may have information related to one or more taxpayers whose identities are unknown to the IRS. § 7609(f).¹⁸⁴⁶ The quintessential example of a target of a JDS is the promoter of an allegedly abusive tax shelter that has been widely sold where the IRS desires to discover the names of all the investors. The JDS must (i) “relates to the investigation of a particular person or ascertainable group or class of persons”;¹⁸⁴⁷ (ii) be issued with a “a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law”;¹⁸⁴⁸ and (iii) the information sought by the JDS “a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law.”¹⁸⁴⁹ Further the information sought must be “narrowly tailored to information that pertains to the failure (or potential failure) of the person or group or class of persons referred to in paragraph (2) to comply with one or more provisions of the internal revenue law which have been identified for purposes of such paragraph.”¹⁸⁵⁰

Since the JDS is issued to determine the identity of one or more unknown taxpayers as well as to obtain other tax relevant information or documents, the IRS cannot give the taxpayer(s) notice otherwise required for third party summonses.¹⁸⁵¹ Rather, § 7609(f) requires that the IRS first convince a court that the investigation relates to a particular person or ascertainable group or class of persons, that there is reasonable cause to believe that the person or persons so identified may not have complied with the tax laws, and that the information sought is not readily available from other sources.¹⁸⁵² The check in the normal third party summons procedures is that the taxpayer, who must be notified (subject to the rules noted above), will have the incentive to contest any overreaching by the IRS. As to unidentified taxpayers, however, the IRS cannot provide notice because it does

¹⁸⁴⁶ Section 7609(f) was enacted in 1976 in response to *United States v. Bisceglia*, 420 US 141 (1975) which sustained John Doe summonses under the general Code authority to investigate and summons. Section 7605(f) imposes conditions not otherwise required by *Bisceglia*. For a history, see Bryan T. Camp, Tax Administration as Inquisitorial Process and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998, 56 Fla. L. Rev. 1, 66-69 (2004).

¹⁸⁴⁷ § 7609(f)(1).

¹⁸⁴⁸ § 7609(f)(2).

¹⁸⁴⁹ § 7609(f)(3).

¹⁸⁵⁰ § 7609(f) (flush language), as added by Taxpayer First Act of 2019, § 1204, P.L. 116-25, 133 Stat 981 (July 1, 2019). It is not clear to me that this addition adds anything material because § 7609(f)(2) requires that the Government establish “a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law.” See also IRM 25.5.7.3.2 (06-04-2020), Necessary Purpose (“A John Doe summons cannot be used to conduct a ‘fishing expedition.’”). Perhaps the added language is just a reminder that the IRS, DOJ Tax and the court focus on the needs and articulate them in the pleadings and order, respectively.

¹⁸⁵¹ § 7609(c)(2)(F) excepts this situation from the general taxpayer notice requirement. See also Reg. 301.7609-2(f).

¹⁸⁵² In a case (apparently aberrational), the IRS served the JDS without first obtaining court approval. See *Hohman v. Eadie*, 894 F.3d 776 (6th Cir. 2018).

not know who they are.¹⁸⁵³ The requirement for advance court approval for such summonses is a surrogate -- a check by an objective third party -- for notice to the taxpayer.¹⁸⁵⁴

Traditionally, a taxpayer within the scope of the JDS had no pre-enforcement remedy, meaning that the taxpayer could only contest the validity of the JDS, if at all, after the IRS uses the information or documents obtained by the JDS in tax determinations or in criminal tax cases where the taxpayer might seek to prevent use of the information or document. However, in a recent case,¹⁸⁵⁵ based on an extension of *CIC Services, LLC v. IRS*, 583 U.S. ___, 141 S. Ct. 1582 (2021) (discussed at p. 655), the First Circuit held that a taxpayer can challenge the JDS issued to obtain his information and documents from a cryptocurrency exchange, Coinbase. The Court reasoned that the Anti-Injunction Act (“AIA”), § 7421(a), prohibiting suit involving assessment and collection of tax did not apply because all the JDS sought was information, noting that the AIA applies to assessment and collection and does not apply all activities that may improve ability to assess and collect taxes. (I caution readers that I think this holding is questionable and may not stand the test of further litigation or amendments to the statute.)

If the summonsed party refuses to comply with the JDS, the Government must seek judicial enforcement under the regular summons enforcement procedures.¹⁸⁵⁶

Like the regular summons, “in the absence of the resolution of the summoned party’s response to the summons,” the JDS extends the tax statutes of limitation – civil and criminal – for

¹⁸⁵³ § 7609(i)(4) requires the party receiving the JDS summons to notify the taxpayer if the statute of limitations is suspended under § 7609(e)(2), but that suspension kicks in after 6 months from the receipt of the summons, so it would not be timely notice to the taxpayer in time to assert defenses to the original issuance of the summons.

¹⁸⁵⁴ See *United States v. Gertner*, 65 F.3d 963, 965 n.1 (1st Cir. 1995) (“[T]he court in effect ‘takes the place of the affected taxpayer’ who, being unnamed, cannot herself be expected to know about—let alone to oppose—the summons even if it is irregular.” (quoting *Tiffany Fine Arts*, 469 U.S. at 321)). See also *Samuels, Kramer and Co.*, 712 F.2d 1342, 1346 (9th Cir. 1983) (“a procedural safeguard which Congress created to provide extra protection to unknown target taxpayers to whom the IRS cannot give notice.”). Congress could have required – but did not require – that the summoned party, who presumably does know the unnamed targets of the summons, give timely notice to those targets which could give them an opportunity to contest the summons. Congress did, however, require that the summoned party give notice to those persons when the statute of limitations has been suspended by noncompliance with the JDS. § 7609(i). That notice, however, would only be given 6 months after service of the summons. § 7609(e)(2).

Of course, if the unnamed persons within the scope of the JDS discover it in time to make an effective intervention in the summons proceeding, they may intervene anonymously to protect their interests. E.g., *United States v. Coinbase*, 2017 U.S. Dist. LEXIS 111756 (N.D. Cal. 2017) (allowing intervention as of right and permissive intervention by anonymous customer of Coinbase).

It appears that a taxpayer damaged by issuing a JDS without the required court approval may not have a remedy for damages, even if the improper JDS is issued to a bank where the taxpayer might otherwise have a damages remedy under 12 U.S.C. § 3417, the Federal Right to Financial Privacy Act. See *Hohman v. Eadie*, 2017 U.S. Dist. LEXIS 106439 (E.D. Mich. 2017), aff’d sub nom. *Hohman v. Eadie*, 894 F.3d 776 (6th Cir. 2018).

¹⁸⁵⁵ *Harper v. Rettig*, 46 F.4th 1 (1st Cir. 2022).

¹⁸⁵⁶ *United States v. Coinbase*, 2017 U.S. Dist. LEXIS 111756 (N.D. Cal. 2017) (noting the summons enforcement proceedings and allowing an anonymous customer within the scope of the summons to intervene).

the unidentified persons within the scope of the JDS.¹⁸⁵⁷ The person receiving the JDS is required to give notice of the statute extension to those unidentified persons.¹⁸⁵⁸

The JDS procedures were designed to provide checks and balances. But the IRS often finds that the procedures are slower and more cumbersome than the regular summons. For the JDS, the IRS must convince DOJ Tax, whose attorneys are plenty busy with other work, that it is worth going through the procedures to get the summons. DOJ Tax must gear up and present the matter to a frequently skeptical and almost always overworked District Judge who must play devil's advocate to the Government's ex parte application for the summons. Obviously, the IRS would much prefer just to use its administrative summons which has no such cumbersome steps.

In *United States v. Tiffany Fine Arts, Inc.*, 469 U.S. 310 (1985), the Supreme Court blessed the IRS's use of the regular administrative summons rather than the JDS where the target of the summons had transactions relevant to its tax liability which, if discovered, might also identify unknown third parties' and be relevant to their tax liabilities. The person summonsed in *Tiffany Fine Arts* was a tax shelter promoter who sold the allegedly abusive tax shelter product to unknown third parties. By allegedly investigating the promoter's tax liability by inquiring into the sources of its income, the IRS could summons the information under the general administrative summons by meeting the minimal requirements of *Powell*. The Supreme Court blessed that gambit and refused to require the JDS procedure. After *Tiffany Fine Arts*, the IRS saw the end-run around the JDS procedures – simply find a reason to audit the third party record-keeper such as the tax shelter promoter and find some pretext that obtaining the names of the third parties is relevant under the *Powell* standards to the audit of the third party record-keeper; indeed, in the IRM, the agents are encouraged to seek such a “dual-purpose” regular summons as in *Tiffany-Fine Arts*.¹⁸⁵⁹

In *United States v. Gertner*, 65 F.3d 963 (1st Cir. 1995), which you should now read, a law firm filed a Form 8300 (Report of Cash Payments Over \$10,000 Received in a Trade or Business) notifying the IRS that the law firm had received in excess of \$10,000 in cash. The form, however, failed to identify the taxpayer, asserting ethical grounds, the attorney client privilege and constitutional grounds. The IRS then issued a regular IRS summons to the law firm to produce the withheld information. The IRS used the regular IRS summons as opposed to the JDS on the ground the Supreme Court blessed in *Tiffany Fine Arts* -- i.e., that the summonsee's – the law firm's – taxes were being investigated as well as the unknown taxpayer's taxes. Analyzing the case under the

¹⁸⁵⁷ Section 7609(e)(2).

¹⁸⁵⁸ Section 7609(i)(4); Reg. § 7609-3(d) (reiterating the statutory notice requirement and stating the contents of the required notice and the time and manner of notification). There is no indication that the statute extension does not apply if the summonsed third party does not provide the required notice; hence, I suspect that the extension would apply.

¹⁸⁵⁹ IRM 34.6.3.5(1) (02-01-2011), John Doe Summonses provides:

Prior to making a determination with regard to the service of a John Doe summons, consideration should be given to the use of a dual-purpose summons. See *Tiffany Fine Arts, Inc. v. United States*, 469 U.S. 310 (1985). A dual purpose summons is a summons served with the dual purpose of investigating liabilities of a taxpayer and of unnamed parties. Such a summons does not need to meet the requirements of a John Doe summons if the information sought may be relevant to the legitimate investigation of the identified taxpayer.

Powell good faith standard, the district court concluded that the IRS's grounds for using the general summons—i.e., that it was investigating the law firm's tax liability—was pretextual, mere smoke and mirrors to achieve the real goal of discovering the identify the unknown taxpayer to investigate him. The Court of Appeals affirmed, noting importantly that the JDS procedure required advance court approval, a procedure the Government sought to avoid here on the pretext that it was after something more than the taxpayer's identity. The Court of Appeals noted that the requirement of advance court approval could not be ignored by the IRS simply by chanting in the affidavit a litany based on *Tiffany Fine Arts*.

In IRS moves against tax shelters, the IRS issued general IRS summonses directly to advisors promoting the products (large accounting and law firms) to obtain the lists of investors that the statute requires them to keep when selling tax shelters. The general summons was used because the obligation to maintain the lists is on the promoter and thus the IRS was investigating whether the promoters had met that obligation. Obviously, if the IRS got such a list, the IRS would have the identities of the investors and could proceed against them accordingly. The accounting and law firms, looking to protect their “clients,” asserted the various privileges (including the attorney-client identity privilege and a variant thereof under the new tax practitioner privilege under § 7525). After meeting some resistance in the courts, the IRS shifted to using the JDS against the accounting and law firms and used both the regular summons and JDS.

In two successive initiatives involving foreign bank accounts, the Government has also used JDSs to identify holders of foreign bank accounts and foreign bank credit or debit cards that are the frequent tools of U.S. tax evaders.¹⁸⁶⁰ The first round in the late 1990s was directed toward the Caribbean banks offering credit cards to the U.S. taxpayers that supposedly left no U.S. paper trail. The JDS was issued to the U.S. based credit card receipt processors.¹⁸⁶¹ The second round, a 2009 initiative, was against UBS, a prominent Swiss bank, that allegedly had up to 52,000 U.S. taxpayer accounts and had extensive U.S. presence so as to be subject to the jurisdiction of U.S. courts. The IRS's ability ultimately to force compliance with the summons to UBS, a foreign bank, was ultimately never tested because the Government combined a criminal initiative against UBS (ultimately including a deferred prosecution agreement and a fine of \$780 million). The combination gave UBS and the Swiss Government incentive to reach a deal with the United States. Compliance ultimately came, at least for 4,500 of the names, from Switzerland's re-imagining of its obligations under the mutual information exchange provisions of the U.S. / Switzerland's double tax treaty. The IRS has used similar JDS's against other foreign banks with sufficient U.S. presence directly or through subsidiaries to be within the compulsive power of the JDS.

Both of the initiatives discussed in the last paragraph were coupled with specially targeted voluntary disclosure initiatives to get the U.S. taxpayers to pony up the information and delinquent tax and interest in exchange for reduced penalties. In the case of the second initiative, the penalty

¹⁸⁶⁰ For a good article, see William M. Sharp, Sr. and Larry R. Kemm, The UBS Summons and Voluntary Disclosure, TNI 1043 (9/22/2008).

¹⁸⁶¹ For a case showing how the IRS used the JDS in this initiative, see *United States v. Norwood*, 420 F.3d 888 (8th Cir. 2005).

relief included relief from the potentially draconian FBAR penalties discussed beginning p. 967. I discuss these voluntary disclosure initiatives beginning on p. 328.

Since the UBS JDS, the IRS has continued to use the JDS in its broader offshore account initiative when it has been able to obtain a foreign bank affiliate with sufficient U.S. presence to support the issuance of a summons with effective contempt power.

In 2016, the IRS obtained court permission to serve a JDS on a leading “bitcoin” processor located in the U.S., Coinbase. Bitcoin is an internet based medium of exchange with features of currency that seemed to offer anonymity to users.¹⁸⁶² Law enforcement is concerned that bitcoin attracts illegal activity, such as money laundering. In the tax setting, bitcoin’s perceived anonymity seemed to offer tax evaders the type of risk profile that previously attracted tax risk takers to offshore bank accounts.¹⁸⁶³ The IRS had information that bitcoins had been used to repatriate money from offshore accounts. The JDS sought from Coinbase the names of the unknown users of bitcoin accounts, similar to the way the UBS JDS was used for unknown account holders.¹⁸⁶⁴ After some trial level sparring, the IRS and Coinbase settled for a scaled down set, but still significant set of 13,000 customers.¹⁸⁶⁵

Bitcoin is only one type of “virtual” currency that may lend itself to criminal activity, including tax evasion. The IRS may expand this activity to other virtual currencies and processors.

4. The Designated Summons.

Section 6503(j) authorizes the IRS to issue a designated summons to a corporate taxpayer under the coordinated issue case program (“CIC”)¹⁸⁶⁶ or a third party with respect to a corporate tax

¹⁸⁶² *United States v. Coinbase* (N.D. Cal. No. 17-cv-01431-JSC).

¹⁸⁶³ For the IRS’s view on how bitcoin transactions are taxed, see IR-2014-36; and Notice 2014-21. Basically, the IRS treats bitcoins as property rather than as currency, so that all transactions in bitcoin are taxed as if they were property transactions with the consequences the same as if the payment were in any other type of property. For example, an employee paid in bitcoin is taxed the same as if the employee were paid by gold coins, so that withholding and Forms W-2 are required.

¹⁸⁶⁴ I have reported this development in [IRS seeks John Doe Summons to Bitcoin Firm](#) (Federal Tax Crimes Blog 11/23/16; 11/30/16). The IRS subsequently narrowed the scope of the JDS to Coinbase. *United States v. Coinbase*, 2017 U.S. Dist. LEXIS 111756 (N.D. Cal. 2017)

¹⁸⁶⁵ See [Coinbase Will Comply with JDS on Approximately 13,000 Customers for Bitcoin Transactions](#) (Federal Tax Crimes Blog 2/26/18).

¹⁸⁶⁶ Prop. Reg. § 301.6503(j)-1(c)(1)(i). The statute refers to the “coordinated examination program” which was the program the IRS previously used to exam larger corporate taxpayers. The statute contemplates that the program may evolve and thus applies to “any successor program.” The IRS has identified the current program in the Proposed Regulations as the CIC specified in the text. See IRS Notice of Proposed Rulemaking reproduced at 2003 TNT 147-10 (7/31/03). Taxpayers are divided into two categories—CICs and ICs with CICs generally comprising the largest taxpayers each of whom is examined by teams of IRS examiners and ICs each of whom is generally assigned to one examiner. The CIC program is being renamed the Large Corporate Compliance (“LCC”) Program. See Publication 5319, titled FY2019 LB&I Strategic Goals, LB&I Commissioner’s Message.

liability under the program.¹⁸⁶⁷ The designated summons suspends the statute of limitations if (1) the corporate taxpayer or third party does not comply with the summons and (2) the IRS brings a judicial enforcement proceeding before the end of the statute of limitations.¹⁸⁶⁸ The statute of limitations is suspended during the judicial enforcement proceeding plus a minimum of 60 days.¹⁸⁶⁹

The designated summons is just a type of summons and therefore must meet the *Powell* standards. Further, the IRS can issue the designated summons without any requirement that the taxpayer has been uncooperative or dilatory.¹⁸⁷⁰ In other words, the IRS can issue the summons when it (the IRS) has itself been dilatory or has not timely allocated adequate audit resources to conclude the audit within the time frame that Congress allowed for audits, and thereby unilaterally keep open the statute of limitations. The suspension period begins on the date the court proceeding to enforce the summons is commenced and ends on the day the court proceeding is finally resolved. § 6503(j)(3).¹⁸⁷¹ The regulations and the IRM provide guidance as to how the suspension period is calculated and the court proceeding is finally resolved so as to end the suspension period.¹⁸⁷² The Commissioner or his delegate makes the determination of final compliance as soon as practicable. A procedure is established for the summoned party to make a statement of compliance that will require that the IRS respond with notice that the IRS takes the position that the party has or has not complied.

Because it can be used to keep open the statute of limitations unilaterally, Congress required that the designated summons be reviewed and approved in writing by the Commissioner of the operating division and by Chief Counsel and attach a statement of facts establishing that the IRS made reasonable requests for the information subject to the summons.¹⁸⁷³ In any court proceeding, the IRS must establish that the IRS made those reasonable requests.¹⁸⁷⁴ Consistent with Congress' purpose, the IRS uses the designated summons only sparingly because, so it is reported, just the

¹⁸⁶⁷ § 6503(j)(2). When the summons is to a third party, the summons is referred to as a “related summons.” IRM 25.5.3.3.2 (08-02-2019), Conditions a Related Summons Must Meet.

¹⁸⁶⁸ § 6503(j)(1). For a discussion of the interplay of the suspension for the designated summons and consents to extend the statute of limitations, see FSA 200221004 (2/6/02), reprinted at 2002 TNT 102-74 (5/28/02).

¹⁸⁶⁹ § 6503(j)(1).

¹⁸⁷⁰ *United States v. Derr*, 968 F.2d 943 (9th Cir. 1992).

¹⁸⁷¹ For more on the procedures for the designated summons, see IRM 25.5.3.3 (08-02-2019), Designated Summons and the subparts to this part of the IRM. The IRM says that:

The suspension provision for designated and related summonses was enacted to address the refusal by some corporate taxpayers to disclose information necessary to the examination, such as by transferring the records to another entity, and the refusal to extend the limitations period, thus forcing the IRS to issue notices of deficiency before fully examining the return.

¹⁸⁷² Reg. § 301.6503(j)-1. See also IRM 25.5.3.3.3 (08-02-2019), Concepts Key to Correct Application of IRC § 6503(j) Suspension, and the subparts to this part of the IRM. For example, IRM 25.5.3.3.5 (07-11-2013), Final Resolution provides “Final resolution occurs when the designated or related summons or any order enforcing any part of the designated or related summons is fully complied with and all appeals or requests for further review are disposed of, the period in which an appeal may be taken has expired, or the period in which a request for further review may be made has expired.”

¹⁸⁷³ § 6503(j)(2)(A)(i), as amended by Taxpayer First Act of 2019, § 1207(a), P.L. 116-25, 133 Stat 981 (July 1, 2019).

¹⁸⁷⁴ § 6503(j)(4).

threat that the summons might be used has modified taxpayer behavior in response to IRS's requests for information and documents.

The IRS uses the standard IRS summons¹⁸⁷⁵ for the designated summons but must display prominently at the top of that summons the following: "This is a designated summons pursuant to section 6503(j)."¹⁸⁷⁶

5. Litigation Regarding Summonses.

Litigation regarding summonses may arise in the following contexts.

(1) If the IRS is not satisfied with the witness's response, the IRS may bring a summons enforcement proceeding under §§ 7402(b) and 7604. The summons enforcement proceeding is pursued as in *Powell* and *Tiffany Fine Arts* by the government filing a petition (just a pleading) and an affidavit containing the critical allegations of fact, along with any other supporting documents to establish its prima facie case. The taxpayer will then have a limited opportunity to contest the existence of the *Powell* predicates. See the discussion earlier in the text (beginning p. 423) about summons enforcement proceedings. To summarize, courts usually summarily enforce the summons with only limited discovery or hearing on the IRS's petition to enforce, if the petition is procedurally regular with an IRS affidavit asserting the *Powell* predicates and no taxpayer responsive allegation with some support as to the absence of one or more of the *Powell* predicates. Usually, the taxpayer will be unable to successfully perfect a *Powell* attack.

The IRS will often choose not to file a summons enforcement proceeding upon a witness' noncompliance, if it has some alternative method for obtaining the information, if the information is deemed relatively unimportant, or if the statute of limitations does not permit the orderly conclusion of the judicial enforcement proceedings (including the administrative steps to obtain DOJ approval to institute the proceedings). Note, however, that the key element of the designated summons -- the suspension of the statute of limitations -- requires the prompt commencement of judicial enforcement proceedings.

(2) If the witness is a third party witness, the taxpayer entitled to notice under § 7609(a)(1) of the summons may file a court proceeding to quash or intervene in a proceeding to enforce the summons unless the third party witness is not a third party recordkeeper. § 7609(b)(1) & (2)¹⁸⁷⁷ and (c)(2)(E). Recall from the discussion of the notice requirement above that there are

¹⁸⁷⁵ Form 2039.

¹⁸⁷⁶ IRM 25.5.3.3.1 (08-02-2019), Conditions a Designated Summons Must Meet.

¹⁸⁷⁷ Thus, parties who might potentially be affected but who are not entitled to notice may not file a petition to quash. For example, the third party witness upon whom the summons is directed may not bring a proceeding to quash because the summons itself is not the required notice which is the jurisdictional prerequisite to a proceeding to quash. *Xoriant Corporation v. United States*, 2014 U.S. Dist. LEXIS 152675 (N.D. Cal. 2014). In addition, other affected parties who are not entitled to notice cannot bring a proceeding to quash. For example, in *Stewart v. United States*, 511 F.3d 1251 (9th Cir. 2008), the IRS summoned the records of a bank account in which husband and wife were co-owners and the husband and wife then filed a motion to quash. The Court held that the wife, who was not name in the summons, (continued...)

exceptions to the general requirement that the taxpayer be given notice; if the taxpayer is not entitled to notice, the taxpayer may not move to quash or intervene.¹⁸⁷⁸ The proceeding to quash must be brought in the district where the witness “resides or is found.”¹⁸⁷⁹ The petition to quash must be filed within 20 days after notice of the summons and a copy of the petition must be contemporaneously mailed to the summonsed party and to the IRS.¹⁸⁸⁰ However, taxpayers and their counsel considering such action need to seriously review the bases they will assert for quashing. As noted above, under the *Powell* standard the bases for overturning an IRS summons are limited indeed. Accordingly, framing the motion to quash must be done with care and with attention to the fact that a frivolous motion might attract sanctions under Rule 11 of the Federal Rules of Civil Procedure.

The rights to move to quash or intervene are rights to participate in litigation. The statute does not confer any rights for the taxpayer being investigated to participate in or attend the summons interview itself. The statute does not deny the taxpayer the right to participate in or attend the interview, but courts have generally held that the taxpayer has no such right unless the taxpayer has some legally protectable interest, such as confidential attorney-client communications, that the summonsed witness might not properly preserve.¹⁸⁸¹

Litigating the propriety of the summons can affect the statute of limitations even if the summons is not a designated summons. If the taxpayer brings the proceeding to quash a summons subject to the limitations of § 7609, the civil and the criminal statute of limitations will be suspended during the period that the proceeding, including appeals, is pending. § 7609(e)(1).¹⁸⁸² Further, if the IRS and the summoned party—either a third party to which the taxpayer is entitled to notice or a third party served a John Doe Summons (“JDS”)—do not resolve compliance with the summons, the civil and criminal statute of limitations for the taxpayer with respect to whom the summons was issued is suspended from a date six months after the summons was issued until compliance is finally resolved. § 7609(e)(2).¹⁸⁸³ The point, of course, that merely moving to quash the summons even if you can avoid potential sanctions under Rule 11 may not be in the client's interest. On the other hand, however, in some situations depending upon close analysis of the situation, merely slowing

¹⁸⁷⁷(...continued)

could not file a petition. See also *United States v. First Bank*, 737 F.2d 269 (2d Cir. 1984) (holding that, under § 7609(a)(2), a co-owner of an account not identified in the summons is not entitled to notice of the summons).

¹⁸⁷⁸ *Gaetano v. United States*, 994 F.3d 501, 506-511 (6th Cir. 2021) (holding that the exceptions defeat the United States' waiver of sovereign immunity, thus defeating jurisdiction).

¹⁸⁷⁹ § 7609(h)(1). See *Deal v. United States*, 759 F.2d 442, 444 (5th Cir. 1985); *Masat v. United States*, 745 F.2d 985, 986-8 (5th Cir. 1984).

¹⁸⁸⁰ § 7609(b)(2)(B); see Reg. § 301.7609-4(b)(3) and *Mollison v. United States*, 568 F.3d 1073, 1075 (9th Cir. 2009) (holding that the requirements in the text above must be met, but no requirement that the United States be served within the 20 day period).

¹⁸⁸¹ *United States v. McEligot*, 2015 U.S. Dist. LEXIS 45519 (N.D. Cal. Apr. 6, 2015) (discussing cases).

¹⁸⁸² Note that, if the summons is not subject to the requirements of § 7609, its contest in litigation also does not invoke the § 7609 provision for suspending the statute of limitations on assessment. Thus, for example, summons in aid of collection of an assessment already made are not subject to § 7609 (and obviously do not need a suspension of the assessment statute of limitations). See ILM 200550001 (11/9/05), reproduced at 2005 TNT 242-20.

¹⁸⁸³ Reg. § 301.7609-5(d)(1) and (3). A John Doe summonsee is required to notify the ultimate taxpayer(s)—the “John Doe(s)” —of the statute suspension. § 7609(i)(4); Reg. § 7609-3(d) (reiterating the statutory notice requirement and stating the contents of the required notice and the time and manner of notification).

down the IRS's investigative juggernaut even at the cost of a suspended statute of limitations may be a good strategic call.

The district court ordering enforcement of the summons may order compliance with the summons before an appeal can be pursued.¹⁸⁸⁴ The taxpayer feeling the district court has improperly enforced the summons then faces the Hobson's choice of complying or refusing to comply, thus being held in contempt by the district court. Courts will undertake a balancing of the following interests in determining whether to stay compliance pending an appeal: (1) whether the stay applicant has made a strong showing that he is likely to succeed on the merits; (2) whether the applicant will suffer irreparable injury without a stay; (3) whether issuance of a stay would substantially injure the other parties; and (4) whether the public interest would be served by a stay.¹⁸⁸⁵

The district court may not enforce the summons as written by the IRS. The district court may enforce as to part of the summons but not as to a part as to which the *Powell* factors are not present, or the district court may conditionally enforce a summons.¹⁸⁸⁶

For those practitioners advising clients whether to contest a summons, consider the following quote:

Those who resist an IRS summons all have one thing in common: They lose. Only about one challenge in 200 succeeds even in part.

* * * *

Practically speaking, “the taxpayer bears an almost impossible burden to resist enforcement of the summons.”¹⁸⁸⁷

It is not inconceivable that contesting a summons without some minimum good faith basis might draw sanctions in the proceeding but might even be viewed as an attempt to obstruct justice as a sentencing enhancement in a subsequent criminal conviction.¹⁸⁸⁸

¹⁸⁸⁴ See e.g., *United States v. Soong*, 2015 U.S. Dist. LEXIS 118585 (N.D. Cal. 2015) (ordering contempt for noncompliance while appeal was pending), aff'd 650 Fed. Appx. 425 (9th Cir. 2016).

¹⁸⁸⁵ *Hilton v. Braunskill*, 481 U.S. 770, 776 (1987); see also *Ruiz v. Estelle*, 650 F.2d 555, 565 (5th Cir. Unit A June 1981); see also *Boyd v. United States*, 2002 U.S. Dist. LEXIS 25425 (E.D. Ky. 2002).

¹⁸⁸⁶ *United States v. Monumental Life Ins. Co.*, 440 F.3d 729 (6th Cir. 2006).

¹⁸⁸⁷ Bryan T. Camp, *The Inquisitorial Process of Tax Administration*, 2004 TNT 120-43 (6/10/04), quoting *United States v. Garden State Nat'l Bank*, 607 F.2d 61, 67 (3rd Cir. 1979) (when “the IRS has not recommended criminal prosecution to the Justice Department and the investigating agent has not recommended prosecution to his superiors within the IRS, the taxpayer bears an almost impossible burden to resist enforcement of the summons”).

¹⁸⁸⁸ See Sentencing Guidelines § 3C1.1 (2008 ed.).

6. Use of IRS Summonses under U.S. Tax Treaties.

In an increasingly globalized economy, records relevant to tax administration in one country may be possessed by someone in another country. Under many U.S. bilateral tax treaties, one treaty partner is obligated to assist the other in gathering information relevant to the latter's tax administration. For example, the Canadian tax authority (referred to as the “competent authority” in treaty parlance) under the U.S./Canada Double Tax Treaty may request the U.S. tax authority (i.e., the U.S. competent authority) to obtain information in the U.S. for Canadian tax administration. (This is commonly referred to as an “exchange of information” provision.) If the request is within the scope of the treaty, the U.S. competent authority will authorize the IRS to issue an administrative summons. The ultimate taxpayer involved may then bring a motion to quash if the summons is to a third party or, if the summons is to the taxpayer, may invoke any basis for noncompliance and await the IRS's pursuit of a summons enforcement proceeding.

In *United States v. Stuart*, 489 U.S. 353 (1989), Canada made such a request to the U.S., the U.S. issued summonses to third parties, and the taxpayer brought a motion to quash. The issue presented was whether the Code's limitation on the use of administrative summonses when a DOJ referral is in effect (§ 7602(d)) applies in the case of a summons issued under the Canadian treaty in relation to the Canadian tax. That Code limitation had been enacted after the U.S./Canadian double tax treaty in question had been negotiated and entered into force. Arguably, even if that limitation were not in the treaty, Congress's subsequent legislation may have created a treaty override. The taxpayer argued that the status of the Canadian tax investigation was the equivalent of a DOJ referral and thus the use of an IRS administrative summons was not proper. The Court held that, notwithstanding the subsequent enactment, the treaty itself controlled and had no such limitation, so that it need not inquire into the status of the Canadian investigation.

In subsequent cases, courts have held that the propriety of the foreign country's tax investigation is not relevant to whether the IRS can issue and enforce the summons (or avoid a petition to quash the summons); rather, the issue is whether the IRS has met the *Powell* requirements for the summons focusing on its actions and not that of the foreign treaty partner requesting the IRS to use its processes to obtain the requested information.¹⁸⁸⁹

Similar processes are available under the OECD Convention on Mutual Assistance in Tax Matters, which is a multilateral treaty, and possibly other treaties as well, although most of the litigated cases appear to involve the bilateral double tax treaties.

The situation discussed deals with the procedure whereby the IRS uses its processes to obtain information for treaty partner tax administration. I discuss below the processes available when, for U.S. tax administration, the IRS requests foreign authorities to use their processes to obtain information in their jurisdiction.

¹⁸⁸⁹ E.g., *Mazurek v. United States*, 271 F.3d 226, 230 (5th Cir. 2001); and *Hanse v. United States*, 2018 U.S. Dist. LEXIS 35571 (N.D. Ill. 2018).

7. Taxpayer Interviews.

a. Taxpayer Rights.

Section 7521 grants certain rights for taxpayer interviews, whether voluntarily or pursuant to a summons. The statute says that these rights do not apply in criminal investigations, but as I note in the footnote the practical equivalent of the key right (right to counsel in interviews) does apply in criminal investigations.¹⁸⁹⁰

An authorized practitioner may represent the taxpayer at meetings with the IRS; the IRS may not require the taxpayer's presence except by summons.¹⁸⁹¹ Notwithstanding this, taxpayers or authorized representatives sometimes agree to taxpayer interviews **without a summons**. If the taxpayer voluntarily (without summons) participates in the interview without representation, upon the taxpayer's request to consult with an authorized representative, the interview will be suspended.¹⁸⁹² If the taxpayer at an unrepresented interview **pursuant to IRS summons** and the taxpayer asks that the interview be suspended to consult a representative, the IRM advises IRS personnel to continue interview;¹⁸⁹³ as a practical matter, the taxpayer can decline to answer further questions, in which case the IRS's choice is to continue the interview after the taxpayer consults with the representative or seek judicial enforcement of the summons after making the record of all the questions asked for which an answer was not given.¹⁸⁹⁴

If the IRS officer and his immediate supervisor determine the representative is unreasonably delaying or hindering the examination, the IRS may notify the taxpayer directly (rather than through

¹⁸⁹⁰ § 7521(d) (also applying to interviews in "investigations relating to the integrity of any officer or employee of the Internal Revenue Service."); As to criminal investigations, see 26 C.F.R. § 601.107(b) ("A witness when questioned in an investigation conducted by the Criminal Investigation Division may have counsel present to represent and advise him."); IRM 9.4.5.11.1 (02-01-2005), Right to Advice of Counsel ("Subject's counsel, however, should not be permitted to control or censor the replies of the witnesses nor attempt to interfere with the examination or impede or delay the progress of the interview, interrogation, or conference."); IRM 9.5.1.3.3 (09-27-2011), Dealing with Powers of Attorney (speaking broadly to powers of attorney (rather than just for attorneys, "Despite the exemption provided by 26 USC §7521(d), it is CI's policy to honor powers of attorney so long as doing so would not hinder an investigation."). Prior to starting interview ("interrogation"), the IRS criminal agent will advise the interviewee of the modified *Miranda* rights to remain silent, that his statements may be used against him, and the right to presence of an attorney. IRM 9.4.5.11.3.2.1.1 (05-15-2008), Procedures (The IRM refers to these as *Miranda* rights, based on *Miranda v. Arizona*, 384 U.S. 436 (1966). Technically, full blown *Miranda* rights warnings are required only for custodial interrogations, which are rarely made in criminal tax investigations. IRM 9.4.5.11.3.2.1 (05-15-2008), Interview of Persons in Custody. The IRS version of the *Miranda* rights is slightly modified to reflect noncustodial setting interviews.

¹⁸⁹¹ § 7521(c); see also 5 U.S.C. § 555(b) (a parallel provision when the Government agency compels attendance).

¹⁸⁹² § 7521(b)(2).

¹⁸⁹³ IRM 25.5.5.4.2(2) (12-18-2015), Right to Be Represented by Counsel.

¹⁸⁹⁴ Although the IRM seems to encourage the latter, I doubt that in the sparse facts, this is summons enforcement choice will be made by the IRS. If the IRS enforces the summons, the worst that can happen is that the court orders the taxpayer to appear and properly answer the questions (asserting such privileges as the taxpayer may have, with such consultation and representation by counsel as the taxpayer deems appropriate). So, in most cases, the IRS will not have achieved anything by summons enforcement that it could not have achieved by suspending the interview and reconvening after consultation with the representative and probably the representative's appearance at the reconvened interview.

the representative) of that determination.¹⁸⁹⁵ Given the seriousness of this determination, the IRM provides detailed procedures as to how this determination is made and the potential consequences, including potentially exclusion of the representative from the interview if the hindrance rises to obstruction of the interview.¹⁸⁹⁶

If the taxpayer does attend voluntarily or is summoned, the taxpayer may record the interview upon advance request by the taxpayer.¹⁸⁹⁷ The IRS may record upon advance notice to the taxpayer and must provide the taxpayer a transcript or copy of the recording if the taxpayer reimburses the IRS for the transcript or copy of the recording.¹⁸⁹⁸

The IRS officer must explain the process—either the examination process or the collection process, as appropriate.¹⁸⁹⁹

b. Special Risks / Issues in Criminal Investigations.

Taxpayer interviews in criminal investigations are dicey. The best advice a taxpayer (or any potential criminal target) can receive is that, if approached without counsel present, he should decline, respectfully, to participate by deferring any questions to seek advice of counsel. Often, however, a taxpayer is not well advised or even not advised at all at the first interview. It is not uncommon for two IRS CI agents to show up without advance notice to talk with the taxpayer. This will be the first time the taxpayer becomes aware of a criminal investigation and often the taxpayer does not have an attorney engaged with respect to his potential criminal liability. The CI agent will read the taxpayer a modified version of the *Miranda* warnings, based on *Miranda v. Arizona*, 384 U.S. 436 (1966), advising him or her of the right to counsel and to remain silent.¹⁹⁰⁰ Many times the taxpayer will attempt to “fade the heat” at that interview, without seeking counsel or invoking the Fifth Amendment, thinking that he or she can talk the agents into giving up the investigation. Two bad things can and often do happen in such interviews. First, the taxpayer may make a damaging admission that can then be used against him or her. Second, the taxpayer may lie, thus committing a separate offense (remember § 7212(a) and 18 U.S.C. § 1001). Either way, it is not a pretty picture.

¹⁸⁹⁵ § 7521(c).

¹⁸⁹⁶ For the procedures see IRM 5.1.23.6 (12-26-2019), By-Passing a Taxpayer’s Authorized Representative; and particularly see IRM 25.5.5.5.2 (04-30-1999), Obstruction of Interview.

¹⁸⁹⁷ § 7521(a)(1); see IRM 4.10.3.4.7 (05-03-2023), Requests to Audio Record Interviews (noting *inter alia* that the taxpayer or the IRS can request the recording and providing the procedures for each. The Tax Court has read this entitlement to record expansively so as to permit a taxpayer to invoke it in the Appeals Office hearing in a Collection Due Process case. *Keene v. Commissioner*, 121 T.C. 9 (2003). I cover Collection Due Process and the special procedures below (beginning p. 733).

¹⁸⁹⁸ § 7521(a)(2). See also 5 U.S.C. § 555(c) (A person compelled to submit data or evidence is entitled to retain or, on payment of lawfully prescribed costs, procure a copy or transcript thereof, except that in a nonpublic investigatory proceeding the witness may for good cause be limited to inspection of the official transcript of his testimony.”).

¹⁸⁹⁹ § 7521(b)(1).

¹⁹⁰⁰ IRM 9.4.5.11.3.2.1.1 (05-15-2008), Procedures. (“Prior to questioning, the special agent will warn the subject in clear and unequivocal terms of his/her right to remain silent, that any statements made can and will be used as evidence against him/her, and of his/her right to the presence of an attorney, either retained or appointed. These rights are commonly referred to as the subject’s *Miranda* rights following *Miranda v. Arizona*.”

As noted, the IRS's internal procedures require the CI agent to give the modified *Miranda* warnings at the beginning of the interview. The *Miranda* rule applies only to custodial or similarly coercive interviews. Typically, an interview at the taxpayer's place of business or home on one of these surprise visits is neither custodial nor coercive in the *Miranda* sense. Accordingly, the question is whether *Miranda* requires any warning at all. The IRM now requires a limited form of a *Miranda* warning. What happens if the IRS violates the IRM requirement? Remember the *Caceres* doctrine? Normally, the *Caceres* doctrine (*United States v. Caceres*, 440 U.S. 741 (1979)) holds that the failure to follow the manual as to a matter not otherwise required is not a problem. However, in this area although *Miranda* has not been formally extended to noncustodial and noncoercive interviews in nontax contexts, some courts have been willing to suppress the evidence obtained in an interview that was not preceded by the modified *Miranda* warning required by the IRM.

Although CI agents routinely give the modified *Miranda* warning, civil agents do not. Often IRS administrative criminal cases are preceded by IRS civil examinations. The IRS revenue agent conducting the civil examination is supposed to throttle back on the civil investigation to consult with his manager and Technical Fraud Advisor and to refer the case to CI when there is a firm indication of fraud. Sometimes IRS revenue agents will prefer not to give the matter up quite at that point and proceed to conduct their own criminal investigation. They will usually then not give the modified *Miranda* warning and often will give some assurance, express or implied, that the investigation continues to be civil in nature when, in fact, it has turned criminal (although systemically even the IRS may not know that yet). The IRM prohibits the IRS from developing a criminal investigation under the guise of a civil audit. The question is whether the fruits of any taxpayer interviews in that context can be suppressed. Courts sometimes state a willingness to suppress the evidence under various theories -- such as that the interview under deception as to its nature (civil or criminal) is an unreasonable search and seizure, but often find some way to avoid suppression.¹⁹⁰¹

8. Representing the Taxpayer and a Summoned Witness.

A common pattern in IRS investigations is for the IRS to summons the taxpayer's accountant, a family member, partner, employee or former employee or other person or formerly associated in some way with the taxpayer. Often the summoned person will not want to engage separate counsel to respond to the summons. The summoned person will often seek advice from the taxpayer's attorney as to how to respond and may even ask the taxpayer's attorney to appear with the person at the summons proceeding. Particularly in an "eggshell" case with criminal potential, the taxpayer's practitioner will want to control the flow of information to the IRS and will thus want to be involved in the process. The issue presented is whether the practitioner can represent the third party witness in the summons proceedings.

This raises fundamental ethical issues for the attorney. The easy answer in that situation is to have the summoned person obtain separate counsel. The taxpayer's counsel can then work with the third party's counsel to bring him or her up to speed efficiently. Often, however, the third party

¹⁹⁰¹ See e.g., *United States v. McKee*, 192 F.3d 535 (6th Cir. 1999); and *United States v. Peters*, 153 F.3d 445 (7th Cir. 1998); but see *United States v. Kontny*, 238 F.3d 815 (7th Cir. 2001). These cases are discussed in John A. Townsend, *Taxpayer Rights in Criminal Investigations*, 90 Tax Notes 1842 (2001).

will not want to go to the trouble or expense of hiring a lawyer and will lean on the taxpayer's counsel to represent him or her at the summons proceeding. But there is at least usually a potential, if not actual, built-in conflict of interest. If there are problems with the return and there are potential civil or criminal penalties involved, the taxpayer may point the finger at the accountant, thus putting the accountant at jeopardy of civil or criminal penalties or potential disbarment by the Office of Professional Responsibility. Moreover, the taxpayer may want to bring a malpractice case against the accountant, which would put the attorney who undertook dual representation in a tough spot.

Dual representation is thus a potential problem that could blow up in the lawyer's face. This dual representation ethical problem can appear in many contexts—often more subtle than the accountant-taxpayer relationship. For example, in an investigation with criminal overtones and having more than one potential target, representing more than one target can raise serious problems because of the opportunity for one to strike a deal at the expense of the other. In dual representation, it is difficult to give effective representation as to this negotiation because to do so might hurt another person who is represented. On the other hand, under our system, individuals can choose the lawyer they want to represent them and, with proper advice as to the problems of dual representation, can waive any conflict or appearance of conflict of interest. Whether or not they have made a knowing and intelligent waiver is a different issue, but the attorney must address that issue as the first order of business in a dual representation.

Not surprisingly, the IRS does not like dual representations because the Special Agent or IRS Revenue Agent assumes that the taxpayer's attorney may be only nominally representing the summoned party but is really there to protect the interests of the taxpayer by interfering with the agent's ability to develop the case. The feeling is that the taxpayer's lawyer will have woodshedded the witness to give favorable testimony for the taxpayer or simply intimidate the witness by his presence, so that the witness is less candid than he might otherwise be. In any event, the IRS representative will likely perceive that dual representation will hamper the information gathering process. Accordingly, in such cases, the IRS agents are directed to review the dual representation carefully, consult with their superiors and Division Counsel, as deemed appropriate, and take action to disqualify the attorney in extreme cases -- such as where the attorney is obstructing the interview.¹⁹⁰² To determine whether the dual representation is potentially a problem, the agent may attempt to discuss the issue directly with the witness, including inquiring as to whether the taxpayer is paying the attorney and whether the witness knows that there is a conflict of interest or potential conflict of interest.

E. Formal Document Requests (“FDRs”).

Section 982 authorizes the IRS to issue a “formal document request” (“FDR”) which is not a summons but imposes a surrogate for compulsion by evidence preclusion. If the taxpayer fails to comply within 90 days of the FDR, the taxpayer may be prohibited from using in any subsequent judicial proceeding any foreign documentation within the scope of the request that was not produced during the 90 day period unless the taxpayer establishes that its failure to produce was due to

¹⁹⁰² See IRM 25.5.5.5 (03-16-2022), Dual Representation.

reasonable cause.¹⁹⁰³ Foreign law prohibitions imposing civil or criminal penalties are not reasonable cause.¹⁹⁰⁴

The taxpayer may bring a proceeding to quash the FDR; if the taxpayer brings such a proceeding, the IRS “may seek to compel compliance with such request.”¹⁹⁰⁵ Thus, the taxpayer by moving to quash the FDR can turn the process from merely an evidence preclusion into a compulsory process.¹⁹⁰⁶ The statute of limitations for both civil and criminal purposes will be suspended.¹⁹⁰⁷

As noted, the compulsion behind the FDR is the risk of evidence preclusion, unless the Government seeks compulsion in response to the taxpayer’s filing a proceeding to quash the FDR. However, the IRS may contemporaneously with the FDR issue an IRS administrative summons which is compulsory and does not require a predicate FDR.¹⁹⁰⁸ The administrative summons may then be enforce.

F. Privileges at the Examination Level.

Privileges are an evidentiary concept. The general rule in Anglo-American jurisprudence is that each person—both individuals and artificial entities—may be compelled to tell what the witness knows to administrative agencies and courts to assist those agencies and courts administer the laws and dispense justice. Pithily, the Supreme Court proclaims that “the public has the right to everyman’s evidence.”¹⁹⁰⁹ Privileges, where applicable, permit persons to withhold evidence and thereby hamper the truth finding process so critical to good government. Privileges are thus justified only where there is some overriding public benefit—a “public good transcending the normally predominant principle of utilizing all rational means for ascertaining truth.”¹⁹¹⁰ Privileges must be justified, and the party asserting the privilege must establish that the privilege applies.¹⁹¹¹

¹⁹⁰³ § 982(a) & (b)(1).

¹⁹⁰⁴ § 982(b)(2).

¹⁹⁰⁵ § 982(c)(2)(A). The standard applicable in such the proceeding to quash and the responsive request for compliance is the *Powell* standard for administrative summonses which I discussed in the text above beginning p. 420. See *United States v. Powell*, 379 U.S. 48, 57-58 (1964). See *VEG Corp., Inc. v. United States*, 2018 U.S. Dist. LEXIS 126804 (D. Nev. 2018); and *Vickrey v. United States*, 2020 U.S. Dist. LEXIS 162430 (S.D. Cal. 2020).

¹⁹⁰⁶ For an example, see *LaRue v. United States*, 2016 U.S. Dist. LEXIS 50255 (D. Ore. 2015).

¹⁹⁰⁷ § 982(e). For an example of taxpayers unsuccessfully bringing a proceeding to quash, see *Good Karma, LLC v. United States*, 2008 U.S. Dist. LEXIS 87132 (E.D. Ill. 2008) (holding that “If Petitioners wish to introduce responsive documents in Tax Court, they simply must do as the Government suggests and ‘produce (or have produced) such document(s) to the IRS pursuant to the FDR.’”

¹⁹⁰⁸ A now discontinued provision in IRM Exhibit 4.61.4-1 (05-01-2006), Formal Document Request IRC section 982, par. 9 offered as an example: “FDRs apply only to foreign-based documentation, not to U.S.-based documentation. If the location of the documents is unknown, then the IE should issue both an FDR and a summons for the same information. In this situation, the IE should follow the separate procedures for the issuance of an FDR and a summons.”

¹⁹⁰⁹ *Trammel v. United States*, 445 U.S. 40, 50 (1980) (internal quotes and words omitted for clarity), quoting *United States v. Bryan*, 339 U.S. 323, 331 (1950)).

¹⁹¹⁰ *Trammel v. United States*, 445 U.S. 40, 50 (1980) (internal quotes omitted, but quoting *Elkins v. United States*, 364 U.S. 206, 234 (1960) (Frankfurter, J., dissenting)).

¹⁹¹¹ *United States v. BDO Seidman*, 337 F.3d 802, 811 (7th Cir. 2003). See also FRCP 26(b)(5) (requiring (continued...))

In the federal system, the recognized privileges are those that existed at common law subject to such adjustments as Congress or, sometimes, the courts have made “in light of reason and experience.”¹⁹¹²

A witness’ obligations for an IRS summons (and other compulsory processes such as subpoenas) are subject to the traditional privileges and limitations of any other compulsory process.¹⁹¹³ The traditional privileges most commonly encountered in tax practice:

- (1) The attorney/client privilege;
- (2) A variant of the attorney/client applicable only in certain (but not all) tax contexts - the federally authorized tax practitioner privilege (“FATP”);
- (3) Work product privilege;
- (4) Fifth Amendment privilege against self-incrimination; and
- (5) Spousal Privileges.

There are other privileges that may apply in a tax setting and practitioners and students should be aware of them. For example, there is a doctor / patient privilege and clergy-penitent privilege. These other privileges are not commonly encountered in tax practice, so I do not discuss them here.

Privileges apply both in administrative proceedings—such as, most prominently here, IRS audits and collection activities—and in judicial proceedings. The privilege issue arises most prominently in the context of the IRS compulsory process, the IRS summons. The privilege issue also arises in other tax contexts, such a grand jury investigations when grand jury subpoenas are used and in civil and criminal trial contexts where the taxpayer or witnesses may have to either

¹⁹¹¹(...continued)

that a party asserting privilege in discovery must expressly assert the claim and provide sufficient detail to support the privilege without disclosing the underlying privileged information). As to documents for which a privilege is claimed in whole or in part (through redaction), this is usually done via a “privilege log,” containing as much detail as possible (e.g., date of the document, author, etc., supported by an accompanying affidavit describing the confidential nature of the documents. Maura I. Strassberg, Privilege Can Be Abused: Exploring the Ethical Obligation to Avoid Frivolous Claims of Attorney-Client Privilege, 37 Seton Hall L. Rev. 413, 461-462 (2007) (noting that the precise requirements of the privilege log may vary from district to district, but all require minimal information to support the privilege).

¹⁹¹² Rule 501 of the Federal Rules of Evidence states:

Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience.

The “in light of reason and experience” mandate is a quote from *Wolfe v. United States*, 291 U.S. 7, 12 (1934). Under this Rule, courts may develop the law—the common law—on a case by case basis. See *United States v. Cintolo*, 818 F.3d 980, 1002 (1st Cir. 1987), citing *United States v. Gillock*, 445 U.S. 360, 367 (1980); *Trammel v. United States*, 445 U.S. 40 (1980). Courts do not view this as a license to create new privileges, but certainly they can embellish the privileges that are there. See *Trammel* (embellishing the common law privilege), and *United States v. Arthur Young & Co.*, 465 U.S. 816 (1984) (refusing to create a new privilege).

¹⁹¹³ *Upjohn Co. v. United States*, 449 U.S. 383, 398 (1981) (quoting *United States v. Euge*, 444 U.S. 707, 714 (1980)); see also FRE Rule 501 (except as otherwise specifically provided, privileges are “governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience”).

testify or claim a privilege to avoid having to testify. The party having the privilege can assert the privilege to prevent a compelled disclosure of the information subject to the privilege.¹⁹¹⁴ The privileges can usually be waived either by not asserting them to a compulsory disclosure requirement or by some affirmative act inconsistent with maintaining the privilege. For example, clients can waive the privilege for otherwise privileged attorney-client communications by disclosing the communications to persons other than those authorized to receive the privileged communications.¹⁹¹⁵

I simply point out here that the generally available privileges in federal (and state) controversy practice apply in tax investigations (whether administrative or criminal investigations) and in tax-related judicial proceedings. Because the principal focus of this text for students of tax procedure, I won't discuss here those privileges further but do offer a more detailed discussion in Chapter 15, titled Evidentiary Privileges in Tax Controversy Practice (beginning p. 891).

G. Financial Status Inquiries.

Earlier in the 1990s the IRS made a big deal of so-called financial status audits, also sometimes referred to as “fraud” audits. At some time in an audit, often early on, the agent would do a financial check from the IRS's and third party sources to see if the taxpayer's assets were consistent with what was reported on the return. For example, let's assume the taxpayer has reported about \$30,000 of taxable income per year for the last five years. Let's further assume that the agent quickly checks with the Department of Motor Vehicles and determines that the taxpayer owns a Rolls Royce, a Mercedes, and a Maserati. This would suggest that something may be amiss. And this is not even a full bore economic status audit reconstructing the taxpayers net worth and income.¹⁹¹⁶

Many practitioners were upset with this type of audit—particularly when full bore and intrusive—because it assumed criminal misconduct virtually from the get-go. Congress listened and prohibited such audits enacted § 7602(e), which provides:

(e) Limitation on examination on unreported income

The Secretary shall not use financial status or economic reality examination techniques to determine the existence of unreported income of any taxpayer unless the Secretary has a reasonable indication that there is a likelihood of such unreported income.

Neither the Code nor the Regulations define “financial status or economic reality examination techniques.” One author has recently summarized the understanding as:

¹⁹¹⁴ See e.g., FRCP Rule 26(b) providing for discovery of nonprivileged matter.

¹⁹¹⁵ FRE 502 protect against unintended waivers incident to litigation discovery or even waivers as to so-called sneak-peeks designed to narrow down real discovery disputes as to potentially privileged matters. FRE 502 should be read along with FRCP 26(b)(5)(B).

¹⁹¹⁶ For a brief discussion of the history leading to the enactment of § 7602(d) discussed in the next paragraph, see Bob Kamman (Guest Blogger), Memoirs of the Last Century: Some Notes on Economic Reality and Section 7602(e) (Procedurally Taxing Blog 11/2/21).

The general understanding is that they pertain to “indirect methods” of proving unreported income. At its simplest, indirect methods are used where there is not a specified “source” of taxable income. If the IRS suspects that you have unreported income but can’t point to a specific source, indirect methods come into play. The IRS might look at the income on a tax return and compare it to some other data (depicting the individual’s “financial status or economic reality”) that strongly suggests there was more income than reported. The most common indirect method that the IRS uses to show unreported income is bank accounts analysis -a method routinely upheld by courts.¹⁹¹⁷

The type of initial nonintrusive inquiry I noted above is not prohibited “to determine whether such a reasonable indication exists to permit the IRS to implement its Financial Status Audit procedures.”¹⁹¹⁸ But an opening audit inquiry to the taxpayer to produce detailed financial statements (net worth and income), along with supporting documents with no advance information of material unreported income would certainly violate the prohibition.

H. Church Examination Activities.

Because of concerns of First Amendment Free Exercise and the role (and political power) of religion in America, § 7611 provides special rules for certain inquiries to and examinations of churches.¹⁹¹⁹ Church inquiry rules relate to qualification for tax exempt status and whether the church is conducting an unrelated trade or business subject to tax even though the church tax exempt.¹⁹²⁰ Examination rules relate to whether the entity is subject to any tax and whether the entity is a church.¹⁹²¹ Section 7611 does not apply to certain investigations that may require inquiries to

¹⁹¹⁷ Caleb Smith, IRC § 7602(e) Will Not Save You (From Bank Information Return Exams) (Procedurally Taxing Blog 10/26/21) (cleaned up). The IRM has provisions guiding agents to the type of predicate activity permitted without implicating § 7602(e). E.g. IRM 4.10.4.2.9 (08-09-2011), Formal Indirect Method (such as source and application of funds, net worth, etc.); these methods as “are also known as financial status audit techniques”: IRM 4.10.4.3 (08-09-2011), Minimum Requirements For Examination of Income (requiring consideration of gross income in all income tax examinations, with certain minimum income probes that are not subject to § 7602(e); and minimum income probes not subject to § 7602(e) described in related IRM provisions which are designed to determine whether there is a reasonable indication unreported income to permit the financial status inquiry under § 7602(e). As Professor Smith notes in the blog, the NRP audit discussed may put some pressure upon what is permitted under § 7602(e). In a related posting, Professor Smith discusses how to raise a potential § 7602(e) violation issue. Caleb Smith, So You Want to Raise an IRC § 7602(e) Issue... (Procedurally Taxing Blog 10/27/21).

¹⁹¹⁸ The quoted text is from the Written Statement of Nina E. Olson, National Taxpayer Advocate, Before the Senate Subcommittee on Federal Financial Management, Government Information, and International Security on October 26, 2005), reproduced at 2005 TNT 207-25. IRM 4.10.4.3 (08-09-2011), Minimum Requirements For Examination of Income, stating that what are called Minimum Income Probes are required, as indicated, and that “The minimum income probes are not subject to IRC 7602(e) governing the use of financial status audit techniques.”

¹⁹¹⁹ This statute is sometimes referred to as the Church Audit Procedure Act (“CAPA”). I mention in the two–inquiries to and examination of churches–in summary fashion. The section also provides rules for timing of examinations and limitation periods, procedures applicable for summonses, limitations on additional inquiries and examinations, etc.

¹⁹²⁰ § 7611(a)(2).

¹⁹²¹ § 7611(b)(1).

or information from the church.¹⁹²² Nor does it apply to third party summonses even if the taxpayer under investigation is the church.¹⁹²³

I. Fraud Referrals; Search Warrants.

The civil examination may develop indications of fraud—often called “badges” or “indicators”¹⁹²⁴ of fraud—that may warrant referral to and investigation by IRS’s Criminal Investigation (“CI”). This is sometimes referred to as the fraud referral program or procedures. The procedures for Examination processing when such badges of fraud appear are set forth in the IRM.¹⁹²⁵ The key features of this Fraud Referral Program are (highly summarized):¹⁹²⁶

- The Examination agent must be alert to the indicators of fraud appearing in the audit and document the indicators of fraud;
- Upon determining fraud potential in the case warranting further development, the agent will consult with his manager and then, with manager approval, consult with the Fraud Enforcement Advisor (“FEA”).
- If the FEA concurs, an initial plan to develop and document acts of fraud will be documented. The case will be placed in “fraud development status.”
- If “affirmative acts of fraud are established,” the Examiner will suspend collection activity and notify the manager and FEA. With the approval of the manager and the FEA, the case will be referred to CI.
- If the case is not referred to CI or CI has returned the case to Examination, the agent will consider assertion of the civil fraud penalties under § 6663 or § 6651(f) (and other potential sections requiring fraud).

One major issue that has been presented over the years has been whether the civil Examination agent held onto the case too long after developing indicators of fraud before referral to CI required by the IRM and, in the process, interviews the taxpayer without giving the taxpayer proper *Miranda*-type warnings (modified for noncustodial interviews) of basic rights to remain silent and consult with an attorney.¹⁹²⁷ The issue usually arises in the context of a criminal prosecution where the taxpayer’s statements in the interview will be used to prove the taxpayer’s guilt of the

¹⁹²² § 7611(i); see *Rowe v. United States*, 2018 U.S. Dist. LEXIS 82384 (E.D. La. 2018) (citing *United States v. Grayson County State Bank*, 656 F.2d 1070, 1074 n.5. (5th Cir. 1981) (which allowed inquiries to bank for church bank account records regarding the church’s minister’s tax liability)).

¹⁹²³ See § 7611(h)(4)(B)(i); *United States v. C.E. Hobbs Foundation for Religious Training and Education, Inc.*, 7 F.3d 169 (9th Cir. 1993); and *Bible Study Time Inc. v United States*, 240 F. Supp. 3d 409 (D. S.C. 3/7/2017).

¹⁹²⁴ E.g., IRM 25.1.2.3 (04-23-2021), Indicators of Fraud; and IRM 9.4.1.5.1.3 (03-02-2018) Criminal Fraud Referrals.

¹⁹²⁵ See generally IRM 25.1.2 Recognizing and Developing Fraud.

¹⁹²⁶ I summarize these from IRM 25.1.2 Recognizing and Developing Fraud (last reviewed and updated 4/23/21 and viewed 9/15/23). See also Michael Saltzman and Leslie Book, *IRS Practice and Procedure*, ¶ 12.05[4][a][ii] Referral from other IRS functions (principally civil investigations) (Thomsen Reuters 2015).

¹⁹²⁷ Michael Saltzman and Leslie Book, *IRS Practice and Procedure*, ¶ 12.05[4][a][ii] Referral from other IRS functions (principally civil investigations) (Thomsen Reuters 2015), discussing the principal cases (discussing the cases, including principally *United States v. Rutherford*, 555 F.3d 190 (6th Cir. 2009), reh’g denied, 2009 US App. LEXIS 12986 (6th Cir. 2009); *United States v. McKee*, 192 F.3d 535, 541 (6th Cir. 1999) and *United States v. Tweel*, 550 F.2d 297 (1977).

crime(s) charged, and the taxpayer seeks to exclude the interview from being used by the prosecution. Normally, interviews in civil examinations require no such warning. The courts have suggested that there may be limits depending upon whether the agent has conducted such interviews after developing sufficient indicators of fraud that should have required referral to CI where the taxpayer's *Miranda*-type rights would be protected. Although suggesting such limits, the courts typically provide no relief absent some affirmative "deception or trickery" as to the nature of the investigation.¹⁹²⁸ For example, if upon specific questions as to whether the investigation was a fraud investigation or involved IRS CI personnel, the IRS civil agent falsely assures the taxpayer that the investigation is not a fraud investigation or does not involve CI personnel, both the taxpayer's otherwise voluntary testimony or documents delivered "voluntarily" in reliance on the false assurance may be excluded from evidence.¹⁹²⁹

The IRS may develop information in an administrative investigation that justifies seeking a search warrant. This type of investigation will be a criminal investigation conducted by CI, although it may have started as a regular audit investigation. The IRS will have to seek the search warrant from a district court under Rule 41, Federal Rules of Criminal Procedure, which requires the showing of probable cause to believe that a crime has been committed.

Emails are often the mother lode of potential incriminating information. Law enforcement investigators and prosecutors love to gain access to emails. Often, as in entity investigations, an entity will store the emails and archive them. Investigators or prosecutors may summons or subpoena those emails or, alternatively, the entity may just offer them up to curry favor with the investigators or prosecutors. In the KPMG individual defendant prosecution in which I represented one of the original 19 defendants, emails were at the core of the prosecutors' case.¹⁹³⁰

Emails may also be stored on third party servers, such as gmail, Microsoft or Yahoo. Under what is known as the third party doctrine, those emails may be subject to compulsory process because a person has no expectation of privacy for documents voluntarily stored with a third party.¹⁹³¹ But recognizing that, in the real world, someone may indeed have an expectation of privacy for emails on third party servers, Congress enacted the Stored Communications Act ("SCA"), 18 USC §§ 2701 et seq. The SCA provides users (i) users privacy protections, with sanctions, for electronic communications (such as email) stored with electronic communications services (ECS) and (ii) sets for the requirements for compulsory access to those stored communications, permitting subpoena or summons of the basic subscriber information and contents more than 180 days old and, for other information, a special court order (called a § 2703 order) or an SCA warrant requiring a showing of probable cause. Because of substantial controversy about the application of this act, the

¹⁹²⁸ *United States v. Rutherford*, 555 F.3d 190 (6th Cir. 2009), reh'g denied, 2009 US App. LEXIS 12986 (6th Cir. 2009).

¹⁹²⁹ See e.g., *United States v. Tweel*, 550 F.2d 297 (1977).

¹⁹³⁰ As a lawyer for one of the defendants, I had to read through thousands, perhaps hundreds of thousands, of emails, some of which were ugly indeed. I understand that, although the lead prosecutor insisted to me during the investigation that no grand jury subpoena had been issued, KPMG in fact had a grand jury subpoena pursuant to which it opened its kimono not only for emails but for documents and testimony.

¹⁹³¹ E.g., *United States v. Miller*, 425 U.S. 435, 443 (1976) (bank records are not subject to Fourth Amendment requiring access by warrant rather than subpoena or other compulsory process because the depositor does not have the reasonable expectation of privacy).

IRS has indicated that it will require its agents obtain a “search warrant” for all of its access to emails on third party servers.¹⁹³²

The SCA warrant may require a U.S. based ECS to produce emails stored on servers outside the U.S.¹⁹³³

A major issue has arisen as to whether the SCA warrant can be used to access stored communications on servers located outside the U.S. which are owned and operated by an entity in the U.S.¹⁹³⁴ The case involved Microsoft and it stored communications at various locations throughout the world. The particular stored communications the prosecutors wanted was in Ireland. The SCA warrant requires the person upon whom it is served to retrieve the stored communications described in the warrant. Microsoft objected because warrants generally can seize documents only within the geographical area of the U.S. The Second Circuit held that offshore stored communications were beyond the scope of the SCA Warrant.

Information developed by CI may be subject to prohibitions on use in the civil examination. These most notably include grand jury matters under Rule 6(e), Federal Rules of Criminal Procedure. Accordingly, the IRS has procedures to insure that such information is not available to the civil divisions of the IRS for use in determining civil liability for tax and penalties.¹⁹³⁵ Any civil agent assisting CI or an attorney for the government may be subject to the same restrictions. So there may be significant information that will not be available in the civil examination for assertion of tax and penalties.

J. Covert Activities.

In addition, the IRS may conduct stings or other covert activities (such as mail drops), often through CI but sometimes through the civil Divisions. These types of covert activities implicate Fourth Amendment concerns. For example, the IRS and other law enforcement agencies have used so-called Cell-Site Simulators that can track and even acquire certain data from cell phones. The use of this technology is quite controversial. DOJ adopted a policy, which the IRS adopted as well, that, except in exigent circumstances, (i) it will collect only limited information from the cell phone (signal strength and general direction) and will not collect the content of communications or items

¹⁹³² IRS Policy Statement 4-120 (May 3, 2013).

¹⁹³³ 18 U.S.C. § 2713, as added by the Clarifying Unlawful Overseas Use of Data Act (“Cloud Act”), incorporated as Division V in the 2018 Omnibus Spending Bill, Consolidated Appropriations Act, 2018, H.R. 1625, 115th Cong., 2d Sess. (2018) enacted March 28, 2018. The ECS is relieved from suit for providing information allowed by the Cloud Act. § 2713(d).

The background for the enactment of the Cloud Act is *Microsoft Corp. v. United States*, 829 F.3d 197 (2d Cir. 2016), reh’g denied, 855 F.3d 53 (2017), cert. granted, 138 S. Ct. 356 (2017). In *Microsoft*, the Second Circuit held that “§ 2703 of the Stored Communications Act does not authorize courts to issue and enforce against U.S.-based service providers warrants for the seizure of customer e-mail content that is stored exclusively on foreign servers.” The Supreme Court granted the Government’s petition for certiorari. The Supreme Court was considering the case after oral argument when, on March 23, 2018, Congress passed the Cloud Act. It is reported, as of this writing, that the Government has asked the Supreme Court to moot the case because of the Cloud Act.

¹⁹³⁴ *Microsoft Corp. v. United States*, 829 F.3d 197 (2d Cir. 2016).

¹⁹³⁵ E.g., 25.1.5.5(2) & (3) (06-10-2021), Unique Features (prohibiting disclosure for civil purposes and prohibiting the agent assigned to assist the grand jury from participating in the subsequent civil examination).

stored on the cell phone, and (ii) it will obtain a warrant under FRCP 41 (requiring probable cause) and an order under the Pen Register Statute (18 U.S.C. §§ 3121–3127).¹⁹³⁶

K. International Evidence Gathering.

1. Introduction.

The explosive growth of international business—the global economy if you will—has been accompanied with an explosive growth in tax fraud across international boundaries. The simple model, used since virtually the inception of the modern income tax, is the use of an offshore bank account in a country whose secrecy laws place a premium upon hiding the existence and ownership of the account and thus the taxable income that is in the account. An infinite number of more complex cross-border tax fraud models exist, including concealing the existence of foreign investment accounts, reporting foreign sham transactions where the IRS’s ability to discover the sham is more limited than if the transactions occurred in the U.S., manipulating the complex foreign tax deferral regimes for foreign corporations controlled by U.S. persons and manipulating transfer pricing so that income is pushed from the United States into foreign tax haven countries. I address here the common IRS tools to gather evidence of the U.S. tax fraud and U.S. taxable income that might otherwise go untaxed even in the absence of fraud.

2. Prototypical U.S. International Tax Fraud.

As I mentioned above, the prototypical cross-border tax fraud is the use of a foreign bank account in a tax haven. We addressed this fraud in the discussion of FBARs and the use of the John Doe Summons procedure to get information from the credit card companies whose cards were used by tax haven banks to give their secret depositors access to the hidden cash. A simple model is for a taxpayer with a cash business to divert some portion of the cash to the foreign bank account so that the IRS will not be able to discover the diverted income. In terms of the tax offense, this is just the cross-border analog to burying the unreported cash in the back yard.

The advantage of the foreign bank account is that the cash is not subject to the ravages of weather and critters (worms, etc.) and can draw some extra return (e.g., interest, dividends and capital gain, depending upon how invested) that the taxpayer also will not report for tax purposes. Of course, merely spiriting the cash out of the country may be a separate criminal act (e.g., failing to file the currency reports required on departing the U.S. with more than \$10,000 of cash). But we are focusing here upon the mere act of hiding the cash representing taxable income in a place that, if it works, the IRS is unlikely to discover.

The taxpayer will then effectuate his or her tax fraud by not reporting the income on the return and, to conceal the existence of the foreign bank account, answering no to -- or cleverly failing to answer -- the question on the tax return (Schedule B) about ownership interest in or signatory control over foreign bank accounts. (The latter question and instructions advise the taxpayer of his or her responsibility to file the FBAR, FinCEN Form 114.) At that point, the taxpayer has violated §§ 7201 (tax evasion) and 7206(1) (tax perjury), and upon failure to file the

¹⁹³⁶ Department of Justice Policy Guidance: Use of Cell-Site Simulator Technology (Sept. 3, 2015).

FBAR has also violated another statute for which there are substantial civil and criminal penalties. Of course, if the taxpayer had some assistance in effecting the transaction (e.g., a business partner or even a family member who actually took the cash to the tax haven), that other person may be guilty of a conspiracy or aiding and abetting. And, as noted, there could be a host of related problems (such as getting the cash out of the country, etc.).

A variation of this offshore secrecy gambit, perhaps with elements of more sophistication, came to the surface in the late '70s and '80s as many taxpayers invested in various tax shelter schemes, some of which depended upon the secrecy laws of foreign countries and the IRS's relative inability to discover and investigate the tax fraud. Such schemes, with various iterations, used foreign trusts in such exotic places as the Isle of Man (in the Irish sea between Great Britain and Ireland) and the Cook Islands (in the South Pacific Ocean). The foreign trusts, which the promoters and the taxpayer hoped could not be pierced for information, would acquire property or assets with the view toward the taxpayer not reporting the income or, if the taxpayer had large debts (including tax debts), the creditor not discovering the taxpayer's real interest in the trust.

The Government's initiatives involving Swiss banks gives at least a public appearance that the ability to evade through use of offshore entities claiming secrecy is in the process of being curbed.

More sophisticated evasion or at least aggressive avoidance is often encountered in the transfer pricing arena where many large corporate enterprises use their related foreign companies to push income from the U.S. to another tax jurisdiction where the effective tax rate is significantly less than in the United States.

The IRS needs the ability to investigate by gathering information that would be outside its normal powers (e.g., the IRS summons which is effective generally only within the U.S.). We consider in this section the tools that may be available for the IRS to investigate offshore.

3. Tax Treaties and International Comity.

a. Introduction.

We covered above the tools that are generally available to tax investigations. The IRS administrative summons and the grand jury subpoena require U.S. jurisdiction over the person summoned or subpoenaed to establish the constitutional nexus for contempt sanctions for failure to comply. That means that, for example, a Swiss bank with no U.S. nexus (such as a branch office in the U.S.) is beyond the summons power and the subpoena power—or at least beyond the compulsion for defying a summons or subpoena. Is the U.S. stymied from developing the facts?

The principal avenue to obtain tax related information from foreign sources such as foreign banks has come through treaties or other international agreements. Tax treaties have several goals. One important goal is to facilitate cross-border trade by minimizing the adverse effect of double

taxation. Another major goal of the U.S. tax treaty system is to obtain information to protect the integrity of each treaty partner's tax system.¹⁹³⁷

Although each treaty or international agreement (certainly the bilateral agreements) are separately negotiated and may differ, the general exchange of information provisions in the tax treaties and other tax-related international agreements (discussed below) are:

- A general obligation to exchange information for purposes of carrying out the provisions of the agreement or the domestic laws pertaining to the taxes covered by the agreement (this is often referred to as the “exchange of information” provision);
- Procedures regarding the use and disclosure of information received, which generally require that information received be treated as confidential and permit disclosure of such information to persons specified by the agreement as concerned with the taxes covered by the agreement - e.g., for judicial and administrative proceedings; and
- Language which limits the obligation of the parties to provide information which: i) is not obtainable, either by the requesting country under its own laws or by the receiving country; ii) would require the receiving country to carry out administrative procedures at variance with its laws or those of the requesting country (although some agreements require the provision of banking and financial information notwithstanding these limitations); or iii) would disclose trade secrets or other information contrary to public policy.¹⁹³⁸

Implementing exchange of information obligations under these agreements, the U.S. provides information pursuant to the following (if otherwise required or obligated by the agreements):

- Specific Information Requests (“Specific Requests”) from the treaty partner for information, including a request that the requested country use its internal processes to obtain the requested information. I discuss how specific requests work in the next section dealing with Double Tax Treaty Exchange of Information, but the process can be used for other agreements requiring that type of use of internal processes.
- Automatic Exchanges whereby one party to the agreement shares information automatically and on an ongoing basis with the treaty partner. For example, a U.S. bank paying interest to a resident of a partner state, as identified by the IRS, must report the interest to the IRS which, in turn, shares the information automatically with the treaty partner.¹⁹³⁹

¹⁹³⁷ A good introduction to the exchange of information process with foreign countries is in IRM 4.60.1.1.1 (02-23-2023), Background.

¹⁹³⁸ IRM 4.60.1.1.1 (02-23-2023), Background.

¹⁹³⁹ Some agreements require the partners “to exchange certain tax-related information on a regular and systematic basis, without the need for a specific request.” IRM 4.60.1.10 (02-23-2023), Automatic Exchange of Information (AEOI) Program. For example, to implement the U.S. reporting for interest paid by banks, Regulations 1.6049-4(b)(5) and 1.6049-8(a) require U.S. banks to report to the IRS interest paid to residents of countries identified in a Revenue Procedure (currently Rev Proc 2018-36, 2018-38 I.R.B.). The reporting is on Form 1042-S, Foreign Person’s U.S. Source Income Subject to Withholding. The IRS can then share the information with the other country as required by the relevant treaty or other agreement.

- Spontaneous Exchanges involve “the transmission of information that has not been specifically requested by a Competent Authority, but which in the judgment of the providing authority may be of interest to a foreign partner for tax purposes.”¹⁹⁴⁰
- Simultaneous Examination Program involve the IRS working with a treaty partner for a simultaneous examination working through provisions of international exchange agreements such as tax treaties.¹⁹⁴¹ “Simultaneous examinations involve the United States and one or more of its foreign partners conducting separate, independent examinations of selected taxpayer(s) within their respective jurisdictions in which the partners have a common or related interest.”¹⁹⁴²
- Joint Audits involve “two or more Joint Audit Parties join together to form a single audit team to examine issue(s) and/or transaction(s) of one or more related U.S. persons (as defined under IRC §7701(a)(30)) with cross-border business activities, involving one or more foreign affiliated companies in which the Joint Audit Parties have a common or complementary interest”.¹⁹⁴³
- Simultaneous Criminal Investigation Program (“SCIP”) “involve the United States and one of its foreign partners conducting separate, independent criminal income tax investigations of selected taxpayer(s) within their respective jurisdictions in which the partners have a common or related interest.”¹⁹⁴⁴
- MLAT Information/Evidence Requests involve requests under MLATs (discussed below) “to secure evidence to be used in criminal judicial proceedings in the requesting country.”¹⁹⁴⁵
- Collection Requests are request made under certain treaties for assistance in collection of taxes.¹⁹⁴⁶

b. Double Tax Treaty Exchange of Information.

The major U.S. tax treaties are so-called “Double Tax” treaties.¹⁹⁴⁷ In very broad strokes, the most important enforcement provision in these treaties is establishing a procedure to eliminate or mitigate double taxation of the same quantum of income, so that, at least in theory, any given quantum of income is taxed only by the source jurisdiction or, if taxed in both the source jurisdiction and non-source (usually residence) jurisdiction, the non-source jurisdiction credits the tax paid to the source jurisdiction so that the source jurisdiction is given priority and the taxpayer is not subject to higher tax than the non-source jurisdiction imposes. There are other provisions in the treaty to avoid rough edges in the commerce between the treaty states, but eliminating double taxation is the principal driver. U.S. double tax treaties have an exchange of information provision. The current

¹⁹⁴⁰ IRM 4.60.1.3(1) (02-23-2023), Spontaneous Exchange of Information Program

¹⁹⁴¹ IRM 4.60.1.4 (02-23-2023), Simultaneous Examination Program (SEP).

¹⁹⁴² IRM 4.60.1.4.1(1) (10-15-2018), SEP Objectives and Benefits.

¹⁹⁴³ IRM 4.60.1.11.1 (02-23-2023), Joint Audit Program Scope

¹⁹⁴⁴ IRM 4.60.1.5.1 (02-23-2023), SCIP Objectives and Benefits.

¹⁹⁴⁵ IRM 4.60.1.7 (10-15-2018), Mutual Legal Assistance Treaty (MLAT) Program.

¹⁹⁴⁶ IRM 4.60.1.6 (02-23-2023), Mutual Collection Assistance Request (MCAR) Program.

¹⁹⁴⁷ The treaties are usually named “Convention Between the United States of America and [Foreign Country Name] for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income.” I refer to these treaties as “Double Tax Treaties.”

U.S. Model Double Tax Treaty,¹⁹⁴⁸ which (in the version then applicable) is the starting point for the U.S. treaty negotiations on income tax treaties, has the exchange of information provision in Article 26. (The U.S. treaty generally and the exchange of information provision is substantially similar to the OECD model treaty which is the starting point for most developed country treaty negotiations.) Under that provision, one treaty partner may request the other partner to use its internal evidence gathering processes to obtain information relevant to tax administration of the requesting treaty partner. This provision is found in virtually all U.S. income tax treaties.

In pertinent part, the language of the current Model Treaty (not necessarily treaties negotiated earlier than the current 2016 model), Article 26, titled Exchange of Information and Administrative Assistance, provides

1. The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or the domestic laws of the Contracting States concerning taxes of every kind imposed by a Contracting State to the extent that the taxation thereunder is not contrary to the Convention, including information relating to the assessment or collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, such taxes.

Such taxes are defined in the treaty, but for present purposes let's focus on income taxes of the two treaty partners. The authority is fairly broad as worded and requires a restriction, not unlike the *Powell* summons restriction, that it be for a need in the assessment, collection, enforcement or prosecution.

U.S. treaty partners may request the U.S. to use its evidence gathering authority—IDRs (which are not compulsory) but, as a fallback, the IRS administrative summonses (which are compulsory, at least if the summons is enforced)—to gather information for use in the treaty partner's

¹⁹⁴⁸ The current U.S. model is the 2016 model, titled United States Model Income Tax Convention (2016). The U.S. Model Treaty is based significantly on the OECD Model. For an explanation of how these tax treaties are negotiated, ratified and interpreted, see John A. Townsend, Tax Treaty Interpretation, 55 Tax Law. 219 (2001) (also arguing for a *Chevron*-type deference for the executive branch's treaty interpretations, most particularly those in the technical explanation accompanying the particular treaty and other submissions that inform the Senate Finance Committee in its ratification of the treaty); but see Michael S. Kirsch, The Limits of Administrative Guidance in the Interpretation of Tax Treaties, 87 Tex. L. Rev. 1063 (2009). I think the conceptual confusion in the area of how a U.S. court interprets a treaty, particularly a tax treaty, arises from a focus on a contract model a treaty to meet the "shared expectations of the parties," rather than the executive branch interpretation of the treaty it negotiated and the Senate's understand of the treaty it ratified. Those interpretations where clear should, in my view, inform U.S. courts' interpretation and application of the treaty rather than any search for how the treaty partner interpreted the treaty. Of course, the treaty partner's reasonable interpretations not shared by the executive branch or the Senate may mean that the U.S. and the treaty partner did not have a meeting of the minds on the treaty and that, in some international court, the treaty partner may be entitled to hold the U.S. to the treaty partner's reasonable interpretation. But, from a U.S. law perspective and in U.S. courts, it is the treaty that the executive branch negotiated and the Senate ratified that alone is the law of the land and what should control the law of the land is the executive branch's and Senate's understandings of the treaty. This is, of course, my BS and I am sticking to it even in the face of apparent lack of acceptance of my BS. And then you get to the issue of *Chevron* deference, and I would suggest that in the treaty area, *Chevron* deference is particularly appropriate, but I must end this footnote. Perhaps, if the "shared expectations" model is accepted, *Chevron* deference could still be applied if the shared expectations are ambiguous.

tax administration.¹⁹⁴⁹ The IRS views its authority to gather information for the treaty partners quite broadly, and the U.S. courts do also. For example, although the IRS administrative summons may not be used for U.S. purposes when the criminal investigation has reached the DOJ referral stage (see § 7602(d)), the IRS administrative summons may be used to obtain information for a treaty partner regardless of the stage of the treaty partner's investigation. See *United States v. Stuart*, 489 U.S. 353 (1989). Furthermore, the *Powell* IRS summons analysis must be modified to have the relevancy and scope determined by reference to the treaty partner's taxes, rather than U.S. taxes.

By the same token, the treaty gives the IRS the right to request that a treaty partner use its internal processes to gather information for the IRS. A treaty partner's requests and negotiations about the scope of the other treaty partner's responses are often off the radar screen and rarely surface in the U.S. The typical pattern for the exchange of information treaty provision is invoked by the requesting treaty country notifying the requested treaty country to use its internal tax information gathering process to obtain evidence related to a specifically named person over whom the requesting treaty country has tax jurisdiction. Only a legitimate tax enforcement need is generally required.

Some older treaties still in existence predicated the exchange of information as requiring "tax fraud." The 1996 Swiss treaty, still in effect, requires a showing of "tax fraud and the like." Focusing on the Swiss treaty, there were two problems with the Swiss double tax treaty which the Swiss exploited to protect its financial services industry which, in part, was involved in assisting U.S. persons in hiding financial assets and U.S. taxable income. The Swiss did that through two techniques. First, and historically, it interpreted the treaty provision "fraud or the like," very restrictively, although in negotiating the treaty the U.S. apparently thought a restrictive interpretation would not be applied by the Swiss.¹⁹⁵⁰ As thus interpreted restrictively, the U.S. had to virtually prove a criminal case against a specific named individual or taxable entity to get the Swiss competent authority to respond to a treaty request. By contrast, the exchange of information provision is viewed by most treaty partners (including the U.S.) as including merely a legitimate tax administration need (as opposed to tax fraud). Practically speaking, that meant that the U.S. rarely got any information from the Swiss via a treaty request. Second, and the problem that surfaced in

¹⁹⁴⁹ See generally, IRM 4.60.1.2.2 (02-23-2023), Foreign-Initiated Specific Requests for Information for a discussion of the process the IRS uses for such requests and IRM 4.60.1.2 (10-15-2018), Specific Exchange of Information (EOIR) Program.

¹⁹⁵⁰ "The Protocol contains a broad definition of tax fraud that should ensure that more information will be made available to U.S. authorities." See the President's 5/29/97 letter of submittal of the Swiss double tax treaty to the Senate. The protocol definitions were:

The parties agree that the term "tax fraud" means fraudulent conduct that causes or is intended to cause an illegal and substantial reduction in the amount of the tax paid to a Contracting State.

Fraudulent conduct is assumed in situations when a taxpayer uses, or has the intention to use, a forged or falsified document such as a double set of books, a false invoice, an incorrect balance sheet or profit and loss statement, or a fictitious order or, in general, a false piece of documentary evidence, and in situations where the taxpayer uses, or has the intention to use a scheme of lies ("Lügengebäude") to deceive the tax authority. It is understood that the acts described in the preceding sentence are by way of illustration, not by way of limitation. The term "tax fraud" may in addition include acts that, at the time of the request, constitute fraudulent conduct with respect to which the requested Contracting State may obtain information under its laws or practices.

a big way in 2008, was the U.S. difficulty in identifying the U.S. depositors in the Swiss banks so as to formulate the traditional request under the Swiss treaty when the Swiss insisted upon names. The U.S. did not know the names of the U.S. persons but the Swiss banks did. At least conceptually, the treaty did not require specific names and, from the U.S. perspective might permit so-called “group requests” where the identities are not given but characteristics are given—such as, for example, in this case, U.S. persons owning through a nominee foreign entity a bank account (or related bank accounts) exceeding \$500,000. These characteristics might not be proof of tax fraud and the like, but at least could permit a not unreasonable inference. But, wanting to avoid impediments to the U.S. tax evasion industry/franchise (a big industry in Switzerland), the Swiss competent authority pushed back on that and declined to respond to group requests even when they might arguably meet the tax fraud and the like standard. I sometimes refer to these group requests as “John Doe” treaty requests because the concept is similar to the concept used for John Doe summonses where the identity of the taxpayer is not known.

There has been a lot of activity on the group request front, not only with the U.S. and Switzerland but among other countries as well. For example, focused on the DOJ reached an agreement with Switzerland called the U.S. DOJ Swiss Bank Program¹⁹⁵¹ that allowed Swiss Banks to seek a nonprosecution agreement for tax evasion activity that required both a monetary penalty and turnover of aggregate data about the accounts (data from which characteristics of accounts could be determined) that permitted group requests based thereon to be made to the Swiss competent authority, with the expectation that Switzerland would respond.

In addition, in 2012, OECD has revised its model tax convention, which most developed countries consult in treaty negotiations, to permit group requests.¹⁹⁵² In response to that and other pressures, the Swiss began permitting group requests for information from February 1, 2013 provided that there is a “Double Taxation Agreement (DTA) or Tax Information Exchange Agreement (TIEA) with a clause on administrative assistance in line with the OECD Standard providing for group requests.”¹⁹⁵³ In addition, the OECD Convention on Mutual Assistance in Tax Matters which many countries have entered (including Switzerland effective January 2017) permits group requests.¹⁹⁵⁴ That OECD Convention is discussed below.

Then, with continuing pressure on Swiss banks, Switzerland agreed to a protocol to the U.S. Switzerland double tax treaty that would allow such group requests for other banks information. The U.S. Senate confirmed the protocol in 2019.

¹⁹⁵¹ See DOJ web site titled Swiss Bank Program (updated 7/24/19).

¹⁹⁵² See OECD announcement dated 7/18/12, stating:

The update explicitly allows for group requests. This means that tax authorities are able to ask for information on a group of taxpayers, without naming them individually, as long as the request is not a ‘fishing expedition’. This update represents a step forward towards more transparency, according to the OECD’s Centre for Tax Policy.

¹⁹⁵³ See KPMG Financial Services, Tax Transparency with Group Requests (copyrighted 2017).

¹⁹⁵⁴ Id. See also Department Treasury Technical Explanation of the Protocol signed May 27, 2010 to the Convention on Mutual Administrative Assistance in Tax Matters signed in 1989 and ratified in 1991. The explanation notes that Article III amends Article 18 on information to be provided to permit group requests. The protocol had not been approved by the Senate as of 1/3/17. See the Congress.gov web page titled “Protocol Amending the Convention on Mutual Administrative Assistance in Tax Matters” (viewed 7/2/17).

In an increasingly global economy, it may fairly be expected that the U.S. and other developed countries will enter more such double tax income tax and administrative assistance treaties.

c. OECD Convention on Tax Administrative Assistance.

The U.S. is a signatory to the OECD Convention on Mutual Administrative Assistance in Tax Matters, a multilateral tax treaty among members of the OECD who have ratified it.¹⁹⁵⁵ The U.S. ratified the original treaty. However, the U.S. has only signed (not ratified) the key 2010 protocol amending the Convention and signed the 2010 protocol subject to certain reservations which, in effect, exempt the U.S. from obligations under the treaty to the extent of the reservations.¹⁹⁵⁶ The provisions of this convention are solely procedural.

Due to intervening developments in tax enforcement for cross-border transactions, particularly related to offshore financial institutions, this treaty has been amended by protocol and is before the Senate for approval.¹⁹⁵⁷ The following is a brief explanation of the effect of the protocol from the U.S. perspective, focusing on the key portions of the treaty:

As amended, those chapters now reflect the OECD standards requiring that mechanisms for exchange of information upon request exist; that exchange of information is available for purposes of domestic tax law in both criminal and civil matters; that there are no restrictions of information exchange caused by application of the dual criminality principle **n3** or a domestic tax interest requirement; respect for safeguards and limitations; strict confidentiality rules for information exchanged; and availability of reliable information (in particular bank, ownership, identity and accounting information) and powers to obtain and provide such information in response to a specific request. It also opens the multilateral treaty to participation by States that are not members of either Council of Europe or OECD and thus were previously ineligible.

n3 The principle of dual criminality derives from the law regarding extradition and grounds for refusal to grant a request. Extradition is generally permitted only if the crime for which a person is to be extradited is treated as a similarly serious offense in the state in which the fugitive has sought refuge. Restatement (Third) of the Foreign Relations Law of the United States, sec. 476 (1987). The principle is relevant to a request for exchange of tax information only if the treaty in question limits the scope of its permitted exchanges to criminal tax matters.¹⁹⁵⁸

¹⁹⁵⁵ See OECD web site titled “Convention on Mutual Assistance in Tax Matters” (viewed on July 2, 2017 as last updated June 2017).

¹⁹⁵⁶ OECD Web Page titled “Convention on Mutual Administrative Assistance in Tax Matters” (viewed on 7/20/22); and Jeremy Temkin and Jasmine Juteau, The Revenue Rule and International Tax Collection, New York L.J. (11/17/21).

¹⁹⁵⁷ As of the latest information, the protocol has been approved by the Senate Foreign Relations Committee but, along with other treaties and protocols, is being from approval by the full Senate by Senator Paul. How long Senator Paul will play that game is unclear.

¹⁹⁵⁸ JCT Staff Report, Explanation of Proposed Protocol Amending the Multilateral Convention on Mutual
(continued...)

Because of developments in offshore evasion, more countries—even tax haven countries under considerable pressure—have joined the treaty.¹⁹⁵⁹ The G-20 finance members are solidly behind the treaty, urging other countries to join the treaty and similar initiatives for more transparency in cross-border tax matters.¹⁹⁶⁰

As a practical matter, there is substantial overlap administrative assistance in the double tax treaties and the administrative assistance in this treaty, but the signatories to this treaty include countries with whom the U.S. does not have a double tax treaty.¹⁹⁶¹

d. IRS Summons and the Hague Convention.

The IRS takes the position that it may serve the IRS administrative summons abroad under the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil or Commercial Matters.¹⁹⁶² The IRS will apparently use this process, which is probably less effective than under specific treaties, only where the specific treaties do not apply for some reason.¹⁹⁶³ Of course, for those foreign persons and entities enabling U.S. taxpayers to stash untaxed money overseas, the IRS summons has no teeth because its ultimate force is the contempt power of a U.S. court, which has no contempt power over foreign persons or at least no power to enforce any holding of contempt so long as they stay outside the U.S.

e. Other Treaties.

In addition to the income tax treaties, there may be other treaties having information exchange as a principal focus.

¹⁹⁵⁸(...continued)

Administrative Assistance in Tax Matters, JCX-9-1 (2/21/14).

¹⁹⁵⁹ Only recently, due principally to the push against offshore tax evasion, have traditional tax havens joined the treaty. Thus, the current list includes British Virgin Islands, the Cayman Islands, Luxembourg, and Switzerland.

¹⁹⁶⁰ Stephanie Soong Johnston, G-20 Endorses OECD's Common Reporting Standard for Automatic Information Exchange, 2014 TNT 37-5 (2/15/14).

¹⁹⁶¹ E.g., the U.S. has no double tax treaty with Singapore, but Singapore has signed this treaty (although Singapore's approval has not yet entered into force).

¹⁹⁶² ILM 200143032 reprinted in 2001 WTD 210-29 (10/30/01).

¹⁹⁶³ For example, in ILM 200143032, *supra*, the IRS indicated that it would use the process only because the treaty partner took the position that the exchange of information provision of the double tax treaty applied only where it had a "tax interest" in the information sought and there appeared to be no treaty partner tax interest. In that situation, the U.K. was the treaty partner and the ILM notes that the negotiated tax treaty which was not yet in force did eliminate the "tax interest" requirement for invocation of the exchange of information provision.

(1) MLATs.

One such treaty is the mutual legal assistance treaty (often acronymed to “MLAT”) for criminal and related matters.¹⁹⁶⁴ MLATs generally deal with broader information exchanges than just for tax matters. A good summary of the process is:

The MLAT is a treaty-based mechanism for seeking foreign law enforcement cooperation and assistance in support of an ongoing criminal investigation or proceeding. The MLAT process, and its benefits, are available only to government officials, typically prosecutors. MLATs do not apply to civil litigants or proceedings. Supervising the execution of incoming MLATs—requests for assistance from foreign jurisdictions—requires direct federal district court oversight and involvement. In contrast, the courts play no part in initiating or processing outgoing MLAT requests. That is the province of the executive branch.¹⁹⁶⁵

Generally, the MLAT process is much more efficient to U.S. investigators than the alternative letters rogatory process (discussed below).

(2) TIEAs.

Another type of contract or agreement with a similar goal to allow each treaty partner access to information in the jurisdiction of the other treaty partner is a Tax Information Exchange Agreement (also referred to as a “TIEA”).¹⁹⁶⁶ TIEAs are executive branch agreements entered under some other authorization (such as a statute or treaty). TIEAs do not require Senate approval.

(a) Caribbean Basin Initiative TIEAs.

TIEAs have been most prominent in the so-called Caribbean Basin Initiative (the popular name for the Caribbean Basin Economic Recovery Act).¹⁹⁶⁷ Some Caribbean countries have been notoriously uncooperative in sharing information with the U.S. for tax purposes and indeed have built major economies by promoting that noncooperation. In some of these countries, financial industries with secrecy as their main attraction are a large component of the local economies. As a result, these countries have been unwilling to enter into agreements or relationships that would undermine their local financial industries. Under the CBI, countries that enter into TIEAs with the United States gain certain trade benefits, thus giving them a financial incentive that may override

¹⁹⁶⁴ See generally, T. Markus Funk, *Mutual Legal Assistance Treaties and Letters Rogatory: A Guide for Judges* 1 (Federal Judicial Center 2014); and IRM 4.60.1.7 (10-15-2018), Mutual Legal Assistance Treaty (MLAT) Program.

¹⁹⁶⁵ Funk, *id.*, p. 2.

¹⁹⁶⁶ IRM 5.21.2.3 (04-06-2018), Exchange of Information. For the State Department’s list of TIEAs, see its Resource Center: Treaties and TIEAs. The discussion in section is largely drawn from these authorities.

¹⁹⁶⁷ See the web page for the Office of the United States Trade Representative titled “Caribbean Basin Initiative (CBI).”

their financial interest in maintaining strict secrecy for foreign customers of their financial institutions.¹⁹⁶⁸

In 2014, a Senate subcommittee described TIEAs:

The United States has . . . signed dozens of TIEAs with other countries containing information exchange provisions similar to those in the model Article 26. Those TIEAs typically include more detailed provisions on exchanging tax information, including what information must be provided by the requesting country and as well as the responding country. The United States began entering into TIEAs after enactment of a 1983 law authorizing the U.S. Treasury Department to negotiate bilateral or multilateral tax information exchange agreements with certain countries in the Caribbean and Central America. TIEAs became increasingly popular after the OECD published a model TIEA in 2003, encouraged countries around the world to use bilateral and multilateral TIEAs to combat cross border tax evasion, and increasingly used the willingness of a jurisdiction to enter into TIEAs as an indicator for avoiding its designation as an uncooperative tax haven.¹⁹⁶⁹

The CBI TIEA provides for the exchange of such information “as may be necessary or appropriate to carry out and enforce the tax laws of the United States and the beneficiary country (whether criminal or civil proceedings) including information which may otherwise be subject to nondisclosure provisions of the local law of the beneficiary country such as provisions respecting bank secrecy and bearer shares.”¹⁹⁷⁰ That is the general goal of the TIEA, but TIEAs are still negotiated documents that may vary in their specific provisions—and thus scope—depending upon the negotiating stance of the treaty states involved.¹⁹⁷¹ Thus, the statute permits the U.S. to enter TIEAs that will limit the exchange of information for civil tax purposes if (1) the Secretary of Treasury, after making reasonable efforts to negotiate an agreement which includes the exchange of such information, determines that such an agreement cannot be negotiated but that the agreement was negotiated will significantly assist in the administration and enforcement of the U.S. tax laws, and (2) the President determines that the agreement as negotiated is in the national security interest of the U.S.¹⁹⁷² The determination of whether information is sought only for civil tax purposes is made by the requesting party.¹⁹⁷³

A TIEA provides for the exchange of information pursuant to specific requests, as well as routine and spontaneous exchanges of information. If a party specifically requests, information shall

¹⁹⁶⁸ The discussion in this section is substantially drawn from the IRM discussion previously appearing at IRM 42.2.6.

¹⁹⁶⁹ Report of the Senate Committee on Homeland and Governmental Affairs Permanent Subcommittee on Investigations, titled *Offshore Tax Evasion: The Effort to Collect Unpaid Taxes on Billions in Hidden Offshore Accounts* 12 (8/20/14).

¹⁹⁷⁰ § 274(h)(6)(C)(i).

¹⁹⁷¹ The discussion draft to commence negotiations for a TIEA and the related Technical Explanation are reproduced in the IRM at Exhibit 42.2.6-1.

¹⁹⁷² § 274(h)(6)(C)(ii).

¹⁹⁷³ § 274(h)(6)(C)(iv).

be furnished in the form of depositions of witnesses and authenticated copies of unedited original documents (including books, papers, statements, records, accounts, and writings) in a form admissible into evidence in the courts of the requesting country.¹⁹⁷⁴ The authority and obligation to exchange information extends to information with respect to persons who are not residents or nationals of one of the contracting states.¹⁹⁷⁵ The officials of each country have a duty not to disclose information obtained under a TIEA other than to those involved in the country's tax administration.¹⁹⁷⁶ The CBI TIEAs are treated as income tax conventions for purposes of section 6103(k)(4) of the Code which allows the U.S. to disclose information to tax treaty partners pursuant to the exchange of information provision of such treaties.

U.S. enforcement at the request of the other party to a TIEA is discussed in *Barquero v. United States*, 18 F.3d 1311 (5th Cir. 1994) involving the TIEA between the U.S. and Mexico. In that case, the Mexican tax authority (through its treaty office referred to in treaty speak as the competent authority) requested the U.S. counterpart (the U.S. competent authority) to obtain tax information relating to a Mexican national. Pursuant to that request, the IRS served a U.S. bank with an IRS summons. The Mexican national filed a motion in the district court to quash the summons. The U.S. counterclaimed to enforce the summons. The Fifth Circuit upheld the constitutionality of the TIEA and said that the IRS had authority to issue the summons. The Fifth Circuit also rejected the taxpayer's argument that the IRS issued the summons in bad faith, applying the *Powell* standard (minimum relevancy showing and absence of bad faith) to TIEA requests.

The United States has entered several TIEAs with Caribbean countries and more will undoubtedly be entered.

(b) Other TIEAs.

TIEAs may also be entered independent of the Caribbean Basin Initiative. For example, the United States entered a TIEA with Bermuda to implement the Mutual Assistance in Tax Matters provisions of a treaty between the U.S. and the U.K. TIEAs have thus been entered with a number of non-Caribbean jurisdictions that are perceived as tax havens.¹⁹⁷⁷

f. Letters Rogatory.

Another form of request from one country to another for assistance in gathering information is in the form of letters rogatory. The following is a good introduction to the process:

Letters rogatory are formal requests for judicial assistance made by a court in one country to a court in another country. Once issued, they may be conveyed through diplomatic channels, or they may be sent directly from court to court. Letters rogatory are often used to obtain evidence, such as compelled testimony, that may not be accessible to a foreign criminal or civil litigant without judicial authorization.

¹⁹⁷⁴ § See H.R. Rep. No. 266, 98th Cong., 1st Sess. 30 (1983).

¹⁹⁷⁵ Id at 29.

¹⁹⁷⁶ Id .

¹⁹⁷⁷ E.g., TIEAs with Jersey and the Isle of Man since October of 2002.

They are used primarily by non-government litigants who do not have access to the MLAT process. “While it has been held that federal courts have inherent power to issue and respond to letters rogatory, such jurisdiction has largely been regulated by congressional legislation.”¹⁹⁷⁸

28 U.S.C. § 1781 permits the U.S. Secretary of State to receive such requests from foreign countries and to make such requests on behalf of a tribunal in the U.S. The Convention on the Taking of Evidence Abroad in Civil or Commercial Matters of March 18, 1970 (the “Hague Evidence Convention”), to which the U.S. is signatory, provides procedures for making a “letter of request” (the equivalent of a letter rogatory). For requests not within the Hague Evidence Convention (as would be criminal investigative requests), letters rogatory may still issue but the procedures are not set out and whether or not the requested country honors the letters rogatory will depend upon the existence of other agreements, other internal laws of the requested country, or that country's belief that important national interests, including its interest in international comity, compel honoring the request.

For outgoing letters rogatory (in the current context of IRS investigations desiring evidence in a foreign country), here is a good summary:

The letter rogatory process is less formal than pursuing evidence through an MLAT, but its execution can be more time-consuming. Outgoing letters rogatory—requests for assistance with obtaining evidence abroad, made by counsel through the U.S. court—are issued by the U.S. State Department pursuant to 28 U.S.C. § 1781, and provided for under Federal Rules of Civil Procedure 28(b) and 4(f)(2)(B). Section 1781(b), however, also allows for a district court (and, for that matter, a foreign court) to bypass the State Department and transmit the outgoing letter rogatory directly to the “foreign tribunal, officer, or agency.”

In most cases, foreign courts honor requests issued pursuant to letters rogatory. However, international judicial assistance is discretionary, based upon principles of comity rather than treaty, and is also subject to legal procedures in the requested country. Compliance with a letter rogatory request is left to the discretion of the court or tribunal in the “requested” jurisdiction (that is, the court or tribunal to which the letter rogatory is addressed). For example, if a request for compelled testimony is granted by a foreign court, the taking of that testimony may not necessarily follow procedures similar to those of the United States, such as through depositions,¹⁹⁷⁹

As a result, letters rogatory will be used in U.S. tax investigations only where there is not an available treaty.¹⁹⁸⁰ And, in a criminal case, are generally effective only post-indictment.¹⁹⁸¹

¹⁹⁷⁸ See generally, T. Markus Funk, *Mutual Legal Assistance Treaties and Letters Rogatory: A Guide for Judges* 17 ff. (Federal Judicial Center 2014).

¹⁹⁷⁹ *Id.*, at pp. 17-18.

¹⁹⁸⁰ IRM 9.4.2.6.4 (03-15-2007), Letters Rogatory; and IRM 35.4.5.3.2 (12-21-2010), Letters Rogatory.

¹⁹⁸¹ IRM 9.4.2.6.4 (03-15-2007), Letters Rogatory, but noting that “ There also exists case law that (continued...) ”

For incoming letters rogatory, 28 U.S.C. § 1782 permits U.S. district courts to order a person within the district to give testimony or produce documents “for use in a proceeding in a foreign or international tribunal, including criminal investigations conducted before formal accusation.” The order may issue “pursuant to a letter rogatory issued, or request made, by a foreign or international tribunal or upon the application of any interested person.” This is broad and sweeping authority for district courts to order discovery at the request of foreign governments (both courts and investigators) and even private parties.¹⁹⁸² Under § 1782, the party subject to the order may assert privileges.

4. Non-Treaty Techniques.

Let’s assume the prototypical situation where the taxpayer has a Swiss bank account that, somehow, the IRS has discovered. The IRS then serves a summons upon a New York branch of the Swiss bank. Clearly the New York branch is within the U.S. summons power. Will the U.S. get the information? This turns upon how much punishment (fines) the Swiss bank is willing to stand to avoid giving up the information. Of course, the Swiss bank's first line of defense will be that it cannot give up the information because to do so would violate Swiss law. That defense usually fails based upon a balancing of interests test.¹⁹⁸³

Note in this regard that *United States v. Balsys*, 524 U.S. 666 (1998), although not dealing directly with this issue, indicates that U.S. legal imperatives are sufficiently important to trump foreign law at least in the context of the constitutional Fifth Amendment privilege, so that certainly the possibility of violating foreign law will not be a strong imperative here. Assuming the court concludes in favor of the U.S., the court will enforce the summons which, in the case of a corporate summonsee, means that, should it fail to honor the summons, it will suffer monetary contempt penalties that can be great indeed.¹⁹⁸⁴

This means, of course, that the smart evader will not use a foreign institution with sufficient U.S. presence to suffer this risk. Where that happens, the IRS will resort to the court-ordered consent directive ordering the U.S. taxpayer to sign a consent form directing the foreign institution (bank, brokerage concern, etc.) to disclose information to the U.S. authorities. (See p. 921.).

¹⁹⁸¹(...continued)

recognizes a district court's authority to issue letters rogatory for criminal cases that have not yet been indicted.”

¹⁹⁸² For an example of the use of § 1782 to obtain a discovery order at the request of Russian criminal tax investigators, see *United States v. Sealed I*, 231 F.3d 484 (9th Cir. 2000).

¹⁹⁸³ See, e.g., *In re Grand Jury 81-2*, 550 F. Supp. 24, 27 (W.D. Mich. 1982); but see *United States v. First Nat'l Bank*, 699 F.2d 341, 342 (7th Cir. 1983).

¹⁹⁸⁴ See *In re Grand Jury Proceedings (United States v. Bank of Nova Scotia)*, 691 F.2d 1384 (11th Cir. 1982), cert. denied, 462 U.S. 1119 (1983); and the companion case *In re Grand Jury Proceedings (United States v. Bank of Nova Scotia)*, 740 F.2d 817, 832-33 (11th Cir. 1984), cert. denied, 469 U.S. 1106 (1985).

VIII. Joint International Audits and Simultaneous Examinations.

A. Joint International Audits.

Related to international evidence gathering is an initiative, particularly for OECD countries to perform joint international audits of multinational companies where the tax authorities of two or more countries can coordinate their audit or investigation efforts to maximize the effect of limit enforcement resources.¹⁹⁸⁵ The joint audit is a jointly conducted audit by two or more tax jurisdictions rather than simultaneous audits by two or more tax jurisdictions.¹⁹⁸⁶

B. JITSIC.

The IRS had earlier joined a joint effort with the tax authorities of the U.K., Canada and Australia, called the Joint International Taskforce on Shared Intelligence and Collaboration (JITSIC) (“JITSIC”).¹⁹⁸⁷ This effort is more narrowly focused than joint audit initiative, focusing on cross-border strategies of the tax shelter variety. For example, JITSIC is reported to have found foreign tax credit generators involving U.S. and British Banks.¹⁹⁸⁸ JITSIC morphed into a broader collaboration among nations under OECD auspices called Joint International Tax Shelter Information & Collaboration, the acronym for which is also JITSIC.¹⁹⁸⁹ On its website,¹⁹⁹⁰ the OECD JITSIC is described:

The JITSIC brings together 38 of the world's national tax administrations that have committed to more effective and efficient ways to deal with tax avoidance. It offers a platform to enable its members to actively collaborate within the legal framework of effective bilateral and multilateral conventions and tax information exchange agreements – sharing their experience, resources and expertise to tackle the issues they face in common.

* * * *

JITSIC was originally established in 2004 as the Joint International Tax Shelter Information Centre to combat cross-border tax avoidance. Building on its initial achievements, the JITSIC Network was re-established in 2014 with many new members from across the FTA.

¹⁹⁸⁵ Prepared Remarks of Commissioner of Internal Revenue Douglas H. Shulman before the OECD/BIAC (6/8/10); Barry Shott, *International Joint Audits: Is Two Better Than One?*, The Tax Advisor (January 2, 2014); and IRM 4.60.1.11 (02-23-2023), Joint Audit Program.

¹⁹⁸⁶ IRM 4.60.1.11.1 (02-23-2023), Joint Audit Program Scope.

¹⁹⁸⁷ IRM 4.32.2.4.7 (06-04-2018), Joint International Taskforce on Shared Intelligence and Collaboration (JITSIC).

¹⁹⁸⁸ Lee A. Sheppard, *Foreign Tax Credit Generator Disallowed*, 133 Tax Notes 400 (Oct. 24, 2011) (discussing an abusive foreign tax credit generator case, *Pritired 1 LLC v. United States*, No. 4:08-cv-00082 (S.D. Iowa 2011)).

¹⁹⁸⁹ The original more limited JITSIC continues to be identified in the IRM, so this group may continue in addition to the OECD version of JITSIC.

¹⁹⁹⁰ See OECD web site here.

* * * *

MEMBERSHIP

The JITSIC Network is open on a voluntary basis to members of the Forum on Tax Administration. The current members are:

Australia, Austria, Belgium, Canada, Chile, China, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, India, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Malaysia, Mexico, Netherlands, New Zealand, Norway, Portugal, Russian Federation, Slovak Republic, South Africa, Spain, Sweden, Switzerland, Turkey, the United Kingdom and the United States.

A current initiative of OECD's JITSIC is to deal with the issue of offshore accounts and entities permitting avoidance or evasion of member nation's taxes. A current specific initiative is to deal with the so-called Panama Papers where voluminous data from a Panama law firm disclosed massive potential tax evasion and other crimes.

C. Simultaneous Examination Program.

As noted, the Simultaneous Examination Program is not a joint audit but rather one that occurs simultaneous with some mutual cooperation between the taxing authorities pursuant to exchange of information provisions of treaties and TIEAs.¹⁹⁹¹ "Simultaneous examinations involve the United States and one or more of its foreign partners conducting separate, independent examinations of selected taxpayer(s) within their respective jurisdictions in which the partners have a common or related interest."¹⁹⁹² The two jurisdictions do not share personnel as might be the case in joint audits.¹⁹⁹³

D. Simultaneous Criminal Investigation Program ("SCIP").

There is a parallel Simultaneous Criminal Investigation Program ("SCIP") also relying on exchange of information provisions of treaties and TIEAs.¹⁹⁹⁴ These are also "separate, independent criminal income tax investigations of selected taxpayer(s) within their respective jurisdictions in which the partners have a common or related interest."¹⁹⁹⁵ As of 2018, "working arrangements for the conduct of SCIP with Australia, Canada, France, Italy, Japan, Mexico and South Korea."¹⁹⁹⁶

¹⁹⁹¹ IRM 4.60.1.4 (02-23-2023), Simultaneous Examination Program (SEP).

¹⁹⁹² IRM 4.60.1.4.1 (10-15-2018), SEP Objectives and Benefits. For an illustration of the SEP, see *Aloe Vera of Am., Inc. v. United States*, 2015 U.S. Dist. LEXIS 16605 (D. Ariz. 2015) (a case involving the improper disclosure of false return information by the IRS to Japanese tax authorities in the course of an SEP), *aff'd* in part and *rev'd* in part 686 Fed. Appx. 451 (9th Cir. 2017).

¹⁹⁹³ IRM 4.60.1.4.1 (10-15-2018), SEP Objectives and Benefits.

¹⁹⁹⁴ IRM 4.60.1.5 (02-23-2023), Simultaneous Criminal Investigation Program (SCIP); and IRM 9.4.2.6.3 (08-02-2018), Simultaneous Criminal Investigation Program.

¹⁹⁹⁵ IRM 4.60.1.5.1(1) (02-23-2023), SCIP Objectives and Benefits.

¹⁹⁹⁶ IRM 9.4.2.6.3(2) (08-02-2018), Simultaneous Criminal Investigation Program.

E. Joint Chiefs of Global Tax Enforcement (J5).

The IRS has an initiative called Joint Chiefs of Global Tax Enforcement (J5) whereby the criminal tax enforcement agencies of member countries (Australia, Canada, the Netherlands, United Kingdom, and the U.S. focus on combating transnational tax crime by cooperation “to gather information, share intelligence, conduct operations and build the capacity of tax crime enforcement officials.”¹⁹⁹⁷

IX. IRS Methodology for Determining Additional Tax Liability.

A. Specific Items.

In the examination, the IRS may focus on specific items such as specific deductions or specific omitted income and determine from its investigation (including submissions by the taxpayer) that the taxpayer owes additional taxes with respect to those items. These determinations will be reflected in the Revenue Agent's Report (“RAR”).¹⁹⁹⁸

For example, the IRS becomes aware through information returns that the taxpayer did not report dividend income of \$1,000 and interest income of \$1,500. The IRS could do a correspondence audit to resolve those issues. However, based on its other information (such as a DIF score), the IRS determines that it wants to do a field audit. The IRS conducts a field audit and, in the course of the field audit, determines that the taxpayer improperly deducted certain Schedule C trade or business expenses—specifically claimed deductions for contract labor in excess of \$500 of what he could prove. The IRS then proposes to adjust taxable income:

Increase for \$1,000 unreported dividends
Increase for \$1,500 unreported interest
Increase for \$500 unproved deductions
Aggregate increase to taxable income of \$3,000

The IRS then issues an RAR showing that increase to taxable income and the resulting income tax liability. The RAR will indicate whether any penalty is being asserted. The RAR will not assert interest on the tax and penalty (if asserted), because interest is automatic.

This is an example of a specific items audit and audit proposals. The agent takes the taxpayer’s return as filed and makes specific item adjustments.

A variation of that approach is where the taxpayer did not file a return and thus the IRS has to reconstruct the specific items or components required to compute a tax liability. This is still a specific items audit because each discrete item of income, deduction and credit is determined and

¹⁹⁹⁷ See IRS Web Page titled “Joint Chiefs of Global Tax Enforcement” (Last reviewed or updated 6/30/22 and viewed 6/20/22).

¹⁹⁹⁸ The RAR was described in *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner*, 154 T.C. 68, 72 n. 3 (2020) (citing *Branerton Corp. v. Commissioner*, 64 T.C. 191, 194-195 (1975) as: “a Form 4549-A, “Income Tax Discrepancy Adjustments,” along with a Form 886-A, “Explanation of Items”), rev’d on other grounds 29 F.4th 1066 (9th Cir. Mar. 25, 2022)).

the tax computed accordingly. The IRS will typically assert that liability through a Substitute for Return.

B. Indirect Methodologies.

The IRS also has several indirect methodologies to determine that the taxpayer has underreported his tax liability and owes additional tax. The common theme in the use of these indirect methodologies is that (i) direct methodologies do not work and (ii) the particular indirect methodology used in a particular case is persuasive to provide a reasonable estimate of a tax liability. This is key—the use of an indirect methodology will not be perfect and will produce only an estimate that is the best under the circumstances or, state alternatively, produces a more reasonable result than if no methodology were used. These methodologies, if accurately and persuasively applied and reasonable under the circumstances, will be sustained by the courts.

1. Net Worth Method.

The net worth method is used often when there is reason to believe that such records as the taxpayer maintains do not accurately reflect his or her taxable income (and components thereof). Basically, the net worth method develops taxable by identifying the taxpayer's increase in net worth and nondeductible expenses during the period that can, by inference, indicate that the increase in net worth and nondeductible expenses are from taxable income.¹⁹⁹⁹ In brief, the methodology is:

Taxpayer's net worth at the beginning of the period (one or more years)
Less: Taxpayer's net worth at the end of the period
Plus: Taxpayer's nondeductible expenditures during the period
Less: Income (or asset receipts) from nontaxable sources (such as gifts)
Yields: Taxpayer's income during the period

There are variations on this formula. The methodology is highly factual and depends upon whether the IRS did sufficiently reasonable work, including tracing leads, to fairly -- even if not precisely -- measure taxpayer's income in the absence of more correct calculations. Where several years are included in the period, the IRS must have some method to allocate the income among the years so that the annual tax can be computed.

2. Bank Deposits and Expenditures Method.

This method uses bank deposits on the opening premise that all unexplained bank deposits are taxable income.²⁰⁰⁰ Depending upon the facts involved, the method then proceeds to reconstruct income. An example of a formula that might be used is:

All of the deposits to the taxpayer's bank account(s) during the period
Less: Deposits shown to be nontaxable income (such as gifts)
Plus: All known expenditures which were not from the bank account(s)

¹⁹⁹⁹ IRM 9.5.9.5 (11-05-2004), Net Worth Method of Proof.

²⁰⁰⁰ IRM 9.5.9.7 (11-05-2004), Bank Deposits Method of Proving Income.

Less: All expenditures which are deductible
Yields: Taxpayers' taxable income during the period

A related method is the expenditures method.²⁰⁰¹

3. Others.

There are other methodologies, such as a percentage markup method for gross income relative to costs, but all are used and ultimately sustained only if reasonable under the circumstances of the particular case. All of these methods are circumstantial methods of proving income. Because they are imprecise, they are likely to be conservative estimates of the income.

4. General Problems with Indirect Methods.

Such indirect methods are inherently fraught with inaccuracy and are justified only where the books and records maintained by the taxpayer, if any, are found to be inadequate for a fair determination of his or her tax liability. Then an indirect method is allowed only if it persuasively, rationally and fairly, based upon the unique facts of the taxpayer's case, reconstructs the taxpayer's tax liability. If the IRS has done a sloppy job in performing the indirect method analysis or used a methodology that does not fit under the taxpayer's circumstances, a court may throw it out altogether or give the taxpayer all benefit of the doubt despite the supposed burden of proof being on the taxpayer.

And don't forget that these methodologies can be available to the taxpayer to try to prove that his or her tax liability is less than claimed by the Government.²⁰⁰²

X. Taxpayer Discovery of Information in the Examination.

I have discussed above the various tools that the IRS has to obtain information or documents from the taxpayer and third parties during the course of the examination. I focus here on a taxpayer's ability to discover information. There is no compulsory discovery process for third-party information or documents comparable to the IRS summons process. Hence, a taxpayer or his representative will have to obtain such information or documents from third parties at their discretion.

The taxpayer may, however, be able to obtain information or documents from the IRS. I covered in Chapters 18 and 19 FOIA and the confidentiality requirements for return information held by the IRS. The key exception for present purposes is that the IRS may disclose to the taxpayer involved that taxpayer's return information which would include the information and documents in the file related to the audit of the taxpayer.²⁰⁰³ For this reason, the IRM provides that taxpayers general have a right to information in their files, so upon request of the taxpayer or representative, "Examiners should provide the taxpayer and their POA a copy of the file and workpapers for **open**

²⁰⁰¹ IRM 9.5.9.6 (11-05-2004), Expenditures Method of Proving Income

²⁰⁰² See *Kikalos v. United States*, 408 F.3d 900 (7th Cir. 2005) (Posner, J.); and John A. Townsend, Judge Posner's Opinion in Kikalos, 108 Tax Notes 593 (Aug. 1, 2005).

²⁰⁰³ § 6103(e).

examinations directly when asked, to the extent their release does not adversely impact tax administration.”²⁰⁰⁴ The taxpayer or the representative should seriously consider taking advantage of this opportunity unless the conclusion is reached that, in the case, it is not indicated.

As to valuation determinations by the IRS, the IRS must furnish any affected person (executor, donor or person required to make a return) making a request a written statement of the components of the valuation. § 7517.

XI. Settlement at Examination.

Generally speaking, in the past, Examination had little delegated authority to settle cases. Examination could propose adjustments, and the taxpayer was limited, in theory, to convincing the agent not to make any adjustment. The taxpayer and the agent could not just “split the baby” or, at least theoretically, engage in other more subtle forms of splitting the baby. Examination and the taxpayer could not make a “hazards of litigation” settlement -- meaning a settlement that reflected the risks to each side of litigating the issue. Thus, for example, if the issue were one that the IRS felt should be asserted but the IRS had lost it consistently in the courts, Examination could not settle on a basis reflecting doubt as to its ultimate ability to sustain the adjustment. The Appeals Office (the next level in the administrative process after Examination completes its examination and proposes its adjustments) does have the authority, generally, to settle on the basis of hazards of litigation.

Initiatives to make the IRS more user friendly have somewhat relaxed this historical limitation on Examination's ability to settle cases, but not much in most cases. The future may and probably will bring more relaxation of these strictures, provided that some safeguards are instituted to assure that Examination can make the proper assessments for hazard of litigation settlements and safeguards against abuses are adopted.

Even in the current environment, there are some issues that are inherently susceptible of settlement on an effective hazards of litigation basis at examination. Let's take a valuation issue such as the valuation of a closely held business for estate tax purposes. There is usually no significant principle of tax law involved, the “willing buyer, willing seller” standard having been entrenched for many years now. The only issue is what is a fair valuation and ultimately the issue is what a court would say is a fair valuation. Examination and the taxpayer can reach a settlement on valuation that, from a practical standpoint, is a hazards of litigation settlement. The tax law is shot-through with similar fact issues that control the tax results and that are susceptible of settlement at Examination. Notwithstanding the possibility of reaching a settlement on such inherently factual issues such as

²⁰⁰⁴ IRM 4.2.5.6 (03-16-2022), Requests for Open Examination File and Workpapers. As to what the examiner should withhold because disclosure would impair tax administration, the IRM notes that the DIF information for scoring the tax return and confidential informant information. Id. At (2). The IRM further requires the examiner to seek assistance from the Disclosure if the file contains information that is exempted from disclosure (such as informant or other sensitive information, third party tax information or any other concerns the examiner may have. Id., at (3). The IRM finally requires withholding the information from the taxpayer if it would jeopardize collection of the tax, involve reprisal against any person or jeopardize a pending criminal investigation. It is clear, however, whether the request is informally made to the examiner rather than by formal FOIA request, the examiner has to identify that he or she is withholding information or documents and give the type of justifications that are given in response to withholding for a formal FOIA request.

valuation, the usual approach for the agent will be to take aggressive positions in important valuation cases (such as transfer pricing cases), and then let settlement be achieved somewhere in between the parties positions by the Appeals Office or by the attorneys in litigation.

By contrast, as suggested above, legal issues are not susceptible of settlement by Examination. Either a complex business re-adjustment is a tax-free reorganization or it is not, depending upon how the law is applied to the facts that may or may not be disputed. For such issues, Examination is to propose the Government's position without regard to the hazards of litigation. Then, at the next level, the Appeals Office can assess the hazards of litigation and reach a settlement if the parties make consistent assessments of the hazards of litigation.

It may be helpful to analogize the IRS Examination and Appeals functions as an advocacy role (for Examination) and a mediator role (for Appeals). The analogies are not perfect but may help you understand the process. Examination is to identify issues and assert the Government's position with respect to those issues, without settling them on the basis of the hazards of litigation. Then, after Examination concludes its business, the Appeals Office comes in to attempt to reach a settlement based on the hazards of litigation. I deal in more detail with the Appeals function in Chapter 8 below.

In negotiating with the IRS, as with any governmental organization, the practitioner must be concerned with who has authority to perform the action being negotiated. We consider settlements at the examination level here, so the practitioner must determine who has authority to settle. Settlements are delegated in Commissioner delegation orders. Attempts to settle with an IRS agent who has no authority to settle are generally rejected.²⁰⁰⁵

XII. Closing the Examination.

A. General.

The Agent concludes the examination by preparing a Notice of Proposed Adjustment (“NOPA”) and Revenue Agent's Report (“RAR”)²⁰⁰⁶ and providing it to the taxpayer.²⁰⁰⁷ The Agent will request the taxpayer to file a Form 870, Waiver of the Restrictions on Assessment,²⁰⁰⁸ or Form

²⁰⁰⁵ *Dorl v. Commissioner*, 507 F.2d 406, 407 (2d Cir. 1974); and *Gardner v. Commissioner*, 75 T.C. 475, 477-478 (1980).

²⁰⁰⁶ Forms 4549 and 4549-A may serve as the RAR. IRM 4.10.8.2.2 (03-25-2021), Preparation of Audit Reports

²⁰⁰⁷ See generally Reg. 601.105(b)(4). The RAR was described in *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner*, 154 T.C. 68, 72 n. 3 (2020) (citing *Branerton Corp. v. Commissioner*, 64 T.C. 191, 194-195 (1975) as: “a Form 4549-A, “Income Tax Discrepancy Adjustments,” along with a Form 886-A, “Explanation of Items”), rev’d on other grounds 29 F.4th 1066 (9th Cir. Mar. 25, 2022)).

²⁰⁰⁸ The Form 870 waiver language is:

I consent to the immediate assessment and collection of any deficiencies (increase in tax and penalties) and accept any overassessment (decrease in tax and penalties) shown above, plus any interest provided by law. I understand that by signing this waiver, I will not be able to contest these years in the United States Tax Court, unless additional deficiencies are determined for these years.

A parallel form is used for transfer tax: Form 890, Waiver of Restrictions on Assessment and Collection of Deficiency (continued...)

4549, Income Tax Examination Changes,²⁰⁰⁹ with similar waiver language to permit the IRS to assess without sending a notice of deficiency.²⁰¹⁰ The waiver—authorized by § 6213(d)—merely waives the requirement in § 6213(a) that a notice of deficiency be issued prior to an assessment.²⁰¹¹ It is not an agreement that the taxpayer owes the taxes and penalties stated therein.²⁰¹² There is some potential benefit to the taxpayer in filing a waiver because, if the IRS then does not assess within 30 days, interest on the deficiency will not accrue from the 30th day through the date of the ultimate assessment. § 6601(c). The IRS thus has an incentive for prompt assessment. The downside to the taxpayer in filing the waiver is that he will not get the notice of deficiency and thus foregoes his opportunity to litigate in the Tax Court.²⁰¹³

If the taxpayer does not file the waiver, the IRS will send a 30-day letter provided that the protest can be filed and the case transferred to Appeals 365 days (270 days for estate tax cases) before the statute expiration for assessment.²⁰¹⁴ The 30-day letter is the taxpayer's ticket to Appeals

²⁰⁰⁸(...continued)

and Acceptance of Overassessment - Estate, Gift and Generation - Skipping Transfer Tax.

²⁰⁰⁹ The Form 4549 waiver language is:

Consent to Assessment and Collection - I do not wish to exercise my appeal rights with the Internal Revenue Service or to contest in the United States Tax Court the findings in this report. Therefore, I give my consent to the immediate assessment and collection of any increase in tax and penalties * *

* * It is understood that this report is subject to acceptance by [named IRS officials].”

The Form 4549 is an effective waiver under § 6213(d). *Lua v. United States*, 843 F.3d 950, 954 (Fed. Cir. 2016) (citing *Perez v. United States*, 312 F.3d 191, 197 n.23 (5th Cir. 2002)). But the Form 4949, like the Form 870, is not a binding agreement as to the taxpayer’s tax liability. All it does is waive the restrictions on assessment. *Hudock v. Commissioner*, 65 TC 351, 362-363 (1975); and *Holland v. Commissioner*, 70 TC 1046, 1048–1049 (1978) (citing *Hudock*), *aff’d*, 622 F.2d 95 (4th Cir. 1980) (same, although the Fourth Circuit rejected the argument on the ground that the Form 4549 was not approved by the manager and seemed to suggest that it could bind the taxpayer; the Court was just wrong, but it did not affect the outcome on appeal).

²⁰¹⁰ One author has summarized the differing uses of the forms (Ronald A. Stein, Settling with the IRS: the Importance of Procedure, Tax Notes 1675 (June 27, 2005)):

Form 870 generally is used for partially agreed individual and corporate income tax cases; unagreed income tax cases requiring a 30-day letter; JCT cases; and certain other situations. Form 4549 is generally used for regular, fully agreed income tax cases * * * *.

²⁰¹¹ Despite this limited effect of the Forms 870 and 4549, Courts sometime erroneously describe it as an agreement as to liability. E.g., *Williams v. Commissioner*, T.C. Memo. 2015-198, at *12 (“He signed the Form 4549 agreeing that he was liable for a fraud penalty for each year. . . . [H]e signed the Form voluntarily, and he thereby admitted that he knew about the omissions from income.”) In the context of the case, the erroneous statement probably did not affect the case, but such loose statements sometimes can have ramifications in other contexts if they are not recognized as simply wrong.

²⁰¹² See *Smith v. Commissioner*, 328 F.3d 760 (5th Cir. 2003), citing *Daugette v. Patterson*, 250 F.2d 753, 755-57 (5th Cir. 1957). One collateral consequence of signing the waiver, which allows the IRS to make an assessment without issuance of a notice of deficiency, is that upon assessment the IRS can invoke its various collection remedies (discussed below beginning on p. 733) and the taxpayer will be denied the Collection Due Process remedy as a means of contesting the underlying tax liability. See *Aguirre v. Commissioner*, 117 T.C. 324, 327 (2001).

²⁰¹³ As to the Form 4549 with the waiver language, see *Aguirre v. Commissioner*, 117 T.C. 324 (2001). *Aguirre* holds that, in addition to losing their right to go to the Tax Court, the taxpayers also lose their right to a collection due process proceeding in the Tax Court. (See the discussion of the collection due process rights below beginning p. 733.)

²⁰¹⁴ Reg. § 601.105(d). See e.g., IRM 4.10.8.12.1 (03-25-2021), 30-Day Letters; and IRM 4.25.10.7.3 (07-30-2019), 30-Day letter Procedures (for estate, gift and generation skipping transfer tax examinations).

which the taxpayer invokes by filing a protest.²⁰¹⁵ The taxpayer may be requested to sign a consent to extend the statute of limitations to permit Appeals processing; if the taxpayer refuses, the taxpayer may not get a “30-day letter” and the IRS will proceed to issue a notice of deficiency (colloquially called a “90-day letter” because the taxpayer then has 90 days in which to petition the Tax Court for redetermination of the proposed deficiency). For this reason, the notice of deficiency is sometimes also called the “ticket to the Tax Court.”²⁰¹⁶ The notice of deficiency is issued under § 6212.

Under § 7430(g), after receipt of the “30 day” letter offering an opportunity for administrative appeal, the taxpayer may make a “qualified offer” to settle. I will deal more with “qualified offers” later (p. 611), but the key point here is that it should be considered as soon as the 30-day letter is received if the taxpayer can make a reasonable projection of how the case may ultimately be resolved.

Finally, a key consequence of closing an examination is that second examinations (or inspections) are prohibited by § 7605(b) except in narrow circumstances. See the discussion of second examinations beginning on p. 400.

Upon timely request, the IRS may issue an estate tax closing letter.²⁰¹⁷ The estate tax closing letter is not a closing agreement and “its issuance does not prevent the IRS from reopening or reexamining the estate tax return to determine estate tax liability if there is (1) evidence of fraud, malfeasance, collusion, concealment, or misrepresentation of a material fact, (2) a clearly-defined, substantial error based upon an established IRS position, or (3) another circumstance indicating that a failure to reopen the case would be a serious administrative omission.”²⁰¹⁸ The closing letter, although not a closing agreement, is used by “local probate courts, state tax departments, and others * * * for confirmation that the IRS examination of the estate tax return has been completed and the IRS file has been closed.” A user fee of \$67 is required for a closing letter.²⁰¹⁹ If the estate tax closing letter is not timely requested or the person does not wish to make the request or pay the fee, the free IRS “account transcript may substitute for an estate tax closing letter.”²⁰²⁰

²⁰¹⁵ Reg. § 601.105(d) (providing that, although a protest is not required in some smaller cases, it will be in the type of field audit examination we assume here); See IRS Publication 5 on Filing a Protest.

²⁰¹⁶ *McKay v. Commissioner*, 89 T.C. 1063, 1067 (1987).

²⁰¹⁷ See Notice 2017-12, 2017-4 I.R.B. (the estate tax closing letter is a notification that the return has been accepted as filed or an audit adjustment has been resolved, citing Rev. Proc. 2005-32, 2005-1 C.B. 1206). As to time for filing the request for a closing letter, the Notice says that the “request is to be made at least four months after the filing of the estate tax return; the IRS; the IRS web page titled “Frequently Asked Questions on Estate Taxes” (last reviewed or updated 2/20/22 and viewed 7/20/22) states that requesters should be made “at least nine months after filing the return” and, for examined returns, the closing letter will not issue for up to 30 days after the examination.

²⁰¹⁸ Notice 2017-12, 2017-4 I.R.B. (citing § 5 of Rev. Proc. 2005-32, 2005-1 C.B. 1206). I cover closing agreements elsewhere. Closing agreements are more conclusive but may be reopened if some of the conditions cited above (such as fraud) are present.

²⁰¹⁹ Reg. § 300.13(b) (effective 10/28/21).

²⁰²⁰ Notice 2017-12, 2017-4 I.R.B. (containing an explanation of the account transcript and the transaction code “421” and explanation which indicates that an estate tax examination has been closed.). A good discussion of the account transcript as an alternative to a closing letter is contained in the preamble to Reg. § 300.13 (adopting the user fee), at T.D., 86 F.R. 53539- (9/28/21). See also IRS web page titled “Transcripts in Lieu of Estate Tax Closing Letters” (last reviewed and updated 5/19/22; viewed 7/20/22).

B. Substitute for Return (“SFR”).

At the conclusion of the examination of a taxpayer who has failed to file a return, the IRS may prepare what is called a substitute for return (“SFR”) under Section 6020(b).²⁰²¹ The statute says that the § 6020(b) SFR is “prima facie good and sufficient for all legal purposes.”²⁰²² For example, once the § 6020(b) SFR is filed, the SFR is the original return and the taxpayer must file an amended return as a means to try to change the result in the SFR return.²⁰²³ However, for some purposes, the SFR is not treated as the taxpayer’s return. Some examples of an SFR not being treated as a return are:

- The § 6020(b) SFR does not allow immediate assessment, as with the case of a return, requiring that the IRS must follow the deficiency procedures.²⁰²⁴
- The § 6020(b) SFR is not treated as a return that starts the running of the statute of limitations for assessment.²⁰²⁵
- The § 6020(b) SFR is not treated as the taxpayer’s return for purposes of bankruptcy proceedings which permit a discharge for returns filed more than three years before bankruptcy.²⁰²⁶
- The § 6020(b) SFR is not subject to the accuracy related penalties for returns, so that the § 6651(a)(1) failure to file penalties will continue to apply and will continue to

²⁰²¹ Actually, § 6020 provides two types of returns each of which are sometimes called substitute for return (“SFR”). *Mass. Dep’t of Revenue v. Shek (In re Shek)*, 947 F.3d 770, 774 (11th Cir. 1/23/20). The § 6020(a) return, signed by the taxpayer, “is almost never used and results in a ‘minute’ number of returns, according to the IRS.” Accordingly, to be clear, when I refer to the SFR, I am referring to the § 6020(b) procedure unless I specify otherwise (usually by specific reference to § 6020(a)). Where I am referring to the § 6020(b) SFR, I will often specifically mention § 6020(b) as well as SFR

²⁰²² § 6020(b)(2).

²⁰²³ *Adams Challenge v. Commissioner*, 156 T.C. 16,35 n. 10 (2021) (noting that the IRS is not even required to accept an amended return, citing *Badaracco v. Commissioner*, 464 U.S. 386, 393 (1984)).

²⁰²⁴ *Spurlock v. Commissioner*, 118 T.C. 155 (2002). See generally for a deeper discussion Bryan Camp, [Lesson From The Tax Court: Don’t Confuse Dummy Returns With Substitutes For Returns](#) (Tax Prof Blog 10/3/22) (citing *Taylor v. Commissioner*, 36 B.T.A. 427 (1937) (requiring IRS to follow deficiency procedures when it had prepared return without consent or cooperation of the taxpayer) and noting that, although the IRS must use the notice of deficiency procedure with § 6020(b) SFRs, it can use the notice of deficiency procedures for nonfilers without the § 6020(b) SFRs).

²⁰²⁵ § 6501(b)(3). See IRM 25.6.1.9.4.5 (10-05-2016), Substitute for Return (SFR) (§ 6020(b) SFR does not start the assessment statute of limitations but an assessment pursuant to the SFR does start the collection statute of limitations. Note that, if the taxpayer petitions to redetermine a deficiency determination by notice pursuant to the SFR, the Tax Court decision will close the tax year, thus rendering the assessment statute of limitations irrelevant.

²⁰²⁶ 11 U.S.C. § 523(a)(3), flush language at end specifically stating that § 6020(a) SFRs (those signed by taxpayers, thereby becoming returns) are returns for discharge but § 6020(b) SFRs (those not signed by taxpayers) are not returns for discharge). (This flush language in § 523(a)(3) is often called the “hanging paragraph,” and often referenced as § 523(a)(*)). The issue for discharge has been whether a taxpayer filed return after the § 6020(b) SFR can be treated as a return for discharge purposes. Generally not. See Ken Weil, [Rare Discharge in Bankruptcy for Taxpayers with a Return Filed After an SFR Assessment](#) (Procedurally Taxing Blog 5/22/22.); and Bryan Camp, [Lesson From The Tax Court: Don’t Confuse Dummy Returns With Substitutes For Returns](#) (Tax Prof Blog 10/3/22) (“[A] §6020(b) SFR will almost always preclude the taxpayer from obtaining a discharge of the taxes in bankruptcy,” citing *In Re: Payne*, 431 F.3d 1055 (7th Cir. 2005), and cases cited therein; and noting that, if the IRS sends a notice of deficiency without a § 6020(b) SFR, “the well-advised non-filer will promptly file returns to minimize penalties, set up a potential bankruptcy discharge, and start the §6501 limitations period running.”).

accrue after the date of the SFR; the § 6050(b) SFR will be subject to § 6651(a)(2) and (3) failure to pay penalties.²⁰²⁷

- Since these returns are not signed by the taxpayers under penalties of perjury, they are not eligible for the tax benefits of joint return treatment.²⁰²⁸

There are other collateral consequences of the SFR, such as loss of elections the taxpayer might otherwise have qualified for.²⁰²⁹

The IRS has a procedure to create automated SFRs, referred to as ASFRs.²⁰³⁰ The IRS's computers determine whether the taxpayer had filed a return for the year and whether, based on information reporting to the IRS (such as W-2s and 1099s), the taxpayer should have filed a return but did not file.²⁰³¹ The computer then generates a letter requesting a copy of the return, if filed, or that a return be filed. If the taxpayer does not respond or fails to respond satisfactorily, the computer generates a letter to the taxpayer stating the determination of tax, penalties and interest due based on that information. The letter notifies the taxpayer that the IRS will issue a notice of deficiency unless that taxpayer responded with sufficient information to show that the amount due was incorrect. The process is generally conducted under the Substitute for Return procedures, but the process is automated.

Finally, the § 6020(b) SFR still requires that a notice of deficiency be sent the taxpayer; however, the IRS may proceed by notice of deficiency to a nonfiler without a § 6020(b) SFR.²⁰³²

C. The Closing Agreement.

As noted above, a taxpayer subjected to audit will normally not be subjected to further audits for the year because of the second audit prohibition we discussed above (beginning p. 400). IRM

²⁰²⁷ § 6651(g).

²⁰²⁸ Rev. Rul. 2005-59, 2005-37 I.R.B. 505.

²⁰²⁹ *McDonald v. Commissioner*, T.C. Memo. 2015-16; and *Redfield v. Commissioner*, T.C. Memo. 2017-71, both denying the foreign earned income exclusion which, under the governing regulation, requires a timely election be made on a timely filed return or a delinquent return filed before the IRS discovers the failure to elect; the SFR without the election means that the IRS has discovered the failure to elect.

One issue that I have focused on with a colleague is whether, if the SFR showed an overpayment, the SFR could serve as a claim for refund or at least an informal claim for refund. The colleague cited *Simmons v. United States*, 29 Fed. Cl. 136 (1993) for the proposition that an SFR could not be a claim for refund. *Simmons*, however, said (p. 140): "Plaintiff's substitute return clearly does not satisfy this test [state the basis of the claim for refund] as it does not state the grounds for a refund, **much less that a refund was even due.**" (Emphasis supplied.) The practical answer is that SFRs are not used if the IRS thinks there is an overpayment. IRM 4.12.1.10.6 (10-05-2010), No Return Secured - Refund Years. Still, if an SFR were to show an overpayment and the IRS did not refund the overpayment, the correspondence between the IRS and the taxpayer might establish an informal claim for refund to support a refund suit.

²⁰³⁰ The ASFR procedures highly summarized in this paragraph of the text are from IRM 5.18.1 Automated Substitute for Return (ASFR) Program (last reviewed and updated 3/12/20 and viewed 7/20/22). See generally for a deeper discussion Bryan Camp, [Lesson From The Tax Court: Don't Confuse Dummy Returns With Substitutes For Returns](#) (Tax Prof Blog 10/3/22) (noting that the § 6020(b) SFR process is pretty much run by computers and explaining the process).

²⁰³¹ IRM 5.18.1.1 (12-13-2017), Program Scope; and IRM 5.18.1.1.1 (12-13-2017), Background.

²⁰³² *Hartman v. Commissioner*, 45 T.C. 542, 545 (1975) (discussing *United States v. Harrison*, an unreported case (E.D.N.Y. 1972, 30 AFTR 2d 72-5367, 72-2 USTC Para. 9573), aff'd without opinion 486 F.2d 1397 (2d Cir. 1972), cert. denied 411 U.S. 965 (1973)).

Policy Statement 1.2.13.11 (12-21-84), Policy Statement 4-3 provides that the IRS will not open a closed case after examination except in the following cases:

1. there is evidence of fraud, malfeasance, collusion, concealment or misrepresentation of a material fact;
2. the prior closing involved a clearly defined substantial error based on an established Service position existing at the time of the previous examination; or
3. other circumstances exist which indicate failure to reopen would be a serious administrative omission.

So, upon the conclusion of the audit, the taxpayer will be reasonably assured, barring some most unusual circumstance, that will conclude the matter for the year(s) audited. Nevertheless, there is no assurance that the IRS will not exercise its authority to undertake a second audit. A taxpayer desiring to have finality thus must consider the alternatives available to achieve finality.

If the taxpayer litigates the liability for the year (as in a Tax Court case), the finality rules for litigation may, in all but rare cases, close out the tax liability for the year with finality.²⁰³³ However, litigation raises some risks that the IRS may be able to assert additional matters in the litigation or even reverse positions it agreed to in audit. Achieving finality through litigation may not be exactly what the client wants.

The Code provides only one administrative method for finalizing tax liabilities with some degree of certainty. That is the closing agreement under § 7121(a) which authorizes the IRS to agree in writing as to the liability of any taxpayer. The statute provides that a closing agreement is “final and conclusive, except upon a showing of fraud or malfeasance, or misrepresentation of a material fact” (§ 7121(b)²⁰³⁴), and those exceptions are stated verbatim in the closing agreement (so that the exception is mandated both by the statute and the “contract.” The usual Closing Agreement forms

²⁰³³ See § 6212(c)(1) providing that a Tax Court decision would not be conclusive for the year if there are items of fraud for the year.

²⁰³⁴ Misrepresentation for this purpose requires something more than mere error or mistake—“misrepresentation is not a misrepresentation is not synonymous with a mistake: It ‘denotes something more deliberate or more conscious than mere error or mistake.’” *Halpern v. Commissioner*, 79 T.C. Memo. 2000-151, at *9 (quoting *Ingram v. Commissioner* 32 B.T.A. 1063, 1066 (1935)). **As a caveat**, the statutory term misrepresentation in other IRC contexts may include innocent misrepresentations. See *NPR Invs., L.L.C. v. United States*, 740 F.3d 998 1007-1008 (5th Cir. Tex. 2014) (interpreting a similar provision in TEFRA § 6223(f) (predecessor to CPAR § 6231(b) similarly worded) and holding that misrepresentation can encompass “innocent misrepresentations”).

One issue is whether the misrepresentation must be from statements in negotiating the closing agreement or can have arisen earlier (i.e., with the return or positions taken with respect to the return)? Consider the following: assume the taxpayer filed a return underreporting tax by \$1,000,000. Upon audit, the IRS suspects fraud as to the underreporting of \$600,000 of the \$1,000,000 but does not think it can prove fraud by clear and convincing evidence. The IRS and the taxpayer enter a closing agreement for the taxpayer to pay the \$1,000,000 underreported tax plus a 20% accuracy related penalty on the \$600,000 portion. The IRS thereafter stumbles upon evidence that shows the taxpayer’s fraud making the IRS reasonably certain that it can prove fraud by clear and convincing evidence. Does the exception for “fraud or malfeasance, or misrepresentation of a material fact” apply? Let’s say that, during the course of the negotiations, the taxpayer committed no fraud and made no misrepresentations of fact, and the only fraud the IRS can identify relates to the initial fraud in reporting the items resulting in the \$600,000 portion of the underreported tax. Some cases suggest that the required fraud or misrepresentation must be in the inducement to enter the agreement rather than with respect to the underlying tax liability. See *Ingram v. Commissioner*, 32 B.T.A. 1063 (1935), aff’d *Commissioner v. Ingram*, 87 F.2d 915 (3d Cir. 1937).

are Form 866, Agreement as to Final Determination of Tax liability, or Form 906, Closing Agreement On Final Determination Covering Specific Matters.²⁰³⁵ Both specifically state the requirement of the statute that the agreement is final and conclusive except for “fraud, malfeasance, or misrepresentation of material fact.” Thus, subject to the foregoing caveat, the closing agreement may be used to close out a period (for income taxes, the period is a year) with some degree of finality.

Further, closing agreements may settle past years and future periods (although settlements for future periods will be for specific issues rather than the tax liability for the future year).²⁰³⁶ Closing agreements affecting future periods are “subject to any change in, or modification of, the law enacted subsequent to the date of the agreement and made applicable to such taxable period.”²⁰³⁷

Closing agreements are contracts.²⁰³⁸ They are “subject to rules of Federal common law contract interpretation.”²⁰³⁹ As contracts, both the IRS and the taxpayer must make sure that the agreement covers the ground they expect it to cover.²⁰⁴⁰

Although closing agreements are often entered at the conclusion of the audit section of this book, closing agreements may be entered in other contexts. Indeed, as in the steel cases just discussed, there was no controversy between the IRS and the taxpayer. The closing agreement process was used simply to establish a procedure for the taxpayers to obtain quick refunds based on their claims as to the amounts they were entitled to. The IRS neither agreed nor disagreed as to whether they were actually entitled to the refunds.²⁰⁴¹ You may want to think creatively for your

²⁰³⁵ The Tax Court stated the function of the two forms for compromises under § 7121 (*Estate of Duncan v. Commissioner*, T.C. Memo. 2016-2014, at *17) (some extraneous words and citations omitted for readability; bold-face supplied), aff'd 2018 U.S. App. LEXIS 12257 (5th Cir. 2018) (unpublished):

The IRS has prescribed two forms of closing agreements. [Reg. § 301.7121-1(d).] One type, Form 866, Agreement as to Final Determination of Tax Liability, conclusively determines a taxpayer's liability for a particular year or years. The second type, Form 906, [Closing Agreement On Final Determination Covering Specific Matters,] finally determines one or more “specific matters” that affect the taxpayer’s liability. A Form 906 closing agreement does not determine the taxpayer's final liability for any particular year but simply binds the parties to the tax treatment of the “specific matters” upon which they have agreed.

²⁰³⁶ Reg. § 301.7121-1(b)(3).

²⁰³⁷ Reg. 301.7121-1(c)(2). In *Hopkins v. Commissioner*, 120 T.C. 451 (6/30/03), the Tax Court has held that, despite this general proposition, a spouse previously entering a closing agreement before the existence of the expanded innocent spouse relief provision (§ 6015) may nevertheless obtain innocent spouse relief as to the liability in the closing agreement. The decision is based upon the retroactive policies clearly intended by Congress in the expanded version of innocent spouse relief and is thus viewed as limited exception to the general proposition that a liability included in a closing agreement is set in stone.

²⁰³⁸ *United States v. National Steel Corp.*, 75 F.3d 1146, 1150 (7th Cir. 1996); *Bethlehem Steel Corp. v. United States*, 270 F.3d 135, 139 (3d Cir. 201); and *Analog Devices Inc. v. Commissioner*, 147 T.C. 429, 446 (2016) (reviewed opinion).

²⁰³⁹ *Analog Devices Inc. v. Commissioner*, 147 T.C. 429, 446 (2016) (reviewed opinion).

²⁰⁴⁰ Rev. Proc. 68-16, 1968-1 C.B. 770, provides procedures applicable for processing closing agreements.

²⁰⁴¹ The IRS could have agreed in the closing agreement that the taxpayers were entitled to the refunds or methodologies from which the refunds would necessarily follow, in which case the taxpayers would have prevailed. Under the circumstances, however, it is clear that the IRS would likely have wanted to audit or examine the entitlement to the refunds first and would not have been able to move expeditiously to a closing agreement. The time required to

(continued...)

clients about how closing agreements can be used at various times, whether in audit or not, to assist your clients in achieving their objectives.

If the taxpayer appeals administratively, the taxpayer will have an opportunity to achieve some degree of finality by entering a Form 870-AD, Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Overassessment, with the IRS. The use of this Form is discussed below in the Chapter 8 on Appeals. This Form requires only the approval of the Appeals Officer and supervisor and may close out the year or years or specific issues in the year or years before the Appeals Office. This requires, however, that the taxpayer pursue the appeals remedy within the IRS, which is generally no big deal. The Form 870-AD, where available, is much more commonly used than the closing agreement which requires many more procedural hoops and higher level approvals within the IRS.

For supposed tax administration purposes, the IRS will sometimes want to disclose the resolution of a tax controversy via a closing agreement. This can happen, for example, if a taxpayer settles a hot tax issue with the settlement tilted in the Government's favor. Because of § 6103's prohibition on disclosure of return information—which a closing agreement surely is—the IRS would need the taxpayer's consent to the disclosure.²⁰⁴² That consent becomes an item of negotiation with the IRS. The taxpayer does not have to give the consent and, logically, in the bargaining process should achieve something for it that the taxpayer might not have been able to achieve. Thus, the taxpayer may obtain a waiver or significant concession on penalties with respect to the underlying tax being settled or may receive even some unrelated concession that is not publicized (although I think that, should the latter phenomenon occur and become known, the IRS would be perceived as having done nothing other than paid for the taxpayer "concession" it wishes to publicize and that is not much of a concession at all).

²⁰⁴¹(...continued)

enter the more definitive agreement would probably have assured that it was not reached before the repeal. Further, under the facts, the IRS was likely aware of the possibility of repeal and would not have entered a more definitive closing agreement for that reason in any event. That is probably why the taxpayers did not insist that the IRS agree to amounts or methodologies—i.e., the taxpayers knew the IRS would not agree. The taxpayers were thus left with the need to argue that those unstated "agreements" should be implied by the courts. And with the large amounts involved, the taxpayers felt it was appropriate to run the argument up the flagpole to see if a court would salute.

²⁰⁴² See CC-2008-014, reproduced at 2008 TNT 80-7, explaining the process for obtaining taxpayer consents to disclosure.

Ch. 8. Appeals.

I. Appeals Office in IRS Structure.

The IRS Appeals Office, formally called the Internal Revenue Service Independent Office of Appeals,²⁰⁴³ is an office within the IRS designed to resolve taxpayer disagreement(s) with actions proposed by the IRS Examination (or Collections) short of litigation. § 7803(e)(1).²⁰⁴⁴ The preceding chapter covered Examination (i.e., audits of returns) and much of the time in your practice that will be the way you will invoke your right to go to the Appeals Office for an opportunity to resolve the matter without litigation. But there will be other times that you will represent taxpayers before the IRS—most prominently (i) in collection matters after the tax is assessed but unpaid—and you will usually have an opportunity to invoke the Appeals Office process to see if the matter can be resolved and (ii) with regard to refund claims that the IRS proposes to deny in whole or in part. For the present discussion of the Appeals Office function, I assume unless otherwise noted that the process is invoked at the conclusion of an Examination (audit). For discussion of appeals in collections, there are two key processes that I discuss in the collections chapter: the Collections Appeals Program, beginning p. 732 and the Collection Due Process program (“CDP”), beginning p. 738.

IRS Appeals is an independent appeals function within the IRS.²⁰⁴⁵ It is outside the structure of the IRS operating divisions (such as LB&I, SBSE, etc.), with the Chief of Appeals appointed by and reporting to the Commissioner.²⁰⁴⁶

Appeals Officers may seek legal assistance and advice from Chief Counsel attorneys “who were not involved in the case with respect to which such assistance and advice is sought and who are not involved in preparing such case for litigation.”²⁰⁴⁷ Also, as I note later in this Chapter, the Appeals Officer cannot consult ex parte with the originating line officer (examinations or collections).

²⁰⁴³ As added by Taxpayer First Act of 2019, P.L. 116-25, 133 Stat 981 (July 1, 2019).

²⁰⁴⁴ IRM pt. 8.6.2.1.1 (Aug. 17, 2017).

²⁰⁴⁵ Prior to the Taxpayer First Act of 2019, P.L. 116-25, 133 Stat 981 (July 1, 2019), the Appeals Office was an independent branch within the IRS, although not a separate independent federal agency. *Our Country Home Enterprises, Inc. v. Commissioner*, 855 F.3d 773 (7th Cir. 2017) (quoting “Internal Revenue Service Restructuring and Reform Act of 1998, 112 Stat. at 689, § 1001(a)(4).); *Fonticella v. Commissioner*, T.C. Memo. 2019-74 (2019). The Taxpayer First Act of 2019, § 1001(a), added § 7803(e) to further ensure Appeals independence within the IRS.

Congress considered putting the Appeals function in an agency that was independent of the IRS, but ultimately decided that, by making it independent within the IRS. Saltzman Treatise, ¶ 9.01[4], Appeals Independence. There are still some issues that, at least facially, suggest lack of complete independence from the operating divisions (such as involvement in settlement initiatives, coordinated issues and the Industry Specialization Program). *Id.*, ¶ 9.01[4][c], Additional Issues with Appeals independence.

²⁰⁴⁶ § 7803(e)(2)(A) & (B). The statutory power in the Commissioner to appoint the Chief of Appeals may violate the Constitution’s Appointment Clause (Art. II, sec. 2, cl. 2), which seems to require appointment by the Secretary of Treasury, a deficiency which President Trump tried to address in a signing statement accompanying his signing the Taxpayer First Act of 2019 requiring approval for appointments by the Secretary of the Treasury. See Carlton Smith, Appointments Clause Errors in the Taxpayer First Act that the President is Deeming that He Corrected (Procedurally Taxing Blog 7/15/19).

²⁰⁴⁷ § 7803(e)(6)(B), as added by Taxpayer First Act of 2019, § 1001(a), P.L. 116-25, 133 Stat 981 (July 1, 2019).

II. Appeals' Mission.

Section 7803(e)(3) states Appeals' function as:

to resolve Federal tax controversies without litigation on a basis which—
(A) is fair and impartial to both the Government and the taxpayer,
(B) promotes a consistent application and interpretation of, and voluntary compliance with, the Federal tax laws, and
(C) enhances public confidence in the integrity and efficiency of the Internal Revenue Service.

This statement of function is a codification of the function as stated in the Appeals Mission statement in the IRM prior to the Act, so the interpretation of the statute should be informed by the interpretation of the Appeals Mission.²⁰⁴⁸ The IRM thus states that:

A fair and impartial resolution is one which reflects, on an issue-by-issue basis, the probable result in the event of litigation, or one which reflects mutual concessions for the purpose of settlement based on the relative strength of the opposing positions where there is substantial uncertainty of the result in the event of litigation.²⁰⁴⁹

The Appeals' standard for settlement is called "hazards of litigation." The key factors that the Appeals Office brings to the resolution of IRS disputes that Examination did not bring are (1) independence from Examination (or other IRS branch or office from which the Taxpayer appeals); (2) a mission that emphasizes objectivity,²⁰⁵⁰ (3) a mission that emphasizes the importance to the system of settling the overwhelming number of tax disputes, and (4) a mission that permits settlement based on the litigating hazards.

III. Appeals Settlement Authority.

Appeals can settle on its own authority virtually all issues, even IRS public positions (e.g., Rev. Rul.), based on the litigating hazards.²⁰⁵¹ Indeed, Appeals is the principal IRS branch with authority to settle tax disputes.²⁰⁵² Conceptually, though, line level IRS officials can practically settle some factual issues in a manner that reflects litigating hazards. For example, in valuation cases, the IRS and the taxpayer may agree upon a value that reflects litigating hazards, although often the

²⁰⁴⁸ IRM 8.1.1.1 (02-10-2016), Accomplishing the Appeals Mission.

²⁰⁴⁹ IRM 8.6.4.2 (06-16-2020), Fair and Impartial Settlements per Appeals Mission; see also IRM 1.2.17.1.6 (04-06-1987), Policy Statement 8-47.

²⁰⁵⁰ The 1998 Reform Act mandated that the Appeals Office, although within IRS, be independent of the Examination function so that it could serve and be perceived as serving the goal to resolve tax disputes fairly and expeditiously.

²⁰⁵¹ Within the Appeals Office, the persons who have settlement authority are determined by Commissioner Delegation Orders. Sec. 601.106(a)(1)(i) and (ii), Statement of Procedural Rules. Delegation Order No. 66 (as revised) set forth the current settlement authority within appeals.

²⁰⁵² IRM 1.2.17.2 (11-04-1998), Policy Statement 8-1

parties will stake out different positions on valuation that have to then be considered and resolved if possible by Appeals.

There are some exceptions.²⁰⁵³ Exceptions include (list not exclusive; caveat the exceptions have been consolidated and, in some cases modified, at least in nuance, by Proposed Regulation issued 9/13/22; this list which includes exceptions as of the date of publication of this text will be modified significantly when the Regulations are finalized).²⁰⁵⁴

- issues involving taxpayer arguments of validity of a Treasury Regulation or procedural validity of an IRS notice or Revenue Procedure;²⁰⁵⁵
- certain controlled issues for nationwide responsibility;²⁰⁵⁶
- certain Compliance Coordinated Issues and issues designated for litigation;²⁰⁵⁷
- issues contrary to a TAM favorable to the taxpayer;²⁰⁵⁸
- Joint Committee on Taxation (“JCT”) cases where § 6405(a) requires a report for JCT review of proposed refunds in excess of \$2,000,000 (\$5,000,000 for C corporations);²⁰⁵⁹
- religious or constitutional “defenses” to tax liability;²⁰⁶⁰
- “elimination” of civil fraud penalty or the fraudulent failure to file (FFTF) penalty, except with the recommendation or concurrence of counsel;²⁰⁶¹

²⁰⁵³ § 7803(e)(4), added by the Taxpayer First Act of 2019, § 1302, P.L. 116-25, 133 Stat 981 (July 1, 2019), says that the Appeals process “shall be **generally** available to all taxpayers.” Treasury interprets this, in conjunction with legislative history, as permitting the Treasury to exercise authority to exclude issues from Appeals consideration as it had done in the past. See Prop. Reg. § 301.7803-2(c)(3), Supplemental Information, Explanation of Provisions I.C. (9/13/22); Prop. Reg., § 301.7803-2(c) proposes to exercise that authority; See IRM 8.1.1.2.1(3)(d) (02-10-2012), Some Exceptions to Appeals Authority. Note that as the title suggests, this is not an exclusive list. Prop. Reg. § 301.7803-2(c) (consolidating the exceptions to Appeals’ authority. See [Rocky Branch Timberlands LLC v. United States](#), ___ F.4th ___, 2023 U.S. App. LEXIS 23606 (11th Cir. 2023); and Leslie Book, [Eleventh Circuit: Anti-Injunction Act Prevents Taxpayer From Accessing Appeals \(Procedurally Taxing \(9/22/23\)\)](#).

²⁰⁵⁴ The following list is my summary of Reg. § 601.106(a)(2) and (b); Rev. Proc. 2016-22, 2016-15 I.R.B. 1, most of which appear in Prop. Reg. § 301.7803-2(c) (9/13/22) but some are modified in the Prop. Reg. I note in the footnotes some points related to specific items in the list.

²⁰⁵⁵ Appeals Notice AP-08-0922-0011 (9/13/22) (with draft of amendment to IRM 8.1.1.2.1(3)(d) (02-10-2012), Some Exceptions to Appeals Authority); See Prop. Reg. § 301.7803-2(c)(19) & (20) (9/13/22) (noting in the explanation that, in light of the extensive review of regulations and notice and comment procedures, it would be inappropriate for Appeals to consider the validity of regulations). The Appeals Notice states that “These challenges tend to raise administrative law questions distinct from the administrative tax determinations most commonly heard in Appeals.” Specifically, this limitation is based on the slew of recent APA and related procedural challenges that have shed more heat than light and would be difficult for most Appeals Officers to assess in terms of litigating hazards. The result is that, if there is resulting litigation because Appeals will not settle, the issues will then be handled by attorneys either with Chief Counsel or the Department of Justice. The exception to this exception (thus permitting Appeals Office consideration is where there is an unreviewable decision invalidating the agency guidance in relevant part. Finally, this exception does not affect Appeals’ authority to consider other claims not within the exception.

²⁰⁵⁶ IRM 8.8.1.1.2.1 (02-10-2012), Some Exceptions to Appeals Authority

²⁰⁵⁷ IRM 8.1.1.2.1(1)(b) (02-10-2012), Some Exceptions to Appeals Authority.

²⁰⁵⁸ IRM 8.1.1.2.1(1)(c) (02-10-2012), Some Exceptions to Appeals Authority.

²⁰⁵⁹ IRM 8.7.9.3 (12-27-2017), Cases Requiring JC Review. The requirement for JCT review is in § 6405(a) discussed beginning p. 838.

²⁰⁶⁰ IRM 8.1.1.3.1 (02-10-2012), No Appeals Conference or Concession on Certain Arguments.

²⁰⁶¹ Regs § 601.106(a)(2)(iv). The denial of authority, as stated, is first in the case of the penalty (continued...)

- settlement in any case (including settlement of the underlying tax liability and any penalty related thereto) without the concurrence of Counsel in any case subject to a pending recommendation to DOJ Tax for prosecution.²⁰⁶²
- Whistleblower Awards.²⁰⁶³
- TAS decisions not to issue a Taxpayer Assistance Order;²⁰⁶⁴
- Issues settled by a Closing Agreement;²⁰⁶⁵

IV. Tickets to Appeals.

A. General Right to Appeal.

The Appeals function is to resolve disputes between the taxpayer and the IRS. This requires that one of the IRS operating divisions has proposed in writing to the taxpayer some preliminary action—such as proposing to issue a notice of deficiency, proposing to deny a claim for refund, or taking certain types of collections actions—which offers the taxpayer an opportunity to contest in Appeals. The written proposal of action is usually contained in a letter or notice and is often referred to as a 30-day letter because the communication states that the taxpayer should file the Appeals request (usually called a protest) within 30 days.²⁰⁶⁶

Section 7803(e)(4) says that the Appeals resolution process “shall be generally available to all taxpayers.”²⁰⁶⁷ (That is a codification of past administrative practice in the IRS, although it may expand to some cases where appeals were not previously allowed.)

²⁰⁶¹(...continued)

determined by Examination (the regulation says “Director,” but that office no longer exists) or for a year or period related to a year for which a criminal prosecution for willful attempt to evade or defeat (§ 7201) has been recommended by IRS to DOJ Tax. The latter denial seems to me to be subsumed by the first, because Appeals would be considering a civil fraud penalty or FTFF penalty only if Examination asserted either penalty. Three other points: First, I don’t know what to make of the use of the word “eliminate,” but I suspect that Appeals would not settle the civil fraud penalty or the FTFF penalty by reading the word eliminate too narrowly. Second, the denial after recommendation to DOJ for criminal prosecution continues after DOJ Tax concludes its action on the recommendation. The denial in the next bulleted section in the text only applies which the prosecution is pending. Third, this denial relates only to the penalties; it does not apply to the underlying tax.

²⁰⁶² Reg. § 601.106(a)(2)(vi). Three points about this denial: First, it applies only while the recommendation to DOJ Tax is “pending.” (Compare the denial in the preceding bulleted point in the text that applies even after such a recommendation.) Second, this denial of authority covers not only the penalties but also the underlying tax. The denial covered in the preceding bulleted section covers only the penalties. Third, this denial applies to any recommendation for criminal prosecution and is not limited just to a recommendation for evasion. Hence, for example, a recommendation for tax perjury (§ 7206(1)) is covered by this denial but is not covered by the denial in the preceding bulleted point.

²⁰⁶³ Prop. Reg. § 301.7803-2(c)(3) (9/13/22).

²⁰⁶⁴ Prop. Reg. § 301.7803-2(c)(5) (9/13/22).

²⁰⁶⁵ Prop. Reg. § 301.7803-2(c)(9) (8/13/22).

²⁰⁶⁶ The IRS lists the types of correspondence offering the Appeals opportunity at the web site titled Letters and Notices Offering an Appeal Opportunity (last reviewed or updated 11/18/20 and visited 2/9/21).

²⁰⁶⁷ As added by Taxpayer First Act of 2019, § 1001(a), P.L. 116-25, 133 Stat 981 (July 1, 2019). For a useful discussion of the language and the legislative history, see the Supplemental Information for Prop. Reg. § 301.7803-2(c)(3) (9/13/22).

The taxpayer's request (or protest) for an Appeals will generally be in a formal writing. The taxpayer's written request, in most cases a "protest," will state the action the taxpayer disagrees with and state the basis for the taxpayer's disagreement.

B. Tax and Penalties Requiring a Notice of Deficiency.

1. Introduction.

In this section, I consider Appeals jurisdiction to consider tax and certain penalties that are based on the tax liability (such as the ad valorem accuracy related penalty in § 6662 and the civil fraud penalty in § 6663). The additional tax (deficiency) and those penalties are asserted in a notice of deficiency which is generally preceded by a thirty day letter (a "ticket" to Appeals). Appeals has the same authority to settle these penalties as for the underlying tax liability.

2. 30-Day Letter and Protest.

At the conclusion of the audit and prior to issuing a notice of deficiency, the IRS will advise the taxpayer that it intends to determine a deficiency and the basis for the deficiency. The taxpayer will be offered the right to an Appeals review. This will come in the form of a 30-day letter, requiring that the taxpayer take affirmative action to request Appeals review.

The taxpayer may get to Appeals after an audit by filing a **protest** to a 30-day letter. IRS Publication 5, titled *Your Appeal Rights and How To Prepare a Protest If You Don't Agree*, should have accompanied the 30-day letter and describes the appeal rights and procedure for handling the appeal. Similar procedures are available for IRS action denying a claim for refund in whole or in part and for other IRS proposed actions (such as collection actions).

The protest serves like a pleading to identify the IRS actions the taxpayer protests. Unlike the "notice" pleading that lawyers are familiar with, the protest should fairly state the basis of the disagreement. I discuss protests later in this section. Suffice it to say that the taxpayer cannot just generally deny the IRS's positions.

The Appeals Office will not accept the case unless, at the time of receipt in Appeals, the statute of limitations on assessment will not expire before a certain period offering orderly Appeals Office processing and consideration. Currently, the general rule is that 365 days (270 days in case of transfer tax) must remain on the statute of limitations (either the normal statute date ("ASED") or an extended ASED) when the case is received in Appeals.²⁰⁶⁸

²⁰⁶⁸ Reg. § 601.105(d). See e.g., IRM 4.10.8.12.1 (03-25-2021), 30-Day Letters (subparagraph (1) says 365 days; subparagraph (3) says that, generally, a 30-day letter should issue to the taxpayer if 240 days is left on the statute; reconciling the two is that the taxpayer receiving a protest with 240 days on the ASED will have to extend to process the Appeal); and IRM 4.25.10.7.3 (07-30-2019), 30-Day letter Procedures (for estate, gift and generation skipping transfer tax examinations).

3. After Filing a Tax Court Petition (“Docketed Appeal”).

The filing of a petition in the Tax Court will result in automatic referral to Appeals unless: (1) Appeals issued the notice of deficiency or made the determination being litigated, (2) the taxpayer advises the IRS that it desires to forego Appeals consideration, (3) the case either is designated for litigation **or** Division Counsel or higher level has determined that “referral [to appeals] is not in the interest of sound tax administration.”²⁰⁶⁹

The automatic referral usually happens where the taxpayer did not seek appeals review after the audit (i.e., upon receipt of the 30-day letter), so that the notice of deficiency then issues with no Appeals review. If the taxpayer files a petition in the Tax Court, the case will be referred to Appeals. Because the case is then docketed in the Tax Court, it is referred to as a “Docketed Case” or “Docketed Appeal.” A case that proceeds to Appeals via the protest route discussed above is often referred to as a “Non-Docketed Appeal.” In the Docketed Case, once referred to Appeals, Appeals has the “sole authority” to resolve the case by settlement until it is returned to the IRS attorney.²⁰⁷⁰

If the case is not automatically referred to Appeals, the taxpayer requests referral to Appeals, and the IRS denies the request and the position is not frivolous, the Commissioner shall provide the taxpayer (i) “a detailed description of the facts involved, the basis for the decision to deny the request, and a detailed explanation of how the basis of such decision applies to such facts,” and (ii) a description of the procedure the taxpayer may invoke to contest the decision.²⁰⁷¹ The IRS is directed to provide procedures for a taxpayer to contest the decision.²⁰⁷²

C. Other Avenues to Appeals.

1. Introduction.

I present in this section the more prominent instances in which Appeals review may be available after the IRS has proposed or has taken some action. In all instances, the pattern is the same: the IRS has taken or proposed some action, the taxpayer protests in writing, and Appeals attempts to resolve the matter.

²⁰⁶⁹ Rev. Proc. 2016-22, 2016-15 I.R.B. 1 § 3.01 & 3.03; see also Reg. § 601.106(c)(3)(a). Appeals has (exclusive settlement jurisdiction for 4 months after the filing of the petition). Where the matter was before Appeals but Appeals issued the notice of deficiency before full consideration (e.g., a pending statute date), Appeals can include in the file an indication that referral of that case to Appeals upon filing the Tax Court petition is appropriate. *Id.*, § 3.02. In *Facebook, Inc. v. IRS*, 2018 U.S. Dist. LEXIS 81986 (N.D. Cal. 2018), the IRS issued Facebook a notice of deficiency, Facebook filed a petition in the Tax Court, and the IRS declined to transfer the case to Appeals because, it stated, “not in the interest of sound administration.” The IRS never explained why it did not transfer to Appeals. Facebook filed a suit in district court to force the IRS to transfer to Appeals. The district court held that Facebook had no right to a transfer to Appeals, rejecting a mélange of Facebook claims under the APA, TBOR, etc. Basically, the Court held that Facebook had no right to the transfer to Appeals at that stage. The reason that Facebook did not pursue an Appeal at the conclusion of the audit prior to issuance of the notice of deficiency is apparently because Facebook would not agree to an extension of the statute of limitations on assessment.

²⁰⁷⁰ *Id.*, § 3.05.

²⁰⁷¹ § 7803(e)(5)(A) & (D),.

²⁰⁷² § 7803(e)(5)(C).

2. Appeals from Notice of Deficiency.

Once the notice of deficiency is issued, the taxpayer normally gets to Appeals only by filing a petition in the Tax Court (see above for how that works), filing a claim for refund after paying all or some of the tax, by CDP proceedings, or by adverse action in a case accepted for audit reconsideration.²⁰⁷³ Section 7803(e)(5) provides that a taxpayer may request Appeals after issuance of a notice of deficiency and, if denied, be given written notice of the basis for denial and the right to appeal the denial to the Commissioner pursuant to procedures established by the IRS. This provision read literally seems to offer a new right of Appeals Office consideration with the sole condition that a notice of deficiency have been issued. The IRS is directed to report annually to Congress the number of denials of Appeals Office consideration requests and the basis for denial by category.²⁰⁷⁴ I am not aware that the IRM has created procedures for this, but I think that a taxpayer could invoke protest a denial on the basis of the statute,²⁰⁷⁵ getting the protest to the right office might be daunting but, I suspect, sending the protest to the Commissioner setting forth the statute might get it to the right place. In any event, it is important the taxpayer not let the 90-day period to petition the Tax Court not expire on the hope that the IRS might fix the problem later; a protect petition might be in order.

3. Penalties Not Requiring a Notice of Deficiency.

Some penalties do not require a notice of deficiency—meaning that they can be immediately assessed and collection action commenced. Some of those penalties are offered preassessment Appeals review. For example, the Trust Fund Recovery Penalty and Return Preparer Penalties are offered Appeals review.²⁰⁷⁶ In addition, the IRS permits a prepayment Appeals hearing for certain international penalties under Chapter 61, such as for failure to file Forms 5471, 5472, or 8865.²⁰⁷⁷

4. Appeals from Certain Collection Procedures.

Taxpayers may seek Appeals Office review in Collection Due Process (“CDP”) cases after the IRS has assessed or filed a federal tax lien. See CDP procedure discussion beginning p. 733.²⁰⁷⁸

Taxpayers may also seek Appeals Office review under the Collection Appeals Program (“CAP”), including some appeals that might have been to CDP Appeals review if the taxpayer had filed a timely request. See the CAP procedure discussion beginning p. 732.

²⁰⁷³ As to Appeal after audit reconsideration, see IRM 5.1.15.4.6.4 (04-16-2010), Appeal Rights on Reconsiderations.

²⁰⁷⁴ § 7803(e)(5)(B).

²⁰⁷⁵ I suspect that the denial letter will state the procedure.

²⁰⁷⁶ IRM 20.1.1.4.1.1 (10-19-2020), Pre-assessment Appeals (noting the TFRP and Preparer Penalties where the statute offers the review and the intentional disregard penalty under § 6721(e) when it applies to the cash reporting requirements under § 6050I.

²⁰⁷⁷ IRM 8.11.5 International Penalties.

²⁰⁷⁸ Rev. Proc. 2005-34; 2005-24 I.R.B. 1 provides procedures related to appeals of trust fund recovery determinations.

In these appeals, the taxpayer usually deals with a Settlement Officer (“SO”) rather than an Appeals Officer.²⁰⁷⁹ An SO will have expertise in IRS collection practices but may not have expertise in the application of the tax law in determining the tax liability. SOs do not get into the merits of the tax liability except in those cases in CDP where the taxpayer may contest the tax liability, generally requiring that the taxpayer not have a prior opportunity to contest.²⁰⁸⁰ That may mean that the SO may have to enlist the assistance of an Appeals Officer to deal with the merits of the tax liability.²⁰⁸¹

5. Denial of Claim for Refund.

Appeals review can also be achieved upon denial of a claim for refund.²⁰⁸²

6. Denial of Offer in Compromise.

Appeals review can be obtained upon denial of an offer in compromise.²⁰⁸³

D. Assumption for Balance of Chapter.

For the balance of this Chapter on Appeals, I present the discussion in the context of the historical appeals route—cases requiring a notice of deficiency, with Appeals review prior to the issuance of a notice of deficiency in a Non-Docketed Appeal or after issuance of the notice of deficiency in a Docketed Appeal.

E. Strategies as to Route to Appeals.

The taxpayer in a case requiring a notice of deficiency has two avenues to Appeals after Examination proposes action (such as a proposal to assert additional tax liability or deny a refund). The taxpayer can invoke Appeals jurisdiction by filing a protest upon receiving the 30-day letter (Non-Docketed Appeal); the taxpayer can invoke Appeals jurisdiction, at least in most cases where the taxpayer has not previously gone to Appeals on the issue, by Tax Court petition after receiving the notice of deficiency (Docketed Appeal). Either way, the case gets to Appeals, and most cases settle in Appeals.

²⁰⁷⁹ IRM 8.1.3.6 (10-01-2012), Settlement Officer (SO).

²⁰⁸⁰ See p. 733.

²⁰⁸¹ See *Dodd v. Commissioner*, T.C. Memo. 2021-118; see also the discussion of *Dodd* in Bryan Camp, Lesson From The Tax Court: Of Distributive Shares And The CDP Mashup (Tax Prof Blog 10/25/21) (noting the importance for tax practitioners to know the difference between Appeals Officers and SOs in order to solicit the SO to seek assistance of Appeals Officers where difficult tax merits issues are involved).

²⁰⁸² IRM 34.5.2.2(5) (12-21-2012), Pre-Litigation Activity (“A revenue agent or tax auditor will review the claim for refund and inform the taxpayer, by letter, if the Service will accept the claim or disallow the claim in full or in part. A taxpayer can then request a conference with the Appeals Office if the claim is disallowed in whole or in part. If the Appeals Officer agrees with the revenue agent’s determination or if the taxpayer does not request a conference, the Service will generally issue a statutory notice of claim disallowance.”).

²⁰⁸³ § 7122(e).

Some practitioners believe that better and quicker Appeals settlements are achieved via a Docketed Appeal. The notion is that, because of the risk of the Tax Court calendaring the case soon after the case is at issue (usually the filing of the IRS's answer), Appeals will put the docketed cases at the top of the stack. Then, the thinking goes, because Appeals may have less time to deal with that type of case, it may miss or not pursue things it might otherwise have pursued to the taxpayer's detriment. But keep in mind that some time is already lost going the Docketed route, because the IRS has to issue a notice of deficiency after the 30-day letter, the taxpayer then has to file a petition and the IRS has to answer, all of which will chew up several months just getting to Appeals in a Docketed Appeal, whereas a protest would have gotten the taxpayer there earlier.

And, I think, it is problematic as to whether the Appeals Officer will give a better settlement simply because there may be a short fuse before the case is calendared. Human dynamics, particularly in a bureaucracy, is to do nothing when time is too short rather than to give away the store.

There might be an advantage in the Docketed Appeal, for example, if there are lurking unspotted issues in the audit or issues which the Agent conceded during the audit. The thinking is that the Appeals Officer may be less likely to deal with them in a Docketed Appeal than in a Non-Docketed Appeal because of the time factor. I think this factor is probably marginal, particularly with the new guidance discussed below limiting Appeals from raising new issues. (See discussion beginning p. 492.)

Some practitioners tout yet another supposed benefit of going the Docketed Appeal route. The Non-Docketed Appeal requires a protest (except in small cases). As I develop elsewhere, the protest should be drafted to persuade the Appeals Officer and thus should lay out the facts and law in a persuasive fashion. A protest is not technically required in a Docketed Appeal, and the only writing technically required is the petition, which is the Tax Court petition, a “notice” pleading that sets forth the facts and law in highly summary fashion that is usually not likely on its face to persuade anyone that the taxpayer is entitled to prevail on the issue. The notice pleading just puts the opposing party on notice; in Appeals, the taxpayer must do more—the taxpayer must persuade. Many Appeals Officers will request or practitioners will find it in their client's best interest to submit a position paper in a Docketed Appeal that substantially tracks what they would have put in a protest. I have always found it in my client's interest on significant issues to submit position papers in a Docketed Appeal. Particularly with significant issues, an Appeals Officer is not likely to be moved by a simple conference without supporting arguments and documentation. Hence, this touted benefit is marginal except in the simplest and smallest of cases where preparing a protest or position paper is not cost-justified.

Section 6673(a)(1)(C) gives the Tax Court authority to award up to \$25,000 in damages against a taxpayer who unreasonably failed to pursue administrative remedies. The Tax Court has said that the underlying purpose of this provision is “to penalize taxpayers who needlessly involve the Tax Court in a dispute that should have been resolved in the Appeals Division of the IRS.”²⁰⁸⁴

²⁰⁸⁴ *Birth v. Commissioner*, 92 T.C. 769, 774 (1989). The authority to impose the § 6673 penalty is not subject to the written supervisor approval requirement of § 6751(b). *Williams v. Commissioner*, 151 T.C. 1 (2018) (continued...)

Should you be concerned about this provision if you choose the Docketed Appeal route? The IRS has not sought and the Tax Court has not imposed damages simply for pursuing the Docketed Appeal, but one cannot state for certainty that it won't.

In my view, however, the taxpayer can avoid the problem by meaningfully participating in the Appeals proceeding in the Docketed Case. And, in any event, the Tax Court usually asserts and the Tax Court imposes this penalty only in extreme cases such as tax protester cases raising totally frivolous arguments.²⁰⁸⁵

The Tax Court has warned tax practitioners of another cost of going the docketed route without pursuing an available Appeals hearing. The taxpayer will be foreclosed from recovering attorneys' fees under § 7430. (See discussion of that provision beginning p. 601.)

V. Examination's Rebuttal; Prohibition on Examination Ex Parte Communications.

Examination will have an opportunity to respond to the assertions the taxpayer makes in the protest. If the taxpayer gets to Appeals by filing a protest (whether in an audit or in response to a proposed disallowance of a claim for refund), the protest is filed with Examination which may prepare a rebuttal letter, often just called a rebuttal (which is the term I usually use), to be submitted to Appeals along with the protest.²⁰⁸⁶ The rebuttal is Examination's "last opportunity to counter a taxpayer's arguments" before the case is forwarded to Appeals. The scope of the rebuttal is:

A proper rebuttal addresses each disputed fact, argument of law, and the position of the taxpayer. The rebuttal only addresses the protest. Don't introduce new issues not raised by the taxpayer. If necessary, issue a revised formal report.

* * * *

Some protests include negative comments as to the professional conduct of the examination. Don't address these comments. The taxpayer has the option of holding a conference with the manager, and the manager may address these assertions in the conference.²⁰⁸⁷

If a taxpayer gets to Appeals by filing the petition in the Tax Court, Appeals may ask the taxpayer to file a position paper. Appeals will often ask Examination to respond to arguments the taxpayer makes in the petition or in a position paper. This also is called a rebuttal.

²⁰⁸⁴(...continued)

(which, although it applies textually to all penalties imposed by the Code, makes sense only in the context of an IRS imposed penalty (where there is an IRS supervisor), not one imposed by the Court under § 6673).

²⁰⁸⁵ E.g., *Pierson v. Commissioner*, 115 T.C. 576 (12/14/2000) (warning that these sanctions will be imposed under the collection due process ("CDP") cases brought under the procedures discussed below under Collections (p. 733)); and *Philips v. Commissioner*, T.C. Memo. 1995-540. (Significant sanctions are available in other courts for raising frivolous arguments.)

²⁰⁸⁶ IRM 4.75.15.12 (07-18-2017), Rebuttals to Formal Protests.

²⁰⁸⁷ IRM 4.75.15.12 (07-18-2017), Rebuttals to Formal Protests.

Examination is supposed to provide a copy of the rebuttal to the taxpayer.²⁰⁸⁸ A good practice point is to specifically request the rebuttal in the cover letter submitted with the protest. Indeed, the taxpayer should generally exercise the right granted in § 7803(e)(7), added in 2019,²⁰⁸⁹ to request access to the case files regarding the disputed issue. This should include the rebuttal, but if it does not be sure and ask to confirm whether Examination prepared a rebuttal.

The 1998 Restructuring Act directed reforms to ensure the independence of Appeals. A significant reform was the “prohibition * * * of ex parte communications between appeals officers and other Internal Revenue Service employees to the extent that such communications appear to compromise the independence of the appeals officers.”²⁰⁹⁰ An ex parte communication is “Communication that takes place between any Appeals employee and employees of other IRS functions, without the taxpayer/representative being given an opportunity to participate in the communication. The term includes all forms of communications, oral or written.”²⁰⁹¹ The public perception and reality of an independent Appeals is vital to its functioning in the system to settle disputes without litigation. Congress believed that circumscribing ex parte communications will further the public's confidence in the system. The IRS has issued a revenue procedure governing ex-parte communication and IRM provisions governing those communications.²⁰⁹² You should be familiar with Revenue Procedure and IRM incident to representing a client in an Appeals hearing, so that you can be sensitive to the possibility of impropriety. Generally, those procedures prohibit communications about the substance of the issues or positions in the case, but not about “matters that are ministerial, administrative or procedural in nature.”²⁰⁹³

The prohibition on ex parte communications may be waived by the taxpayer.²⁰⁹⁴ The waiver may be on a communication-by-communication basis or a waiver covering all communications that might occur during the course of Appeals’ consideration of a specified case. The IRM recommends that the waiver be in writing but does not require it. If not in writing, the waiver must be documented in the case activity record showing the date of the waiver and its scope.

I recommend that the taxpayer condition the waiver on the Appeals Officer communicating to the taxpayer or taxpayer representative the substance of the information disclosed or arguments made to the Appeals Officer.

²⁰⁸⁸ IRM 4.10.8.12.9.3 (03-25-2021), Request for Appeals Conference (“A copy of the rebuttal must be provided to the taxpayer at the time the case is sent to Appeals.”)

²⁰⁸⁹ Added by Taxpayer First Act of 2019, § 1101(a), P.L. 116-25, 133 Stat 981 (July 1, 2019).

²⁰⁹⁰ Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998), Pub. L. No. 105-206, § 1001(a)(4), 112 Stat. at 689. RRA 1998 § 1001(a)(4). This statutory requirement was not incorporated into the Code. But an addition to the Code in 2019 does provide a similar requirement to permitting the Appeals Officers to seek legal advice from staff of Chief Counsel “were not involved in the case with respect to which such assistance and advice is sought and who are not involved in preparing such case for litigation.” § 7803(e)(6)(B).

²⁰⁹¹ IRM 8.1.10.1.5(1) (09-21-2021), Terms and Definitions.

²⁰⁹² Rev. Proc. 2012-18, 2012-10 I.R.B. 455; IRM 8.1.10 Ex Parte Communications; IRM Chapter 2. General Examination Procedures, Section 7. Ex Parte Communications.

²⁰⁹³ *Hotchkiss v. Commissioner*, T.C. Memo. 2010-32, at *8 (citing Rev. Proc. 2000-43, sec. 3, Q&A-5 & 6, 2000-2 C.B. at 405) & *11).

²⁰⁹⁴ See IRM 8.1.10.5.1 (06-21-2012), Waiver. The contents of the paragraph in the text are from this IRM provision. The IRM also cites section 2.01(3)(c) of Revenue Procedure 2012-18, Opportunity to Participate, Waiver, for additional information.

One issue that has arisen but is not yet finally settled is whether the entire administrative file sent to the Appeals Officer constitutes an ex parte communication that should or must be disclosed to the taxpayer. This issue may be mooted or at least mitigated by § 7803(e)(7) (discussed immediately below) giving the taxpayer access to the case files in some cases. This will permit the taxpayer the opportunity to learn of some potential ex parte communications (which include extraneous material in the administrative file, not relevant to the operating division's function that should not have been in the file and may be designed to influence the Appeals consideration.²⁰⁹⁵ If there is such extraneous material, the taxpayer could request that it be expunged and the Appeal be reassigned to an Appeals Officer who will have only the expunged administrative file. Where that provision does not apply, the taxpayer or taxpayer representative should inquire as to any files or portion not otherwise provided and request access or file a FOIA request.

So, what's the remedy to violation of this prohibition on ex parte communications? A taxpayer who discovers the ex parte communication while in Appeals can request that the communication be expunged and the case reassigned if there is any possibility that it affected or could affect the case. In a CDP Tax Court proceeding, presumably, the Tax Court could remand to the Appeals Office for consideration by a new untainted Appeals Officer.²⁰⁹⁶ But, absent a showing of some demonstrable material harm independent of the mere violation of the ex parte communication prohibition, the taxpayer could obtain any other relief.²⁰⁹⁷

VI. Taxpayer Discovery in Appeals.

Section 7803(e)(7) requires the Appeals Office to provide a “specified taxpayer * * * access to the nonprivileged portions of the case file on record regarding the disputed issues (other than documents provided by the taxpayer to the Internal Revenue Service).”²⁰⁹⁸ A specified taxpayer is

²⁰⁹⁵ Rev. Proc. 2012-18, sec. 2.03(4)(d) (providing inter alia that “The originating function, however, shall refrain from placing in the administrative file any notes, memoranda, or other documents that normally would not be included in the administrative file in the ordinary course of developing the case if the reason for including this material in the administrative file is to attempt to influence Appeals’ decision-making process.” For an application, see *Stewart v. Commissioner*, 999 F.3d 1150 (8th Cir. 2021) (the administrative file included a comment that the taxpayers’ lawyer was not cooperative; that type of comment should be included in the file forwarded to Appeals only if relevant to the function served by the IRS personnel making the comment and relevant to Appeals’ function; wholly gratuitous comments should not be included; held the comments were not gratuitous).

²⁰⁹⁶ In *Ratke v. Commissioner*, 2016 U.S. App. LEXIS 20430 (9th Cir. 2016), the taxpayer sought sanctions under § 6673(a)(2) on the basis that the administrative appeal had been tainted by an improper ex parte communication with an IRS attorney; the Court held that “[e]ven assuming” an ex parte communications violation (which it did not decide), sanctions are not the appropriate remedy; rather, “[t]he proper remedy would be remand for an unbiased CDP hearing.”

²⁰⁹⁷ In *Robert v. United States* 364 F.3d 988 (8th Cir. 2004), the Appeals Officer had an ex parte communication with the examining auditor suggesting that the auditor obtain an outside appraisal. The IRS issued summonses for information for the outside appraisal. The taxpayer moved to quash the summons on the ground that the communication violated the ex parte communication prohibition. The IRS conceded the violation, but the Court held that the summonses were nevertheless enforceable under the *Powell* standard. The Court said: “[W]e generally will not fashion a remedy where Congress creates a right but fails to create an accompanying remedy.” In denying relief, however, the Court did consider whether the taxpayer had been harmed beyond the fact of the violation of the ex parte communication prohibition, suggesting that it might fashion some appropriate relief if the taxpayer were really harmed.

²⁰⁹⁸ One author thinks that the parenthetical is a problem because some representatives in the Appeals Office proceeding may actually want to see prior documents submitted by the taxpayer if the representative thinks, for
(continued...)

a natural person with adjusted gross income not exceeding \$400,000 for the taxable year in dispute or other taxpayers whose gross receipts not exceeding \$5 million for the year.²⁰⁹⁹ The access must be provided at least 10 days before the Appeals conference, but the specified taxpayer may elect to obtain access on the date of the conference.²¹⁰⁰

The access obviates the need for specified taxpayers to file a FOIA request. Taxpayers who are not specified taxpayers should know or find out the Appeals Office's practices with respect to access and, if access will not be provided, file an appropriate FOIA request. In my past practice, I have found that Appeals Officers often will allow access regardless of the size of the case, but the limitation in the 2019 codified provision may suggest that Appeals may deny or limit such access.

VII. Conferences.

The taxpayer will have at least one conference with the Appeals Officer. Historically, the conference was usually in person at the Appeals Officer's office, but sometimes could be handled by telephone, or even by correspondence.²¹⁰¹ In October 2016, however, the IRS adopted IRM procedures that appeals conferences are generally held by telephone and, where the taxpayer desires an in-person conference, to offer the taxpayer "a virtual conference as an alternative when the technology for a virtual conference is available."²¹⁰² The IRM recognizes that "[T]here may be situations in which an in-person conference, including circuit riding should be held to help reach resolution"; in those cases, an in-person conference may be available.²¹⁰³ These new procedures limiting the circumstances in which an in-person conference is available are controversial.²¹⁰⁴ It is too early to know how they will affect the actuality and perception of the Appeals procedures.

Depending upon the complexity of the case and amount in issue, there may be many conferences stretching over several years. For example, I represented a taxpayer in a Docketed Appeal involving complex transfer pricing and foreign tax credit issues over a 4 year tax period. We had probably 8-10 in-office conferences and many telephone conferences and sharing of information and position papers over several years before the case was finally settled. The Tax Court

²⁰⁹⁸(...continued)

whatever reason, his file may be incomplete. So the legal question is whether the statutory provision means that the taxpayer or his representative is not entitled to the documents submitted by the taxpayer? See Caleb Smith, Is IRS Appeals Using the Taxpayer First Act to Restrict Taxpayer Access? (Procedurally Taxing Blog 7/23/21) (noting the problem that, as an "automatic" response to a taxpayer's or representative's request for documents is to supply only the documents required by the statute and thus exclude documents previously submitted by the taxpayer; he recommends specifically requesting any documents, including taxpayer submitted documents, not required by the statute; in theory this should require the Appeals Officer to acknowledge any documents that are being withheld for privilege reasons or otherwise).

²⁰⁹⁹ § 7803(e)(7)(C).

²¹⁰⁰ Guidance for Appeals employees is contained in ap-08-0622-0006 (6/17/22 with an expiration date of 6/17/24).

²¹⁰¹ IRM 8.6.1.1 (06-25-2015), Introduction to Discussion on Conferences. The current provision is IRM 8.6.1.5.1 (09-25-2019), Conference Practice, which discuss the IRS's move away from in-person conferences in many cases. I discuss this move in the text.

²¹⁰² IRM 8.6.1.5.1 (09-25-2019), Conference Practice.

²¹⁰³ IRM 8.6.1.5.1 (09-25-2019), Conference Practice.

²¹⁰⁴ See Leslie Book, Technology and the Tax System: A Less Personal Appeals Office Coming Our Way (Procedurally Taxing Blog 10/13/16).

accommodated the ongoing settlement process by continuing the cases (multiple years) at the request of the parties.

In less complex cases, there will be only one conference. Often, the Appeals Officer will make an offer toward the conclusion of the conference, and the taxpayer and/or his representative should be well enough prepared to respond to the offer, pending final approval by the taxpayer (who often does not attend the Appeals Office conference).

Historically, in most cases, the attendees at Appeals conferences were the Appeals Officer(s) and the taxpayer representative(s). In 2016, the IRM was modified to give Appeals “the discretion to invite” Counsel, Compliance or other IRS experts to the conference, provided that ex parte communications are not permitted.²¹⁰⁵ Although this authority existed prior to 2016, it was only used in limited cases. The amendment to the IRM suggests that it may be used more often. Although the IRM does not make clear precisely what role those other IRS personnel serve in the conference, the Taxpayer Advocate indicates that is solely so that each side (the taxpayer and Compliance) can explain their positions (facts and law); settlement discussions will not occur with Compliance in the Conference.²¹⁰⁶ I presume that would be true also for the other IRS experts (such as valuation engineers) that might be invited. It is not clear what role Counsel would serve.²¹⁰⁷

In May 2017, the IRS initiated an Appeals Team Cases Conferencing Initiative in which, in some cases, Appeals Team Case Leaders (ATCLs) routinely had Compliance Examination Teams attend the opening conference.²¹⁰⁸ Appeals Team cases are cases received from LB&I, so they are the larger cases with multiple and complex issues.²¹⁰⁹ The goal is through joint discussion of the issues at the inception Appeals can better focus on the issues.²¹¹⁰ Key features include: (i) the taxpayer cannot elect not to participate; (ii) new issues cannot be raised; and (iii) IRS counsel may attend if requested by Compliance or Appeals. After vetting the issues with Compliance’s attendance, all settlement negotiations will, as before, be with the taxpayer without Compliance in attendance.²¹¹¹ The three-year initiative was completed on May 1, 2020, with evaluation of the

²¹⁰⁵ IRM 8.6.1.4.4 (10-01-2016), Participation in Conferences by IRS Employees.

²¹⁰⁶ See Appeals Should Facilitate Mutual Respect and Trust by Allowing Taxpayers a Choice in the Expanded Participation of Counsel and Compliance in Appeals Conferences (NTA Tax News 6/21/17).

²¹⁰⁷ On two occasions over the years, I have asked for Counsel involvement when I thought the Appeals Officer was insisting on a position that I was pretty sure Counsel would not defend when the Tax Court petition was filed if we could not reach agreement at Appeals. On both occasions, the Appeals Officer refused. In one of those cases, when we filed the Tax Court petition, Counsel advised before filing the answer that the IRS would concede altogether in a case where we had offered Appeals \$250,000 to settle; in the other, Counsel immediately agreed to settle for the offer that Appeals had rejected.

²¹⁰⁸ IRS web document titled “Appeals Team Cases Conferencing Initiative: Frequently Asked Questions about Compliance Attendance at Conferences” (Viewed 8/4/18). It is reported that this initiative has been extended for another year. See Controversial IRS Appeals Conference Pilot Program Extended for Another Year (Morgan Lewis Lawflash Alert 5/16/19).

²¹⁰⁹ IRM 8.7.11.1 (09-04-2018), Program Scope and Objectives.

²¹¹⁰ Appeals and LB&I could previously have pre-conferences in some cases prior to Appeals meeting with taxpayers, but the taxpayer was notified of the conference and could attend. IRM 8.7.11.8.1 (03-16-2015), Purpose of Pre-Conference Meeting (2. The taxpayer is notified of, and given an opportunity to participate in, any pre-conference in accordance with requirements involving ex parte communications.).

²¹¹¹ In the National Taxpayer Advocate’s Annual Report to Congress 2017, the NTA as Most Serious
(continued...)

results following completion. In the meantime, ATCLs “will operate under longstanding guidelines in effect prior to the initiative, which provide the ATCL the discretion to include the IRS Examination team and their Counsel in the non-settlement portion of the conference, but do not mandate that the ATCL include them.”²¹¹² The IRS’s survey of customer satisfaction for f/y 2020 (merging data for 2019 and 2020 because of the limited number in each year) indicated a 92% Overall Satisfaction score.²¹¹³

VIII. New Issues.

A. Raised by Appeals.

One of the most important concerns the taxpayer and the practitioner historically faced in considering whether and when to go to Appeals was the risk that Appeals may raise issues other than the ones for which Appeals is sought. This can happen in two contexts. First, Examination has not spotted an issue at all but Appeals discovers it in reviewing the files. Second, Examination spotted the issue but resolved it in favor of the taxpayer. The concern is that the Appeals Officer, often a more seasoned and experienced IRS employee, may raise the issue sua sponte as a “new issue.” If the statute of limitations is still open for assessment, this could be a real concern.

Historically, Appeals was permitted to raise a new issue sua sponte if “the ground for such action is a substantial one and the potential effect upon the tax liability is material.”²¹¹⁴ However, even this limited right to raise new issues seemed inconsistent with Appeals broader role to resolve disputes between the taxpayer and Exam. The IRS conducted an Appeals Judicial Approach and Culture (“AJAC”) Project which resulted in significant limitations its role to resolving disputes and thus not raising new issues. Consistent with AJAC, IRS Appeals Officers may “not raise new issues” or “reopen an issue on which the taxpayer and the Service are in agreement.”²¹¹⁵

Consistent with this new policy, the IRS revised its instructions to Appeals Officers in various contexts—including Collection Due Process, Offers in Compromise, Collection Appeals

²¹¹¹(...continued)

Problem #18 identified the changes to allow and encourage participation of Counsel and Compliance Personnel. The NTA’s summary is:

Effective October 2016, Appeals implemented guidance explicitly allowing Hearing Officers to invite IRS Counsel and Compliance to participate in Appeals conferences. This step, however, may have far-reaching negative consequences for Appeals’ effectiveness in resolving cases with taxpayers. Among other things, Appeals’ emphasis on expanding participation of Counsel and Compliance in conferences will fundamentally change the nature of conferences, jeopardize both the real and perceived independence of Appeals, and generate additional costs for taxpayers and the government.

²¹¹² See IRS Document titled “ATCL Conferencing Initiative Completed” (undated), notifying of completion and requesting comments. The ABA Tax Section gave comments on August 28, 2020.

²¹¹³ IRS web page titled “Independent Office of Appeals Customer Satisfaction Surveys” (last review or updated 1/23/23; reviewed 8/15/23).

²¹¹⁴ Policy Statement P-8-2, approved 1/5/07. The Policy Statement gave the following example of one in which a new issue could be raised: “The existence of unreported income, deductions, credits, gains, losses, etc. stemming from a tax shelter which is a listed transaction constitutes such a substantial ground with a material effect upon the tax liability.”

²¹¹⁵ IRM 1.2.1.9.2 (08-13-2014), Policy Statement 8-2 (Rev. 1) (Formerly P-8-49), New issues not to be raised by Appeals.

Program, and Examination Cases. I focus on Examinations. Key facets of the instructions for examinations appeals are:²¹¹⁶

- Appeals will focus on resolving the identified differences between the parties and will not raise new issues or reopen issues previously agreed. However, Appeals may raise a new issue “upon a showing of fraud, malfeasance or misrepresentation of fact.”
- “A new issue is a matter not raised during Compliance's consideration. Any issue not raised by Compliance in the report (e.g., 30-Day Letter) or rebuttal and disputed by the taxpayer is a new issue.” Additional authority for a position is not a new issue, whether raised by the taxpayer or Appeals. But Appeals “will not develop evidence that is not in the case file to support the new theory or argument.”
- Where, however, Appeals identifies “systemic issues” requiring “change or modification to an established procedure, process or operation,” Appeals may notify appropriate officials, but that is not to raise the new issue in the pending Appeal.
- Appeals will not reopen a closed mutual concession Appeal except for “fraud, malfeasance, concealment or misrepresentation of a material fact, an important mistake in mathematical calculation or discovery that the return contains” items “resulting from “the taxpayer's participation in a listed transaction.”
- Appeals may have jurisdiction to act in Tax Court cases (outside the pre-litigation context for Appeals jurisdiction, see p. 555). In those cases (called docketed cases or docketed Appeals), Appeals “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.”²¹¹⁷

B. Raised by the Taxpayer.

Although there are policy considerations against Appeals raising new issues, there are no such considerations against a taxpayer raising a new issue. The new issue may require transfer to Examination.²¹¹⁸

IX. New Information or New Theory or Alternative Arguments Submitted by Taxpayer.

Appeals will consider new information submitted by the taxpayer related to a disputed issue. If the new information merits further “analysis or investigative action by Examination,” it may be referred to Examination.²¹¹⁹ Indeed, in recent IRM changes adopted but not yet incorporated in the IRM as of 7/18/22, for Appeals employees working Tax-Exempt/Government Entities

²¹¹⁶ I have synthesized the following bulleted items from IRM 8.6.1.7 (09-25-2019), New Issues and Reopening Closed Issues; IRM 8.6.1.7.1 (10-01-2016), Defining a New Issue; and IRM 8.6.1.7.2 (10-01-2016), General Guidelines.

²¹¹⁷ Although the burden of proof is on the IRS when it raises a new issue in the Tax Court,

²¹¹⁸ IRM 8.6.1.7.4 (06-25-2015), Taxpayer Raises New Issue (“Appeals gives full, fair, and impartial consideration to the merits of each new issue a taxpayer raises once the originating function has had an opportunity to examine the issue,” but there may be time limits requiring a consent to extend the statute of limitations.).

²¹¹⁹ IRM 8.6.1.7.5 (10-01-2016), Taxpayer Provides New Information.

(TE/GE)-sourced cases, “the presentation of new factual information generally will require that the case be returned to TE/GE.”²¹²⁰

Appeals will consider new theories or new alternative legal arguments not considered by Examination, but in some cases, may seek Examination’s consideration.²¹²¹

X. Special Alternative Dispute Resolution-Type Procedures.

A. General.

The general processing of appeals is for the Appeals Officer to review the protest, the agent’s rebuttal (if the agent prepares one), and the portions of the file the Appeals Officer deems appropriate. The Appeals Officer will schedule an appeals conference and such additional conferences as appropriate (in most cases there is but a single appeals conference). The parties (through counsel, if represented) will then negotiate to see if settlement of some or all issues can be achieved.

In this section, I discuss some special procedures within Appeals. Generally, these special procedures are available and make sense only in larger cases. I don’t go into detail on these procedures because the specifics of their implementation will change over time; it is more important that the student be aware that there are such opportunities available short of proceeding through the normal administrative process, with only litigation as the alternative.

B. Alternative Dispute Resolution (“ADR”).

Although Appeals functions much like the mediation form of alternative dispute resolution (“ADR”), Appeals is not truly independent, even though it is called the Independent Office of Appeals. I noted above some mechanisms designed to ensure Appeals’ independence (e.g., circumscribing ex parte communications with Examination). Nevertheless, Appeals Officers are still employees of the IRS, a party to the dispute before the Appeals Office. For this reason, the IRS has been offering some forms of ADR for several years and has had some success in fact intensive cases such as valuation where legal issues are not critical.

The ADR types the IRS has used are arbitration and mediation. In arbitration, the arbitrator makes a final decision. In mediation, the mediator works with the parties to help them reach an agreement to settle the issue(s); the mediator does not make the decision. At the inception, both processes require the agreement of the parties as to the terms (such as arbitrator(s) or mediator(s), who pays for the process, etc.). The parties may agree upon one or more Appeals Officers unrelated to the case or even one or more outside mediators or arbitrators.

²¹²⁰ Memo dated 12/6/21 For Certain Directors from Steven M. Martin re New Issues, New Information, and New Theories or Alternative Legal Arguments Received on Tax- Exempt/Government Entities-Sourced Cases (including an approved addition to the IRM for IRM 8.7.8.5, New Issues, New Information, and New Theories or Alternative Legal Arguments - General Guidelines.).

²¹²¹ IRM 8.6.1.7.6 (10-01-2016), Taxpayer Raises New Theory or Alternative Legal Argument.

The types of mediations the IRS offers may change from time to time, so I won't get into the details. I refer readers to the current Appeals publication 4167 (Rev. 4-2021) titled "Introduction to Alternative Dispute Resolution." The types of ADR are mediations rather than arbitrations (which have to be separately negotiated). The types of mediation include:

- Fast Track Mediation - Collection ("FTMC") (where the Appeals Officer mediates a dispute with IRS Collection over Offers in Compromise and Trust Fund Recovery Penalties),²¹²²
- Fast Track Settlement ("FTS") (where other division seeks mediation of a dispute before a 30-day letter is issued).²¹²³
- Post-Appeals Mediation ("PAM") (invoked where limited number of legal and factual issues remain after settlement discussions in Appeals).²¹²⁴
- Rapid Appeals Process ("RAP") (in LB&I and SB/SE Estate and Gift Tax cases (bringing Appeals, Examination and the taxpayer together to mediate disputes; failing resolution in RAP, the normal Appeals process continues; some issues such are excluded from this process).²¹²⁵
- Early Referral ("ER").²¹²⁶

XI. Settlement in Appeals.

A. Issue by Issue Approach.

Appeals settles cases two ways as suggested in the quote at the beginning of the chapter, which I repeat here to set up the discussion:

A fair and impartial resolution is one which reflects, on an issue-by-issue basis, the probable result in the event of litigation, or one which reflects mutual concessions for the purpose of settlement based on the relative strength of the opposing positions where there is substantial uncertainty of the result in the event of litigation.²¹²⁷

Appeals generally settles cases on an issue-by-issue basis as stated in this policy statement. To illustrate assume a \$3,000,000 proposed deficiency based on three adjustments each of which has a tax effect of \$1,000,000. Adjustment 1 is \$3,000,000 of additional income; Adjustment 2 is \$3,000,000 disallowed deduction; and Adjustment 3 is \$1,000,000 of disallowed credit. In Appeals, the taxpayer is protesting all adjustments. The Appeals Officer assesses Adjustment 1 at 50% for the IRS, Adjustment 2 at 15% for the IRS and Adjustment 3 at 70% for the IRS. Although there may be some sparring back and forth, the Appeals Officer may settle as follows: Adjustment 1 by

²¹²² IRM 8.26.3 Fast Track Mediation for Collection Cases.

²¹²³ IRM 4.51.4 LB&I/Appeals Fast Track Settlement Program (FTS); and IRM Section 2. Fast Track Settlement for Small Business/Self Employed (SB/SE) Taxpayers.

²¹²⁴ IRM Section 5. Post Appeals Mediation (PAM) Procedures for Non-Collection Cases; and 8.26.9 Post-Appeals Mediation Procedures for Collection Cases.

²¹²⁵ IRM 8.26.11 Rapid Appeals Process (RAP).

²¹²⁶ IRM 8.26.4 Early Referral Procedures; and IRS web page titled "Early Referral to Appeals" (last reviewed or updated 11/2/21 and viewed 7/17/22).

²¹²⁷ See 8.6.4.2 (06-16-2020), Fair and Impartial Settlements per Appeals Mission.

including in income \$1,500,000 (50% of the proposed income inclusion); Adjustment 2 at \$0 denied deduction (because the IRS has a policy of conceding adjustments of less than 20%); and Adjustment 3 by denying \$700,000 of credit (70% of the proposed credit disallowance).

This process of considering and settling each issue on its own merits is particularly highlighted in the penalty area. Sometimes a taxpayer will have an incentive to avoid a penalty and may try to negotiate the IRS's concession of a penalty by conceding more of the merits of the substantive tax issue. For example, in the Sarbanes Oxley world, penalties become an item of required public disclosure that are internally embarrassing for the corporate tax function (specifically the Tax Director or even the CFO) and are embarrassing for the corporation. In my practice, I have found that Appeals Officers rarely do that anyway, but the IRS specifically prohibited Appeals Office settlement of the penalty on any basis other than the merits of the penalty.²¹²⁸

If there is no other method of settlement (specifically issue by issue), "Appeals may consider and accept proposals for split issue settlements," defined as "the settlement of an issue for a percentage or a stipulated amount of the tax in controversy that if litigated, would result in a decision completely for the Government or the taxpayer."²¹²⁹

If there is a proposed penalty on any or all of the proposed adjustments, the Appeals Officer will also address each penalty separately.²¹³⁰

In some cases, an issue by issue settlement may not work. In those cases, the IRS can settle other than issue by issue (such as by trading positions). But in my experience, these are rare.

B. Effecting the Settlement - Form 870-AD.

Settlement with Appeals is usually accomplished in income tax cases by executing a Form 870-AD, Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and of Acceptance of Overassessment (and in other types of cases by signing an equivalent form with a different number).²¹³¹ The title of the Form is the same as the Form 870. However, the "AD" suffix means that it serves a larger purpose than simply waiving the restrictions on assessment. When executed by both sides, the Form 870-AD is supposed to commit the parties to the settlement. The IRS will not reopen the case except for fraud, concealment, misrepresentation or similar conduct,²¹³²

²¹²⁸ IRM 8.6.4.2(4) (06-16-2020), Fair and Impartial Settlements per Appeals Mission, which provides: Penalty issues are not traded in Appeals. Penalties are settled, but the settlement is based on the merits and hazards surrounding each penalty issue standing alone. See IRM 8.11.1.2.7.5, Hazards of Litigation.

²¹²⁹ IRM 1.2.1.9.7 (06-02-2016), Policy Statement 8-48 (Rev. 1), Split-Issue and Specific Dollar Settlements Permitted Under Certain Circumstances.

²¹³⁰ CC-2004-036 (9/22/04), reproduced at 2004 TNT 186-9.

²¹³¹ The part of the document waiving restrictions on assessment authorized by § 6213(d).

²¹³² One issue is whether misrepresentation can include an innocent misrepresentation or requires some degree of culpability or at least negligence. **Caveat as to misrepresentation:** The IRC contains provisions, variously worded, that provide exceptions to a prescribed result when certain conditions, including misrepresentation, are present. The ones relevant to this course are: §§ 6231(b) (if FPAA issued and petition filed, no more FPAA's permitted "in the absence of a showing of fraud, malfeasance, or misrepresentation of a material fact); 6532(b) (statute of limitations on (continued...)

the taxpayer will not seek a refund of any tax paid pursuant to the agreement. The form is a contract and is construed by the courts by using contract interpretation principles.

There is a split of authority among the circuits as to the binding effect of the Form 870-AD. The controversy arises because the only settlement agreement contemplated by the express language of the Code is a closing agreement under § 7121 (p. 474). A Form 870-AD is not a closing agreement.²¹³³ The question is then whether either of the parties can pursue claims for the year involved after executing a Form 870-AD? Can the taxpayer claim a refund, or the IRS assert additional tax? Since the IRS resource allocation and imperatives to live by its agreement would rarely permit it to pursue a claim for a matter otherwise closed by a Form 870-AD,²¹³⁴ the issue has come up only in the context of a taxpayer pursuing a claim for refund beyond any refund that might be allowed by the Form 870-AD (which usually asserts a deficiency rather than recognizing a refund). The older cases are not consistent. Some cases held that, since the Form 870-AD is not a settlement in the manner authorized by the Code, the taxpayer is free to pursue by claim for refund any matter he or she wishes for the year. Other cases—lately the trend—applying contract-like analysis hold that contract, equitable estoppel and/or perhaps duty of consistency principles preclude the taxpayer from going around the parties’ expressed intent in the Form 870-AD to close out the year.²¹³⁵

The IRS synthesized the essence of these holdings by focusing on the equities as to whether the taxpayer knew or should have known of the claim when the Form 870-AD was reached.²¹³⁶ Thus, as to matters that were actually considered in reaching the settlement or, perhaps which reasonably should have been considered at that time, the Form 870-AD will be binding and foreclose the taxpayer from seeking a refund for the years covered by the Form 870-AD. However, as to matters which were discovered after the settlement by Form 870-AD, the Form 870-AD would not bar the taxpayer from filing a claim for refund.²¹³⁷ Practitioners should, however, be aware that this

²¹³²(...continued)

erroneous refund suit is 2 years except extended to 5 years if “any part of the refund was induced by fraud or misrepresentation of a material fact”); and 7121(b) (closing agreement final except for “fraud or malfeasance, or misrepresentation of a material fact” (Note, CPAR § 6231(b) is the successor to repealed TEFRA § 6223(f) similarly worded.)

Depending upon context, the word “misrepresentation” may mean either an innocent misrepresentation of fact or requires some level of culpability (at least negligence, but usual intent to deceive). E.g., *Halpern v. Commissioner*, T.C. Memo. 2000-151, at *9 (“For purposes of section 7121, a misrepresentation is not synonymous with a mistake: It denotes something more deliberate or more conscious than mere error or mistake.” (Internal quotations omitted)); and *NPR Invs., L.L.C. v. United States*, 740 F.3d 998 (5th Cir. Tex. 2014) (TEFRA § 6223(f), barring a second FPAA notice except for “fraud, malfeasance, or misrepresentation of a material fact,” does not require intent to deceive for misrepresentation and even innocent misrepresentations can apply).

²¹³³ Some cases refer to the Form 870-AD as an “informal agreement” to distinguish it from the more formal and statutorily authorized closing agreement. *Shafmaster v. United States*, 707 F.3d 130 (1st Cir. 2013).

²¹³⁴ In *Shafmaster v. United States*, 707 F.3d 130 (1st Cir. 2013), the First Circuit said (emphasis supplied): “Even assuming arguendo that an informal IRS settlement such as the Form 870-AD could ever have estoppel effects against the government -- a proposition of which we are skeptical -- the Shafmasters' argument would fail.”

²¹³⁵ See e.g., *Kretchmar v. United States*, 9 Cl. Ct. 192 (1985); and *Ihnen v. United States*, 272 F.3d 577 (8th Cir. 2001).

²¹³⁶ ILM 200738010 (6/5/07), reproduced at 2007 TNT 185-12.

²¹³⁷ Presumably, in this narrow circumstance, the matters actually settled in reaching the Form 870-AD (continued...)

synthesis, while satisfying at an equitable level, has not been reached by the courts and may not be; hence there may be an ongoing opportunity or risk in the Form 870-AD; accordingly, all known claims should be dealt with in reaching the settlement behind the Form 870-AD.²¹³⁸

Because of this potential problem as to which there is no certainty, Appeals Officers are encouraged to consider a formal closing agreement (which requires more work and extra levels of review) if they are concerned that the taxpayer might not abide by the Form 870-AD.²¹³⁹

A related question is whether the IRS would be bound by the Form 870-AD. As a practical matter, since the IRS does intend to be bound and has limited systemic resources to keep looking back, it is hard to contemplate that the IRS would attempt to avoid the intended binding effect of the Form 870-AD. But the types of arguments that would bind the taxpayer (particularly estoppel) may not apply with the same force to the IRS. One court has expressed skepticism that the Form 870-AD could be binding on the IRS, particularly if the claim is some type of estoppel rather than the terms of the Form 870-AD.²¹⁴⁰ Thus, at least in terms of estoppel, there may not be a reciprocal application.

Note, however, that if either the IRS or the taxpayer desires not to totally close out the year but to reserve one or more issues, they can do so by expressly stating the reservation on the “contract”—i.e., the Form 870-AD. This is not a solution for later discovered matters but is a solution for known matters. Of course, as to a known matter, it should be on the table, discussed and resolved in the settled resulting in the Form 870-AD if that is possible. And, if the taxpayer does file a claim for refund as to the reserved unsettled issues in the Form 870-AD, although the settled issues will remain settled (barring fraud, etc.), the IRS can consider the settled issues and even new issues in determining whether the taxpayer is entitled to a refund on the reserved, unsettled issues.²¹⁴¹

²¹³⁷(...continued)

would be binding and only “new” matters considered in determining whether the taxpayer is entitled to a refund. Since the IRS could, under this scenario, also raise new matters to offset the claim and even assert a new deficiency, taxpayers recognizing this problem may try to time their filing of the claim for refund (which clearly signals their attempt to avoid the Form 870-AD), when the IRS still has time to make an assessment but administratively would likely not be able to do so in the time remaining. See Raby, The Finality of Settlements with the IRS, 2001 TNT 235-43 (12/6/01).

²¹³⁸ Furthermore, clarity as to matters affected by the Form 870-AD should be considered and, if possible, dealt with in the Form 870-AD. For an interesting case where the Form 870-AD was found to be ambiguous as to a related item (thus permitting extrinsic evidence as to the interpretation of the Form 870-AD), see *Schortmann v. United States*, 82 Fed. Cl. 1 (2008).

²¹³⁹ IRM 8.6.4.5.3 (10-15-2005), Closing Agreement Form 866 and Form 906.

²¹⁴⁰ *Shafmaster v. United States*, 707 F.3d 130 (1st Cir. 2013); see *Howe v. Commissioner*, T.C. Memo. 2020-78, at *13-*20 (denying a taxpayer claim that Form 870-AD should bind the IRS; in issuing a notice of deficiency inconsistent with the Form 870-AD agreement, the IRS believed and asserted that the taxpayer had misrepresented a material fact, a circumstance that, on the face of the Form permits the IRS to not be bound by the Form; the Court did not determine whether there was such a misrepresentation because it found that, even if there had not been a misrepresentation, the taxpayer had not established a basis for estoppel against the IRS).

²¹⁴¹ CCA 2011120714125 (12/7/11) (concluding that such reconsideration is not a reopening (citing Rev. Proc. 2005-32, 2005-1 C.B. 1206) and going back to settled law that the issue on a refund is whether the taxpayer overpaid the tax for the year, as to which the IRS can consider everything (even previously settled issues) bearing on whether there was an overpayment (citing *Lewis v. Reynolds*, 284 U.S. 281 (1932))).

C. Appeals Reconsideration of a Settlement.

Appeals' settlements usually are inconsistent, to a greater or lesser degree, with the line IRS recommendation (e.g., Examination's recommendation in the 30-day letter) with a result more favorable to the taxpayer. (This possibility is inherent in Appeals' authority to settle based on the litigating hazards, an authority not given to Revenue Agents. There are informal and formal processes whereby the IRS line function (let's say Examination) can disagree with Appeals' settlements, including filing formal written dissents.²¹⁴² These processes can result in Appeals exercising any authority it may have to void the settlement. I don't think Appeals acts inconsistently with the settlement in most cases, but that is based on hunch without even anecdotal experience rather than data. But it can happen, even if Appeals has to act inconsistently with a settlement reflected in a Form 870-AD. For example, in a case involving a settlement with Form 870-AD, Examination lodged a formal written dissent asserting that the taxpayer had misrepresented the facts in obtaining the settlement, whereupon Appeals issued a less taxpayer-friendly notice of deficiency.²¹⁴³ As noted above, Appeals' reconsideration and change is not possible if the settlement is effected by closing agreement rather than Form 870-AD.

²¹⁴² IRM 8.6.4.2.10 (06-16-2020), Disagreements with Appeals Determinations (noting informal processes and providing the formal written dissent when informal processes do not resolve the disagreement).

²¹⁴³ *Howe v. Commissioner*, T.C. Memo. 2020-78, at *10-*11 & *13-*20, (in the case, the Appeals Officer prepared an Appeals Case Memorandum ("ACM") per IRM 8.6.2 Appeals Case Memo Procedures, explaining the settlement; upon Examination's formal written dissent, Appeals issued the notice of deficiency without the settlement; the Court rejected the taxpayer's argument that the Form 870-AD was binding).

Ch. 9. Notice of Deficiency.

I. The Notice of Deficiency and its Role in the System (A Reprise).

A. Introduction.

The notice of deficiency (also called a statutory notice of deficiency and sometimes initialized to NOD or SNOD)²¹⁴⁴ is the procedural device that notifies the taxpayer the IRS has determined a deficiency (amount of tax due in excess of amount previously assessed) and penalty, and offers the taxpayer an opportunity to litigate liability for the deficiency in the Tax Court without first paying the amount of the deficiency and penalty.²¹⁴⁵ The notice of deficiency advises that, if the taxpayer does not petition the Tax Court for redetermination of the deficiency, the IRS will assess the amount asserted in the notice of deficiency. The notice of deficiency requirement prior to assessment applies only to certain types of tax, most prominently income tax and estate and gift tax.²¹⁴⁶

The IRS issues²¹⁴⁷ the notice of deficiency after the audit if the taxpayer does not pursue appeals or after the Appeals consideration if the taxpayer does appeal and settlement is not reached in Appeals.²¹⁴⁸ The notice of deficiency is issued under § 6212. In the notice of deficiency, the IRS must notify the taxpayer that the IRS believes (i) that there is a deficiency and penalty, identifying the type of tax and period involved, and (ii) that the taxpayer has a right to bring suit in the Tax Court before assessment and payment. § 6213(a).²¹⁴⁹ The taxpayer has 90 days from the date of the notice of deficiency in which to petition the Tax Court, hence the notice of deficiency is often

²¹⁴⁴ I generally use notice of deficiency rather than the longer form statutory notice of deficiency or the initialisms for each version. I don't believe that adding the term statutory at the beginning adds to the term notice of deficiency which is the term used in the Code. § 6212, titled "Notice of Deficiency."

²¹⁴⁵ §§ 6211, 6212 and 6213. See *Flora v. United States*, 362 U.S. 145, 158 (1960) ("The Board of Tax Appeals [the predecessor to the Tax Court] was established by Congress in 1924 to permit taxpayers to secure a determination of tax liability before payment of the deficiency."). The Board of Tax Appeals was the predecessor to the Tax Court.

²¹⁴⁶ § 6212(a). The notice of deficiency requirement also applies to certain taxes in Subtitle D (Miscellaneous Excise Taxes) imposed in Chapters 41-44 (dealing with public charities, private foundations, qualified pensions, and qualified investment entities).

²¹⁴⁷ Technically, some person within the IRS, with delegated authority, issues the notice of deficiency for the IRS. In *Muncy v. Commissioner*, T.C. Memo. 2017-83, the Tax Court revised and supplemented its earlier opinion to find the requisite delegated authority after the Court of Appeals, in *Muncy v. Commissioner*, 637 Fed. Appx. 276 (8th Cir. 2016), reversed the earlier opinion and remanded for the IRS to show the authority of the person signing the notice of deficiency. The question the *Muncy* opinions raise is whether in any case where the deficiency is at issue (such as a redetermination case, CDP case requiring a valid assessment when based on a notice of deficiency, collection suit requiring a valid assessment when based on a notice of deficiency) the IRS has a predicate procedural burden to show the validity of the notice of deficiency. And how does this further ripple out – does it require proof of a proper delegation to the IRS person making the assessment? And there are many other contexts requiring that the IRS act through a properly authorized person.

²¹⁴⁸ As noted above, if settlement is reached in appeals and a deficiency is agreed upon, the settlement will be reflected in a Form 870-AD which will permit the IRS to make an assessment without issuing a notice of deficiency.

²¹⁴⁹ The notice does not notify the taxpayer that he or she can litigate the asserted tax or penalty later in the process after assessment. The usual way to litigate after assessment has traditionally been a tax refund suit, but also includes the CDP proceeding and collection suits.

referred to as a 90-day letter or the “ticket to the Tax Court.”²¹⁵⁰ This period is extended to 150 days if the notice is “addressed to a person outside the United States.”²¹⁵¹ In addition, the 90-day or 150-day periods are tolled if the Tax Court filing location “inaccessible or otherwise unavailable to the general public on the date a petition is due”; the tolling period is “for the number of days within the period of inaccessibility plus an additional 14 days.”²¹⁵²

I discuss in this section specific aspects of the notice of deficiency, but in brief it is a letter (including attachments) notify the taxpayer that (i) the IRS had determined a deficiency (and penalty, if appropriate), (ii) the amount(s) of the deficiency(ies) and penalty(ies); (iii) the type of tax (e.g., income) and penalty(ies); (iv) in the case of income tax, the year(s); (v) the date by which a petition for redetermination must be filed in the Tax Court; and (v) an explanation of the adjustments supporting the deficiency and penalty determinations. I deal with specific aspects of these requirements below.

B. What is a Notice of Deficiency?

1. A Deficiency.

Section 6211(a) defines a deficiency. For present purposes, a deficiency is the taxpayer's correct tax liability less the amount the IRS has previously assessed.²¹⁵³ Usually, the previous assessment is the amount the taxpayer reported on the taxpayer's tax return.²¹⁵⁴ The definition can

²¹⁵⁰ *McKay v. Commissioner*, 89 T.C. 1063, 1067 (1987); *Hallmark Research Collective v. Commissioner*, 159 T.C. ___ No. 6 (2022), Slip Op. *14.

²¹⁵¹ § 6213(a). The quoted language, as applied, is not quite so straightforward as might otherwise be assumed. See *Smith v. Commissioner*, 140 T.C. 48 (2013), reviewed opinion (discussing many of the nuances in the application of this text which the majority found to be ambiguous, but holding generally that “the critical inquiry has generally been whether the taxpayer fell within the categories of taxpayers Congress intended to benefit: foreign residents or U.S. residents temporarily absent from the country.”). Thus, as interpreted, a foreign resident will qualify for the 150 day period even if that person is in the U.S. on the day the notice of deficiency is mailed or delivered. The *Smith* majority holding drew vigorous dissents because of the unique facts.

²¹⁵² § 7451(b)(1) (applied in *Sall v. Commissioner*, 161 T.C. ___ No. 13 (2023)). The filing location is either by physical filing at the Tax Court clerk's office or by electronic filing of the Tax Court petition.

²¹⁵³ Note that the amount of a deficiency does not depend upon the amount the taxpayer has paid. *Zhou v. United States*, 133 Fed. Cl. 322 (2017), aff'd 2018 U.S. App. LEXIS 6668 (Fed. Cir. 2018) (unpublished) (both decisions citing *Longino v. Commissioner*, T.C. Memo. 2013-80; and *Hillenbrand v. Commissioner*, T.C. Memo. 2002-303).

²¹⁵⁴ The prior assessment is usually based on the tax return the taxpayer filed. See *Manning v. Seeley Tube & Box Co. of N.J.*, 338 U.S. 561, 565 (1950) (usually “the difference between the tax imposed by law and the tax shown upon the return.”). An example of where the deficiency would be the tax previously assessed rather than just the tax reported on the return is: (i) return for year 01 filed on April 15 of year 01 reporting \$100 tax which the IRS assesses immediately since no notice of deficiency is required; (ii) the IRS sends taxpayer a notice of deficiency for \$25 (say, automatically generated by a 1099 amount he did not report on the return); (iii) the IRS then does an audit and determines that the tax for year 01 was really \$200 rather than the \$125 aggregate previously determined and assessed, so that the resulting “deficiency” is \$75; and (v) the IRS sends the taxpayer a notice of deficiency for \$75 based upon the difference between the correct tax of \$200 and \$125 previously assessed.

A so-called substitute for return prepared by the IRS under § 6020(b) is not the equivalent of a return for this purpose. *Spurlock v. Commissioner*, 118 T.C. 155 (2002).

be a little more complex than that,²¹⁵⁵ but for most of the situations you encounter, the only critical components will be the correct tax liability as determined by the IRS less the amount assessed pursuant to the taxpayer's reporting of the liability on his or her original or amended returns.²¹⁵⁶

The deficiency does not include interest on the deficiency which runs from the original due date of the return.²¹⁵⁷ Interest on the deficiency will be computed and assessed (without notice of deficiency for the interest) at the following times: (i) initially when the deficiency is assessed and (ii) thereafter periodically until the deficiency and interest are paid.²¹⁵⁸

2. The Notice of Deficiency.

a. The Notice and Determination Requirement.

The IRS is authorized to send the taxpayer a deficiency notice “If the Secretary **determines** that there is a deficiency.” § 6212(a).²¹⁵⁹ The “notice advises the person who is to pay the deficiency that the Commissioner means to assess him.”²¹⁶⁰ The elements of the notice of deficiency are: (i) it must identify the taxpayer, (ii) it must indicate that the IRS has determined a deficiency (the determination requirement), (iii) it must “describe the basis for, and identify the amounts (if any) of, the tax due, interest, additional amounts, additions to the tax, and assessable penalties included in such notice” (the explanation requirement) and (iv) it must identify the year or periods involved. § 7522(a).²¹⁶¹

²¹⁵⁵ See Patrick Thomas, *Losing Jurisdiction through Excessive Payments – Designated Orders: May 27 – 31, 2019* (Procedurally Taxing Blog 7/29/19) (discussing some of the complexity).

²¹⁵⁶ Where the taxpayer claims refundable credits that are subsequently disallowed, there is the possibility of the formula producing a negative amount which is then taken into account for determining the deficiency. See *Galloway v. Commissioner*, 149 T.C. 407 (2017).

²¹⁵⁷ § 6601(e)(1) provides that, although interest is assessed in the same manner as taxes, interest is not subject to the deficiency procedures. That would be the result absent this provision because deficiency as defined the Code and discussed in the text above does not include the interest on the deficiency. The key consequence is that the assessment of interest does not require a notice of deficiency and generally is not subject to the Tax Court's jurisdiction. See *Pen Coal Corp. v. Commissioner*, 107 T.C. 249 (1996); and *Sunoco Inc. v. Commissioner*, 663 F.3d 181, 189 (3d Cir. 2011) (both holding that generally the Tax Court has no deficiency redetermination jurisdiction over interest); see also *United States v. Beane*, 841 F.3d 1273 (11th Cir. 2016).

²¹⁵⁸ Interest is time based. The IRS can calculate and assess the interest when the underlying tax is assessed. Thereafter, if the assessed tax and interest are not paid, additional interest will accrue and will be assessed periodically.

²¹⁵⁹ Related provisions also restate the determination requirement. For example, the role of the notice of deficiency is to permit the taxpayer to petition for “redetermination” in the Tax Court pursuant to § 6214. The redetermination is of the determination made in the “notice of which has been mailed to the taxpayer.” *Id.*

²¹⁶⁰ *Olsen v. Helvering*, 88 F.2d 650, 651 (2d Cir.1937) (L. Hand, J.) (cleaned up). Section 274(a) of the Revenue Act of 1924 actually said Commissioner. Section § 6212(a) now says Secretary rather than Commissioner but, of course, the Secretary of Treasury delegates that authority to the Commissioner who, in turn, delegates it to others in the IRS. For a discussion of the delegation authority for notices of deficiency, see *Harriss v. Commissioner*, T.C. Memo. 2021-31, slip op. at 8-9.

²¹⁶¹ Technically, § 7522(a) does not have a year requirement, but that is subsumed in the explanation requirement. See *O'Rourke v. United States*, 587 F.3d 537, 541 (2d Cir. 2009) (quoting *Andrew Crispo Gallery v. Commissioner*, 16 F.3d 1336, 1340 (2d Cir. 1994)).

One court has held that where the notice of deficiency explains the deficiency based on facts that patently do not exist for the taxpayer, then the IRS has not met the requirement that it determine a deficiency. In that case, *Scar v. Commissioner*, 814 F.2d 1363 (9th Cir. 1987), the notice of deficiency said that it was disallowing a deduction for certain tax shelter partnership items with respect to a named partnership. The taxpayer was not a partner in the named partnership. The taxpayer was a partner in a tax shelter partnership with another name, and it is likely that the IRS just plugged in the wrong name on the notice of deficiency. Moreover, the notice of deficiency indicated that the IRS had not actually examined the taxpayer's return but just calculated the tax proposed in the notice at the highest marginal rate rather than the progressive income tax rates. The Ninth Circuit held that, on these facts on the face of the notice of deficiency, the IRS had made no determination as required by § 6212. The result was that the notice of deficiency was invalid.²¹⁶²

Cases since *Scar* have read the holding narrowly; a notice of deficiency will not be honored “only where the notice of deficiency reveals on its face that the Commissioner failed to make a determination.”²¹⁶³ As a result, *Scar* is an outlier, with its analysis and holding rarely invalidating a notice of deficiency.²¹⁶⁴

The tolerance for some level of imperfection in notices of deficiency is understandable given the ability to resolve or moot the problems by filing a Tax Court petition for redetermination. But what about a document in the regular form of a notice of deficiency that states the amount of the deficiency as \$0.00? A taxpayer receiving such a document would know that it is described as a notice of deficiency and that he may file a petition for redetermination if he does not agree. But the

²¹⁶² It is not clear in *Scar* whether the IRS was foreclosed from fixing the problem by issuing a new notice of deficiency. As I note later in the discussion in the text, suspensions of the assessment may have permitted the IRS to issue a new notice of deficiency. And, if it could and did in *Scar*, the taxpayer's win in the Ninth Circuit case would be a pyrrhic victory.

²¹⁶³ *Clapp v. Commissioner*, 875 F.2d 1396, 1402 (9th Cir. 1989); *Kantor v. Commissioner*, 998 F.2d 1514, 1521-1522 (9th Cir. 1993); *Meserve Drilling Partners v. Commissioner*, 152 F.3d 1181, 1183 n.3 (9th Cir. 1998); and *Campbell v. Commissioner*, 90 T.C. 110, 112-113 (1988). For good discussions of the narrow limits of *Scar*, see *Anderson v. Commissioner*, T.C. Memo. 2009-44 (holding notice of deficiency valid although it relied on bare allegations in a criminal tax evasion indictment; dismissal avoided even though the notice of deficiency did not have the benefit of the underlying grand jury records because Rule 6(e), F.R.Cr.P., prohibited them from disclosure to the IRS at the time the notice of deficiency was issued). The court distinguished *Scar* as a case in which the IRS facially had not made the required determination, whereas in *Anderson* the IRS clearly had made the precise determination contained in the notice (albeit, perhaps, without the underlying support); and *Cross v. Commissioner*, T.C. Memo. 2012-344 (sustaining adjustments made without a review of the return itself but a review of the IRS's RTVUE transcript which is a computerized record of the information which is input at the Service Center when the return is originally received and processed; see *Whittington v. Commissioner*, T.C. Memo. 1999-279). See also Bryan Camp, [Lesson From The Tax Court: What Makes A NOD Invalid? \(Tax Prof Blog 10/23/23\)](#).

²¹⁶⁴ See *Dees v. Commissioner*, 148 T.C. 1 (2017) (reviewed decision) (discussion in the majority, concurring and dissenting opinions) (I discuss *Dees* in the next paragraph in the text. See also Steve R. Johnson, [Reasoned Explanation and IRS Adjudication](#), 63 Duke L.J. 1771, 1803 (2014) (invalidating notices are “rare occasions”; see also *Green Gas Delaware Statutory Trust v. Commissioner*, T.C. Memo. 2015-168, at *16 (“*Scar* applies only in the narrowest of cases where the notice of deficiency on its face reveals that the Commissioner failed to make a determination.”) A variation on the *Scar* theme is when the IRS sends a TEFRA partnership computational adjustment by flowing through items from the partnership that have no need for partner level adjustments other than computational. Taxpayers have attempted to read *Scar* as requiring that the deficiency procedures are required, notwithstanding the statute saying that it is a computational adjustment not requiring a notice of deficiency and, more broadly, at least required the IRS to review the return. This nonsense has been rejected. See *Bush v. United States*, 106 Fed. Cl. 563 (2012), aff'd 717 F.3d 920 (Fed. Cir. 2013), cert. den. 571 U.S. 1132 (2014).

deficiency is stated to the \$0.00, and he may agree with that number. In a 2017 reviewed opinion of the Tax Court (with strong concurring and dissenting opinions), the Court held that the standard form letter for a notice of deficiency met the determination requirement when it stated that the deficiency amount was \$0.00 but included attachments clearly indicating that a deficiency had been determined because a claimed credit was disallowed.²¹⁶⁵ The majority formulated the questions presented as:

- “Whether the notice objectively put a reasonable taxpayer on notice that the Commissioner determined a deficiency in tax for a particular year and amount. If the notice, viewed objectively, sets forth this information, then it is a valid notice”
- If, however, that inquiry does not provide an answer (i.e., the notice is ambiguous as to the requirements for a deficiency), then, for the notice to be valid, the evidence must “establish that the Commissioner made a determination and that the taxpayer was not misled by the ambiguous notice.” The majority elsewhere in the opinion frames the latter inquiry as to whether the “taxpayer was prejudiced by an ambiguous notice.” On the latter point, the majority concluded:

The notice on its face is ambiguous, but the Commissioner has established that he made a determination and that Mr. Dees was not misled by the notice. Mr. Dees timely filed a petition to challenge the notice, and that petition makes clear that Mr. Dees understood that the Commissioner had disallowed his refundable credit: He stated in his petition both that the Commissioner had erred in denying his premium tax credit and that he had documents to substantiate his entitlement to the credit. This establishes that Mr. Dees was not misled by the notice.

The tests thus enunciated may be described as an objective test and a subjective test.²¹⁶⁶ In a later case, the Tax Court added one more bullet point to this test:

- the purported notice of deficiency, when read in context of the complete notice package (including the explanation), unambiguously identifies the taxpayer for whom the determination of deficiency was made.²¹⁶⁷

As with the last known address requirement for notices, a taxpayer desiring to present this issue should consider the statute of limitations on assessment. If the taxpayer brings the issue to the IRS’s attention while the statute for assessment is still open, the IRS may solve the problem by issuing a new notice. In this regard, if the taxpayer files a petition in the Tax Court while the statute for assessment is still open, the mere filing of the petition will suspend the statute of limitations

²¹⁶⁵ *Dees v. Commissioner*, 148 T.C. 1 (2017) (reviewed opinion).

²¹⁶⁶ Judge Ashford’s concurring opinion says that “The opinion of the Court delineates a two-prong approach (with both objective and subjective elements) to determining our deficiency jurisdiction * * * .”

²¹⁶⁷ *U.S. Auto Sales, Inc. v. Commissioner*, 153 T.C. 94 (2019) (reviewed opinion) (involving enclosures identifying a different taxpayer than the letter notice identified, thus, the Court held, in the context of the entire package making the letter notice sufficiently ambiguous as to make the package not a notice of deficiency; in making this holding, the Tax Court reaffirmed its *Dees* opinion).

under § 6503(a)(1) until the Tax Court decision is final even if the notice is ultimately determined by the Tax Court to be invalid.²¹⁶⁸ So, the most effective strategy to raise this notice of deficiency issue would be to forego filing a timely petition for redetermination in the Tax Court and raising the issue later after the assessment statute of limitations has otherwise expired.²¹⁶⁹

Finally, to state the obvious, the notice must determine a deficiency (as defined), but what happens if the taxpayer pays the amount before the IRS sends a notice of deficiency which does not reflect the payment, so that, although there is a deficiency indicated in the notice, there is no deficiency? This may happen, for example, at the conclusion of an audit where the taxpayer pays the tax before the notice but the notice issues anyway. The general rule is that payment extinguishes the deficiency and that an ensuing notice of deficiency is invalid thus preventing Tax Court jurisdiction if the taxpayer petitions based on the notice of deficiency.²¹⁷⁰ But, if the taxpayer's remittance to the IRS is properly construed as a deposit toward payment of the tax rather than payment of the tax, then there is a deficiency to support Tax Court jurisdiction.²¹⁷¹ (For the treatment of a remittance as a payment rather than a deposit, see discussion of § 6603 above beginning p. 282.)

b. The Explanation Requirement.

The notice of deficiency should “describe the basis for, and identify the amounts (if any) of, the tax due, interest, additional amounts, additions to the tax, and assessable penalties included in such notice,” § 7522(a).²¹⁷² The notice comes in a letter that includes various items including an “explanation of the adjustments.”²¹⁷³ The Explanation of Adjustments is (i) “to inform the taxpayer in clear and concise language of the adjustments,” and (ii) “to state the position or positions of the IRS with respect to the adjustments being made.”²¹⁷⁴

²¹⁶⁸ §§ 6213(a) (prohibition on assessment which Tax Court petition for redetermination is pending; and 6503(a)(1) (suspension during period of prohibition). See *Shockley v. Commissioner*, 686 F.3d 1228 (11th Cir. 2012) (holding that the filing of a Tax Court petition invoked the suspension even if the notice of deficiency was invalid or the filing was not by the proper person; per § 6503(a)(1), the suspension occurs “if a proceeding in respect of the deficiency is placed on the docket of the Tax Court”).

²¹⁶⁹ I discuss this nuance later in discussing how to contest a notice of deficiency that is invalid because not sent to the last known address. The basic issue is the same—was the notice of deficiency valid and, if not, how to contest its validity without alerting the IRS to the need to fix the problem by issuing a new, valid notice of deficiency within the assessment statute of limitations.

²¹⁷⁰ *Peacock v. Commissioner*, T.C. Memo. 2020-63 at *7 (citing cases).

²¹⁷¹ *Peacock v. Commissioner*, T.C. Memo. 2020-63, at *7-8.

²¹⁷² There are other IRS notices that, with respect to an explanation requirement, are subject to the same analyses as § 7522(a). For example, the FPAA under the partnership TEFRA rules (now repealed prospectively) serves as “the partnership equivalent of a notice of deficiency, and we therefore analyze an FPAA the same way we would analyze a notice of deficiency.” *Green Gas Delaware Statutory Trust v. Commissioner*, T.C. Memo. 2015-168, at *12-*13 (citing *Sealy Power, Ltd. v. Commissioner*, 46 F.3d 382, 385-386 (5th Cir. 1995), affg in part, rev'g and remanding in part T.C. Memo. 1992-168); *United States v. Clarke*, 816 F.3d 1310, 1313 n.2 (11th Cir. 2016) (“An FPAA is the functional equivalent of a Statutory Notice of Deficiency for individual taxpayers.”); and *Bedrosian v. Commissioner*, 143 T.C. 83, 107 (2014) (“The FPAA is to the litigation of partnership items and affected items * * * what the statutory notice of deficiency is to tax controversies before this Court that involve respondent's determination of a deficiency.”).

²¹⁷³ IRM 4.8.9.8 (10-13-2020), Preparing Notices of Deficiency. “Letter 531 is the notice letter used most often in income tax cases.” IRM 4.8.9.8.3 (07-09-2013), Notice of Deficiency Letter.

²¹⁷⁴ IRM 4.8.9.8.6 (07-09-2013), Explanation of Adjustments. The IRM also explains the sentence structure and content and citation of Code Sections. IRM 4.8.9.8.6.1 (07-09-2013), Sentence Structure and Content (use present (continued...))

The text and legislative history of § 7522(a) do not prescribe in detail the standards for the explanation it requires. I quote the statutory text above. The cases suggest the following standards reached through interpretation in light of the history, purpose and context of the notice of deficiency:

- the notice of deficiency must state the “basis for” the amounts of tax, interest, etc., that the IRS is asserting.
- the notice must state the amount asserted.
- the notice must contain enough information to allow the taxpayer to craft a meaningful Tax Court petition challenging the notice.
- the notice need not identify the statutory provisions supporting the adjustments in the notice.
- the notice need not set out the factual bases of its determinations.
- In the *Scar* line of analysis, the notice must not indicate on its face that it is arbitrary.²¹⁷⁵
- Considering the entire notice of deficiency package (the notice letter and attachments), the notice must not be ambiguous as to any required component (such as the identity of the taxpayer to whom the deficiency was determined or even that a deficiency was determined).²¹⁷⁶

The notice of deficiency often will be somewhat spare in its explanation, such as the taxpayer has not shown entitlement to a deduction;²¹⁷⁷ courts nevertheless have not shown an inclination to hold the explanation requirement has not been met so long as the spare explanation is not facially deficient.²¹⁷⁸ In this regard, as noted, the notice of deficiency will usually have been accompanied with or preceded by some form of revenue agent report with more explanation, so that the taxpayer can hardly claim to be prejudiced by a cryptic statement in the notice of deficiency.²¹⁷⁹ In any event,

²¹⁷⁴(...continued)

tense, positive phrasing, cautions about references in the files and so forth); and IRM 4.8.9.8.6.2 (07-09-2013), Citing Code Sections (cite only as necessary to inform taxpayer of nature of the adjustment). The explanations may be in Forms 5278, Statement of Changes, and 886-A Explanation of Changes.

²¹⁷⁵ These bullet points (except the last) are synthesized from (i) the statutory text itself, (ii) Steve R. Johnson, Reasoned Explication and IRS Adjudication, 63 Duke L.J. 1771, 1803-1804 (2014); and *Green Gas Delaware Statutory Trust v. Commissioner*, T.C. Memo. 2015-168, and cases cited therein.

²¹⁷⁶ E.g., *Dees v. Commissioner*, 148 T.C. 1 (2017) (letter said \$0.00 deficiency but attachments indicated deficiency; held, deficiency notice valid); and *U.S. Auto Sales, Inc. v. Commissioner*, 153 T.C. 94 (2019) (letter addressed to one taxpayer and attachments explaining the deficiency were for another taxpayer; held, ambiguous as to which taxpayer for whom a deficiency was determined, so notice invalid).

²¹⁷⁷ The IRM provides template standard explanations. IRM Exh. 4.10.10-2 Standard Paragraphs and Explanations of Adjustments.

²¹⁷⁸ In *QinetiQ U.S. Holdings Inc. v. Commissioner*, 845 F.3d 555 (4th Cir. 2017), cert. den. 583 U.S. 816 (2017), the IRS issued a notice of deficiency saying crisply that the taxpayer “ha[d] not established that [it was] entitled” to a deduction “under the provisions of § 83.” The Court held that that notice was all that was required, with no requirement to provide a further reasoned explanation in view of the taxpayer’s obligation to show entitlement to a deduction, citing *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992). As I note elsewhere in the text, where income omissions are the basis for the notice of deficiency, the courts require more explanation than a general statement that you had unreported income and further impose upon the IRS a form of production burden – more descriptively called a risk of nonproduction – as to the unreported income.

²¹⁷⁹ In *Est. of Streightoff v. Commissioner*, 954 F.3d 713, 721-722 (5th Cir. 2020), the Court considered the enclosures with the notice of deficiency as satisfying the explanation requirement, although it also relied upon *Selgas* (continued...)

the same statute provides: “An inadequate description under the preceding sentence shall not invalidate such notice.”²¹⁸⁰ So, § 7522(a) is a statutory obligation but, except as constrained by the determination standard discussed above, there appears to be no remedy for failure to meet the explanation obligation.²¹⁸¹

The Tax Court has held that, although there is no statutory remedy for violating § 7522(a), the Court would in fairness impose a procedural one that any position relied upon by the IRS that is not described in the notice will be treated as new matter upon which the IRS bears the burden of persuasion.²¹⁸² In effect, the Court simply imposed its historic position on new matters raised by the IRS to positions which were taken but not adequately described in the notice of deficiency.

Just to close the loop on the Explanation Requirement, an argument has been made that a cryptic notice of deficiency explanation that might otherwise pass the standards above may nevertheless violate the APA’s requirement that the agency’s rationale for decision not be made arbitrarily, a requirement that is interpreted to mean that the agency provide a reasoned explanation for its action.²¹⁸³ That argument has not fared well because, the courts hold, the APA requirement is not intended to displace the more specific and robust judicial review (de novo rather than arbitrary and capricious or abuse of discretion) in the Tax Court with respect to notices of deficiency.²¹⁸⁴

c. Procedural Requirements.

(1) The Form of the Notice.

The Code prescribes no particular form for the notice of deficiency. As the courts held early on, “the notice [of deficiency] is only to advise the person who is to pay the deficiency that the Commissioner means to assess him; anything that does this unequivocally is good enough.”²¹⁸⁵

²¹⁷⁹(...continued)

v. *Commissioner*, 475 F.3d 697, 700 (5th Cir. 2007) (“Like our sister circuits, we conclude that a notice of deficiency is valid as long as it informs a taxpayer that the IRS has determined that a deficiency exists and specifies the amount of the deficiency.”). In *QinetiQ U.S. Holdings Inc. v. Commissioner*, 845 F.3d 555 (4th Cir. 2017), cert. den. 583 U.S., 816 (2017), the Court relied significantly upon being able to “discern no prejudice to QinetiQ due to the absence of additional information in the Notice of Deficiency.”

²¹⁸⁰ § 7522(a).

²¹⁸¹ *Est. of Streightoff v. Commissioner*, 954 F.3d 713, 720-721 (5th Cir. 2020) (holding also that the APA does not apply to “previously established special statutory procedures relating to specific agencies,” including the deficiency procedures for the IRS, citing *QinetiQ*).

²¹⁸² *Shea v. Commissioner*, 112 T.C. 183 (1999).

²¹⁸³ 5 U.S.C. § 706(2)(A) (reviewing court may set aside set aside agency action, findings, and conclusions found to be * * * arbitrary, capricious, an abuse of discretion”; see *FCC v. Fox Television*, 556 U.S. 502, 515 (2009) (interpreting this standard as requiring that “an agency provide a reasoned explanation for its action”).

²¹⁸⁴ *QinetiQ U.S. Holdings Inc. v. Commissioner*, 845 F.3d 555 (4th Cir. 2017), cert. den. 583 U.S., 816 (2017) (noting that the review of notices of deficiency in Tax Court is more robust and specific than the APA review and, citing *Bowen v. Massachusetts*, 487 U.S. 879, 903 (1988), and *Hinck v. United States*, 550 U.S. 501, 506 (2007) (given that APA general procedures are not “superimposed on the Internal Revenue Code’s specific procedures for de novo judicial review of the merits of a Notice of Deficiency”).

²¹⁸⁵ *Gregory v. Commissioner*, T.C. Memo. 2018-192, at *21:

As the Court of Appeals for the Second Circuit explained in *Olsen v. Helvering*, 88 F.2d 650, 651 (2d Cir. 1937), “the notice [of deficiency] is only to advise the person who is to pay the deficiency that

(continued...)

As I will note below, the Code and the IRM does state additional items that a notice of deficiency should have, but the failure of a notice to include those items will not invalidate the notice that clearly advises the taxpayer that the IRS has determined a deficiency and intends to assess the deficiency.

(2) The Date to File a Petition.

The 1998 Restructuring Act imposed a requirement that the notice of deficiency state the latest date for the taxpayer to file the Tax Court petition.²¹⁸⁶ The provision is not codified into the Code. It is still the law, however. The courts have held that the IRS's failure to meet this requirement does not render the notice of deficiency fatally defective,²¹⁸⁷ so a taxpayer actually receiving the notice within the ninety day period takes a substantial risk if he or she does not file the petition timely.²¹⁸⁸

Sometimes the date for filing a petition is incorrectly stated on the notice of deficiency. If the date is earlier than the 90-day for filing, the 90-day period will govern; if the date is beyond the 90th date from the petition, the date on the notice will govern.²¹⁸⁹

(3) Taxpayer Advocate Contact.

The notice should advise the taxpayer of the right to contact the Taxpayer Advocate's Office and the location and phone number of the office. § 6212(a). The IRS's form has been changed to meet this requirement, so it is unlikely that it will not be met. If and when this notice is not given, the Courts are split as to whether the notice is valid, depending upon the courts' assessment of whether the defendant is harmed by the failure to give the notice.²¹⁹⁰

²¹⁸⁵(...continued)

the Commissioner means to assess him; anything that does this unequivocally is good enough." More recently, this Court observed that "no particular form is required" for a notice of deficiency "as long as it is a formal communication informing the taxpayer that a deficiency has been determined and stating either the taxable period involved or giving sufficient information that the taxpayer reasonably could not be deceived as to the taxable period." *Smith v. Commissioner*, T.C. Memo. 1979-16, T.C.M. (P-H) para. 79,016, at 79-53 (1979).

²¹⁸⁶ § 3463(a) of the 1998 Restructuring Act. Though not codified, this section of the statutes at large has the force of law. 1 U.S.C. § 112.

²¹⁸⁷ Fatally defective in this sense would mean that, if it were not a notice of deficiency, the Tax Court would have no jurisdiction but, more importantly, the IRS would not have met the requirement of § 6213(a) that a notice of deficiency precede the assessment of the tax and the suspension statute of limitations under § 6503(a)(1) would not apply. If that were the consequence, of course, the statute of limitations may well have expired before the IRS has time correct the problem.

²¹⁸⁸ *Rochelle v. Commissioner*, 116 T.C. 356 (2001), aff'd 293 F.3d 740 (5th Cir. 2002) (timely petition not filed); *Smith v. Commissioner*, 114 T.C. 489 (2000), aff'd 275 F.3d 912 (10th Cir. 2001) (timely petition filed); and *Elings v. Commissioner*, 324 F.3d 1110 (9th Cir. 2003) (timely petition filed).

²¹⁸⁹ *Nutt v. Commissioner*, 160 T.C. ___, No. 10, (Slip Op. at *3) (2023) (Caveat: the opinion says: "If the notice of deficiency specifies a last day for filing a petition that is later than the 90th day, then the deadline by which to file a petition is extended to the date specified. I.R.C. § 6213(a); *Rochelle v. Commissioner*, 116 T.C. 356 (2001), aff'd, 293 F.3d 740 (5th Cir. 2002);" I don't think either authority cited stands for the proposition for which they are cited; I do think that the proposition is correct.)

²¹⁹⁰ Compare *John C. Hom & Assoc. v Commissioner*, 140 T.C. 210 (2013) (notice valid; no prejudice) (continued...)

(4) The Last Known Address Requirement.

The notice must be sent to the taxpayer by certified or registered mail. § 6212(a).²¹⁹¹ The mailing is “sufficient” if sent to the taxpayer’s last known address. § 6212(b). “Sufficient” means that, if notice is so sent, the taxpayer need not have actually received the notice of deficiency.²¹⁹² The Fifth Circuit explained the rationale for this rule:

[t]he statutory scheme . . . provides a method of notification which insures that the vast majority of taxpayers will be informed that a tax deficiency has been determined against them without imposing on the Commissioner the virtually impossible task of proving that the notice actually has been received.²¹⁹³

So, the risk if the notice is sent to the last known address is that the taxpayer for some reason does not receive it, either because the taxpayer has moved or some other reason. In that case, the notice is still valid. If the taxpayer does not then actually receive the notice in time to petition the Tax Court, the taxpayer cannot exercise the right to pre-assessment review of the merits in the Tax Court. (The taxpayer can still judicially contest the merits of the liability in a tax refund suit or, if he did not receive the notice of deficiency and had no other opportunity to contest (a term of art), in a Collection Due Process (“CDP”) Proceeding before Appeals and, failing there, before the Tax Court (see discussion beginning on p. 739).

Consider the following:

Another question in this case is whether the IRS should have exercised diligence and located an additional address for petitioner after the statutory notice of deficiency was returned undelivered. Whether the Commissioner has exercised reasonable care and diligence is a question of fact. The relevant facts are those

²¹⁹⁰(...continued)

and *Marangi v. Government of Guam*, 319 F. Supp. 2d 1179, 1184 (D. Guam 2004) (notice invalid; taxpayer prejudiced).

²¹⁹¹ The IRS may also send a duplicate mailing by regular mail. See *Pagonis v. United States*, 575 F.3d 809, 813 n. 2 (8th Cir. 2009) (“Counsel for the government represented at oral argument that the IRS now goes beyond the requirements of § 6212 and also sends a notice to the taxpayer by regular mail.”)

The IRS should also send a copy by regular mail to the representative on the power of attorney, Form 2848. IRM 4.8.9.11.2(2) (07-09-2013), Power of Attorney.

²¹⁹² See e.g., *Keado v. United States*, 853 F.2d 1209, 1211 (5th Cir. 1988) (“Code does not require that the taxpayer receive the notice of deficiency”); *Pomeroy v. United States*, 864 F.2d 1191, 1192 (5th Cir. 1989) (“The relevant statutes simply require that the deficiency notice be mailed to the taxpayer’s last known address, not that it be received.”). In *Pagonis v. United States*, 575 F.3d 809, 815 (8th Cir. 2009), the taxpayer attacked the system because, she alleged, she did not receive the notice of deficiency. Without receipt of the notice, she alleged, the assessment was like a seizure without due process. The Court responded:

This case, however, concerns the IRS’s assessment of a tax deficiency, which is “little more than the calculation or recording of a tax liability.” *Galletti*, 541 U.S. at 122 [*United States v. Galletti*, 541 U.S. 114, 122-23 (2004)]; see 26 U.S.C. § 6203. *Jones* [*Jones v. Flowers*, 547 U.S. 220 (2006)] does not require additional efforts at notice before the government establishes a tax deficiency, because no deprivation of property has occurred.

I cover below the limited effect of the assessment as a recordation of a tax liability and predicate action to permit use of collection tools, such as levy, but the assessment itself is simply an assessment and not a levy. *Jones*-type issues may be presented in how the IRS uses its collections tools, but the assessment itself does not present those issues.

²¹⁹³ *Jones v. United States*, 889 F.2d 1448, 1450 (5th Cir. 1989).

known before the notice of deficiency was mailed, such as return of letters sent to the taxpayer on earlier dates. In *Pomeroy v. United States*, 864 F.2d 1191, 1195 (5th Cir. 1989), the Court of Appeals for the Fifth Circuit stated: “The relevant statutes simply require that the deficiency notice be mailed to the taxpayer's last known address, not that it be received.” The Code does not require re-mailing the notice, and nothing in the statute suggests that respondent would be obligated to take additional steps to effectuate delivery if the notice is returned. A notice that is returned undelivered is still valid as long as it was sent to the last known address. Thus, respondent was not required to investigate further when the notice of deficiency was returned undelivered.²¹⁹⁴

The Code does not define last known address, but the Regulations based on the substantial case authority in this area does deal in some detail with the last known address requirement.²¹⁹⁵ The regulations state the general rule as follows:

[A] taxpayer's last known address is the address that appears on the taxpayer's most recently filed and properly processed Federal tax return, unless the Internal Revenue Service (IRS) is given clear and concise notification of a different address.²¹⁹⁶

A return is a return such as Form 1040 used to report tax information and liability.²¹⁹⁷ A return for this purpose does not include documents that are not returns, including, for example, Forms 2848 (Power of Attorney and Declaration of Representative) or 4868 (Application for Automatic Extension of Time for File U.S. Individual Income Tax Return) which are not used to update the taxpayer's last known address.²¹⁹⁸

The Rev. Proc. authorized by the Regulations provides the IRS something akin to a grace period stating that a return otherwise processable is considered properly processed generally 45 days, from the date of receipt by the IRS Processing Campus or, if filed earlier than the due date,

²¹⁹⁴ *Blocker v. Commissioner*, T.C. Memo. 2005-279, at *8-*9 (most case citations omitted). See also *Gille v. United States*, 33 F.3d 46, 48 (10th Cir. 1994); *Armstrong v. Commissioner*, 15 F.3d 970, 975 (10th Cir. 1994); and *Frieling v. Commissioner*, 81 T.C. 42, 52 (1983).

²¹⁹⁵ Reg. § 301.6212-2. The regulations were promulgated in 2001, so do not reflect nuance developed in later cases. I try to add some of the nuance in my discussion, with appropriate citations particularly in the footnotes for the sources for the nuance.

²¹⁹⁶ Reg. § 301.6212-2(a), A return is considered properly processed 45 days from the date the return is received by the Submission Processing Campus. Rev. Proc. 2010-16, sec. 5.02(1), 2010-19 I.R.B.

²¹⁹⁷ Rev. Proc. 2010-16, sec. 5.01(1)(a), 2010-19 I.R.B.; see *Gregory v. Commissioner*, 152 T.C. 129, 133 (2019) (using the *Beard* test, *Beard v. Commissioner*, 82 T.C. 766 (1984), aff'd, 793 F.2d 139 (6th Cir. 1986)).

²¹⁹⁸ Rev. Proc. 2010-16, sec. 5.01(4), 2010-19 I.R.B.; *Gregory v. Commissioner*, 152 T.C. 129, 134 (2019) (the Form 4868 instructions warned taxpayers that filing the form will not update their address” and stated that for change of address taxpayers should use Form 8822).

45 days after the day after due date.²¹⁹⁹ Whether or not these “grace” periods are binding on taxpayers in all cases has not been decided.²²⁰⁰

As to what is clear and concise notification in the absence of return notification, the Regulations refer to Rev. Proc. guidance.²²⁰¹ Form 8822, Change of Address is the prescribed form for the notification.²²⁰² Other forms of written, electronic or even oral notification are permitted provided that the change of address is clearly indicated as such (such as where, in response to IRS correspondence the taxpayer returns the correspondence with address correction).²²⁰³ Similar “grace periods” are allowed to the IRS to process the notification of change of address other than by a return.²²⁰⁴

The following types of documents filed with the IRS are not clear and concise notification of a change of address:

- Forms 2848 (Power of Attorney) and 4868 (Application for Extension of Time to File Return), neither of which are returns.²²⁰⁵
- Third party documents filed with the IRS (such as W-2 and Form 1099-NEC) with the taxpayer’s correct address information.²²⁰⁶

²¹⁹⁹ Rev. Proc. 2010-16, sec. 5.02(1) & (2), 2010-19 I.R.B. Actually, the grace period in the Rev. Proc. is a bit more nuanced, with the nuance not important for the text above. The grace period is the later of the following:

- If filed before the due date of the return, 45 days after the day after the due date of the return;
- For certain of the high volume returns filed during filing season (such as Forms 1040, 1040-A, 1040-EZ), on July 16 if filed between February 14 and June 1;
- 45 days after receipt.

²²⁰⁰ For example, if the IRS receives the return 43 days before issuing a notice of deficiency sent to the address other than on that filed return, would a court hold that the notice was sent to the last known address? The issue is important because the consequence of a failure to meet the last known address requirement could be that the IRS statute of limitations on assessment has expired. See e.g., *Williams v. Commissioner*, 2019 U.S. App. LEXIS 35693 (5th Cir. 2019)(unpublished) (because of uncertain facts, the Court determined that it “need not decide whether the Commissioner is automatically entitled to 45 days to process a change-of-address notification based on its Revenue Procedure or whether the regulations and Revenue Procedure entitle the IRS to more time to process notifications.”) See Keith Fogg, Proving Clear and Concise Notification of New Address (Procedurally Taxing Blog 12/24/19).

²²⁰¹ The regulations refer to Rev. Proc. 90-18 “or in procedures subsequently prescribed by the Commissioner.” Reg. § 301.6212-2(a). The IRS has subsequently stated the procedures, with the current version in Rev. Proc. 2010-16, 2010-19 I.R.B. 664.

²²⁰² See Rev. Proc. 2010-16, par. 5.04(1)(a)(c).

²²⁰³ Rev. Proc. 2010-16 par. 5.05(2)-(4). See Additional Actions Are Needed to Further Reduce Undeliverable Mail (TIGTA Ref. No. 2019-40-074 9/11/19), p. 1, noting that the IRS also updates its address information when the taxpayer notifies the IRS in person or by telephone provided all pertinent information is provided and the IRS employee authenticates the taxpayers identity and informs the taxpayer that the address will be used for all purposes or from USPS National Change of Address (“NCOA”) database with information supplied by the taxpayer.

²²⁰⁴ E.g., Rev. Proc. 2010-16, par. 5.02(4) & (5).

²²⁰⁵ *Gregory v. Commissioner*, 152 T.C. 129, 136 (2019). The *Gregory* court noted that under prior IRS practice the Form 2848 could meet the clear and concise notice, citing *Hunter v. Commissioner*, T.C. Memo. 2004-81, but that changes to the instructions and governing Rev. Proc. rendered Form 2848 ineffective to give clear and concise notice of change of address.

²²⁰⁶ Reg. § 301.6212-2(b)(1); see *Blocker v. Commissioner*, T.C. Memo. 2005-279. The key is that the notification must be by the taxpayer to the IRS. Third parties are not authorized to make a change of address notification (continued...)

- The mere return of the properly addressed envelope containing the notice of deficiency with a USPS notation that the mailing was unclaimed, when the IRS has no other evidence that the address was incorrect, does not invalidate the notice.²²⁰⁷

The IRM does require that, if the IRS is aware of more than one address and is uncertain as to which is the last known address, duplicate notices be sent to all known addresses.²²⁰⁸

There are two key nuances here:

First, the Tax Court holds that the mailing of the notice of deficiency to the last known address is not sufficient if “**before** the mailing of the notice of deficiency respondent knew of a change in petitioner’s address and did not exercise due diligence in ascertaining his correct address.”²²⁰⁹ Whether the IRS had sufficient knowledge of a change of address to put the IRS on notice to exercise due diligence is based on facts and circumstances that the IRS personnel involved in determining and issuing the notice knew.²²¹⁰

The rule as I have stated it in the preceding paragraph focuses on the IRS’s knowledge before the mailing. What circumstances **after** the mailing should force the IRS to exercise due diligence with respect to the notice actually sent? The key circumstance would be either the return of the envelope containing the notice indicating an insufficient address or, perhaps, even a failure of the IRS to receive or retain a USPS return receipt acknowledgment from the taxpayer. The statute itself merely requires mailing to the last known address and thus focuses the inquiry upon the knowledge at the time of mailing.²²¹¹ However, in some very limited circumstances, courts will consider failure to receive and retain the return receipt or the return of the document undelivered as putting the IRS on some notice to perform due diligence.²²¹² The IRS further will change its address information if the USPS returns undeliverable mail with its address information on the yellow label affixed which is from the USPS National Change of Address (“NCUA”) database.²²¹³

²²⁰⁶(...continued)

to the IRS.

²²⁰⁷ *Thomas v. Commissioner*, T.C. Memo. 1998-438, aff’d without published opinion, 194 F.3d 1305 (4th Cir. 1999). Unclaimed could mean any number of things other than that the notice was not sent to the last known address in the IRS records.

²²⁰⁸ IRM 4.8.9.8.2.1 (08-11-2016), Last Known Address.

²²⁰⁹ *Taylor v. Commissioner*, 2016 T.C. Memo. 81, at *6 (citing *Keeton v. Commissioner*, 74 T.C. 377, 382; *Alta Sierra Vista, Inc. v. Commissioner*, 62 T.C. 367, 374 (1974), aff’d without published opinion, 538 F.2d 334 (9th Cir. 1976)).

²²¹⁰ *Berg v. Commissioner*, T.C. Memo. 1993-77. For example, if the IRS had correspondence addressed to the “last known address” in its records returned to it, it might be on duty to exercise due diligence before sending as important a document as a notice of deficiency with a specific last known address requirement. *Mulder v. Commissioner*, 855 F.2d 208, 210 (5th Cir. 1988); and *Terrell v. Commissioner*, 625 F.3d 254, 257 (5th Cir. 2010).

²²¹¹ See Lisa Perkins (Guest Blogger), [Returned to Sender: Should the IRS Be Required to Search for A Taxpayer’s New Address Beyond its Own Databases When a Notice is Returned as Undeliverable?](#) (Procedurally Taxing Blog 3/15/18).

²²¹² E.g., *McPartlin v. Commissioner*, 653 F.2d 1185, 1191 (7th Cir. 1981); and *Powell v. Commissioner*, 958 F.3d 53 (4th Cir. 1992).

²²¹³ IRM 1.22.5.13.2 (01-14-2021), Change of Address (COA) (“As provided in Treas. Reg. § (continued...)”).

Second, is the notice valid if the notice is sent to an address other than the last known address but the taxpayer otherwise receives the notice in time to petition the Tax Court? The courts have held that, even if the address would otherwise fail the last known address requirement, the taxpayer's actual or constructive receipt within sufficient time to petition the Tax Court, then the notice of deficiency will not fail.²²¹⁴ The Tax Court explained:

Section 6212(b)(1) provides that a notice of deficiency "shall be sufficient" if it is "mailed to the taxpayer at his last known address." The language of this section is clearly permissive: Congress did not create a mandatory address to which a notice of deficiency must be mailed, but rather provided the Commissioner a 'safe harbor' address to which he could send the notice. By using this safe harbor, the IRS can ensure that a notice of deficiency will be valid regardless of whether the taxpayer actually receives it. The last known address rule thus comes into play when the taxpayer does not receive the notice of deficiency or receives it with insufficient time to file a timely petition for redetermination.

However, a notice of deficiency need not be sent to the taxpayer's last known address in order to be valid. Rather, the notice will be valid if it is actually received by the taxpayer without prejudicial delay, that is, generally in time to file a timely petition in this Court. Actual notice from the IRS to a taxpayer, whether transmitted by certified mail, ordinary mail, or hand delivery, will suffice.²²¹⁵

Focusing on the receipt in time to file a timely petition, the Tax Court has said:

In general, we have held that when a notice of deficiency is actually received by the taxpayer with at least 30 days remaining in the filing period, the taxpayer had sufficient time to petition this Court for review. [Citing cases where the days remaining after actual receipt were: 74, 69, 60, 52, 45, 30, and 30.]

²²¹³(...continued)

301.6212-2(b)(2), an address obtained from the NCOA database becomes the taxpayer's last known address unless the taxpayer provides clear and concise notification of a change of address (as set out in Rev. Proc. 2010-16) or the Service properly processes a taxpayer's federal income tax return with a different address.").

²²¹⁴ E.g., *St. Joseph Lease Capital v. Commissioner*, 235 F.3d 886 (4th Cir. 2001); *Erhard v. Commissioner*, 87 F.3d 273, 274 (9th Cir. 1996) (notice of deficiency is valid if "the taxpayer actually receives the notice, regardless of where the IRS mails the notice"); *Scheidt v. Commissioner*, 967 F.2d 1448, 1450-1451 (10th Cir. 1992); *Borgman v. Commissioner*, 888 F.2d 916, 917 (1st Cir. 1989). See *Sarkassian v. Commissioner*, T.C. Memo. 2012-278 for a good synthesis of cases finding timely actual or constructive receipt sufficient even if the notice was not sent to the last known address; and *Lindstrom v. Commissioner*, T.C. Memo 2007-243 ("It is settled law that the validity of a notice of deficiency will be sustained when mailing results in actual notice to the taxpayer without prejudicial delay.")(internal quotes and citations omitted).

²²¹⁵ *Bongam v. Commissioner*, 146 T.C. 52, 56-57 (2016) (cleaned up). One question that occurred to me is whether, apart from the last known address requirement in § 6212(b), a valid notice of deficiency still requires that it be sent by certified or registered mail. Section 6212(a) says that the IRS is "is authorized to send notice of such deficiency to the taxpayer by certified mail or registered mail." (Emphasis supplied). That language can be read as one authorized way but perhaps not the only way permitted. Hence, as noted in the text, actual timely service of the notice by ordinary mail or by hand will suffice.

However, when a notice was received with only 17 days remaining in the filing period, we held that the taxpayer had insufficient time to petition this Court. Similarly, the Court of Appeals for the Eleventh Circuit held as a matter of law that receipt of a notice of deficiency with only 8 days remaining in the filing period was insufficient to permit the timely filing of a petition.²²¹⁶

Let's explore this issue in a little more detail, however. I set up this discussion by using examples:

Example 1: Taxpayer files his Year 1 return on April 15 of Year 2. The normal three-year statute of limitations applies, making the last day the IRS may assess April 15 of Year 5. On January 1 of Year 5, the IRS sends Taxpayer a notice of deficiency but sends it to an address other than Taxpayer's last known address within the meaning of § 6212(b). The IRS also sends a copy of the notice to Taxpayer's attorney who represented Taxpayer in the audit. Taxpayer's attorney, being a careful sort, routinely forwards a copy of his copy to Taxpayer at this correct address. On February 1 of Year 5, Taxpayer receives a copy of the notice from his attorney.

In Example 1, the taxpayer does receive the notice in time to file a petition. I discuss cases above that hold that the notice will be deemed valid. Only if the taxpayer does not receive the notice of deficiency in reasonable time to petition the Tax Court will the notice be deemed invalid and therefore incapable of meeting § 6213(a)'s requirement that a notice of deficiency precede the assessment. Note in this regard that § 6213(a) requires that before the IRS may assess it must first issue a notice meeting the requirements of all of § 6212 which includes the requirement in § 6212(b) that the notice be sent to the last known address.

Example 2: This example is the same except that the notice is sent toward the end of the three-year period. Taxpayer files his Year 1 return on April 15 of Year 2. The normal three year statute of limitations applies. On April 14 of Year 5, with one day remaining on the assessment period, the IRS sends Taxpayer a notice of deficiency but sends it to an address other than Taxpayer's last known address within the meaning of § 6212(b). The IRS also sends a copy of the notice to Taxpayer's attorney who represented Taxpayer in the audit. Taxpayer's attorney, being a careful sort, routinely forwards a copy of his copy to Taxpayer at his correct address. On May 15 of Year 5, Taxpayer receives the copy of the notice forwarded by his attorney. On July 1 of Year 5, the Taxpayer petitions the Tax Court and promptly moves the Tax Court to dismiss the petition on the basis that, because no valid notice of deficiency was issued (i.e., it was not mailed to the last known address), no valid assessment could be made and therefore the Tax Court proceeding was moot.

The key difference between Example 2 and Example 1 is that Example 2 requires also a suspension of the statute of limitations under § 6503(a), otherwise any assessment would be untimely. Should there be a different result -- i.e., should the taxpayer who receives a notice of deficiency in time to petition the Tax Court timely be able to assert that the statute of limitations was not suspended because the notice of deficiency is invalid? The courts addressing this issue have

²²¹⁶ *Kuykendall v. Commissioner*, 129 T.C. 77 (2007) (case citations omitted).

held that, if the notice is valid by virtue of its actual receipt in time to petition the Tax Court, it is valid for purposes of suspending the statute of limitations under § 6503(a).²²¹⁷

Finally, to state the obvious, the IRS must have timely mailed the notice of deficiency to an address that meets the last known address requirement. The IRS establishes timely mailing by the circumstances of the mailing including internal and USPS records that some envelope was sent and, if a receipt was returned, establishes that the mailed envelope was received. That alone does not establish the contents of the envelope. In those circumstances, the IRS can prove by reasonable circumstantial evidence that the envelope in question included the notice of deficiency.²²¹⁸

(5) Joint Return Liability.

A notice of deficiency sent to spouses filing a joint return “may be a single joint notice.”²²¹⁹ If, however, the IRS has “been notified by either spouse that separate residences have been established,” the notice must be issued in duplicate original “to each spouse at his last known address.”²²²⁰

d. Consequences of Invalidity of the Notice.

If the notice of deficiency is invalid or never sent for any reason, any assessment requiring a notice as a predicate is likewise invalid. This means, for example, if the taxpayer did not receive the notice of deficiency in time to petition the Tax Court because it was not sent to the last known address, he can assert that a subsequent assessment is invalid. However, by statute, notices without the explanation required by § 7522(a) are not invalid (see above). But, in other cases of an invalid notice, the taxpayer will want to invalidate the assessment which required a valid notice of deficiency.

How does the taxpayer do that? First, he or she can ask the IRS kindly to abate the assessment because the notice was invalid. The Form 843, Claim for Refund and Request for Abatement, can be used. But before doing that, the taxpayer should consider whether the statute for assessment (“ASED”) is still open for the IRS to correct the invalid notice by sending a new valid notice; if it is, the taxpayer might consider postponing if possible until the statute is closed. Second, if the IRS refuses to abate or does not act timely, the taxpayer has judicial options.

- The taxpayer can pursue two avenues for Tax Court review. The avenue traditionally pursued is for the taxpayer to file a petition in the Tax Court

²²¹⁷ *St. Joseph Lease Capital Corp. v. Commissioner*, 235 F.3d 886, 888-889 (4th Cir. 2000); *Scheidt v. Commissioner*, 967 F.2d 1448, 1450-51 (10th Cir. 1992).

²²¹⁸ See *Welch v. United States*, 678 F.3d 137 (Fed. Cir. 2012).

²²¹⁹ § 6212(b)(2). It is reported that, even if not notified of separate addresses, the IRS “policy” is to send duplicate notices to each spouse at the same address. Leslie Book, [Tax Court Order Highlights Faulty Stat Notice Issued to Married Taxpayers](#) (Procedurally Taxing Blog 6/7/18). This policy may reflect an uncodified requirement that “wherever practicable, send any notice relating to a joint return under section 6013 of the Internal Revenue Code of 1986 separately to each individual filing the joint return.” 1998 Restructuring Act, § 3201(d).

²²²⁰ *Id.* The use of “his” in reference to each spouse is, of course, a relic where the meaning is clear. This use of his is in other provisions of § 6212 as well.

after the 90 day period has expired.²²²¹ There is no statutory authority for this because a timely filed Tax Court petition is jurisdictional.²²²² But, by established practice, the following procedure will work: (i) after filing the untimely petition, the taxpayer moves to dismiss the petition for lack of jurisdiction because the notice of deficiency was not valid; (ii) the IRS will usually move to dismiss because the notice was valid and the petition was untimely; and (iii) in either event, the Tax Court will dismiss for lack of jurisdiction, but if, in dismissing, the Tax Court finds that the notice of deficiency was invalid, any action—specifically assessment—based on the void notice is void.²²²³ The IRS can then issue a new, valid notice of deficiency if the statute of limitations is still open. Accordingly, timing the untimely petition for this purpose must pay careful attention to whether the statute is still open.²²²⁴

²²²¹ This procedure is described in *Adolphson v. Commissioner*, 842 F.3d 478 (7th Cir. 2016) (in dicta discussing this procedure for improper notices of deficiency in the context of holding why it is not applicable to notices of determination for CDP cases; in support of this procedure in deficiency cases).

²²²² *Hallmark Research Collective v. Commissioner*, 159 T.C. ___ No. 6 (2022).

²²²³ For examples showing the Tax Court procedural moves of cross-motions for dismissal and their consequences, see *Edwards v. Commissioner*, 791 F.3d 1 (D.C. Cir. 2015) (remanding so that the Tax Court could state in the final order of dismissal on which basis it dismissed); and *Estate of Rule v. Commissioner*, T.C. Memo. 2009-309. In *Edwards*, the Court said (p. 6, citations omitted for readability):

Because the basis of dismissal may affect a taxpayer's rights or the IRS's ability to collect taxes owed, it is essential that the tax court clearly state the grounds for its dismissal. If the tax court determines that a notice of deficiency was not properly issued, then the IRS may not assess the deficiency or seek to collect it from the taxpayers. If the statute of limitations has already run, the IRS cannot simply correct its error by issuing a new notice of deficiency. In that event, the taxpayer's liability becomes unenforceable. Alternatively, if the court dismisses the case because the taxpayer did not file a timely petition, the Service is free to assess and collect the tax. Accordingly, the tax court must articulate the basis for its order to inform the parties of the rights and obligations it establishes.

²²²⁴ Practitioners should pay special attention to § 6503(a)(1) parenthetical “and in any event, if a proceeding in respect of the deficiency is placed on the docket of the Tax Court.” The suspension applies during the period that the proceeding is on the docket of the Tax Court awaiting the decision to dismiss, its finality and an additional 60 days. *Shockley v. Commissioner*, 686 F.3d 1228 (11th Cir. 2012). For example, assume the tax return for year 01 was filed on April 15 of year 02. The IRS would generally have 3 years – until April 15 of year 05 – to mail a proper notice of deficiency, but assume that the IRS sends the invalid notice of deficiency on July 1 of year 04, well within the three-year period. The IRS assesses the tax liability on January 3 of year 05. Then on January 10 of year 05, the taxpayer receives the assessment notice and demand. Upon inquiry to the IRS, on March 1 of year 05, the taxpayer obtains a copy of the notice of deficiency and discovers that the notice of deficiency was invalid because not sent to the last known address. If the taxpayer files the untimely petition in the Tax Court immediately (say by March 15 or even by April 15 of year 05, the statute of limitations will be suspended from the date of filing the petition until 60 days after the Tax Court decision becomes final and then will have another 30 days (the period remaining from March 15 to April 15). The IRS will be on notice of the issue and will have ample time to send a valid notice of deficiency before the expiration of the suspension period plus the number. If, however, the taxpayer does not file the untimely petition until April 16 of year 05 or thereafter, the assessment statute will have expired and the suspension required by § 6503(a) cannot revive an expired statute. Note in this regard, that § 6213(a) and § 6503(a)(1) suspend the statute of limitations after issuance of a notice of deficiency for the 9-day period of time required for the taxpayer to file a “timely” petition for redetermination plus 60 days. That suspension, however, would not apply because the notice of deficiency is not valid. Suspension of the statute is not required in the case of an invalid notice of deficiency until the case is placed on the docket of the Tax Court and in the example where that does not occur until the statute has otherwise expired, the
(continued...)

- The taxpayer may file an injunction suit in the district court because both (i) § 6213(a) so provides and (ii) the Anti-Injunction Act, § 7421(a), expressly excepts § 6213(a) from its scope. Either way, the taxpayer if successful obtains a judicial determination that the notice of deficiency was not valid, thus invalidating the assessment predicated on a valid notice of deficiency. Again, however, because of statute suspensions while CDP proceeding, this should be done only after the assessment statute of limitations has expired.
- The taxpayer can pay the tax outside the assessment statute of limitations that would apply without a valid notice of deficiency and pursue a refund remedy to test whether the notice of deficiency and resulting assessment were valid.²²²⁵
- The taxpayer can do nothing and await the IRS taking some collection action permitting access to the Tax Court to contest the validity of the assessment (i.e., via the CDP procedures).²²²⁶
- The taxpayer can do nothing and, if able to avoid payment until the Government feels it must file a collection suit, contest the validity of the assessment in the collection suit.

Merely having an invalid notice will not necessarily carry the day for the taxpayer. To win, the assessment statute of limitations (“ASED”) must have expired by the time the IRS becomes aware of the problem. If the statute is still open when the IRS learns of the problem, the IRS can simply issue a new notice of deficiency.²²²⁷ I previously discussed through the rules for the statute of limitations, and you should be able to figure out the statute of limitations.

For another wrinkle, consider what would happen if the taxpayer extended the assessment statute of limitations with Form 872-A, the unlimited extension. You will recall that this extension is terminated only in one of three ways. In this circumstance, if the notice of deficiency had been valid, it would have terminated the statute of limitations as prescribed in Form 872-A. However, I have posited here that the notice of deficiency is not valid because not sent to the last known address, so the unlimited extension has not been terminated. What is the taxpayer to do? Well, he could send in the termination form, Form 872-T, but if he does that while the 90-day Tax Court

²²²⁴(...continued)

statute suspension cannot revive a lapsed statute of limitations.

²²²⁵ As I note elsewhere, the payment of the tax due and owing during the statute of limitations will not be refunded even if the assessment is made outside the statute of limitations or is not made at all.

²²²⁶ I discuss the CDP Procedure below beginning p. 733, but a case recognizing this procedure is *Hoyle v. Commissioner*, 131 T.C. 197 (2008). If for any reason, the assessment statute of limitations is still open when the issue is raised, the IRS can fix the problem with a new proper notice of deficiency. Section 6330(e)(1) suspends the collection statute but not the assessment statute for CDP proceedings. But, for example, the CDP proceeding may be pursued when the six-year statute (§ 6501(e)) or the unlimited statute (§ 6501(c)(1)) for assessment might be applicable.

²²²⁷ For a cautionary discussion about using the alternative to file a Tax Court petition and move to dismiss, see Andy R. Roberson and Kevin Spencer, *11th Circuit Allows Invalid Notice to Suspend Assessment Period*, 136 Tax Notes 709 (Aug. 6, 2012) where the statute of limitations is still open on the date the Tax Court petition is filed. In the case there discussed, *Shockley v. Commissioner*, 686 F.3d 1228 (11th Cir. 2012), the Eleventh Circuit held that a Tax Court petition filed in response to an invalid notice of deficiency will have the effect of suspending the statute of limitations as of the date the petition is filed. Thus, before filing the petition, the taxpayer will want to make sure the statute has closed.

petition is due, that might alert the IRS as to the problem which may then be fixed by sending a new valid notice and, in any event, would be some evidence that the taxpayer knew of and had likely received the notice of deficiency in time to petition the Tax Court. The taxpayer could send the Form 872-T in when he receives the notice of assessment, because by then he should have some idea that the notice may not be valid and, when the IRS receives the Form 872-T, it will check and see that the tax has been assessed and may think no more of it. It is not at all certain that the mere receipt of a Form 872-T after assessment will alert the IRS to potential problems in the notice of deficiency. The taxpayer can then pursue the remedies noted above when he is sure the assessment statute has otherwise expired.

3. Prohibition on Assessment.

a. General - No Assessments.

If the taxpayer does not petition the Tax Court, the IRS will make the assessment after the 90 (150) day period expires. If the taxpayer petitions the Tax Court for redetermination of the deficiency, the statute of limitations is suspended until the Tax Court decision becomes final but the IRS is not prohibited from the making the assessment after there is an appeal from the Tax Court decision unless the taxpayer files a bond for the tax.²²²⁸

b. Exceptions to Prohibitions on Assessment.

Section 6213(b) contains certain exceptions to the § 6213(a)'s prohibition on assessment without first issuing a notice of deficiency. The principal ones you will encounter are: (1) "mathematical or clerical errors" on the return may be assessed despite the prohibition (see further discussion on p. 659); (2) deficiencies where the taxpayer has signed a written waiver of the prohibition authorized by § 6213(d) (the ones commonly encountered in an income tax setting are Forms 870 and 4549);²²²⁹ (3) improper carrybacks that have previously resulted in refunds may be assessed despite the prohibition;²²³⁰ (4) amounts paid as a tax may be assessed despite the prohibition;²²³¹ and (5) restitution for tax in a criminal tax case which may be assessed despite the prohibition ("restitution based assessment, or "RBA").²²³²

²²²⁸ §§ 6213(a), 6503(a)(1), 7481 and 7485.

²²²⁹ *Lua v. United States*, 843 F.3d 950 (Fed. Cir. 2016). The *Lua* Court noted the Regulation provision that the taxpayer may withdraw the waiver, thus requiring the notice of deficiency "at any time until 'such waiver has been acted upon by the district director and the assessment has been made in accordance with its terms . . .'" Treas. Reg. § 301.6213-1(d) (2016)." The waiver of the restrictions on assessment authorized under § 6213(d) is not the assessment itself; the assessment is a separate act which is authorized by the waiver. *United States v. Kohls*, 2020 U.S. Dist. LEXIS 503 (S.D. Ohio 2019) (citing *Singleton v. Commissioner*, T.C. Memo. 1996-249, *3, n. 3 (1996).

²²³⁰ § 6213(b)(3).

²²³¹ § 6213(b)(4).

²²³² §§ 6201(a)(4) & 6213(b)(5). Certain points: First, normally, tax restitution is not available for Title 26 offenses. However, courts may impose tax restitution for Title 18 convictions, such as the ubiquitous *Klein* / defraud conspiracy under 18 U.S.C. 371(a). In tax cases, in pleading guilty to a Title 26 offense, a defendant often agrees to "contractual" restitution in the plea agreement that the sentencing court then incorporates as a restitution order in the criminal judgment. Or, in imposing sentence for Title 26 offenses, a court may impose restitution as a condition for some benefit (such as supervised release for some period rather than incarceration). Second, tax restitution may be assessable (continued...)

4. Effects of Prepayments and Deposits on Notices.

I noted earlier that interest accrues on deficiencies from the date of the return. During the course of an audit, taxpayers will sometimes want to stop that interest from running. The taxpayer can stop the accrual of interest by sending in an advance payment or a deposit. If the taxpayer sends in a deposit to stop the running of interest, there will still be a deficiency because the taxpayer has not made a payment on the tax liability and the IRS will be required to issue a notice of deficiency which will give the taxpayer the option of litigating in the Tax Court. The deposit mechanism simply stops the accrual of interest to the extent of the deposit. However, if in advance of the IRS's issuance of a notice of deficiency, that taxpayer sends a payment that fully covers the deficiency, the payment will be assessed immediately,²²³³ there will thus be no deficiency and no notice of deficiency. The taxpayer making full payment of the deficiency thus will be precluded from litigating in the Tax Court because, as we have noted, the notice of deficiency is the jurisdictional prerequisite.

²²³²(...continued)

if imposed under Title 18 “if the offense of conviction is based upon a failure to pay a tax imposed under Title 26.” CCN 2011-018 (8/26/11) (Q&A 2). Third, The net effect of these statutory changes to the Code is that the IRS can immediately assess the tax restitution as if it were a tax (the assessment acronymed RBA) and deploy the IRS collection tools for tax assessments. *Carpenter v. Commissioner*, 152 T.C. 202 (2020), aff'd 788 F. App'x 187 (4th Cir. 2019); and *Reynolds v. Commissioner*, T.C. Memo. 2021-10 (also holding that the IRS can collect on the RBA even if the person has an agreement with DOJ for installment payment of the restitution). A predicate notice of deficiency is not required. Fourth, the restitution imposed upon a defendant need not be the defendant's tax; the restitution is treated as a tax and thus assessable as RBA. *Bontrager v. Commissioner*, 151 T.C. 213 (2018). Fifth, a key part of the new statutory scheme is that the taxpayer may not contest the RBA in civil proceedings, § 6201(a)(4)(C). Administratively, the RBA is not a tax assessment but is assessed and collected by IRS collection tools as if it were a tax. This gets a little esoteric, but this means that

- If the IRS believes that more tax, penalties or interest is due than is incorporated in the restitution order and resulting RBA, the IRS must make a regular tax assessment of the underlying tax liability (including the restitution based assessment amount) through the notice of deficiency procedure. See *Klein v. Commissioner*, 149 T.C. 341 (2017); see also *Muncy v. Commissioner*, T.C. Memo. 2017-83, aff'd on other grounds, 890 F.3d 724 (8th Cir. 2018); and CC 2011-018 (8/26/11). If the IRS does proceed by deficiency assessment, the RBA will include some amount also included in the regular tax assessment; the aggregate of the two assessments will be duplicative to that extent. Both assessment amounts are still only one tax liability and the taxpayer must be given appropriate credits against both assessments as the taxpayer pays so that the taxpayer pays the liability only once. For further discussion of these issues see CCN 2019-004 (6/27/19), discussed in Keith Fogg, [Interest and Penalties on Restitution-Based Assessments](#) (Procedurally Taxing Blog 7/31/19).
- If the RBA amount exceeds the actual tax liability, the taxpayer will be unable to get any relief in civil tax proceedings but must request relief from the sentencing court to reduce the amount of the restitution order which will then permit the IRS to abate the amount of the RBA. CC 2011-018 (8/26/11) (Q&A 10). There is a lot of nuance here, so I direct readers to my blog entry at [Tax Court Holds that Restitution Assessments under § 6201\(a\)\(4\) Do Not Permit Tax Interest and Additions](#) (Federal Tax Crimes Blog 10/8/17). The DOJ CTM (Par.44.04) states that restitution can be modified “only in a limited set of circumstances” and “there is no statutory basis to reduce the amount of restitution ordered payable to the IRS based on a claim that the actual tax loss is less than the restitution ordered.
- RBA based on restitution as a condition for supervised release may be collected by the IRS only during the period of supervised release. PMTA 2018-19 (8/23/18); and [The Interplay of Restitution as Condition of Supervised Release and § 6201\(a\)\(4\) Restitution Based Assessment](#) (Federal Tax Crimes Blog 1/19/20).

²²³³ § 6213(b)(4).

However, once the IRS issues the notice of deficiency, the taxpayer can then make full payment without foreclosing his Tax Court remedy.²²³⁴

5. Rescinding Notices of Deficiency.

With the consent of the taxpayer, the IRS may rescind a notice of deficiency.²²³⁵ The IRM cautions IRS personnel to consider the unique facts and circumstances, particularly the statute of limitations implications, in each case.²²³⁶ The IRM provides criteria for rescission as follows: (1) the notice was issued for an incorrect tax amount; (2) the notice was issued to the wrong taxpayer or for the wrong tax period; (3) the notice was issued without considering a properly filed consent to extend the statute of limitations; (4) the taxpayer submits information establishing the tax due is less than the amount shown in the notice (although supplemental deficiency procedures can address the issue); or (5) the taxpayer requests a conference with the appropriate Appeals office, but only if Appeals decides that the case is susceptible to agreement.²²³⁷

I discussed above (p. 484) the opportunity to request an Appeals hearing after the notice of deficiency is issued. That opportunity might be an appropriate procedure to request rescission of the notice of deficiency.

There are special concerns in rescinding a notice of deficiency. Most importantly, if the notice of deficiency is rescinded, the statute of limitations will be determined without any suspension of the statute afforded by a notice of deficiency.²²³⁸ Accordingly, the IRS is unlikely to agree to extend unless there remains sufficient time to do whatever may be required or the taxpayer gives an appropriate consent to extend the statute of limitations.²²³⁹ In addition, the IRS will not rescind if the taxpayer has already filed a petition in the Tax Court.²²⁴⁰

The rescission is effected by an agreement, usually Form 8626, Agreement to Rescind Notice of Deficiency, or some other sufficient writing signed by the IRS and the taxpayer.²²⁴¹

6. Second Notices of Deficiency.

Section 6212(c)(1) bars the IRS from issuing a second notice of deficiency, except in the case of fraud, if the IRS has mailed a notice of deficiency **and** the taxpayer has petitioned the Tax Court. Section 6512(a) provides, in effect, that the Tax Court proceeding is preclusive as to credit

²²³⁴ § 6213(b)(4).
²²³⁵ § 6212(d). The IRS Form used for rescinding a notice is Form 8626.
²²³⁶ IRM 8.2.2.4 (05-29-2014), Statutory Notice of Deficiency Rescinded Under Rev. Proc. 98-54; IRM 8.2.2.4.1 (05-29-2014), Criteria for Rescinding a Statutory Notice of Deficiency.
²²³⁷ IRM 4.8.9.28.1 (07-09-2013), Criteria for Rescinding. See also IRM 8.2.2.4.2 (03-09-2012), Basis for Rescission (providing a different but substantially overlapping categorization for Appeals.)
²²³⁸ § 6503(a). See IRM 4.8.9.28.2 (07-09-2013), Statute of Limitations Considerations Before Rescinding Notice.
²²³⁹ Id.; see also IRM 4.8.9.28.3 (07-09-2013), Other Considerations Before Rescinding.
²²⁴⁰ Id.
²²⁴¹ IRM 4.8.9.28.6.1 (07-09-2013), Rescission Document.

or refund claims that the taxpayer may make.²²⁴² In the case of the income tax, these prohibitions generally close out the year once except to effect the decision that is entered by the Tax Court; the issue presented to the Tax Court when a petition is filed is whether the taxpayer owes a deficiency, owes nothing or is entitled to a refund. This necessarily requires a determination of the taxpayer's correct tax liability for the year. The Tax Court proceeding thus generally will be preclusive as to the year under claim preclusion.²²⁴³ Any matter as to which the IRS has concerns after the taxpayer petitions the Tax Court must be raised affirmatively in the answer or, if raised later, in an amended answer if allowed by the Tax Court in the management of its docket.

There are some exceptions to this general rule prohibiting claims for the year. The fraud exception is perhaps the most important. Claim preclusion for the year (as opposed to an issue resolved) will not bar the IRS from issuing a second notice of deficiency for fraud. § 6212(c)(1) ("except in the case of fraud").²²⁴⁴ Most practitioners will almost routinely advise the taxpayer that the entry of the Tax Court decision will end all matters for the year involved. That is not true for fraud.²²⁴⁵ As a practical matter except in the most unusual of cases, the IRS will not revisit the issue

²²⁴² § 6512(a) provides "no suit by the taxpayer for the recovery of any part of the tax shall be instituted in any court" when "the Secretary has mailed to the taxpayer a notice of deficiency . . . and . . . the taxpayer files a petition with the Tax Court . . . [and] the Secretary has determined the deficiency shall be allowed or made." See also *First Nat'l Bank of Chicago v. United States*, 792 F.2d 954, 955-6 (9th Cir. 1986) (§ 6512 has a 'broad general application [such] that if the taxpayer files a petition with the tax court, the mere filing of the petition operates to deprive the district court of jurisdiction to entertain a subsequent suit for refund," whether or not the issues were actually presented and decided in the Tax Court, saying "It is not the decision which the Tax Court makes but the fact that the taxpayer has resorted to that court which ends his opportunity to litigate in the District Court his tax liability for the year in question."); and *Billhartz v. Commissioner*, 794 F.3d 794 (7th Cir. 2015) (settlement cannot be avoided to obtain refund merely because subsequent events are inconsistent with settlement).

²²⁴³ See *Zackim v. Commissioner*, 887 F.2d 455, 458 (3d Cir. 1989). The history of claim preclusion in the predecessor of the Tax Court is interesting. That original predecessor was the Board of Tax Appeals. Prior to 1926, the appeals to the Board of Tax Appeals were not preclusive; either of the parties could present the issue again in appropriate district court actions (such as refund suit or, presumably, collection action). See *Hemmings v. Commissioner*, 104 T.C. 221, 227-228 (1995) (reviewing this history).

²²⁴⁴ See *Zackim v. Commissioner*, 887 F.2d 455 (3d Cir. 1989); and *Burke v. Commissioner*, 105 T.C. 41, 47 (1995).

²²⁴⁵ Practitioners should at least be curious as to whether the other traditional ways of closing out tax cases will also be subject to some risk that the IRS may seek to open up the year after the closing. Usually, this will be a risk only for fraud because the normal three-year or, where applicable, the six-year statute of limitations will have closed so as to preclude further notices. Fraud has no statute of limitations under § 6501(c)(1). Although there is no refund suit parallel to § 6212(c)(1) that directly denies claim preclusion, there seems to be authority that the IRS can issue a notice of deficiency after a refund suit. See *Hemmings v. Commissioner*, 104 T.C. 221 (1995) (suggesting that there is no such limitation, but holding open the issue that, if the assessment occurred prior to or during the refund litigation, the assessment might be a compulsory counterclaim in the litigation that would foreclose later litigation on the issue). As to administrative closings by way of Form 870-AD and Form 906 Closing Agreement, each of those except from the settlement "fraud, malfeasance or misrepresentation of a material fact." See also § 7121(b). It is not clear whether these exceptions extend only to "fraud, malfeasance or misrepresentation" as inducements for entering of the closing agreement or, on the other hand, can be other "fraud, malfeasance or misrepresentation," specifically in this context a fraudulent return for the year settled in the Form 870-AD or the closing agreement. Certainly, by analogy to § 6212(c)(1), it might be argued that the closing agreement so worded should permit the issues not to be settled, so that, if the issue were still open and the statute of limitations is open (say due to fraud), then the IRS might assert the additional tax and civil fraud penalty. Cf. *Hemmings*. I have to say that I was concerned that claim preclusion might arise in a civil refund suit that actually determined a refund to be due because, from the bottom-line perspective, no
(continued...)

of additional liability for a year in which the Tax Court has rendered a decision. Still, § 6212(c)(1) gives the IRS the possibility of doing so, and the careful practitioner who is aware of a potential fraud problem in a year before the Tax Court that the IRS has not spotted should advise the taxpayer of the potential for the IRS pursuing it even after the Tax Court decision is otherwise final.²²⁴⁶

There are also other exceptions listed in § 6213(b)(1) for mathematical or clerical errors²²⁴⁷ and for termination and jeopardy assessments. And courts may piggyback an exception in certain cases. For example, a court found that an exception for carry-backs is appropriate even though the year to which the carryback is taken has been decided by the Tax Court.²²⁴⁸ From a policy and administration perspective, why did the Court reach that result?

C. Non-Deficiency Cases.

Remember that a deficiency is not required in all cases where the IRS determines that the taxpayer owes additional taxes. The notice of deficiency is required only with respect to taxes imposed by subtitles A and B (i.e., income taxes and estate and gift taxes) and certain types of excise taxes. § 6212(a). This means that the foregoing internal administrative processes (including an opportunity for Appeals Office consideration) could have been followed and, at the end of them, the assessment will be made without a notice of deficiency because the prohibitions on assessment in § 6213(a) apply only to taxes for which a notice of deficiency is required.

In my practice, this type of non-deficiency notice tax most frequently encountered is the responsible person penalty tax under § 6672. Some of the penalties (e.g., tax shelter promoter type penalties) do not require a notice of deficiency. In non-deficiency notice tax cases, the IRS may offer the taxpayer an internal appeal to the IRS Appeals Office before assessment but will make the assessment in any event within the application period of limitations without the taxpayer or person involved having a preassessment and prepayment remedy. The taxpayer will have refund suit remedies in the district courts or the Court of Federal Claims. (As noted below, procedures for partial payment are usually provided to mitigate the harsh effects -- even due process problems -- that might otherwise be encountered if the taxpayer were required to prepay the entire amount of the tax before having a judicial forum to litigate liability for the tax.)

²²⁴⁵(...continued)

refund could be due if the Government had a valid claim for additional tax. However, given the *Hemmings*'s compulsory counterclaim analysis, that may not be the case.

²²⁴⁶ Indeed, as I note later in this book, most Tax Court decisions are agreed decisions signed by counsel for the parties after the Tax Court has resolved all issues which the parties disputed and could not otherwise resolve. One ethical issue that has been presented is whether counsel can sign an agreed decision when that counsel knew that the decision understates the liability because of some item the IRS did not discover.

²²⁴⁷ See p. 659.

²²⁴⁸ *Jefferson Smurfit v. United States*, 439 F.3d 448 (8th Cir. 2006).

II. Jeopardy and Termination Assessments.

A. Introduction to the Issues.

The notice of deficiency procedure, where applicable, plays the central role in affording the taxpayer a prepayment litigating forum. The linchpin to the prepayment remedy is § 6213(a)'s prohibition on assessment. The deficiency cannot be assessed until the Tax Court proceedings are concluded, and the IRS cannot take collection measures until the assessment is made. The system places ultimate collection at jeopardy, for the taxpayer's financial situation can deteriorate between (i) the tax due date or even the later date that the IRS determines the taxpayer owes additional taxes and (ii) the date, after the Tax Court litigation, that the IRS can then assess and collect. What happens if the IRS determines there are additional taxes due and is aware of circumstances that put ultimate collection at jeopardy?

To put this in some perspective, in our fast moving world, it follows inevitably that there is some risk to the fisc inherent in the prepayment litigation system where assessment and collection is deferred. Any taxpayer's situation can change to impact adversely the IRS's ultimate ability to collect any tax found due. Certainly, if the prepayment remedy is to be effective at all, this risk just must be tolerated in most cases. Quite a different circumstance exists, however, where the taxpayer takes deliberate steps to avoid having assets that the IRS can ultimately collect upon.

Example 1 - after the IRS determines the taxpayer owes more taxes and sends the taxpayer a notice of proposed adjustment (the predicate to a notice of deficiency) the taxpayer liquidates all his assets and prepares to move to a country that will not extradite for tax crimes and will not enforce U.S. tax liabilities in its administrative and judicial systems.

Example 2 - a suspected drug dealer is picked up with \$10,000,000 cash. The Government does not have enough proof to pursue forfeiture under the general criminal laws, and the Government knows that, if the cash is returned to the person, it will not be available to pay any tax liability that may be due.

In both cases and other egregious cases, Congress believed that special assessment and collection measures were appropriate. However, because of the serious Constitutional issues inherent in any process whereby the Government summarily seizes assets,²²⁴⁹ the Code sets forth elaborate safeguards -- the Government may assess and collect if collections are in true jeopardy (as defined) but the taxpayer must be afforded a virtually immediate right to a judicial review of the bases for the assessments. The IRM also includes IRS policy statements that these jeopardy and termination assessment procedures are "to be used sparingly and assessment to be reasonable in amount."²²⁵⁰

²²⁴⁹ *Commissioner v. Shapiro*, 424 U.S. 614 (1976); see also *Laing v. United States*, 423 U.S. 161 (1976). Because of the Court's concerns about the constitutional adequacy of jeopardy and termination procedures, Shortly after the cases, Congress enacted elaborate procedures, discussed in this section, to permit prompt review of jeopardy and termination assessments. Steve R. Johnson, Reforming Federal Tax Litigation, 41 Fla. St. U.L. Rev. 205, 230-231 (2013).

²²⁵⁰ IRM 1.2.13.1.27 (01-06-1999), Policy Statement 4-88 (jeopardy assessments); and IRM 1.2.13.1.28 (continued...)

B. Jeopardy Assessments.

Section 6861 allows the IRS to make a jeopardy assessment for the mainstream taxes—income, estate, gift— notwithstanding the prohibition on assessment in § 6213(a),²²⁵¹ if the IRS determines that assessment or collection “when collection of taxes will be endangered if regular assessment and collection procedures are followed and there is neither a voluntarily filed return nor an IRC 6020(b) return prepared by the Service.”²²⁵² The safeguards against abuse of this extraordinary power are set forth in § 7429:

(1) The Chief Counsel or his delegate must approve if there is to be a levy pursuant to the assessment in less than 30 days after the notice and demand for payment.²²⁵³

(2) Prompt administrative and judicial review is available:

(a) Within 5 days of the jeopardy assessment or levy, the IRS must provide the taxpayer a written statement of the basis upon which it was made.²²⁵⁴

(b) The taxpayer may request IRS administrative review within 30 days of being furnished the statement or, if not furnished, the end of the 5 day period.²²⁵⁵

(c) The IRS must then determine:

(1) the circumstances of jeopardy justified the assessment (such circumstances do not mean that economic conditions may not permit a taxpayer to pay after the normal assessments procedures apply; rather, it means some type of special jeopardy usually that the taxpayer can control (e.g., by appearing to intend to put assets beyond the IRS’s ultimate ability to collect, such as by transferring them overseas)²²⁵⁶;

²²⁵⁰(...continued)

(01-06-1999), Policy Statement 4-89 (termination assessments).

²²⁵¹ § 6861 also applies to certain excise taxes. Section 6862 provides summary procedures for jeopardy assessments for “taxes other than income, estate, gift, and certain excise taxes.” I don’t deal with this latter category of jeopardy assessments because, in my practice, I have never encountered them and believe that they are outside the mainstream tax procedure practice.

²²⁵² IRM 5.1.4.2 (03-10-2022), Jeopardy and Termination Assessment Overview. Jeopardy assessments are not the same as “quick assessments,” an internal IRS procedure to implement an assessment when a period of limitations will soon expire. IRM 5.1.4.4 (03-10-2022), Quick Assessment (used when tax is not at risk but assessment statute will expire within 90 days); see also IRM 5.1.4.1.1 (03-10-2022), Background (listing 4 types of assessments outside normal course). The predicate acts for jeopardy assessments are not required for quick assessments, but any other statutory predicate to assessment (e.g., notice of deficiency in the case of tax liabilities requiring a notice of deficiency) is required. See *McCall v. Commissioner*, T.C. Memo. 2009-75 (discussing the difference between quick assessment and jeopardy assessment in a trust fund penalty context).

²²⁵³ § 7429(a)(1)(A).

²²⁵⁴ § 7429(a)(1)(B).

²²⁵⁵ § 7429(a)(2).

²²⁵⁶ Reg. § 1.6851-1(a)(1) providing, in the case of termination assessments but applying also to jeopardy assessments, that collection may be in jeopardy because:

(i) The taxpayer is or appears to be designing quickly to depart from the United States or to conceal himself or herself.

(ii) The taxpayer is or appears to be designing quickly to place his, her, or its property beyond the reach of the Government either by removing it from the United States, by concealing it, by dissipating it, or by transferring it to other persons.

(continued...)

(2) the amount is reasonable (note that the requirement is that it be reasonable, not that it be correct),²²⁵⁷ and

(3) whether any levy is reasonable under the circumstances.²²⁵⁸

(d) The taxpayer then has the right to bring suit in the district court within 90 days after the earlier of (i) the 16th day after requesting the determination in paragraph (2)(b) and (ii) the day of actually being furnished the determination in 2(b).²²⁵⁹ If the matter is already pending in the Tax Court, the Tax Court will have jurisdiction.²²⁶⁰

(e) Within 20 days, the court must make a de novo determination of the same issues the IRS considered under (c) above.²²⁶¹ If the court finds the levy or assessment unreasonable (either in the making or in the amount), it can take such action releasing or abating the levy or assessment as appropriate.²²⁶² In this proceeding the burden of proof is on the IRS as to the reasonableness of making the jeopardy assessment or levy, but, provided the IRS has given the taxpayer a written statement of the basis for the amount of the assessment, the taxpayer then bears the burden of showing that the amount was unreasonable.²²⁶³ Discovery in the proceeding will necessarily be limited because of the limited scope of the issues and the accelerated time frame.²²⁶⁴ Further, because of the extraordinarily short time frame, the case may be presented in summary form without the procedures that might otherwise apply for trials.²²⁶⁵ The district court's decision is final

²²⁵⁶(...continued)

(iii) The taxpayer's financial solvency is or appears to be imperiled.

Paragraph (a)(1)(iii) of this section does not include cases where the taxpayer becomes insolvent by virtue of the accrual of the proposed assessment of tax, and penalty, if any.

In addition, the IRS and the court may consider other factors that may indicate that collection may be in jeopardy, such as possession of large amounts of cash inconsistent with past tax filings or consistent with illegal activity, unusual dissipation of assets, removal and other unusual actions giving rise to an inference to avoid payment of tax that has not yet been assessed. E.g., *Kalkhoven v. United States*, 2021 U.S. Dist. LEXIS 175844 *8 (E.D. Cal. 9/15/21). For most taxpayers, the normal vicissitudes of the economic cycles could make it possible that collection could be in jeopardy in almost any case pre-assessment, but the inference from the cases is those type of normal vicissitudes will not attract a jeopardy assessment.

²²⁵⁷ Reasonable means something more than “not arbitrary or capricious” and something less than “supported by substantial evidence.” *Varjabedian v. United States*, 339 F. Supp. 2d 140, 144 (D. Mass. 2004); see also *Kalkhoven v. United States*, 2021 U.S. Dist. LEXIS 175844, *2-*3 (E.D. Cal. 9/15/21) (citing and quoting *Varjabedian*).

²²⁵⁸ § 7429(a)(3).

²²⁵⁹ § 7429(b)(2)(A). The word “earlier” means just that, so that the suit may be filed upon and after the 16th day period after the request for administrative relief is filed even if the matter is still under consideration by the IRS. See *Fernandez v. United States*, 704 F.2d 592, 593 (11th Cir. 1983); and *Green v. Commissioner*, 121 T.C. 301 (2003). Also, if you parse the language carefully, you will see that either a request for the determination is required for judicial review; this is an exhaustion of administrative remedies requirement (or deemed exhaustion if a timely request is made and a determination is not made in 16 days) that may or may not be jurisdictional, but it must be met. *Abraitis v. United States*, 709 F.3d 641 (6th Cir. 2013).

²²⁶⁰ § 7429(b)(2)(B).

²²⁶¹ § 7429(b)(3).

²²⁶² § 7429(b)(4).

²²⁶³ § 7429(g).

²²⁶⁴ For a discussion of discovery, see Steve Johnson, *Discovery in Section 7429 Proceedings*, 2001 TNT 200-65 (10/16/01). This article also appears as Steve Johnson, *Discovery in Summary Assessment Proceedings*, 32 Tax Practice 129 (11/2/01).

²²⁶⁵ In *Kalkhoven v. United States*, 2021 U.S. Dist. LEXIS 175844, *4 (E.D. Cal. 9/15/21), the court said (cleaned up):

(continued...)

and not reviewable by any other court.²²⁶⁶ Keep in mind that the court determines only whether the assessment is reasonable, not whether it is correct. The taxpayer can litigate actual liability for the tax later.

Note the truly extraordinary time frames involved in this judicial remedy. The taxpayer can be in court as early as 21 days after the jeopardy assessment and/or levy and will have a judicial determination 20 days thereafter. The judicial determination is not as to whether or not the taxpayer owes the tax; the issue is whether or not the IRS acted reasonably. Obviously, in order to act reasonably, the IRS will have to make a persuasive showing to the court that taxes are likely due. But whether taxes are ultimately due is not the issue in the proceeding and it is possible for a court to determine that the IRS acted unreasonably, and the taxpayer still ultimately owes the tax. Or, alternatively, it is possible for the court to determine that the IRS acted reasonably and no taxes are ultimately due. (The latter scenario may not be likely in most jeopardy cases, but it is possible.)

(3) If the IRS has not yet sent the taxpayer a notice of deficiency setting forth the basis for its determination that additional tax is due, it must do so within 60 days.²²⁶⁷ The taxpayer will have an opportunity to petition the Tax Court upon receipt of the notice of deficiency.

(4) The taxpayer may file a bond to stay collection.²²⁶⁸ In most jeopardy situations, this is not practical.

(5) The applicable court may stay sale of any seized property.²²⁶⁹

Consistent with the clear purpose of this provision, the IRS's stated policy is to use this provision sparingly and to make the assessments reasonable in amount.²²⁷⁰ And, given the potentially severe consequences of the jeopardy assessment, courts will exercise their review power to be sure that the IRS has established the foundations for the jeopardy assessment.²²⁷¹

In addition to this remedy, although for obvious reasons, the taxpayer is specifically denied a pre-jeopardy levy collection due process hearing, the taxpayer may obtain a collection due process hearing within a reasonable time after the levy.²²⁷² I discuss the collection due process procedure below beginning p. 733.

²²⁶⁵(...continued)

In conducting this form of summary judicial review the courts may decide the case based on affidavits only and need not conduct an evidentiary hearing. In reaching its conclusion, the court can hear evidence that may be inadmissible in a trial and take into account not only information available to the IRS on the assessment date, but also any other information which bears on the issues before it.

²²⁶⁶ § 7429(f).

²²⁶⁷ § 6861(b).

²²⁶⁸ § 6863.

²²⁶⁹ § 6863(b)(3) and (c).

²²⁷⁰ IRM 1.2.1.5.27 (01-06-1999), Policy Statement 4-88, Jeopardy assessments to be used sparingly and assessment to be reasonable in amount.

²²⁷¹ E.g., *Fumo v. United States*, 2014 U.S. Dist. LEXIS 77082 (E.D. Pa. 2014) (exhaustively reviewing the evidence and holding that the IRS had not met the burden of proving the reasonableness of the jeopardy assessment).

²²⁷² § 6330(f).

C. Termination Assessments.

There are parallel provisions applicable where the tax return is not yet due and hence technically a deficiency could not be determined but there are circumstances which suggest collection of a tax liability is in jeopardy. § 6851.²²⁷³ This section is somewhat differently worded -- i.e., the IRS must determine:

- (1) the taxpayer “designs quickly”
 - (a) “to depart from the United States or to remove his property therefrom”; or
 - (b) “to conceal himself or his property therein”; or
 - (c) “to do any other act (including in the case of a corporation distributing all or a part of its assets in liquidation or otherwise).”
- (2) which act tends “prejudice or to render wholly or partially ineffectual proceedings to collect the income tax for the current or the immediately preceding taxable year unless such proceeding be brought without delay.”

The procedures and remedies are roughly parallel in the authority statute (§ 6851) and are basically the same in the judicial remedy statute (§ 7429). So, not surprisingly, IRS policy here is also to use the assessment authority sparingly and to make the assessments reasonable in amount.²²⁷⁴

There is one oft recurring instance of the use of this termination procedure—when persons depart the U.S. The problem here is that a person could depart the U.S. mid-stream in a year before the tax filing and payment obligation is due after earning substantial income and just walk away from the U.S. tax obligations by not returning to the U.S. The IRS could still assess the tax after it becomes due (say April 15 of the next year), but the ability to collect is diminished greatly. There are two relevant categories of such persons.

- U.S. Citizens. The IRS may waive these requirements and routinely does so unless there is an indication that the departing citizen intends to avoid the U.S. tax obligation.
- Aliens to the U.S. Departing aliens must procure a certificate of income tax compliance from the IRS.²²⁷⁵ The number of aliens departing from the United States is quite large. Certain categories of departing aliens are exempted, such as employees

²²⁷³ IRM 5.1.4.2 (03-10-2022), Jeopardy and Termination Assessment Overview (“Termination assessments are very similar to jeopardy assessments except that, under the provisions of IRC 6851, they are made only for the current or immediately preceding taxable year and can be made at any time prior to the due date for filing those years' returns.”).

There is a parallel provision—§ 6852, Termination assessments in case of flagrant political expenditures of section 501(c)(3) organizations. That provision is a special provision that, from my observation point, is invoked only extremely rarely, if at all.

²²⁷⁴ IRM 5.1.4.2(6) (03-10-2022), Jeopardy and Termination Assessment Overview (citing the need to comply with Policy Statement 4-89, found in IRM 1.2.13.1.28).

²²⁷⁵ § 6851(d); see Reg. § 1.6851-2, titled “Certificates of compliance with income tax laws by departing aliens”; and Pub. 519 (U. S. Tax Guide for Aliens).

of foreign governments or international organizations, certain students and education visitors with no income other than certain categories of income related to education, visitors for pleasure, aliens for business for limited time, and certain others.²²⁷⁶ The IRS may require, before issuing the certificate, that departing aliens file a return for the short taxable year. It is important to consult the regulations for details on these exemptions.

D. Assessments Where Owner of Large Amount of Cash is Unknown.

Section 6867 allows a jeopardy assessment where a possessor of a large amount of cash does not claim ownership and does not identify as owner another readily identified person who claims ownership.²²⁷⁷ In that circumstance, for purposes of making the jeopardy or termination assessment. The cash is presumed to be the gross income of the unknown person for the year in which the possessor has possession and is taxed at the highest rate.²²⁷⁸ The possessor is nevertheless treated as the taxpayer for purposes of the assessment and collection procedures.²²⁷⁹ This means that the termination or jeopardy assessment is against the possessor but may be abated against the possessor when and if the true owner is identified.²²⁸⁰

E. Jeopardy Levies.

Jeopardy levies may accompany jeopardy assessments for reasons that are apparent. But jeopardy levies may occur when the assessments have been made through other processes, including those made after notice of deficiency, if collection is in jeopardy.²²⁸¹ A jeopardy levy requires the same conditions as a jeopardy assessment.²²⁸²

F. Comments on Procedures.

The judicial review procedures are designed only to determine whether the ultimate collection of any tax liability is in jeopardy and such summary administrative procedures are therefore appropriate. The judicial review procedures are not designed to determine finally the

²²⁷⁶ Reg. 1.6851-2(a)(2) lists the exceptions and details. Lawful Permanent Residents having some of the rights and permanence of U.S. citizens are not exempted from these requirements except through the recognized exemptions.

²²⁷⁷ § 6867(a). See IRM 1.2.13.1.27(5)(d) (01-06-1999), Policy Statement 4-88.

²²⁷⁸ § 6867(b).

²²⁷⁹ § 6867(b)(3). As a result, the possessor may bring a Tax Court proceeding. Reg. 301.6867-1(d)(1).

²²⁸⁰ § 6867(b)(3); see Reg. 301.6867-1(c)(2), Example.

²²⁸¹ The conditions for jeopardy levy without a jeopardy assessment are: “(1) after the tax is assessed but before the section 6303 notice and demand for payment is issued; (2) after the notice and demand is issued but before the 10-day period in section 6331(a) has expired; (3) after the 10-day period but before the 30-day notice of intent to levy (section 6331(d)) and notice of a right to a CDP hearing (sections 6320(a) and 6330(a)) have been issued; or (4) after the notice of intent to levy and notice of a right to a CDP hearing have been issued, but before the 30-day period has passed,” CCA 201830013 (2/6/17) (citing IRM 5.11.3.5 (04-03-2013), Forms and Letters for a Jeopardy Levy without a Jeopardy Assessment.

²²⁸² IRM 5.11.3.3 (08-20-2010), Required Conditions for Jeopardy; *Prince v. United States*, 133 T.C. 270, 276-277 (2009)).

amount of any tax that the taxpayer may owe. The taxpayer will have a right later in the process to contest the IRS's determination of tax liability in the standard judicial forums that I discuss elsewhere. For this reason, findings made in the summary judicial proceedings are not fact preclusive in later judicial proceedings where the correct amount of the tax liability is in issue.²²⁸³

²²⁸³ See *Sykes v. Commissioner*, T.C. Memo. 2001-169.

Ch. 10. Litigation.

I. Introduction.

My focus here is civil tax litigation. I do not discuss criminal tax litigation, although I do expect you to know the more commonly encountered tax crimes discussed beginning p. 299. Further, within civil tax litigation, I focus principally on civil tax litigation regarding the merits of whether a taxpayer owes a tax or penalty. There are types of civil litigation where the merits of the underlying tax or penalty liability are not in issue. I will discuss in the collections chapter (Chapter 14) the principle types of litigation affecting the collection function. I cover only key points of tax litigation appropriate for this type of survey text.²²⁸⁴

II. Choices of Courts.

A. United States Tax Court.

1. Introduction.

The United States Tax Court is an Article I court independent of the executive branch of government; the Tax Court only has the judicial powers and jurisdiction conferred upon it by the Code.²²⁸⁵ Most civil tax litigation is handled by the Tax Court.²²⁸⁶ In litigating the merits of a tax liability, taxpayers generally have two other judicial forums—the district court and the Court of Federal Claims where refund suits may be pursued. Overwhelmingly, taxpayers choose to litigate the merits of the liability in the Tax Court either in a deficiency proceeding or in a Collection Due Process (“CDP”) Proceeding because they can litigate the issue of whether and how much they owe the IRS without first paying the tax. In addition, the Tax Court has a range of jurisdiction related to other aspects of the tax system—principally collection matters via its CDP jurisdiction. The combination of these proceedings in the Tax Court make it the principal forum for tax litigation.

Focusing on the issue of whether the taxpayer owes tax and, if so, how much, let’s do a quick review with respect to what is called the Tax Court’s “legacy” jurisdiction since inception—redetermining deficiencies in income tax, estate and gift tax and excess profits tax determined by the IRS,²²⁸⁷ which represent by far the largest category of Tax Court cases.²²⁸⁸ What

²²⁸⁴ For a detailed analysis, see Thomas D. Greenaway, Choice of Forum in Federal Civil Tax Litigation, 62 Tax Law. 311 (2009). For statistics on numbers and dollar amounts in cases in the various forums, see Information from Court Practice and Procedure Programming at ABA Tax Section Meeting Part 2 (Procedurally Taxing Blog 5/26/22).

²²⁸⁵ §§ 7441 and 7442; see *Freytag v. Commissioner*, 501 U.S. 868 (1991). For a good overview of the history and key aspects of the Tax Court, see James S. Halpern, What has the Tax Court Been Doing? An Update, Tax Notes 1277 (May 30, 2016).

²²⁸⁶ See Harold Dubroff & Brant J. Hellwig, The United States Tax Court: An Historical Analysis (2d ed. 2014), available on the U.S. Tax Court site here. For statistics on the various forums for tax litigation, see Information from Court Practice and Procedure Programming at ABA Tax Section Meeting Part 2 (Procedurally Taxing Blog 5/26/22).

²²⁸⁷ James S. Halpern, What has the Tax Court Been Doing? An Update, Tax Notes 1277, 1284 (May 30, (continued...))

is the Code structure that makes the Tax Court a prepayment forum? Section 6213(a) prohibits an assessment before sending a notice of deficiency and, if the taxpayer files a petition to redetermine the deficiency in the Tax Court, further prohibits assessment until the Tax Court decision becomes final.²²⁸⁹ Without an assessment, the taxpayer is not required to pay, and the IRS may not undertake any collection measures. Keep in mind that, particularly as to some large corporate taxpayers, the large corporate underpayment rate of § 6621(c) may give those taxpayers an economic incentive to pay the amount they project they will ultimately owe even while litigating in the Tax Court; but there is no requirement for a prepayment. And the amount the taxpayer will ultimately owe may be quite substantially less than the IRS asserts in the notice of deficiency.

The Tax Court is a national court, meaning that its home base is in Washington, D.C., but Tax Court Judges come out—“ride the circuit,” if you will—to the local areas (usually the larger cities) for trials.²²⁹⁰ For example, in the state of Texas, the Tax Court regularly comes to Houston, Dallas, and San Antonio, and less regularly to cities such as Austin, El Paso and Lubbock. One of the goals of Congress in creating a national tax adjudicatory body (originally labeled the Board of Tax Appeals and now called the Tax Court) was to have a source for a uniform body of precedents.²²⁹¹ I will talk about precedent later in discussing the appeals from the Tax Court and the Tax Court’s *Golsen* rule, but for now in the vast crevices of the tax law where the Tax Court is often the first court to speak, it has filled this function quite well even though Courts of Appeals do take different positions from time to time.

The Tax Court only has bench trials—trials to the Judge without a jury.

The Tax Court has two types of judges. The first is the Tax Court Judge appointed by the President with the advice and consent of the Senate.²²⁹² The Judge has a 15 year term.²²⁹³ These are often referred to as “regular” Tax Court judges. There are 19 slots for regular judges,²²⁹⁴ although one or more may be vacant from time to time. These judges are sometimes re-appointed after the conclusion of their first terms. Those who are not re-appointed take senior status and may be assigned cases to handle as a senior retired judges.²²⁹⁵ The second type of Tax Court Judge is a Special Trial Judge (“STJ”) appointed by the Court to serve somewhat like Magistrate Judges in the

²²⁸⁷(...continued)
2016).

²²⁸⁸ Chief Judge Kerrigan reported at the May 2023 ABA Tax Section meeting that 96% of the 2022 cases filed were deficiency cases. Keith Fogg, Where Have All the Judges Gone (and Other Information from the ABA May Meeting) Part 2(Procedurally Taxing Blog 6/2/23).

²²⁸⁹ This is the deficiency jurisdiction of the Tax Court which was the original basis for jurisdiction in the Tax Court. Over the years, Congress has added other jurisdiction to the Tax Court. Note that the jurisdiction to redetermine the deficiency permits the IRS to test items otherwise in the IRS’s discretion to determine whether the discretion was arbitrarily exercised. See Est of Caan v. Commissioner, 161 T.C. ___, No. 6, *6-*7 (2023).

²²⁹⁰ §§ 7445 & 7446.

²²⁹¹ James S. Halpern, What has the Tax Court Been Doing? An Update, Tax Notes 1277, 1280 (May 30, 2016).

²²⁹² § 7443(b).

²²⁹³ § 7443(d).

²²⁹⁴ § 7443(a).

²²⁹⁵ § 7443(c).

district court system.²²⁹⁶ The STJ may be assigned certain categories of cases, including prominently deficiency cases where the amount in dispute is \$50,000 or less, and CDP cases, and, as a catch all, “any other proceeding which the chief judge may designate.”²²⁹⁷

It will be helpful to present briefly the history of the Tax Court.²²⁹⁸

- The modern income tax was first enacted in 1916,²²⁹⁹ increasing the potential interaction between Treasury (via the IRS) and taxpayers.²³⁰⁰
- In 1924, Congress created the Board of Tax Appeals (“BTA”) as an independent agency in the executive branch.²³⁰¹ The BTA originally had de novo jurisdiction to redetermine deficiencies prior to payment. This jurisdiction was intended to give the taxpayer a prepayment and simpler alternative to traditional tax refund litigation which required the taxpayer to prepay and then to litigate in one of a refund forums (district court or the predecessor to the current Court of Federal Claims) where the litigation procedures might be traps for the unwary. In addition to offering more convenience to taxpayer in contesting tax disputes, the tribunal thus created was intended to serve the need of creating a better and more consistent body of precedent.²³⁰²

²²⁹⁶ § 7443A. See Tax Court Rules 180-183 dealing with STJ’s. In broad strokes, the STJ serves somewhat the same role as magistrate judges in the federal district court system. For some background into how the STJ system has evolved, see *Ballard v. Commissioner*, 544 U.S. 40 (2005), discussed in more detail below. For example, magistrate judges make recommended findings of fact and conclusions of law to which the parties may object, with objections resolved by the district judge. Under the current Tax Court Rules, for most of the cases handled by an STJ, the STJ makes a report which is delivered to the Chief Judge who can either enter the report as the report of the Tax Court or assign the case to a regular judge, in which case the STJ report will be entered as the recommended findings of fact and conclusions of law. Tax Court Rule 182(d). In other cases in which the STJ is assigned, the STJ handles the trial process as a regular trial and makes recommended findings of fact and conclusions of law, which are served on the parties, and, as with the magistrate judge model, the parties may object in which case a regular Tax Court judge may adopt, revise, or recommit to the STJ. Rule 183. If the STJ recommendations are adopted or revised, the recommendations (as revised, if revised) are then the report of the Court. Rule 183(d). On that review, “Due regard shall be given to the circumstance that the Special Trial Judge had the opportunity to evaluate the credibility of witnesses, and the findings of fact recommended by the Special Trial Judge shall be presumed to be correct.

²²⁹⁷ § 7443A(b).

²²⁹⁸ There are a number of good sources for the history. A good source is Harold A. Dubroff & Brant J. Hellwig, *The United States Tax Court: An Historical Analysis* (2d Ed. 2014), which may be viewed and downloaded on the Tax Court website: https://www.ustaxcourt.gov/resources/book/Dubroff_Hellwig.pdf. Other shorter discussions are: Stephanie Hoffer and Christopher J. Walker, *The Death of Tax Court Exceptionalism*, 99 Minn. L. Rev. 221, 229-233 (2014); and James S. Halpern, *What has the Tax Court Been Doing? An Update*, Tax Notes 1277, 1277-1280 (May 30, 2016). The sources for the statements in this paragraph may be found in those sources, so I shall not separately footnote them here except for the more important sources.

²²⁹⁹ Revenue Act of 1916, Pub. L. No. 63-16.

²³⁰⁰ The Revenue Act of 1916 caused only about 15% of American families to pay income tax, but that was much larger than before and but the percentage rose significantly over the next few years. Eric A. San Juan, *From Tax Collector to Fiscal Panopticon: A Social History of a Century of Federal Income Taxation*, 15 Rutgers J.L. & Pub. Pol’y 128, 139 ff. (2018).

²³⁰¹ Revenue Act of 1924, Pub. L. No. 68-176, § 900, 43 Stat. 253, 336-38.

²³⁰² See particularly James S. Halpern, *What has the Tax Court Been Doing? An Update*, Tax Notes 1277, (continued...)

- In 1942, Congress changed the name of the Board to the Tax Court of the United States and formally named the arbiters “judges,” although it remained an administrative agency within the IRS.
- In 1969, Congress reconstituted the Court as “the United States Tax Court” (its current name) and made it an Article I court.²³⁰³
- Throughout the history, the Tax Court and its predecessors functioned like court in the traditional sense, even when it had a different name and constitutional status. After 1969, Congress expanded the types of disputes that the Tax Court could consider. I discuss summarily some of the expanded jurisdiction later in this section but discuss in detail two of the principal expansions in other chapters – innocent spouse jurisdiction in Chapter 12, beginning at p. 758; and Collection Due Process (“CDP”) jurisdiction in considerable detail in Chapter 12, beginning below on p. 733.

2. Tax Court Rules.

As with all federal courts, the Tax Court has procedural rules, the Tax Court Rules of Practice and Procedure (“Tax Court Rules or just Rules), that govern practice in the Tax Court.²³⁰⁴ These Rules are available on the Tax Court website: <https://www.ustaxcourt.gov/rules.html>. These Rules have much in common with the Federal Rules of Civil Procedure applicable in district courts, but vary significantly to address the Tax Court practices and needs. Most importantly, much of the variance is driven by the Tax Court’s origin and desire to make Tax Court practice more user friendly, particularly for taxpayers representing themselves in the Tax Court. But the Rules also address the needs for more sophisticated represented taxpayers, so the FRCP is often a source for Tax Court Rules to manage litigation.

The Tax Court applies the Federal Rules of Evidence applicable in other federal courts.²³⁰⁵

²³⁰²(...continued)
1280 (May 30, 2016).

²³⁰³ Tax Reform Act of 1969, Pub. L. No. 91-172, sec. 951, 83 Stat. 487, 730 (enacting § 7441).

²³⁰⁴ § 7453 requires that proceedings be conducted in accordance with rules of practice and procedure prescribed by the Tax Court. All Tax Court Rules cited in this edition of this book are to the Tax Court Rules in effect at the time of publication. However, on May 23, 2022, the Tax Court proposed amended rules which included new proposed rules and amended rules with substantive and stylistic changes (not changing the substance of the Rule). For the Tax Court Rules cited in this edition, I believe the discussion is consistent with the Rules being stylistically amended; in other words, I do not cite Rules for their substantive amendments. Hence, the Rule references should be correct.

²³⁰⁵ § 7453, as amended in 2015; see Tax Court Rule 143(a). Prior to amendment of § 7453, the section required that the Tax Court apply “the rules of evidence applicable in trials without a jury in the United States District Court of the District of Columbia.” That requirement created the possibility that the D.C. Courts’ interpretations of the FRE might be different than the interpretations of Circuit Courts to which the Tax Court case might be appealed under the Tax Court *Golsen* rule. With the 2015 amendment, in applying the FRE, the Tax Court will look to the interpretations of the Circuit to which the case is appealable under *Golsen*. See generally Joni Larson, [A Practitioner’s Guide to Tax Evidence, Second Edition](#) (ABA 2017); and Joni Larson (Guest Blogger), [Changes to the Rules of Evidence Applied in the Tax Court](#) (Procedurally Taxing Blog 2/17/16).

3. Tax Court Website.

An important resource for taxpayers and practitioners is the Tax Court website. The website contains, for example, the following:

- Tax Court Rules of Practice and Procedure.
- Guidance for Practitioners.
- Information on the Judges.
- Information on fees and charges.
- Docket Entries for Tax Court cases.²³⁰⁶
- New decisions and orders issue on the day (but on the day only, rather than cumulatively for prior orders and decisions, requiring that decisions and orders be accessed through the docket entry for a particular case).²³⁰⁷
- Online Sources Cited in Opinions.²³⁰⁸

4. User Friendly Court.

a. General.

In setting up the predecessor to the Tax Court (the BTA) in the 1920s, Congress had the following specific purposes: (1) a forum for expert and impartial review of tax disputes; (2) a tribunal for a uniform body of tax precedents for aid in future interpretation, and (3) a tribunal that could offer prepayment review.²³⁰⁹ The Tax Court administers cases in a manner that reflects these congressional purposes.

²³⁰⁶ This feature is similar to the docket entries for other courts (such as district courts) available on the Public Access to Court Electronic Records (“PACER”) system. PACER is now a fee based (10 cents per page for documents viewed or downloaded, although the fee requirement may be mitigated or eliminated in the near future) system, but does permit access to all documents in the docket entries except for documents that have been sealed. Unlike PACER, however, in DAWSON, Tax Court filings by parties (such as briefs) are not available and, generally, only orders and decisions are available to the public (other than parties to the case). See Tax Court Rule 27(b).

²³⁰⁷ Prior to implementation of the Tax Court’s website called DAWSON, orders and decisions were available cumulatively and were searchable by certain characteristics (date, judge, etc.) without requiring access to the docket entries. For example, a search could be made for opinions or orders drafted by a particular judge or could be accessed for particular time periods (or combinations of judge and dates). That type of functionality is a rather simple implementation of database features. For scholars and practitioners particularly, these database features were very useful. DAWSON does not have this features, thus requiring that decisions and orders be retrieved by first going to the case docket entries, a clunky and often impractical way to access aggregate information across individual docket entries (such as all opinions by a particular judge).

²³⁰⁸ This feature is, in my opinion, of limited usefulness. All judicial opinions are available online, including non-fee based sources such as CourtListener and Google Scholar, but as of the date last viewed (6/12/22) in preparing this the 2022 editions, only three cases were included for 2022. The description on to the Tax Court page says that it is intended to include only references to permanent URLs actually referenced in an opinion, so I guess it is not intended to include all judicial opinions cited unless the cite also includes the permanent URL. But, I just don’t understand why anyone would think that limited information (only 3 cases to date in 2022) would be useful to taxpayers or practitioners.

²³⁰⁹ James S. Halpern, What Has the Tax Court Been Doing? An Update, Tax Notes 1277, 1279 (May 30, 2016).

b. Small Tax Case Procedure.

Consistent with Congress's goal to make the Tax Court “user-friendly,” in 1969, Congress established a small tax case procedure. § 7463, called the S-Case Procedure. The non-tax world analogy is the small claims court where justice is meted out, quite fairly in the aggregate, with great informality, less stress and less cost (and fewer lawyers!). The S-Case Procedures are in Tax Court Rules Title XVII, called Small Tax Case Rules.²³¹⁰ Key points for the S-Case Procedures are:

- Jurisdiction Amounts at Issue Limits. Where the Tax Court proceeding arises from a notice of deficiency, the taxpayer’s claims as to a disputed deficiency and penalty must not exceed \$50,000 for any one taxable year and, if the taxpayer claims that there is not only a disputed deficiency but there is an overpayment, the claim of the overpayment must not exceed \$50,000 for any one taxable year.²³¹¹ Analogous \$50,000 limits are prescribed for other types of tax liabilities that may be contested in the Tax Court (e.g., innocent spouse claims and collection due process cases).²³¹²
- Simplified pleadings may be used.²³¹³
- For a qualifying case, the taxpayer may request S-Case status in the petition or later upon motion.²³¹⁴
- As in all Tax Court cases, the taxpayer may appear pro se or with any person admitted to practice before the Tax Court.²³¹⁵ I have not seen statistics on this, but I will speculate that probably 90% of S-Cases are handled pro se.
- Pretrial and trial proceedings are much less formal than regular Tax Court proceedings (which are themselves not very formal as compared to district courts). For example, rules of evidence are generally suspended with the only limitation being that the evidence have “probative value.”²³¹⁶ And briefs are not required unless the Court directs.²³¹⁷
- The opinions in the cases are not precedential²³¹⁸ and are not appealable.²³¹⁹
- These cases are usually heard by the Tax Court's Special Trial Judges.

Outside the formal rules applying to S-Cases, there are perhaps two other practical realities that make S-Cases, particularly pro se S-Cases, attractive options for the taxpayer. First, the IRS attorneys generally tolerate a lot more inefficiency and stretch more to get the right result from pro se taxpayers than they would with represented taxpayers. Of course, pro se taxpayers may appear in regular cases as well, but the higher percentage of pro se taxpayers in S-Cases coupled with the

²³¹⁰ Tax Court Rules 170-174. See also IRM 35.1.3.2 (07-24-2012), Small Tax Case Procedures.

²³¹¹ § 7463(a).

²³¹² Unlike the deficiency limit where it is the amount in dispute, the collection due process limit is based on the “unpaid tax.” *Leahy v. Commissioner*, 129 T.C. 71 (2007). See also IRM 35.1.3.2.1 (07-24-2012), Small Tax Case Procedures for Collection Due Process Cases.

²³¹³ T.C. Rule 173.

²³¹⁴ T.C. Rule 170(a) and (c).

²³¹⁵ T.C. Rule 172.

²³¹⁶ T.C. Rule 174(b).

²³¹⁷ T.C. Rule 174(c).

²³¹⁸ § 7463(b).

²³¹⁹ *Id.*

relative informality contributes to IRS attorney working harder to get the right result. I don't have statistics to back this statement, but my anecdotal experience tells me that it is right. Second, some practitioners think that in close cases on the law, the Tax Court judge may be more solicitous to the taxpayer, particularly because the opinion is nonprecedential.²³²⁰

5. Taxpayer Representation.

a. Pro Se.

Taxpayers can represent themselves—"pro se" in litigators' jargon—and receive quality justice in the Tax Court with a minimum of hassle, at least in comparison to hassle encountered in other courts.²³²¹ Pro se taxpayers now comprise over 80% of the Tax Court's docket.²³²² And even represented taxpayers can achieve quality justice in the Tax Court with less procedural hassle—meaning usually less cost—than would ordinarily attend litigating in the other fora for tax cases (the district court or the Court of Federal Claims).

As in other courts, Tax Court judges will not hold pro se taxpayers to the same level of "practice" before the Tax Court that they expect and demand from members of the Tax Court bar (principally attorneys). Thus, pleadings will be more liberally construed.

²³²⁰ See Bryan Camp, Lesson From The Tax Court: The Unwritten Advantage Of Small Case Procedure (Tax Prof Blog 8/10/10) (analogizing the nonprecedential effect to the "Las Vegas rule" that what happens in Las Vegas stays in Las Vegas).

²³²¹ Tax Court Rule 24(b), styled "Representation Without Counsel."
A study based on factors that the authors believe permit measuring results achieved by pro se taxpayers and represented taxpayers in the Tax Court found (1) no measurable difference between pro se taxpayers and represented taxpayers in settled cases (the large majority of cases in the Tax Court) and (2) a measurable difference when the case is tried, with represented parties achieving better outcomes. Leandra Lederman & Warren B. Hrunig, Do Attorneys do their Clients Justice? An Empirical Study of Lawyers' Effects on Tax Court Litigation Outcomes, 41 Wake Forest L. Rev. 1235 (2006). The institutional bias for the IRS attorney in Tax Court cases is to achieve a settlement if at all possible and thus reasonable taxpayers, whether represented or pro se, will settle rather than go to trial. In this settlement process, my observation is that IRS attorneys do not favor represented taxpayers over pro se taxpayers and just want to do the right thing. So, I am not surprised by the conclusions for settled cases. In other words, they do not insist upon settlements in the IRS favor because they think the pro se taxpayer will not go to trial or will be outgunned if he or she does. Cases that do not settle, however, are often the result of unreasonable parties; pro se taxpayers do not have an attorney help them reasonably predict the outcome if they go to trial and thus are more likely to unreasonably force a trial rather than settle. In other words, in the prototypical case going to trial, pro se taxpayers are more likely to bring the losers than represented taxpayers and, of course, even with the IRS attorneys and the courts giving the taxpayers a lot of leeway, pro se taxpayers still will lose more often.

²³²² National Taxpayer Advocate Annual Report to Congress and Related Documents: 2021, p. 195 Figure 3.11 (1/14/22); Keith Fogg, Pro Se Petitions in Tax Court (Procedurally Taxing Blog 2/4/22) (discussing the NTA statistics); and Christine Speidel, Tax Court Practice & Procedure Updates from the 2023 ABA Tax Midyear Meeting (Procedurally Taxing Blog 2/16/23) (also noting that, according to IRS Chief Counsel's statistics, taxpayers self-represented in more than 90% of the cases; the Tax Court and the Chief Counsel's statistics do not match but I don't think that is important for this book).

b. Through Members of the Tax Court Bar.

(1) Attorneys.

Taxpayers can be represented by attorneys who have been admitted to the bar of the Tax Court; admission requires admission to practice before the Supreme Court or the highest court of their local U.S. jurisdiction (state, District of Columbia or any U.S. Commonwealth, territory or possession).²³²³

(2) Tax Court Practitioners (Nonattorneys).

Unlike other courts, nonattorneys can represent taxpayers in the Tax Court if they pass a written examination.²³²⁴ The nonattorney must pass an examination designed to show that “the applicant possesses the requisite qualifications to provide competent representation before the Court.”²³²⁵ The applicant need have no other professional qualifications. The practitioners are referred to as United States Tax Court Practitioners (“USTCPs”).²³²⁶ I don’t think USTCPs constitute many of the practitioners representing taxpayers in the Tax Court; in other words, most represented taxpayers are represented by attorneys.

c. Entering an Appearance; Limited Appearance.

A practitioner admitted to the Tax Court bar (hereafter in this section referred to as “Member”) enters his or her “appearance” to represent the petitioner (taxpayer) by signing the initial petition or, if later, by filing an entry of appearance on the Tax Court Form.²³²⁷ As in litigation in other forums, once the Member takes on the representation, the Member must have the approval of the Tax Court to withdraw. While my experience and observation are that the Tax Court judge will permit withdrawal on good cause shown (including nonpayment of fees), Members should carefully consider the possibility at the inception of the representation that they may not be permitted to withdraw or that withdrawal might be a hassle.

A Tax Court Rule permits Members to enter a Limited Entry of Appearance (“LEA”) for limited representation by an authorized Tax Court practitioner “to the extent permitted by the

²³²³ Tax Court Rule 200(a)(2).

²³²⁴ Tax Court Rule 200(a)(3). § 7452 provides that taxpayer representation in the Tax Court is subject to the rules of practice by the Court but that “No qualified person shall be denied admission to practice before the Tax Court because of his failure to be a member of any profession or calling.” This was explicitly intended to permit nonattorneys to practice, provided that they otherwise meet the requirements of the Tax Court. See also Tax Court Rule 200(a)(3). The requirements include a 4-hour written examination. For a good discussion on nonattorneys authorized to practice in the Tax Court, see Nathan Richman, *A Peek Behind the Curtain at the Tax Court Exam for Non-Attorneys*, 148 Tax Notes 1180 (Sept. 14, 2015). Currently, [t]he exam consists of four sections: Tax Court Rules of Practice and Procedure (25 percent of the test), the Federal Rules of Evidence (25 percent), substantive federal tax law (40 percent), and legal ethics (10 percent) and is described as “notoriously difficult.” *Id.* As of the date of the cited article, there were 250 USTCPs “250 USTCPs in contrast to the 70,000 attorneys currently admitted to the Tax Court bar.” *Id.*

²³²⁵ Tax Court Rule 200(a)(3).

²³²⁶ *Id.*

²³²⁷ The entry of appearance is Tax Court Form 7.

Court.”²³²⁸ The LEA permits a practitioner to enter a practitioner-client relationship with advance agreement that the services are limited in scope and duration less than full representation. The LEA may be used by both pro bono and paid counsel.²³²⁹ The LEA often is used to permit a Member to represent the taxpayer for a specific Trial Session, but does not include representation following that Trial Session.²³³⁰ Thus, for example, the Member can represent the taxpayer at the Trial Session to argue a motion or represent the taxpayer at trial. However, the Member would not be responsible for filing post-trial briefs. Since the Rule permits limited representation to the extent permitted by the Court, presumably upon special motion, a Member could enter an appearance pursuant to terms other than those in the current Tax Court Form for Limited Entry of Appearance. A practitioner filing a limited appearance may terminate it otherwise than pursuant to its terms (called early termination) only by filing a Motion to Withdraw as Counsel.²³³¹

Limited representation occurs frequently with various pro bono programs whereby volunteer lawyers come to Trial Sessions to assist pro se taxpayers who would otherwise not have representation. In the past, the lawyers typically did not enter appearances to represent the taxpayers in the Tax Court and could only informally advise the taxpayers and perhaps interface with IRS counsel in the presence of and with the permission of the petitioner (taxpayer) to possibly reach a settlement or perhaps reach stipulations that permitted more efficient litigation.

d. Standards of Practice; Disciplinary Proceedings.

Members of the Tax Court bar are subject to the normal rules of professional practice including the “letter and spirit of the Model Rules of Professional Conduct of the American Bar Association”²³³² and disciplinary proceedings.²³³³

²³²⁸ Tax Court Rule 24(a)(4)(A); see also Administrative Order No. 2020-03 (May 29, 2020), titled “Limited Entry of Appearance Procedures, Effective June 1, 2020.” The inspiration for the limited representation is Rule 1.2(c), Model Rules of Professional Conduct of the American Bar Association (ABA). I have had no experience with this type of representation since, with semi-retirement, I have not attended the docket calls for Trial Sessions, but I recommend the following for more information: Karen Lapekas (Guest Blogger), Limited Appearance Rule Expands Access to Representation (Procedurally Taxing Blog 3/20/20),

²³²⁹ Christine Speidel, Tax Court Practice & Procedure Updates from the 2023 ABA Tax Midyear Meeting (Procedurally Taxing Blog 2/16/23).

²³³⁰ See the Form titled “Limited Entry of Appearance” on the Tax Court website. By the terms of the Form, the appearance is limited specifically (for example to a specific Trial Session and for certain matters in the Trial Session) and appears by its terms to be no longer applicable once the Trial Session has passed. However, the Firm requires that the person authorized by the limited appearance file a “Notice of Completion.”

²³³¹ Administrative Order No. 2020-03 (May 29, 2020), titled “Limited Entry of Appearance Procedures, Effective June 1, 2020.”

²³³² Tax Court Rule 201(a).

²³³³ Tax Court Rule 202(a).

6. Attorneys for the IRS.

In the Tax Court, the IRS is represented by attorneys from the office of Chief Counsel assigned to the larger operating divisions of the IRS. By contrast, in other courts where tax issues are litigated, the IRS is represented by DOJ Tax. The differences are historical dating to the 1930s.²³³⁴

7. Court of Limited Jurisdiction and Authority; Scope of Review.

a. Jurisdiction and Authority.

The Tax Court is an Article I Court²³³⁵ and is a court of limited jurisdiction²³³⁶ because it exercises only specifically delegated aspects of the judicial power.²³³⁷ Congress has conferred upon the Tax Court power to litigate certain federal tax controversies.²³³⁸ Historically, the principal jurisdiction has been the power to “redetermine” deficiencies in response to an IRS notice of deficiency. § 6214(a).²³³⁹ The Tax Court can also determine overpayments where no deficiency is owed, provided only that a deficiency notice was initially issued so as to confer jurisdiction. § 6512(b)(1). Most Tax Court cases involve this deficiency jurisdiction.²³⁴⁰

²³³⁴ For a general discussion of the history, see Keith Fogg, End of SAUSA Program at Chief Counsel’s Office (Procedurally Taxing Blog 6/3/15), noting that, at the time litigation in other courts was assigned to DOJ and then DOJ Tax, “The DOJ apparently felt that the Tax Court was essentially an administrative agency for deciding disputes that did not need its lawyers to represent the government.”

²³³⁵ § 7441 (“There is hereby established, under article I of the Constitution of the United States, a court of record to be known as the United States Tax Court. * * * * The Tax Court is not an agency of, and shall be independent of, the executive branch of the Government.”).

²³³⁶ The notion that the Tax Court is a court of limited jurisdiction has sometimes been asserted to try to circumscribe the Tax Court’s exercise of powers, such as equitable powers, that courts such as district courts exercise. In *Flight Attendants v. Commissioner*, 165 F.3d 572, 578 (7th Cir. 1999), Judge Posner crisply explained: “The argument that the Tax Court cannot apply the doctrines of equitable tolling and equitable estoppel because it is a court of limited jurisdiction is fatuous. All federal courts are courts of limited jurisdiction.” Hence, although certain equitable powers such as equitable recoupment are not specifically granted the Tax Court, the Tax Court can deploy those concepts in deciding cases within its granted jurisdictions. See e.g., *Estate of Branson v. Commissioner*, 264 F.3d 904 (9th Cir. 2001), discussed p. 256.

²³³⁷ § 7442.

²³³⁸ See generally §§ 7481-7487.

²³³⁹ The jurisdiction to redetermine deficiencies does not include jurisdiction to determine whether a tax deficiency so determined has been properly discharged in bankruptcy. *Ferguson v. Commissioner*, 568 F.3d 498 (5th Cir. 2009) (noting, however, that the Tax Court does have that jurisdiction in a collection due process proceeding under § 6330). Also, the jurisdiction to redetermine deficiencies does not include jurisdiction over the interest on deficiencies. § 6213(a) gives jurisdiction over deficiencies, but § 6601(e)(1), although treating interest generally as a tax, excludes interest from deficiency procedures. See also *Urbano v. Commissioner*, 122 T.C. 384, 4390 (2004) (“We generally lack jurisdiction over issues concerning interest computed under § 6601). Hence, the decision document in a Tax Court deficiency redetermination proceeding will address only the tax and penalties; interest is then calculated by the IRS when the assessment of the deficiencies as redetermined is made. See *United States v. Beane*, 841 F.3d 1273 (11th Cir. 2016); § 7481(c) does give the IRS authority to resolve disputes over interest calculations related to determinations made in the Tax Court proceeding.

²³⁴⁰ *Mainstay Business Solutions v. Commissioner*, 156 T.C. ___, ___ No. 7, slip op. at *2 (2021). Indeed, statistics almost 95% of the cases in the Tax Court are deficiency cases. U.S. Tax Court Budget Justification for Fiscal (continued...)

To redetermine the “deficiency” for the open year before the Tax Court, the Tax Court can look to years that not before the court. § 6214(b). Thus, if in the year before the Tax Court, the taxpayer claims a carryover deduction or credit, the Tax Court can look to the year from which the deduction or credit is carried to determine whether there is really a carryover to the year before the court.²³⁴¹ Example: Assume that the taxpayer claims in year 3 an unused credit carryforward from year 1 and then the IRS disallows the carryover to year 3 because, the IRS asserts, the taxpayer had sufficient unreported tax liability in year 1 to use up the credits in year 1 so that they are not available to carry to year 3. The Tax Court is redetermining the year 1 tax to redetermine properly the tax for year 3, the year actually before the Court.²³⁴² But, although redetermining the tax for year 1, Year 1 is not before the Tax Court for it to enter a decision with respect to the correct tax liability for year 1.²³⁴³

The Tax Court has jurisdiction “to determine whether any additional amount, or any addition to the tax should be assessed, if claim therefor is asserted by the Secretary at or before the hearing or a rehearing.”²³⁴⁴ Merely because it has jurisdiction for such additional amounts does not mean that the Court will exercise the jurisdiction. In managing its docket, the Tax Court, like other courts will require that claims over which it otherwise has jurisdiction be timely asserted.

The Tax Court also has jurisdiction to hear a potpourri of nondeficiency cases specified in the Code.²³⁴⁵ The nondeficiency jurisdiction, invoked by the taxpayer or other person subject to IRS action by some type of IRS notice or denial. Examples of such nondeficiency jurisdiction include

- Collection Due Process (“CDP”) cases under §§ 6320 and/or 6330. CDP cases now represent a high percentage of the cases before the Tax Court. CDP cases are covered beginning p. 744.
- Actions for redetermination of employment status (employment/independent contractor issues, including Section 530 relief) under § 7436.
- Petitions to redetermine a Final Partnership Administrative Adjustment.
- Actions to review a final determination of whistleblower award under § 7623(b).

²³⁴⁰(...continued)

Year 2022, 21 (4/5/21) (percentage for fye 2020).

²³⁴¹ *Hill v. Commissioner*, 95 T.C. 428 (1990).

²³⁴² This rule applies as well in refund suits. *R.H. Donnelly Corp. v. United States*, 641 F.3d 70 (4th Cir. 2011).

²³⁴³ Section 6214(b) provides in relevant part (**bold-face supplied**): “The Tax Court in redetermining a deficiency of income tax for any taxable year . . . shall consider such facts with relation to the taxes for other years . . . as may be necessary correctly to redetermine the amount of such deficiency, but in so doing **shall have no jurisdiction to determine whether or not the tax for any other year . . . has been overpaid or underpaid.**” However, that determination in the year before the Tax Court (year 3 in the example in the text) might be preclusive under principles of claim preclusion (*res judicata*) or issue preclusion (*collateral estoppel*) if the referenced year (year 3 in the example) is ever properly before a court for determination of tax liability. Thus, in the example, if year 1 were still open for the IRS to issue another notice of deficiency, the determinations made as to year 1 in the year 3 Tax Court case may be preclusive as to some or all issues in year 1.

²³⁴⁴ This includes, for example, the § 6651(a)(2) penalty for failure to pay, “where the Tax Court already has jurisdiction to redetermine a deficiency in tax with respect to that return,”

²³⁴⁵ See IRM 35.1.1.2 (06-29-2022), Types of Proceedings (listing in addition to deficiency jurisdiction other grants of jurisdiction summarized in the text above).

- Actions to contest denial of relief from joint liability on a joint return under § 6015(e)

These are just samples. As I discuss the IRS procedures leading to the determinations or other IRS actions giving rise to the case, I will discuss administrative and litigation issues.

Congress has generally declined to confer Tax Court jurisdiction for the plethora of Code assessable penalties unrelated to deficiency notices.²³⁴⁶

Unless otherwise specifically noted, the balance of the discussion of the Tax Court will assume a context of deficiency jurisdiction since that is the type most commonly encountered in a tax practice. The IRS takes some action (for deficiency jurisdiction, a notice of deficiency and for other types of jurisdiction, some type of notice or determination) and the taxpayer or other person subject to the action petitions the Tax Court for determinations or redeterminations that it is authorized to make. The procedures for the various types of jurisdiction may differ because the type of IRS actions being contested differently, but the basic template for the Court's jurisdiction is for the IRS to take action via a written notice to the taxpayer, with the notice being the jurisdictional ticket to the Tax Court permitting the taxpayer to file a petition to contest the action.

With respect to deficiency jurisdiction, a substantial jurisdictional issue arose as to whether the Tax Court had equitable recoupment jurisdiction to mitigate the amount of a deficiency otherwise proper for a year when that deficiency somehow related to an overpayment in a year barred by the statute of limitations. The history of this issue is presented in *Estate of Branson v. Commissioner*, 264 F.3d 904 (9th Cir. 2001) which you read earlier. In summary, the Tax Court assumed for most of its existence (since the 1920s) that it had no such authority and but the Tax Court and the Courts of Appeals re-thought that issue and decided that the Tax Court did have jurisdiction exemplified by *Branson*. Congress amended the Code after the *Branson* decision to provide: "the Tax Court may apply the doctrine of equitable recoupment to the same extent that it is available in civil tax cases before the district courts of the United States and the United States Court of Federal Claims." § 6214(b).

Query whether the Tax Court's equitable jurisdiction is limited to equitable recoupment? That might be one inference from its statutory codification. In *Branson*, however, the Ninth Circuit made the more general statement that the Tax Court had "the authority to apply the full range of equitable principles generally granted to courts that possess judicial powers."²³⁴⁷ I don't think this means that the Tax Court has general equitable jurisdiction such as district courts (e.g., injunctive power), but certainly in the context of, for example, resolving deficiency disputes, the Tax Court is

²³⁴⁶ *Diversified Group, Inc. v. United States*, 841 F.3d 975, 981 n. 3 (Fed. Cir. 2016) (citing *Smith v. Commissioner*, 133 T.C. 424, 430 (2009)).

²³⁴⁷ See *Zapara v. Commissioner*, 652 F.3d 1042, 1045-1046 (9th Cir. 2011) (citing and quoting *Branson*, p. 1046 & n. 11. *Zapara* involved a collection due process case where the Tax Court did justice by forcing the IRS to reduce the tax liability by the amount that the IRS should have been able to realize by selling the assets subject to jeopardy levy at the client's direction under § 6335(f). So, the Tax Court with the blessing of the courts of appeals is feeling its equitable oats.

authorized to do equitable justice as to the tax liability before it just as a district court could do.²³⁴⁸ The Tax Court cannot exercise general equitable jurisdiction to order equitable remedies such as injunctions, but in terms of doing justice with regard to the jurisdiction it does have to redetermine a tax deficiency or order a refund, it may consider equitable concepts that previously might not have been considered.

In considering the Tax Court's or any court's equitable jurisdiction, it is important to distinguish between jurisdictional and nonjurisdictional time limits to bring proceedings. The distinction between the two types of time period requirements is not clear. Historically, most time periods to commence action in the tax context were treated as jurisdictional, thus foreclosing equitable relief for untimely filing,²³⁴⁹ but recent Supreme Court developments beginning outside the tax area and spreading to the tax area have put many tax time limits in play to be considered nonjurisdictional and thus subject to equitable tolling. (I discuss these developments further in the text beginning on p. 181.)

b. Scope of Review.

Related to jurisdiction is the scope of review in the exercise of jurisdiction. The two key standards in this and related administrative determination contexts de novo review and abuse of discretion review.

- **De novo** scope of review means that the court can review all of the evidence, even outside the administrative record, to make its own determination without deference to the agency determination. I earlier discussed deference to agency interpretations

²³⁴⁸ For example, the IRS has jurisdiction to reform documents signed by the IRS and the taxpayer, such as Form 872 extensions of the statute of limitations and Forms 870 waivers on restrictions on assessment. E.g., *Kelley v. Commissioner*, 45 F. 3d 348 (9th Cir. 1995); *Kunkel v. Commissioner*, 821 F. 3d 908 (7th Cir. 2016); and *Woods v. Commissioner*, 92 T.C. 776 (1989). All of these cases involved reformation of a contract (or quasi-contract) between the IRS and the taxpayer. A different issue is presented where the Tax Court has jurisdiction a contract between a taxpayer and a third party, not before the Tax Court, so as to achieve a favorable result for one of the parties before the Tax Court. (I presume that, if viable, the IRS could also seek reformation to achieve a nontaxpayer favorable result.) In *Hoffman Properties II v. Commissioner*, 956 F.3d 832 (6th Cir. 2020), the taxpayer requested that the Tax Court reform a contract between the taxpayer and a conservation organization to achieve the benefit of a conservation deduction. The Court said (p. 835, cleaned up):

What's more, the Tax Court refused Hoffman's request to reform the donation agreement. In the end, it was up to the Tax Court to grant this form of equitable relief. And Hoffman hasn't shown that the court's refusal to do so was an abuse of discretion.

The quote seems to suggest that the Tax Court has that jurisdiction to reform the contract between the taxpayer and a third party. I doubt that. I think that the Tax Court would be limited to applying contract interpretation principles in coaxing, if possible, an interpretation of the contract that might permit a taxpayer to overcome language in the contract, but I don't think it could reform the contract. (In this regard, there might be a fine line indeed between reformation and interpretation.) And to extend this argument, I doubt that a district court in a tax refund suit could reform a contract between the taxpayer and a third party (but confess that is probably more hunch than reasoned and researched conclusion).

²³⁴⁹ *Rubel v. Commissioner*, 856 F.3d 301, 304-06 (3d Cir. 2017); *Matuszak v. Commissioner*, 862 F.3d 192 (2d Cir. 2017); *Guralnik v. Commissioner*, 146 T.C. 230, 237 (2016); *Hauptman v. Commissioner*, 831 F.3d 950, 953 (8th Cir. 2016); *Gray v. Commissioner*, 723 F.3d 790, 793 (7th Cir. 2013); and *Naufflett v. Commissioner*, 892 F.3d 649 (4th Cir. 2018).

of law; de novo review does not displace that type of statutory interpretation deference. Further, burden of persuasion rules which I discuss below may require that the agency determinations apply in the event of the Tax Court's equipoise as to a factual issue; de novo review does not speak to burden of persuasion. Rather, de novo review means that the taxpayer can introduce relevant evidence even outside the administrative record and have the Tax Court consider that evidence in making its own independent determination.

- **Abuse of discretion** scope of review means that the reviewing court determines whether, on the basis of the administrative record before the agency, the agency (IRS here) abused its discretion in making a determination over which the court has jurisdiction.

The question has been raised as to whether and to what extent the Administrative Procedure Act ("APA") judicial review standards apply to Tax Court proceedings. This is a large subject, so I will just introduce the issue here.²³⁵⁰ The APA generally prescribes judicial review of agency actions on an abuse of discretion standard based solely on the administrative record;²³⁵¹ some call this the default APA review or, alternatively the APA default standard of review and the APA default scope of review. The Tax Court's jurisdiction arises because the IRS has taken some predicate action that confers jurisdiction on the Tax Court—e.g., a notice of deficiency for deficiency jurisdiction, a notice of determination for other types of action such as CDP cases, etc. The question is whether, in each form of jurisdiction, the Tax Court's review is de novo or default APA review as to both facts and law. Various facets of this issue seem to have evoked different and inconsistent responses from judges and commentators. In my view, this issue must be considered in the specific context of particular types of jurisdiction assigned to the Tax Court.

For example, no one seems to seriously contest that the **Tax Court's traditional deficiency jurisdiction affords de novo review rather than the APA default review.**²³⁵² For other types of

²³⁵⁰ See James S. Halpern, *What has the Tax Court Been Doing? An Update*, *Tax Notes* 1277, 1285-1286 (May 30, 2016) (Halpern is a Tax Court Judge, thus situated to speak authoritatively, although as he notes in the article, on this issue he is in the Tax Court minority); and Stephanie Hoffer and Christopher J. Walker, *The Death of Tax Court Exceptionalism*, 99 *Minn. L. Rev.* 221 (2014). Most of the statements I make in this paragraph are supported in the authorities thus cited (with, of course, the authorities they cite).

²³⁵¹ 5 U.S.C. § 706(2)(A); *Camp v. Pitts*, 411 U.S. 138, 142 (1973) ("In applying * * * [the] standard [provided in § 706(2)(A)], the focal point for judicial review should be the administrative record already in existence, not some new record made initially in the reviewing court." Although the focus should be on the administrative record, some courts certain "narrow" exceptions which seemed designed to make the record rule function properly. For example, the Ninth Circuit permits consideration of matters outside the administrative record: "(1) if admission is necessary to determine whether the agency has considered all relevant factors and has explained its decision, (2) if the agency has relied on documents not in the record, (3) when supplementing the record is necessary to explain technical terms or complex subject matter, or (4) when plaintiffs make a showing of agency bad faith." *Lands Council v. Powell*, 395 F.3d 1019, 1030 (9th Cir. 2005) (cleaned up).

This standard of review, if applicable, may function like *Chevron* deference with respect to statutory interpretations. Thus, if the IRS in a notice of deficiency asserted an interpretation of the law, the abuse of discretion standard, if it applied, seems to require deference to the IRS interpretation.

²³⁵² My analysis summarily stated, is that the Tax Court was created to handle deficiency jurisdiction and was conceived as an alternative to refund jurisdiction in the district courts which was de novo, although the taxpayer (continued...)

Tax Court jurisdiction, the issue of whether its review is APA (default administrative record rule with abuse of discretion standard) or not may be a live issue. In some cases of jurisdiction, the statute text creating the jurisdiction, properly interpreted will provide the scope of review; in other cases, the default APA abuse of discretion scope of review may apply. Accordingly, other than to state the issue so that students will recognize it, I think it will be most helpful in this text to deal with the issue in the specific context of the Tax Court's jurisdiction that I discuss below or elsewhere in the text.²³⁵³

Sometimes, in some contexts, the Tax Court may conflate the two types of review to create a hybrid scope of review with features of both. For example, the abuse of discretion standard seems to assume that only the administrative record before the IRS will be considered, because the IRS cannot have abused its discretion based on evidence that the taxpayer did not put before the IRS. But the Tax Court has applied the abuse of discretion standard based on new evidence that the taxpayer introduces in the Tax Court proceeding.²³⁵⁴ I think this may be an outlier, but practitioners should be aware of times that it may be deployed.

Finally, if there is to be effective review for abuse of discretion, the agency (IRS here) action must be tested on the basis that the agency articulated and not one that it asserts post hoc. In administrative law this is often referred to as the *Chenery* Rule.²³⁵⁵ An important corollary of the *Chenery* rule is that "If the administrative action is to be tested by the basis upon which it purports to rest, that basis must be set forth with such clarity as to be understandable."²³⁵⁶

²³⁵²(...continued)

was limited to the issues raised in the claim for refund. There is no reason to believe that Congress intended different type of review in the Tax Court. Accordingly, the Tax Court early adopted de novo review for deficiency determinations which was the Tax Court's original jurisdiction. See *Barry v. Commissioner*, 1 B.T.A. 156, 157 (1924) (So, although the Tax Court with deficiency jurisdiction was created (via the predecessor Board of Tax Appeals) before the APA, it should easily avoid the general rule of the APA. In this regard, perhaps this is an application of Justice Oliver Wendell Holmes statement in a famous tax case that "A page of history is worth a volume of logic." *New York Trust Co. v. Eisner*, 256 U.S. 345, 349 (1921). For a more detailed and supported conclusion, see Stephanie Hoffer and Christopher J. Walker, *The Death of Tax Court Exceptionalism*, 99 Minn. L. Rev. 221, 254-256 (2014) (quoting Judge Bybee as concluding in dissent (but not on this issue) that Tax Court de novo review for deficiency jurisdiction may have sub silentio been grandfathered in the APA, *Wilson v. Commissioner*, 705 F.3d 980, 1003 n.3 (9th Cir. 2013),).

²³⁵³ For example, I will discuss the scope of review in the CDP proceedings when I discuss CDP beginning p. 733.)

²³⁵⁴ See *Hinerfeld v. Commissioner*, T.C. Memo. 2019-47, discussed in Bryan Camp, *Lesson From The Tax Court: The Scope And Standard Of Review In CDP Cases* (Tax Prof Blog 11/25/19).

²³⁵⁵ *SEC v. Chenery Corp. (Chenery I)*, 318 U.S. 80 (1943), and *SEC v. Chenery Corp. (Chenery II)*, 332 U.S. 194 (1947). As stated by the Court in *Chenery II*, p. 196: "a reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency."

²³⁵⁶ *Chenery II*, p. 196.

8. Opinions and Decisions.

a. Introduction.

After the case has been submitted (i.e., after trial and post-trial briefing of any issue requiring a trial or after submission on motion for summary judgment), the Tax Court makes a “report” which is the form of a judicial opinion.²³⁵⁷ The opinion must include findings of fact and opinions (i.e., the legal conclusions from the findings of fact).²³⁵⁸ Readers of Tax Court opinions will surely be familiar with the format consisting first of perhaps some introductory statement, then Findings of Fact, and then the opinion or conclusions of law (which often repeat, in summary form, the findings of fact critical to the opinion or conclusions of law).

There is usually a single opinion in a case resolving all open issues for the years before the Tax Court. Sometimes, however, in complex cases, the Court may issue multiple opinions. When all issues have been resolved either by opinion, by stipulation of the parties or by the IRS’s concession of no deficiency for any issues not otherwise stipulated,²³⁵⁹ the Tax Court renders its decision which is the bottom-line redetermination of the amount of the deficiency or overpayment for the years. § 7459. The decision is the Tax Court analog of the final judgment in the district

²³⁵⁷ § 7459(a); see § 7460(a).

²³⁵⁸ § 7459(b).

²³⁵⁹ One way to read § 7459 is that an opinion (called report in the statute) must be rendered in all cases before the decision is entered. See subsections (a) and (b). However, the case can be fully resolved by the parties’ stipulation of issues thus requiring only technical calculation of the tax due, if any, for inclusion in the decision or by the IRS’s unilateral concession of all issues otherwise in dispute. Is an opinion (report) then required although serving no purpose in moving to decision? No, at least generally no. See Order in *Puglisi v. Commissioner* (4796-20, 4799-20, 4826-20, 13487-20, 13488-20, 13489-20) (Nov. 5, 2021), discussed in Bryan Camp, Lesson From The Tax Court: Not Every Decision Comes With An Opinion (Tax Prof Blog 11/15/21) (discussing inter alia *LTV Corp. v. Commissioner*, 64 T.C. 589 (1975) (stating the general rule that, if the Tax Courts accepts an IRS concession fully resolving otherwise disputed issues, the Tax Court may enter a decision without an opinion (report)). Basically, in summary, if the Tax Court accepts the stipulations or unilateral IRS concession that resolves all issues, the Tax Court may enter decision without an opinion on the issues stipulated or unilaterally conceded despite a literal reading of the statute to require report. An opinion in that circumstance would be an advisory opinion, which courts are loathe to render and may even be prohibited from rendering. There may be exceptional circumstances that would permit the Tax Court to reject the stipulations or concessions thus leaving a live issue to resolve by an opinion. To understand how this issue even comes up, a taxpayer is a case otherwise fully resolved by stipulation or concession might want an opinion because the issue may arise in future years and a decision without predicate resolution of the legal issue will not give rise to issue preclusion (collateral estoppel) in a later dispute. *Arizona v. California*, 530 U.S. 392, 415 (2000) (noting that stipulated Tax Court judgments have no preclusive effect unless the court actually reached an adjudication of the merits); and *United States v. Int’l Bldg. Co.*, 345 U.S. 502, 506 (1953) (“[U]nless we can say that [the stipulated Tax Court judgments] were an adjudication of the merits, the doctrine of estoppel by judgment would serve an unjust cause: it would become a device by which a decision not shown to be on the merits would forever foreclose inquiry into the merits.”). More likely, where the taxpayer really fights for an opinion, the taxpayer may have something else going on. In *Puglisi*, the issue conceded by the IRS involved microcaptive tax benefits the IRS was conceding and was continuing to contest against other taxpayers. The IRS allegedly made the concession to avoid a decision because the *Puglisi* case was not a good litigating vehicle for the IRS position on microcaptives. So, recognizing that a more taxpayer friendly litigating vehicle was being lost, other taxpayers with the issue may have encouraged and even funded the *Puglisi* taxpayers to strive for an opinion.

court;²³⁶⁰ the decision closes the Tax Court case and is the action from which an appeal is taken. § 7482.²³⁶¹

b. Tax Court Opinions.

Tax Court opinions are of four types.²³⁶² First, there is the formal opinion (called “reports” in the statute)²³⁶³ of the Court published as T.C. opinions formally published by the Government Printing Office (“GPO”) in Tax Court Reports.²³⁶⁴ Formal opinions may be either division opinions (single judge, sometimes called divisions of the Tax Court) or court-reviewed opinions (like en banc opinions in appellate courts, with opportunity for concurring and dissenting opinions).²³⁶⁵ except that there is no formal procedure for practitioners to request review and there is no oral argument or further briefing beyond that before the single division judge.²³⁶⁶ The opinions are reported by case name with the volume and page number of Tax Court (“T.C.”) reports. For example, one of the more prominent cases for tax procedure practice is *Golsen v. Commissioner*, 54 T.C. 742 (1970), subsequent history omitted.²³⁶⁷ The citation format is the same as other federal cases. Tax Court T.C. opinions are supposed to address the more important issues, at least if the Tax Court has not previously resolved those issues or they otherwise make significant expansions, extrapolations or limitations of prior precedents.²³⁶⁸ Reviewed opinions are a step up in importance over unreviewed

²³⁶⁰ FRCP 54(a) (“Judgment’ * * * includes a decree and any order from which an appeal lies.”).

²³⁶¹ § 7482(a) (giving courts of appeals authority “to review the decisions of the Tax Court.”); see Tax Court Rule 190(a)

²³⁶² See generally Mary Ann Cohen, How to Read Tax Court Opinions, 1 Houston Business and Tax Law Journal 1 (2001).

²³⁶³ § 7460(b) and § 7462. For the history of the use of the term report, see James S. Halpern, What has the Tax Court Been Doing? An Update, Tax Notes 1277, 1280-1281 (May 30, 2016).

²³⁶⁴ § 7462. These are published originally as slip opinions with internal pagination and thereafter (some years later) are published in bound volumes with the final pagination. The Tax Court offers interim pdf volumes called pamphlets that offer that pages as they will appear in the final published volume: <https://www.ustaxcourt.gov/pamphlets.html>

²³⁶⁵ Unlike appellate courts, there is no formal procedure to formally request reviewed opinion review for Tax Court opinions. I have suggested full court review in oral argument in one case (resulting in no full court review but my client getting what the client needed on settlement because the IRS did not want full court review).

²³⁶⁶ See James S. Halpern, What has the Tax Court Been Doing? An Update, Tax Notes 1277, 1280-1281 (May 30, 2016) (discussing the process for division opinions and reviewed opinions; opinions in the technical jargon are “reports” of the court per § 7460(b); all opinions (reports) whether reviewed or not “are reports of the Court and are not reports of individual judges or divisions of the Court.”). Tax Court Judge Halpern also discusses the procedure for the Chief Judge to designate the review of an opinion and other aspects of the procedure for reviewed opinions). Notwithstanding, on one occasion where I thought the Tax Court judge (Judge Wells, as I recall) made an egregiously wrong oral ruling at a pretrial conference, I strongly urged that a precedential T.C. opinion be issue and that, given the importance of the issue, it be a reviewed opinion. The judge was taking my strong urging under advisement when IRS counsel a taxpayer-generous offer to settle (I think because of concern about the issue involved), so we settled without further ado on the precedential opinion.

²³⁶⁷ Aff'd, 445 F.2d 985 (10th Cir. 1971), cert. denied, 404 U.S. 940 (1971).

²³⁶⁸ See Judge Mary Ann Cohen, How to Read Tax Court Opinions, 1 Hou. Bus. and Tax L.J. 1, 7 (2001).

T.C. opinions,²³⁶⁹ reviewed opinions are often accompanied by spirited concurring and dissenting opinions.²³⁷⁰

Second, the Court issues Memorandum Opinions, not officially published (but available on the Tax Court website), which are generally considered less important precedentially because they are not supposed to set new precedent, but rather apply or expand prior precedent or resolve complex fact issues considered so unique as to be of no material precedential value.²³⁷¹ That is the articulated dividing line between regular and memorandum opinions—precedential value. Nevertheless, important issues are resolved in memorandum opinions. Although the Tax Court continues to pay lip service to the proposition that they are not “binding” precedent,²³⁷² in truth Memorandum opinions are frequently cited by the Tax Court and other courts in support of propositions decided in the opinions.²³⁷³ They are thus at least persuasive authority, even if (in the Tax Court’s view) not controlling.²³⁷⁴

²³⁶⁹ Technically, upon original issuance, the unreviewed opinion (called a report) is the report of the division (the particular judge) but becomes the report of the court if the Chief Judge does not direct it for review. § 7460(b). I think the practice is that the division opinion is not issued publicly until the Chief Judge has made the decision not to have it reviewed by the full Tax Court, so that, as a practical matter, it is the report of the Tax Court when it is made publicly available as an unreviewed report.

²³⁷⁰ Reviewed opinions with concurring and dissenting opinions that indicate that the reasoning in the lead opinion was not accepted by a majority of the Tax Court judges present a problem. This is an uncommon occurrence that has some analogs in other court cases with full court review—most prominently in the Supreme Court. What is the precedential value of the lead opinion in such a case? The issue may be the same regardless of court, but the issue may be resolved differently. I won’t get further into the issue, but do encourage readers to the following articles: Kandyce Korotky, All for One, and Five for Sixteen? When the Tax Court’s “Majority” Opinion Isn’t (Procedurally Taxing Blog 4/10/18), which discusses *Coffey v. Commissioner*, 150 T.C. 60 (2018), rev’d 982 F.3d 1127 (8th Cir. 2020), which had a split that left the lead opinion with less than a majority and the imperfect analog in the Supreme Court, *Marks v. United States*, 430 U.S. 188 (1977).

²³⁷¹ See Judge Mary Ann Cohen, How to Read Tax Court Opinions, 1 Hou. Bus. and Tax L.J. 1, 5-8 (2001). The Tax Court says that “memorandum opinions are not binding.” *Huffman v. Commissioner*, 126 T.C. 322, 350 (2006). See also James S. Halpern, What Has the Tax Court Been Doing? An Update, Tax Notes 1277 (May 30, 2016) (“The official position of the Tax Court appears to be that, with respect to memorandum opinions, we are not bound by the doctrine of stare decisis”); and Amandeep S. Grewal, The Un-Precedented Tax Court, 101 Iowa L. Rev. 2065 (2016) (arguing that the Tax Court should abandon its general claim on nonprecedential status, because it cites those opinions frequently).

²³⁷² The Tax Court says that “memorandum opinions are not binding.” *Huffman v. Commissioner*, 126 T.C. 322, 350 (2006).

²³⁷³ James S. Halpern, What Has the Tax Court Been Doing? An Update, Tax Notes 1277, 1287 (May 30, 2016) (Despite the official position, “Tax Court case law, for decades, has simultaneously affirmed a significant persuasive value for memorandum opinions;” Judge Halpern, however, favors “reviving the custom of our not citing memorandum opinions”); and Amandeep S. Grewal, The Un-Precedented Tax Court, 101 Iowa L. Rev. 2065, 2099 (2016) (“As a practical matter, Memo opinions already enjoy ersatz precedential status, given the frequent reliance on them.”). See also *Bardahl Mfg. Co. v. Commissioner*, 24 T.C.M. 1030 (1965), a leading case on the accumulated earnings tax is cited as an example of a memorandum opinion that is frequently cited and relied upon. Mark F. Sommer and Anne D. Walters, Tax Court Memorandum Decisions -- What are they “Worth”, 98 TNT 138-96 (1998).

²³⁷⁴ My comment in the text is influenced by two strains. First is the firestorm created by the original panel decision in *Anastosoff v. United States*. 223 F.3d 898 (8th Cir. 2000), vacated en banc 235 F.3d 1054 (8th Cir. 2000), holding unconstitutional the practice in the Eighth Circuit of issuing unpublished decisions which were not intended to be precedent. But see *Hart v. Massanari*, 266 F.3d 1155 (9th Cir. 2001) (rejecting the *Anastosoff* analysis). The practice rejected in *Anastosoff* or a variation thereof was in place in a number of the circuits. The practice was based on reasons (continued...)

Memorandum opinions have a citation format: *Transupport, Inv. v. Commissioner*, T.C. Memo. 2016-216. The numerical reporting is the year followed by a hyphen and a sequential number starting with 1 for the year of the decision.²³⁷⁵ When those cases are reported by unofficial sources, they may have citations in the format for those unofficial sources but should always have the official Tax Court citation in the format above.

Third, the Court issues Summary Opinions in small tax case proceedings. These opinions have no precedential value²³⁷⁶ and serve only to resolve the particular matter before the court. These opinions are written by the Special Trial Judge before whom the cases were tried.

Fourth, the Tax Court may issue bench opinions where the findings of fact and legal issues can be resolved quickly and orally, by reading the findings and legal conclusions into the record produced as a transcript after the trial or hearing.²³⁷⁷ Such bench opinions do not have precedential effect “except as may be relevant for purposes of establishing the law of the case, res judicata, collateral estoppel, or other similar doctrine.”²³⁷⁸ (Note that res judicata generally refers to claim preclusion which is the more common usage now, whereas collateral estoppel refers to issue preclusion which is the more common usage now; See discussion of claim preclusion (res judicata)

²³⁷⁴(...continued)

analogous to the Tax Court’s decision to issue Memorandum Opinions. Like the Tax Court’s Memorandum Opinions, the court of appeals’ unpublished decisions are easily available to the public via sources like LEXIS and Westlaw and are intended not to be precedential and in some cases not even citable to or by the court deciding them. The *Anastasoff* decision was vacated for reasons unrelated to the merits of the constitutional holding. However, the issue which had percolated before the original *Anastasoff* holding heated up afterwards and has resulted in a change to the Federal Rules of Appellate Procedure permitting the citing of appellate opinions designated “unpublished,” “not for publication,” “non-precedential,” “not precedent,” or the like. FRAP Rule 32.1; see for a good succinct discussion, Peter A. Lowy, Juan F. Vasquez, Jr., and Jaime Vasquez, Citing Unpublished Opinions in Tax Court Proceedings, 114 Tax Notes 171 (Jan. 15, 2007) and 2007 TNT 11-52 (1/16/07). Second, Memorandum Opinions (like unpublished circuit court opinions) are still opinions in actual litigated cases and may be persuasive. Thus, hearkening back to the issue of the appropriate deference to be given administrative determinations (the *Chevron / Mead* issue), certainly decisions in actual decided cases should be given something like *Skidmore* deference rather than being nothing except to the parties involved in the actual case.

²³⁷⁵ Since the year is provided within the citation itself, it is not necessary to put the year at the end as is typically done in citing cases from most reporters where the year is not otherwise indicated.

²³⁷⁶ § 7463(b).

²³⁷⁷ § 7459(b) (statutory requirements are “met if findings of fact or opinion are stated orally and recorded in the transcript of the proceedings.”); see Tax Court Rule 153. For an explanation of the process, along with statistics as to the frequency of its use, see T. Keith Fogg, Tax Court Decisions “Shall Be Made As Quickly As Practicable” -- A Discussion of Bench Opinions, 17 J. Tax Prac. & Proc. 41 (Feb-March 2015); and Andy Grewal, The Un-Precedented Tax Court: Bench Opinions (Procedurally Taxing Blog 5/19/15). A more recent statistical study indicated that judges issued only 112 bench opinions in the one-year study period (4/15/17 to 1/1 5/18), of which 26 were “Designated Orders.” Patrick Thomas (Guest Blogger), Designated Orders: 10/15 – 10/19/2018 and Statistics from the Project’s First Year (Procedurally Taxing Blog 11/8/18). The suggestion is that bench opinions may be underutilized as a tool for dealing with an overloaded docket. See also Keith Fogg, Innocent Spouse Bench Opinion – Part II (Procedurally Taxing Blog 11/4/22). For an example of a long bench opinion that (I suspect) was actually written by the judge and read into the record (and thus could have been done by unpublished order), see *Cross Refined Coal, LLC v. Commissioner* (T.C. Dkt. No. 19502-17, order dated 8/29/19 with transcript stating “oral findings of fact and opinion” rendered at the trial session).

²³⁷⁸ Tax Court Rule 153(c).

and issue preclusion (collateral estoppel) below beginning p. 648.) Bench opinions are not published by the Court in the T.C. or T.C.M. formats but are entered by the Court as Orders.

A controversy erupted over the process whereby opinions drafted by Special Trial Judges (STJs) in cases other than small tax cases²³⁷⁹ are reviewed and adopted by the Tax Court as its opinion. The process was that the STJ would hear the testimony, review the exhibits and otherwise conduct trial proceedings just as any other trial judge. The STJ would then draft an opinion. Within certain categories of cases and subject to authorization by the Court, the STJ opinion is then the opinion of the Tax Court.²³⁸⁰

In other cases, the STJ opinion is reviewed and adopted by a regular Tax Court Judge, subject to any changes the regular Tax Court Judge makes or requires the STJ to make. As it then interpreted its rules, the Tax Court treated the STJs' initial opinions to the regular Tax Court judge as advisory and not as public documents available even to the parties. The public and the parties would not know if the final opinion entered by the Court contained any changes by the Tax Court regular judge. (By contrast, the district court's magistrate judges, a conceptual analog to STJs, routinely release their opinions and any changes made by the district judges are easily discerned by the parties and the interested public.) Perhaps the most sensitive area in which such "secret" changes are important is with respect to findings influenced by credibility issues. In the only released opinion (the one finally approved by the Tax Court Judge after any changes he or she requires are incorporated), the Tax Court Judge who did not actually hear any witness conceivably could make witness credibility fact findings different than the STJ who did hear the witnesses. Thus, in a case where civil fraud is an issue (for penalty and statute of limitations purposes), the STJ who hears the witnesses (e.g., the taxpayer, the accountants and lawyers who advised the taxpayer, etc.) may make a finding that the taxpayer's return reporting position was not attributable to fraud. Then, it is conceivable that a Tax Court Judge on review of the bare record (including a transcript of the testimony which, of course, excludes demeanor testimony that is so important in the truth finding process) might determine that the taxpayer's return reporting position was fraudulent and change the STJ's draft opinion to include the finding of fraud.

In *Ballard v. Commissioner*, 540 U.S. 44(2005), the Supreme Court held that the Tax Court Rules, properly interpreted, do not permit the STJ draft opinion to be kept secret, so that the parties will be able to determine what changes, if any, are made by the regular Tax Court Judge. The Supreme Court was clearly influenced in reaching that interpretation by the serious potential due process issues that might be presented if the Tax Court Rules were interpreted to allow the practice that the Tax Court had adopted.²³⁸¹

²³⁷⁹ § 7443(a). For a discussion of the role of Special Trial Judges, see Kathleen Pakenham, *You Better Shop Around: The Status and Authority of Specialty Trial Judges in Federal Tax Cases*, 2004 TNT 120-42 (6/9/04).

²³⁸⁰ § 7443(c).

²³⁸¹ One of the significant issues chewed on by Justice Rehnquist in *Ballard* was the proper deference to be given to the Tax Court's own interpretation of its Rules to allow the practice it had adopted of keeping the STJ drafts secret. This raises in a judicial setting the deference issue presented in an administrative setting in *Chevron* and *Mead* discussed earlier. For further discussion on that issue (if not enlightenment), see the opinions in *Ballard*, although Justice Rehnquist's dissenting opinion (joined by Justice Thomas) is the only opinion directly addressing the issue.

In response to *Ballard*, the Tax Court changed its practice to make it more in line with the U.S. Magistrate model. Generally, the STJ either makes the decision of the Court in certain types of cases or makes recommended findings of fact and conclusions of law that are served on the parties and submitted to the Court for such changes as deemed appropriate.²³⁸² In any event, the action of the STJ is available to the parties and the public.

Another Tax Court case document of potential importance is designated simply “Order.” A court may resolve disputed issues by some type of document such as bench opinions dictated for typing in the transcript or written—in any number of ways short of what is formally designated as an opinion. These are usually in documents nominated “Orders.” The Orders in a case are available on the current web site through the Case docket entries. Prior to the Tax Court’s adoption of a new web site format in December 2020, the “Orders” were available on the Tax Court’s web site separate from the docket entries in a searchable database, with a subset of orders published daily as “Designated Orders.”²³⁸³ The designation status was determined by the judge issuing the order, presumably because the judge felt that there is something in the order that should be called to the attention of practitioners. Although the Tax Court Rules say that Orders are not precedential,²³⁸⁴ sometimes, the Orders (and particularly the Orders previously categorized as Designated Orders) offer practitioners important insight into particular Judge’s thinking on substantive and procedural issues. The easy access to such orders was a feature of the prior Tax Court website (before December 2020), but are not available in the new Tax Court website, called DAWSON. As of this publication, all Orders (without designation), are available on the Tax Court web site on the date issued or through the docket entries for each individual case. The Designated Orders feature is not currently available; I am aware of no expectation that it will be resumed.

If, in a deficiency proceeding, the Tax Court has jurisdiction and the case is not adjudicated on the merits, a dismissal of the proceeding (say, on motion of the petitioner) will constitute a decision that the amount determined by the IRS in the notice of deficiency is correct. § 7459(d).²³⁸⁵ (In nondeficiency Tax Court cases, the statute may not compel a decision on the merits and thus permit the taxpayer to dismiss (or withdraw) without prejudice.)²³⁸⁶ One key exception in

²³⁸² Tax Court Rule 182 & 183.

²³⁸³ After appearing daily as designated orders, at this time, there is no other way for the practitioner to determine which orders in the searchable database are designated. See Patrick Thomas (Guest Blogger), Designated Orders: 10/15 – 10/19/2018 and Statistics from the Project’s First Year (Procedurally Taxing Blog 11/8/18). I would expect this to change in anticipate upgrades to the Tax Court’s web site for document access.

²³⁸⁴ Tax Court Rule 50(f). Indeed, the orders have this banner across the top of the first page: “Pursuant to Tax Court Rule 50(f), orders shall not be treated as precedent, except as otherwise provided.”

²³⁸⁵ *Estate of Ming v. Commissioner*, 62 T.C. 519, 522-523 (1974). The result is that the taxpayer may not withdraw a petition to avoid a decision on the merits as indicated in the statute.

The same is true for transferee liability petitions because transferee liability is “assessed, paid, and collected in the same manner and subject to the same provisions and limitations” as a deficiency in tax” (§ 6501(a)), thus invoking the procedures, including § 7459. *Schussel v. Commissioner*, 149 T.C. 363 (2017).

²³⁸⁶ *Wagner v. Commissioner*, 118 T.C. 330 (2002) (CDP case); *Davidson v. Commissioner*, 144 T.C. 273 (2015) (stand-alone § 6015(e) innocent spouse case); *Jacobson v. Commissioner*, 148 T.C. 68 (2017) (whistleblower case); *Mainstay Business Solutions v. Commissioner*, 156 T.C. ___ No. 7 (2021) (abatement of interest case); and *Pugh v. Commissioner*, 161 T.C. ___, No. 2 (2023) (passport revocation case).

deficiency cases is a Tax Court dismissal for lack of jurisdiction which is not a decision on the merits of the deficiency.²³⁸⁷

c. Decisions.

In deficiency cases, the decision in a case is the final dollar determination of the deficiency (if any), the overpayment (if any), and the amount of any penalties that the Court approved. It is basically equivalent of a dollar judgment in district court. The decision is the document from which review in the Courts of Appeals may be sought.²³⁸⁸

In most cases, the parties are able to compute the dollar amounts for entry in the decision of the Court based upon the Court's determinations in the case (including a Rule 155 proceeding if necessary to compute the dollar amounts). That will permit the parties to submit an agreed or stipulated decision to the Court. In many cases, the parties will include in the document certain stipulations not necessary to the decision below the line for the Court's signature (these are referred to as "below-the-line stipulations"). For example, a common stipulation is that "effective upon the entry of this decision by the Court, petitioner waives the restrictions contained in I.R.C. § 6213(a) prohibiting assessment and collection of the deficiency (plus statutory interest) until the decision of the Tax Court becomes final."²³⁸⁹ There often are other below-the-line stipulations in decision documents binding on the parties but not part of the Court's determinations in the decision documents depending upon the needs of the case.²³⁹⁰

²³⁸⁷ § 7459(d) ("An order specifying such amount shall be entered in the records of the Tax Court unless the Tax Court cannot determine such amount from the record in the proceeding, or unless the dismissal is for lack of jurisdiction."). The classic instance of dismissal for lack of jurisdiction is an untimely filed deficiency redetermination case.

²³⁸⁸ § 7482.

²³⁸⁹ E.g. *Hill v. Commissioner*, 64 F. 4th 1240, 1246 (11th Cir. 2023).

²³⁹⁰ E.g., *Hill v. Commissioner*, 64 F. 4th 1240, 1246, 1251-1252 (11th Cir. 4/10/23).

9. Tax Court Pleadings and Other Filings.

a. Petition and Related Filings.

A Tax Court case is started by the taxpayer filing a petition with the Tax Court for a redetermination of the deficiency within the ninety day period. § 6213(a).²³⁹¹ If an action that could have been filed in the Tax Court is erroneously filed in the district court or the Court of Federal Claims which thereby lacks jurisdiction, in the interest of justice, the court may transfer the case to the Tax Court and the Tax Court action will be deemed to have commenced on the date of the filing in the transferring court. 28 U.S.C. § 1631.²³⁹²

Consistent with federal court pleading practice since the first Federal Rules of Civil procedure were adopted in the 1930s, the petition is a “notice” pleading that should be a summary statement to fairly notify the IRS as to the matters the taxpayer contests.²³⁹³ The Tax Court Rules provide in effect a checklist of the matters the petition should contain²³⁹⁴ and, further, contain an addendum with a form for the petition.²³⁹⁵ Since, in cases petitioning with respect to IRS determinations (such as notices of deficiency), the IRS notice is the “ticket” to the Tax Court’s jurisdiction, the forms require that the notice be attached to the petition. You should be able to see how summary the petition may be (although some practitioners file very detailed petitions).²³⁹⁶ Keep

²³⁹¹ Tax Court Rule 20(a) (“A case is commenced in the Court by filing a petition with the Court.”). Filing within the 90 day period is jurisdictional, meaning that there is no equitable or other relief that would permit an out of time filing for deficiency jurisdiction. *Hallmark Research Collective v. Commissioner*, 159 T.C. ___ No. 6 (2022).

Although technically the petition appears as an opening pleading, in fact, it serves like a answering pleading—answering the IRS determinations in the notice of deficiency. Cf. Bryan Camp, [Lesson From The Tax Court: What Makes A NOD Invalid?](#) (Tax Prof Blog 10/23/23) (“the NOD serves a pleading function.”) The petition serves like an answer in normal litigation, setting the parameters by stating the IRS NOD claims the taxpayer disagrees with and, by not disagreeing, does not contest the others. Normally in civil trial litigation, the party seeking affirmative relief (here, at least arguably the IRS seeking more tax for assessment) bears burdens of proof and persuasion. But, for reasons other than the taxpayer’s nominal role of moving party, the taxpayer is functionally a responding party. But unlike responding parties generally in litigation, the taxpayer generally has burdens of proof and production normally borne by moving parties. See discussion of Burden of Proof beginning on p. 616.

²³⁹² As amended in 2018 by the Protecting Access to the Courts for Taxpayers Act, P.L. 115-332. § 2. Prior to this amendment, § 1631 generally allowed transfer in the interests of justice for cases filed in the wrong court, but the courts interpreted this provision as not permitting a transfer from the district court or the Court of Federal Claims to the Tax Court.

²³⁹³ Tax Court Rule 31(a) & (b). The parties in the proceeding are the taxpayer(s) in the plaintiff position (but referred to as petitioner(s)) and the Commissioner of Internal Revenue in the defendant position (referred to as respondent). The Commissioner, of course, is only a nominal party and, institutionally, the IRS is the party defending the case.

As with cases in other judicial forums, opening pleadings—petition, answer and reply—do not normally inform the judge. Usually, the judge does not pay substantive attention to the pleadings unless directed to them by the parties because of some subsequent issue—e.g., one party has diverted inappropriately from those pleadings.

²³⁹⁴ See, for example, in deficiency cases, Tax Court Rule 34(a) & (b). As to notices of deficiency, Rule 43(b) requires that the petition “must be substantially in accordance with Form 1 (Petition) shown in the Appendix” and have certain specific items. Tax Court Rule 31(c) references the check list petition matters in nondeficiency cases.

²³⁹⁵ Tax Court Rules, Appendix 1, Form 1. Rule 43(a) says that the petition filed should be “substantially in accordance with Form 1 (Petition).”

²³⁹⁶ I have never been convinced that detailed petitions serve any useful purpose, other than permitting the
(continued...)

in mind that a summary petition works because the IRS has the notice (e.g., notice of deficiency) for detail and, beyond that, the underlying files, so the IRS is rarely unable to understand the issues raised in a summary petition and prepare a proper answer to the petition. More detail might be required where the taxpayer not only seeks to redetermine a deficiency to zero but have the court consider some new matter not addressed in the audit (such as unclaimed deductions to mitigate the deficiency or even claim a refund). In the latter case, the IRS may not have previously “audited” the issues that give rise to the right to the overpayment and thus may require more detail to give it notice than would be required for issues that it has audited.

Along with the petition, the taxpayer files separately the following:

- A Statement of Taxpayer Identification Number. This is the Social Security Number in the case of individuals. This Statement is **not** part of the public record.²³⁹⁷ (Such identifying information is generally required to be redacted in all Tax Court filings open to public inspection.²³⁹⁸)
- A Designation of Place of Trial.²³⁹⁹ For example, the taxpayer can designate Houston as the place of trial. So long as the case has some reasonable nexus to the place designated by the taxpayer, the Tax Court will honor the place of trial designated by the taxpayer. The Tax Court may, however, hold the trial somewhere else upon good grounds shown. Sometimes large dollar complex litigation cases requiring many days for trial will, by agreement of the parties, be tried in Washington at the Tax Court courtrooms.
- A Filing Fee of \$60 (which may be waived based on inability to pay).²⁴⁰⁰
- If a nongovernmental entity, a Disclosure Statement of related entities.²⁴⁰¹

The original petition (with related documents) is filed with the Court.²⁴⁰² The Court delivers the petition—“serves” the petition in litigation jargon—on the Commissioner.²⁴⁰³

²³⁹⁶(...continued)

lawyer to generate a lot of pages to impress the client and, probably more practically for the lawyer, to generate fees. In this regard, the counterpart requests for admission do serve a purpose because of the obligation imposed upon the opposing party with respect to requests for admissions. For petitions, however, the opposing party, the IRS in Tax Court cases, merely need provide notice answers – usually just denying the allegation. So, while I am a proponent of notice pleadings, I am also a proponent of detailed requests for admission. And, also, I am a proponent for detailed stipulations which I address later in the text.

²³⁹⁷ See Tax Court Rules 20(b). Since the IRS needs the taxpayer identification number to retrieve the administrative record for cases filed in the Tax Court, the taxpayer at the time of filing the petition must file a Form 4 which will not be publicly filed and will instead be served on the IRS when the Tax Court serves the petition and designation of place of trial on the IRS. Documents that contain such information should be either redacted (with an unredacted copy filed under seal) or filed under seal without filing a redacted copy.

²³⁹⁸ Tax Court Rule 27, titled Privacy Protection for Filings Made With the Court.

²³⁹⁹ Tax Court Rules, Appendix 1, Form 5.

²⁴⁰⁰ Tax Court Rule 20(d).

²⁴⁰¹ Tax Court Rule 20(c).

²⁴⁰² Tax Court Rule 34(e) (only the signed original; no copies; this is an exception to the general rule for copies in Tax Court Rule 23(b)).

²⁴⁰³ Tax Court Rule 21(b)(1).

b. Answer.

The Commissioner must file an answer to the petition within 60 days.²⁴⁰⁴ The purpose of the answer is to notify the petitioner (the taxpayer) which of the issues raised in the petition are in dispute. Like the petition, the answer is a notice pleading that only requires a summary answer to the allegations of the petition. As in pleadings in other courts, the answer may assert some affirmative defense which must be asserted in the answer or will be deemed waived unless the IRS moves timely to amend the answer.²⁴⁰⁵

c. Reply.

The taxpayer then may or should file a reply to the Commissioner's answer.²⁴⁰⁶ The taxpayer is required to reply to matters asserted in the Commissioner's answer as to which the Commissioner bears the burden of proof.²⁴⁰⁷

d. Filings After Petition Online.

Filings after the petition are now required to be online.²⁴⁰⁸ Service on other parties of filings after the original petition is made by filing with the electronic case management system that copies other parties or other appropriate means (such as electronic (email or fax) means consented to by the served party), mail or personal delivery).²⁴⁰⁹

e. Filing of Documents Timely.

Documents filed must be filed in the Tax Court on the final day allowed or required for filing under the following rules.

- If in paper format, the document must be received by the Tax Court Clerk on or during business hours on due date for filing (**before 5:00pm eastern time**).²⁴¹⁰ I presume the same rule would apply for electronic documents physically delivered to the Court in some physical digital format (such as thumb or hard drive).
- Exceptions:
 - If filed by mail, **documents required by Title 26**, including most prominently petitions for redetermination of deficiency or petitions in CDP cases, the timely mailing-timely filing rule of § 7502 may apply if the mailing is timely mailed but received after the filing date; **Caveat:** documents not subject to § 7502 but required by the Tax Court rules or other

²⁴⁰⁴ Tax Court Rule 36.
²⁴⁰⁵ Tax Court Rule 39.
²⁴⁰⁶ Tax Court Rule 37.
²⁴⁰⁷ Tax Court Rule 37(b).
²⁴⁰⁸ Tax Court Rule 26.
²⁴⁰⁹ Tax Court Rule 21(b)(2).
²⁴¹⁰ Tax Court Rule 22(a) (general rule)

- order or procedure of the Tax Court are not subject to the timely-mailing timely filing rule; and
- If filed electronically, the document will be deemed timely if “electronically filed **at or before 11:59 p.m., eastern time**, on the last day of the applicable period for filing.”²⁴¹¹

f. Form and Style of Filings.

The Tax Court rules prescribe the form and style of filings, requiring a caption, date, signature and contact information, formatting for text, manner of bindings, and bold or italic type-face for case citations.²⁴¹²

The required signature made by electronic filing simply by entering the person’s name on the signature block (meaning handwritten signature is not required).²⁴¹³

10. New Matters.

a. Raised by IRS.

The IRS can raise new issues in its answer that seek to increase the amount of the deficiency on a basis not asserted in the notice of deficiency or to justify the deficiency asserted (or part thereof) on some basis not asserted in the notice of deficiency. Jurisdictionally, the Tax Court case is a case to redetermine the correct amount of tax liability for the year(s) involved, thus permitting it to determine a higher deficiency amount or an overpayment. § 6214(a) & 6512(b).²⁴¹⁴ So, the IRS can seek additional taxes and penalties not previously asserted.²⁴¹⁵ The statute of limitations will be open because, to reprise what we learned earlier, the statute is suspended during the period the Tax Court case is pending. §§ 6213(a) and 6503(a). This is one of the dangers in proceeding in the Tax Court where the IRS has not previously spotted an issue.²⁴¹⁶ Since the statute of limitations is

²⁴¹¹ Tax Court Rule 22(d) (emphasis supplied); see *Nutt v. Commissioner*, 160 T.C. ___, No. 10 (2023) (document filed electronically from the Central Time Zone at 12:05AM Eastern Time (the Tax Court location) deemed untimely although it was filed 11:05 PM Central Time on the day prescribed for filing).

²⁴¹² Tax Court Rule 23.

²⁴¹³ Tax Court Rule 23(a)(3).

²⁴¹⁴ In *Ax v. Commissioner*, 146 T.C. 153 (2016), the Tax Court rejected the argument that the APA and *SEC v. Chenery Corp.*, 318 U.S. 80 (1943) bar the IRS from raising new grounds in a Tax Court proceeding to redetermine the deficiency because, by statute, the Tax Court redetermines the deficiency (or overpayment) rather than merely reviews the deficiency.

²⁴¹⁵ *Graev v. Commissioner*, 147 T.C. 460,476 n. 9(2016) (reviewed opinion, often referred to as *Graev II*) (“The Commissioner routinely asserts sec. 6662(a) penalties in answers, and the Court has jurisdiction over them pursuant to sec. 6214(a). In the case of a motion to assert penalties in an amended answer, the Court considers whether granting leave for the amendment would prejudice the taxpayer.”). In his dissenting opinion in *Graev*, Judge Gustafson makes the same point. (p. 521, n. 19.) This opinion in *Graev* was reversed on other grounds in a second opinion, *Graev v. Commissioner*, 149 T.C. 485 (2017) (reviewed opinion). See also *Roth v. Commissioner*, T.C. Memo. 2017-248, at *10-*11, aff’d, 922 F.3d 1126 (10th Cir. 2019) (IRS attorneys have authority to assert new penalties.)

²⁴¹⁶ See *Wegbreit v. Commissioner*, T.C. Memo. 2019-82 (IRS raised the civil fraud penalty by amended answer and prevailed); and See Burgess J.W. Raby and William L. Raby, “Other” Issues When a Tax Court Case Goes (continued...)

suspended upon issuance of the notice of deficiency (§ 6503(a)), all new matters may be raised, assuming that the statute of limitations did not bar the notice of deficiency in the first place.²⁴¹⁷

The IRS's ability to raise new issues after its original answer is, however, limited by rules of fairness in the Court's management of the litigation. If the IRS does assert new matters after filing its original answer, it will formally do so by moving to amend the original answer. The Tax Court rules, like the Federal Rules of Civil Procedure applicable in district courts and the Court of Federal Claims' Rules, permit amended pleadings, usually requiring the approval of the Court which is liberally granted to promote justice on the underlying merits.²⁴¹⁸ New issues cannot be inserted too late in the process so as to deny the taxpayer the effective opportunity to respond. And, as to "new matters," the IRS bears the burden of persuasion.²⁴¹⁹ (Of course, if the new matter is the civil fraud penalty not asserted in the notice of deficiency, the IRS would have the burden of persuasion anyway to prove civil fraud by clear and convincing evidence, so asserting civil fraud as a new matter has no effect on the burden of persuasion.) If the new matter is a penalty, the IRS must prove not only the basis for the penalty but, if the penalty allows affirmative defenses (such a reasonable cause or care and prudence in preparing the return), the absence of the affirmative defense.²⁴²⁰

The IRS is allowed to raise a new theory or ground in support of an issue raised in the notice of deficiency without the theory or ground being a new matter.²⁴²¹ Depending upon how much

²⁴¹⁶(...continued)

to Court, 2003 TNT 227-7 (11/25/03), discussing in part an extreme example in *Ferguson v. Commissioner*, 47 T.C. 11 (1966).

²⁴¹⁷ For a recent example of the IRS attorney raising a new penalty issue in the context of § 6751(b)'s requirement for written supervisor approval, see *Roth v. Commissioner*, 922 F.3d 1126 (10th Cir. 2019) ("Notably, this reading of the statute harmonizes § 6751(b)'s initial determination requirement with § 6214(a)'s grant of jurisdiction to the Tax Court to consider new penalties asserted by IRS counsel in a deficiency proceeding.").

²⁴¹⁸ Tax Court Rule 41.

²⁴¹⁹ Tax Court Rule 142(a)(1). In *Illinois Tool Works v. Commissioner* (unpublished order dated 12/2/14, published at 2014 TNT 232-10), the Tax Court denied a taxpayer motion to strike the IRS's assertion, for the first time in the answer, of a substantial understatement penalty. The Court affirmed its prior holdings and Tax Court rule allowing the raising of new matters not previously asserted in the notice of deficiency. The Court said the "sanction" for raising new matters after the notice of deficiency is to shift the burden of persuasion to the IRS on the matter. A related issue not definitively decided is whether Section 6751(b)(1)'s requirement for supervisor approval of the initial determination of a penalty might require such approval before the IRS asserts the penalty, whether initially or by new matter in litigation. See Ajay Gupta, *How Late is Too Late for Slapping on a Penalty?*, 2014 TNT 238-1 (12/11/14).

²⁴²⁰ *Sanderling, Inc. v. Commissioner*, 66 T.C. 743, 757 (1976), aff'd in part, rev'd in part, 571 F.2d 174 (3d Cir. 1978); and *Crecrescenzo v. Commissioner*, T.C. Memo. 2023-7 at *20. Of course, the burden of persuasion on affirmative defenses is often on the party against whom they work because they usually have better access to the information relevant to the defense. For example, if the affirmative defense is reasonable cause because the taxpayer relied on advice of counsel or exercised care and prudence, the IRS may not have access to that information. The IRS would have to elicit the information either in Tax Court discovery or by questioning the taxpayer at trial. See *Crecrescenzo v. Commissioner*, *supra*, at 21 (noting that "it is difficult to prove a negative (e.g., the absence of either reasonable cause or good faith).")

²⁴²¹ In *Estate of Kanter v. Commissioner*, 337 F.3d 833, 851 (7th Cir. 2003), rev'd on other grounds, 125 S. Ct. 1270 (2005), the Court said:

The Commissioner is allowed the latitude to amend his pleadings and even adopt entirely new theories supporting assessed deficiencies without triggering Rule 142's shift in burden, so long as the new theory is not inconsistent with the original allegation, does not require new evidence in its support,

(continued...)

variance the new theory or ground has with the notice of deficiency, the variance might be considered a new matter subject to the foregoing new issues discussion.²⁴²² Certainly, if it is raised so late that the taxpayer cannot fairly respond with evidence addressing the new issue, the Court should deny the IRS's attempt to assert the new issue.

If the IRS asserts an affirmative defense (such as estoppel), it will be deemed denied and the taxpayer need not file a responsive pleading, which is usually called a "reply."²⁴²³ If, however, the IRS raises "new matter" either in an answer or an amended answer, the taxpayer should file a reply providing the IRS notice as to the taxpayer's position on the new matter. This is frequently done via a simple denial of the various matters pled with respect to the new matter.

I think it would be helpful to illustrate the new matter issue. Recall that § 6662 provides a 20% substantial understatement penalty that is then increased to 40% if the understatement is attributable to a gross valuation misstatement.²⁴²⁴ If the notice of deficiency asserted the 20% penalty but, in its answer, the IRS asserts the 40% penalty, the IRS will have the burden of proof on the increase in the penalty. That seems to be the straight-forward reading of the rule shifting the burden of proof to the IRS. But let's focus on one issue raised in this setting. The taxpayer can avoid the accuracy related penalties if there was reasonable cause for the position on the return.²⁴²⁵ This is like an affirmative defense to the penalty. Thus, as to the 20% penalty asserted in the notice and contested in the petition, the taxpayer bears the burden of proving reasonable cause even after the IRS meets its production burden under § 7491(c); as to the increased 40% penalty, however, the IRS bears the burden of proof, including establishing absence of reasonable cause.²⁴²⁶

²⁴²¹(...continued)

nor increases the amount of the deficiency.

Cavallaro v. Commissioner, 842 F.3d 16, 23 (1st Cir. 2016) ("if a deficiency notice is broadly worded and the Commissioner later advances a theory not inconsistent with that language, the theory does not constitute new matter, and the burden of proof remains with the taxpayer," quoting *Estate of Abraham v. Commissioner*, 408 F.3d 26, 36 (1st Cir. 2005)); see also *Transupport, Inc. v. Commissioner*, T.C. Memo. 2016-216.

²⁴²² In *Cavallaro v. Commissioner*, 842 F.3d 16 (1st Cir. 2016), the Court explained (case citations and some quotation marks omitted for easier readability):

Under the "new matter" exception, if the Commissioner seeks to establish the deficiency on a basis not described in the Notice, the burden shifts to the Commissioner on that new basis. A new theory presented to support a deficiency is treated as a new matter when it either alters the original deficiency or requires the presentation of different evidence. If, however, the theory merely clarifies or develops the original determination, it is not a new matter.

²⁴²³ Tax Court Rule 37(c).

²⁴²⁴ § 6662(a) and § 6662(h).

²⁴²⁵ § 6664(c)(3).

²⁴²⁶ See *Blau v. Commissioner*, 924 F.3d 1261, 1279-1280 (D.C. Cir. 2019) the Court discussed Tax Court authority and expressed "no opinion as to whether Rule 142 requires the IRS to negate affirmative defenses when it pleads a new penalty in an answer." The Court of Appeals accepted the Tax Court's holdings that the burden on the reasonable cause defense did shift to the IRS as new matter; but "If a defense to a new matter "is completely dependent upon the same evidence," *id.*, as a defense to the penalty originally asserted, then there is no practical significance to shifting the burden of proof." The Court then held that the burden had been met on the record but the facts were fully developed so "there was no additional fact to which that burden applied." I am not sure exactly what that holding means, because, assuming that the trier (the Tax Court) were in equipoise as to reasonable cause (equipoise being a possible, although rare phenomenon), the IRS could have prevailed on the 20% penalty but the taxpayer on the 40% penalty.

An even worse case for the taxpayer who improvidently petitions for redetermination is that the IRS can raise as new matter a civil fraud penalty. Say in the above example, the notice of deficiency asserted either the 20% or 40% accuracy related penalty in § 6662 and then in the answer (or amended answer), the IRS asserts the 75% civil fraud penalty in § 6663. Note in this regard that, if the IRS raises the civil fraud penalty as a new matter, its burden of proof is not affected because, as to civil fraud, the IRS bears the burden of persuasion by clear and convincing evidence anyway, just as if the civil fraud penalty had been asserted in the notice of deficiency. So, if the IRS prevails, the taxpayer will be even worse off for having filed a petition for redetermination.²⁴²⁷ Thus, taxpayers and practitioners should think carefully about unspotted potential issues before filing a petition for redetermination in the Tax Court.

Finally, “new matter” subject to the foregoing does not include correcting a mathematical or clerical errors in the notice of deficiency.²⁴²⁸

b. Raised by Taxpayer.

Since the Court has jurisdiction to determine the correct tax liability, the taxpayer may raise new matter not addressed previously in the notice of deficiency. Assuming that the taxpayer timely raises the new matter, the taxpayer will bear the burden of proof on the matter.²⁴²⁹

11. From Petition to Trial.

a. Petition.

The Tax Court case is commenced by timely filing the petition (and related documents) within 90 days of the notice of deficiency (or 150 day period if the notice is addressed to a person outside the U.S.). § 6213(a). If the 90th day falls on a weekend, a holiday in the District of Columbia, or a day that the Tax Court is not accessible, the petition is timely if filed on the next business that the Court is accessible.²⁴³⁰ In 2023, in a unanimous reviewed opinion, the Tax Court held that the 90-day (or 150-day) period is jurisdictional and thus not subject to equitable tolling to extend the petition period.²⁴³¹ (Readers should keep in mind that the trend has been recently to treat many time deadlines in the Code, including deadlines to petition the Tax Court for CDP review, as nonjurisdictional and thus subject to equitable tolling;²⁴³² it is possible that a Court of Appeals may disagree with the Tax Court’s reviewed opinion.)

²⁴²⁷ E.g., *Wegbreit v. Commissioner*, T.C. Memo. 2019-82.

²⁴²⁸ E.g., *Jadhav v. Commissioner*, T.C. Memo. 2023-140, *13-14 (citing authority). For this calculation or clerical error exception to apply, I think that the error must be determined on the basis of the notice of deficiency and not the IRS files underlying the notice of deficiency.

²⁴²⁹ *Sham v. Commissioner*, T.C. Memo. 2020-119, at *38-39.

²⁴³⁰ § 6213(a); *Guralnik v. Commissioner*, 146 T.C. 230 (2016) (Tax Court inaccessible because of snow day). *Guralnik* appears to be authority for other types of inaccessibility as well, such as most prominently Government shutdowns. Keith Fogg, [The Broad Impact of Guralnik](#) (Procedurally Taxing Blog 8/16/19)

²⁴³¹ *Hallmark Research Collective v. Commissioner*, 159 T.C. ___ No. 6 (2022),

²⁴³² E.g., *Boechler, P.C. v. Commissioner*, 596 U.S. ___, 142 S. Ct. 1493, 1501 (2022) (“[s]ection 6330(d)(1)’s 30-day time limit to file a petition for review of a CDP determination is an ordinary, nonjurisdictional deadline subject to equitable tolling.”)

b. Appeals Office Review.

If the case has not had Appeals Office review by the time the petition is filed, it is generally automatically referred to Appeals after the IRS files its answer and, in most cases, Appeals generally has jurisdiction in conjunction with Counsel to settle the case.²⁴³³ I discussed this referral, subject to exceptions, above under “Docketed Appeals” beginning p. 483.

If the matter has already had Appeals Office review prior to issuance of the Notice of Deficiency, it will not be automatically referred but may be referred if there is some reason to believe that further Appeals Office consideration would be helpful to settle some or all of the issues.

c. Discovery.

(1) General.

Discovery permits litigating parties obtain evidence relevant to the litigation.²⁴³⁴ Discovery processes may be used to obtain evidence from the opposing party or from third parties. In Tax Court litigation, by far the discovery processes are principally used to obtain information from the opposing party. The key characteristic of Tax Court discovery as compared to litigation in district court or the Court of Federal Claims is the Tax Court’s emphasis on informal discovery before undertaking the formal discovery processes (which parallel those discovery processes in the other courts). With the emphasis on informal discovery and other facets of Tax Court practice, plus the general professionalism of the IRS Chief Counsel’s attorneys representing the IRS in Tax Court, the general practice in the Tax Court tends to support a level of civility not encountered in the other courts.²⁴³⁵

(2) Informal Discovery from the Opposing Party

(a) General.

Informal discovery is encouraged and required by the Tax Court prior to undertaking formal discovery requests or procedures.²⁴³⁶ Informal discovery is as simple as calling up the person from whom discovery is sought, usually the opposing party (or counsel if represented) and requesting information. The request should be documented in formal written correspondence, but it is informal in the sense that it is not a pleading. It is important not to undertake formal discovery without first using the informal *Branerton* procedure.²⁴³⁷

(b) From Opposing Party.

²⁴³³ Rev. Proc. 87-24, 1987-1 C.B. 720; see IRM Part 8 Appeals, Chapter 4 Appeals Docketed Cases; see specifically IRM 8.4.1.1.2 (09-13-2019), Authority (referring to Rev. Proc. 87-24).

²⁴³⁴ See Tax Court Rules 70 - 104.

²⁴³⁵ William Schmidt, The U.S. Tax Court’s Promotion of Civility (ABA Tax Section Practice Point 5/26/22).

²⁴³⁶ Tax Court Rule 70(a)(1).

²⁴³⁷ See *Schneider Interests, L.P. v. Commissioner*, 119 T.C. 151 (2002).

Informal discovery from the opposing party is often referred to as a *Branerton* procedure because the case of that name put practitioners on notice that the Tax Court viewed the informal discovery process as critical.²⁴³⁸ A Tax Court judge stated the gravamen of the informal discovery requirement under *Branerton* as “asking the other party nicely first.”²⁴³⁹ The IRS district counsel will usually write a letter—referred to as a *Branerton* letter, citing the case by name—requesting the informal discovery.²⁴⁴⁰ The taxpayer or practitioner must also use an equivalent procedure—perhaps with a letter citing *Branerton*—so as to preserve the right to pursue formal discovery if the informal discovery is not satisfactory.

One issue that has come up recently in the spate of conservation easement tax shelter cases where the party from whom discovery is sought is a limited partner in the partnership which is the party in the Tax Court case. Is a limited partner in a represented partnership in the case sufficiently like a party in the case that the rules for the opposing party apply? If so, ethics rules require the IRS to make informal discovery through the represented party, the partnership. The Tax Court does not treat the limited partner as a party and thus permits the IRS to seek informal discovery from the limited partner without going through the attorney for the partnership.²⁴⁴¹

(c) From Third Parties.

Similar informal discovery may be sought from third parties other than the parties in the Tax Court case. That too requires little more than a letter or a telephone call before the letter. The third party is not required to respond, but might be subject to formal discovery if he does not.

Also, as noted in the preceding subsection, care must be taken to insure that the third party is a third party rather than sufficiently close to the party in the case that informal discovery should be sought through the related lawyer in the proceeding.

(3) Formal Discovery.

The Tax Court has formal discovery procedures which substantially parallel those found in the FRCP.²⁴⁴² Thus, generally, the scope of discovery includes “any matter not privileged that is relevant to the subject matter involved in the pending case.”²⁴⁴³ The key differences are that (i) formal discovery must be preceded by informal discovery under the *Branerton* procedure and (ii) deposition discovery is the least favored form of discovery.

²⁴³⁸ *Branerton Corp. v. Commissioner*, 61 T.C. 691 (1974).

²⁴³⁹ Tax Court Judge Mark Holmes as quoted in Sam Young, Tax Court Judge, IRS Attorneys Discuss Impact of Changes to E-Discovery Rules, 2010 TNT 44-13 (3/8/10).

²⁴⁴⁰ IRM 35.4.3.2 (08-11-2004), Informal Requests.

²⁴⁴¹ *Oconee Landing Property, LLC v. Commissioner* (ORDER in Dkt. No. 11814-19. 3/19/22)

²⁴⁴² Tax Court Rules 70 - 104. These include admissions and stipulations which are often used like discovery devices but technically are not, for to frame a request for admission or a request for stipulation, presumably the party already knows the fact(s) in question.

²⁴⁴³ Tax Court Rule 70(b)(1), which substantially tracks Federal Rule of Civil Procedure Rule 26.

Generally, the taking of depositions of party, nonparty and expert witnesses requires the consent of the parties.²⁴⁴⁴ Non-consented discovery depositions are considered “extraordinary” methods of discovery to be used only where informal discovery cannot suffice.²⁴⁴⁵ Party witnesses may be taken without consent only by filing a motion to do so and obtaining an order.²⁴⁴⁶ Nonparty witnesses may be deposed without consent of the parties and without leave of Court under certain circumstances requiring notice to the nonparty and opportunity to object.²⁴⁴⁷ Expert witnesses may be deposed without consent of all parties.²⁴⁴⁸

Depositions may be taken to perpetuate evidence so that the testimony is available for trial where it might not otherwise be available.²⁴⁴⁹ Such depositions require an order of the court or a stipulation of the parties filed with the court.²⁴⁵⁰ Such depositions may be used to contradict or impeach the testimony of the deponent at trial, for use as adverse party testimony, and any other purpose that the judge finds to be in the interest of justice (such as death or other inability to attend and testify at trial).²⁴⁵¹

Trial subpoenas (both for testimony or for documents or things)²⁴⁵² may be used for discovery, but this may irritate a Tax Court Judge who may feel that discovery should have been done in advance, particularly since exhibits must be exchanged in advance of trial.²⁴⁵³

The Tax Court Rules limit discovery of privilege information (including work product) under scope rules similar to the Federal Rules of Civil Procedure.²⁴⁵⁴

²⁴⁴⁴ Tax Court Rule 74(a) & (b).

²⁴⁴⁵ Tax Court Rule 74(c)(1).

²⁴⁴⁶ Tax Court Rule 74(c)(3).

²⁴⁴⁷ Tax Court Rule 74(c)(2).

²⁴⁴⁸ Tax Court Rule 74(c)(4).

²⁴⁴⁹ Tax Court Rules 80-85.

²⁴⁵⁰ Tax Court Rule 81(b) & (d).

²⁴⁵¹ Tax Court Rule 81(i).

²⁴⁵² § 7456(a)(1) permitting subpoenas for testimony or documents or things “at any designated place of hearing.” Tax Court Rule 147(c) is the authority for a trial and deposition subpoenas. Two issues have arisen. First, where the trial subpoena is to actually do discovery that should have been done in the discovery process, the Tax Court may quash the subpoena. *YA Global Investments, LP v. Commissioner* (Docket Nos. 14546-15, 28751-15 Order dtd. 10/1/20) (see the next footnote below). Second, where the documents to be returned are substantial, production in advance of the trial setting may be more efficient to manage the documents, so can the return date on the subpoena be in advance of the trial setting date? The Tax Court has held in orders (rather than in opinions) that the statute does not permit the Tax Court to issue such subpoenas, but Judge Gustafson offered alternatives to request the third party to produce in advance with the inducement of excusing appearance at trial or the third party may seek the court intervention to induce the parties to reach agreement. *Johnson v. Commissioner* (T.C. Dkt. No. 17324-18, Order dated 12/26/19).

²⁴⁵³ See *YA Global Investments, LP v. Commissioner* (Docket Nos. 14546-15, 28751-15 Order dtd. 10/1/20) (holding that trial subpoenas for documents were used for improper discovery). See Samantha Galvin, [A Tax Court Procedural Anomaly: the Trial Subpoena Duces Tecum, Designated Orders July 29 – August 2](#) (Procedurally Taxing Blog 9/24/19) (discussing unpublished order in *Cross Refined Coal, LLC, v. Commissioner* (Dkt 19502-17 Order Dtd. 8/1/19)).

²⁴⁵⁴ Tax Court Rule 70(b). The procedure for asserting privilege from disclosure are in Tax Court Rule 70(d).

(4) Some Limitations on Discovery.

(a) Relevancy.

The parties may discover “any matter not privileged and which is relevant to the subject matter involved in the pending case.”²⁴⁵⁵ As with the similar scope provided for civil litigation discovery in other venues, relevancy is determined by the subject matter of the litigation.

There is one relevancy issue that has been generally imposed in deficiency litigation. The Tax Court will generally not permit discovery designed to “look behind a deficiency notice to examine the evidence used or the propriety of respondent's motives or of the administrative policy or procedure involved in making his determinations.”²⁴⁵⁶ This is because the Tax Court redetermination proceeding is for re-determination—by de novo proceeding—of the deficiency. Hence, what is behind the deficiency notice is not relevant to the issue of the proper deficiency (or refund).

(b) Privileges.

The parties may not discover matters as to which the parties otherwise compelled to produce asserts a relevant privilege from discovery. Privileges include the privileges normally encountered in litigation,²⁴⁵⁷

(c) Prohibitions on Discovery - § 6103.

Discovery may be denied where, as in the case of the IRS, the IRS is prohibited by law from disclosing the information or documents. The most commonly encountered such prohibition in tax litigation generally is § 6103's prohibition on disclosing return information of taxpayers not involved in the litigation or having some relationship to the taxpayer in the litigation that permits disclosure of their return information.

As noted, the Tax Court's discovery opportunities are more limited than in other venues for litigation. This is not so bad as to the taxpayer who usually has control of the facts. The IRS does not usually have easy access to the facts, but the IRS is expected to have developed the facts using its audit processes, including its broad summons power, if necessary, during the audit. Litigation, including Tax Court litigation, is often commenced with parties not having all of the facts needed

²⁴⁵⁵ Tax Court Rule 70(b), which parallels FRCP Rule 26(b) for district courts which permits discovery of “any nonprivileged matter that is relevant to any party's claim or defense” with the requirement, that the discovery be “proportional to the needs of the case,”

²⁴⁵⁶ *Greenberg's Express, Inc. v. Commissioner*, 62 T.C. 324, 327 (1974). For a possible exception to this rule foregoing inquiry behind the notice of deficiency, see *Suarez v. Commissioner*, 58 T.C. 792 (1972) which, although questioned in *United States v. Janis*, 428 U.S. 433, 457 (1976), the Tax Court continues to cite Suarez but notes that the holding might not invalidate the notice of deficiency as opposed to requiring the IRS to bear additional burdens it would not otherwise have. *Moya v. Commissioner*, 152 T.C. 182 (2019).

²⁴⁵⁷ These are basically the same privileges that may be asserted in response to compulsory IRS summonses which we discuss earlier in the text. These include the Fifth Amendment privilege, the attorney-client privilege, and the work product privilege.

for litigation, hence the discovery processes and limitations on discovery processes are important. Importantly, are there “work-arounds” the limitations on the discovery processes?

(d) IRS Use of Audits for Discovery.

What happens when the IRS has not adequately developed its case during the audit in the case before the Tax Court and needs broader discovery than the Tax Court rules might comfortably permit? The IRS has been known or suspected to use other audits -- either a subsequent year audit or even a third party audit -- to develop information for a case pending in the Tax Court. Suppose a large corporate taxpayer has a case before the Tax Court in which it contests a transfer pricing (§ 482) adjustment for years 1 and 2. The IRS has not adequately developed the issue in the audits of years 1 and 2 and finds that the Tax Court discovery rules are “limiting.” It needs more information and broader discovery-- e.g., from the taxpayer's competitors and other industry sources. Many large corporate taxpayers are subject to continuous audits, so let's suppose that this taxpayer is then undergoing an audit for years 3 and 4 while its Tax Court case for years 1 and 2 is pending. Can the IRS use the summons process to develop the same issue in years 3 and 4? If the taxpayer is not otherwise subject to audit in years 3 and 4, can the IRS commence one for this purpose? Alternatively, the information the IRS needs in the case before the Court may be from third parties, such as taxpayer's competitors. Can the IRS use a third party audit as a fulcrum for issuing summons for information needed in the Tax Court case of a different taxpayer?²⁴⁵⁸

Certainly, in a transfer pricing audit, relevant information is not limited to just the years in audit, since a whole range of years' information can reasonably bear on the issue, nor just to the taxpayer involved since third parties may have relevant information. Hence, the IRS agents in the taxpayer's years 3 and 4 audit and in third parties' audits could responsibly assert under the *Powell* standards that the information it seeks is relevant and use the IRS summons--far more powerful than Tax Court discovery devices--to get the information.

These issues and variations on them have troubled the Tax Court, and it has found no easy answer to the issues. The Tax Court has developed the following general guides to resolve the problems: (1) for IRS summonses to the same taxpayer issued before the petition was filed in the pending Tax Court case, the Tax Court will not interfere at all with the IRS's subsequent enforcement of the summonses; and (2) if the IRS summons relates to the same taxpayer for a year not before the court or to another taxpayer for a year before the court, normally the Tax Court will not issue a protective order, but will do so if the taxpayer can show, essentially, that the audit discovery process in issue is pretextual to gather evidence for the Tax Court case.²⁴⁵⁹

²⁴⁵⁸ I hope you have spotted a potential § 6103 problem with this scenario but set that aside here. See John A. Townsend, Section 6103 and the Use of Third Party Tax Return Information in Tax Litigation, 46 Tax L. Rev. 923 (Summer 1993).

²⁴⁵⁹ *Ash v. Commissioner*, 96 T.C. 469 (1991); see Burgess J.W. Raby and William L. Raby, IRS Summons Power and the Tax Court, 34 Tax Practice (Tax Analysts) 193 (5/31/02). And, as to the Government's power to seek judicial enforcement of a summons in the district court, see *United States v. Administrative Enterprises*, 46 F.3d 670 (7th Cir. 1995).

d. Expert Witnesses.

The Tax Court rules require an expert to render an expert's report stating the expert's qualifications, opinions and facts and data upon which they are based.²⁴⁶⁰ The expert's report must be served on opposing parties not less than 30 days before the case is calendared for trial.²⁴⁶¹ Provided that the expert is qualified, the report will be introduced into evidence "as the direct testimony of the expert witness."²⁴⁶² The expert witness' oral direct testimony may be permitted if there is some reason to do so on direct or perhaps on cross examination.²⁴⁶³ (There may be a trap there for the party offering the expert witness report if the Tax Court judge thinks the report is sufficient without oral direct testimony; the opposing party could insist on oral cross-examination.) As the direct testimony of the expert, the report must comply with requirements for expert testimony in FRE 702.

The parties may not discover drafts of the expert witness's reports or communications between the opposing party and the expert regarding the report, except for communications which (i) relate to the expert's compensation; (ii) identify facts or data that the expert was provided to form the opinions; and (iii) identify assumptions provided to and relied upon by the expert.²⁴⁶⁴

e. Alternative Dispute Resolution.

The parties may move to resolve "any factual issue in controversy" by "voluntary binding arbitration."²⁴⁶⁵ The parties may also move to resolve "any issue in controversy" by "voluntary nonbinding mediation."²⁴⁶⁶ These rules do not "exclude use by the parties of other forms of voluntary disposition of cases."²⁴⁶⁷

f. Piggyback Agreements.

The parties in a docketed case involving issues similar to issues presented in another docketed case, may stipulate to be bound by the resolution of the issue in the other case.²⁴⁶⁸ The procedure was developed particularly for issues presented in a large number of cases (often found with widely promoted tax shelters).²⁴⁶⁹ This procedure will then permit one or more "test cases" to be litigated and resolve the issue in the other cases. Obviously, care needs to be taken if the outcome

²⁴⁶⁰ Tax Court Rule 143(g)(1).

²⁴⁶¹ Tax Court Rule 143(g)(2).

²⁴⁶² Tax Court Rule 143(g)(2).

²⁴⁶³ Tax Court Rule 143(g)(2).

²⁴⁶⁴ Tax Court Rule 70(c)(3) and (c)(4)(A) & (B).

²⁴⁶⁵ Tax Court Rule 124(a).

²⁴⁶⁶ Tax Court Rule 124(b).

²⁴⁶⁷ Tax Court Rule 124(c).

²⁴⁶⁸ Obviously, as with any stipulation, care must be exercised to assure the process being stipulated. See *Monahan v. Commissioner*, 321 F.3d 1063, 1068 (11th Cir. 2003) (stipulating that the resolution of the referenced case will resolve all of the remaining issues in the stipulated case).

²⁴⁶⁹ For example, in the infamous "Kersting" cases, it is reported that 1,300 taxpayers signed piggyback agreements. See *Hongsermeier v. Commissioner*, 621 F.3d 890, 893 (9th Cir. 2010).

can be affected by different Circuit precedents in the courts of appeals to which the cases could be appealed.

12. The Stipulation Process.

Stipulations are the parties' written agreement as to the facts and, sometimes, the law in the case. Rule 91(a)(1) states (emphasis supplied):

The parties are required to stipulate, to the fullest extent to which complete or qualified agreement can or fairly should be reached, all matters not privileged which are relevant to the pending case, regardless of whether such matters involve fact or opinion or the application of law to fact.

Stipulations are usually used for facts or opinions. The Rule allows stipulation of the application of law to fact, but “does not expressly contemplate stipulations as to pure questions of law.”²⁴⁷⁰

Stipulations are required regardless of the party bearing the burden of proof with respect to the facts;²⁴⁷¹ this means that a party cannot refuse a stipulation simply because the opposing party bears the burden of proof as to the fact. Stipulations—even a fully stipulated case—do not change the burden of proof.²⁴⁷² Of course, stipulated facts can meet the burden of proof.

Stipulations should be comprehensive.²⁴⁷³ Stipulations can include relevant facts and documents (usually identified by exhibit number). Stipulations are binding as to the matter covered unless the Court relieves the party or parties to the stipulation.²⁴⁷⁴ The stipulations are binding only in the case and cannot be used in other cases.²⁴⁷⁵ However, since the stipulations usually result in fact findings in the opinion resolving contested issues (often incorporated verbatim), the fact findings may have preclusive effect in other cases between the parties (usually the taxpayer and the IRS) in other cases under *res judicata* principles.

The parties may stipulate issues to remove them from further trial consideration. For example, if the petition disputes the IRS's disallowance of a business expense deduction, rather than stipulating the facts related to the deduction, the parties can stipulate that the taxpayer is entitled to the deduction in a particular amount. That stipulation is commonly referred to as a stipulation of a settled issue. Sometimes such stipulations can be comprehensive to cover all issues in the case other than the bottom line tax calculation which will then be either agreed upon or subject to Rule 155,

²⁴⁷⁰ *Siemer Milling Co. v. Commissioner*, Unpublished Order dated 12/4/17, p. 2, n. 3. I am not sure what the court means by the “expressly” qualifier. I am not sure what the court means by the “expressly” qualifier. Of course, there really is not much difference between stipulations of law and stipulations as to the application of law to fact.

²⁴⁷¹ Tax Court Rule 91(a)(1).

²⁴⁷² *Borchers v. Commissioner*, 95 T.C. 82, 91 (1990), *aff'd*, 943 F.2d 22 (8th Cir. 1991).

²⁴⁷³ Tax Court Rule 91(a)(2).

²⁴⁷⁴ Tax Court Rule 91(e).

²⁴⁷⁵ Tax Court Rule 91(e).

titled Computation by Parties for Entry of Decision.²⁴⁷⁶ The parties may make stipulations in presenting an agreed decision document for the Court to enter. The stipulations will appear **below** the Judge’s signature line on the decision and are not technically part of the Court’s decision; hence they are binding on the parties but do not represent a holding of the court.²⁴⁷⁷

The Tax Court views the stipulation process as critical to its orderly functioning.²⁴⁷⁸ By undertaking the stipulation process to the maximum extent, the resulting actual courtroom trial is minimized and, if the parties pursue stipulations in good faith, the more formal discovery mechanisms are avoided or minimized. This permits the average Tax Court trial to be concluded in a fraction of the time it takes trials in the district courts where stipulations can also save trial time but tend to be less comprehensive. The Tax Court expects the parties to have conducted the stipulation process diligently and to have concluded it by a signed stipulation document for filing by the docket day or by the trial date.

A party may move to compel the other party to stipulate.²⁴⁷⁹ However, the motion must be filed sufficiently in advance of trial for it to be dealt with. The Rules require that it be filed not later than 45 days before trial. Thus, it is important that the parties move to stipulate well before that 45 day cutoff. In practice, however, the stipulation process often does not commence in earnest until after that 45 day cutoff and thus the practical ability to force stipulations may be limited. Notwithstanding that, of course, the Tax Court Judge will be mightily disappointed if the parties fail to stipulate as to matters that they really don’t dispute—for that takes up his time in the courtroom listening to those uncontested matters. You don’t want the Judge to be unhappy, so you don’t want to be perceived by the Judge as the party who refused to stipulate as to such matters and thereby wasted his time.

Some cases may be fully stipulated, requiring no trial.²⁴⁸⁰ Fully stipulated cases do not, however, alter the burden of proof. Practitioners should recall that in fully stipulated cases (as well as in trials) that “the burden of proof, or the requirements otherwise applicable with respect to adducing proof, or the effect of failure of proof.”²⁴⁸¹

²⁴⁷⁶ The stipulations are binding. There has, however, been some commotion about just how binding stipulations of settled issues are if the either party, upon calculating the effect, wants to avoid the effect of the stipulations. E.g., *Dollarhide Enterprises Inc. v. Commissioner* (T.C. Dkt. 23139-12 Order dated 9/27/22); and Keith Fogg, *A Procedural Goldmine* (Procedurally Taxing Blog 9/30/22) (discussing the *Dollarhide* Order). I am not sure what that commotion is about. The stipulation of settled issues should bind both parties to the matters so stipulated even if they did not anticipate the bottom line effect, at least unless the party has some basis (such as fraud or misrepresentation) to avoid the stipulations. Then, with the stipulations of settled issues, the parties and the Court should be able to move to the calculation process, resolving any matters unresolved by the stipulations.

²⁴⁷⁷ *Hill v. Commissioner*, ___ F.4th ___, ___ (11th Cir. 4/10/23)

²⁴⁷⁸ The Tax Court says that the stipulation process is “the bedrock of Tax Court practice.” *Branerton Corp. v. Commissioner*, 61 T.C. 691, 692 (1974). There is no similar stipulation requirement in the Federal Rules of Civil Procedure. *Farrell v. Commissioner*, 136 F.3d 889, 893 (2d Cir. 1998).

²⁴⁷⁹ Rule 91(f).

²⁴⁸⁰ Rule 122(a).

²⁴⁸¹ See Rule 122(b).

13. Requests for Admission.

The Tax Court Rules allow requests for admission.²⁴⁸² Although some treat requests for admission as a form of discovery, when properly used they are not discovery. A party (the proponent) should request an admission from the other party when he can formulate a request that he believes to be true. In that sense, the proponent is not seeking to discover the content of the admission but is instead seeking a form of agreement for the litigation so that the content does not have to be proved. It is somewhat like the stipulation process where a party requests a stipulation from the other party so that the stipulated matters become settled.²⁴⁸³

Requests for admission may include relevant and nonprivileged matter that relate “relate to statements or opinions of fact or of the application of law to fact, including the genuineness of any documents described in the request.”²⁴⁸⁴ As with discovery and stipulations, the Rules state the Court’s expectation that the parties “attempt to attain the objectives of such a request through informal consultation or communication” before using requests for admission.²⁴⁸⁵

14. Notice Setting Case for Trial.

The case is set for trial by a Notice Setting Case for Trial²⁴⁸⁶ which sets the date and time for the beginning of the trial session (called a calendar call or docket call on the first day of the trial session where all parties or their counsel appear to permit the Judge to set the calendar for trials in the session). The Notice will advise the parties of deadlines leading up to the trial session (including a pretrial memorandum in a specific format is due seven days before the start of the session), remind that undisputed facts should be stipulated, and provide other information about how to proceed.

A recent inclusion on the Notice is the opportunity for parties to file a motion for a remote trial of the case. The experience is that such motions are filed by taxpayers and not by the IRS; the Tax Court has liberally granted such motions.²⁴⁸⁷

15. PreTrial Memorandum.

As noted, the parties will each file a pretrial memorandum. The memorandum will provide key information to the Court in a specific format. The information includes amounts in dispute and periods involved, status of the case (e.g., probable settlement, probable trial, definite trial), estimate of time for trial, motions expected, status of stipulation of facts, witnesses the party expects to call, summary of the facts and legal authorities), and evidentiary problems).

²⁴⁸² Tax Court Rule 90.

²⁴⁸³ Its analog to discovery is shown by its inclusion under Tax Court Rule Title IX, named Admissions and Stipulations, rather than under Titles VII, Discovery, or Title VIII, Depositions to Perpetuate Testimony.

²⁴⁸⁴ Tax Court Rule 90(a).

²⁴⁸⁵ Id.

²⁴⁸⁶ Tax Court Rule 131. The standard form for the Notice is on the Tax Court web site.

²⁴⁸⁷ Christine Speidel, Tax Court Practice & Procedure Updates from the 2023 ABA Tax Midyear Meeting (Procedurally Taxing Blog 2/16/23).

16. The Trial.

The policy of the Tax Court is generally to try all of the issues raised in a case in one proceeding to avoid piecemeal and protracted litigation.²⁴⁸⁸ Although there may be exceptions in unusual cases, I will deal here with the usual progress of a single-proceeding Tax Court case.

The trial calendar will commence with a docket call at the beginning of the week. Prior to the docket call, the Tax Court will have sent notice for counsel or pro se litigants to appear at the opening of docket call, often 10am on a Monday. Such notices will have gone out in a number of cases. At the opening of the docket, the judge will move through a list of the cases on the docket sequentially from oldest to newest. Counsel or pro se litigants will advise the court of the status of the case (settled, will be settled shortly, ready for trial, not ready for trial, etc.) The Judge will determine which cases are to be tried during the session and the timing of the trials. The judge will then, in the following days, handle the trials scheduled and deal with various motions parties may present.

In some cases that the parties know will not settle and may require special trial dates (e.g., witnesses coming in from out of town), the parties may have arranged a special trial date in advance. A special trial setting should be discussed with the court well in advance of the docket call at the general calendar. And, while special settings can be in the place originally designated in the Designation of Place of Trial filed with the Petition, it is not uncommon for the parties to agree to trial at the Tax Court in Washington in large high stakes cases that will require many days to try. This is done principally for the convenience of the Tax Court judge who would otherwise have to spend that time working out of a hotel room in another city. The judge is likelier to be a happier judge when he or she can sleep in his or her own bed at night. That is not to say that the judges begrudge having to go out across the country on the normal trial sessions to try cases. I don't think they do. But in appropriate cases, it might be worth at least considering a Washington trial setting.²⁴⁸⁹ This decision is usually not made at the inception of the case but after much or all of the discovery has been done and the stipulation process has at least started, so that the parties will have some idea of shape and length of the trial.

Trials are relatively informal (at least as compared to trials in district courts). The parties will (or should), as noted, stipulate as much as possible, leaving only the critical unstipulated facts, if any, to be tried. Because of the Tax Court's insistence on the fullest possible stipulations, many cases require no trial and most of those that are tried are fairly summary, often being concluded in a matter of hours.

Trials are conducted pursuant to the Tax Court's own Rules of Procedure and under the Federal Rules of Evidence.²⁴⁹⁰

²⁴⁸⁸ *Markwardt v. Commissioner*, 64 T.C. 989, 998 (1975).

²⁴⁸⁹ Although I have not heard of it being done, I certainly can at least imagine / dream of a special setting in Honolulu. That would make everybody happy, but may not be as productive in terms of the efficiency of the trial.

²⁴⁹⁰ § 7453; and Tax Court Rule 143(a) (providing that any rule of evidence contained in the FRCP will also apply). A good resource for the Tax Court's rules of evidence is Joni D. Larson, *A Practitioner's Guide to Tax* (continued...)

At the end of trial, the judge will set a briefing schedule for the parties and take the case under advisement.²⁴⁹¹ Except in relatively easy cases, the Judge will rarely indicate which way he is inclined to rule.

17. Briefing.

The parties will then brief the case according to the schedule set by the Judge. The briefing will include detailed proposed findings of fact (with references to the trial record, including the exhibits and transcript) and legal arguments.²⁴⁹²

18. Opinion and Decision.

Upon receiving the briefs, the Judge will consider the matter for as long as it takes (several months, or even years) and then render an opinion resolving the issues presented to him for resolution. Setting aside the small tax cases, the opinion will be a Tax Court division opinion (T.C.) (either a division opinion or a reviewed opinion) or a memorandum opinion.

After the opinion is issued, the parties will translate all of their agreements and the Tax Court's rulings into bottom-line numbers and incorporate the bottom-line numbers into a decision document (the Tax Court equivalent of a judgment in the district courts). If the parties agree to the calculations and wording of the decision document, they will sign the document and, usually, the judge will enter the submitted decision, which is often referred to as a stipulated decision. If the parties cannot agree upon the bottom-line numbers because of disputes as to the calculations, the Tax Court has a procedure to resolve their differences which then permits the judge to enter a decision (whether agreed or stipulated or not).²⁴⁹³

The decision document always has a “determination” component where the Tax Court determines the bottom-line numbers of the determinations it has made as to the amount of the deficiency or overpayment. These determinations will appear above the Tax Court Judge’s signature on the decision document. The decision document may also contain parties stipulations as to related matters not determined by the Tax Court. These matters not constituting determinations by the Tax

²⁴⁹⁰(...continued)

Evidence, Second Edition (ABA 2017).

²⁴⁹¹ Tax Court Rule 151(a).

²⁴⁹² Tax Court Rule 151(e).

²⁴⁹³ Tax Court Rule 155. Rule 155 permits the parties to calculate the bottom-line tax and penalties or overpayment due based on the issues stipulated by the parties or resolved by the court. See *Cloes v. Commissioner*, 79 T.C. 933, 935 (1982). New matters that should have been raised earlier are not heard in the Rule 155 proceeding. See Rule 155(c); *Molasky v. Commissioner*, 91 T.C. 683, 685-686 (1988); *Vento v. Commissioner*, 152 T.C. 1, 8-9 (2019) (reviewed opinion); and *Eaton Corp. v. Commissioner*, 153 T.C. 119, 123 (2019), rev’d on other issues 47 F.4th 434 (6th Cir. 2020). Technically, the “starting point for the [Rule 155] computation is the statutory notice of deficiency from which the parties compute the redetermined deficiency based upon matters agreed by the parties or ruled upon by the Court.” *Home Group, Inc. v. Commissioner*, 91 T.C. 265, 269 (1988), aff’d 875 F.2d 377 (2d Cir. 1989). For an explanation of how the issues resolved either by agreement or tax court opinion are then turned into the numbers (deficiency redetermination) that are reflected in the final decision document (the equivalent of a judgment in a district court), see Keith Fogg, [Doing the Right Thing](#) (Procedurally Taxing Blog 11/18/16).

Court will appear below the Judge's signature in a stipulated decision document.²⁴⁹⁴ One example of a stipulation in some decision documents is the parties' agreement that the IRS may assess without awaiting the prohibitions on assessment that would otherwise require the IRS to await the time period in § 6213(a).

The Tax Court's Regular Opinions are printed in official volumes by the Government Printing Office. The Memorandum Opinions are not printed by the Government, but are printed by private services, such as CCH and Tax Analysts. All opinions (including Summary Opinions) are published on the Tax Court web page.²⁴⁹⁵ As to Summary Opinions, the Web site cautions: "Pursuant to Internal Revenue Code Section 7463(b), these opinions [Summary Opinions] may not be treated as precedent for any other case."

19. Appeals and Precedent.

a. Appellate Review.

Appeals are taken to the court of appeals. § 7482(a)(1). The court of appeals has "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." *Id.* Appeals are generally from the final decision (like a judgment in district court) resolving all issues in the case. Using the district court analog, this is called the "final judgment rule."²⁴⁹⁶ Exceptions allowing appeals before the final decision are:

- Certain dispositive orders may be appealed.²⁴⁹⁷ Dispositive orders include (i) "an order granting or denying a motion to restrain assessment or collection, made pursuant to Code section 6213(a)," and (ii) "an order granting or denying a motion for review of a proposed sale of seized property, made pursuant to Code section 6863(b)(3)(C)."

²⁴⁹⁴ Distinguishing between the two categories is only important where an issue depends upon what the Tax Court has determined in the decision document. For example, in some cases, the Tax Court's jurisdiction with respect to interest on overpayments may depend upon whether the Tax Court determined that there was an overpayment (above the signature line) or the parties' stipulations below the signature line merely indicate an overpayment credit. See *Hill v. Commissioner*, T.C. Memo 2021-121 discussed in this context in Bob Probasco (Guest Blogger), *Overpayment, or Not?* (Procedurally Taxing Blog 11/29/21).

²⁴⁹⁵ Actually finding opinions is more difficult under the Tax Court's recent web site changes. Those changes referred to as DAWSON, the acronym for "Docket Access Within a Secure Online Network," the U.S. Tax Court's electronic filing and case management system. As of this writing, the opinions are accessed generally through the docket entries for those cases that have not had some portion of the docket entries sealed. In addition, on the day of publication only, the IRS publishes opinions, orders and other dispositions on the daily publications pages. After the day of publication, the opinions, orders and other dispositions are available, if at all, only through docket entry searches. Prior to the DAWSON changes, the Tax Court had a robust database system that permitted opinions (T.C. and T.C.M.) to be retrieved by dates, case names and docket numbers, judges, etc. Thus, for example, one could search for the opinions drafted by a particular judge.

²⁴⁹⁶ *Kovens v. Commissioner*, 91 T.C. 74, 76-78 (1988) (noting the district court analog, the policy behind the rule, and applying it to the Tax Court).

²⁴⁹⁷ Tax Court Rule 190(b).

- Interlocutory appeals (appeals of orders before the final decision, called interlocutory orders) are allowed if (i) the Tax Court judge makes “a statement that a controlling question of law is involved with respect to which there is a substantial ground for difference of opinion and that an immediate appeal from that order may materially advance the ultimate termination of the litigation,” and (ii) the Court of Appeals exercises its discretion to permit the appeal.²⁴⁹⁸ Interlocutory appeals are rare.

On the appeal, Courts of Appeals have power “to affirm or, if the decision of the Tax Court is not in accordance with law, to modify or to reverse the decision of the Tax Court.”²⁴⁹⁹ Basically, and at a risk of oversimplification, factual findings are reviewed for clear error, legal interpretations are reviewed de novo,²⁵⁰⁰ and mixed questions of fact and law are reviewed under either standard or a blend (such as de novo to the extent that the alleged error is based on misunderstanding of the law), depending upon the particular court of appeals’ jurisprudence.²⁵⁰¹

²⁴⁹⁸ § 7482(a)(2); see Tax Court Rule 193, titled Appeals from Interlocutory Orders. This authority parallels FRCP Rule 5(a) and 28 U.S.C. § 1292(a) and (b) for district court appeals, so that authorities under those provisions guide the Tax Court in application of § 7482(a)(2). E.g., *Kovens v. Commissioner*, 91 T.C. 74, 76-78 (1988). The Tax Court, in an order denying interlocutory appeal, recently summarized the requirement for controlling question of law (*Belair Woods, LLC v. Commissioner* (T.C. Dkt. 19493-47, Order dated 3/19/20 cleaned up):

A "controlling question of law" must be a pure issue of law that the court of appeals 'can decide quickly and cleanly without having to study the record. A "controlling question" is not simply a question which if decided erroneously would lead to a reversal on appeal. Rather, the question must be one that is serious to the conduct of the litigation. The requirement that an immediate appeal materially advance the ultimate termination of the litigation means that resolution of the controlling legal question "would serve to avoid a trial or otherwise substantially shorten the litigation.

²⁴⁹⁹ § 7482(c)(1).

²⁵⁰⁰ The de novo standard of review is thought to be compelled by Congress’ enactment of the language in § 7482 requiring review “in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury” enacted in reaction to *Dobson v. Commissioner*, 320 U.S. 489 (1943). Nonetheless, the debate has simmered for years over whether the Tax Court’s interpretations of law should be subject to de novo review on appeal or should be given some form of deference which would tilt the appellate outcome in favor of adopting the Tax Court interpretation (perhaps akin to the later concept of *Chevron* deference discussed beginning p. 86). See e.g., Leandra Lederman, (Un)Appealing Deference to the Tax Court, 63 Duke L.J. 1833 (2014) (arguing for de novo review); and Andre L. Smith, Deferential Review of the United States Tax Court: The Chevron Doctrine, 37 Va. Tax Rev. 75 (2017) (arguing for review under a deference standard like the *Chevron* standard for agency interpretations); David F. Shores, Rethinking Deferential Review of Tax Court Decisions, 53 Tax Law. 35, 49 (1999) (arguing for deferential review); and Steve R. Johnson, The Phoenix and the Perils of the Second Best: Why Heightened Appellate Deference to Tax Court Decisions Is Undesirable, 77 Or. L. Rev. 235, 252 (1998) (suggesting that, although paying allegiance to de novo review via boilerplate language, the courts of appeals may in fact adopt deference (referred to as *Dobson* deference, sub silentio). Lederman, *supra*, pp. 1867-71, discusses instances of courts using language suggesting courts’ deferential review of Tax Court interpretations of law despite the amendment to § 7482(a), but argues that there should be no deference.

²⁵⁰¹ A case illustrates this phenomenon of a different approach employed by two circuit courts to review of Tax Court appeals—the Second Circuit and the Seventh Circuit. In *Diebold Found. v. Commissioner*, 736 F.3d 172 (2d Cir. 2013), the Second Circuit reversed its earlier holding that the clear error standard for fact findings also applied to mixed questions of fact and law. The Second Circuit opinion candidly noted that its earlier precedent adopting the clear error standard erroneously relied upon Seventh Circuit law where that is and remains the standard. Upon reflection, the Second Circuit said that it had erred but now held that “mixed questions of law and fact are reviewed de novo, to the extent that the alleged error is in the misunderstanding of a legal standard.” I think the key point is that Tax Court decisions are reviewed like district court decisions. There is no unanimity among the circuits as to which standard applies to mixed questions of fact and law. Even this is substantially summarized at the expense of nuance for a large
(continued...)

b. Appellate Timing.

Appeal from a Tax Court **decision** is taken by filing the notice of appeal with the Tax Court within 90 days after the decision.²⁵⁰²

c. Appellate Venue.

Appellate venue is important at the conclusion of a case for the parties to be able to properly file the notice of appeal, which must state the Circuit Court of Appeals to which the appeal is taken. Appellate venue is important earlier in the case because of the Tax Court's *Golsen* rule (discussed in the next section) which determines precedent in the case based upon the Court of Appeals to which an appeal is taken.²⁵⁰³ Section 7482(b) generally provides venue based on the petitioner's residence or, if an entity, principal place of business (although I discuss in more detail below) at the time the Tax Court petition was filed.²⁵⁰⁴ For this reason, one of the first findings in Tax Court decisions is the residence or principal place of business, thus determining the Court of Appeals to which an appeal may be taken.

Other key facets of the appellate venue are:

²⁵⁰¹(...continued)
subject.

²⁵⁰² § 7483. There are traps for the unwary here.

First, taxpayers will sometimes file an appeal with the Court of Appeals rather than the Tax Court itself. In that case, since the statute commands that the notice of appeal be filed with Tax Court and filing with the Court of Appeals will not suffice. § 7483; see also FRAP Rule 13(a)(1). By contrast, an appeal from district court judgments filed with the courts of appeals will be sent to the district court where it should have been filed and will be deemed filed with the district court on the date it was filed with the Court of Appeals. FRAP Rule 4(d); see FRAP Rule 14 excluding Rule 4 and other rules from application to appeals from Tax Court decisions.

Second, most courts treat the 90 period as jurisdictional; there is no equitable tolling of that period. *Annamalai v. Commissioner*, 884 F.3d 530 (9th Cir. 2018).

Third, although FRAP 13 treats a timely filed motion to vacate or revise as re-setting the starting point for the 90 day appeals period to the action on the motion, the period will not be extended for successive such motions. *Annamalai v. Commissioner*, p. 532 n. 4, *supra* (saying that the 90 day period is not tolled or suspended by the motion but restarted from the date of action on the motion).

Fourth, a taxpayer will sometimes file a notice of appeal before the decision is entered. The appeal is from the decision. A premature appeal that is not then perfect by filing another notice of appeal after the decision is filed may result in dismissal of the appeal for lack of jurisdiction. See *Davison v. Commissioner*, 2022 U.S. App. LEXIS 16947 (10th Cir. 6/17/22) (Non precedential) (but with good discussion of factors for Court of Appeals to exercise discretion to treat a premature notice of appeal as precedential.) The practice lesson is to always file the notice of appeal **after** the decision.

²⁵⁰³ *Golsen v. Commissioner*, 54 T.C. 742, 757 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971), *aff'd*, 445 F.2d 985 (10th Cir. 1971), *cert. denied*, 404 U.S. 940 (1971).

²⁵⁰⁴ § 7482(a)(1), (b)(1)(A), (B), (C)-(F). Appeals to the Court of Appeals for the Federal Circuit are specifically excluded by the parenthetical in the first sentence of § 7482(a)(1). See also 28 U.S.C. § 1295 (stating the jurisdiction of the Court of Appeals for the Federal Circuit). However, an appeal improvidently filed in the Court of Appeals for the Federal Circuit can be transferred to the appropriate Court of Appeals under 28 U.S.C. § 1631. *Heintz v. Commissioner*, 2012 U.S. App. LEXIS 17357, 2012 WL 3307003 (Fed. Cir. 2012).

- For cases not listed in § 7482(b) (such as whistleblower awards), venue is to the Court of Appeals for the D.C. Circuit.²⁵⁰⁵
- Some cases may not fall crisply into these venue provisions, so that the Court will be required to analyze and analogize to a result as to the appropriate venue.²⁵⁰⁶
- If a timely appeal is filed to the wrong Court of Appeals, the appeal may be transferred to the correct Court of Appeals if the transfer “is in the interest of justice.”²⁵⁰⁷
- In all cases, the parties may stipulate to venue in a different circuit, although this is rarely used.²⁵⁰⁸
- Once an interlocutory appeal is permitted, all further appeals from the Tax Court in the case is to the Court of Appeals permitting the interlocutory appeal.²⁵⁰⁹

d. The *Golsen* Rule - Precedent from Circuit Court.

²⁵⁰⁵ See § 7482(b)(1), flush language.

²⁵⁰⁶ For an interesting, although brief, discussion of some of these uncertainties, see *Buckrey v. Commissioner*, T.C. Memo. 2017-138 at *15, n. 11 (noting inter alia some uncertainty as to whether a notice of liability for transferee liability where the putative transferors are questioning liability but not amount of tax fits under these rules, particularly where more than one may be liable and residing in different circuits); see also Chief Counsel Notice CC-2015-006 (6/30/15) giving IRS attorneys guidance as to appeals from decisions of the Tax Court.

Indian Tribes: In *Mescalero Apache Tribe v. Commissioner*, 148 T.C. ___, No. 11 (2017), involving an Indian tribe treated as a “sovereign government,” the Court noted the it is neither an individual or a corporation as to which venue is clearly in the Court of Appeals for the circuit of residence or principal place of business, but then assumed venue in the Tenth Circuit for purposes of applying the *Golsen* rule (*Golsen v. Commissioner*, 54 T.C. 742, 757 (1970), aff’d, 445 F.2d 985 (10th Cir. 1971), , aff’d, 445 F.2d 985 (10th Cir. 1971), cert. denied, 404 U.S. 940 (1971) looking to precedent in the applicable court of appeals.

Trust or estate appeal where the co-fiduciaries of trusts or estates reside in different circuits: Apparently, § 7482 looks to the residence of the co-trustees rather than the residence or principal place of business of the trust as an entity. The Sixth Circuit held that appellate venue could lie in the Court of Appeals appropriate for any of the fiduciaries. *Julia R. Swords Trust v. Commissioner*, 2014 U.S. App. LEXIS 24746 (6th Cir. 2014) (unpublished order) (reproduced at 2014 TNT 245-7) (case involved an IRS appeal that the IRS could have appealed to Fourth or Sixth Circuits but IRS preferred Sixth Circuit because of unfavorable precedent in Fourth Circuit (this IRS forum shopping may have irritated the Sixth Circuit); holding that, based on all the facts (including notions of convenience to taxpayer (taxpayer favorable precedent is certainly convenient to the taxpayer), notions of waiver of Sixth Circuit venue and reliance by the trust and its fiduciaries), the Fourth Circuit was the more proper forum (close reading of the cryptic facts recited in the Order is necessary) and therefore case transferred to Fourth Circuit). I question this holding; developing the position would require many pages and is not appropriate for this book.

²⁵⁰⁷ 18 U.S.C. § 1631. I infer from the cases I have observed (anecdotal) is that the authority is liberally applied “in the interest of justice,” particularly pro se appeals from Tax Court decisions. However, in cases where the appellant’s arguments on the merits are weak, a court may exercise discretion to not transfer and to instead dismiss the appeal. *Kanofsky v. Commissioner*, 2017 U.S. App. LEXIS 13299 (4th Cir. 2017) (citing *Sorcica v. Holder*, 643 F.3d 117, 122-23 (4th Cir. 2011)).

²⁵⁰⁸ § 7482(b)(2). Generally, if a party wants to stipulate to a different Circuit Court of Appeals than designated under the rules discussed in the text, it will be because that chosen Circuit has better precedent; the other party is not likely to agree to such a stipulation. For an odd case in which normal venue was in the Eleventh Circuit but the parties apparently stipulated to venue in the Sixth Circuit and the taxpayer attempted unsuccessfully to assert that precedent from Eleventh Circuit controlled the outcome, see *Maloof v. Commissioner*, 456 F.3d 645, 652 (6th Cir. 2006) (“That he volitionally filed this challenge to the Tax Court’s decision in the Sixth Circuit, not the Eleventh Circuit, makes this something of a bewildering argument.”)

²⁵⁰⁹ § 7482(a)(2)(C); see Tax Court Rule 193, titled Appeals from Interlocutory Orders.

In interpreting the law, the Tax Court (just as other courts), may apply “precedent”—prior judicial interpretations²⁵¹⁰—from the Tax Court or from other courts for either controlling or persuasive effect.²⁵¹¹ Normally in our federal system, the ordering of priority for such judicial precedent is: (i) Supreme Court precedent (compulsory on the Supreme Court until overruled and on lower courts); (ii) Court of Appeals precedential opinions (compulsory within the circuit until overruled and on lower courts, including district courts in the circuit and on the Tax Court in cases which are appealable to the circuit and perhaps persuasive in other courts), and (iii) trial level precedential opinions in those courts and other courts for their own precedential values.

The rule in the second category as applicable to the Tax Court is referred to in tax litigator jargon as the *Golsen* rule (sometimes called *Golsen* doctrine), named after the Tax Court case establishing the rule.²⁵¹² Prior to establishing the *Golsen* rule, the Tax Court practice (sometimes described as the *Lawrence* rule (or doctrine) was to decide cases based on its best interpretation of the law where, in reaching that best interpretation, the Tax Court was not bound by precedent from Courts of Appeals (even courts to which the cases were appealable).²⁵¹³ As a matter of judicial efficiency, however, in the 1970 *Golsen* case, the Tax Court adopted a “narrow exception” to the *Lawrence* rule to “follow a decision of the Court of Appeals to which an appeal from our disposition of a case lies so long as that decision is squarely in point and a failure to follow that decision would result in an inevitable reversal.”²⁵¹⁴

²⁵¹⁰ In determining the effect of prior judicial interpretations, it is important to distinguish between interpretations that are holdings necessary to the result in the case (sometimes called judicial precedent) and other holdings, not necessary to the holding, that are sometimes called judicial dicta or obiter dicta. Only the former are deemed “controlling” precedent either by the same court or by lower courts; the latter are not controlling but may be persuasive (particularly if uttered by the same court or a higher level court). There is some considerable nuance as to how to distinguish the two categories. A good article that goes into the detail is Michael Abramowicz & Maxwell Stearns, *Defining Dicta*, 57 Stan. L. Rev. 953 (2005); see also Pierre Laval, *Judging Under the Constitution: Dicta About Dicta*, 81 N.Y.U. Law Review 1249 (2006). For a more accessible and shorter discussion, I recommend Paul J. Watford, Richard C. Chen and Marco Basile, *Book Review: Crafting Precedent: The Law of Judicial Precedent*, 131 Harv. L. Rev. 543, 575-576 (2017), which discusses the concepts presented in Bryan A. Garner, et al., *The Law of Judicial Precedent* 62-70 (Thomson Reuters 2016).

²⁵¹¹ As to such “precedent” generally, see Bryan A. Garner, et al., *The Law of Judicial Precedent* (Thomson Reuters 2016).

²⁵¹² *Golsen v. Commissioner*, 54 T.C. 742, 756-58 (1970), aff’d, 445 F.2d 985 (10th Cir. 1971), cert. denied, 404 U.S. 940 (1971). An excellent discussion of the *Golsen* rule is in Tax Court Judge Halpern’s article: James S. Halpern, *What has the Tax Court Been Doing? An Update*, Tax Notes 1277, 1286-1287 (May 30, 2016). Judge Halpern calls it a “doctrine” rather than a rule. In 2020, I searched Lexis-Nexis with the following results: Cases: 30 for doctrine and 91 for rule; and secondary materials (including law reviews): 10 for doctrine and 139 for rule. Accordingly, based on majority “rule” (so to speak), I refer to the *Golsen* rule.

²⁵¹³ This practice has been called the “Lawrence doctrine, based on the Tax Court opinion in *Lawrence v. Commissioner*, 27 T.C. 713, 718 (1957), rev’d, 258 F.2d 562 (9th Cir. 1958). See James S. Halpern, *What has the Tax Court Been Doing? An Update*, Tax Notes 1277, 1286 (May 30, 2016).

²⁵¹⁴ *Rauenhorst v. Commissioner*, 119 T.C. 157, 162, fn. 3 (2002) The Tax Court reasons that, while it is not required to follow the applicable court of appeals holding in point, it does so because it would be wasteful to do otherwise but cautions that the *Golsen* rule should apply only where “where the holding of the Court of Appeals is squarely on point.” *Robinson v. Commissioner*, 54 T.C. 742, 757 (1970). We encountered the *Golsen* rule above in discussing the proper deference to be given Revenue Rulings and noted that the Tax Court does not apply a circuit court’s holdings on deference to Revenue Rulings because such holdings are not substantive. Consider that issue as you consider the *Golsen* rule above. Consider specifically whether approaches to statutory interpretation—which is what
(continued...)

The Tax Court spelled out some nuance for the *Golsen* rule:

- the Court should determine whether the court of appeals decision at issue “is so clearly on point that it would be futile” to issue a decision contrary to it.²⁵¹⁵
- where the court of appeals interpretation is not squarely in point, concerns for “uniformity in interpretation” throughout the country require that the Tax Court its own best interpretation.²⁵¹⁶

In effect, in considering these competing considerations, the Tax Court must exercise some judgment.²⁵¹⁷

A related issue is whether, when *Golsen* does not apply to require the Tax Court to follow the Circuit Court to which an appeal would apply, the Tax Court can or should apply a Circuit Court opinion in another Circuit. The Court takes the position that it can reach its own independent opinion without following a Circuit Court opinion from another Circuit.²⁵¹⁸

Accordingly, in determining whether the Tax Court is a favorable or unfavorable forum, you look not only to the precedent of the Tax Court but also the precedent of the Court of Appeals to which an appeal may be taken, with the Court of Appeals precedent trumping Tax Court precedent. Unfavorable Tax Court precedent but favorable appellate court precedent will produce a winner in the Tax Court under *Golsen*; favorable Tax Court precedent but unfavorable appellate court precedent will produce a loser in the Tax Court under *Golsen*, in which case relief will come only if you can convince the Court of Appeals that it messed up in its earlier precedent (usually unlikely).

What if there is no precedent in the Court of Appeals for the circuit in which the individual taxpayer resides? Well, if the matter is important enough, presumably the taxpayer could change residence (or, if a corporation, its principal place of business) before filing the petition and thereby

²⁵¹⁴(...continued)

deference is all about—that can produce different interpretations of the statute and results in the case at hand are not substantive? Must the Government be forced to appeal to have the court of appeals hold in its favor under its application of the concept of deference?

As Judge Halpern notes that the *Golsen* rule is a “narrow exception” to the *Lawrence* rule and application of the *Golsen* rule can mean that the Tax Court may enter a decision that it does not agree with and that could result in impairing the original goal of the Tax Court to develop a uniform body of tax law. James S. Halpern, What Has the Tax Court Been Doing? An Update, Tax Notes 1277, 1286-1287 (May 30, 2016).

²⁵¹⁵ I analogize this review to the much ballyhooed *Chevron* Footnote 9 rigorous statutory interpretation to eliminate ambiguity at *Chevron* Step One. If by vigorous review of the Circuit’s case authority, the Tax Court finds that the authority is not squarely on point (meaning, I think, that the authority can be meaningfully distinguished or otherwise not applicable), the Court can then apply its own best interpretation.

²⁵¹⁶ *Lardas v. Commissioner*, 99 T.C. 490, 494-5 (1992); see *Kraske v. Commissioner*, 161 T.C. ___ No. 7 (2023), Slip Op. *5-*8, for an illustrative application of this nuance.

²⁵¹⁷ Bryan Camp, Lesson From The Tax Court: The Rules For Penalty Approval Depend On Geography (Tax ProfBlog 10/30/23) (discussing *Kraske v. Commissioner*, 161 T.C. ___ No. 7 (2023), noting its “practical approach” to the *Golsen* rule “means that the Tax Court will not automatically apply the *Golsen* rule but will basically decide the likelihood that the Circuit Court of Appeals would reverse the Tax Court in the case at hand.”).

²⁵¹⁸ *Sanders v. Commissioner*, 161 T.C. ___ No. 8, *6-*7 (2023) (reviewed opinion).

secure the favorable precedent.²⁵¹⁹ This is unlikely to be a satisfactory alternative for most taxpayers. The taxpayer might still be able to obtain the benefit of the favorable precedent in other circuits, however, even if the Tax Court precedent is not consistent with that favorable precedent. Note that the usual formulation of the *Golsen* rule would permit the Tax Court to follow its own precedent if the Circuit of the taxpayer's residence has not yet spoken, despite contrary precedent in other circuits. Consider the following argument. Some courts of appeals take the position that, in the absence of that court having spoken on the issue, that court should give respectful consideration to other circuits' decisions. For example, the Seventh Circuit said:

As a general matter, “[r]espect for the decisions of other circuits is especially important in tax cases because of the importance of uniformity, and the decision of the Court of Appeals of another circuit should be followed unless it is shown to be incorrect.”²⁵²⁰

In this circumstance, the taxpayer should argue to the Tax Court that, indeed, the Tax Court is bound to follow the decision of another circuit or, at a minimum, give substantial deference to that decision, even if the Tax Court has a prior different position on the matter.

I noted above that, at present, some Tax Court appeals are to the Court of Appeals of residence or principal place of business and some are to the Court of Appeals for the District of Columbia Circuit. This dichotomy can and, should it continue, over time will affect the interpretation and application of the tax law. Where the appeals are not defaulted to the Court of Appeals for the District of Columbia Circuit, as apparent from the foregoing discussion, conflicts among the circuits can develop in the various Courts of Appeals to which Tax Court appeals can be taken. Those conflicts are not always resolved by the Supreme Court and certainly not quickly resolved. So, taxpayers in different parts of the country can be treated differently. However, where the appeal must be taken under the default provision to the Court of Appeals for the District of Columbia, a uniform rule will apply.

20. Nondeficiency Jurisdiction of the Court.

The foregoing discussion of litigation in the Tax Court has dealt principally with its deficiency jurisdiction—i.e., its jurisdiction requiring a timely petition to redetermine the tax liability asserted in a notice of deficiency. Congress has, however, added jurisdiction over other tax issues over the years. I just summarize some of these to give you a flavor for the Tax Court's nondeficiency jurisdiction.

²⁵¹⁹ But the change of residence or principal place of business must be real and substantial rather than gossamer solely to affect the legal consequences (here the Court of Appeals' precedents). See e.g., *Uviado LLC v. United States*, 755 F. Supp. 2d 767 (S.D. Tex. 2010) (in the case of the TEFRA rules for partnership district court proceedings).

²⁵²⁰ *Square D. Company v. Commissioner*, 438 F.3d 739 (7th Cir. 2006). This notion that, in federal tax matters, the need for uniformity in taxation across the circuits justifies deference to other circuits has been echoed in opinions of circuits other than the Seventh Circuit.

a. Collection Due Process Proceedings.

A major addition to Tax Court jurisdiction is the collection due process proceeding (“CDP”). I discuss CDP and the Tax Court jurisdiction below beginning p. 733.

b. Declaratory Judgment.

The Tax Court has jurisdiction to issue declaratory judgments (i) as to the qualification and continuation of qualification of certain retirement plans,²⁵²¹ (ii) as to the IRS’s valuation of a gift disclosed on a return provided there is “an actual controversy” and the taxpayer has exhausted administrative remedies,²⁵²² (iii) as to the qualification for certain governmental bonds for exclusion from income under § 103,²⁵²³ and (iv) as to eligibility for installment payment of estate tax under § 6166.²⁵²⁴ The IRS has special rules for such declaratory judgments.²⁵²⁵

c. Employee - Independent Contractor Disputes.

The Tax Court has jurisdiction to determine whether the IRS has properly characterized a person providing services to a taxpayer as an employee or an independent contractor or whether the taxpayer is entitled to so-called “Section 530 relief” which provides a safe harbor to permit such service providers to be characterized as independent contractors even if they might otherwise be treated as employees.²⁵²⁶ (I discuss § 530 relief beginning p. 96.) Paralleling the procedure for deficiency determinations for income and estate and gift tax, the IRS will make a determination of employment status or Section 530 relief, giving the taxpayer 90 days to petition for redetermination.²⁵²⁷ For purposes of triggering the right to petition the Tax Court, the taxpayer is usually notified of the IRS determination by a Notice of Employment Tax Determination Under IRC § 7436 (called a “§ 7436 Notice”),²⁵²⁸ but it is possible for the IRS to make the determination without the § 7436 Notice.²⁵²⁹

²⁵²¹ § 7476.

²⁵²² § 7477. No deficiency or refund need be in issue. Reg. § 301.7477-1.

²⁵²³ § 7478.

²⁵²⁴ § 7479.

²⁵²⁵ Tax Court Rules of Practice Title XXI.

²⁵²⁶ § 7436(a). See Tax Court Rules Title XXVIII. Merely because, in an audit, worker compensation is increased does not mean that the issue is a worker classification issue subject to Tax Court jurisdiction. CCA 201735021 (5/18/17) (involving increase in worker compensation as a result not involving whether the pay was to an employee or independent contractor).

²⁵²⁷ § 7436(b)(2). The IRS generally issues a Notice of Determination which functions like a Notice of Deficiency giving access to the Tax Court. Omeed Firouzi (Guest Blogger), Section 7436 Notice Not Jurisdictional Requirement for Employers to Appeal Certain Determinations in Tax Court (Procedurally Taxing Blog 12/20/22) (noting that some determinations not appearing in a Notice of Determination may be litigated in the Tax Court).

²⁵²⁸ Rev. Proc. 2022-13, 2022-6 I.R.B., § 1.

²⁵²⁹ Rev. Proc. 2022-13, 2022-6 I.R.B., § 2.05 (“even in the absence of the issuance of a § 7436 Notice, a taxpayer may petition the Tax Court on an IRS worker reclassification or section 530 relief determination to the extent that the determination meets the requirements set forth in the Tax Court opinions.”). The Rev. Proc. summarizes in § 3 the requirements for filing a petition for redetermination.

A small case procedure is provided, again paralleling the small case procedure for deficiency determinations.²⁵³⁰ Finally, to make this remedy a prepayment remedy, the statute provides that “The principles of” the various Code sections assuring the prepayment remedy for deficiency proceedings (e.g., § 6213(a)’s prohibition on assessment) apply as if the IRS’s determination were a notice of deficiency.²⁵³¹

The Tax Court held that this jurisdiction includes the jurisdiction to determine the amount of liability as well as the proper additions to tax and penalties.²⁵³²

d. Disclosure Disputes.

Section 6110 provides that written determinations by the IRS be disclosed to the public. Congress’s concern was that there was a body of “hidden” law in various IRS determinations—the most prominent of which are private letter rulings—and that the taxpaying public should have reasonable access to that hidden law. The tension, however, was to ensure that sensitive taxpayer return information be kept confidential. The solution in § 6110 is to require that the determination be disclosed, but to require redactions of information that would identify the taxpayer.

Two problems may come up with such disclosures. First, the taxpayer to whom the determination relates may feel that the IRS’s proposed disclosure is not sufficiently redacted to delete unique information that might identify the taxpayer. Second, the public at large or particular taxpayers may feel that a determination has not been disclosed or that too much information is redacted in violation of Congress’s desire to have the public know the bases for such written determinations.

The solution to the first problem is to provide the taxpayer an administrative and judicial remedy before disclosure if the taxpayer believes too much identifying information is being disclosed. Before making the disclosure, the IRS must send the taxpayer a notice of intention to disclose showing the part of the written determination that will be redacted and the part that will be disclosed. If the taxpayer feels that not enough information is being redacted, the taxpayer may pursue an administrative remedy and thereafter, if still not satisfied, may bring a proceeding in the Tax Court.²⁵³³

The solution to the second problem is that members of the public may bring a proceeding in the Tax Court or in District Court for additional disclosure.²⁵³⁴

The Tax Court is specifically granted authority to make rules to close the portions of the record necessary to maintain secrecy of sensitive information.²⁵³⁵

²⁵³⁰ § 7436(c).
²⁵³¹ § 7436(d).
²⁵³² *Ewens and Miller Inc. v. Commissioner*, 117 T.C. 263 (2001).
²⁵³³ § 6110(f).
²⁵³⁴ § 6110(f)(4).
²⁵³⁵ § 6110(f)(6).

e. Partnership Proceedings.

As discussed below (in Chapter 16, beginning p. 934), the Code has unified audit and litigation procedures. Disputes regarding partnership level items are resolved in unified audits and litigation. The litigation procedures include a Tax Court remedy similar to the deficiency proceedings. The IRS makes a determination and the partnership or the partners may institute or participate in the unified litigation.

f. Supplemental and Related Proceedings.

Miscellaneous jurisdiction is given for certain supplemental proceedings—to enforce an overpayment determination,²⁵³⁶ to redetermine interest on assessments resulting from Tax Court decisions or overpayments determined by the Tax Court,²⁵³⁷ and proceedings to modify decisions in § 6166 dealing with deferred payment of estate taxes.²⁵³⁸

g. Recovery of Administrative Costs.

Similarly, the Tax Court may hold supplemental proceedings to determine the amount of administrative costs to be awarded under § 7430.²⁵³⁹ If the matter were litigated in the Tax Court, the Court could award such costs incident to the pending Tax Court litigation. However, if the matter is resolved administratively in appeals, there will be no Tax Court case; this confers the necessary jurisdiction to permit a judicial remedy for recovery of these costs. Since § 7430 applies to all litigation, I discuss § 7430 after the sections introducing the particular forums. (See discussion beginning p. 601)

h. Proceedings to Abate Interest.

Section 6404 permits the IRS to abate interest in certain cases (p. 277). The Tax Court has jurisdiction to review the IRS's determination.²⁵⁴⁰

B. District Courts.

1. The Judges.

District Court judges are Article III judges—i.e., have life tenure.²⁵⁴¹ Vis-a-vis the tax law, they are usually generalist judges without a specialized tax practice background who at any given time will have civil tax cases as a very low percentage of their dockets. Civil tax cases are not priority items in terms of scheduling trials; criminal cases take priority and other types of civil

²⁵³⁶ Tax Court Rule 260.

²⁵³⁷ Tax Court Rule 261.

²⁵³⁸ Tax Court Rule 262.

²⁵³⁹ Tax Court Rules Title XXVI.

²⁵⁴⁰ § 6404(i).

²⁵⁴¹ U.S. Constitution, Article III, Section 1 (“The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour.”).

litigation may take priority. Hence, pursuing tax cases in busy district courts can take much more time than in the other available fora.

District Judges may use Federal Magistrate Judges for certain functions in the litigation, and in civil cases (such as tax cases) the parties may consent to trial by the Magistrate Judge.²⁵⁴² Like the District Judge, the Magistrate Judge will usually be a generalist vis-a-vis the tax law.

2. Rules of Procedure.

The Federal Rules of Civil Procedure (“FRCP”) govern practice in federal district courts. The Legal Information Institute offers a good free version: <https://www.law.cornell.edu/rules/frcp>. In addition, particular district courts may adopt what are referred to as “local rules” governing practice in their courts. Those local rules are available on the district courts’ websites.

3. Types of Tax Litigation in District Courts.

District courts are courts of limited jurisdiction, meaning they can only hear cases authorized by the United States Constitution or federal statutes. District courts have original jurisdiction for any case arising under federal statutes, the Constitution, or treaties,²⁵⁴³ and are specifically conferred jurisdiction for tax refund suits against the United States. 28 U.S.C. § 1346(a)(1) and § 7422(a). Historical note: Prior to 1966, refund suits could also be brought against the Collector based on illegal exactions without invoking § 1346(a)(1) which was subject to some limitations in earlier periods,²⁵⁴⁴ hence a number of leading tax cases from the pre-1966 period are refund suits brought against the Collector. E.g., *Lewis v. Reynolds*, 284 U.S. 281 (1932).²⁵⁴⁵

I also note prominently the collection suit.²⁵⁴⁶ The Government may bring a collection suit in the district court to reduce an assessment to judgment and to obtain judicial remedies with respect to the tax liability. If the taxpayer has not by that time judicially contested the underlying tax

²⁵⁴² FRCP Rule 73.

²⁵⁴³ 28 U.S.C. § 1331.

²⁵⁴⁴ § 7422(f), enacted in 1966, abolished refund suits against the Collector and required them against the United States. Pub. L. No. 89-713, § 3(a), 80 Stat. 1107, 1108 (1966). During much of the period prior to 1966, refund suits in the district courts could be pursued under the predecessor of § 1346(a)(1) subject to the jurisdictional limitation amount (initially \$1,000, subsequently raised to \$10,000), but that jurisdictional amount on refund jurisdiction in § 1346(a)(1) was eliminated in 1954. But, while the amount limitation applied, it could be avoided by suing the Collector. *Flora v. United States*, 362 U.S. 145, 151-152 (1960); see Leandra Lederman, *Equity and the Article I Court: Is the Tax Court's Exercise of Equitable Powers Constitutional?*, 5 Fla. Tax Rev. 357, 402-403 (2001); William T. Plumb, Jr., *Tax Refund Suits Against Collectors of Internal Revenue*, 60 Harv. L. Rev. 685, 686-687 (1947) (providing an excellent analysis of the history and quirks of the refund suit against the collector). Now (after 1966), refund suits can be brought under §§ 7422 and 1346(a)(1) only against the United States and with no limit as to amount.

²⁵⁴⁵ “Petitioners [Trustees] sued the respondent Collector to recover \$7,297.16 alleged to have been wrongfully exacted as income tax upon the estate of Cooper.” *Id.*, p. 282 (cleaned up). One aside, the opinion is just barely over 2 pages long; those were the good old days!

²⁵⁴⁶ For a summary of the process, including authority, jurisdiction, etc., for such suits, see IRM 5.17.4 Suits by the United States.

liability, he or she can do so in that collection suit.²⁵⁴⁷ Sometimes a collection suit is asserted as a counterclaim in a refund suit. The classic case is the so-called divisible tax case—best exemplified by the fairly common trust fund recovery penalty under § 6672. As I note elsewhere (beginning p. 793), this penalty is usually litigated by a refund suit. The putative responsible person will pay a small amount to meet the jurisdictional prerequisite that there be a payment which could be refunded. In the resulting refund suit, the Government will typically file a counterclaim for the balance of the amount that has been assessed. That counterclaim is a collection suit that could have otherwise been brought independently by the Government to obtain a judgment for the unpaid assessed tax. The Government will pursue the matter as a counterclaim to get the putative responsible person's liability for all quarters concluded in one litigation.

In addition, the district courts have a potpourri of other jurisdiction, examples of which include jurisdiction to quash an IRS formal document request (“FDR”),²⁵⁴⁸ to order more disclosure of a written determination,²⁵⁴⁹ to consider petitions for readjustment of partnership adjustments,²⁵⁵⁰ jurisdiction to approve a levy on a principal residence,²⁵⁵¹ general jurisdiction to enter orders and judgments necessary or appropriate for the internal revenue laws,²⁵⁵² jurisdiction over summons enforcement proceedings,²⁵⁵³ actions to enforce a lien and declare a sale,²⁵⁵⁴ certain injunctions against persons abusing the tax system,²⁵⁵⁵ wrongful levy suits where a third party claims his or her property was levied upon to pay another taxpayer’s taxes,²⁵⁵⁶ declaratory judgments for § 501(c)(3) organizations,²⁵⁵⁷ review of jeopardy assessments and levies,²⁵⁵⁸ and so on and on.²⁵⁵⁹ I discuss some of these in other sections of this book.

For purposes of this course in this section, please focus your attention on the refund suit jurisdiction and its collection suit counterpart.

²⁵⁴⁷ E.g., *United States v. O'Connor*, 291 F.2d 520, 527-528 (2d Cir. 1961).
²⁵⁴⁸ § 982(c)(2)(B).
²⁵⁴⁹ § 6110(f)(4)(A) (concurrent jurisdiction with the Tax Court).
²⁵⁵⁰ § 6226(a) (concurrent jurisdiction with Tax Court). Note: this is under the TEFRA procedures which have been replaced by the BBA regime discussed in Chapter 16, beginning p. 934.
²⁵⁵¹ § 6334(e)(1)(B).
²⁵⁵² § 7502.
²⁵⁵³ § 7402(b).
²⁵⁵⁴ § 7403.
²⁵⁵⁵ §§ 7407 & 7408.
²⁵⁵⁶ § 7426.
²⁵⁵⁷ § 7428.
²⁵⁵⁸ § 7429.
²⁵⁵⁹ The district courts had certain residual jurisdiction over CDP determinations issued prior to 10/17/06. § 6330(d)(1), prior to amendment by the Pension Protection Act of 2006, Pub. L. No. 109-280, § 855(a), 120 Stat. 780, enacted on August 17, 2006. That Act amended § 6330(d)(1) to give the Tax Court exclusive jurisdiction after 10/17/06.

4. Refund Suits.

a. Introduction.

Refund suits are for return of tax overpayments and thus a suits for monies “had and received.”²⁵⁶⁰ The taxpayer must claim and prove entitlement to a refund, hence the IRS can moot refund suits by refunding the claimed tax and interest, even if the same issue might be possible in another open year.²⁵⁶¹

b. Prerequisites for Refund Suits.

To bring a refund suit, the taxpayer must first file a claim for refund and, upon its denial by the IRS or the IRS's failure to act within six months, then file a suit for refund. § 7422.²⁵⁶² I discuss these requirements (beginning p. 223).

The refund suit must be generally brought by the taxpayer whose liability was paid. If some other person actually remitted the tax to the IRS in payment of the taxpayer’s taxes, the remitter generally cannot bring the suit because the remitter is not the taxpayer. In cases where the IRS may have acted egregiously in collecting the amount involved, there may be work arounds that will give the remitter some relief permitting some type of legal action, including a refund suit, but they are very limited instances. Thus, the Court of Federal Claims has a narrow exception that permits a remitter to file a suit in the Court of Federal Claims to recover tax where the IRS has coerced the remitter to pay another’s tax liability.²⁵⁶³ The theory of this type of suit is not a refund suit, however, but an implied contract on the part of the United States to make restitution.

Perhaps more importantly, the Supreme Court stretched the refund suit notion to cover a nontaxpayer remitter in *United States v. Williams*, 514 U.S. 527 (1995). *Williams* too may be a very narrow situation, made even more narrow by subsequent legislation giving persons in Mrs. Williams’ situation a remedy without having to distort the requirement that the plaintiff in a refund suit be the taxpayer. I direct readers to the *Williams* discussion beginning p. 749.

There is a special rule where the taxpayer has brought a refund suit in either the district court or the court of Federal Claims and the IRS thereafter issues a notice of deficiency (on the theory that the taxpayer is not only not entitled to a refund but owes more taxes). Section 7422(e) imposes a stay on the refund suit to give the taxpayer the option of filing a petition in the Tax Court, whereupon

²⁵⁶⁰ *Lewis v. Reynolds*, 284 U.S. 281, 283 (1932).

²⁵⁶¹ E.g., *Drs. Hill & Thomas Co. v. United States*, 392 F.2d 204, 205 (6th Cir. 1968); and *Christian Coalition, Inc. v. United States*, 662 F.3d 1182, 1192 (11th Cir. 2011).

²⁵⁶² The Sixth Circuit held that where the Government has refunded an overpaid tax and all that is in issue is the interest on the overpaid tax, the taxpayer may sue for refund rather than being relegated to a Tucker Act contract claim in the Court of Federal Claims. *E.W. Scripps Company v. United States*, 420 F.3d 589 (6th Cir. 2005). The *Scripps* holding was rejected in *Pfizer, Inc. v. United States*, 939 F.3d 173 (2d Cir. 2019) and *Bank of America v. United States*, 964 F.3d 1099 (Fed. Cir. 2020).

²⁵⁶³ The seminal case in the predecessor court to the present Court of Federal Claims is *Kirkendall v. United States*, 31 F. Supp. 766, 769, 90 Ct. Cl. 606 (Ct. Cl. 1940). *Kirkendall* and the subsequent cases are collected and discussed in *Robinson v. United States*, 2011 U.S. Claims LEXIS 1 (2011).

the entire case is transferred to the Tax Court. If the taxpayer does not file a petition in the Tax Court, the IRS is then given the opportunity to counterclaim in the refund suit and everything gets resolved there.²⁵⁶⁴

c. Claim for Refund and Variance.

As noted above (beginning p. 223), there are strict statutes of limitations on filing the claim for refund and then bringing a refund suit. Furthermore, jurisdictionally, the taxpayer will be limited to litigating the claims asserted in the claim for refund.²⁵⁶⁵ Accordingly, it is critical to identify all the issues that might be raised and raise them in the claim for refund in a manner that fairly puts the IRS on notice of the claims.

d. The Full Payment Rule and its Mitigation.

(1) Claim for Refund Predicate.

Before filing a suit for refund, the taxpayer must first file a claim for refund and have it either denied or not acted upon during the six month period after filing the claim.²⁵⁶⁶ This requirement is designed to allow the IRS to pass first upon matters that it may not have previously considered, so that the refund can be granted without court proceedings if the claim has merit sufficient that the IRS does not wish to contest it. Of course, in most cases where a claim for refund is filed, the IRS will have already considered the issue (e.g., in the audit) and the filing of a claim for refund is a formality, for the IRS has no intention of granting the claim. In a case where it is unlikely that the IRS will act favorably because the IRS has previously refused the relief requested, the taxpayer desiring to litigate expeditiously can do so by sending with the claim a request for prompt

²⁵⁶⁴ There is one nuance here that practitioners should be aware of. The question is whether the Government must assert its claim in the refund suit by way of counterclaim. The statute says that the Government “may” assert the counterclaim. Apparently seizing on that language, the cases seem to permit the IRS to forego asserting a counterclaim and pursue the administrative collection measures after the refund suit is concluded. The cases speak in terms of the compulsory counterclaim under FRCP 13(a) and conclude in broad strokes that this seems to be permitted by the statutory scheme and the use of the permissive word “may.” I am skeptical, but it is a skepticism in the face of significant at least *dicta*. Let me posit 2 situations: In each case, assume (i) the taxpayer has filed a refund suit; (ii) the refund suit is pending; (iii) the IRS issues a notice of deficiency for additional taxes for the same year. If the taxpayer loses in the refund suit, the holding is that the taxpayer has not shown that he has overpaid the tax for the year; the holding is not that the taxpayer does not owe additional tax. There should be nothing preclusive about that holding unless there were something in the statute that prohibits (like the prohibition on notices of deficiency once a case is pending in the Tax Court). If, by contrast, the taxpayer prevails in the refund suit, the holding is that the taxpayer has in fact overpaid his tax liability for the year; this holding implicitly but necessarily is a holding that the taxpayer does not owe additional tax liability otherwise the Court could not find that he has made an overpayment. Those wishing to pursue this issue might want to start with *Hemmings v. Commissioner*, 104 T.C. 221 (1995) which reviews much the authority up to the date of that decision and note particularly footnote 14 on page 235:

n14 We need not decide whether, if an assessment had been made, the claim of the United States would then constitute a compulsory counterclaim. See *Crocker v. United States*, 323 F. Supp. 718 (N.D. Miss. 1971). But cf. *Pfeiffer v. United States*, 518 F.2d at 129-130 n.11. There had been no assessment at the time of the MDL [the refund] proceedings in this case.

²⁵⁶⁵ *United States v. Felt & Tarrant Mfg. Co.*, 283 U.S.269 (1931).

²⁵⁶⁶ § 7422(a).

disallowance of the claim. The IRS usually will grant a prompt disallowance if the taxpayer requests it and the matter has indeed been previously considered by the IRS.

The Code allows the taxpayer to waive notice of disallowance under § 6532(a)(3). You must be careful not to file that waiver and then sue for refund before the 6 month period elapses. The waiver is not the equivalent of notice of disallowance. I see no reason to file such a waiver.

(2) The Prepayment Rule (*Flora*).

To file a claim for refund and then sue for refund, the taxpayer must be able to assert that he or she overpaid taxes. The critical question has been how much the taxpayer must pay to assert an overpayment. The historical answer was that the taxpayer must have fully paid the outstanding and unpaid assessment (which includes penalties (if assessed) and interest) to bring a refund suit. This prepayment requirement is often referred to as the *Flora* rule, after the Supreme Court case, *Flora v. United States*, 362 U.S. 145 (1960).²⁵⁶⁷ This is a refund **suit** predicate only. Full prepayment is not required for the taxpayer to file a claim for refund of assessed taxes paid, coupled with a claim for abatement of the unpaid assessed tax. The IRS has full authority to consider such a claim, typically filed on Form 843, and grant the refund and the abatement, if it determines that action is appropriate. The *Flora* full payment rule is just a limitation on refund suits.

Why is a prepayment rule important for refund litigation? As the Supreme Court in *Flora* viewed the history and fabric of the procedures Congress adopted for tax litigation, any other rule would be counterproductive to those procedures. Congress created the Tax Court as the forum for litigating most tax controversies. The Tax Court is a prepayment judicial forum and is the only prepayment judicial forum we have for resolving the merits of tax liabilities (excepting of course collection suits in the district courts and CDP cases). If the IRS could assert a deficiency of, say, \$100,000 and the taxpayer could get a prepayment remedy simply by paying \$1 against the assessment that follows, the taxpayer could effectively turn the district courts or Court of Federal Claims into prepayment fora, and eliminate the factor of opportunity to litigate first as a powerful incentive forcing most deficiency tax cases into the Tax Court.²⁵⁶⁸

Of course, this highlights one of the problems with the *Flora* prepayment rule. A taxpayer who does not have the money to pay (the \$100,000 assessed amount in the above example) doesn't really have a choice. He or she must pursue the prepayment remedy in the Tax Court. Is that fair? Do citizens get better choices, perhaps better justice, solely because they have substantial resources?

²⁵⁶⁷ There was a predicate decision in *Flora v. United States*, 357 U.S. 63 (1958) (sometimes referred to as "*Flora I*"), with the subsequent decision cited in text then sometimes referred to as *Flora II*. But, usually, when only there is a reference to "*Flora*" in terms of conditions for refund suits, the reference is to the second decision, 362 U.S. 145 (1960).

²⁵⁶⁸ A taxpayer cannot avoid the prepayment rule by filing an amended return that, by showing less tax than determined by the IRS, would result if the amended return were accepted by the IRS in having fully paid the amended tax liability. The IRS is not required to accept the amended return that might result in full payment. E.g., *Potts v. United States* (D. Ariz. CV-19-04965-PHX-SPL Dkt No.33 7/24/20). However, if the IRS were to accept the amended return as the correct liability (with resulting full payment), the IRS would abate the previously assessed larger amount to the amount on the return and make any refund accordingly without the need for a refund suit.

That is a policy question, and of course the answer is yes (just as substantial resources open up better and more choices throughout the law and life).

More fundamentally, the *Flora* prepayment rule, as interpreted and applied subsequently, applies whether or not a prepayment judicial remedy (such as the Tax Court deficiency redetermination) is available. The Code has many immediately assessable penalties not requiring a notice of deficiency thus precluding that common prepayment judicial remedy in the Tax Court. In some of those cases, Congress recognized that full prepayment required by *Flora* might be burdensome and mitigated the *Flora* rule by providing for refund jurisdiction with some lesser payment (sometimes, for example, 15% of the amount assessed). (I discuss this genre of mitigation in the next section.) But such partial payment mitigation of the *Flora* rule is not applicable to all assessable penalties and, even where it is, the gross assessed amount could be so large that the mitigated payment amount (e.g., 15% in the example) might be prohibitive.²⁵⁶⁹ The current state of authority is that, nevertheless, even if payment is prohibitive, the *Flora* full payment (or, where applicable the mitigated amount) will apply to preclude a refund suit.²⁵⁷⁰ (I am not sure that the final word on *Flora*'s application in such prohibitive amount cases has been spoken, but for now the *Flora* rule seems to apply.²⁵⁷¹)

For much of the history of *Flora*, many authorities and commentators felt that *Flora* required full payment of not only the principal amount of tax liability but also any penalties and interest assessed by the IRS. This, of course, makes the cost of entry to refund litigation more expensive, particularly if distant years are involved where the interest on the tax and penalties (if any) can be significant. It is not unusual in tax cases involving old years (particularly involving years where the interest rate was high) to have the interest alone, because of the passage of time, cause the total bill with interest to double or triple the principal amount of tax and penalty (if any) involved. With this “cost” of refund litigation, many taxpayers are forced to pursue the Tax Court route if it is available to them, as it is when income tax, estate and gift tax and certain types of miscellaneous tax liabilities are in dispute.

²⁵⁶⁹ E.g., in *Larson v. United States*, 888 F.3d 578 (2d Cir. 2018), the IRS assessed a net § 6707 penalty of about \$61 million. Larson paid \$1.4 million, but allegedly could not pay the balance. The Court held that the *Flora* full payment rule applied, thus denying him a refund remedy.

²⁵⁷⁰ *Diversified Group Inc. v. United States*, 841 F.3d 975 (Fed. Cir. 2016); *Larson v. United States*, 888 F.3d 578 (2d Cir. 2018); and *Interior Glass Sys. v. United States*, 927 F.3d 1081 (9th Cir. 2019). In *Larson*, the Court said in closing (cleaned up):

We close with a final thought. The notion that a taxpayer can be assessed a penalty of \$61 million or more without any judicial review unless he first pays the penalty in full seems troubling, particularly where, as Larson alleges here, the taxpayer is unable to do so. But, while the *Flora* rule may result in economic hardship in some cases, it is Congress' responsibility to amend the law.

²⁵⁷¹ See the outstanding blog discussion on this issue in Carlton Smith (Guest Blogger), *Larson Part I Post: Full-Payment Rule of Refund Suits Held to Apply to Assessable Penalties* (Procedurally Taxing Blog 5/6/18). In summary, Smith in the blog argues that the *Flora* rule should apply only when there is a prepayment judicial remedy available. The argument is based on a close reading of the two *Flora* decisions and the subsequent *Laing* decision, particularly considered in light of the Solicitor General's explanation of that limitation on the *Flora* rule in oral argument in *Laing*. *Flora v. United States*, 357 U.S. 63 (1958), here (often referred to as “*Flora I*”); and 362 U.S. 145 (1960), here (often referred to as “*Flora II*”); and *Laing v. United States*, 423 U.S. 161 (1976).

(3) Mitigating the Prepayment Rule.

(a) Express Statutory Mitigation.

The Code allows certain portions of the estate tax to be paid in installments.²⁵⁷² The prepayment rule if not relaxed would not permit a refund suit until the final installment is paid and, worse, the 2 or 3 year limitation would result in denials of refunds properly due. Accordingly, the Code specifically provides that a refund suit may be brought even if the tax is not fully prepaid, provided that the installments have not been accelerated and no installments are overdue.²⁵⁷³

In addition, for certain penalties against promoters of shelters, the IRS has provided that, since they are not subject to prepayment contest in the tax court because no deficiency notice is issued, the taxpayer can pay 15% of the amount and sue for refund.²⁵⁷⁴

Although not a refund suit, the taxpayers can contest liability in a collection due process (CDP) proceeding, including Tax Court litigation, if the taxpayer has not previously had the opportunity to contest. The mitigated payment opportunity to file a refund action is not considered a previous opportunity to contest.²⁵⁷⁵ I cover CDP beginning p. 733.

(b) Divisible Tax Mitigation.

Taxes which are divisible can permit the taxpayer to fully pay one or more divisible portions but not all. A divisible tax has been described:

Where a tax is considered a “divisible tax,” the taxpayer need only pay a portion of the tax before instituting [refund] suit (assuming other jurisdictional prerequisites are met). A divisible tax is one that represents the aggregate of taxes due on multiple transactions (e.g., sale of items subject to excise taxes). It is a tax the assessment of which reflects the cumulation of several separable assessments based on separate transactions.²⁵⁷⁶

²⁵⁷² See § 6166.

²⁵⁷³ § 7422(j); see *Hansen v. United States*, 248 F.3d 761 (8th Cir. 2001) (holding that a taxpayer behind on the installments may not sue for refund under this provision).

²⁵⁷⁴ § 6703(c) applying to penalties under §§ 6701 and 6702.

²⁵⁷⁵ See *Gardner v. Commissioner*, 145 T.C. 1761 (2015) which is a case where the CDP contest of liability was pursued.

²⁵⁷⁶ ILM 201150029 (11/9/11), reproduced at 2011 TNT 243-31 (citations and some quotation marks omitted); see also ILM 201315017 (12/20/12, reproduced at 2013 TNT 72-23 (“hallmark of a divisible tax is that the gross tax imposed is composed of the accumulation of discrete assessments based on separate underlying transactions, rather than being one assessment flowing from a single underlying event.”); *Boynton v. United States*, 566 F.2d 50, 52 (9th Cir. 1977) (as to the § 6672 TFRP, “section 6672 assessments represent a cumulation of separable assessments for each employee from whom taxes were withheld.” and *Diversified Group Inc. v. United States*, 841 F.3d 975, 981 (Fed. Cir. 2016) (involving § 6707 penalty for failure to register a tax shelter; held that the penalty is not divisible); and *Pfaff v. United States*, 2016 U.S. Dist. LEXIS 30844 (D. Colo. 2016) (same as *Diversified*).

Hence, on rehearing, in *Flora*, the Court said excise taxes “may be divisible into a tax on each transaction or event, so that the full-payment rule would probably require no more than payment of a small amount.”²⁵⁷⁷ Basically, the construct is that *Flora*’s full payment rule is met as to the paid divisible tax.

The divisible tax I have most frequently encountered in practice is the trust fund tax penalty (“TFRP”) imposed under § 6672 upon persons who are responsible to collect and pay over the employees share of withholding taxes and FICA but who fail to do so.²⁵⁷⁸ These taxes are reported and taxed on a quarterly basis. Although these withholdings are accounted for, in the aggregate, quarterly for all employees, they are separate liabilities for each employee. A taxpayer wishing to contest the IRS’ assertion of responsible person penalty tax liability need only pay the withholding tax for one employee for one or more quarters.²⁵⁷⁹ I discuss the responsible person penalty litigation in a subsequent portion of this book. Although I discuss the TFRP in some detail, many of the principles may apply to other divisible taxes.²⁵⁸⁰

In divisible tax cases, the refund litigation from the payment of the divisible portion of the tax and denial (or deemed denial by inaction) of the claim for refund proceeds: (i) the taxpayer sues for refund of the divisible taxes paid, putting in play his or her liability for the taxes paid and, by operation of principles of claim preclusion (res judicata) or issue preclusion (collateral estoppel), his or her liability for the taxes not paid;²⁵⁸¹ and (ii) the Government will then counterclaim for the unpaid taxes putting in play his or her liability for the unpaid taxes.²⁵⁸² For example, in the TFRP

²⁵⁷⁷ *Flora v. United States*, 362 U.S. 145, 175 n.38 (1960).

²⁵⁷⁸ §§ 6672 and 3505.

²⁵⁷⁹ See e.g., *Godfrey v. United States*, 748 F.2d 1568, 1573 (Fed. Cir. 1984).

²⁵⁸⁰ See e.g., ILM 201315017 (12/20/12, reproduced at 2013 TNT 72-23, concluding that penalties arising from failure to report transactions in the aggregate and failure to issue forms 1099s to independent contractors are divisible, thereby permitting the party against whom the penalties are asserted to bring a refund suit with respect to the discrete underlying transactions (e.g., payment of the penalty attributable to only one of many independent contractors); and CCA 201315017 (12/20/12) (saying that penalties under §§ 6721 and 6722 are divisible for purposes of *Flora* rule on refund suits).

²⁵⁸¹ In TFRP cases, claim or issue preclusion may apply for other unpaid tax in the quarter put at issue by the suit for refund, but may not apply for other quarters where the facts may be different. Of course, as noted in the text, the Government will usually counterclaim for the unpaid taxes in the other quarters so that litigation will get resolved in one proceeding.

²⁵⁸² *Univ. of Chicago v. United States*, 547 F.3d 773, 785 (7th Cir. 2008) (citing *Korobkin v. United States*, 988 F.2d 975, 976 (9th Cir. 1993) (per curiam); *Ruth v. United States*, 823 F.2d 1091, 1093 (7th Cir. 1987); and *Diversified Group, Inc. v. United States*, 841 F.3d 975 (Fed. Cir. 2016) (citing *Univ. of Chicago*).

Peppers v. United States, 2012 U.S. App. LEXIS 12498 (6th Cir. 2012) illustrates the conceptual difficulty. There, the taxpayer paid a small amount of a divisible tax sufficient to give a district court jurisdiction (\$150), filed a claim for refund of that portion and abatement of the unpaid portion (Form 843), but filed suit for refund untimely after denial of the claim. The taxpayer then paid a small amount (this time \$200) for another divisible portion of the tax, filed another claim for refund and abatement, and, upon its denial, filed a timely suit for refund. The district court dismissed on the basis that the failure to file timely suit on the first claim precluded the second claim. The Sixth Circuit affirmed in a cryptic per curiam nonprecedential opinion. I am not sure this was a correct holding. The original claim for refund was for different divisible tax than the subsequent one and hence the failure to sue timely for denial of the original tax should not foreclose a subsequent claim and suit unless the unpaid portion of the divisible tax is put in issue by filing a suit through either claim preclusion or issue preclusion or by the Government counterclaiming.

situation, a party against whom the TFRP may pay the penalty for a single employee for a single quarter regardless of how many quarters were assessed to start this process.²⁵⁸³

Being able to pay less than all tax, penalties and interest assessed would be of little benefit if the IRS could continue collection activity for the unpaid balance of the assessed tax, penalties and interest. Section 6331(i) prohibits levy or collection suit for that balance during the pendency of the refund suit if the decision in the refund suit would be conclusive under claim preclusion (*res judicata*) or issue preclusion (*collateral estoppel*) as to the balance.²⁵⁸⁴ This works fine for the assessments to which it applies—employment taxes under subtitle C of the Code and the TFRP. However, other taxes may be divisible as well, and there is no prohibition on levy during the pendency of the case. Back in the old days when I was with DOJ Tax, when there was no prohibition on levying for the TFRP, a request from the attorney representing the taxpayer in a TFRP would be passed on to the IRS which would voluntarily hold off on levies. That might work. Alternatively, if the IRS attempts a levy, the taxpayer or other person assessed might invoke a collection due process proceeding.

(c) Judicial Interpretation Mitigation.

Cases from the Court of Federal Claims have mitigated strict reading of the full payment rule by holding that, where the taxpayer is contesting only the principal amount of the tax liability, he or she need only fully pay the principal amount of the tax liability and not the interest (which can be substantial where extensions to the statute of limitations are involved). I discuss these cases under the discussion of the Court of Federal Claims below, but there is no reason that the holdings would not equally apply in federal district courts.²⁵⁸⁵

The concept developed in these cases must, of course, work around *Flora*'s full payment rule. So the concept goes, if the taxpayer is urging overpayment of all or part of the underlying principal tax liability (and not contesting the determination and assessment of penalties and interest separate and apart from overpayment of the principal tax), the taxpayer may meet *Flora* by paying the amount of the assessed tax with a designation that the payment is to be applied to the assessed tax alone and not to assessed penalties and interest.²⁵⁸⁶ I hope you have already spotted that, in this

²⁵⁸³ See *Todd v. United States*, 2009 U.S. Dist. LEXIS 90096 (S. D. Ga. 2009) (held a taxpayer need only pay the withholding tax of one employee for one quarter to meet the jurisdictional requirements for all quarters at issue for that employer); and *Hassel Family Chiropractic DC PC v. United States*, 2016 U.S. Dist. LEXIS 192293 (S.D. Iowa 2017). Notwithstanding *Todd* and *Hassel*, which may be outliers, I think it is still risky to assume that the refund case can include the quarters where the minimum payment is not made. Of course, the Government will usually counterclaim for those quarters, so the court will have jurisdiction to resolve all quarters. In addition, and this may be a really fine point, technically, the payment of tax for one employee for one quarter would not give the refund court jurisdiction to resolve any issue other than the refund for the particular employee whose tax was paid; it is conceivable that the facts that for employee might be different from other employees and thus some form of preclusion might not apply to them. But the Government would almost certainly counterclaim for the tax on the other employees.

²⁵⁸⁴ See discussion of claim preclusion (*res judicata*) and issue preclusion (*collateral estoppel*) below beginning at p. 648.

²⁵⁸⁵ I understand from informal discussions with representatives of DOJ Tax which represents the IRS in refund litigation cases that it will not contest jurisdiction on the basis of *Flora* where these rules are met.

²⁵⁸⁶ In dicta, the Supreme Court said: “the statute lends itself to a construction which would permit suit (continued...)”

posture, the taxpayer succeeding as to all or part on the principal tax liability will also succeed in wiping out the assessment for the unpaid ad valorem penalties (such as the accuracy related and fraud penalties) and interest attributable to the principal tax, but the taxpayer will not be able to contest whether the penalties were erroneously assessed (either because the elements of liability other than the existence of a principal tax liability to which the penalty attaches do not exist or a reasonable cause exception applied). Similarly, if the taxpayer is contesting only the application of penalties, the taxpayer can fully pay the penalties with an appropriate designation and *Flora* is then satisfied in a refund suit to recover the overpaid penalties, albeit the IRS could then apply the amount of the penalty overpayment to any unpaid tax and interest on the tax. (In either case, where there are unpaid assessments of either principal tax liability, penalties or interest, the Government will likely counterclaim in the refund suit.)

(d) Alternative Judicial Remedy Mitigation.

Merely because a traditional judicial remedy is denied does not mean that there may not be judicial remedies available to contest an IRS assessment without full payment. Obviously, as noted above, where the assessment requires a predicate deficiency notice, the taxpayer will have an opportunity to contest in the Tax Court without payment. If the Tax Court opportunity is not available or not taken, the taxpayer (or other person subject to the assessment such as a nontaxpayer penalty) can still contest liability in a collection suit brought by the Government to reduce the assessment to judgment,²⁵⁸⁷ in a Collection Due Process (“CDP”) proceeding (subject to the prior opportunity problem if an Appeal was taken earlier),²⁵⁸⁸ or in a bankruptcy proceeding.²⁵⁸⁹

²⁵⁸⁶(...continued)

for the tax after full payment thereof without payment of the interest.” *Flora v. United States*, 362 U.S. 145, 170 n. 37 (1960). Notwithstanding that suggestion, the Second Circuit subsequently said: “the full payment rule requires as a prerequisite for federal court jurisdiction over a tax refund suit, that the taxpayer make full payment of the assessment, including penalties and interest.” *Magnone v. United States*, 902 F.2d 192, 193 (2d Cir. 1990). To add to the confusion, the Federal Circuit, citing the *Flora* footnote, held that a taxpayer could designate the payment and sue for refund. *Shore v. United States*, 9 F.3d 1524, 1527-28 (Fed. Cir. 1993). I have been advised and it has been reported, however, that DOJ Tax will not contest jurisdiction in these cases. Carl Smith (Guest Blogger), Tenth Circuit Hook Opinion: Interest and Penalties Must Also Be Paid to Satisfy Flora Full Payment Rule (Procedurally Taxing Blog 8/25/15) (noting that, since the prepayment rule is jurisdictional, the courts may stray into the area even if not led there by the parties (as happened at the trial level in *Shore*) and suggesting a legislative fix / clarification); see also Keith Fogg, Access to Judicial Review in Nondeficiency Tax Cases, 73 Tax Lawyer 435, 467-468 (2020).

²⁵⁸⁷ See discussion of collection suits below, beginning p. 634.

²⁵⁸⁸ See discussion of CDP proceedings, beginning p. 733.

²⁵⁸⁹ As to dismissal in bankruptcy, A. Lavar Taylor, an outstanding practitioner, said in response to my Blog comment that bankruptcy may apply (Carlton Smith, Larson Part I Post: Full-Payment Rule of Refund Suits Held to Apply to Assessable Penalties (Procedurally Taxing Blog 5/6/18) (Taylor response to JAT Comment): (i) the 6707 penalty could be litigated in bankruptcy if the IRS filed a claim or if the Government filed an abstention motion (JAT note I am not sure what an abstention motion is, but interested readers can track that down); and (ii) the “most important point as far as I am concerned is that the penalty is completely dischargeable in Bankruptcy if the conduct giving rise to the penalty occurred more than three years prior to the date of the Bankruptcy petition.”)

e. Jury Trial.

In district courts, where juries are available, fact issues in tax refund suits are triable to a jury.²⁵⁹⁰ One of the major complaints against the British Crown that led to the revolutionary war was that the Crown had taken away the right to jury trial for tax refund suit. Hence, jury trials for fact issues related to refunds in the district courts are assured.²⁵⁹¹

Although Congress usually conditions a waiver of sovereign immunity upon the plaintiff's relinquishing a jury trial,²⁵⁹² the key exception for tax purposes is the refund suit.²⁵⁹³ Either side may request a jury. Although we focus here on refund suits, it is useful—even though redundant—to state also that, in nonrefund suits, actions against the United States, including other types of actions in tax cases, do not permit a jury trial.²⁵⁹⁴

f. Setoffs.

(1) The Setoff Concept.

Since the issue in a refund suit is whether a taxpayer has overpaid his liability, the Government is permitted to raise issues that have not previously been asserted but that would show that, even if the taxpayer is correct on the issue for which he is asking a refund, the taxpayer nevertheless has not overpaid his tax liability for the period in issue. This is called a setoff (or offset). It does not force open an otherwise closed statute of limitations and permit the Government to collect additional taxes; all it does is to permit the Government to defend against having to pay a refund because the taxpayer has not overpaid his tax and thus is not entitled to a refund for the year

²⁵⁹⁰ U.S. Constitution, 7th Amendment; and FRCP Rule 38. I should note for those that want to dig deeper in this subject that, in *Wickwire v. Reinecke*, 275 U.S. 101, 105 (1927), the Court said that the right to jury trial in a refund suit was not based on the Seventh Amendment but rather on the statute). However, historical analysis suggests otherwise. See Judge Pryor's concurring opinion in *United States v. Stein*, 881 F.3d 853, 859 ff (11th Cir. 2018) (en banc) (developing this history).

²⁵⁹¹ See Judge Pryor's concurring opinion in *United States v. Stein*, 881 F.3d 853, 859 ff (11th Cir. 2018) (en banc) (developing this history). Of course, jury trials are not available for refund suits in the Court of Federal Claims, so if the taxpayer wants a jury he will have to go to the district court. And, to close the loop, refund suits are not trial at all in the Tax Court except that the Tax Court with jurisdiction to redetermine a deficiency may order a refund. § 6512(b). Juries are not available in the Tax Court.

²⁵⁹² *Lehman v. Nakshian*, 453 U.S. 156, 161 (1981); see 28 U.S.C. § 2402.

²⁵⁹³ 28 U.S.C. § 2402 (providing the exception that "any action against the United States under section 1346 (a)(1) [the refund provision] shall, at the request of either party to such action, be tried by the court with a jury.")

²⁵⁹⁴ 28 U.S.C. § 2402. Examples would include FOIA suits, wrongful levy suits, suits for damages under § 7433, etc.

in question.²⁵⁹⁵ The case establishing this right of setoff is *Lewis v. Reynolds*, 284 U.S. 281 (1932), and that case name should be part of the tax lawyer's jargon.²⁵⁹⁶

(2) Procedural Predicates for Setoffs in Refund Cases.

The Government's right to setoff means, practically, that, upon the taxpayer filing the refund suit, the Government might do a re-audit to avoid having to pay a refund on the basis of the taxpayer's claims in the claim for refund and resulting suit for refund.²⁵⁹⁷ Obviously, should the Government do so, the resulting audit via discovery and trial of new issues could substantially affect and disrupt the orderly progress of litigation. For that reason, the courts generally require that the Government meet some procedural burdens to assert and pursue the setoff in the litigation.

First, the Government should assert the right to setoff in its answer in the case. While it might be argued that the right to setoff is not technically an affirmative defense,²⁵⁹⁸ Courts have treated it as an affirmative defense that must be pled under FRCP Rule 8(b)(1)(A).²⁵⁹⁹ There is an issue of the level of factual specificity, if any, required to plead the set off in the answer, but there

²⁵⁹⁵ A court may deny the Government the right to assert the offset if the Government failed to assert the claim timely in the orderly course of the litigation. See e.g., *Principal Life Ins. Co. v. United States*, 77 Fed. Cl. 2007 (2007). Because the issue is whether the taxpayer has overpaid tax for the year and is thus entitled to a refund, it makes no difference that the statute of limitations on assessments has expired. For example, in *Hamilton v. United States*, 156 F. Supp. 3d 1269 (D. Colo. 2016), the IRS had entered a limited consent to extend the statute of limitations that, by agreement, only extended the statute for certain issues. In a subsequent refund suit, the taxpayer sought a refund and the Government asserted the setoff on a basis that was outside the limited consent. The Court held that, while it was true that the IRS could not have asserted a deficiency on the issue outside the scope of the limited consent, it could assert that issue as a basis for there being no overpayment and thus no refund due within the meaning of *Lewis v. Reynolds*.

²⁵⁹⁶ In *Pacific Gas & Electric Co. v. United States*, 417 F.3d 1375 (Fed. Cir. 2005), the Court found limits on *Lewis v. Reynolds*. The taxpayer earlier received an erroneous refund of "statutory interest" (i.e., interest calculated on a refund for the year in question) for 1982. The IRS just had miscalculated and overpaid the statutory interest. The taxpayer thereafter filed a refund claim for the same year (1982) based upon carrybacks from a subsequent year (1984). In considering the claim, the IRS discovered the overpayment of statutory interest. By this time, however, the period during which the IRS could have sued for erroneous refund (2 years under §§ 7405 and 6532(b)) had expired. The IRS therefore sought to set off the erroneous overpayment of statutory interest against the refund otherwise due on the other items. The Court rejected the IRS setoff based on a close (perhaps too thin) reading of the "overpayment" analysis developed in *Lewis v. Reynolds* and its progeny.

In an interesting and perhaps aberrational decision, a majority on a panel of the Fourth Circuit perhaps in dicta found some limits to *Lewis v. Reynolds*, but the facts are so aberrational and the decision so questionable as to its application of the Anti-Injunction statute, I do not discuss it further here. See *Estate of Michael v. Lullo*, 173 F.3d 503 (4th Cir. 1999). I do, however, discuss the case further below in the part of the text dealing with the Anti-Injunction statute and the judicially created *Enochs v. Williams Packing* exception to the Anti-Injunction statute.

²⁵⁹⁷ The Supreme Court so recognized this potential based on its holding in *Lewis v. Reynolds*.

²⁵⁹⁸ This may depend upon how one defines affirmative defense. An affirmative defense is something that defeats an otherwise valid claim. The setoff does not defeat an otherwise valid claim. The setoff is just a claim that the taxpayer, as plaintiff, has not met his burden to prove he is entitled to a refund. However, in the context, it functions and has the attributes of a defense and perhaps an affirmative defense.

²⁵⁹⁹ *Lockheed Martin Corp. v. United States*, 973 F. Supp. 2d 591 (D. Md. 2013); see also *Wells Fargo & Company v. United States*, 750 F. Supp. 2d 1049 (D. Minn. 2010). As to timely identification of the set off offense, see *Principal Life Ins. Co. v. United States*, 77 Fed. Cl. 2007 (2007).

is no question that the Government has the right to plead the setoff.²⁶⁰⁰ The pleading burden is not much of a burden, particularly if, as at least one court has held, all the Government must assert is the general legal proposition that it has the right to assert an offset without identifying any offset or any factual basis for that general legal proposition.²⁶⁰¹

Second, the Government must then undertake the “re-audit” allowed by the setoff concept approved in *Lewis v. Reynolds*. That would be done through discovery in the litigation. Courts can control the discovery process and prevent fishing expeditions in search of the setoff.²⁶⁰²

If the setoff issue(s) then get to the trial stage, courts that have addressed the issue require that the Government meet some sort of production burden to put the offset issue in play.²⁶⁰³ If that production burden is met, then, of course, the defendant will have to meet its ultimate burden of persuasion to prove that it has made an overpayment and thus is entitled to a refund.

(3) Statutes of Limitations and Offsets.

One of the traditional strategies in refund suits is to time the suit so that the statute of limitations for additional assessments has expired. If this is done adeptly, even if the taxpayer does not prevail in the refund suit on the issue the taxpayer presents in the claim, the taxpayer at least will not be subject to more tax than already assessed. Litigating in the Tax Court does not offer this opportunity since the issue in such litigation is the taxpayer's correct liability for the year, an issue that will necessarily allow the IRS to raise new issues that bear upon the correct liability for the year.²⁶⁰⁴ By contrast, the issue in a refund suit is whether the taxpayer overpaid his liability for the year. Whether the taxpayer has underpaid his tax liability is not technically the issue, and thus so long as the statute of limitations has expired on additional assessments, the refund suit offers less risk than a Tax Court suit.²⁶⁰⁵

²⁶⁰⁰ *Lockheed Martin Corp. v. United States*, 973 F. Supp. 2d 591 (D. Md. 2013).

²⁶⁰¹ *Lockheed Martin Corp. v. United States*, 973 F. Supp. 2d 591 (D. Md. 2013).

²⁶⁰² *Lockheed Martin Corp. v. United States*, 973 F. Supp. 2d 591 (D. Md. 2013) (noting general limitations on discovery, such as limited number of interrogatories and the Court’s ability to fashion an appropriate order to deal with onerous discovery requests).

²⁶⁰³ See e.g., *Missouri Pac. R. Co. v. United States*, 338 F.2d 668 (Ct. Cl. 1964); see also *Dysart v. United States*, 340 F.2d 624, 638 (Ct. Cl. 1965). For an interesting case addressing the issue of whether this must be done before the Government may assert the offset in its responsive pleading or at a later stage in the trial development, see *Wells Fargo & Company v. United States*, 750 F. Supp. 2d 1049 (D. Minn. 2010).

²⁶⁰⁴ See § 6214(a).

²⁶⁰⁵ See *R.H. Donnelly Corp. v. United States*, 641 F.3d 70 (4th Cir. 2011) for an example of what the court viewed as a too slick—and thus failed—attempt to exploit the closing of the statute of limitations. In that case, the taxpayer underreported its tax liability for 1994 thus permitting it to carryback tax credits to 1991 and 1992. The claims for refund for the carryback years was filed 2 days before the statute closed on the 1994 year. In investigation the claims for refund for 1991 and 1992, the IRS investigated 1994 and, despite the fact the 1994 year was otherwise closed for additional 1994 assessments, the IRS made adjustments to 1994 for the sole purpose of determining that there were no available credits to allow for 1991 and 1992 and denied the carryback claims. The taxpayer sued for refund arguing that the closing of the assessment statute of limitations prevented the IRS from decreasing the credits for carryback. The Fourth Circuit disagreed, relying on a straight-forward reading *Lewis v. Reynolds* and stating that “It takes real chutzpah for Donnelly to demand a refund under the circumstances.”

A related issue is whether the taxpayer can assert not asserted in the claim for refund when and if the Government asserts setoffs to deny the refund for the claims made in the claim for refund. These are sometimes referred to as “counter-setoffs,”²⁶⁰⁶ but are really setoffs to setoffs. This is important because the statute of limitations for additional claims may have expired and the taxpayer will have not stated the new offset claim in the original claim for refund. Courts allow the taxpayer to raise a new setoff claim to the Government’s offset.²⁶⁰⁷

g. Venue for Refund Suits in District Courts.

Refund suits may be brought in the district court for the district where the individual taxpayer resides.²⁶⁰⁸ If an individual taxpayer has no residence in a district—e.g., a nonresident alien—that taxpayer cannot sue for refund in the district court but must bring the refund suit in the Court of Federal Claims.²⁶⁰⁹ Refund suits by corporations or similar entities are brought in the district where the entity’s “principal place of business or principal office or agency” is located or, failing any such principal place, the judicial district for the office in filing its return or, if no return was made, in the District of Columbia.²⁶¹⁰

5. Department of Justice Tax Division (“DOJ Tax”) Role.

Suits in the District Court involving tax issues are handled by DOJ Tax. On those occasions in which, in the allocations of the Government's resources, IRS attorneys appear in district court,

²⁶⁰⁶ See *Cencast Services, LLP v. United States*, 94 Fed. Cl. 425 (2010) (citing Gerald A. Kafka & Rita A. Cavanagh, *Litigation Of Federal Civil Tax Controversies* § 16.03 (2009), aff’d 729 F.3d 1352 (Fed. Cir. 2013)).

²⁶⁰⁷ See *Charter Co. United States*, 971 F.2d 1576 (5th Cir. 1992); *Cencast Services LLP v. United States*, 94 Fed. Cl. 425 (2010) (citing and discussing cases), aff’d 729 F.3d 1352 (Fed. Cir. 2013). *Cencast* presented an interesting nuance on the issue. *Cencast* involved a so-called “divisible” tax which permitted the taxpayer to pay a limited amount of the total assessment and sue for refund without having to meet the *Flora* requirement of full payment of the assessment. The Government then, as is typical, counterclaimed for the balance of the assessment. Under traditional tax procedure theory, the suit therefore consisted of a refund suit and a collection suit which were joined in one litigation. Although not crisply discussed in the case, I think the question was whether the taxpayer in the collection suit could not raise a new issue not previously asserted in the refund claim but could still assert that defense in the collection suit (the counterclaim). The court melded the two suits together in terms of applying the variance doctrine, but it seems to me that the Court did not come to grips with the issue and, indeed, was wrong. I think there is no question that, had the Government pursued the collection suit in a stand-alone case, the taxpayer could have asserted any defense to the Government’s claims. I am aware of no theory that, by joining the collection suit with the refund suit, the Government can limit the taxpayer’s defenses. By contrast, the IRS claims that this setoff to setoff reasoning is not applicable where a taxpayer carries back an NOL to an otherwise closed year where the taxpayer attempts to claim otherwise unclaimed deductions in the barred carryback year to increase the amount of NOL going forward. See ECC 201215008, 2012 TNT 73-51.

²⁶⁰⁸ 28 U.S.C. § 1346(a)(1) (refund suits may be brought in district court or Court of Federal Claims); and 28 U.S.C. § 1402(a)(1) (suits, including refund suits, brought in the district court against the U.S. may only be pursued in the district of residence). See *Malajalian v. United States*, 504 F.2d 842, 843-45 (1st Cir. 1974) (holding in tax refund suit by nonresident alien that, under Section 1402(a)(1), Congress intended that “an alien not ‘residing’ in any judicial district could not sue the United States in any district court”).

²⁶⁰⁹ Id.

²⁶¹⁰ 28 U.S.C. § 1402(a)(2).

they are designated as a special category of DOJ representative, such as Special Assistant United States Attorneys.²⁶¹¹

Settlement of the issues is controlled by DOJ Tax. § 7122(a).²⁶¹² In settling the more important cases, DOJ Tax solicits the IRS's views, but DOJ Tax has ultimate control of the case.²⁶¹³ This is not true, for example, in Tax Court litigation where the DOJ is not involved at all and the IRS has complete settlement authority. Finally, the settlement may require Joint Committee on Taxation (“JCT”) review if a large refund is required (see discussion beginning p., 838).

The IRS Chief Counsel usually provides DOJ Tax appropriate background for the case. In a refund case, this background is provided by a “defense letter” which provides the known facts and the law and authorizes DOJ Tax to defend the case. Although authority to control and settle the case is in DOJ Tax, in the defense letter, the IRS will designate whether the case is Settlement Option Procedure (“S.O.P.”) or Standard. DOJ Tax may settle S.O.P. cases without further consultation with the IRS but should consult with the IRS prior to settling Standard cases.²⁶¹⁴

6. The Rules of Procedure and Evidence; Discovery.

The procedure rules are the Federal Rules of Civil Procedure and the particular court’s own rules, commonly referred to as the local rules and well as any specific rules of the assigned judge. The evidence rules are the Federal Rules of Evidence.²⁶¹⁵

Discovery is generally much broader and more formal in the district courts than in the Tax Court. The Federal Rules of Civil Procedure and the district court's local rules control discovery.²⁶¹⁶ The Tax Court rules and the Court of Federal Claims Rules generally parallel the FRCP. In the Tax Court, the key difference between the district court and the Tax Court is that the district court relies less on informal discovery and stipulations and more on depositions and other forms of discovery. Requests for admission, although not technically a discovery device, are also available as they are in the Tax Court.

²⁶¹¹ In the past, IRS attorneys have been designated Special Assistant United States Attorneys (SAUSAs) to handle certain matters in bankruptcy courts, but apparently that program has ended. See Keith Fogg, End of SAUSA Program at Chief Counsel’s Office (Procedurally Taxing Blog 6/3/15).

²⁶¹² See Executive Order No. 6166, § 5 (June 10, 1933), reprinted in 5 U.S.C. § 901, transfer all authority to “compromise” a dispute from the IRS to the Department of Justice once a lawsuit regarding the dispute is filed in court other than the Tax Court. DOJ’s authority over compromise apparently continues after its role in reducing an assessment to judgment in a collection and the case is returned to the IRS. See *United States v. Jackson*, 2013 U.S. App. LEXIS 1674 (3d Cir. 2013), a nonprecedential decision, collecting and discussing the authority.

²⁶¹³ The division is currently made by the designation of the IRS when the files are forwarded to DOJ Tax. Settlements of cases designated “Standard” required that DOJ seek the IRS’s views of proposed settlements; settlement of cases designated Settlement Option Procedure (“SOP”) do not require that DOJ Tax seek the IRS’s views. The settlement authority remains with DOJ even under the Standard designation. Internal procedures require higher level approvals when the IRS disagrees with DOJ’s proposed settlement.

²⁶¹⁴ IRM 34.5.1.1.1 (08-11-2004), Case Classification. The S.O.P classification is for suits presenting “commonplace issues of fact, legal issues that do not substantially affect the collection of revenue, or the application of legal principles that have already been established through prior litigation.”

²⁶¹⁵ LII maintains a web site with the FRCP: <https://www.law.cornell.edu/rules/fre>.

²⁶¹⁶ FRCP Rules 26-37.

To assist discovery, FRCP Rule 26 imposes certain requirements for disclosures by the parties and submission of a discovery plan to assist the court in entering appropriate discovery orders.

7. Precedent.

Binding judicial precedent in the district courts are based on the courts to which appeals may be taken. Appeals are taken first generally to the court of appeals for the circuit in which the district court is located and then, usually by certiorari, to the Supreme Court.

C. Court of Federal Claims.

1. Nature of the Court.

The Court of Federal Claims is an Article I Court that Congress authorizes to hear tax refund suits which are “claims” against the United States.²⁶¹⁷ The judges hear cases other than tax cases, such as customs and patent cases. Thus, they tend to specialize in tax cases less than Tax Court judges but more than district court judges. In its general attitude as to how to proceed (efficiently and informally), the Court is more akin to the Tax Court. However, being a more generalist court, the Court of Federal Claims will often produce results that could not be achieved in the highly specialized Tax Court.

The judges in the Court of Federal Claims are appointed by the President with the consent of the Senate. Since they are not Article III judges, they do not have lifetime tenure; they are appointed for 15 year terms.

The Court of Federal Claims is a relatively informal Court and operates much like the Tax Court in this regard.

2. Rules of the Court of Federal Claims.

The CFC has rules of procedure, titled Rules of the United States Court of Federal Claim; they are available here: <https://www.uscfc.uscourts.gov/rfcf>. These rules bear a resemblance to the FRCP, but vary to meet the needs of the CFC and its practice. The CFC applies the Federal Rules of Evidence.²⁶¹⁸

²⁶¹⁷ 28 U.S.C. § 1491(a)(1), commonly referred to as the Tucker Act, grants the Court of Federal Claims jurisdiction over “any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department,” including tax refund actions. Apparently because of some confusion, Judge Allegra, stated in the emphatic that the Court of Federal Claims “jurisdiction over refund suits does not — NOT — derive from 28 U.S.C. § 1346(a)(1).” *Ferguson v. United States*, 2014 U.S. Claims LEXIS 1068 n . 2 (Fed. Cl. 2014) (citing inter alia *Hinck v. United States*, 64 Fed. Cl. 71, 74-76 (2005) (“The better view is that neither paragraph of section 1346 directly impacts this court's jurisdiction.”), *aff'd*, 446 F.3d 1307 (Fed. Cir. 2006), *aff'd*, 550 U.S. 501 (2007).

²⁶¹⁸ LII maintains a web site with the FRCP: <https://www.law.cornell.edu/rules/fre>.

3. Refund Jurisdiction.

The same rules apply for refund jurisdiction as apply in the district court.

4. Court's Spin on Prepayment (*Flora*) Rule.

You will recall that the *Flora* rule requires prepayment of the assessment prior to bringing a refund suit. The Court of Appeals for the Federal Circuit has held that, to contest the principal amount of a federal tax liability, the taxpayer need only pay the principal amount of the tax liability assessed.²⁶¹⁹ The taxpayer need not pay the interest or penalties assessed. If the taxpayer is successful in contesting the principal amount, any ad valorem penalties based on the amount of the principal tax liability will be reduced and, of course, any interest on the principal will be reduced pro tanto with the reduction of the principal. If a taxpayer is separately contesting the penalty (e.g., asserting that he is entitled to avoid the penalty on reasonable cause grounds even while owing the tax liability), the taxpayer will have to pay the amount of the penalty to contest it.²⁶²⁰ In other words, the components of the aggregate tax liability (principal, penalty and interest) may be fragmented, with payment required of only the fragment that the taxpayer desires to contest. (If the taxpayer does not pay the uncontested amount, the Government can pursue collection or even bring a counterclaim.)

5. Counterclaim Jurisdiction.

The Government cannot bring an original collection suit in the Court of Federal Claims but can counterclaim to a taxpayer refund suit if the taxpayer paid less than the full amount owing to the Government.²⁶²¹ For example, if a person assessed a Trust Fund Recovery Penalty (“TFRP”) pays sufficiently to support a refund suit under the “divisible tax” concept,²⁶²² the Government can counterclaim.²⁶²³

6. Appeals and Precedent.

Appeals are to the United States Court of Appeals for the Federal Circuit in Washington, D.C. That Court is composed of Article III Judges, even though the trial level court, the Court of Federal Claims, is composed of Article I Judges. Although the Court is Washington-based, many of the judges come from geographically diverse areas of the country, based upon the relative

²⁶¹⁹ *Shore v. United States*, 9 F.3d 1524 (Fed. Cir. 1993).

²⁶²⁰ *Nasharr v. United States*, 105 Fed. Cl. 114 (2012); see also *Auto Pride Collision East, Inc. v. United States*, 2017 U.S. Dist. LEXIS 210306 (S.D. Mich. 2017) (although not a CFC case, it does reach the conclusion by analysis of the *Shore* and *Nasharr* holdings).

²⁶²¹ CFC Rule 13.

²⁶²² Discussed below beginning p. 793.

²⁶²³ E.g., *Gens v. United States*, 615 F.2d 1335, 1343 (Ct. Cl. 1980) (TFRP where the person made partial payment and Government counterclaimed; held remanded to determine the merits of the claim and counterclaim), and on remand, 673 F.2d 366 (1982) (sustaining judgment on counterclaim); *Bob Jones Univ. v. United States*, 670 F.2d 167, 171 (1982); and *Vir v. United States*, 125 Fed. Cl. 293, 303 (Ct. Cl. 2016) (citing cases; although, after dismissing the refund suit, the Court dismissed the counterclaim because, without the refund suit which conferred jurisdiction, the counterclaim was just a collection suit via counterclaim was not authorized as a stand-alone action in the CFC).

political influence of their political “champions” for the office. This is good in giving the Court a national balance rather than a purely Washington outlook. It is, of course, different to that extent than the regional courts of appeals to which Tax Court and district court (including bankruptcy) cases are appealed. And a large part of the Court of Appeals docket is in nontax cases, such as Government contract cases and patent cases, which subtly affect the way the Court approaches tax cases.

Just as the Court of Appeals to which appeals in Tax Court and district court cases establish the controlling precedent for Tax Court and district court cases, so the Court of Appeals for the Federal Circuit establishes controlling precedent for the Court of Federal Claims.

7. Discovery.

Discovery in the Court of Federal Claims parallels that in the district court.²⁶²⁴ The key, of course, is that depositions are more widely used than in the Tax Court. The other discovery devices are equally available.

8. Trials.

Trials in the Court of Federal Claims may be anywhere the Court directs. The Court will usually allow trial in a place convenient to the parties or the witnesses. In tax litigation this means that the parties will usually have the trial in the location of the taxpayer, since that is usually where the documents and witnesses are. Depending upon the needs of the case, portions of the trial may occur in different cities.

For strategy reasons, large taxpayers who can afford the logistics of a Washington trial will have the trial in Washington to accommodate the judge who lives in Washington and would be substantially inconvenienced by a long trial away from home. This is why the Court of Federal Claims bar has historically been centered in Washington, D.C. which seemed for so long to have a franchise on at least the good Court of Claims business. Nevertheless, since the Court of Claims will accommodate smaller taxpayers, taxpayers and their practitioners from the boondocks should not be reluctant to pursue smaller cases; there is no real need for a Washington lawyer to handle the case. Equal justice is dispensed by the Court.

Without the formalities required by a jury trial, the Claims Court like the Tax Court can be more relaxed in its trial proceedings.

D. Bankruptcy Courts.

Federal tax issues may arise and be resolved in a bankruptcy proceeding. For example, a common federal tax issue in bankruptcy proceedings is the debtor's failure to pay employee taxes (both employer share and employee share, called trust fund taxes). The debtor/employer is, of

²⁶²⁴ See Rules of the United States Court of Federal Claims, Rules 26-37.

course, responsible for those taxes.²⁶²⁵ (See discussion beginning p. 793) Similarly, a debtor may owe income taxes. The following are some key points related to tax issues arising in the bankruptcy court.

1. The bankruptcy courts have some jurisdiction to determine tax issues, such as liability for the taxes (if liability has not previously been adjudicated by a tribunal of competent jurisdiction)²⁶²⁶ and dischargeability. The tax issues may arise from the IRS's assertion of tax claims or from the debtor/bankrupt estate's assertion of the rights to a refund. As to the tax liability issues, the jurisdiction is not compulsory and thus the bankruptcy court may forego deciding the liability if determining the liability will not assist in resolving the bankruptcy issues.²⁶²⁷ If, in the exercise of its jurisdiction, the bankruptcy court determines the tax liability for the year, that determination will be entitled to preclusive effect in later litigation between the taxpayer and the IRS.²⁶²⁸ Although bankruptcy courts have the initial and principal jurisdiction to determine dischargeability, if in a later case unrelated to the bankruptcy, a relevant issue is whether the taxpayer was in fact discharged in the bankruptcy proceeding, the court properly hearing that case can make that determination.²⁶²⁹ I cover the rules that govern dischargeability in discussing IRS collection activity beginning p. 721).

²⁶²⁵ For a discussion of the limits of the bankruptcy court's jurisdiction to litigate the Trust Fund Recovery Penalty ("TFRP") under § 6672, see *Johnston v. City of Middletown*, 2012 Bankr. LEXIS 5956 (S.D. Ohio 2012) (dealing with a no asset Chapter 7 bankruptcy proceeding, and discussing a split among the bankruptcy courts, and concluded that, in such a proceeding, the bankruptcy court has no jurisdiction but that, even if it had jurisdiction, it should abstain from deciding the issue. Note in this regard that, although the TFRP may not be discharged in bankruptcy, the goal is to see whether the bankrupt taxpayer can litigate the liability there. See also Bryan Camp, [Lesson From The Tax Court: Cannot Use CDP To Contest Trust Fund Recovery Penalty \(9/5/23\)](#) (discussing bankruptcy courts as an often looked pre-payment judicial remedy, provided that the bankruptcy court cannot review if "if such amount or legality was contested before and adjudicated by a judicial or administrative tribunal of competent jurisdiction before the commencement of the case under this title.")

²⁶²⁶ 11 U.S.C. § 505(a)(1) & (a)(2)(A).

²⁶²⁷ *Internal Revenue Service v. Luongo (In re Luongo)*, 259 F.3d 323, 330 (5th Cir. 2001). Perhaps the classic case would be a no asset bankruptcy where the taxpayer is not discharged from tax debt. In that case, there is nothing relevant to the bankruptcy proceeding to decide because determining liability only affects the taxpayer's liability outside bankruptcy. See *In re Perry v. United States*, 2014 Bankr. LEXIS 1031 (Bankr. MD AL 2014), discussed in Keith Fogg, [When Should Bankruptcy Court Hear a Tax Case](#) (Procedurally Taxing Blog 7/31/14).

²⁶²⁸ *Breland v. Commissioner*, 152 T.C. 156 (2019) (holding that, because the bankruptcy determination by consent order did not determine the total tax liability for the year, the IRS could issue a notice of deficiency to the taxpayer and litigate the issue of total tax liability); and *Florida Peach Corp. v. Commissioner*, 90 T.C. 678 (1988) (res judicata even if bankruptcy case subsequently dismissed). Although this is not my area of specialty, it is reported that:

Bankruptcy debtors generally have two main avenues to fix the amount of their tax liability for a given year: (1) file a motion for the bankruptcy court to determine the amount of their tax debt pursuant to 11 U.S.C. § 505; or (2) object to the IRS's proof of claim.

Brad D. Jones, [Breland, Jr. v. Commissioner: Another Bankruptcy-Tax Trap for the Unwary Practitioner](#) (Procedurally Taxing Blog 5/29/19).

²⁶²⁹ For example, a court such as the Tax Court properly considering a collection due process case where collection of an allegedly discharged liability is in issue can determine whether the bankruptcy proceeding discharged the tax liability in issue. See *Washington v. Commissioner*, 120 T.C. 114 (2003); and *Swanson v. Commissioner*, 121 T.C. 111(2003). By contrast, in a deficiency proceeding where only the amount of the tax liability (and not its collection) is at issue, the Tax Court does not have jurisdiction to determine whether the bankruptcy proceeding discharged the tax liability. *Neilson v. Commissioner*, 94 T.C. 1, 9 (1990); *Graham v. Commissioner*, 75 T.C. 389, 399 (1980); *Swanson v. Commissioner*, 65 T.C. 1180, 1184 (1976).

2. The filing of bankruptcy will impose an automatic stay of:

the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title.²⁶³⁰

The question has arisen whether this automatic stay applies to Tax Court proceedings.²⁶³¹ A subsection, however, provides for stay (i) corporate tax liabilities and (ii) individual tax liabilities “for a taxable period ending before the date of the order for relief under this title.”²⁶³²

If the IRS “willfully violates” the stay, the debtor-taxpayer may recover damages.²⁶³³

The automatic stay suspends the statutes of limitations on assessments or collections.²⁶³⁴

3. The bankruptcy code establishes the priority of tax liens relative to other creditors in the estate. I do not expect you to know those priority rules.

The bankruptcy court has a different culture and different focus than the other available tax fora discussed above. Thus, results in the bankruptcy court may differ from the results that might be obtained in the other fora and may be more taxpayer-friendly results. As the ubiquitous Lee Sheppard has said pithily in contrasting bankruptcy court to the Tax Court as a taxpayer-friendly litigation forum:

Readers, the Tax Court is not a court of equity. Federal bankruptcy court is a court of equity. A bankrupt taxpayer that wants to throw itself on the mercy of a court of equity can ask the bankruptcy court to adjudicate its tax questions. Bankruptcy judges usually empathize with debtors -- that's why they became bankruptcy judges -- and do not feel constrained by the fine points of the tax code.²⁶³⁵

Of course, in tax matters, the district courts and the Court of Federal Claims are not equity courts as to the tax matters that are commonly litigated, but district courts particularly sometimes flex their equity muscle in tax cases (implicitly, if not explicitly) and, in respect to equity, may be viewed as somewhere on the spectrum between the Tax Court and the bankruptcy courts. Many taxpayers are

²⁶³⁰ 31 U.S.C. § 362(a)(1). For a good discussion of the bankruptcy context and importance of the automatic stay, see *IRS v. Murphy*, 892 F.3d 29 (1st Cir. 2018).

²⁶³¹ See e.g., *Schoppe v. Commissioner*, 711 F.3d 1190 (10th Cir. 2013), cert. den. 134 S. Ct. 365 (2013); and *Delpit v. Commissioner*, 18 F.3d 768 (9th Cir. 1994).

²⁶³² 11 U.S.C. § 362(a)(8).

²⁶³³ § 7433(e). For a good discussion of “willfully violates,” see *IRS v. Murphy*, 892 F.3d 29 (1st Cir. 2018) (adopting the majority view that intentional action knowing of the stay is actionable regardless of good faith).

²⁶³⁴ § 6503(h).

²⁶³⁵ Lee A. Sheppard, [Tax Court Decision Allows Guarantees for Income Stripping](#), 126 Tax Notes 1010 (Mar. 1, 2010).

unwilling or unable to seek bankruptcy court refuge to litigate their tax issues, but for the right taxpayer, this forum choice should be considered.

III. Miscellaneous Trial Related Matters Applicable to All Forums.

A. Choosing the Forum (aka Forum Shopping).

Traditionally, when the IRS claims by notice of deficiency that a taxpayer has underpaid tax, the taxpayer has the choice of litigating in the Tax Court or awaiting assessment and litigating liability via one of the post assessment remedies (e.g., refund suit in the district court or Court of Federal Claims (“CFC”)), CDP proceeding in the Tax Court, collection suit in the district court or, possibly in a bankruptcy proceeding). This gives the taxpayer some choices where to litigate. In making the choices, taxpayers and their counsel will want to consider key factors such as:

- whether the taxpayer’s case will appeal best to a jury (only available in the district court), to a tax specialist judge (the Tax Court), or to moderate tax specialist judge (CFC) or a generalist judge (district court).
- whether there is favorable or adverse precedent in the forum or in the appellate venue from just forums (i.e., the trial courts may themselves have precedents that are favorable or adverse, and the courts of appeals for cases in the trial courts may have such precedents.²⁶³⁶
- the courts’ rules of practice and procedure which, for example, may affect how much discovery such as depositions parties can pursue and how expensive it will be to litigate. For example, proceedings in the Tax Court can usually be handled with less commotion (and thus less attorneys’ fees and related costs) than in the other fora.

Focusing on the precedent consideration, if the taxpayer-favorable precedent is in the CFC or its appellate court, the Court of Appeals for the Federal Circuit, the taxpayer will want to choose the refund suit in the CFC unless (i) the taxpayer cannot meet the *Flora* full-pay jurisdictional requirement or some CFC mitigation of the full payment rule or (ii) the taxpayer is ill-informed. Of course, many taxpayers feel the pressure to litigate first and pay later (if necessary), a choice only available in a deficiency case in the Tax Court, in a CDP proceeding in the Tax Court, in a collection suit in the district court or in a bankruptcy case. In such situations, the mitigation rules for the *Flora* full-payment requirement should be explored to achieve the CFC venue in a refund suit, if possible.

One of the features of this system is that, once the CFC or Court of Appeals for the Federal Circuit obtains a taxpayer-favored precedent, and all taxpayers are able to shape their affairs to obtain access to the CFC via refund suit, that precedent is, in effect, the law even if there are other Circuits with no precedent on the issue or unfavorable precedent on the issue. The Government can

²⁶³⁶ For an example of unsuccessful, but creative forum shopping for favorable precedent, see *Pfizer, Inc. v. United States*, 939 F.3d 173 (2d Cir. 2019) and *Bank of America v. United States*, 964 F.3d 1099 (Fed. Cir. 2020). In that case, to claim a taxpayer-favorable precedent, the taxpayer had to make an expansive claim for refund jurisdiction in the Second Circuit which ultimately failed, but there was no downside because the Second Circuit ordered the case transferred to the CFC which clearly had jurisdiction over the overpayment interest claim but had not favorable precedent as in the Second Circuit).

then change that practical effect only by (i) convincing the CFC or Court of Appeals for the Federal Circuit to reverse its taxpayer-favorable precedent or (ii) convincing the Supreme Court to accept certiorari to achieve a truly national Government-favorable precedent for all courts by arguing conflict among the Circuits or importance of the issue or both.

In the process described above, the taxpayer is in control of the forum choice. The Government has an analogous choice by avoiding asserting additional tax liabilities (or conceding them in litigation) where the taxpayer can litigate in a forum controlled by precedent adverse to the Government. It is not the same, because taxpayers in the fora with taxpayer-favorable controlling precedent still get the taxpayer-favorable result. But the Government can force taxpayers in other fora to litigate the issue where there is no controlling precedent or even taxpayer-adverse precedent. The Government may do that to have other courts weigh in on the issue in the Government's favor, thereby creating a trend that will be ultimately resolved among the Circuits or by the Supreme Court. We shall see below in the section discussing recovery of attorneys' fees that, when the Government does this type of seriatim forum shopping, taxpayers may have the right to recover attorneys' fees.²⁶³⁷

Finally, over the years, there have been thoughtful critiques of whether offering the multiple litigation forums are inconsistent with a national tax system that might suggest that tax litigation should be channeled into a single litigation forum and a single court of appeals forum.²⁶³⁸ The arguments have not gained traction.²⁶³⁹

B. Recovery of Attorneys' Fees & Costs from the Government - § 7430.

1. The Setting.

Section 7430 of the Code provides that a taxpayer who is a "prevailing party" in may recover "reasonable administrative costs" and "reasonable litigation costs," including attorneys' fees, incurred in some levels of administrative proceeding and in most forms of tax litigation.²⁶⁴⁰ The

²⁶³⁷ See discussion beginning p. 609.

²⁶³⁸ Erwin N. Griswold, The Need for a Court of Tax Appeals, 57 Harv. L. Rev. 1153, 1183-84 (1944); Roger John Traynor, Administrative and Judicial Procedure for Federal Income, Estate, and Gift Taxes-A Criticism and a Proposal, 38 Colum. L. Rev. 1393 (1938); Stanley S. Surrey, Some Suggested Topics in the Field of Tax Administration, 25 Wash. U. L.Q. 399, 417-22 (1940); Henry J. Friendly, Averting the Flood by Lessening the Flow, 59 Cornell L. Rev. 634, 644 n.38 (1974); Judge Howard A. Dawson, Jr. Should the Federal Civil Tax Litigation System Be Restructured, 40 Tax Notes 1427 (1988).

²⁶³⁹ Dean Griswold was convinced that some proposal to consolidate and channel tax litigation would be required. Mortimer M. Caplin, The Tax Lawyer's Role in the Way the American Tax System Works (13th Annual Erwin N. Griswold Lecture Before The American College of Tax Counsel 1/22/05) (after noting the inadequacy of the cert system to resolve conflicts in tax law, Caplin quoted Griswold's 1992 biography, Ould Fields, New Come, "Eventually, something along the lines proposed will have to come as it makes no sense to have tax cases decided by thirteen different courts of appeals, with no effective guidance on most questions from the Supreme Court." Nevertheless, Caplin notes the practicing bar's opposition based on tax lawyers find[ing] it advantageous to have uncertainty and delay—a preference for forum shopping.")

²⁶⁴⁰ Attorneys or even others who represent themselves pro se do not "incur" such costs and thus are not entitled to recover notional fees for their time. See *United States v. Hudson*, 2010 U.S. App. LEXIS 23338 (2d Cir. (continued...))

covered administrative proceeding or tax litigation must involve “the determination, collection, or refund of any tax, interest, or penalty under this title,” which is construed to include applications for tax exempt status proceedings.²⁶⁴¹

2. Some Issues Regarding Recovery of Fees and Costs.

a. Eligible Persons.

A party to the litigation may be a “prevailing party” entitled to recover fees and costs. An attorney for the prevailing party is not the prevailing party and thus may not pursue recovery even if the attorney is the real party in interest (in the sense that a recovery by the prevailing party must, by the attorney engagement, be remitted to the attorney).²⁶⁴²

The party to the litigation must be either (i) an “individual” (including an estate or trust) with a net worth not exceeding \$2 million. or (ii) an “owner” of an unincorporated business entity or any juridical entity such as a corporation or partnership with a net worth not exceeding \$7 million **and** does not have more than 500 employees (both tested at the time the civil action was filed).²⁶⁴³ Net worth based on cost of acquisition (less depreciation) rather than current appraisal.²⁶⁴⁴ Individuals filing a joint return are treated separately in calculating net worth.²⁶⁴⁵

b. Tax Liability Must be in Issue.

Excluded from § 7430 recoveries is “any proceeding in which the amount of tax liability is not in issue.”²⁶⁴⁶ See the qualified offer exception discussed below.

c. Costs Recoverable.

(1) Administrative Costs.

²⁶⁴⁰(...continued)

2010) (unpublished).

²⁶⁴¹ 7430(a); *Friends of the Benedictines in the Holy Land, Inc. v. Commissioner*, 150 T.C. 107, 111 n. 3 and 112-113 (2018).

²⁶⁴² *Greenberg v. Commissioner*, 147 T.C. 382 (2016).

²⁶⁴³ See § 7430(c)(4)(A)(ii) & (D), and, by reference, 28 U.S.C., § 2412(d)(2)(B). See Reg. § 301.7430-5(g).

²⁶⁴⁴ Reg. § 301.7430-5(g)(6), based on legislative history. H.R. Rep. No. 96-1418, at 15 (1980), 1980 U.S.C.C.A.N. 4984, 4994. See *United States v. 88.88 Acres of Land*, 907 F.2d 106 (9th Cir. 1990).

²⁶⁴⁵ § 7430(c)(4)(D)(ii).

²⁶⁴⁶ § 7430(c)(4)(E)(ii). Included in the “not in issue” excluded category are: “any declaratory judgment proceeding, any proceeding to enforce or quash any summons issued pursuant to this title, and any action to restrain disclosure under section 6110(f).” Although a partnership pays no tax, the amount of tax is in issue in a TEFRA proceeding may include the partner level adjustments. *BASR Partnership v. United States*, 915 F.3d 771 (Fed. Cir. 2019); but see *Hurford Investments No. 2, Ltd v. Commissioner*, (Dkt. 23017-11 Designated Order 9/11/19) (Holmes, J., disagreeing with the Federal Circuit in *BASR*.)

Administrative and litigation costs are recoverable. There are two key dates for recovery of administrative costs.

First, the IRS position is tested for being substantially justified or not as of the earlier of (1) the date the taxpayer receives the notice of the Appeals Office decision, and (2) the date of the notice of deficiency.²⁶⁴⁷ This means that substantially unjustified IRS positions prior to those dates are irrelevant if not incorporated in the decision or notice of deficiency. Hence, the taxpayer settling prior to those key events at the conclusion of the Appeals Office hearing will not be entitled to recover administrative costs.

Second, if the first test is cleared (i.e., the IRS position was not substantially justified on the testing date), the quantum of administrative costs that may be recovered are those incurred after the **earliest** of the following dates: (1) the date of receipt of the Appeals Office decision; (2) the date of the notice of deficiency; or (3) the date of notice of proposed deficiency (“30 day letter”) offering an Appeals Office hearing.²⁶⁴⁸ These dates permit recovery of administrative costs in income tax cases where Appeals access is obtained after the 30-day letter, but will effectively deny recovery in other cases, such as CDP Appeals, where accessing Appeals through other means, because the third date is inapplicable and the first two dates coincide with the conclusion of the Appeals process.²⁶⁴⁹

(2) Litigation Costs.

The position for litigation costs is tested at the date the Government files its answer.²⁶⁵⁰ Once, this testing date is met, the taxpayer may recover reasonable litigation costs from the inception of the litigation. Prior to these applicable dates, the IRS is not considered to have taken any position for which costs are recoverable.²⁶⁵¹

(3) Fees Paid by Third Party.

In some tax proceedings fees may be paid by a third party—such as an employer. For example, I have represented a line-level employee with an issue common to other employers arising out of employment, where the employer paid the fees. Although the statute requires that the fees be incurred, which impliedly meant by the taxpayer, the Ninth Circuit held that the word “incur” is broader than the implication. The taxpayer before the court is incurring the fees even though they

²⁶⁴⁷ § 7430(c)(7)(B).

²⁶⁴⁸ § 7430(c)(2) (flush language).

²⁶⁴⁹ Because of the statutory dates, administrative costs (as opposed to litigation costs) are not available in collection appeals. *Dang v. Commissioner*, T.C. Memo. 2020-150, Slip Op.8 n5 (citing H.R. Conf. Rept. No. 100-1104, at 226 (1988), 1988-3 C.B. 473, 716 (“Thus, with respect to a collection action, only reasonable **litigation** costs are recoverable under * * * [sec. 7430].” (Emphasis supplied), aff’d 2022 U.S. App. LEXIS 4453 (9th Cir. 2022) (unpublished). Thus, administrative costs are not available in collection proceedings, including Collection Due Process (CDP) proceedings. Reg. § 301.7430-3(a) & (b). In affirming in *Dang*, the Ninth Circuit did not reach the validity of the regulation, but Judge O’Scannlain in concurring stated his belief that the regulation was invalid.

²⁶⁵⁰ § 7430(c)(2)(A); and *Huffman v. Commissioner*, 978 F.2d 1139, 1148 (9th Cir. 1992).

²⁶⁵¹ See e.g., for administrative costs *Rathbun v. Commissioner*, 125 T.C. 7, 13 (2005); and *Fla. Country Clubs, Inc. v. Commissioner*, 122 T.C. 73, 86 (2004).

may be advanced by a third party. And this is true even if the taxpayer's obligation to repay the third party advancing the fees is contingent upon and to the extent that the taxpayer obtains judicial recovery of the fees.²⁶⁵² The court thus summarized: "We hold instead that a taxpayer can "incur" attorneys' fees if he assumes either: (1) a non-contingent obligation to repay the fees advanced on his behalf at some later time; or (2) a contingent obligation to repay the fees in the event of their eventual recovery." In such cases, presumably, the dollar limitations for eligible taxpayers discussed above would be the taxpayer before the court.

²⁶⁵² Morrison v. Commissioner, 565 F.3d 658 (9th Cir. 2009).

(4) Exception for Protracting Proceedings.

Costs are not recoverable “with respect to any portion of the administrative or court proceeding during which the prevailing party has unreasonably protracted such proceeding.”²⁶⁵³

d. Prevailing Party (Substantially Prevailed and Substantially Justified).

The taxpayer must be the prevailing party to recover costs.²⁶⁵⁴ The prevailing party is the party who substantially prevailed with respect to an actual IRS position²⁶⁵⁵ either with respect to the amount in controversy or the significant issues or set of issues presented.²⁶⁵⁶ The IRS position against which the taxpayer must prevail is (1) “the notice of the decision of the Internal Revenue Service Independent Office of Appeals”; or (2) “the notice of deficiency” whichever comes first.²⁶⁵⁷

A taxpayer will not be deemed a prevailing party on issues or amounts where the Government’s position was substantially justified.²⁶⁵⁸ Substantially justified means that the IRS has a reasonable basis as to both fact and law.²⁶⁵⁹ As covered in discussing the accuracy related penalties, reasonable basis is substantially less than more likely than not. Thus, the mere fact that the taxpayer prevails is not proof per se that the IRS’s position was not substantially justified.²⁶⁶⁰

Portillo v. Commissioner, 988 F.2d 27 (1993) represents perhaps an extreme case, but illustrates the requirement that the IRS position be substantially justified to avoid award of costs to an otherwise prevailing party. In that case, the IRS asserted in the notice of deficiency that the taxpayer, a laborer, received additional income paid in cash by a contractor. The contractor had issued a Form 1099 in that amount. The IRS relied solely on the contractor’s allegation in the Form 1099, even though the taxpayer denied receiving the income. In this circumstance, it is at least

²⁶⁵³ § 7430(b)(3).

²⁶⁵⁴ § 7430(a).

²⁶⁵⁵ § 7430(c)(7) defines position of the IRS as (1) “the notice of the decision of the Internal Revenue Service Independent Office of Appeals”; or (2) “the notice of deficiency,” whichever comes first.

²⁶⁵⁶ § 7430(c)(4)(A).

²⁶⁵⁷ § 7430(c)(7). See *Klopfenstein v. Commissioner*, T.C. Memo. 2019-156 (rejecting argument that the IRS asserted a “position” before Appeals actually took a position.)

²⁶⁵⁸ § 7430(c)(4)(B).

²⁶⁵⁹ Reg. § 301.7430-5(c)(1); *Portillo v. Commissioner*, 988 F.2d 27, 28 (1993). For an application of *Portillo*, see *Owens v. Commissioner*, 2003 U.S. App. LEXIS 12481 (5th Cir. 2003) (unpublished opinion). The Tax Court has held that the Government (there the IRS) must actually take a position in the litigation in order for the taxpayer to be a prevailing party, so that a concession by the Government prior to taking a position means that the taxpayer cannot be the prevailing party as to the position. For example, concession in the IRS answer, the IRS’s first statement of position in the Tax Court, will mean that the taxpayer has not substantially prevailed on the issue and cannot recover attorneys fees. in the Tax Court. At least that is the position of the Tax Court. *Friends of the Benedictines in the Holy Land, Inc. v. Commissioner*, 150 T.C. 107, 113-116 (2018) (discussing *Fla. Country Clubs, Inc. v. Commissioner*, 122 T.C. 73 (2004), *aff’d*, 404 F.3d 1291 (11th Cir. 2005) and distinguishing cases where a district court allowed litigating costs even when the Government conceded before filing an answer); see also *Huffman v. Commissioner*, 978 F.2d 1139, 1148 (9th Cir. 1992); and *Dang v. Commissioner*, T.C. Memo. 2020-150, *aff’d* 2022 U.S. App. LEXIS 4453 (9th Cir. 2022) (unpublished affirmance).

²⁶⁶⁰ *Portillo v. Commissioner, supra*; *Nalle v. Commissioner*, 55 F.3d 189, 192 (5th Cir. 1995).

possible that the contractor may have overstated the Form 1099 amount to justify deductions to which it was not entitled. In the case involving the substantive issue, the Fifth Circuit held that the IRS could not prevail solely on the basis of the employer's Form 1099 and was required to come forward with some further evidence which it had not done. In the subsequent appeal involving recovery of litigation costs under § 7430, the IRS asserted that it had been substantially justified based on its reliance upon the payor's allegations in the Form 1099. The Court rejected the argument, awarding costs to the taxpayer. The Court reasoned that it had previously held that the IRS position lacked any fact basis and was clearly erroneous as a matter of law.

Portillo should be contrasted with *Johnson v. Commissioner*, 972 F.3d 655 (5th Cir. 2020), where the IRS relied upon information returns from third parties showing that the taxpayer had received distributions from tax deferred retirement accounts. As it turned out, the taxpayer (unknown to the reporting payors and to the IRS) rolled the distribution amounts into a rollover qualifying account which permitted the taxpayer to avoid the taxable income on the distributions. The taxpayers did not, however, file the form to claim the rollover and did not respond to the IRS's request before the notice of deficiency was sent for information as to the discrepancy between the third party information returns and the taxpayer's income tax return. Taxpayers engaged in lengthy correspondence with the IRS claiming the rollover but not producing proof of the rollover or the required form. The IRS issued a notice of deficiency. The taxpayers petitioned the Tax Court for redetermination. As often occurs, once the IRS filed its answer, the matter was referred to Appeals, and the taxpayers produced the proper documentation for appeals. The IRS then conceded. The taxpayers moved for their costs under § 7430. The Tax Court and the Fifth Circuit on appeal held that the IRS's position was substantially justified. The only document stating the IRS position was the answer which asserted a denial of the taxpayers' allegations "for lack of sufficient knowledge or information." (Keep in mind that the taxpayers had not yet submitted the supporting documents.) The Tax Court and Fifth Circuit held that the IRS position in the answer was substantially justified and denied costs under § 7430.

The statute creates a rebuttable presumption that IRS position is not substantially justified if the IRS fails to follow applicable published guidance in the administrative proceeding.²⁶⁶¹ Such published guidance are of two categories: (1) publicly issued precedential guidance ("regulations, revenue rulings, revenue procedures, information releases, notices, and announcement") and (2) certain guidance issued to the taxpayer in issue ("any of the following which are issued to the taxpayer: private letter rulings, technical advice memoranda, and determination letters").²⁶⁶² For review, you should ask yourself why Congress made this distinction in applicable published guidance.

For legal positions, the requirement that the IRS's position be substantially justified is reminiscent to the standard applying for the substantial understatement penalty—i.e., that the position be based upon substantial authority. As with the substantial authority escape from the substantial understatement penalty, the issue of substantial justification can also turn upon the facts and whether, based on reasonable inquiry into the facts, the IRS did not have substantial justification for

²⁶⁶¹ § 7430(c)(4)(B)(ii).

²⁶⁶² § 7430(c)(4)(B)(iv).

the position it takes. For example, in valuation cases where both sides are prone to take extravagant positions fortified by expert opinion, the issue will be whether the IRS was substantially justified or reasonable in taking the position.²⁶⁶³

In a multiple issue case, the costs allocable to issues as to which the IRS was not substantially justified may be recovered.²⁶⁶⁴

e. Exhaustion of Administrative Remedies.

The taxpayer must have pursued available administrative remedies, including most critically the Appeals procedure discussed above if it is available to the taxpayer.²⁶⁶⁵ The Tax Court has sent clear warning to taxpayers and their representatives about foregoing their Appeals opportunities before commencing litigation:

For years, many tax practitioners, on behalf of their clients, have adopted a strategy to bypass a protest of respondent's proposed audit adjustments to respondent's Appeals Office. This strategy is based on the perceived risk that filing a protest and “going to” appeals might result in new issues [sic] being raised by the Appeals Office and on a perceived advantage of getting into court as soon as possible. See for explanations of this strategy, Saltzman, *IRS Practice & Procedure*, par. 9.04[1] (2d ed. 1991), and Shafiroff, *Internal Revenue Service Practice & Procedure Deskbook*, sec. 4.1, at 4-6 (3d ed. 2001). * * * *. In light, however, of the exhaustion-of-administrative-remedies requirement of section 7430, if counsel wish to preserve the opportunity to seek a recovery of litigation costs, continued use of this strategy carries with it its own new risks evident in the instant cases.²⁶⁶⁶

You may recall from the discussion of the Appeals function that, to pursue Appeals, Appeals will need sufficient time on the statute of limitations. Access to Appeals requires a 30-day letter, but, if the IRS does not have time to process an Appeal, a quick assessment can be made without a 30-day letter.²⁶⁶⁷ Given the length of time for effective Appeals processing any time shorter than 120 days is likely to result in a notice of deficiency. Generally, on a short statute date, the IRS will insist upon extension on the statute of limitations to pursue the appeal. The taxpayer is not required to agree to an extension of the statute of limitations to meet the requirement that he or she have exhausted

²⁶⁶³ See *Estate of Baird v. Commissioner*, 416 F.3d 442 (5th Cir. 2005) (holding the IRS valuation position not substantially justified); *Smith v. United States*, 850 F.2d 242, 246 (5th Cir. 1988); and *Fair v. Commissioner*, T.C. Memo. 1994-602 (when deciding if respondent's position on valuation is substantially justified, the Court “must consider the facts of the case, the nature of the asset to be valued, the qualifications of the expert, the soundness of the valuation methods, the reliability of the expert's factual assumptions, and the persuasiveness of the reasoning supporting the expert's opinion”).

²⁶⁶⁴ Reg. § 301.7430-5(c)(2); see *Swanson v. Commissioner*, 106 T.C. 76, 87-92 (1996).

²⁶⁶⁵ § 7430(b)(1). Courts describe this requirement as “jurisdictional,” so that dismissal of any suit for the remedy is required. E.g., *Kuhl v. United States*, 467 F.3d 145, 147 (2d Cir. 2006) (“Failure to exhaust [administrative] remedies deprives the federal court of jurisdiction over the suit.”).

²⁶⁶⁶ *Haas & Associates Accountancy Corp. v. Commissioner*, 117 T.C. 48, 62 (2001); see also *Covert v. Commissioner*, T.C. Memo. 2008-90.

²⁶⁶⁷ IRM 5.1.4.4 (03-10-2022), Quick Assessment.

administrative remedies.²⁶⁶⁸ Accordingly, in this situation, it appears that the taxpayer should file the protest and let the IRS refuse the Appeals hearing by issuing the notice of deficiency without the hearing.

What if the taxpayer does not receive a 30-day letter which is generally the “ticket” to Appeals? In that case, the taxpayer will not be deemed to have failed to exhaust his administrative remedies if (1) the failure to receive the letter was not due to his fault (e.g., the taxpayer failed to give the IRS a proper address for mailing the 30-day letter) and (2) the taxpayer then participates in an Appeals conference at the next critical opportunity (e.g., while in docketed case if the taxpayer files a petition in the Tax Court).²⁶⁶⁹

f. Amount of Attorneys’ Fees.

Usually in administrative and judicial proceedings, the taxpayer’s costs are principally attorneys’ fees. There may also be associated costs, such as expert witness fees and miscellaneous other costs. But the lion’s share will usually be attorneys’ fees.

Attorneys are expensive. In Houston, attorneys’ fees can easily range from \$200 to even \$900 and above per hour. The amount recoverable in 2023 is \$230 per hour (as adjusted for inflation),²⁶⁷⁰ unless the court determines that a special factor, such as “the limited availability of qualified attorneys for such proceeding, the difficulty of the issues presented in the case, or the local availability of tax expertise, justifies a higher rate.”²⁶⁷¹ This standard to obtain higher hourly rates should not be read too generously. Since the statute assumes competency to file the tax proceeding at the adjusted hourly rate, some special expertise beyond capability of handling an IRS administrative proceeding or tax litigation is required to recover fees in excess of that rate.²⁶⁷² Nor is the fact that the prevailing attorneys’ fees rate for that type of tax controversy legal service in the location is a special factor justifying an hourly rate in excess of that prescribed in the statute.²⁶⁷³

²⁶⁶⁸ § 7430(b)(1).
²⁶⁶⁹ Reg. § 301.7430-1(e)(3).
²⁶⁷⁰ Rev. Proc. 2022-38; 2022-45 I.R.B. 1 § 3.60 Attorney Fee Awards (adjusting for inflation the statutory amount of \$125 per hour).

²⁶⁷¹ § 7430(c)(1)(B)(iii).
²⁶⁷² General tax expertise is not sufficient, otherwise all attorneys competent to handle tax proceedings would be able to charge higher rates than the amount provided pursuant to the statute (as adjusted for inflation). See *Tolin v. Commissioner*, T.C. Memo. 2018-29, at *49, n28 (citing cases), aff’d 929 F.3d 548 (8th Cir. 2019); see also *Cassuto v. Commissioner*, 936 F.2d 736, 743 (2d Cir. 1991) (“Section 7430 applies only to tax cases; therefore most of the applications for attorneys’ fees under it would be to pay attorneys who have brought or defended tax cases. Such lawyers presumably all have a certain degree of ‘tax expertise.’ To suppose that Congress intended them all to be paid at a higher than \$[125] an hour rate would allow this ‘special factor’ exception to swallow the \$[125] an hour rule.”); *Pohl Corp. v. United States*, 29 Fed. Cl. 66, 75 (1993) (“While [the plaintiff’s] two attorneys may be, as is claimed, tax specialists, this does not entitle [the plaintiff] to a fee in excess of the statutory rate.”).

Also, “The hourly rate charged by representatives in the geographical area is not relevant in determining whether tax expertise is locally available.” Reg. § 301.7430-4(b)(3)(iii)(D).

²⁶⁷³ *Tolin v. Commissioner*, T.C. Memo. 2018-29, at *48-*51 (citing cases), aff’d 929 F.3d 548 (8th Cir. 2019).

Notwithstanding, if the lawyer brings some special expertise other than tax to the tax issue involved, a higher rate may be awarded.²⁶⁷⁴

Fees of nonattorneys authorized to practice before the Tax Court or the IRS are treated as services of an attorney for § 7430.²⁶⁷⁵ Also, courts may award reasonable attorneys' fees in cases where the attorney is serving pro bono.²⁶⁷⁶

This limitation applies to attorneys, but not to experts engaged by the attorney in the litigation or for technical reports necessary for trial preparation.²⁶⁷⁷

The ultimate fee awarded depends not only on the rate but the number of hours involved in the representation as to which fees are awarded. In awarding fees, courts may take a critical look at the number of hours that an attorney claims to have spent, so that if the attorney spent more time than appropriate in the representation (or its segmentable components, such as writing an opening brief or reply brief), the court may scale back the number of hours for which the hourly fee is awarded.²⁶⁷⁸

g. Government Circuit Shopping.

One of the features of our tax litigation system is that, until and unless the Supreme Court resolves an issue, that issue may be resolved differently among the various courts of appeals and taxpayers in different parts of the country may be taxed differently. Taxpayers frequently take advantage of this opportunity by litigating in a circuit that has not yet resolved an issue that has been resolved unfavorably in other circuits. For example, if a taxpayer has the traditional litigating choices noted above and the Court of the Appeals for the Circuit (governing the Tax Court and the district court) has rendered an unfavorable decision but the Court of Appeals for the Federal Circuit has not yet addressed the issue or has rendered a favorable decision, the taxpayer should pursue the matter in the Court of Federal Claims. The Government does not have this opportunity since the taxpayer generally controls the forum for litigation.

However, the Government does have a forum shopping opportunity as among the circuits after it loses an issue in one or more of the circuits. In that case, although the Government is bound in the circuit(s) in which the unfavorable precedent(s) exist, it may continue to set up taxpayers on the issue in the other circuits, force them into litigation in the other circuits, and thereby attempt to prevail in other circuits. If the Government could then prevail in one or more of the other circuits,

²⁶⁷⁴ *Bode v. United States*, 919 F.2d 1044, 1051 (5th Cir. 1990) (“[s]pecial legal expertise about the quarterhorse industry may well * * * qualif[y] as a special factor”).

²⁶⁷⁵ § 7430(c)(3)(A); for a discussion of this requirement, see *Ragan v. Commissioner*, *supra*.

²⁶⁷⁶ § 7430(c)(3)(B).

²⁶⁷⁷ E.g., § 7430(c)(1)(B)(i) (imposing only a limit that the fees not be “in excess of the highest rate of compensation for expert witnesses paid by the United States”); & § 7430(c)(1)(B)(ii) (technical reports); See also *Ragan v. Commissioner*, *supra*.

²⁶⁷⁸ See *Tolin v. Commissioner*, 929 F.3d 548 (8th Cir. 2019) (even here, for the briefing that was done, although the Tax Court scaled back the hours and was affirmed by the Eight Circuit in doing so, it seems to me that even the scaled back hours were generous for the tasks as described. I think in this exercise courts would not want to be too picky, but that does not mean that taxpayers and their lawyers can be aggressive in claiming the time.

it would either seek to have the Supreme Court resolve the issue nationwide or, alternatively, try to use the new court of appeals precedent in its favor to build toward a reversal in the other circuit courts of appeals (including the ones previously rendering unfavorable precedents). However, when the Government continues to litigate in the face of unfavorable precedents in other circuits, obviously there is unfairness to the taxpayers in those other circuits who are to bear the costs of the Government's search for favorable precedents, particularly when the Government is unsuccessful in the other circuits. The courts are directed to consider such Government forum shopping in determining recoverable costs.²⁶⁷⁹

Moreover, although not dealt with specifically in the statute, the courts will also award attorneys' fees where the Government forces litigation in a circuit in an unsuccessful attempt to reverse a prior court of appeals opinion in the same circuit.²⁶⁸⁰

h. Sanctions for Litigation Abuses.

Taxpayers and / or their counsel may be sanctioned for inappropriate action with respect to litigation.

In Tax Court proceedings, § 6673 authorizes:

- a taxpayer sanction up to \$25,000 for proceedings (i) “instituted or maintained by the taxpayer primarily for delay,” (ii) “frivolous or groundless” position, or (iii) the taxpayer’s unreasonable failure to pursue administrative remedies.²⁶⁸¹ This penalty may be applied against tax protesters, but usually only after repeated warnings from the Tax Court that their continued assertion of frivolous grounds or unnecessary delay could draw the penalty.²⁶⁸²
- counsel for a taxpayer may be sanctioned up to \$10,000 where he or she “multiplied the proceedings in any case unreasonably and vexatiously.” Sanctions may also be awarded against an IRS attorney, and the Tax Court has given substantial attorneys’ fees in the case of a truly aberrational situation where it found the IRS attorneys actions, amounting to a fraud on the court, unreasonable and vexatious.²⁶⁸³
- The Tax Court may impose the penalty sua sponte.

²⁶⁷⁹ § 7430(c)(4)(B)(iii).

²⁶⁸⁰ *Foster v. United States*, 249 F.3d1275 (11th Cir. 2001).

²⁶⁸¹ For example, advancing frivolous arguments risk being given short shrift by the Tax Court and drawing this sanction. *Wnuck v. Commissioner*, 136 T.C. 498 (2011). As to the application of § 6751(b)’s supervisor written approval requirement to this penalty, see CCN 2018-006 (6/6/18).

²⁶⁸² The penalties are often asserted by order rather than a reported opinion. For a good compilation of some statistics on the assertion of the penalty against tax protesters, see William Schmidt, [Tax Protesting and 6673 Penalties: Designated Orders 9/2/19 to 9/6/19](#) (Procedurally Taxing Blog 11/12/19) (collecting statistics and the number of times asserted in 2011 through 2019, broken down by judge; one judge has imposed the penalty in 58 cases, whereas some judges have never asserted the penalty).

²⁶⁸³ *Dixon v. Commissioner*, 132 T.C. 55 (2009).

In other proceedings in the district court or claims court, the courts have other authority to sanction misconduct (e.g., Rule 11(c), FRCP),²⁶⁸⁴ but § 6673 provides special sanctions for proceedings under § 7433 and special authority to assess such sanctions as a tax and, upon notice and demand, collect the assessed sanctions in the same manner as a tax.

i. Qualified Offer (“QO”).

(1) General.

If the taxpayer makes a settlement offer qualifying under § 7430(c)(4)(E) (called a “qualified offer” or “QO”) that the IRS rejects and the judgment²⁶⁸⁵ in the case is equal to or less for the IRS than the offer, the taxpayer may recover costs.²⁶⁸⁶ Unlike the general provision discussed above, there is no IRS escape if its litigating position was substantially justified. The only issue is whether the final judgment was equal to or less than the offer.

The taxpayer must still meet the net worth limitations discussed above.²⁶⁸⁷ The qualified offer must:

- (a) be in writing;
- (b) specifically state that it is a qualified offer;
- (c) be for an amount that will fully resolve the tax liability for the year (i.e., must cover all issues);²⁶⁸⁸
- (d) be made in the period between (i) the 30-day letter is received or, if no 30-day letter is received, the date of the 90-day letter and (ii) 30 days before the case is first set for trial; and
- (e) remain open until the earliest of (i) the date the offer is rejected, (ii) the date the trial begins, or (iii) 90 days from the date of the offer.²⁶⁸⁹

²⁶⁸⁴ See e.g., *Szopa v. United States*, 460 F.3d 884 (7th Cir. 2006), an opinion by Judge Easterbrook, imposing sanctions on a taxpayer based on the estimated cost to the Government of responding to the appellate brief filed by the taxpayer. What is particularly interesting is how the court calculates that estimated cost.

²⁶⁸⁵ In the Tax Court, the judgment for this purpose is the decision document which serves the equivalent role in the Tax Court to judgments in the district court.

²⁶⁸⁶ The taxpayer must meet the other requirements, including specifically exhaustion of administrative remedies discussed earlier. See *Haas & Associates Accountancy Corp. v. Commissioner*, 117 T.C. 48 (2001); and *Covert v. Commissioner*, T.C. Memo. 2008-90.

²⁶⁸⁷ § 7340(c)(4)(E)(i).

²⁶⁸⁸ For this reason, if the taxpayer makes a qualified offer that does not take into account a net operating loss carryover to the year (usually a carryback) and the IRS accepts the offer as made, the taxpayer cannot thereafter seek the further benefit of the carryback. *Johnston v. Commissioner*, 122 T.C. 124 (2004), affd. 461 F.3d 1162 (9th Cir. 2006) (2004).

²⁶⁸⁹ § 7430(c)(4)(E) and (g); see *Lewis v. Commissioner*, 158 T.C. ___, No. 3 (2022) (offer regarding principal tax liability but reserving innocent spouse issue is not a QO). If the offer letter states that the offer may be withdrawn at any time, the offer is not a qualified offer. *Simpson v. Commissioner*, 668 Fed. Appx. 241, (9th Cir. 2016).

The judgment must not be entered “pursuant to a settlement.”²⁶⁹⁰ Thus, in a multi-issue case, there must be at least one unsettled issue the Court is required to resolve. Then, costs with respect to settled issue(s) are not subject to the QO rules but may be recovered under § 7430 generally if the requirements are met.

If the IRS accepts the QO, the taxpayer and the IRS are contractually bound to the settlement thus reached.²⁶⁹¹ This points out a danger of settlements generally, not just QOs. Settlements are contracts and bind the parties. Thus, if the taxpayer settles a suit, whether by QOs or otherwise and fails to take into account other favorable adjustments that might potentially apply, the taxpayer will be out of luck (just as in the reverse, the IRS would be out of luck. This danger was presented in the context of a QO that failed to mention that the taxpayer might have NOL carrybacks that could potentially reduce the contractual amount of the accepted QO. The courts held that the taxpayer is out of luck. If the taxpayer wanted the benefit of the carryback, he should have mentioned it in his QO and thus made it a term of the contract that the IRS agreed to by accepting the offer.²⁶⁹²

QOs may be revised—via new QOs—as the ebb and flow of the pre-trial work requires. Indeed, multiple QOs offer good opportunities and should be considered.²⁶⁹³

(2) Costs Covered.

The costs covered are the costs incurred on or after the date of the offer.²⁶⁹⁴ A taxpayer can make multiple QOs as the process continues. But the amount subject to the QO rules is based on the last offer and the taxpayer can only recover costs incurred after the last offer.²⁶⁹⁵ In a multi-issue case, so long as one issue is left for trial, QOs can be recovered but only as to the issue that is in fact tried. The costs of the settled issues may be recovered under the other rules of § 7430 but not under the QOs special rules. This puts a premium on detailed time and cost records so that the taxpayer can meet the burden of showing costs of the issue(s) that was tried.

Recoverable costs include costs incurred to deal with the substantive issue and costs incurred in pursuing the claim for recovery of such costs (so-called “fees on fees”).

²⁶⁹⁰ § 7430(c)(4)(E)(ii)(I). However, the Tax Court has held that, where the final decision is reached by settlement after the substantial issues are litigated (in that case through appeal, with the settlement then being reached on remand), this exception to QO liability will not apply. *Gladden v. Commissioner*, 120 T.C. 446 (6/27/03). The IRS’s unilateral concession is not a settlement disqualified from recover of attorneys’ fees. *Knudsen v. Commissioner*, 2015 U.S. App. LEXIS 12183 (9th Cir. 2015), reversing *Knudsen v. Commissioner*, T.C. Memo. 2013-87.

²⁶⁹¹ See e.g., *Johnston v. Commissioner*, 461 F.3d 1162 (9th Cir. 2006) (holding that contract analysis applies to accepted QOs).

²⁶⁹² See *Johnston v. Commissioner*, *supra*.

²⁶⁹³ See Burgess J.W. Raby and William L. Raby, Qualified Offers and Settlement of Tax Controversies, 113 Tax Notes 455 (2006).

²⁶⁹⁴ § 7430(e)(4)(E)(iii)(II).

²⁶⁹⁵ § 7430(e)(4)(E)(iii)(I).

(3) Thoughts and Strategies.

Strategizing the QO requires careful analysis. Let's use two examples.

Example 1: Suppose a case involves a single issue with a proposed additional tax of \$100,000. The issue is a valuation issue that a court may resolve to produce additional tax anywhere between 0 and \$100,000. Taxpayer's aggressive position is that the right result is 0, but taxpayer believes that a court might find a range of values that would produce additional tax of between \$30,000 and \$40,000. The Appeals Officer, however, assesses the range of potential values differently, to produce say from \$60,000 to \$70,000 additional tax. (FYI, I have chosen a valuation issue first because, by the time the IRS refines its position for trial, it is likely that, absent a QO, a Court would find that the IRS's position was substantially justified, thus precluding recovery under the general § 7430 rules; in this example, if the IRS refines its position in the notice of deficiency to \$70,000, the upper end of the Appeals Officer's range, then presumably the Court will find that the IRS was substantially justified.)

If the taxpayer were comfortable with his assessment of the range, the taxpayer might make an offer of \$35,000 (middle of the taxpayer's range). The taxpayer does not think the Appeals Officer would accept that offer, and they will go to trial. The taxpayer's risk, of course, would be that the Court would determine a higher value than the taxpayer's mid-range, thus producing a tax in excess of \$35,000. The taxpayer might therefore be more conservative and propose additional tax of \$40,000 (which represents the top end of his range). The Appeals Officer is not likely to accept this offer either, and it would give the taxpayer a better chance at recovering § 7430 costs. Still, there is some risk that the Court might come up with a higher value than even the taxpayer predicted as the top of the range. The taxpayer thus might consider an offer of \$50,000 which is the mid-point between the respective mid-points of their two assessments. The taxpayer really does not want to settle for that amount (because he still believes the \$30,000-\$40,000 range is right), but the higher amount will better situate him to recover § 7430 costs which will be substantial and, if accepted, will at least avoid the further costs of litigation which will substantially exceed the amount recoverable under the qualified offer concept.

The tension, of course, is created because the QO works best when the taxpayer is conservative (i.e., offers the higher proposed additional tax). An aggressive taxpayer offer (e.g., one producing say \$20,000 of tax in this example) is unlikely to be accepted, and, in this example, it may not be likely that an ultimate court holding would sustain that small a tax liability. A conservative taxpayer offer (i.e., one producing higher tax) better situates the taxpayer to recover § 7430 costs. The risk, of course, is that, if the offer is too conservative, the IRS may accept the offer and thus lock the taxpayer into a significantly worse result than the taxpayer could achieve at trial. Thus, the taxpayer must factor into his offers what he thinks he can get on the merits at trial and whether what he is risking in a conservative offer may be greater than the prospective benefits of recovering § 7430 costs at trial. The taxpayer must keep in mind that, even if he does recover § 7430 costs, the recovery will be less than his real additional costs (e.g., his attorneys' fees will be higher than allowed). It may thus be that, given those additional costs, the taxpayer would be willing to offer \$45,000 or even \$50,000 which is beyond his estimate of the top end of the range in the hope that the IRS would accept it. Or that point may be his point of indifference as to whether the IRS accepts

the offer or rejects it, with the result that, if he has assessed the case correctly, he will recover attorneys' fees.

Example 2: Assume a single issue case also involving \$100,000 in additional tax. The issue is an either/or issue. At trial, either the IRS prevails 100%, or the taxpayer prevails 100%. There will be no point in between as is usually involved in valuation issues. This appears to be a no-brainer in terms of a QO. The taxpayer should offer \$1.

What happens if, in the ensuing litigation, the IRS offers the taxpayer an 80% victory to settle? If the taxpayer accepts, judgment will be entered at \$20,000, which of course exceeds the QO of \$1. Settled issues do not qualify for the QO anyway, so the taxpayer appears no worse off for having offered only \$1. The taxpayer can still seek recovery under the general rules of § 7430, and the substantial concession made by the IRS might at least suggest that its position was not substantially justified, although a 20% settlement might suggest at least reasonable basis. What happens if the IRS trial attorney concedes in full after receiving the QO (or, alternatively, accepts the QO of \$1)? Again, there is no issue left for trial and the QO is irrelevant. However, barring unusual circumstances in which the taxpayer's lack of cooperation led to the IRS's assertion of the worthless position, it would appear that the taxpayer would have a strong case under the general § 7430 rules for recovery of costs. Indeed, in this fact pattern, although with more complexities because presented in a TEFRA proceeding, the taxpayer was awarded substantial attorneys' fees where the qualified offer was for \$1.²⁶⁹⁶

Example 3: Now assume that a single case for a single year involves both of the issues and amounts in Examples 1 and 2. Pull out your crystal ball, and have fun thinking through all the permutations of this one!

C. Recovery of Costs from the Taxpayer - 28 USC 2412(b).

Section 7430, discussed in the prior section, is the fee-shifting provision normally encountered in tax litigation, and it works in favor of the taxpayer. However, I do caveat for readers (particularly those representing taxpayers or others in tax litigation) that there is a general fee-shifting provision, 28 U.S.C. § 2412(b), that permits a court to award to a prevailing litigant costs, including attorneys' fees, if the losing party misbehaves—the words are some variant of acting in bad faith, vexatiously, wantonly, or for oppressive reasons. Section 2412(b) applies to all litigants, but as to misbehavior by the Government, such costs are already covered by § 7430. Where § 2412(b) can be a problem in tax litigation is when the private party—usually the taxpayer as litigant—misbehaves. Taxpayer misbehavior is not uncommon, and the Government rarely presses

²⁶⁹⁶ *BASR Partnership v. United States*, 130 Fed. Cl. 286 (2017), aff'd 915 F.3d 771 (Fed. Cir. 2019); see also *Fitzpatrick v. Commissioner*, T.C. Memo. 2017-88.

the issue, so long as the private litigant does not egregiously misbehave.²⁶⁹⁷ Even when it does seek recovery, the Government will be restrained in the costs it wants to shift to the taxpayer.²⁶⁹⁸

D. Settlements in Tax Litigation.

Settlements in tax litigation are usually based only on the merits (meaning the litigating hazards).²⁶⁹⁹ Collection factors, such as the taxpayer’s ability to pay, are not normally considered.²⁷⁰⁰ After the litigation is resolved on the merits (by judgment or, in the Tax Court, decision, whether reached by settlement or trial processes), the taxpayer with factors indicating doubt as to collectibility or, perhaps, even effective tax administration can request an Offer In Compromise (“OIC”) under the IRS’s normal procedures (discussed beginning p. 707).

I have used words like “usually” and “not normally” in the discussion in the preceding paragraph which suggest that perhaps there might be some cases where factors other than the merits will be considered in reaching a settlement to be recorded in a judgment or decision document for an amount less than the merits would indicate. I just don’t know what that would be.²⁷⁰¹ Taxpayer representatives should be alert to special facts which might support an exception.

²⁶⁹⁷ I could have said unreasonably misbehave, but I do think that even unreasonable misbehavior so long as not egregious might not draw a Government request for fees. I do have a picture (a reprint) by William Weekes titled “I SMELL A RAT.” Link here. My line is that RAT is not a rodent but an acronym for a Reasonably Aggressive Taxpayer. I like to represent RATs. It is the unreasonably–or egregiously–aggressive taxpayer that I do not like to represent. I also do not like to represent taxpayers who egregiously misbehave during the litigation process.

²⁶⁹⁸ See *Heger v. United States*, 2014 U.S. Claims LEXIS 18 (Fed. Cl. 2013) (noting, citations omitted, “The court does not reach this conclusion lightly. Its discretion to award fees for bad faith is exercised with restraint. Such fee-shifting is only invoked when compelling considerations in the interests of justice so require.”).

²⁶⁹⁹ IRM 35.5.2.6 (12-31-2012), Collection Aspects of the Settlement.

²⁷⁰⁰ IRM 35.5.2.6 (12-31-2012), Collection Aspects of the Settlement (stating that the settlement should be a merits settlement “even though there may be a substantial basis for concluding that the petitioner may not be able to pay the agreed deficiency.” The reason is that the IRS has a robust offer in compromise process that considers doubt as to collectibility. Note in this regard that the IRS cannot consider an OIC until the tax is assessed; in deficiency proceedings, the tax is not generally assessed until the conclusion of the Tax Court case and sometimes after conclusion of all appeals. Hence, there is no process for considering claims for anything other than the merits.

²⁷⁰¹ Many years ago when I was with DOJ Tax and had a case that the merits conclusion would require the taxpayer to pay as yet unpaid tax, taxpayer’s counsel sometimes tried to get a settlement for less because the taxpayer could not pay. My standard response was that I did not care whether the taxpayer could pay. I just wanted to quantify the tax liability correctly and then let the other processes for resolving the debt work. I never encountered a case where something other than the merits would be considered, but I do recognize that there may be some cases with highly unusual facts where it might be appropriate to consider factors other than the merits.

E. Burden of Proof (Including Presumption of Correctness).

1. Context and Concepts.

a. Context.

Burden of proof concepts set a conceptual framework for finding facts at trial or, sometimes, before trial in a summary judgment context.²⁷⁰² The burden of proof “instruct[s] the factfinder concerning the degree of confidence our society thinks he should have in the correctness of factual conclusions for a particular type of adjudication.”²⁷⁰³

The classic model to analyze the role of the burden of proof concepts is the jury trial. In a jury trial, the jury is the ultimate trier of fact. However, prior to submitting the fact for the jury’s determination, the judge must determine whether the evidence is of sufficient quality that a reasonable jury could find either way on the fact issue. If the evidence is of sufficient quality that a reasonable jury could reach only one result, the judge will decide the case without submitting the case to the jury. This can happen either during the course of or at the end of trial or, before trial, on motion for summary judgment if the summary judgment evidence is so strong that the judge concludes there is no fact reasonably in dispute for a trier of fact to resolve. In this discussion, I use the jury trial model because it best teaches the function of burden of proof concepts, but the concepts are equally applicable (although sometimes less evident) in trials in which the judge is the ultimate fact finder (called “bench trials”).²⁷⁰⁴

There are two principal burden of proof concepts -- the burden of production and the burden of persuasion.²⁷⁰⁵ There is a significant related concept, called a presumption, that can affect the burden of production and possibly also the burden of persuasion.

The following introductory discussion for these concepts is not a substitute for a deeper study of the subject. This introductory discussion paints in broad strokes, at the risk of omitting some nuance and foregoing developing the exceptions. I simply want you to have a general understanding

²⁷⁰² In the footnoted version of this text, since I am dealing with basic burden of proof principles that have interested me since with DOJ Tax Appellate in the mid-1970s, I have footnote citations only sparsely and not always consistently. I try to footnote with authority those propositions that may be outside the mainstream for practitioners or may be controversial or may be of special interest to tax procedure enthusiasts. Any good procedure or evidence book will cover these concepts. One that I have found particularly helpful since in law school in its earliest edition is Geoffrey C. Hazard, John Leubsdorf, and Debra Lynn Bassett, Civil Procedure (6th ed. 2011).

²⁷⁰³ *Addington v. Texas*, 441 U.S. 418, 423 (1979) (quoting *In re Winship*, 397 U.S. 358, 370 (1970) (Harlan, J., concurring)).

²⁷⁰⁴ In *Cook v. United States*, 46 Fed. Cl. 110, 116 n.13 (2000), the court said that in a non-jury trial, the production burden (which is the burden being addressed when a court decides whether there is sufficient evidence to go to a jury) is meaningless. In a technical sense it is because it does not serve the critical gate-keeping role it serves in a jury trial, but I think the concept is still present with its role being hidden. The concept is to produce enough evidence so that you can get to the judge’s function of deciding whether the evidence is persuasive.

²⁷⁰⁵ Geoffrey C. Hazard, John Leubsdorf, and Debra Lynn Bassett, Civil Procedure § 11.12, p. 458. (6th ed. 2011). In *Schaffer v. Weast*, 546 U.S. 49, 56 (2009), the Court said that “burden of proof is one of the ‘slipperiest member[s] of the family of legal terms.’” (quoting 2 J. Strong, McCormick on Evidence § 342, p 433 (5th ed. 1999)). The Court then said that “Part of the confusion” about burden of proof was the distinct burdens that may be encompassed within the term burden of proof – the burden of persuasion and the burden of production.

before moving to the burden of proof rules in tax cases. For a more recent and robust discussion of some of the burden of proof concepts discussed in this section, see John A. Townsend, Burden of Proof in Tax Cases: Valuation and Ranges—An Update, 73 Tax Lawyer 389 (2020).

b. Burden of Production.

The first burden of proof concept is the burden of production or production burden (also sometimes referred to as the burden of going forward). The burden of production means that the party bearing this burden as to a fact must produce some evidence tending to prove the fact to avoid a directed verdict on the fact.²⁷⁰⁶ The quantum of evidence is an amount sufficient to permit the trial judge to determine that a reasonable juror could be persuaded as to the existence of the fact. If the trial judge assesses the evidence as not sufficient to convince a reasonable juror, the trial judge will direct a verdict on that fact against the party bearing the burden of production. The quantum of evidence to meet the burden of production is not that the fact must be found in favor of the party bearing the burden; rather it is only that a reasonable juror could find in favor of that party. Stated alternatively, a directed verdict will be rendered if no reasonable juror could find in favor of the party bearing the burden of production on that fact. A directed verdict on the fact simply means that the jury will not decide the fact. In this sense, the function of the production burden is to keep jury decisions within the bounds of reasoned decision making.

The judge determines whether the burden of production has been met.²⁷⁰⁷ In trial procedure theory, the burden of production is also referred to as the risk of nonproduction—meaning that the party bears the risk that the quality of evidence is not sufficient have the fact submitted to the jury. Assuming that sufficient evidence is produced to avoid a directed verdict on the issue, the second burden of proof concept -- the burden of persuasion -- is reached.

c. Burden of Persuasion.

The Supreme Court has explained the burden of persuasion (referring to it as the burden of proof):

The function of a standard of proof, as that concept is embodied in the Due Process Clause and in the realm of factfinding, is to instruct the factfinder concerning the degree of confidence our society thinks he should have in the correctness of factual conclusions for a particular type of adjudication. The standard serves to allocate the risk of error between the litigants and to indicate the relative importance attached to the ultimate decision.

Generally speaking, the evolution of this area of the law has produced across a continuum three standards or levels of proof for different types of cases. At one end of the spectrum is the typical civil case involving a monetary dispute between private

²⁷⁰⁶ Geoffrey C. Hazard, John Leubsdorf, and Debra Lynn Bassett, Civil Procedure § 11.15, p. 460-461 (6th ed. 2011).

²⁷⁰⁷ Geoffrey C. Hazard, John Leubsdorf, and Debra Lynn Bassett, Civil Procedure § 11.15, p. 462 (6th ed. 2011).

parties. Since society has a minimal concern with the outcome of such private suits, plaintiff's burden of proof is a mere preponderance of the evidence. The litigants thus share the risk of error in roughly equal fashion.²⁷⁰⁸

The role of the burden of persuasion is to produce an outcome when the trier of fact is not persuaded as to the fact—is in equipoise as to the existence or nonexistence of the fact. The party bearing the burden of persuasion bears the risk that party's evidence is not ultimately persuasive to the degree required to prevail. This burden is often referred to as the risk of nonpersuasion.²⁷⁰⁹ Normally, in a civil trial, the quality of the evidence required to meet the burden of persuasion is that the evidence persuade the trier of fact (the jury in the jury trial model) that the fact in question is more likely than not true. This is commonly referred to as the preponderance of the evidence standard.²⁷¹⁰ What does that mean?

In a jury trial, the judge must instruct the jury as to the meaning of the burden of persuasion so that the jury determines whether the evidence is persuasive one way or the other or, if not persuasive, is in equipoise. The following instruction from a Federal Circuit Court's Pattern Jury Instructions is typical (cleaned up):

Plaintiff has the burden of proving his case by what the law calls a “preponderance of the evidence.” That means Plaintiff must prove that, in light of all the evidence, what he claims is more likely true than not. So, if you could put the evidence favoring Plaintiff and the evidence favoring Defendant on opposite sides of balancing scales, Plaintiff needs to make the scales tip to his side. If Plaintiff fails to meet this burden, you must find in favor of Defendant.²⁷¹¹

Note under this instruction, if the jury affirmatively finds the fact(s) for the Defendant or for the Plaintiff, then no instruction is needed as to what the jury should do if it is in equipoise as to the fact. The assignment of the burden of persuasion is outcome determinative only if the trier of fact (here the jury) is in equipoise—is unable to find the fact(s) for or against either side.

²⁷⁰⁸ *Addington v. Texas*, 441 U.S. 418, 423-425 (U.S. 1979) (some internal quotation marks omitted and all citations omitted).

²⁷⁰⁹ Geoffrey C. Hazard, John Leubsdorf, and Debra Lynn Bassett, *Civil Procedure* §§ 11.13 & 11.14, pp. 458-460 (6th ed. 2011). Sometimes this is referred to as a “default rule” specifying which party will lose if the trier is not affirmatively persuaded – i.e., is in equipoise.

²⁷¹⁰ For example, the Ninth Circuit's Manual Model Jury Instructions (Last Updated 1/2017), 1.6 Burden of Proof—Preponderance of the Evidence, states succinctly:

When a party has the burden of proving any claim [or affirmative defense] by a preponderance of the evidence, it means you must be persuaded by the evidence that the claim [or affirmative defense] is more probably true than not true.

²⁷¹¹ Eleventh Circuit Civil Pattern Jury Instructions (2013 ed.), 1.1. I like to explain concepts that a jury must comprehend with some real instructions. The various Federal Circuits usually Pattern Jury Instructions (Civil and Criminal) that committees in their jurisdiction have prepared to guide parties and the court, particularly with common issues that must be explained to a jury. Generally, considerable thought has gone into how to make the concepts intelligible to a jury so that they can apply the concepts. Geoffrey C. Hazard, John Leubsdorf, and Debra Lynn Bassett, *Civil Procedure* § 11.14, p. 460 (6th ed. 2011) reports a similar construct to the one presented in the Pattern Jury Instruction: “[M]any judges accompany their verbal instructions with a dramatization of the scales of justice, holding their hands out, palms up and level with each other, and then lowering one hand and raising the other.”

Many people attempt to quantify this burden as a likelihood of more than 50% (51% or, conceptually, 50.1% or some other iteration with zeroes after the decimal, will theoretically suffice).²⁷¹² I suppose that this is a rough and ready (not perfect) model for the normal civil burden of persuasion.²⁷¹³

In certain contexts, a higher certainty is required to persuade and thereby to prevail. I noted above that, in a case involving the issue of whether civil fraud penalty is applicable, the IRS bears the burden of persuading as to fraud by clear and convincing evidence.²⁷¹⁴ In a criminal trial, of course, the Government will bear the burden of persuading beyond a reasonable doubt.²⁷¹⁵

What determines which party bears the burden of persuasion?²⁷¹⁶ In the federal system, Congress can assign the burden but often Congress is silent as to which party bears the burden of persuasion. In Anglo-American jurisprudence and in the federal system, courts start with “the ordinary default rule that plaintiffs bear the risk of failing to prove their claims” and “usually assume without comment that plaintiffs bear the burden of persuasion regarding the essential aspects of their claims.”²⁷¹⁷ This general rule is based on the notion that a party asking the court to act – in a civil case, render judgment for the plaintiff – must prove to the Court that it should so act. But, for policy reasons, the burden of persuasion of some elements of a claim or defense may be assigned to a party

²⁷¹² Edward K. Cheng, Reconceptualizing the Burden of Proof, 122 Yale L. J. 1254, 1256 (2013) (“As every first-year law student knows, the civil preponderance-of-the-evidence standard requires that a plaintiff establish the probability of her claim to be greater than 0.5.”)

²⁷¹³ There are many critiques of this greater than 50% explanation of the civil preponderance of the evidence standard. E.g., Kevin M. Clermont, Trial by Traditional Probability, Relative Plausibility, or Belief Function, 66 Case W. Res. 353, 356-357 (2015) (“it is abundantly clear that academics need to let go of their love for $p > 0.5$ and discussing the relative plausibility theory positing that the factfinder compares the stories that the parties argue (spin) based on the evidence and awards the verdict to the party with the better, more plausible, version.); Edward K. Cheng, Reconceptualizing the Burden of Proof, 122 Yale L. J. 1254, 1256 (2013) (proposing a more nuanced approach where “the preponderance standard is better characterized as a probability ratio, in which the probability of the plaintiff’s story of the case is compared with the defendant’s story of the case.”).

²⁷¹⁴ See § 7454(a) and the discussion above in the text and footnotes at p. 343. The IRS is also required to prove by clear and convincing evidence that payments are illegal to deny deductions under § 162(c)(1) & (2) (both subsections specifically incorporate the § 7454(a) burden of proof).

Beyond a clear statutory command for the clear and convincing standard, courts may apply the standard in cases where notions of prudence support its application. The Supreme Court said in *Addington v. Texas*, 441 U.S. 418, 424 (1979) (citations omitted for readability):

The intermediate standard, which usually employs some combination of the words “clear,” “cogent,” “unequivocal” and “convincing,” is less commonly used, but nonetheless “is no stranger to the civil law.” One typical use of the standard is in civil cases involving allegations of fraud or some other quasi-criminal wrongdoing by the defendant. The interests at stake in those cases are deemed to be more substantial than mere loss of money, and some jurisdictions accordingly reduce the risk to the defendant of having his reputation tarnished erroneously by increasing the plaintiff’s burden of proof. Similarly, this Court has used the “clear, unequivocal and convincing” standard of proof to protect particularly important individual interests in various civil cases.

²⁷¹⁵ *In re Winship*, 397 U.S. 358, 364 (1970).

²⁷¹⁶ Geoffrey C. Hazard, John Leubsdorf, and Debra Lynn Bassett, Civil Procedure § 11.16, p. 464 (6th ed. 2011).

²⁷¹⁷ *Schaffer v. Weast*, 546 U.S. 49, 56-57 (2009) (cleaned up).

other than the one seeking to have the court act.²⁷¹⁸ It is beyond the scope of this text to delve further into the policy reasons behind the assignment of burden of persuasion.

Who determines whether the evidence is persuasive? In our jury trial model, the jury does. The presiding judge need not agree with the jury's verdict; the judge cannot change the verdict simply because the judge was persuaded differently than the jury's verdict indicates it was persuaded. The judge may only change the verdict if he or she concludes that, given the state of the proper evidence before the jury, no reasonable juror could have reached the result.²⁷¹⁹

The waters are muddied a bit in terms of crisp analysis when the trial judge is both judge and ultimate fact finder, as where a jury trial is not available (as is the case in Tax Court cases and Court of Federal Claims cases) or the parties either do not request or waive a jury trial. The same phenomena occur, but the dual role served by judge without a jury does not require crisp differentiation of the functions of the burdens. As to a party bearing a burden of production and a burden of persuasion, the judge is likely to just say that party has not persuaded when really the party did not enter sufficient evidence to even meet a production burden. (This is just a truism that evidence that is not produced cannot persuade.)

d. Shifting Burdens.

Under classic procedure theory, the burden of production can shift during trial but the ultimate burden of persuasion cannot. Let's see how that happens. Remember that the burden of production concept is a concept that deals with the issue of whether there is enough evidence to permit a trier of fact (the jury in the jury trial model) to determine whether the burden of persuasion has been met. The judge determines whether a party has a burden of production and whether it has been met. Thus, for example, at the conclusion of the plaintiff's case where the plaintiff started with both the production and persuasion burdens, the judge may conclude that the plaintiff has not met his production burden and dismiss the case. The ultimate trier of fact (the jury) will not determine the fact. Alternatively, the judge may determine that the plaintiff's evidence is so strong that a reasonable trier of fact (here the jury) could not find that the critical fact does not exist. Does that mean that the judge directs verdict for the plaintiff? No, for the defendant has not yet presented his case. In that posture, it can be said that the defendant has a burden of production. The defendant will lose if he does nothing. Then, in theory, the defendant's evidence can not only tend to disprove the plaintiff's evidence (thus meeting the production burden and avoiding direct verdict) but could, depending on its quality, convince the judge that a reasonable trier of fact (the jury) could not find against the defendant's proof. The burden of production would then shift back to the plaintiff to rebut the defendant's evidence, so that, if at the end of trial and before submission to the jury, the plaintiff has not met that burden of production, the judge will direct verdict for the defendant on that fact. So, in this simple model, you can see that the burden of production might shift two times during

²⁷¹⁸ *Shaffer v. Weast*, 546 U.S. 49, 57-58 (2009) ("The ordinary default rule, of course, admits of exceptions."); Geoffrey C. Hazard, John Leubsdorf, and Debra Lynn Bassett, *Civil Procedure* § 11.16, p. 464-466 (6th ed. 2011).

²⁷¹⁹ In that event the judge may enter what is referred to as judgment for the other party j.n.o.v.—Latin for judgment notwithstanding the verdict. The Latin is judgment non obstante veredicto.

the trial. But, in this simple model, the burden of persuasion—the burden that must be met if the matter is submitted to the jury—does not shift.

Classic procedure theory has it that the burden of persuasion does not shift. Thus, in a simple negligence case where the plaintiff must prove the defendant's negligence, the plaintiff will always bear the burden of persuasion and will initially bear the burden of production, but the burden of production may shift during the trial. I think the nuance is that the actual assignment of the burden of persuasion does not occur until the case is submitted to the trier of fact at the end of the evidence.²⁷²⁰ In this sense, the burden of persuasion does not shift during the trial. There may, however, be events that occur during the trial that cause the burden of persuasion to be assigned at the end of trial in a way differently than might have been expected.

Let's look at one example from the tax law. Section 7491(a) assumes the application of the traditional rule that the taxpayer bears the burden of persuasion as to a tax issue but imposes on the IRS the burden of persuasion on the issue if certain conditions are met. The heading to that provision is “Burden shifts where taxpayer produces credible evidence.” Without delving too far into the theory, that is not a shift but rather a substantive assignment of the burden of persuasion – (i) general rule that taxpayer bears the burden of persuasion; and (ii) exception if the taxpayer introduces credible evidence of the type prescribed, the IRS bears the burden of persuasion. Certainly, the evidence as to the taxpayer's production of the credible evidence occurs during trial (often by stipulation), but there is no requirement to assign and then shift the burden of persuasion before the evidence is all in and the persuasiveness of the evidence is being assessed.

Tax Court Rule 142(a)(1) places the burden of persuasion on the taxpayer except for “new matter, increases in deficiency, and affirmative defenses.” Based on the discussion up to this point, readers will likely be able to get a pretty good idea of the application of this assignment of the burden of persuasion.

It is important to be rigorous in thinking about these burdens. Consider this Tax Court case.²⁷²¹ The IRS asserted that the taxpayer was subject to the substantial valuation misstatement 20% penalty for a charitable donation. Accordingly, once the IRS met the production burden imposed under § 7491(c), the taxpayer would bear the burden of persuasion as to that penalty, including any reasonable cause and good faith defense. However, by amended answer, the IRS asserted the gross valuation misstatement 40% penalty. As to that increase from 20% to 40%, the IRS clearly bore the burden of persuasion which included the burden to prove that no reasonable cause and good faith defense applied. Hence, in the same case, each party bore the burden of proof on the same factual issue and facts for different purposes. The Court said:

²⁷²⁰ To be sure, the judge and the parties may anticipate the assignment of the burden of persuasion and refer to it in the opening instructions or argument. But it is the assignment of the burden after all the evidence is in that is critical.

²⁷²¹ *RERI Holdings I, LLC v. Commissioner*, 149 T.C. 1 (2017), aff'd *Blau v. Commissioner*, 924 F.3d 1261 (D.C. Cir. 2019). This was a TEFRA proceeding involving a partnership which is not technically a “taxpayer.” However, in discussing the point in the text, I use the term taxpayer because that is the proper concept for the concept I illustrate in the text—i.e., the concept is equally applicable in a garden variety Tax Court deficiency redetermination proceeding. Readers should also note that, although not relevant to the discussion in the text, the TEFRA regime has been replaced by the Centralized Partnership Audit Regime (“CPAR”), discussed beginning p. 954.

On at least two occasions, we have held that, when the Commissioner increases a penalty in his answer, the burden of proof in regard to the applicability of a reasonable cause defense is divided between the parties: In defending against the penalty initially determined, the taxpayer bears the burden of proving reasonable cause, while the Commissioner, to justify the asserted increase in the penalty, must prove the absence of reasonable cause.

Conceptually, if the finder were in equipoise as to the existence of reasonable cause and good faith in a case like that posited, the taxpayer could be held liable for the 20% substantial valuation misstatement penalty because the taxpayer did not prove reasonable cause but could not be found liable for the increased 40% gross valuation misstatement because the IRS did not prove absence of reasonable cause.²⁷²²

e. Presumptions.²⁷²³

A related concept is the presumption. The role of presumptions in civil trials is a large and nuanced subject, so I offer here only a general summary of what is called the “traditionalist” view” of presumptions, incorporated in Rule 301 of the Federal Rules of Evidence.²⁷²⁴ Rule 301 provides:

Rule 301. Presumptions in Civil Cases Generally

In a civil case, unless a federal statute or these rules provide otherwise, the party against whom a presumption is directed has the burden of producing evidence to rebut the presumption. But this rule does not shift the burden of persuasion, which remains on the party who had it originally.²⁷²⁵

A key point is that a party with a burden of persuasion already has a burden of production—must produce evidence to persuade. Hence, shifting a burden of production to a party that already bears the burden of persuasion is meaningless, or at least redundant. The presumption, and the consequent shift of a production burden, has meaning only when it shifts the burden of production away from the party with the burden of persuasion. If that shift occurs, the opposing party without the burden of persuasion then must introduce sufficient evidence to meet a production

²⁷²² In the case, the Tax Court held, in effect, that the evidence showed affirmatively lack of reasonable cause and thus the partnership was subject to the gross valuation misstatement penalty.

²⁷²³ The discussion in this section incorporates, sometimes verbatim, the discussion of presumptions from my article, John A. Townsend, Burden of Proof in Tax Cases: Valuation and Ranges—An Update, 73 Tax Lawyer 389 (2020).

²⁷²⁴ David W. Louisell, Construing Rule 301: Instructing the Jury on Presumptions in Civil Actions and Proceedings, 63 Va. L. Rev. 281, 301 (1977) (noting that FRE 301 enacts the traditionalist view, often called the “bursting bubble” theory because the strength of the presumption evaporates upon evidence meeting a production burden opposing the fact presumed).

²⁷²⁵ The Rule quoted in the text was amended in 2011 solely for readability and stylistic reasons but without change in substance from Federal Rule of Evidence 301 as enacted in 1976. See Committee Notes on Rules-2011 Amendment.

burden to overcome the presumption.²⁷²⁶ If the opposing party meets that production burden, the burden of persuasion remains on the party originally bearing the burden of persuasion.

Presumptions must be distinguished from inferences. A presumption requires that, if fact A is proved, fact B must be presumed unless the presumption is rebutted; an inference permits the trier of fact “to deduce the existence of fact B from fact A by ordinary rules of reasoning and logic.”²⁷²⁷ In the jury trial paradigm, presumptions are directed to the burden of production managed by the trial judge without involving the jury (i.e., the jury is not instructed on the presumption);²⁷²⁸ inferences are directed to the trier of fact, the jury, which finds facts based on inferences from the evidence. Although a presumption may be rebutted by evidence sufficient to meet the burden of production, the trier of fact (the jury) may still consider reasonable inferences that in its judgment are permitted by the facts that raised the presumption in the first place.²⁷²⁹

Example: C, the plaintiff, sues D, the defendant, on a contract. The contract provided that, if fact X exists and C timely notified D in writing of its existence, C would be entitled to a \$1 million payment from D. The parties agree that fact X exists. The issue for trial is whether D received timely notice from C. C can introduce evidence only that C deposited written notice in the U.S. mail, properly addressed and with sufficient postage prepaid, in sufficient time for D to have received the notice. C cannot, however, prove that D actually timely received the notice, and the

²⁷²⁶ The introduction of rebuttal evidence is said to burst the presumption’s bubble, with the quantum of rebuttal evidence said to be minimal—i.e., just enough to satisfy a production burden. *Cappuccio v. Prime Capital Funding LLC*, 649 F.3d 180, 189–90 (3rd Cir. 2011) (noting that “a single, non-conclusory affidavit or witness’s testimony, when based on personal knowledge and directed at a material issue, is sufficient to defeat summary judgment or judgment as a matter of law”); *Lupyan v. Corinthian Colleges, Inc.*, 761 F.3d 314, 320–23 (3rd Cir. 2014) (in common law mailbox presumption case, the quantum of evidence needed to meet the production burden and rebut the presumption is “minimal”); and *Marr v. Bank of America, NA*, 662 F.3d 963, 967 (7th Cir. 2011) (the quantum required is the standard production burden—evidence sufficient to permit but not require a reasonable jury to find the rebuttal fact).

²⁷²⁷ *Walker v Commissioner*, 115 T.C.M. (CCH) 1082, 2018 T.C.M. (RIA) ¶ 2018-22, at 126–27 n.7 (citing 1 Jack B. Weinstein & Margaret A. Berger, *Weinstein’s Federal Evidence* § 301.02[1], at 301-6 (Mark S. Brodin, ed., 2d ed. 2017)).

²⁷²⁸ Under Rule 301, the judge should not instruct the jury of the presumption, but instead should instruct the jury on the proper burden of persuasion and that the jury may draw inferences from the evidence in determining whether the burden of persuasion has been met. *Cappuccio v. Prime Capital Funding LLC*, 649 F.3d 180, 192 (3rd Cir. 2011) (holding that “as a matter of good practice, where a party has produced sufficient facts to rebut a Rule 301 presumption, and it drops out of the case, the District Court should avoid references to such a presumption in its instructions”); see also David W. Louisell, *Construing Rule 301: Instructing the Jury on Presumptions in Civil Actions and Proceedings*, 63 Va. L. Rev. 281, 309-210 (1977) (citing H. Rep. No. 1597, 93rd Cong., 2d Sess. 5–6 (1974), and noting that where the logic of the inference between the predicate fact and the presumed fact is weak, even drawing the relationship in an instruction may not be appropriate); *Weinstein’s Federal Evidence* § 301.04, Court Should Avoid Using Word “Presumption” in Jury Instruction; Geoffrey C. Hazard, John Leubsdorf, and Debra Lynn Bassett, *Civil Procedure* § 11.17, p. 472 (6th ed. 2011) (noting that, under classic theory, there is no need to mention the presumption itself to the jury and even if, outside the classic theory, the judge feels the need to say something extra, it is better done without using the word presumption that a jury will likely not know how to apply). Although a presumption is not evidence, under the common-law, mailbox-rule example, the proof of timely mailing is evidence from which a jury may (but not must) infer that the burden of persuasion is met. Consequently, it seems to me that a general instruction to the jury to consider all of the evidence and to make its own inferences in the context of all the evidence, including the denial of receipt, that there was timely receipt would be appropriate.

²⁷²⁹ When the presumption is thus rebutted, the presumption is out of the case “leaving only that evidence and its inferences to be judged against the competing evidence and its inferences to determine the ultimate question at issue.” *Cappuccio v. Prime Capital Funding LLC*, 649 F.3d 180, 189 (3rd Cir. 2011).

contract requires D’s timely receipt of the notice. The issue the jury must ultimately resolve is whether D timely received the notice. C may use a rebuttable presumption, the so-called “mailbox rule,” to survive D’s motion for a directed verdict at the conclusion of C’s case in chief.²⁷³⁰ The presumption meets C’s burden of production on the issue of timely receipt and, under Rule 301, will shift the burden of production on nonreceipt to D. If D then puts on evidence of nonreceipt (such as testimonial denial of receipt), the presumption disappears. In submitting the case to the jury, the judge will not instruct the jury about the presumption or that it **must** find D’s timely receipt of notice merely from proof of timely mailing. The judge will instruct the jury that it may make reasonable inferences from the evidence (here C’s proof of timely mailing and D’s testimonial denial) that D received the notice, thus meeting C’s burden of persuasion.

A presumption of correctness is said to attach to the Service’s determinations in a notice of deficiency.²⁷³¹ The presumption of correctness attaching to the notice of deficiency is a subset of the general presumption of regularity attaching to government actions.²⁷³² Under traditionalist theory, as noted above, a presumption does nothing for a party not having a burden of persuasion or

²⁷³⁰ *Baldwin v. United States*, 921 F.3d 836, 840 (9th Cir. 2019), cert. denied 140 S. Ct. 690 (2020) (“Under the common-law mailbox rule, proof of proper mailing—including by testimonial or circumstantial evidence—gives rise to a rebuttable presumption that the document was physically delivered to the addressee in the time such a mailing would ordinarily take to arrive.”); *Ark. Motor Coaches, Ltd., Inc. v. Commissioner*, 198 F.2d 189, 191 (8th Cir. 1952) (“Where, as in this case, matter is transmitted by the United States mails, properly addressed and postage fully prepaid, there is a strong presumption that it will be received by the addressee in the ordinary course of the mails.”); *In re Cendant Corp. Prides Litig.*, 311 F.3d 298, 304 (3d Cir. 2002) (“The common law has long recognized a presumption that an item properly mailed was received by the addressee.”).

²⁷³¹ E.g., *United States v. Fior D’Italia, Inc.*, 536 U.S. 238, 242 (2002) (“It is well established in the tax law that an assessment is entitled to a legal presumption of correctness— a presumption that can help the Government prove its case against a taxpayer in court.”); *Cavallaro v. Commissioner*, 842 F.3d 16, 20 (1st Cir. 2016) (“A rebuttable presumption of correctness cloaks an IRS notice of deficiency.”); Note, The Presumption of Regularity in Judicial Review of the Executive Branch, 131 Harv. L. Rev. 2431, 2432 n 138 (2018) (“Because the presumption of regularity can entail assuming accuracy, it overlaps with a presumption of correctness sometimes applied to technical calculations.” citing *Fior D’Italia, Inc.*); and John Gamino, Tax Controversy Overburdened: A Critique of Heightened Standards of Proof, 59 Tax Law. 497, 504-505 (2006).

²⁷³² John Gamino, Tax Controversy Overburdened: A Critique of Heightened Standards of Proof, 59 Tax Law. 497, 504 (2006) (presumption of correctness is a “specimen of the broader presumption of official regularity.”); Leo P. Martinez, Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases, 39 Hastings L. J. 239, 274-277 (1988) (“The presumption derives from the common-law presumption of administrative regularity.”); Note, The Presumption of Regularity in Judicial Review of the Executive Branch, 131 Harv. L. Rev. 2431, 2447 n. 138 (2018) (“Because the presumption of regularity can entail assuming accuracy, it overlaps with a presumption of correctness sometimes applied to technical calculations,” citing e.g., *United States v. Fior D’Italia, Inc.*, 536 U.S. 238, 242 (2002)); see also *United States v. Chemical Foundation, Inc.*, 272 U.S. 1, 14-15 (1926) (“The presumption of regularity supports the official acts of public officers, and, in the absence of clear evidence to the contrary, courts presume that they have properly discharged their official duties.”); *Borg-Warner Corp. v. Commissioner*, 660 F.2d 324, 330 (7th Cir. 1981) (“[T]here is a presumption of regularity attached to the Service’s actions; it is presumed, whenever an official has acted, that whatever is required to give validity to the official’s act in fact exists.”).

A broad strokes differentiation of the two categories of presumptions in the current context might be that the presumption of regularity would apply to the procedures for making an assessment and the presumption of correctness would apply to the quantum of the tax assessed. See Note, The Presumption of Regularity in Judicial Review of the Executive Branch, *supra* 2432 (stating that the Supreme Court’s cases reveal that “the presumption [of regularity] applies only to a subset of factual disputes about administrative motivations and internal processes”).

production, for the most a presumption can do is shift a burden of production to the other party.²⁷³³ In tax cases, the taxpayer already has the burden of production because the taxpayer has the burden of persuasion;²⁷³⁴ the taxpayer must produce evidence in order to persuade. Consequently, the imposition of the presumption of correctness favoring the IRS accomplishes nothing; as one court pungently noted, a presumption covers with a handkerchief something already covered by a blanket.²⁷³⁵ For that reason, in my mind, the presumption of correctness is meaningless in resolving tax cases when the taxpayer has the burden of persuasion. As a result, readers of opinions which discuss the presumption of correctness in tax cases should be wary because the presumption does not add a burden that the taxpayer did not already have.²⁷³⁶

The foregoing describes the classic operation of the presumption codified in FRE 301. There are other models that apply in particular situations for special reasons. FRE 301 itself allows that Congress can prescribe a different effect for presumptions.²⁷³⁷ I am not aware that Congress has done that in any situations relevant to tax litigation. And, although not expressly allowed by FRE 301, apparently some judicially recognized—usually common law—presumptions that operate differently are still allowed to so operate.²⁷³⁸

²⁷³³ Loose thinking on the limited role of presumptions can lead some courts to use them as a substitute of the proof of the fact. E.g., *Kelley v. Commissioner*, T.C. Memo. 2023-126, at *6-*7 (holding that, given the presumption of regularity and “a corollary principle” that necessary acts for validity of official acts were complied with unless affirmatively shown (quoting *Lewis v. United States*, 279 U.S. 63, 73 (1929), “we find by a preponderance of the evidence that the notice of deficiency sent to the Kelleys reflected a ‘thoughtful and considered determination,’ made by a duly authorized delegate of the Secretary, that the Kelleys understated the amount of tax due on their 2017 return;” The corollary presumptions in theory should just shift the burden of production to the other party, requiring the other party to lose on the issue for failure to meet that production burden, not because the presumption proves the truth of the presumed facts.

²⁷³⁴ In refund suits, the taxpayer must persuade the trier of fact as to the amount of the refund to which he is entitled (a persuasion burden) and, therefore, necessarily has the burden of production. In Tax Court deficiency cases, the taxpayer bears the burden of persuasion and, therefore, the burden of production.

²⁷³⁵ See, e.g., *Chicago Stock Yards Co. v. Commissioner*, 129 F.2d 937, 948 (1st Cir. 1942), rev’d, *Helvering v. Chicago Stock Yards Co.*, 318 U.S. 693 (1943) (involving a statutory presumption against the taxpayer, but noting that presumptions simply “assist the party having the burden of proof” and have no practical effect when asserted against a party who already bears the burden of proof (and, thus, the burden of production); the court analogized the situation as being “like a handkerchief thrown over something also covered by a blanket”). For this reason, in a memorandum I prepared in 1971 while with the DOJ Tax Division and circulated to all attorneys in the Tax Division, I recommended that Tax Division attorneys avoid referring to or relying on the presumption of correctness when the taxpayer bears the burden of persuasion. I suspect that the recommendation was honored in the breach because of a belief that referring to the presumption somehow makes the Service’s position appear stronger.

²⁷³⁶ This reasoning applies only when the taxpayer has the burden of persuasion. The general rule in deficiency and other proceedings in the Tax Court, and in refund suits in the district court and the Court of Federal Claims, is that the taxpayer bears the burden of persuasion. But, in other types of suits, most prominently in collection suits in the district court, when the government is the plaintiff, the plaintiff’s position in the case would normally impose the burden of persuasion (and consequent burden of production) on the government. For a discussion of the burdens in collection suits, see below beginning p. 634.

²⁷³⁷ See also Weinstein’s Federal Evidence § 301.05[1] Rule Controls Unless a Federal Statute Provides Otherwise.

²⁷³⁸ Weinstein’s Federal Evidence § 301.06[1] Common-Law Presumptions Can Override Rule.

Furthermore, for completeness, there are some who argue that presumptions, at least in some cases, should shift the burden of persuasion.²⁷³⁹ Since this is not the classic model reflected in FRE 301, I do not address it further here.²⁷⁴⁰

f. The Limits of Burden of Proof.

Cases are replete with burden of persuasion verbiage—often referred to as burden of proof – as if burden of persuasion played a role in case outcomes. Of course, in criminal cases, burden of persuasion beyond a reasonable doubt is critical and a constitutional requirement. But in most civil cases the assignment of the ultimate burden of persuasion only determines who wins and who loses if the trier of fact is in equipoise—i.e., is unable to find that the fact more likely than not existed or didn't exist. If the trier believes that the evidence establishes that the fact more likely than not existed or did not exist, then it doesn't matter which of the parties had the burden of persuasion. It is only where the trier is unable to make the affirmative finding that the case is affected by which party bore the burden of persuasion.²⁷⁴¹

Most trial observers feel that it is rare that a trier—whether judge or jury—is in this state of equipoise so that the assignment of the burden of persuasion may not ultimately be that important an issue, although it is important in framing and trying a case.²⁷⁴² In fact, in judge tried cases, it is

²⁷³⁹ Geoffrey C. Hazard, John Leubsdorf, and Debra Lynn Bassett, *Civil Procedure* § 11.17, pp. 471 ff (6th ed. 2011) (as to possible persuasive effect of the presumption after it has been rebutted).

²⁷⁴⁰ The Advisory Committee originally proposed that presumptions could shift the burden of persuasion. Congress rejected that proposal. Federal Rules of Evidence Manual § 301.02. Of course, in some cases, the reason for creating the presumption may influence how the burden of persuasion is assigned. But the assignment of the burden of persuasion to the taxpayer in tax cases is based on factors such as the taxpayer's general closer relationship, and thus ability to prove, the operative facts rather than some notion of presuming the regularity of the IRS's tax determinations.

²⁷⁴¹ An interesting case illustrates the phenomenon where the trier is in equipoise so that the resolution turns upon the assignment of the burden of proof, meaning in this case the burden of persuasion. In *Forste v. Commissioner*, T.C. Memo. 2003-103, the issue was whether the taxpayer could exclude \$45,615 from income under a prior version of § 104. The court first determined that then § 7491 which I discuss in more detail below applied to assign the burden of proof to the IRS as to \$25,130. The Court held that the IRS had failed to meet that burden and thus, without an affirmative finding, held that that portion was excluded under § 104. As to the balance of the payment, the Court held that the taxpayer bore the burden of proof and held for the IRS because the taxpayer had not met his burden of proof. In other words, as to both components, the Court was in equipoise so that the assignment of the burden of proof controlled the result. For an application of this type of analysis in a criminal sentencing, see *United States v. Safedine*, 2013 U.S. Dist. LEXIS 179364 (E.D. Mich. 2013) (where the preponderance of the evidence standard applied to tax loss and restitution issues; as to tax loss, the taxpayer bore the burden of persuasion on unclaimed deductions and as to restitution, the Government bore the burden of persuasion; since the court was in equipoise on unclaimed deductions, the tax loss was computed without the unclaimed deductions but as to restitution, the amount was determined with the unclaimed deductions), vacated in part 2013 U.S. Dist. LEXIS 181027 (E.D. Mich. 2013).

²⁷⁴² *Schaffer v. West*, 546 U.S. 49, 58 (2009) (“In truth, however, very few cases will be in evidentiary equipoise.”); see also Justice Ginsburg's dissent in *Schaffer*, p. 68 (“And judges rarely hesitate to weigh evidence, even highly technical evidence, and to decide a matter on the merits, even when the case is a close one. Thus, cases in which an administrative law judge (ALJ) finds the evidence in precise equipoise should be few and far between.”); *Cigaran v. Heston*, 159 F.3d 355, 357 (8th Cir. 1998) (“The shifting of an evidentiary burden of preponderance is of practical consequence only in the rare event of an evidentiary tie”); see also *Polack v. Commissioner*, 366 F.3d 608, 613 (8th Cir. 2003) (citing the *Cigaran* case); *Blodgett v. Commissioner*, 394 F.3d 1030, 1039 (8th Cir. 2004); and *Knudsen v. Commissioner*, 131 T.C. 185, 188 (2008); *Estate of Bongard v. Commissioner*, 124 T.C. 95, 111 (2005) (declining to decide who has the burden of proof (persuasion) because the Tax Court decides the case on the preponderance of the

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common for the trial judge in the opinion to discuss, sometimes at length, the burden of persuasion, but then to say that, after all, the discussion is irrelevant because the judge is not in a state of equipoise as to any issue.²⁷⁴³

2. The General Tax Rule - Taxpayer Bears the Burdens.

The general rule is that the taxpayer bears the burden of persuasion as to fact issues that must be resolved in deciding a civil tax case.²⁷⁴⁴ As noted above, traditionally in civil litigation, the party

²⁷⁴²(...continued)

evidence). See also Neil Buchanan, The Burden of Proof and Tax Law: *Deja Vu Silliness* (Dorf on Law Blog 6/14/13), where Professor Buchanan notes that, although it is conceptually conceivable that there might be a 50-50 case where outcome is determined by the assignment of the burden of persuasion:

In the real world, however, it is never that close (in tax cases, or in any other civil case, as my CivPro-teaching colleagues can attest). In fact, a study in 2008 (ten years after RRA98) showed that shifting the burden of proof under the 50%-plus-a-tiny-amount standard simply makes no difference in tax cases. The outcome is the same, no matter who formally bears the burden of proof.

In *Endeavor Partners, LLC v. Commissioner*, 943 F.3d 464 (D.C. Cir. 2019), the Tax Court had determined that, because it decided the case on the basis of evidence as to which it was persuaded (i.e., no equipoise), the allocation of the burden of persuasion was irrelevant. The Court of Appeals affirmed, citing *Blodgett, supra*, for the following (cleaned up): “the allocation of the burden of proof in these cases is immaterial because the governing standard was the preponderance of the evidence. Under a preponderance standard, once both parties have produced their respective evidence, the side with the more persuasive case prevails.” That is a true statement, but the Tax Court’s point was that it was not in equipoise (i.e., one side had the more persuasive case). As worded by the Court of Appeals, it is just assuming that the Tax Court was not in equipoise rather than stating that directly.

²⁷⁴³ In doing so, the judges often cite the cases cited in the preceding footnote to this text or cases with the applicable circuit’s variation of this theme. *Estate of Jorgensen v. Commissioner*, 2011 U.S. App. LEXIS 9203 (9th Cir. 2011) (“When, as here, the tax court decides the case based on the preponderance of the evidence and without regard to presumptions of correctness, § 7491’s burden-shifting is simply not relevant”); see also *Scheidelman v. Commissioner*, 755 F.3d 148 (2d Cir. 2014) (burden of proof shift under § 7491 is immaterial because the position sustained is “more persuasive, regardless of the burden of proof”). *Estate of Turner v. Commissioner*, 138 T.C. 306, 309 (2012) (citing *Knudsen v. Commissioner*, 131 T.C. 185, 189 (2008))

Moreover, if a trial judge does not expressly say that he is not in equipoise, a court of appeals may effectively so determine by saying that the allocation of the burden of persuasion did not affect the decision. See e.g., *Whitehouse Hotel Ltd. Partnership v. Commissioner*, 615 F.3d 321, 332-333 (5th Cir. 2010) (“there is no indication that the tax court’s decision turned on the allocation of the burden”).

²⁷⁴⁴ *United States v. Rexach*, 482 F.2d 10, 16 (1st Cir. 1973), cert. denied 414 U.S. 1039 (1973) explained the reason for assigning this burden as follows:

This rule for taxpayer-initiated suits is premised on several factors other than the normal evidentiary rule imposing proof obligations on the moving party: the relevant prior Supreme Court precedent indicative, if not determinative of the issue. *Wickwire v. Reinecke*, 275 U.S. 101, 105, 48 S.Ct. 43, 72 L.Ed. 184 (1927); *Welch v. Helvering*, 290 U.S. 111, 115, 54 S.Ct. 8, 78 L. Ed. 212 (1933); *Helvering v. Taylor*, 293 U.S. 507, 515, 55 S.Ct. 287, 79 L.Ed. 623 (1935); *Bull v. United States*, 295 U.S. 247, 260, 55 S.Ct. 695, 79 L.Ed. 1421 (1935); the presumption of administrative regularity; the likelihood that the taxpayer will have access to the relevant information; and the desirability of bolstering the record-keeping requirements of the Code”

Perhaps also the historical development of the modern Code played a part. Well before the modern income tax in 1916. Revenue Act of 1916, Pub. L. No. 63-16, the tax refund suit was the way to contest tax liability. The taxpayer would sue for refund and, as the plaintiff, the standard default rule in civil litigation was applied to require that the taxpayer show that he was entitled to a refund and the amount of the refund. (There may have also been conceptual reasons such as discussed in *Rexach*.) In enacting the key alternative to refund litigation, the Tax Court via the petition for redetermination of a deficiency, I am certain that Congress thought it was doing no more than giving the taxpayer a

(continued...)

bearing the burden of persuasion usually bears the burden of production— if there is no evidence that could be persuasive for the key fact, the jury cannot be persuaded and there is nothing to submit to the jury. Accordingly, the burden of persuasion is normally the key burden. The reasons for assigning the burden of persuasion to the taxpayer are variously stated, and I do not review them here. The burden of persuasion in a civil tax case means that the trier of fact (judge or jury) must find the fact in issue to be more likely than not, otherwise the bearer of the burden of persuasion loses.

3. The Key Cases and Nuances.

I have just stated what I think is the general rules in traditional burden of proof terms. Now, I will introduce you to the key cases where the Courts have sallied forth on burden of proof in tax cases. I develop this analysis in terms of the income tax which has historically represented the bulk of the litigation over tax issues, at least since the inception of the Sixteenth Amendment to the Constitution permitting the modern income tax. In broad strokes, the Courts have divided tax litigation into two categories which are based upon who seeks judgment against whom and what proof is required to obtain the judgment. The judgment in civil cases is judicial decree indicating that the amount, if any, additional tax the taxpayer owes the Government or the Government owes the taxpayer. That Tax Court “decision” is the Tax Court equivalent of the judgment in district court cases. The key is that the judgment (or Tax Court decision) states an amount that one party is liable to the other.

The first category is Tax Court litigation which, as you will recall, is prepayment litigation. In Tax Court litigation, the taxpayer nominally brings the suit (taxpayer is the petitioner, the role of plaintiff in normal civil litigation), but does so only in response to the IRS’s first move—the notice of deficiency which is required for the taxpayer to petition the Tax Court for redetermination of the deficiency. In Tax Court litigation, the IRS seeks to have the Tax Court enter a decision document—the Tax Court equivalent of a judgment—indicating a deficiency, as redetermined by the Tax Court, which permits the IRS to assess that deficiency amount against the taxpayer. So, the IRS seeks, in effect, a judgment against the taxpayer so that it can assess and collect the amount of the judgment from the taxpayer. The second category is refund litigation where the taxpayer, not only the nominal plaintiff but the real plaintiff, seeks a judgment against the United States so that the taxpayer can get money from the United States. (These two categories are simple models to develop the burden of proof principles that will apply to them and provides a conceptual framework for more complex cases.)

Prior to the modern income tax in 1916, refund suits were the only way to litigate tax controversies with the Government.²⁷⁴⁵ Refund suits essentially assert that the Government has the taxpayer’s money—the tax—and is not entitled to retain it because the taxpayer does not owe the tax.

²⁷⁴⁴(...continued)

prepayment alternative to the traditional refund suit and did not consider that a different proof standard than offered in the refund suit might apply. However, I will note below, in fact a key nuanced difference is present in the Tax Court redetermination proceeding.

²⁷⁴⁵ The first modern income tax was Revenue Act of 1916, Pub. L. No. 63-16. For a good history of the history of the right to jury trials in refund suits, see Judge William Pryor’s concurring opinion in *United States v. Stein*, 881 F.3d 853, 859 (11th Cir. 2018) (en banc).

Such suits are classic common law “had and received” lawsuits. In such suits, the plaintiff—the taxpayer suing the Government—must prove his right to recover—which means both liability to return money and the amount to be returned, as the Supreme Court held early on in the seminal case of *Lewis v. Reynolds*, 284 U.S. 281 (1931). The amount to be returned is then entered by the court as a judgment in the case.²⁷⁴⁶

Congress early recognized that the refund suits with the prepayment requirement and the then procedural traps for the unwary in district court litigation prior to the modern rules of civil procedure were ill suited to orderly and fair litigation of tax controversies under the modern income tax. In the early 1920s, therefore, Congress created the Board of Tax Appeals, the predecessor to the Tax Court, and established the deficiency procedures whereby the taxpayer could invoke a prepayment remedy in the Tax Court. Ordinary citizens (the proverbial Moms and Pops running the corner grocery store) could come forward, even without benefit of counsel, in a user-friendly forum to get justice in their disputes with the IRS.

That prepayment remedy requires the IRS to issue a notice of deficiency asserting the amount of tax the IRS intends to assess and then, upon the taxpayer’s petition for redetermination of the deficiency, have the Tax Court redetermine the amount of the deficiency, if any, before the assessment is made. The Tax Court litigation thus seeks to determine the amount of tax that the IRS will collect from the taxpayer. The taxpayer is the nominal plaintiff (or petitioner, as used in the Tax Court), but the Government is really the moving party and seeks to collect money from the taxpayer. If the classic common law “had and received” analogy were applicable, one could argue that perhaps the Government should have the burden of proof in Tax Court cases because it wants to quantify an amount that it is entitled to get from the taxpayer and have the Tax Court decision document state the liability and amount. However, Congress established the Tax Court as a prepayment and less technical forum alternative to the refund suit in the district court but did not address burden of proof issues.²⁷⁴⁷ The Tax Court early on adopted the rule that the taxpayer bears the burden of proof—meaning the burden of persuasion—in Tax Court cases.²⁷⁴⁸ In other words, it appeared early

²⁷⁴⁶ Although some courts use words that suggest the burden is a strict standard (e.g., the “correct,” “precise” or “exact” amount due), it is a lesser reasonable amount of the refund. See *Washington Mutual, Inc. v. United States*, 2017 U.S. App. LEXIS 8451 (9th Cir. 2017) (citing *Trigon Ins. Co. v. United States*, 234 F. Supp. 2d 581, 586 n.7 (E.D. Va. 2002) (“The ‘exact amount’ text is not to be taken literally, but instead is subject to the general proviso that claims for refunds, like those for damages, must be supported by evidence proving the claim amount with reasonable specificity.”)).

²⁷⁴⁷ *Helvering v. Taylor*, 293 U.S. 507, 513 (noting that the statute establishing the BTA “does not prescribe any rule of evidence or burden of proof”).

²⁷⁴⁸ The rule is now Rule 142, Tax Court Rules of Practice and Procedure. The history is interesting. During the hearings leading to the 1926 Tax Act, a former member of the BTA testified to the House Ways and Means Committee that, if the burden of proof were to be placed on the IRS instead of the taxpayer, Congress “might as well repeal the income tax law and pass the hat, because you will practically be saying to the taxpayer, ‘How much do you want to contribute toward the support of the Government?’ and in that case they would have to decide for themselves.” Revenue Revision, 1925: Hearings Before the Committee on Ways and Means, 69th Cong. 907 (1925) (statement of James S. Y. Ivins). Other reasons expressed for placing the burden of proof on the taxpayer were that the taxpayer was the moving party (id. at 907–08), that the actions of the government are “prima facie presumed correct” (id. at 908), and that the evidence is peculiarly within the possession of the taxpayer (id. at 908, 930 (statement of Charles D. Hamel)). See also Leo P. Martinez, *Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases*, 39 Hastings L.J. 239, 259 n.89 (1988) (noting that “[h]earings conducted prior to the Revenue Act of 1928 suggested that no one had (continued...)

on as if the Tax Court would have a burden of proof rule patterned on that applying in the district courts in refund suits. Stated in the context of a prepayment remedy, that rule would be that the taxpayer bears the burden of reducing the amount asserted in the notice of deficiency and, in risk of nonpersuasion terms, would bear the risk that the Tax Court were not persuaded as to any lesser amount.²⁷⁴⁹

So, let's consider how this might work. First, in a refund case, say that the taxpayer has filed a claim for refund of \$100, the IRS has denied it and the taxpayer files suit for refund. The taxpayer seeks a judgment for refund of \$100 against the IRS. The taxpayer then has to prove that he is entitled to a judgment in that amount or some lesser amount. If the taxpayer's proof merely shows that the taxpayer may be entitled to some refund (meaning that the IRS was wrong in denying the entire \$100 refund) but the proof is not persuasive enough to permit the court to quantify the amount of the refund to which the taxpayer is entitled, the burden of proof rules in refund suit would say that the taxpayer has not proved his right to any refund. The taxpayer's burden of proof in the refund suit is to prove by a preponderance of the evidence the amount of the refund, so that it can be incorporated into the judgment in the case. This means that, if the court is in equipoise as to whether any amount of refund is due, the judgment in the refund suit is that the taxpayer gets \$0.

Second, in a Tax Court deficiency case, say the IRS has issued a notice of deficiency for \$100 additional tax, and the taxpayer files petition for redetermination. One could argue from the refund model that, since the IRS wants the judgment—the Tax Court decision document—that will permit it to collect from the taxpayer, it has to prove both liability for the tax and the amount of the liability. But, for policy reasons, the initial burden has always been on the taxpayer to show that the deficiency proposed by the IRS in the notice of deficiency is excessive. (I need not develop here the policy reasons for this allocation of the burden of proof; just accept it for now.) That proof is by a preponderance of the evidence. If the taxpayer shows by a preponderance of the evidence that the deficiency is less than \$100, does the taxpayer then have to show the amount of the deficiency, if any? Since the proof may actually show the amount of the deficiency by a preponderance of the evidence, the Tax Court can just enter a decision in that amount. As noted above, if the proof rises to a preponderance, the allocation of the burden of proof is irrelevant. But, if the proof is of such

²⁷⁴⁸(...continued)

seriously questioned the allocation of the burden of proof to the taxpayer”).

²⁷⁴⁹ The relationship of Tax Court and refund suit proof rules was addressed in the context of the burden of proof for fraud in refund suits in *Paddock v. United States*, 280 F.2d 563 (2d Cir. 1960), a delightful decision by Judge Henry Friendly, one of the leading jurists of all time. Section 7454 imposes upon the IRS the burden of proof as to fraud in Tax Court proceedings. The Government argued nevertheless that the rule did not apply in refund suits for money had and received where the taxpayer bore the burden of proving the amount of the refund. On this concept, the Government argued, the taxpayer must disprove fraud if the taxpayer wanted a refund of a civil fraud penalty he had paid. Judge Friendly rejected the argument, citing both general pleading and proof concepts imposing the burden of proving fraud upon the proponent of fraud (here the Government) and reasoning that the burden imposed by § 7454 should not be different in a refund suit than in the Tax Court. The court said (p. 567):

We see no sufficient practical basis for a difference in the rule as to burden of proof in a taxpayer's attack upon a fraud penalty by petition to the Tax Court and in a suit for refund under 28 U.S.C. § 1346(a)(1). In either the taxpayer has the burden on most issues, in the Tax Court because he is attacking an administrative determination of presumed correctness and in a refund suit because he must show it would be inequitable for the government to retain monies that he has paid. If this general rule as to burden of proof is subject to an exception when the issue relates to fraud, as Congress has directed it to be in the Tax Court for the past 32 years, why should it not be in a refund suit?

quality that, although the deficiency is not \$100, the amount of the deficiency (including \$0) cannot be determined by a preponderance of the evidence, what happens? In the analogous refund suit, the taxpayer would lose because he could not quantify the amount of the refund. Should that same result apply in a Tax Court deficiency redetermination?

Readers should note at this point the key difference between the refund suit and the Tax Court deficiency redetermination proceeding—who is seeking a judgment to obtain money from the other. In the refund suit, the taxpayer seeks money from the Government and hence is assigned the burden of persuasion to prove the amount of the refund. To the extent that the district court is not persuaded as to the amount of the refund, there is no basis to enter judgment for the taxpayer. In the Tax Court deficiency redetermination proceeding, the IRS seeks a judgment (decision) to collect money from the taxpayer and, to the extent that the Tax Court is unpersuaded on the evidence as to the amount it should award permitting the IRS to collect, should a similar outcome apply?

In *Helvering v. Taylor*, 293 U.S. 507 (1935), the Court held that Tax Court proceedings would have a slightly different burden of proof rule than was imposed in refund suits. Specifically, whereas in refund suits the taxpayer bore the burden of showing entitlement to a refund and the amount thereof, in Tax Court deficiency redetermination proceedings the taxpayer need merely show that the IRS's determination in the notice of deficiency was "arbitrary and excessive"—note the conjunctive—whereupon the IRS would lose unless the evidence were sufficient to establish that amount of deficiency that could be incorporated into the decision document that is then the basis for assessment and collection.²⁷⁵⁰ In burden of persuasion and risk of nonpersuasion terms, upon the required "arbitrary and excessive" showing, the IRS would bear the burden of persuasion or risk of nonpersuasion that a deficiency is due and the amount thereof.²⁷⁵¹

The Supreme Court's pronouncement in *Helvering v. Taylor* has led to some confusion in the Courts as to precisely how to apply the "arbitrary and excessive" predicate to the assignment of the burden of persuasion. I do not expect you to know the nuances of the confusion thus spawned but let me illustrate the genre of confusion in first a simplified example and then by discussing two cases.

The simplified example: At the end of trial in the Tax Court is that the record establishes by a preponderance of the evidence that the tax in the above example is not more than \$90, thus establishing that the \$100 in the notice of deficiency is excessive, although on this bare fact pattern, it is not clear that the \$100 is necessarily arbitrary. Further, that same record shows by a

²⁷⁵⁰ For a more detailed analysis of the trajectory of *Helvering v. Taylor*, see John A. Townsend, Burden of Proof in Tax Cases: Valuation and Ranges—An Update, 73 Tax Lawyer 389, 413-419 (2020).

²⁷⁵¹ In *Cavallaro v. Commissioner*, 842 F.3d 16, 26 (1st Cir. 2016), the Court said (cleaned up): In *Taylor*, the Supreme Court made it clear that once the taxpayer shows the Commissioner's determination to be "arbitrary and excessive," the taxpayer cannot be made to pay the amount assessed against him -- even if he fails to prove the correct amount of liability he owes. Once a taxpayer has borne his burden of proving the Commissioner's determination invalid, he has no further obligation to show how much money is owed.

In burden of persuasion terms, once the taxpayer has met the *Helvering v. Taylor* showing, there is no basis upon which to find a deficiency and make an assessment unless the court can find that basis by a preponderance of the evidence and the IRS bears the risk that the court will be unable to make that finding.

preponderance that the tax is at least \$70. The evidence is inconclusive—in a state of equipoise—between \$70 and \$90. (This phenomenon of some range of equipoise often happens in cases where the tax turns on valuation which has ranges.) If the taxpayer bears the burden of persuasion, the Tax Court decision should be \$90; if the IRS bears the burden of persuasion, the Tax Court decision should be \$70. (Stated another way, within the range of equipoise—the range as to which the trier is not persuaded one way or the other—the assignment of the burden of persuasion determines who will prevail within that range.) So, which is it?

Consider *Estate of Mitchell v. Commissioner*, 250 F.3d 696 (9th Cir. 2001). In an estate tax case, the IRS valued the stock owned by a slightly less than 50% shareholder. An unrelated shareholder owned 50% and other unrelated shareholders owned small percentages. Apparently ignoring the unrelated shareholder's 50% ownership, the IRS valued the decedent's shares as a controlling interest. Indeed, the IRS's own expert initially had not valued the shares as a controlling interest and, for some unexplained reason, the IRS directed him to do so. Valuing the less than 50% interest in these circumstances as a controlling interest was just stupid—in the language of *Helvering v. Taylor*, it was “arbitrary.” Moreover, it resulted in a plain and grossly excessive asserted deficiency. The Tax Court held that the taxpayer still bore the burden of persuasion, but on appeal the Ninth Circuit easily found that the circumstances of *Helvering v. Taylor* were present and reversed for reconsideration with the IRS bearing the burden of persuasion as to the amount of the deficiency, if any.²⁷⁵²

Judge Posner made the same point succinctly in a refund suit. In *Kohler v. United States*, 468 F.3d 1032 (7th Cir. 2006), the parties fought over a valuation issue. The Government's valuation proffered at trial—\$19.5 million—was simplistic and clearly excessive, at least Judge Posner for the panel so concluded in his inimitable fashion of bringing pure logic to the task.²⁷⁵³ The taxpayer's valuation proffered at trial—\$11.1 million—was clearly too low. The record offered no persuasive evidence as to a point in between these two erroneous extremes. In traditional refund suit theory, requiring the taxpayer to show not only that the IRS erred but the amount of the refund to which the taxpayer is entitled, this lacuna should theoretically have required a judgment of no refund. However, perhaps perceiving the Government's erroneous position as more outrageous than the taxpayer's erroneous position,²⁷⁵⁴ Judge Posner side-stepped the traditional refund theory by declaring the assessment to be a “naked assessment” “without any foundation whatsoever.” (Citing *United States v. Janis*, 428 U.S. 433, 440 (1976); and *Helvering v. Taylor*.) Where the IRS is plainly

²⁷⁵² I have severely summarized the issues swirling around *Helvering v. Taylor* in this illustration. For more reading on this, see Leandra Lederman, *Arbitrary Stat Notices in Valuation Cases, or Arbitrary Ninth Circuit?*, 92 Tax Notes 231 (2001); and John Townsend, *Burden of Proof in Tax Cases: Valuation and Ranges*, 93 Tax Notes 101 (2001).

Also, see *Cavallaro v. Commissioner*, 842 F.3d 16 (1st Cir. 2016) where the Court said that, even if the IRS's position was found arbitrary and excessive in a valuation matter, that would not compel a decision for the taxpayer but would require the trial court to make the determination for itself, making such reasonable approximations as appropriate for a fair result. The Court did not zero in on precisely who would bear the burden of persuasion; presumably, if the taxpayer establishes that the IRS's position was arbitrary and excessive, the IRS would bear the burden of persuasion.

²⁷⁵³ The *Davis* rule of thumb (from *United States v. Davis*, 370 U.S. 65 (1962)) that what is paid is the value is something otherwise incapable of valuation sets the value was inapt under the facts of the case as perceived by Judge Posner.

²⁷⁵⁴ This perhaps was a sub silentio variation of the baseball decision method.

excessive even in a refund suit, the taxpayer has no burden beyond showing that the IRS claim is excessive. The IRS loses. Judge Posner concluded his opinion:

The Service could have justified a more modest estimate yet one well above \$11.1 million, but clinging stubbornly to its untenable valuation it suggested no alternative to \$19.5 million. It played all or nothing, lost all, so gets nothing.

So, the taxpayer wins, even though the taxpayer's affirmative proof at trial was not persuasive or even credible simply because the Government was more off base than even the taxpayer.

Let's test what Judge Posner was saying. Let's say that the IRS had asserted an \$18 million valuation in *Kohler*, with at least some modicum of basis for that amount. Then, at trial, the trier of fact finds that the taxpayer's proffered valuation of \$11.1 million is too low, that IRS's proffered valuation of \$18 million is too high, that the real valuation is somewhere in between, but that the evidence is so inconclusive that it does not permit the trier to pick the in-between point by a preponderance of the evidence. (This is an extreme and highly unlikely example but assume it for purposes of analysis.) Would or could Judge Posner have applied the naked assessment side-step to shut the IRS out? Wouldn't the IRS then have prevailed under the standard formulation for refund suit burden of proof—no basis to quantify an amount of refund if the evidence does not show a refund is due? Isn't *Kohler* just a specific adaptation in a litigation context of the adage that "bulls make money, bears make money, pigs get slaughtered?"

Kohler does help in a discussing the warp and woof of tax burden of proof theory, but the circumstances will rarely be present in the real world. At a trial on a valuation issue, even if the IRS original assessment were excessive the IRS is unlikely to rest on an excessive valuation and will get reasonable—at least somewhat reasonable—to maintain credibility before the court. So, in the above example, even if the original assessment were based on \$19.1 million, if at trial the IRS admitted that the value did not exceed \$18 million and offered some basis for that amount, the court would not dump the IRS out simply because of the admission that the original \$19.1 million was wrong.²⁷⁵⁵ Rather, the \$18 million would be the number from which to measure and the above analysis would apply because, even if wrong, the IRS's position was not arbitrary. In other words, it appears that the DOJ Tax's counsel in *Kohler* just botched it and suffered the consequences of irritating Judge Posner in the process.

What is the effect of *Helvering v. Taylor* where the IRS in a multi-issue Tax Court redetermination case concedes one or more issues. That does show that the aggregate amount in the notice of deficiency is excessive and, depending upon the nature of the position conceded, might

²⁷⁵⁵ See *Silverman v. Commissioner*, 538 F.2d 927, 930 (2d Cir. 1976) (where IRS makes partial concession in taxpayer's favor, the burden of proof remains on the taxpayer as to the unconceded adjustments, citing Tax Court Rule 142(a)(1) that imposes the burden on the taxpayer except new matter, increases in deficiency and affirmative defenses); and *Cavallaro v. Commissioner*, 842 F.3d 16, 21-22 (1st Cir. 2016) (quoting *Silverman*: "The taxpayer does not carry his burden of showing the determination invalid simply by pointing to the fact that the Commissioner has reduced his original deficiency claim prior to trial."); see also *Transupport, Inv. v. Commissioner*, T.C. Memo. 2016-216 (holding that, if, at trial, the IRS seeks to adjust its valuation number upwards from the amount in the notice of deficiency, the IRS will have the burden of proof; I am not sure that is right unless the increase is so significant as to really be new matter; simple recalibration for trial should not be new matter whether down or up).

even show the aggregate amount to be arbitrary. Does that establish that the IRS has shown the portions of the deficiency for other non-conceded determinations to be excessive for requiring that the IRS bear the burden of persuasion and the burden of production? No.²⁷⁵⁶

4. The Presumption of Correctness.

I discussed (beginning on p. 624) the limited role of the presumption of correctness. I state in that discussion my belief that the presumption of correctness or presumption of regularity should have no—or at most, limited—role with regard to burden of proof in tax cases. The reason is that the presumption could only shift the burden of production to the taxpayer, a burden the taxpayer already had because the taxpayer has the burden of persuasion.

5. What About Collection Suits and Other Litigation Where Liability is in Issue?

In a collection suit (which may be a suit with the Government as plaintiff in the original proceeding or as counter-plaintiff on a counterclaim in a refund suit), the Government is the moving party seeking to reduce a tax assessment to judgment. As the moving party, the Government will have an initial burden of production and persuasion as to the fact of the tax assessment. The Government will introduce an official certified summary of IRS Service Center records of assessment, generally the Form 4340, Certificate of Assessment.²⁷⁵⁷ There is also a general “presumption” that Government acts are regular and proper (referred to as the presumption of regularity and as to the amount, the presumption of correctness).²⁷⁵⁸ That will then both meet the Government's production burden and entitle the Government to judgment on the assessment (shift the burden of production to the taxpayer) unless the taxpayer does something. And, for policy reasons, other than just the Government is the moving party, the taxpayer will bear the burden to prove that the assessment is procedurally improper or that the amount is excessive.²⁷⁵⁹

²⁷⁵⁶ *U.S. Holding Co. v. Commissioner*, 44 T.C. 323, 328 (1965) (“We have stated numerous times that the concession of an issue or issues by respondent prior to or at trial does not destroy the presumptive correctness of his notice of deficiency as to the remaining issues.” citing cases); and *Wycoff v. Commissioner*, T.C. Memo. 2017-203.

²⁷⁵⁷ The Form 4340 proves the assessment based on presumption of correctness or regularity. E.g., *Perez v. United States*, 312 F. 3d 191, 195-196 (5th Cir. 2002). On the presumption of correctness or regularity, see p. 624.

²⁷⁵⁸ E.g., *United States v. Fior D'Italia, Inc.*, 536 U.S. 238, 242 (2002). This presumption is a variation of the presumption of regularity. See Leandra Lederman, “Civil”izing Tax Procedure: Applying General Federal Learning to Statutory Notices of Deficiency, 30 U.S. Davis L. Rev. 183, 201 n. 97 (1996).

²⁷⁵⁹ *United States v. Rexach*, 482 F.2d 10, 16 (1st Cir. 1973) (cleaned up), cert. denied 414 U.S. 1039 (1973).

This proposal, that the burden of proof shifts when the government is the moving party, either in a collection suit or on a counterclaim to a taxpayer refund suit, has been rejected by other circuits, and for sound reasons. To place the burden of persuasion on the government when it moves to collect assessed taxes would encourage taxpayer delay and inaction, thereby imposing on the government the costs and burdens both of borrowing money to meet the gap of unpaid taxes and of initiating litigation. It would also undermine the record-keeping requirements, thereby making the government's case more difficult if not impossible to establish. We therefore hold that in tax collection suits or on government counterclaims, as in tax deficiency or refund suits, the burdens of both going forward and ultimate persuasion are on the taxpayer.

The taxpayer's defense might be that the assessment was not made properly (such as not made by the properly delegated official) or that it was untimely. Those are issues as to which the Government bears the burden of persuasion (and keeps it during trial), but after the introduction of the Form 4340 because of the presumption of regularity and correctness, the taxpayer will bear a production burden on these issues.²⁷⁶⁰ The taxpayer must do something to make sure the record puts the issues in play. If the issues are in play (i.e., the evidence does not compel a result one way or the other), the trier of fact then must determine whether the Government has met its burden of persuasion or not.

In such a collection suit, the taxpayer's defense may be that the assessment might otherwise be legally regular and proper but the taxpayer does not owe the amount of tax assessed. If the taxpayer has not previously judicially contested his or her underlying liability for the tax, the taxpayer can do that in the collection suit.

As to the issue of liability and amount for the underlying tax, however, which burden of proof rule applies? Keep in mind that *Lewis v. Reynolds* is not applicable because a collection suit is not a refund suit—even if it is combined with a refund suit as it often is by counterclaim—for example, in a trust fund penalty case where the IRS assesses a large amount, the taxpayer pays a small amount of the assessment, the taxpayer sues for refund of the small amount paid, and the Government counterclaims for the unpaid balance of the assessment. Nor can the reasoning of *Lewis v. Reynolds*—money had and received—be extrapolated to a collection suit. Arguably, the collection suit better fits the Tax Court model in terms of burden of proof.²⁷⁶¹

What then about Collection Due Process (“CDP”) Tax Court proceedings where tax liability is at issue? As I discuss (p. 733), Congress permits a taxpayer to contest liability in a CDP proceeding if he has not had a prior opportunity to contest. Which model best fits the CDP proceeding—the refund model a la *Lewis v. Reynolds* or the Tax Court deficiency model a la *Helvering v. Taylor*? Think that one through and be prepared to respond.²⁷⁶²

²⁷⁶⁰ The Form 4340 provides details of assessments and payments, including “the relevant date that the summary record of assessment [Form 23-C] was signed by the assessment officer.” *Blackburn v. Commissioner*, 150 T.C. 218, 223 (2018). A Form 4340 is “is probative evidence in and of itself and, ‘in the absence of contrary evidence, [is] sufficient to establish that notices and assessments were properly made.’” *Hansen v. United States*, 7 F.3d 137, 138 (9th Cir. 1993) (quoting *Hughes v. United States*, 953 F.2d 531, 540 (9th Cir. 1992) (which also held that a certified Form 4340 is admissible as a self-authenticating public record)); and *Blackburn v. Commissioner*, 150 T.C. 218, 222 (2018) (“Form 4340 provides presumptive evidence that a tax has been validly assessed under section 6203,” citing cases).

²⁷⁶¹ *Bar L Ranch, Inc. v. Phinney*, 426 F.2d 995, 998-9 (5th Cir. Tex. 1970); see *United States v. Janis*, 428 U.S. 433, 441-442 (1976) (holding that the function of the presumption of correctness and burden of proof rules in collection suit accords “with the burden-of-proof rule which prevails in the usual preassessment proceeding in the United States Tax Court.”).

²⁷⁶² The footnotes are for practitioners, so I will just state my gut reaction. I would argue that the *Helvering v. Taylor* model best fits. However, practitioners who have gotten this far should be prepared (I hope) to contest the merits of my gut reaction.

6. Exceptions to the General Rule.

There are exceptions to the general rule. Various constitutional requirements, statutes or court rules assign the burden of proof differently for various policy reasons. The key exceptions that you will encounter are.:

a. Criminal Cases.

In criminal cases (of which criminal tax cases are a subset), constitutionally, the Government must prove its case beyond a reasonable doubt.²⁷⁶³ If we wanted to use the same percentage methodology to describe the burden, we might say that, in a criminal case, the trier must be convinced perhaps to 90+% certainty.²⁷⁶⁴ This means that the trier of fact (usually a jury in a criminal case) must be persuaded beyond a reasonable doubt. And, to use the burden of production concept, the trial judge may direct a verdict of acquittal if the trial judge determines that no reasonable jury could find beyond a reasonable doubt that the defendant was guilty of the crime charged.

b. Civil Fraud.

Where the tax issue is civil fraud (i.e., only whether the taxpayer is subject to a civil penalty), the IRS must prove fraud by clear and convincing evidence.²⁷⁶⁵ If we used the same methodology, we might say that the trier must be 70% or perhaps even 75% persuaded. And, to use the burden of production concept, the trial judge may direct a verdict for the taxpayer if the trial judge determines

²⁷⁶³ For a good general treatment of the reasonable doubt standard for criminal convictions, see Jon O. Newman, Taking “Beyond a Reasonable Doubt” Seriously, 103 *Judicature* No. 2 (Summer 2019). Judge Newman, a Second Circuit Judge and formerly district court judge has thought deeply about this issue. The article is a summary of his thoughts over many years but is a fair presentation of the general issues involved with the reasonable doubt standard and making the standard meaningful for juries.

²⁷⁶⁴ Sometime this type of percentage “certainty” is described as either a continuum or a probability. Either way the percentage attached conveys that, conviction requires significantly more certainty than the other standards deployed for jury findings—preponderance and clear and convincing. One prominent judge objects to a probabilistic standards but seems to favor a continuum standard from zero to 100 which serves a similar function with “a reasonable doubt would probably be reached at least above ninety, perhaps around ninety-five,” so that guilt would be found only with “near certainty.” Jon O. Newman, On Reasonableness: The Many Meanings of Law’s Most Ubiquitous Concept, 21 *J. App. Prac. & Process* 1, 3-11 (2021). Others note different percentages. One author asserts a 90% probability standard (Michael S. Pardo, The Paradoxes of Legal Proof: A Critical Guide, 99 *Boston U. L. Rev.* 234, 245-246 (2019)), but others assert significantly lower probability standards, some even as low as 75%. Richard A. Posner, An Economic Approach to the Law of Evidence, 51 *Stan. L. Rev.* 1477, 1506 (1999); see also Dan Simon, A Third View of the Black Box: Cognitive Coherence in Legal Decision Making, 71 *U. Chi. L. Rev.* 511, 557 n. 147 (2004) (noting convergence of opinion in the 80 to 90% certainty range); and Erik Lillquist, Recasting Reasonable Doubt: Decision Theory and the Virtues of Variability, 36 *U.C. Davis L. Rev.* 85, 86 (2002) (“The quantity of certainty is never quantified; instead, it is kept quite vague. Is 90% certainty required? 95%? 99%? Or could the amount of certainty be much lower, say perhaps 75%?”). For an interesting analysis of problems with probabilistic explanations of beyond a reasonable doubt (including some concern that a jury might convict at 60% confidence level and a better way to instruct a jury on reasonable doubt, see Michael D. Cicchini, Reasonable Doubt and Relativity, 76 *Wash. & Lee L. Rev.* 1443 (2019).

²⁷⁶⁵ § 7454(a); see also § 162(c)(1) & (2) (incorporating the § 7454(a) burden of proof to proving nondeductible illegal payments). For an example of a case showing just how substantial the clear and convincing burden is, see *Sakkis v. Commissioner*, T.C. Memo. 2010-256.

that no reasonable jury could find fraud by clear and convincing evidence. The clear and convincing evidence burden for proof of civil fraud can be substantial indeed.²⁷⁶⁶

c. Omitted Income.

One problem that has bedeviled the courts over the years is the fairness of imposing the burden of persuasion, along with the burden of production, full bore to the taxpayer in the case of unreported income determinations by the IRS. The problem is that the taxpayer has to prove a negative. The IRS says the taxpayer had income; the taxpayer says he didn't. Particularly in cases where the IRS is alleging the taxpayer was paid in cash, it might be virtually impossible for the taxpayer to meet the burden of persuasion. This problem of having to prove the negative is a problem in many burden of proof contexts, not just tax. But the tax area has produced certain unique solutions.

Some of the cases hold that once the taxpayer meets some production burden which can be a simple denial that is reasonable under the circumstances, the IRS must then meet at least a production burden—described sometimes as a “minimal evidentiary foundation”—by introducing evidence that, if believed, indicates that the taxpayer had the unreported income.²⁷⁶⁷ Under this line of cases, the taxpayer would still bear the normal burdens of production and persuasion once the IRS made the required showing. And a credible argument can be made that there is no shift of burdens at all.²⁷⁶⁸

There is a further wrinkle in this area. Many courts recognizing that the burden of production and possibly the burden of persuasion shift to the Government in unreported income cases seem to limit that shift to illegal income cases. Other cases would apply the rule even in cases of legal source income.

One of the leading cases in this area is a Fifth Circuit case that illustrates the problem of unreported income. In *Portillo v. Commissioner*, 932 F.2d 1128 (5th Cir. 1991), the taxpayer was a painting contractor who was hired by general contractors. One of the general contractors issued

²⁷⁶⁶ E.g., *Matthews v. Commissioner*, T.C. Memo. 2018-212; discussed in Tax Court Case Shows That the IRS Burden to Prove Fraud by Clear and Convincing Evidence Is Formidable Indeed (Federal Tax Crimes Blog 12/17/18)

²⁷⁶⁷ Procedurally, a court may describe this as denying the IRS the benefit of the presumption of correctness, but requiring the IRS then to do something that rises to the level of the presumption which may meet a burden of production. See e.g., *Weimerskirch v. Commissioner*, 596 F.2d 358 (9th Cir. 1979) (describing the required showing as a “minimal evidentiary foundation.”); *United States v. Besase*, 623 F.2d 463, 465 (6th Cir. 1980) (where a taxpayer must make a “negative assertion” that he did not receive the income the IRS claims, “[r]easonable denials of the assessment's validity have sufficed in such cases to shift the burden back to the government.”); and *Anastasato v. Commissioner*, 794 F.2d 884, 887 (3d Cir. 1986) (entitled to presumption of correctness only if IRS makes some predicate showing of income producing activity; must introduce evidence linking the taxpayer to the tax generating activity). But, as the quote from *Weimerskirch* indicates, the required burden on the government is minimal. See e.g., *Banister v. Commissioner*, T.C. Memo. 2008-201, at *4 (“This is not to say that the requirement in *Weimerskirch* is difficult to satisfy. The requisite evidentiary foundation is indeed minimal and need not include direct evidence linking the taxpayer to an income-producing activity.”) For other cases of this genre, see *United States v. McMullin*, 948, F.2d 1188, 1192 (10th Cir. 1991); *Erickson v. Commissioner*, 937 F.2d 1548, 1551 (10th Cir. 1991)

²⁷⁶⁸ See *Curtis v. Commissioner*, T.C. Memo. 2001-308, at *10-*11, n. 2.

a Form 1099 to the taxpayer claiming an amount that was substantially in excess of the amount the general contractor could produce checks made payable to the taxpayer. The taxpayer denied that he received income in excess of the amount of the checks. The Court found that the *Scar* analysis (discussed above) did not apply; this was not a naked notice of deficiency because the IRS did link the determinations to the taxpayer. The problem, the Court found, was that the determinations had no substance because the IRS had failed to do anything other than rely upon the 1099s in the face of the taxpayer's denial of receipt of the income. The Court thus held:

Therefore, before we will give the Commissioner the benefit of the presumption of correctness, he must engage in one final foray for truth in order to provide the court with some indicia that the taxpayer received unreported income. The Commissioner would merely need to attempt to substantiate the charge of unreported income by some other means, such as by showing the taxpayer's net worth, bank deposits, cash expenditures, or source and application of funds. * * * In these types of unreported income cases, the Commissioner would not be able to choose to rely solely upon the naked assertion that the taxpayer received a certain amount of unreported income for the tax period in question.

The courts thus would require that the IRS at least show that the taxpayer had some income producing source.²⁷⁶⁹ Can the IRS do that inferentially? For example, from the fact that the taxpayer had known expenses during the taxable year, can it be inferred that the taxpayer had income during the taxable year and does this meet whatever burden (production or persuasion) that is imposed upon the Government? The answer is, of course, yes. The traditional methods of proving a tax liability (the net worth and cash expenditures methods) rely significantly upon this inference, and those methods subject to appropriate safeguards have been approved by the Supreme Court. See *Holland v. United States*, 348 U.S. 121 (1954). Thus, for example, if taxpayers deny that they had income for the year but had known expenses, the IRS can use Bureau of Labor Statistics, with adjustments for known expenses, to extrapolate the income and meet any burden on the IRS, thus imposing upon the taxpayers the burden of establishing that the IRS's determinations are arbitrary.²⁷⁷⁰

There is one statutory fix that, in the circumstances to which it applies, provides a parallel solution when the IRS asserts that the taxpayer has omitted income that has been reported to the IRS via information return such as a W-2 or Form 1099-NEC. Section 6201(d) provides that in such cases if the taxpayer asserts a reasonable dispute as to the income and the taxpayer otherwise has cooperated, the IRS will bear a production burden as to the item in addition to the information return itself.²⁷⁷¹ This covers a large part of the problem addressed by the judicial solutions noted above, but for the areas not covered by the statute, the judicial solutions might provide some procedural protections for the taxpayer.

²⁷⁶⁹ In more graphic metaphor, it is said that “The tax collector's presumption of correctness has a herculean muscularity of Goliath-like reach, but we strike an Achilles' heel when we find no muscles, no tendons, no ligaments of fact.” *Carson v. Commissioner*, 560 F.2d 693, 696 (5th Cir. 1977) (Goldberg, J.).

²⁷⁷⁰ See *Hanel, et al. v. Commissioner*, 2001 U.S. App. LEXIS 8095 (7th Cir. 2001) (unpublished opinion).

²⁷⁷¹ The statute described this production burden as “the burden of producing reasonable and probative information concerning such deficiency in addition to such information return.” See *Del Monico v. Commissioner*, T.C. Memo. 2004-92, *6.

d. § 7491 - Real or Phantom Shift.

The 1998 Restructuring Act added § 7491 to provide that three key shifts of the burden of proof to the IRS.

(1) Taxpayer Has Done What's Right.

As to facts relevant to the substantive tax issue, the burden of persuasion will be on the IRS if three conditions are present: (1) the taxpayer introduces “credible evidence” to support his position on “any factual issue” (i.e., meets a burden of production on the fact issue); (2) the taxpayer has maintained the required records with respect to the matter and has cooperated during the audit; and (3) the taxpayer has complied with any specific requirements of the Code that he substantiate an item. § 7491(a).

The rule has two key requirements:

1. The taxpayer must introduce “credible evidence.” The Committee Reports explain the concept:

Credible evidence is the quality of evidence which, after critical analysis, the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted (without regard to the judicial presumption of IRS correctness). A taxpayer has not produced credible evidence for these purposes if the taxpayer merely makes implausible factual assertions, frivolous claims, or tax protester-type arguments. The introduction of evidence will not meet this standard if the court is not convinced that it is worthy of belief. If after evidence from both sides, the court believes that the evidence is equally balanced, the court shall find that the Secretary has not sustained his burden of proof.²⁷⁷²

Although there is no overwhelming consensus among the Courts of Appeals as to what is credible evidence, this definition seems to be gaining traction: “the quality of evidence, which after critical analysis, the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted. . . .”²⁷⁷³

As in other contexts, the issue of uncontradicted evidence could be an issue. Generally, it has long been the law that a trier of fact is not required to accept as persuasive the uncontradicted testimony of interested parties. Does § 7491(a) change that rule, at least to the extent of shifting the burden of persuasion on the fact issue? No. The Tax Court thus said:

We decide whether a witness’ testimony is credible by relying on objective facts, the reasonableness of the testimony, the consistency of the witness’ statements, and the

²⁷⁷² H. Conf. Rept. 105-599, at 240-241 (1998), 1998-3 C. B. 747, 994-995.

²⁷⁷³ *Blodgett v. Commissioner*, 394 F.3d 1030, 1035 (8th Cir. 2005) (quoting *Griffin v. Commissioner*, 315 F.3d 1017, 1021 (8th Cir. 2003)); accord *Rendall v. Commissioner*, 535 F.3d 1221, 1225 (10th Cir. 2008) (citing *Blodgett*.)

witness' demeanor. We may discount testimony which we find to be unworthy of belief, but we may not arbitrarily disregard testimony that is competent, relevant, and uncontradicted.²⁷⁷⁴

2. The taxpayer must have cooperated with reasonable requests by the IRS for meetings, interviews, witnesses, information, and documents (including providing, within a reasonable period of time, access to and inspection of witnesses, information, and documents within the control of the taxpayer, as reasonably requested by the IRS). Cooperation also includes providing reasonable assistance to the IRS in obtaining access to and inspection of witnesses, information, or documents not within the control of the taxpayer (including any witnesses, information, or documents located in foreign countries). A necessary element of cooperating with the IRS is that the taxpayer must exhaust his or her administrative remedies (including any predocting appeal rights provided by the IRS). The taxpayer is not required to agree to extend the statute of limitations to be considered to have cooperated with the IRS.

The actual effect of § 7491(a) is unclear.²⁷⁷⁵ First, it is generally considered that, in cases resolved by a preponderance of the evidence, the trier of fact usually is persuaded (not in equipoise), so that the assignment of the burden of persuasion is irrelevant to the outcome.²⁷⁷⁶ Second, the conditions to application of § 7491(a) are significant as noted above.

²⁷⁷⁴ *Keels v. Commissioner*, T.C. Memo. 2020-25, at *15-*16 (cleaned up). The Tax Court has said that “A taxpayer who provides only self-serving testimony and inconclusive documentation fails to provide credible evidence.” *Larkin v. Commissioner*, T.C. Memo. 2020-70, at *32-*33 (citing cases). I think that statement must be read in context to mean that testimony that is self-serving may, in the court’s discretion, be deemed credible and therefore could meet the credible evidence standard; in other words, merely because testimony is self-serving (as it almost always is for taxpayer testimony in the Tax Court on critical issues in dispute) does not mean that a court could not find it credible for general issue resolution and credible for purposes of § 7491(a). For example, in *Larkin* (at *31), the Court had (i) found immediately before the discussion of § 7491(a) that the taxpayer’s testimony “on contested matters was not convincing,” thereby refusing to “rely on his testimony to support the Larkins’ positions, except to the extent his testimony is corroborated by reliable documentary evidence”; and (ii) in the § 7491(a) discussion said that the taxpayer’s testimony was “was not convincing enough to prove any facts without significant corroborating evidence (which is largely absent).”

²⁷⁷⁵ See Philip N. Jones, *The Burden of Proof 10 Years after the Shift*, 121 Tax Notes 287 (October 20, 1998) (analyzing burden of proof, burden of production, and the effect of I.R.C. §7491.); Henry Odower, *United States of America: The Burden of Proof in Tax Matters 4* (Prepared for the European Association of Tax Law Professors 2011 Annual Meeting) (cited as *Odower, Burden of Proof*). The key situation that I have observed where the assignment of the burden of persuasion is outcome determinative (and would be in a situation where § 7491(a) might apply, is in a valuation case where the trier can only determine a range of values by a preponderance of the evidence (i.e., within the range is in a state of equipoise). In that case, the party bearing the burden (either the taxpayer or the IRS) will lose within the range because the trier must set the value at the end of the range least favorable to the party bearing the burden of persuasion. See generally John A. Townsend, *Burden of Proof in Tax Cases: Valuation and Ranges—An Update*, 73 Tax Lawyer 389 (2020).

²⁷⁷⁶ As to the common observation that equipoise is rare, see text and footnotes at p. 626; and *Odower, Burden of Proof* p. 4. For examples, of cases where courts explicitly state that the facts are determined based on persuasion, so that the assignment of the burden of persuasion is irrelevant, see *Knudsen v. Commissioner*, 131 T.C. 185, 189 (2008).

(2) Statistical.

The IRS has the burden of proof with respect to income items which the IRS proves solely through the use of statistical data from unrelated taxpayers. § 7491(b). Sometimes the IRS will be faced with a situation where it is clear that the taxpayer had income but has no way to derive an estimate of the income. We discuss elsewhere indirect methods (such as the net worth method and the bank deposits and expenditures method) that take data directly related to the taxpayer and estimates the taxpayer's income. But, where there are no reasonably ascertainable indications of the taxpayer's income (usually because the taxpayer was in some form of cash business and did not maintain records or did not maintain records that the IRS successfully obtained), the IRS rather than simply retreating may resort to some method such as a purely statistical method designed to extrapolate some reasonable amount of income based on the income from similarly situated taxpayers or using industry statistics. For example, if the taxpayer is a waiter or waitress at a certain type of club and the IRS may have a regional statistic that shows, in broad strokes, the average tip for a particular type of restaurant, the IRS may attempt some extrapolation.²⁷⁷⁷

(3) Penalties - § 7491(c).

The IRS has “the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title.” § 7491(c).²⁷⁷⁸ Burden of production is discussed above and is something less than burden of persuasion. The IRS meets this burden by producing some reasonable evidence that it is appropriate to impose the relevant penalty, although it need not be evidence that establishes liability for the penalty by a preponderance of the evidence.²⁷⁷⁹ If the IRS meets the burden, the taxpayer then has the burden of persuading the Court that he or she is not liable for the penalty.

One of the recent areas in which this production burden has been prominent is with regard to the requirement in § 6751(b) that the IRS’s assertion of penalties include the written approval of the manager. The IRS does bear the burden of production on that issue in cases where § 7491(c) applies.²⁷⁸⁰ (I discuss § 6751(b) beginning p. 386.)

The IRS does not have to meet the production burden for taxpayer defenses, most prominently with respect to accuracy related penalty defenses of reasonable cause or substantial

²⁷⁷⁷ *Fior D'Italia Inc. v. United States*, 536 U.S.238 (2002) (sustaining such estimates for determining the aggregate tip income for the employer’s FICA tax computation).

²⁷⁷⁸ *Higbee v. Commissioner*, 116 T.C. 438, 446-447 (2001). This burden applies, however, only if the taxpayer in the petition contests the penalty on its merits. *Swain v. Commissioner*, 118 T.C. 358 (2002); *Wheeler v. Commissioner*, 127 T.C. 200 (2006). Similarly, if the petition is so deficient that it does not state a claim upon which relief can be granted (other than a nonspecific allegation of error), the burden does not apply. *Funk v. Commissioner*, 123 T.C. 213 (2004). In view of the summary nature of pleadings allowed, I believe that a pleading that is not sufficient to state a claim has to be funky indeed.

²⁷⁷⁹ One case has suggested this burden is minimal where the taxpayer concedes the underlying deficiency without introducing some evidence to avoid the penalty. See *Perry Funeral Home, Inc. v. Commissioner*, T.C. Memo. 2003-340. Query whether this is a correct application of burden of production principals?

²⁷⁸⁰ *Dynamo Holdings Ltd. Pship v. Commissioner*, 150 T.C. 224 (2018).

authority, as to which the taxpayer bears both the burden of production and persuasion.²⁷⁸¹ And, on the other hand, although § 7491 also covers the civil fraud penalty, it has no practical meaning to the civil fraud penalty because the IRS is required to persuade the court to apply the fraud penalty by clear and convincing evidence.²⁷⁸² Since the IRS must thus persuade, it must perforce produce and thus has a production burden independent of § 7491(c).

(4) Comments.

The “relief” provision that has received the most public discussion is the first -- relating to the shift of the burden of persuasion to the IRS where the taxpayer has maintained records and cooperated. Does this really benefit many taxpayers? I and other observers believe that the shift is rarely outcome determinative for three reasons:²⁷⁸³

First, although many cases discuss the burden of persuasion and presumptions, in truth most cases are resolved by the judge (or jury) making an affirmative finding (i.e., is persuaded) as to the existence or nonexistence of each key fact. The burden of persuasion is only relevant if the Court is in a state of equipoise—i.e., it cannot find the existence of the fact or the nonexistence of the fact more likely than not. Courts usually make their factual determinations based on a finding that the facts found are more likely than not. Courts (or juries if they are the triers) are usually not in a state of equipoise. Careful courts will state the burden of proof rules, but will then state that, even if they have stated those rules incorrectly, they are making their findings of fact based on affirmative persuasion and not based upon burden of proof default rules. The burden of persuasion thus only rarely has a real bottom-line effect.²⁷⁸⁴

Second, if indeed the taxpayer fully cooperates and the records he is required to maintain and produce show that he is right on the issue, it will not be incorporated in a notice of deficiency and will not be an issue at a trial. That's the way it was before. The IRS did not have a practice of setting up issues where the taxpayer cooperated and produced reasonable records showing that he was right.

Third, of course, the taxpayer must introduce credible evidence. As noted from the committee report quoted above and the Eighth Circuit's retreat, if the Court finds the taxpayer's factual assertions not credible, he loses. That's the way it always was. And, even before this “relief” provision, if the Court found the taxpayer's factual assertions credible, the Court would have found the facts in the taxpayer's favor.

²⁷⁸¹ See *Higbee v. Commissioner*, 116 T.C. 438, 446 (2001)

²⁷⁸² We noted above the shifting burdens that can apply as to the quantum of the deficiency subject to the fraud penalty. See discussion beginning p. 341.

²⁷⁸³ See e.g., Philip N. Jones, The Burden of Proof 10 Years After the Shift, 121 Tax Notes 287 (Oct. 20, 2008) (a comprehensive discussion of the cases and citing *inter alia* my earlier article, John A. Townsend, Burden of Proof in Tax Cases: Valuation and Ranges, Tax Notes, Oct. 1, 2001 and 2001 TNT 187-37); and Jay A. Soled, Third-Party Civil Tax Penalties and Professional Standards, 2004 Wis. L. Rev. 1611, 1636 n 125 (2004) (citing various authors with differing conclusions).

²⁷⁸⁴ See e.g., *Brinkley v. Commissioner*, 808 F.3d 657, 664 (5th Cir. 2015) (where the Court of Appeals found it unnecessary to determine whether the Tax Court correctly assigned the burden of proof under § 7491(a) because the Tax Court had decided the facts based on a preponderance of the evidence (i.e., was not in equipoise), citing *Whitehouse Hotel Ltd. P'ship v. Commissioner*, 615 F.3d 615 F.3d 321, 332 (5th Cir. 2010); and *Blodgett v. Commissioner*, 394 F.3d 1030, 1039 (8th Cir. 2005)).

Has the “relief” provision affected much in the tax litigation landscape? Not much.²⁷⁸⁵

e. The Strong Proof Rule.

The courts have fashioned a judicial “strong proof” requirement when a party to a contract seeks to avoid the tax consequences that apply to a provision in the contract as to which the parties to the contract have opposing tax interests. The classic instance is a contract selling a business with an allocation of some of the purchase price to a covenant not to compete and/or to good will. All other things being equal, the portion of the purchase price allocable to the covenant not to compete is ordinary income to the seller and is an ordinary deduction to the purchaser. Similarly, the portion of the purchase price allocable to good will is capital gain or return of capital to the seller and is a capital expenditure to the purchaser who amortizes that cost over a period of years rather than deducting immediately. In these cases, so long as the parties report consistently with the contract provision, the Government is not whipsawed²⁷⁸⁶ by, for example, the seller claiming capital gain and the purchaser claiming an ordinary deduction. The parties themselves are in the best position to know what the real deal is and, when they make the allocation in the contract, the purpose of the “strong proof” rule is to permit the IRS to rely upon the parties’ allocation without concern that one or the other will unilaterally seek to change the tax consequences and whipsaw the Government. Although there is a general tax theory that a party’s tax consequences are determined by the real deal rather than words in a contract that do not reflect the real deal, the strong proof rule is designed to encourage the parties to state the real deal in the contract rather than seeking to disavow unilaterally their own contract terms. In these circumstances, a court will require the party seeking such unilateral relief to go beyond the preponderance of the evidence standard and show “strong proof” that some allocation other than provided in the contract should control.

There are at least two general formulations of the strong proof rule.

- Danielson Rule. The first formulation of the rule, commonly referred to as the *Danielson* rule (after a leading case, *Commissioner v. Danielson*, 378 F.2d 771, 775 (3d Cir. 1967)) is that “proof which in an action between the parties to the agreement would be admissible to alter that construction or to show its unenforceability because of mistake, undue influence, fraud, duress, etc.”²⁷⁸⁷ The rule applies only to attempts

²⁷⁸⁵ See Janene R. Finley and Allan Karnes, An Empirical Study of the Change in the Burden of Proof in the United States Tax Court, 6 Pitt. Tax Rev. 61 (2008).

²⁷⁸⁶ A whipsaw against the Government has been illustrated:

A whipsaw situation occurs in the tax field when two different taxpayers take positions with respect to a particular transaction which are so inconsistent with each other than only one should logically succeed—and yet, because of jurisdictional or procedural reasons, first one and then the other prevails against the government.

Remarks by Phillip R. Miller at the Court of Claims Judicial Conference, October 14, 1971 on Whipsaw Problems in Tax Cases, 25 Tax Law. 193 (1972), cited in *Gerardo v. Commissioner*, 552 F.2d 549, 555-556 (3d Cir. 1977).

²⁷⁸⁷ *Commissioner v. Danielson*, 378 F.2d 771, 775 (3d Cir. 1967); see also *Commissioner v. Nat’l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974) (holding taxpayer to the form taken not permitting the taxpayer “the benefit of some other route he might have chosen to follow but did not”); and *Spector v. Commissioner*, 641 F.2d 376, 381 (5th Cir. 1981) (adopting the *Danielson* rule and discussing the reasons for the rule). The *Danielson* rule applies only if the terms of the agreement are not ambiguous. *CMI Int’l, Inc. v. Commissioner*, 113 T.C. 1, 4 (1999) (citing *North* (continued...))

to change the terms of the agreement but does not apply to disputes over the consequences of the agreement's actual terms.²⁷⁸⁸ This *Danielson* rule applies only in the courts that have adopted it (several courts of appeals have), but importantly does not apply in the Tax Court unless the *Golsen* rule requires it because the appeal in the Tax Court case is to a Circuit Court of Appeals that has adopted *Danielson*.²⁷⁸⁹

- **Strong Proof Rule.** Other courts impose a perhaps less rigorous but still quite substantial version of the rule often called the strong proof rule²⁷⁹⁰—that the proponent must prove that both parties actually intended a different allocation than they put in the contract.²⁷⁹¹ (I must confess that they appear to be the same, but courts do not think they are.)²⁷⁹² I have stated only the parameters of the rule and cannot in this text develop its nuances in application. One nuance, however, that was addressed by a court applying the second formulation is that the party's evidence must have persuasive power closely resembling the “clear and convincing” evidence required to reform a written contract on the ground of mutual mistake.²⁷⁹³ (See below regarding the Tax Court's adoption of a preponderance of the evidence standard.)

I have discussed this special proof rule (including the *Danielson* formulation) in the context of contractual provisions involving different parties with competing interests. Similar issues can arise in a unilaterally structured transaction or a transaction where the parties do not have competing interests. Say that a taxpayer structures a transaction with the taxpayer's wholly-owned corporation whereby the taxpayer owning real property desires to (i) have the corporation own the real property and (ii) take cash out of the corporation in the amount of the fair market value of the property. The

²⁷⁸⁷(...continued)

Am. Rayon Corp. v. Commissioner, 12 F.3d 583, 587 (6th Cir. 1993). Hence, a taxpayer wanting to avoid the application of *Danielson* will argue that the agreement is ambiguous. See *Makric Enterprises, Inc. v. Commissioner*, T.C. Memo. 2016-44, aff'd 2017 U.S. App. LEXIS 5301 (5th Cir. 2017) (nonprecedential per curiam decision). The *Danielson* rule will preclude the taxpayer from arguing substance over form and instead binds the taxpayer to the form he chose, unless the conditions for avoiding the *Danielson* rule are present. By contrast, there is substantial authority that the IRS may rely upon substance over form regardless of *Danielson*. *Commissioner v. Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974); see also *Cornelius v. Commissioner*, 494 F.2d 465, 471 (5th Cir. 1974) (applying substance over form is appropriate “at the request of the Commissioner to prevent a taxpayer from unjustifiably using his own forms and labels as a shield from the incidence of taxation,” but “[a] taxpayer's attempt to pierce his own armor does not merit the same consideration.”

²⁷⁸⁸ *United States v. Fort*, 638 F.3d 1334, 1338 (11th Cir. 2011).

²⁷⁸⁹ *Complex Media Inc. v. Commissioner*, T.C. Memo. 2021-14, slip op. at *53-54 (“This Court has never accepted the *Danielson* rule. And, because the cases before us are not appealable to the Third Circuit (or to any other appellate court that has accepted the *Danielson* rule), the *Golsen* doctrine does not require us to apply that rule here.”),

²⁷⁹⁰ *Ullman v. Commissioner*, 264 F.2d 305 (2d Cir. 1959).

²⁷⁹¹ *Muskat v. United States*, 554 F.3d 183, 188-189 (1st Cir. 2009). The contract reformation standard is perhaps a good one, but that would leave the issue up to state law. I would think that the strong proof formulation to require clear and convincing evidence is consistent with tax burden of proof rules that come only in three flavors—preponderance of the evidence, clear and convincing, and beyond a reasonable doubt. To say that there is yet another standard that must be added does not make sense. So, when you concede that it means more than preponderance of the evidence, you get to clear and convincing.

²⁷⁹² E.g., *Complex Media Inc. v. Commissioner*, T.C. Memo. 2021-14, slip op. at *53 n. 16 (citing *Estate of Rogers v. Commissioner*, T.C. Memo. 1970-192, 1970 Tax Ct. Memo LEXIS 166, at *14 (declining to adopt the “one-way street” approach of *Danielson* but suggesting that, in practical consequence “the difference between ‘strong proof’ and proof of ‘unenforceability’ may not be great”), aff'd, 445 F.2d 1020 (2d Cir. 1971).

²⁷⁹³ *Muskat v. United States*, 554 F.3d 183, 191 (1st Cir. 2009).

taxpayer can structure that outcome as (i) a sale to the corporation for fair market value or (ii) a contribution to the corporation of the real property (a nontaxable § 351 exchange) followed or preceded by a distribution of the cash by the corporation to the shareholder. There are other structuring possibilities, but let's stick with the two I mentioned. Those two structuring possibilities have different outcomes to the shareholder and his corporation. If the taxpayer structures the transaction one way, can the taxpayer later, in order to achieve a tax advantage, treat the transaction for tax purposes as having been structured the other way? The general rule is that a taxpayer may not obtain a favorable tax benefit under a structure other than the structure the taxpayer chose. In *Commissioner v. Nat'l Alfalfa Dehydrating & Milling Co.*, 417 U.S. 134, 149 (1974), the Supreme Court said that “[W]hile a taxpayer is free to organize his affairs as he chooses, nevertheless, once having done so, he must accept the tax consequences of his choice, whether contemplated or not, * * * and may not enjoy the benefit of some other route he might have chosen to follow but did not.” This is sometimes referred to as the “nondisavowal principle.”²⁷⁹⁴ (This is essentially the same concept noted above when the transaction involves parties with differing tax interests, but the principle applies even when they do not; both contexts work against the taxpayer desiring some tax result that the form of the transaction does not support; this is a taxpayer limitation; the IRS is not bound by the principle.)

In a 2021 Memorandum Opinion, the Tax Court recently synthesized a test for which the IRS or the taxpayer seeks a tax result different than the form in which the taxpayer cast the transaction, indicating that the test from the caselaw “has become more hospitable to taxpayers seeking to disavow the form of their transactions.”²⁷⁹⁵ The Tax Court said that the evidence must show by a preponderance of the evidence:

- IRS seeks to tax the economic substance and not the form of the transaction: IRS must show: “that the form in which the taxpayer cast the transaction does not reflect its economic substance.”
- Taxpayer seeks to tax the economic substance and not the form of the transaction: Taxpayer must show that (i) the form does not reflect economic substance and (ii) “that the form of the transaction was not chosen for the purpose of obtaining tax benefits (to either the taxpayer itself or to a counterparty) that are inconsistent with those the taxpayer seeks through disregarding that form.”²⁷⁹⁶ The Tax Court reasoned that “When the form that the taxpayer seeks to disavow was chosen for reasons other than providing tax benefits inconsistent with those the taxpayer seeks, the policy concerns articulated in *Danielson* [and I infer the analogous strong proof rule] will not be present.”

I do note, perhaps a cautionary note, that the foregoing synthesis of the more hospitable application may be of limited applicability because it is a Memorandum Opinion which is not as precedential

²⁷⁹⁴ *Dixon v. Commissioner*, T.C. Memo. 2006-90, slip op. at *35 (citing *Nat'l Alfalfa*), supplemented by T.C. Memo. 2006-190, aff'd, 621 F.3d 890 (9th Cir. 2010).

²⁷⁹⁵ *Complex Media Inc. v. Commissioner*, T.C. Memo. 2021-14, slip op. at *64.

²⁷⁹⁶ *Complex Media Inc. v. Commissioner*, T.C. Memo. 2021-14, slip op. at *64 (cleaned up).

as the regular T.C. opinion and hence may be just the opinion of the single division (judge).²⁷⁹⁷ Perhaps more importantly, even if the restated application gains traction in the Tax Court, since the strong proof rules (including *Danielson*) are adopted in various iterations by the Courts of Appeals, the Courts of Appeals ultimately determine the rules for application in cases appealable to those Courts and once determined in the Court of Appeals the Tax Court must follow them for cases appealable to those Courts under the *Golsen* rule.²⁷⁹⁸

The bottom line is that, in structuring the transaction, the practitioner should caution the client to ensure that the real deal is stated in the agreement and that he will likely be bound by the terms of the agreement. The real deal for this purpose has two layers—first the contract should certainly state the parties’ actual agreement; that is, they should have no side oral, wink-wink or other types of agreement inconsistent with the contractual provision. (Indeed, under the second version of the rule a taxpayer may be admitting a crime if he were to assert that the intent of the parties as to a contract provision having tax consequences was different than the parties stated in the contract.) The real deal second layer is an objective test apart from the parties’ intent and meeting of the minds—what does the real objective economic circumstance indicate that the real deal was? For example, if there is no reason whatever for the seller to stay involved in a business or to possibly compete against the purchaser, the parties’ allocation of a material portion of the purchase price to a consulting contract or covenant not to compete will lack economic substance even apart from having to discern their subjective intent and meeting of the minds.

As a further nuance, if the IRS does propose to adjust the tax consequences of one party and the other party is aware of the IRS proposal, the other party should protect his ability to claim the refund that would result from a consistent adjustment. I hope you have spotted a conceptual problem where these rules could overlap to create an injustice that might permit the IRS to tax both sides inconsistently. For example, say the IRS asserts a deficiency against a buyer, denying his deductions as payments are made because the covenant not to compete lacks economic effect. If the IRS is successful, provided the seller reported consistently with the contract (ordinary income), the seller has likely over-paid his tax because the income should be capital gain or return of capital rather than ordinary income to him. So, assuming the seller has protected his refund statute of limitations, must the seller meet the strong proof rule to get a refund and, if he cannot, can the parties be whipsawed and the Commissioner collect tax twice on inconsistent theories? That may conceptually be an issue, but the IRS will work to avoid whipsawing taxpayers. (You should note that this possible whipsaw of taxpayers can conceptually occur even under the normal burden of proof rules where the taxpayer bears that burden; the trier—whether the IRS or a court or jury—would be in a state of equipoise, not knowing who should win; under the formulation of the burden of persuasion rules, both parties could conceptually lose,²⁷⁹⁹ but I suspect that under those circumstances the first

²⁷⁹⁷ See the discussion of the precedential value of the various Tax Court opinions at beginning p. 546.

²⁷⁹⁸ On the *Golsen* rule, see p. 574, above.

²⁷⁹⁹ When I was with DOJ Tax’s Appellate Section, I made a whimsical attempt to convince a fellow attorney who was handling both parties’ appeal from two different trial courts but in the same circuit that he should argue on burden of proof grounds that the Government should win both cases. He did not like that idea, and the Government took sides to obtain a consistent result in the cases. Note, though, that the Government can be whipsawed with no relatively neutral party there to resolve the whipsaw. For example, I was involved with a widow-bonus case involving the issue of whether a cash payment to the widow of a valued employee was compensation (which would be taxable to

(continued...)

deciding court would strive to make a decision on the basis of the burden of persuasion, thus avoiding the inequity.²⁸⁰⁰)

Finally, in many cases, upon close analysis, the form may not really diverge from the substance.²⁸⁰¹

7. Action Within the Statute of Limitations.

The Code imposes statutes of limitation—times during which a party must act to secure a benefit. Two prominent examples: (i) the IRS must assess a tax within the statute of limitations for assessment and, for taxes requiring a notice of deficiency, must send the notice within the assessment statute of limitations;²⁸⁰² and (ii) the taxpayer must file a claim for refund within the refund statute of limitations.²⁸⁰³ The party required to act within the statute of limitations bears the burden of proving that he so acted. For example, the IRS must prove that the assessment (or predicate notice of deficiency) is timely.²⁸⁰⁴ The proof can be either direct proof such as introduction of a timely signed consent to extend the statute of limitations or, in some cases, circumstantial proof such as actions that persuade the trier of fact that a timely signed consent, although missing, had been

²⁷⁹⁹(...continued)

the widow and deductible by the corporate employer) or a gift (which would not be taxable to the widow and would not be deductible to the corporate employer). The widow prevailed in court before a jury who, sympathetically held that the payment was a gift from the corporate employer, and the court of appeals affirmed on the basis that, although the court of appeals did not think that was the right result, it could not find that a rational jury could not so hold. The corporation prevailed in its deduction of the payment because, in truth that was the correct result.

²⁸⁰⁰ As noted above in the discussion of burden of proof, it is the rare case indeed that is decided based on a state of equipoise.

²⁸⁰¹ See *Fletcher v. United States*, 562 F.3d 839 (7th Cir. 2009) (where Judge Easterbrook masterfully logics his way to the right answer).

²⁸⁰² §§ 6501(a) and 6213(a).

²⁸⁰³ § 6511(a).

²⁸⁰⁴ Often the timeliness of the assessment will be obvious from a statement of the facts. Tax for year 01, with a statutory due date and filing date of 4/15/02, with a notice of deficiency on 4/1/05. The notice was timely, so in a Tax Court redetermination proceeding, the Court can easily so find. § 6501(a). If, however, the notice had been sent on 5/15/05, the notice would be untimely from those bare facts and the IRS would bear the burden of establishing that the notice is timely for some reason outside § 6501(a). The IRS could do that under various methods I have covered elsewhere—e.g., a timely executed consent to extend the statute of limitations (§ 6201(c)(4)), false or fraudulent return with intent to evade tax (§ 6201(c)(1)). The IRS must prove the right to assess outside the normal statute of limitations.

timely signed.²⁸⁰⁵ The burden of proof is by a preponderance of the evidence unless some statute or other authority imposes a higher burden.²⁸⁰⁶

F. Claim and Issue Preclusion (Res Judicata and Collateral Estoppel).

At several points in the text, I refer to the preclusion concepts where some claim or issue of fact or law that was or could have been decided in earlier judicial proceedings will be preclusive in later judicial proceedings. The terms commonly used now are claim preclusion and issue preclusion.²⁸⁰⁷ The historical terms used were res judicata for claim preclusion and collateral estoppel for issue preclusion, with res judicata sometimes used to cover both concepts.²⁸⁰⁸ Accordingly, where I refer to the concepts in the text I usually do so as follows: claim preclusion (res judicata) and issue preclusion (collateral estoppel). Readers should remember both terms because courts use both and that res judicata can sometimes be used to encompass both claim preclusion and issue preclusion.²⁸⁰⁹

The concepts may be summarized as follows:

- “Claim preclusion instructs that a final judgment on the merits forecloses successive litigation of the very same claim.”²⁸¹⁰ In a 2020 case, the Supreme Court elucidated:

Claim preclusion prevents parties from raising issues that could have been raised and decided in a prior action—even if they were not actually litigated. If a later suit advances the same claim as an earlier suit between the same parties, the earlier suit’s judgment prevents litigation of all grounds for, or

²⁸⁰⁵ *Malkin v. United States*, 243 F.3d 120, 122 (2d Cir. 2001) (where the entire file had been lost, hence the key Form 872, consent to extend, was lost and the taxpayer did not recall having signed it; the Court held that the Court had properly determined its existence from certain circumstantial evidence being acts taken in the IRS system that would not have been taken had it not existed). One of my first jury trials with DOJ Tax in the 1970s involved basically the same except the taxpayer’s file had not been lost and all that was in the IRS file was a copy of a Form 872 without the taxpayer’s signature but with the IRS officer’s signature. Our theory of the case, based on circumstantial evidence, was that, although there was no testimony from anyone who recalled seeing a taxpayer signed consent, the IRS received more than one copy from the taxpayer but only one copy was signed by the taxpayer, the IRS officer then verified the taxpayer’s signature on the top copy and signed all copies (the signed one and the unsigned one) and mistakenly returned the copy with both signatures to the taxpayer; hence there had been a Form 872 properly signed by all parties. My boss at DOJ Tax told me I was going to lose the case. I offered the taxpayer 2/3s and was willing to go to 75% to settle. The taxpayer insisted on 95% to settle. No settlement. Jury returned a special verdict finding that there had been a valid consent. I could tell several interesting “war stories” about the trial in the case, but I’ll spare readers that.

²⁸⁰⁶ Id.

²⁸⁰⁷ *Bravo-Fernandez v. United States*, 580 U.S. 5, 7-8 n. 1, & 9, n. 2 (2016).

²⁸⁰⁸ *Lucky Brand Dungarees, Inc. v. Marcel Fashions Group, Inc.*, 590 U.S. ___, ___, 140 S. Ct. 1589 (2020). When covering both concepts as well as just one of them, the term res judicata is called an autohyponym. I learned this word from *United States v. Weiss*, 52 F.4th 546, 551 n. 4 (3rd Cir. 2022) (discussing the statutory word “appeal” as having both a general meaning and a narrower meaning within the scope of the general meaning and providing this example: “A common legal term that is an autohyponym is ‘res judicata’: it has a general meaning that encompasses both claim preclusion and issue preclusion, but it also has a narrower meaning that refers only to claim preclusion.” (Citations omitted)). I have written somewhat tongue in cheek on this *Weiss* footnote in [3rd Circuit Holds that Collection Statute of Limitations Is Suspended through Supreme Court Finality](#) (Federal Tax Procedure 11/2/22; 11/3/22).

²⁸⁰⁹ *Bravo-Fernandez*, 580 U.S. at 9 n. 2.

²⁸¹⁰ *Bravo-Fernandez*, 580 U.S. at 9 (cleaned up).

defenses to, recovery that were previously available to the parties, regardless of whether they were asserted or determined in the prior proceeding. Suits involve the same claim (or cause of action) when they arise from the same transaction, or involve a common nucleus of operative facts,²⁸¹¹

- “Issue preclusion ordinarily bars relitigation of an issue of fact or law raised and necessarily resolved by a prior judgment.”²⁸¹² Stated alternatively, “the issue-preclusion principle means that when an issue of ultimate fact has once been determined by a valid and final judgment, that issue cannot again be litigated between the same parties in any future lawsuit.”²⁸¹³

Obviously, if a taxpayer has litigated his tax liability in a Tax Court deficiency proceeding resulting in a Tax Court decision imposing tax liability and penalties, the taxpayer cannot then later contest his liability in a subsequent refund suit, collection suit or CDP Tax Court proceeding. I think that, as to the tax liability, claim preclusion would apply.²⁸¹⁴ I think we can all see and intuit when preclusion might apply in this context.

Issue preclusion (collateral estoppel) is not quite so intuitive. The Tax Court has summarized the elements for issue preclusion:

Six conditions must be met for collateral estoppel to apply. First, there must be a final judgment rendered by a court of competent jurisdiction. Second, the issue in the second suit must be identical with the one decided in the first suit. Third, collateral estoppel may be asserted only against parties (or their privies) to the prior judgment. Fourth, the parties must actually have litigated the issues, and the resolution of these issues must have been essential to the prior decision. Fifth, the controlling facts and applicable legal rules must remain unchanged from those in the prior litigation. Sixth, there must not be any special circumstances that warrant an exception to its application.²⁸¹⁵

A frequent application in tax cases is to determine which issues that may have been involved in a criminal tax case are precluded from re-litigation in a subsequent civil case. Remember, that it can't be claim preclusion (*res judicata*) because a criminal prosecution claim is not the same as a claim (usually for tax liability or penalty) in a subsequent civil proceeding.

Finally, there is a category of possible preclusion termed “defense preclusion” which may be just an application of the concepts of claim and issue preclusion. Defense preclusion, if it is

²⁸¹¹ *Lucky Brand Dungarees, Inc. v. Marcel Fashions Group, Inc.*, 590 U.S. ___, ___, 140 S. Ct. 1589, ___ (2020) (cleaned up).

²⁸¹² *Bravo-Fernandez*, 580 U.S. at 10 (cleaned up); see also *Lucky Brand Dungarees, Inc. v. Marcel Fashions Group, Inc.*, 590 U.S. ___, ___, 140 S. Ct. 1589 (2020).

²⁸¹³ *Bravo-Fernandez*, 580 U.S. 7-8 (cleaned up).

²⁸¹⁴ I suppose it could be issue preclusion, but I am just not going to dance on that head of the pin right now.

²⁸¹⁵ *Atkinson v. Commissioner*, 2012 T.C. Memo. 226, slip op. at *13 (cleaned up) (citing *Peck v. Commissioner*, 90 T.C. 162, 166-167 (1988), *aff'd*, 904 F.2d 525 (9th Cir. 1990); and *Meier v. Commissioner*, 91 T.C. 273, 286 (1988)).

indeed a separate category, is a bit esoteric, so I just point it out here and refer to authority in the footnote.²⁸¹⁶

G. Injunctions in Tax Litigation.

1. Against the Government.

a. General Rule - No Injunctions § 7421(a) (AIA).

Section 7421(a) broadly prohibits suits “for the purpose of restraining the assessment or collection of any tax * * * by any person, whether or not such person is the person against whom such tax was assessed.”²⁸¹⁷ Such suits are commonly called injunction suits but also cover any suit that functions like an injunction.²⁸¹⁸ Section 7421(a) is also called the Anti-Injunction Act, and acronymed to “AIA”;²⁸¹⁹ the AIA should not be confused with the parallel prohibition for injunctions in state tax matters in 28 U.S.C. § 1341 (often called the Tax Injunction Act and acronymed to “TIA.”)²⁸²⁰ The reasons for prohibition on suits to interfere in tax matters are (1) there is a strong governmental imperative in avoiding interference with the revenue function and (2) there are adequate procedures otherwise provided in which taxpayers can contest tax liabilities without undue burden.²⁸²¹

²⁸¹⁶ *Lucky Brand Dungarees, Inc. v. Marcel Fashions Group, Inc.*, 590 U.S. ___, 140 S. Ct. 1589, ___ (2020).

²⁸¹⁷ § 7421(a) derives from a statute originally enacted in 1867. Act of Mar. 2, 1867, § 10, 14 Stat. 475. The original enactment has no legislative history. See *South Carolina v. Regan*, 465 U.S. 367, 373-374 (1984) (citing *Bob Jones University v. Simon*, 416 U.S. 725, 736 (1974)).

A good recent article exploring § 7421(a) in considerable detail is Leslie Book and Marilyn Ames, The Morass of the Anti-Injunction Act: A Review of the Cases and Major Issues, 73 Tax Lawyer 773 (2020).

²⁸¹⁸ As noted later in this section, the federal Declaratory Judgment Act excludes Federal tax matters from otherwise available declaratory relief. 28 U.S.C. § 2201. As interpreted, that exclusion is “coterminous” with the AIA’s prohibition. *The Green Solution Retail, Inc. v. United States*, 855 F.3d 1111 (10th Cir. 2017) (citing *Cohen v. United States*, 650 F.3d 717, 730-31, 397 U.S. App. D.C. 33 (D.C. Cir. 2011) (en banc)).

²⁸¹⁹ The AIA provides that, except for enumerated exceptions, “no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person, whether or not such person is the person against whom such tax was assessed.” Tax, for this purpose, includes tax penalties and interest. See § 6665(a)(2) (“any reference in this title to ‘tax’ imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter”); *Prisco v. IRS*, 2013 U.S. Dist. LEXIS 161356, 9-10 (N.D. N.Y. 2013); *J.J. Re-Bar Corp. v. United States (In re J.J. Re-Bar Corp.)*, 644 F.3d 952, 956 (9th Cir. 2011) (as to TFRP under § 6672).

²⁸²⁰ The TIA was modeled on the AIA. *Direct Mktg. Ass’n v. Brohl*, 575 U.S.1, 8 (2015). But the words are not exactly parallel with the result that actions covered by the AIA are interpreted more broadly under the TIA. See *The Green Solution Retail, Inc. v. United States*, 855 F.3d 1111 (10th Cir. 2017) (so holding in distinguishing the AIA’s broader reach as applied in *Lowrie v. United States*, 824 F.2d 827 (10th Cir. 1987) from the TIA’s narrower reach in *Direct Mktg. Ass’n v. Brohl*; specifically, the AIA covers not only acts of assessment and collection, but also “activities leading up to and culminating” in assessment, whereas, per *Direct Mktg.*, the TIA’s reach may not be so broad.

²⁸²¹ *Enochs v. Williams Packing & Nav. Co.*, 370 U.S. 1, 7 (1962) (“The manifest purpose of § 7421(a) is to permit the United States to assess and collect taxes alleged to be due without judicial intervention, and to require that the legal right to the disputed sums be determined in a suit for refund.”); and *Alexander v. Americans United Inc.*, 416 U.S. 752, 769 (1974) (§ 7421(a) reflects “appropriate concern about the ... danger that a multitude of spurious suits, or even suits with possible merit, would so interrupt the free flow of revenues as to jeopardize the Nation’s fiscal stability.”). As to the availability of alternative remedies for tax disputes, when enacted in 1867, the remedy was the

(continued...)

So, what is a tax subject to the prohibition on injunctions? There is no comprehensive definition of tax for this purpose. It is probably at least any exaction in the Internal Revenue Code, and certainly those labeled or treated in the Code as a tax. E.g., § 6665(a)(2) (providing that, except as otherwise provided in the Code, “any reference to ‘tax’ imposed by this title shall be deemed also to refer to the additions to the tax, additional amounts, and penalties provided by this chapter,” which covers the principal penalties discussed above).²⁸²² But, if some exaction is not labeled a tax but is treated as a tax for some purpose, is there room for not calling it a tax for AIA purposes?

In *National Federation of Independent Business v. Sebelius*, 567 U.S. 519 (2012), the Court held that a penalty in the Affordable Care Act (“ACA,” also popularly called Obamacare) was a tax for purposes of the taxing power in the constitution but was not a tax for purposes of the AIA. I won’t get into the reasoning for making the penalty a tax under the taxing power. But, once justified as a tax, how did the penalty escape the AIA? The Court held, based on a holistic interpretation of the ACA, that Congress did not intend the penalty as a tax for purposes of the AIA. The Court reasoned that the AIA, a statutory and not a constitutional provision, prohibited injunctions against exactions Congress intended as taxes in a statutory sense rather than a constitutional sense. Congress could certainly call an exaction a tax and not include it within the scope of the AIA. From there it is a short or long leap—depending on perspective—to determine through statutory interpretation that a particular exaction not called a tax but justified as a tax is not within the AIA prohibition. This penalty, while constitutionally a tax, was not legislatively a tax within the meaning of the word in the AIA. (I hope I have summarized the holding fairly, but query whether that leaves some room for some of the exactions in the Internal Revenue Code to avoid the AIA.)²⁸²³ Finally, to close the loop on the Supreme Court case, by avoiding the injunction prohibition, the Court had jurisdiction over the constitutional challenge against the ACA and could reject it on the merits because it was within the scope of the taxing power.

The prohibition applies textually to suits restraining “assessment” or “collection.” The IRS performs many actions not formally rising to acts of assessment or collection. For example, before making assessments, the IRS may investigate (via audit); and before taking collection action, the IRS may also investigate. Is such investigative activity, though not formally assessment or collection covered by the AIA? Yes. The AIA’s prohibition reaches to block suits seeking to prevent activities leading to and culminating in assessments or collections.²⁸²⁴

²⁸²¹(...continued)

refund suit. As I note in this text, Congress has provided several alternative remedies to address the potential fairness and due process concerns inherent in refund suits. The remedies include the prepayment Tax Court remedy for the types of tax requiring a notice of deficiency, the remedies for jeopardy assessment and termination, etc. In addition, judicial interpretation of the so-called full pay rule in *Flora* has mitigated its impact via the divisible tax concept and other interpretations that make the refund remedy more accessible.

²⁸²² See also § 6665(a) providing that Code penalties (including additions) shall be assessed “in the same manner as taxes.”

²⁸²³ For example, § 6665(b) defining tax to include the penalties imposed in Chapter 68 leaves room that other penalties might not be a tax without some special definitional provision.

²⁸²⁴ *The Green Solution Retail, Inc. v. United States*, 855 F.3d 1111 (10th Cir. 2017) (re-affirming its prior holding in *Lowrie v. United States*, 824 F.2d 827, 830 (10th Cir. 1987) and distinguishing *Direct Mktg. Ass'n v. Brohl*, 575 U.S. 1 (2015) (involving a more restrictive reading of the parallel provision under the TIA, 28 U.S.C. § 1341). In *Green Solutions*, the taxpayer was a marijuana dispensary authorized under state law. Although lawful under state law, (continued...)

b. Exceptions.

There are several exceptions to the AIA.²⁸²⁵ The key exceptions that I will expect you to know are (i) certain specifically enumerated exceptions in § 7421(a), (ii) a judicial exception, referred to as the *Enochs v. Williams Packing Company*²⁸²⁶ exception, and (iii) another judicial exception narrowly delimited where the person affected by the tax has no remedy to contest liability.

(1) Statutorily Enumerated Exceptions.

Section 7421(a) contains a flat prohibition against a “suit for the purpose of restraining the assessment or collection of any tax.”²⁸²⁵ This means, of course, no injunctions. Section 7421(a), however, enumerates certain exceptions. I expect you to know certain exceptions for this class and encourage you to think about why the exceptions exist.

Let me start with the enumerated exception for § 6213(a). You certainly recall that § 6213(a) is a key Code Section in this class. Briefly, it is the section that creates restrictions on assessment -- specifically a prohibition on assessment until the IRS has first issued a notice of deficiency and waited 90 days during which the taxpayer can petition the Tax Court and then further prohibits assessment during the period a Tax Court case is pending. This prohibition on assessment is an essential feature of an effective prepayment remedy, without it the IRS could assess and begin collection measures. What is the taxpayer's remedy if the IRS, despite the prohibition on assessment, makes the assessment and begins collection measures? The remedy appears in § 6213(a)'s specific provision for an injunction suit (including an order for a refund for taxes paid pursuant to an improper assessment)²⁸²⁷ and § 7421(a)'s carving out of § 6213(a) from the general flat prohibition on injunctions.

But those of you who are both familiar with the law of remedies and the federal tax scheme allowing refund suits to contest tax liabilities, should easily spot that there is a further issue lurking here. What if the taxpayer in an injunction suit alleges only that the IRS assessed without issuing a notice of deficiency—a clear violation of § 6213(a)—but cannot allege or has not alleged the traditional bases for equitable injunction relief—irreparable injury and lack of adequate remedy at law? For example, what if the taxpayer has ample money to pay the taxes wrongfully assessed and thus could litigate in a refund suit? Can the taxpayer sue for injunction under § 7421(a)? The taxpayer has a remedy at law—pay the amount assessed and sue for refund. There is a split in the

²⁸²⁴(...continued)

trafficking in marijuana was not lawful under the federal Controlled Substances Act, which, by prosecutorial discretion was not enforced in states authorizing the distribution of marijuana. But § 280E of the Code disallowed deductions or credits for trades of businesses involved in such trafficking. The IRS began audit activity to determine whether the taxpayer's deductions or credits should be disallowed; the IRS had not made an assessment or begun collection activities. The taxpayer sought to restrain the audit activity. The Court applied the AIA to prohibit the suit.

²⁸²⁵ A more complete list of the exceptions is in Leslie Book and Marilyn Ames, The Morass of the Anti-Injunction Act: A Review of the Cases and Major Issues, 73 Tax Lawyer 773, 781 (2020).

²⁸²⁶ 370 U.S. 1 (1962).

²⁸²⁷ § 6213(a) (contains the general prohibition on assessment while the notice of deficiency is in effect and, if pursued, the Tax Court petition for redetermination is pending and authorizes an injunction “[n]otwithstanding the provisions of section 7421(a)” in “the proper court, including the Tax Court” and authorizing a court to order refunds “of any amount collected within the period during which the Secretary is prohibited from collecting.”

circuits. However, given the importance of the Code's scheme to allow a prepayment remedy which requires the issuance of a notice of deficiency, the better view is that the injunctive remedy is allowed by § 7421(a).²⁸²⁸

Examples of other exceptions are: (1) injunctions to allow the special Tax Court proceeding for innocent spouse claims to proceed without the threat of assessment and collection actions;²⁸²⁹ (2) injunctions to allow the partnership unified audit proceedings to work at the partnership level before assessment and collection action is taken at the partner level (for discussion of these procedures, see pp. 934 ff.),²⁸³⁰ and (3) injunctions in responsible person penalty cases (also referred to as trust fund penalty cases) where the IRS has not given the required notice under § 6672(b).²⁸³¹ The pattern for the exceptions is that Congress has prescribed certain administrative or judicial proceedings or actions that should precede assessment and levy and failure to let those processes play out justifies exempting them from the prohibition on injunctions.

For purposes of this course, I want you to focus on the exception for failure to satisfy § 6213(a)'s restrictions on assessment. In your subsequent practice, of course, you should think about the other exceptions in § 7421(a) where the need arises.

(2) *Enochs v. Williams Packing Exception.*

As mentioned above, there is a nonstatutory exception to § 7421(a)'s general prohibition on injunctions. This is the *Enochs v. Williams Packing* exception, named after *Enochs v. Williams Packing & Navigation Co.*, 370 US 1, 6 (1962). The case holds that if the situation is quite extreme and it is clear, virtually on the face, that the IRS cannot prevail, a court may enjoin. The court stated the predicates for such a suit: (1) it must be “clear that under no circumstances could the government ultimately prevail...on the basis of information available to it at the time of the suit. [taking] the most liberal view of the law and the facts” and (2) “equity jurisdiction otherwise exists” -- meaning there must be irreparable harm and no adequate legal remedy exists.²⁸³² With regard to the latter, note that the comprehensive system for litigating tax liabilities (the notice of deficiency and Tax Court procedure) without paying and the opportunities to litigate in the district court (with the mitigations of the *Flora* rule), will often make it very difficult for taxpayers to satisfy the requirement that equity jurisdiction otherwise exists. Even where there is no prepayment remedy, the mitigations to the full payment rule (e.g., in the case of employment taxes, paying for one employee for one quarter) results in an adequate remedy.

I noted that it is usually difficult to clear the hurdles of *Enochs v. Williams Packing*. However, the potential for success is illustrated in a case that is not without controversy. In *Estate of Michael v. Lullo*, 173 F.3d 503 (4th Cir. 1999), involving the estate tax, the estate had been

²⁸²⁸ *Gardner v. United States*, 211 F.2d 1305 (D.C. Cir. 5/19/2000) (discussing holdings in other circuits to the contrary).

²⁸²⁹ § (e)(1)(B)(ii).

²⁸³⁰ § 6225(b).

²⁸³¹ § 6672(c).

²⁸³² See *Bob Jones Univ. v. Simon*, 370 U.S. 1, 6-7 (1974) (citing *Williams Packing*, the Supreme Court stated: “Only upon proof of the presence of two factors could the literal terms of § 7421(a) be avoided: first, irreparable injury, the essential prerequisite for injunctive relief in any case; and second, certainty of success on the merits.”)

audited, received an estate tax closing letter (not a closing agreement), and paid the amount (i) by a credit for tax paid to England and (ii) by check for the balance. The statute of limitations expired. The IRS then discovered that it had omitted from its calculations in the closing letter certain assets in certain schedules and, recognizing that the statute of limitations prevented further assessments, sought a partial solution by denying the credited English tax, thus, if it worked, reinstating that amount of the assessment to which the foreign credit had been applied. In other words, no new assessment was made, just a reversal of part that had been paid by the English tax credit. The taxpayer then sued for mandamus to order the IRS to acknowledge the amount of English tax claimed as a credit. The district court denied the mandamus action based on the AIA. On appeal, the Fourth Circuit reversed, ordering the mandamus under the *Enochs v. Williams Packing* exception. The Court said: “The Estate's action is precisely the rare type of suit for which this exception was crafted.” The Court based the conclusion on the following steps (which I highly summarize at the risk of misstating the nuances): (i) the IRS conceded that the taxpayer was entitled to the English tax credit that it was seeking to reduce; (ii) the statute of limitations was closed for any further assessments; (iii) since the IRS did not assess the taxes it now sought to collect, whether or not in an academic sense the taxpayer owed additional taxes is irrelevant, for the statute not only bars the IRS from a remedy, it affirmatively extinguishes liability for taxes not assessed timely (hence the taxes resulting from the IRS omission of assets on the schedules are simply nonexistent); (iv) the *Lewis v. Reynolds* right to offset in refund suits is inapplicable because that case only permitted the IRS to retain additional otherwise due taxes but did not give it the right to go out and collect them as it was attempting to do here; and, (v) even apart from *Lewis v. Reynolds*, the IRS gambit short-circuited general procedure for notice of deficiency and right to contest in the Tax Court and thus relegating the IRS to a refund suit that was inconvenient and where the IRS would eventually lose. So reasoned the majority on the panel.

The dissenter in *Estate of Michael* excoriated the majority’s holding based on “frontier instincts.” The dissenter says, in part, that *Enochs v. Williams Packing* required that it be clear or certain that the taxpayer would prevail in any otherwise adequate proceedings, but in a refund suit that is otherwise adequate *Lewis v. Reynolds* makes it far from certain that the taxpayer could prevail. (It is black letter law that the mere inability to prevail in a subsequent otherwise adequate proceeding does not meet the *Enochs v. Williams Packing* exception.)

But don’t get hung up on the scope of *Lewis v. Reynolds* at this point; just think about why the taxpayer’s case in *Estate of Michael* was so compelling to persuade at least a majority on the panel to invoke the *Enochs v. Williams Packing* exception.

(3) No Other Adequate Remedy - *South Carolina v. Regan*.

In *South Carolina v. Regan*, 465 U.S. 367 (1984), the Court seemed to carve out a remedy by reading the AIA as applying only where the person affected by the tax had some other remedy. The Court said: “In sum, the Anti-Injunction Act's purpose and the circumstances of its enactment indicate that Congress did not intend the Act to apply to actions brought by aggrieved parties for whom it has not provided an alternative remedy.”²⁸³³ The scope of this exception is not fleshed out, because in most of the cases applying the AIA, the person is the taxpayer with the standard refund

²⁸³³ 465 U.S., at 378.

suit remedy, as well as deficiency procedures where applicable, and ability to contest in collections suits and collection due process.

A variation is where any other remedy is not adequate to address the harms of the IRS action. In *CIC Services, LLC v. IRS*, 583 U.S. ___, 141 S. Ct. 1582 (2021), the Court permitted pre-enforcement relief where the action—a Notice requiring a material advisor of a tax strategy to provide information—required the covered advisors to incur significant costs of compliance and, perhaps most importantly, failure to provide the information might subject to the advisors to criminal prosecution. In this circumstance, the advisors could test the legal propriety of the Notice without the bar of the AIA. This review is commonly referred to as pre-enforcement review (in tax administration, pre-enforcement means prior to assertion of a tax liability which has traditionally given rise to post-enforcement remedies (such as petition for redetermination in the Tax Court, refund litigation, collection suit, etc.)). Since, *CIC Services*, courts have applied its reasoning to other IRS actions in other pre-enforcement contexts. For example, in *Harper v. Rettig*, 46 F.4th 1 (1st Cir. 2022), the court held that a taxpayer can challenge the John Doe Summons (“JDS”) issued to obtain his information from a cryptocurrency exchange, Coinbase. The JDS summons, authorized under § 7609(f), seeks information on unknown taxpayers from a third party recordkeeper by describing the class of unknown taxpayers and likely tax issues for the class. (See discussion of the JDS beginning on p. 429.) The court reasoned that the Anti-Injunction Act (“AIA”) prohibiting suit involving assessment and collection of tax because all the JDS sought was information, noting that the AIA applies to assessment and collection and does not apply all activities that may improve ability to assess and collect taxes.

c. Declaratory Judgments and Other Injunction Substitutes.

The law of remedies offers potential remedies that might have an equivalent effect to interfere with the revenue function much as an injunction would. Hence, it is not surprising that such other remedies are prohibited, either expressly in the statute or by court interpretation, except in certain narrowly prescribed contexts in which Congress intended those other remedies to apply.

The most obvious similar remedy is the declaratory judgment remedy which could have the same practical effect even though it would be just a pronouncement of legal rights. The statute expressly excepts tax matters from the declaratory judgment remedy.²⁸³⁴ Notwithstanding this general prohibition, Congress has provided certain limited authority for courts to confer declaratory judgment relief. The Tax Court is given certain declaratory judgment authority with respect to, for example, certain exempt organization qualification.²⁸³⁵

²⁸³⁴ See 28 U.S.C. § 2201(a) (denying declaratory judgments in federal tax matters). As interpreted, that exclusion is “coterminous” with the AIA’s prohibition. *The Green Solution Retail, Inc. v. United States*, 855 F.3d 1111, 1115 (10th Cir. 2017) (citing *Cohen v. United States*, 650 F.3d 717, 730-31, 397 U.S. App. D.C. 33 (D.C. Cir. 2011) (en banc)); and *Gilbert v. United States*, 998 F.3d 410, (9th Cir. 2021) (DJA “is coextensive with the Anti-Injunction Act despite the broader language of the former,” quoting *Perlowin v. Sassi*, 711 F.2d 910, 911 (9th Cir. 1983)).

²⁸³⁵ § 7428.

Other remedies that might achieve a similar revenue-inhibiting effect are similarly prohibited except where expressly allowed by statute.²⁸³⁶

2. Against the Taxpayer or Other Parties with Tax Obligations.

The Government may invoke the district court's equitable jurisdiction to obtain injunctive orders against taxpayers and other parties who have obligations under the Code. § 7402(a). Of course, the obligation under the Code and the civil and criminal penalties behind the obligation are lawful commands to the persons with the obligation to perform as the law obligates. The principal effect of obtaining an injunction in such cases is the compulsive effect itself—additional penalties for noncompliance with the injunction. This can include civil penalties and potential incarceration.

For a number of years now, one of the most prominent areas in which the Government obtains injunctions is for tax return preparers who operate as mills for the preparation of returns with false tax claims.²⁸³⁷ Even without injunctions, of course, the preparer civil penalties in §§ 6694 and 6695 and the criminal penalties including § 7206(2) (aiding or assisting) and 18 U.S.C. § 371 (conspiracy) are strong encouragement to not prepare false returns. But sometimes even those are insufficient to address the problem, so the Government may seek to enjoin return preparers and their firms from preparing returns altogether or preparing fraudulent returns.²⁸³⁸

Another area of interest to the Government is in the employment tax context. Employers are obligated to withhold income tax and FICA tax from employees and pay the withheld amounts to the Government.²⁸³⁹ While most employers meet that obligation, many do not. Accordingly, there is a battery of civil and criminal penalties and the Trust Fund Recovery Penalty imposing civil liability to persons responsible for delinquencies. Still, even that may not be sufficient, so that the Government feels the need to obtain an injunction in some cases.

²⁸³⁶ For example, enterprising plaintiff's lawyers might consider the possibility of a False Claims Act suit under 31 U.S.C. § 3729 ff against abusers of the tax system, but will find that there is a bar to litigating tax issues (referred as the "Tax Bar"). 31 U.S.C. § 3729(e); see *United States ex rel. Lissack v. Sakura Global Capital Markets, Inc.*, 377 F.3d 145 (2d Cir. 2004) (citing also § 7401 for the proposition that the IRS has exclusive jurisdiction over tax matters); and *Kent v. N. California Reg'l Office of Am. Friends Serv. Comm.*, 497 F.2d 1325, 1328 (9th Cir. 1974) (attempt to use interpleader to litigate tax liability fails as "hybrid" method to litigate tax liability condemned by the Supreme Court in *Flora*.)

²⁸³⁷ §§ 7402 (general court authority), 7407 ("Action to enjoin tax return preparers"), and 7408 (injunctions for "specified conduct related to tax shelters and reportable transactions"). To obtain an injunction under § 7402, the Government must show (1) a substantial likelihood of success on the merits; (2) irreparable injury will be suffered absent the injunction; (3) the threatened injury outweighs the potential damage of the proposed injunction; and (4) the injunction would not be adverse to the public interest. *United States v. Ernst & Whinney*, 735 F.2d 1296, 1301 (11th Cir. 1984); *United States v. Askins & Miller Orthopaedics, P.A.*, 924 F.3d 1348, 1354-1355 (11th Cir. 2019). The other sections have their own requirements. To obtain an injunction under § 7407 the Government must show that the defendant be a return preparer, that the preparer has engaged in conduct prescribed in subsection (b)(1), and that injunctive relief is appropriate to prevent the recurrence of the conduct. To obtain an injunction under § 7408, the Government must show that (1) the defendant engaged in specified conduct—either (i) conduct to the shelter related penalties (§§ 6700, 6701, 6707 or 6708) or regulations under 31 U.S.C. § 330) and that (2) injunctive relief is appropriate to prevent recurrence of the conduct.

²⁸³⁸ DOJ Tax often issues press releases when such injunctions are obtained. See the DOJ Tax website titled "Tax Division Press Releases" (viewed 7/22/18). The press release serves principally to warn other practitioners of this possible consequence of preparing false returns.

²⁸³⁹ §§ 3101, 3102, 3111, and 3402.

A court may grant other appropriate relief under § 7402(a). For example, a court might invoke the equitable remedy of disgorgement to require the defendant pay to prevent unjust enrichment.²⁸⁴⁰

H. Class Actions in Tax Litigation.

Federal tax litigation rarely presents the opportunity for class actions. Class actions are not available at all in the Tax Court since the Tax Court has jurisdictional prerequisite notices from the IRS to the individual taxpayer (e.g., notice of deficiency or notice of determination). Some of the practical procedural effects of class actions can be achieved via the Tax Court's procedures for handling cases with common issues,²⁸⁴¹ but that is not a class action. For this reason, the Tax Court's rules do not even address the issue of class actions. The district courts and the Court of Federal Claims do have procedures that allow class actions. However, in tax litigation, refund suits are the usual method of contesting tax liabilities and, as we have noted, require a predicate claim for refund and either denial or deemed denial (by inaction for 6 months).²⁸⁴² Many taxpayers will not have met this requirement; nevertheless, in an appropriate case, a class action might be framed.²⁸⁴³ And if that won't work, still other esoteric forms of class action like work arounds may be found, although they are not intuitive in the tax law.²⁸⁴⁴

²⁸⁴⁰ *United States v. Stinson*, 2018 U.S. App. LEXIS 11613 (11th Cir. 2018) (unpublished).

²⁸⁴¹ For example, in large tax shelter cases not subject to the TEFRA unified partnership procedures the Tax Court, working with counsel for the parties, first tries a limited number of representative cases. After the test case litigation, the taxpayers who have stipulated in advance to be bound by the test cases will have their cases resolved accordingly and taxpayers who have not so stipulated will have their cases called to show cause why their cases are sufficiently different that a separate trial should be held.

²⁸⁴² Some functional equivalents of class actions do exist. For example, in *CSX Corporation v. United States*, 52 Fed. Cl. 208 (2002), the employing corporation filed on behalf of its employees with respect to both the employers and employees shares of FICA.

²⁸⁴³ See *Oatman v. Department of Treasury*, 34 F.3d 787 (9th Cir. 1994); see generally, Burgess J.W. Raby and William L. Raby, *Class Action in Income Tax Litigation*, 2002 TNT 206-47 (10/24/02).

²⁸⁴⁴ For example, with respect to allegedly overpaid FICA taxes, the employer which paid ½ the FICA and withheld the other ½ from the employees' wages may be able to file a collective claim for refund and even pursue a collective refund suit, provided that appropriate consents are obtained from the employees before any refund is paid. See 31.6402(a)-2(a)(2)(i), Rev. Rul. 81-310, 1981-2 C.B. 241, and *Chicago Milwaukee Corp. v. United States*, 40 F.3d 373 (Fed. Cir. 1994). See also Rev. Proc. 2017-28, 2017-14 I.R.B. (for procedure for obtaining employees' electronic consent).

Ch. 11. Assessment Procedures.

I. Introduction and a Review.

The assessment is the key event that records on the IRS's books the taxpayer's liability for a tax. The Supreme Court explained in general terms the concept of the assessment for a taxing agency:

Some machinery must be provided for applying the rule to the facts in each taxpayer's case, in order to ascertain the amount due. The chosen instrumentality for the purpose is an administrative agency whose action is called an assessment. The assessment may be a valuation of property subject to taxation, which valuation is to be multiplied by the statutory rate to ascertain the amount of tax. Or it may include the calculation and fix the amount of tax payable, and assessments of federal estate and income taxes are of this type. Once the tax is assessed, the taxpayer will owe the sovereign the amount when the date fixed by law for payment arrives. Default in meeting the obligation calls for some procedure whereby payment can be enforced. The statute might remit the government to an action at law wherein the taxpayer could offer such defense as he had. A judgment against him might be collected by the levy of an execution. But taxes are the lifeblood of government, and their prompt and certain availability an imperious need. Time out of mind, therefore, the sovereign has resorted to more drastic means of collection. The assessment is given the force of a judgment, and if the amount assessed is not paid when due, administrative officials may seize the debtor's property to satisfy the debt.²⁸⁴⁵

As we will see, the assessment is the administrative act that is the fulcrum to the IRS's actions to collect the amount assessed but unpaid. Many of these actions will be administrative enforcement tools, such as recording the assessment, liens and levies. And the assessment can permit judicial action as well, most notably suits to reduce the assessment to judgment, the principal purposes of which is to offer judicial enforcement action and to extend the statute of limitations beyond the statute of limitations offered by the assessment.

But first, let's review some matters previously covered—sometimes more than once. We have a system that, for income and estate and gift taxes, permits a taxpayer to obtain a prepayment remedy if he disputes the amount of tax the IRS proposes to assess. Of course, if the taxpayer reports the liability on his return, the IRS can assess immediately. But, where the taxpayer does not report the liability and does not agree with the IRS proposal to assess, the policy decision is to offer a prepayment remedy.²⁸⁴⁶

²⁸⁴⁵ *Bull v. United States*, 295 U.S. 247, 259-260 (1935).

²⁸⁴⁶ All right, it would be possible to design a system permitting assessment first and then stay of the assessment while the taxpayer litigates. But our system does it otherwise, thus preserving the act of assessment after the taxpayer is given a pre-assessment remedy as the act from which the IRS's collection authority springs into existence unimpeded by stays.

You will recall that a deficiency is, generally, the tax due less the tax previously assessed (generally being the amount the taxpayer reported on the return). § 6211(a).²⁸⁴⁷ For the types of taxes that most concern us here, before the deficiency can be assessed, the IRS must issue a notice of deficiency. §§ 6212 & 6213(a). Only thereafter can the IRS assess the tax.

There are three key exceptions to the predicate notice of deficiency.

First, § 6213(b) provides certain exceptions to § 6213(a)'s general requirement that a notice of deficiency precede assessment. The key exceptions generally applied are: (1) the IRS may assess the amount of tax the taxpayer reports to be due on the return;²⁸⁴⁸ (2) the IRS may assess amounts paid as a tax or in respect of a tax;²⁸⁴⁹ and (3) the IRS may make assessments to correct mathematical or clerical errors (as defined)²⁸⁵⁰ on the face of the return, provided the IRS notifies the taxpayer of the correction and the taxpayer does not request abatement of the assessment within 60 days of the notice.²⁸⁵¹

Second, the taxpayer can sign a waiver of the restrictions on assessment (Form 870 or Form 4549 in the case of income taxes)²⁸⁵² which waives the § 6213(a) prohibition on assessment before

²⁸⁴⁷ See also *Laing v. United States*, 423 U.S. 161, 173 (1976). Section 6211(a) says that the deficiency is the tax actually due less the excess of (i) the sum of the tax shown on the return and amounts previously assessed as a deficiency over (ii) the amount of rebates. Setting aside rebates which are not usually involved, and considering that tax due reported on the return is assessed (§ 6210(a)(1)), the deficiency is the amount of tax due less the amount previously assessed. On the treatment of rebates, see *Galloway v. Commissioner*, 149 T.C. 407 (2017).

²⁸⁴⁸ § 6213(b)(4).

²⁸⁴⁹ § 6213(b)(4).

²⁸⁵⁰ The terms are defined in § 6213(g)(2) containing a list with (i) general terms that fall within the descriptors math or clerical errors (e.g., such as math errors ("subtraction, multiplication, or division," use of incorrect tables, inconsistent entries on the return, omission of required items or information, entries that exceed statutory limits) and (ii) certain specific items or information (such as failure to provide correct TIN for certain Code benefits) that do not fall within the general descriptors but are definitionally included.

²⁸⁵¹ § 6213(b)(1). Section 6213(b)(2) requires the IRS to abate the assessment if the taxpayer objects in writing within 60 days, in which case the IRS must proceed by notice of deficiency. For a good general discussion of the processing problems encountered in the math or clerical error exception, see NTA Blog: [Math Error Parts I and II \(7/28/21 & 8/3/21\)](#). For discussion of a case where the taxpayer objects and the IRS failed to reverse the assessment and issue an appropriate notice of deficiency, see Keith Fogg, [Can a Taxpayer Successfully Sue When IRS Fails to Do What It Should Do](#) (Procedurally Taxing Blog 5/4/23),

Traditionally, the math and clerical error adjustment was made upon the initial processing of the return where the error is generally spotted upon the data input and calculations and algorithms applied to the data. However, some of the items now defined as math or clerical error adjustments are not what would normally be considered math or clerical error adjustments that would be identified on initial processing of the return. Because there is no time limit set to make the adjustments, the IRS claims that it may make the adjustments at anytime otherwise within the statute of limitations for assessment. See PMTA 2018-017 (4/10/18) (concluding that the IRS has authority to assess "even though the returns have already been processed and refunds have been issued," thus allowing the IRS to make the assessment with or without notice of deficiency and noting that fairness concerns may prompt the IRS to use the notice of deficiency procedure giving the taxpayer a clear path to judicial review even though the taxpayer would have the CDP review after assessment if the notice of deficiency is not issued).

²⁸⁵² Other forms are used, depending on context. IRM 4.8.9.23.3(2) (07-09-2013), Waivers of Restriction on Assessment (listing the Forms). E.g., a parallel form is used for transfer tax: Form 890, Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment - Estate, Gift and Generation - Skipping Transfer Tax. All of the forms have some variation of this language which tracks the following language (drawn here (continued...))

issuance of a notice of deficiency and the expiration of the ninety-day Tax Court petition time. § 6213(d). The effect of the waiver is to deny the taxpayer the right to petition for Tax Court redetermination of a proposed deficiency.²⁸⁵³ A taxpayer signing the waiver is not precluded from contesting the tax liability in some judicial forum other than the Tax Court.²⁸⁵⁴

Third, the IRS can make a jeopardy or termination assessment permitting the IRS to make prompt assessments and collections where the taxpayer appears to be doing something deliberately intended to defeat the IRS's ability to collect taxes (see discussion beginning p. 523).

For the balance of this discussion, I assume compliance with the predicates for assessment.

II. Authority for Assessment.

Section 6201(a), titled "Assessment authority," authorizes the IRS to make determinations of liabilities imposed under Title 26 and then assess "all taxes (including interest, additional amounts, additions to the tax, and assessable penalties) imposed by this title, or accruing under any former internal revenue law, which have not been duly paid by stamp at the time and in the manner provided by law." The inference to be drawn would normally be that liabilities imposed by Title 26 can be assessed. Assessment is the predicate requirement for the IRS to use its nonjudicial

²⁸⁵²(...continued)

from the Form 870):

I consent to the immediate assessment and collection of any deficiencies (increase in tax and penalties) and accept any overassessment (decrease in tax and penalties) shown above, plus any interest provided by law. I understand that by signing this waiver, I will not be able to contest these years in the United States Tax Court, unless additional deficiencies are determined for these years.

A waiver may be filed after a notice of deficiency is issued, in which case the waiver permits immediate assessment (and invokes the other features for a waiver, such as suspension of interest after 30 days). Rev. Rul. 66-17, 1966-1 C.B. 272 (waiver "filed within the 90-day period of suspension provided by sections 6213(a) and 6503(a)(1) of the Code, has the effect of terminating the running of such 90-day period and starting the running of the 60-day period provided by section 6503(a) of the Code on the date it is filed.")

²⁸⁵³ In the absence of a waiver for the type of assessments requiring a predicate notice of deficiency under § 6213(a), any assessments and collections without a notice of deficiency would appear from the statute to be facially invalid. The predicate requirement for a notice of deficiency is to give the taxpayer some opportunity for prepayment contest in the Tax Court. However, where the taxpayer signs a closing agreement—thus admitting the tax liability—the question has arisen whether the statutory predicate should be required unless the taxpayer also expressly waives the notice of deficiency. The IRS has taken the position that, where the taxpayer signs a closing agreement as to the assessment, the purpose and need for a notice of deficiency is moot and thus the predicate requirement of a notice can be dispensed with. E.g., Rev. Proc. 68-16, 1968-1 C.B. 770 (although noting that an express waiver can ordinarily be submitted with a closing agreement). One court has agreed with the IRS view. *Marathon Oil Co. v. United States*, 42 Fed. Cl. 267 (1998), affd. 215 F.3d 1343 (Fed. Cir. 1999). While this issue is only infrequently litigated, the Courts seem to be troubled by a taxpayer walking away from an admitted liability where the foot fault of an unneeded notice of deficiency exists. One court has thus suggested that, where the closing agreement closes out the whole year rather than just certain issues for the year, the predicate notice of deficiency is not required, but if it only settles certain issues and not the whole year, a predicate notice of deficiency is required. *Manko v. Commissioner*, 126 T.C. 195 (2006).

²⁸⁵⁴ I discuss below the collection due process ("CDP") procedures as a way to get disputes to the Tax Court after the assessment, but suffice it to say for now that, in a CDP case, the Tax Court may not review the merits of a tax liability if the taxpayer previously had the right to contest the merits. A taxpayer signing such a waiver would have had the opportunity to contest, foreclosing contest of the merits in the CDP proceeding in the Tax Court.

administration collection enforcement tools such as lien and levy and provides the date for the 10-year collection period.

In *Fahry v. Commissioner*, 160 T.C. ___, No. 6 (4/3/23), the Court held that upon close reading of § 6201(a) and related IRC sections, some penalty liabilities under Title 26—specifically, the § 6038(b) penalties for failure to file certain international information returns—do not have Title 26 assessment authority. The principal consequences of that holding, if sustained on the appeal, are: (1) the IRS cannot assess the penalties to invoke the collection tools normally attending assessment but must instead sue for collection within 5-years from the date the liabilities “first accrued” 28 U.S. Code § 2462; and (2) the party penalized will have no administrative rights other than those available before the penalty liabilities were imposed.²⁸⁵⁵

III. Assessment.

A. Procedures for Assessment.

The act of assessment is the formal recording on the IRS's books that, in the IRS's view, the taxpayer has a tax due that has not been previously assessed. § 6203.²⁸⁵⁶ Technically, the assessment does not necessarily mean that the taxpayer actually has a tax due. Rather, if properly made, the assessment means only that the IRS has determined, rightly or wrongly, that the taxpayer has a tax due and that the IRS has performed the predicate procedural acts, if any, to make the assessment formally recording the liability on the IRS books, thus permitting the IRS to take collections action (as discussed in Ch. 12 Collection Procedures).²⁸⁵⁷ The assessment comes after the IRS has made the determination that previously unassessed tax is due, such as after an audit, after finding a mathematical error on a return or some other trigger for the determination. After making the determination, in some cases there are additional procedural steps (such as issuing a notice of

²⁸⁵⁵ For more on my thoughts, see Tax Court Holds that IRS Has No Authority to Assess § 6038(b) Penalties for Form 5471 Delinquencies (4/3/23; 4/23/23). For more from the law firm that successfully litigated *Fahry*, see Cory Stigile & Michael Greenwade, The IRS Cannot Assess or Collect Certain International Penalties--Now What? (Hochman Salkin Toscher Perez P.C.),

²⁸⁵⁶ *Laing v. United States*, 423 U.S. 161, 171 n.13 (1976). In *Hibbs v. Winn*, 542 U.S. 88, 100 (2004), the Supreme Court described assessments (cleaned up):

As used in the Internal Revenue Code (IRC), the term “assessment” involves a recording of the amount the taxpayer owes the Government. 26 U.S.C. §6203. The “assessment” is essentially a bookkeeping notation. Section 6201(a) authorizes the Secretary of the Treasury “to make . . . assessments of all taxes . . . imposed by this title.” An assessment is made “by recording the liability of the taxpayer in the office of the Secretary in accordance with rules or regulations prescribed by the Secretary.” n2 §6203. See also M. Saltzman, IRS Practice and Procedure ¶10.02, pp. 10-4 to 10-7 (2d ed. 1991) (when Internal Revenue Service signs “summary list” of assessment to record amount of tax liability, “the official act of assessment has occurred for purposes of the Code”).

n. 2 Section 301.6203-1 of the Treasury Regulations states that an assessment is accomplished by the “assessment officer signing the summary record of assessment,” which, “through supporting records,” provides “identification of the taxpayer, the character of the liability assessed, the taxable period, if applicable, and the amount of the assessment.” 26 C.F.R. §301.6203-1 (2003).

²⁸⁵⁷ See Bryan Camp, Lesson From The Tax Court: Abatement Of Assessment Brings No Relief From Liability (Tax Prof Blog. 4/26/21).

deficiency for some taxes), but once the procedural steps are followed, the IRS may make the assessment. The assessment itself is not preclusive as to the underlying liability.²⁸⁵⁸

Historically, the assessment occurs at the Service Center on a master or summary record, a Form 23C (Summary of Assessments),²⁸⁵⁹ The Form 23C is a summary of assessments that does not identify on its face the names of the taxpayers who are assessed. The records underlying the summary identify the taxpayer and the amounts involved and permit the IRS to work back to the detail underlying the assessment.²⁸⁶⁰ The assessment roll must be signed by an authorized delegate.²⁸⁶¹ The assessment certificate is often referred to as the 23C, and the date of the assessment is referred to as the 23C date. The IRS has been moving from the preparation of a manually prepared 23C to the general use of RACS 006 (sometimes RAC 006) which is an electronic system signed electronically.²⁸⁶²

I refer later to a Form 4340, Certificate of Assessments and Payments, which is not the assessment itself, but merely summarizes the assessment information, including the 23C or RACS 006 date, as well as other information (such as payments against the assessment).²⁸⁶³ If a taxpayer requests a copy of the record of assessment, the IRS may provide a Form 4340.²⁸⁶⁴ In trials, the Government will often use the Form 4340 to prove the outstanding unpaid assessments, the amount due after application of payments and other matters related to the amount due; courts regularly hold the Form 4340 is presumptive evidence of assessment or other acts it purports to summarize.²⁸⁶⁵ If,

²⁸⁵⁸ If, with tax liabilities requiring a notice of deficiency, the taxpayer petitions to redetermine the tax liability, the assessment made after the Tax Court proceeding is not itself preclusive, but the Tax Court's redetermination of the amount of the liability subsequently assessed is preclusive.

²⁸⁵⁹ Reg. § 301.6203-1; *March v. IRS*, 335 F.3d 1186, 1188 (11th Cir. 2003).

²⁸⁶⁰ Reg. § 301.6203-1 (providing that the assessment is on the summary record which, through supporting records, "shall provide identification of the taxpayer, the character of the liability assessed, the taxable period, if applicable, and the amount of the assessment.") See also Bryan T. Camp, *The Mysteries of Erroneous Tax Refunds*, 114 Tax Notes 231 (Jan. 15, 2007) & 2007 TNT 11-55 (1/16/07).

²⁸⁶¹ *Id.* See also, *Brafman v. United States.*, 384 F.2d 863, 865-66 (5th Cir. 1967) (assessment invalid where officer does not sign).

²⁸⁶² See Camp, *supra*, at n 9. The RACS 006 form is a summary record of the assessment. See *United States v. Rupe*, 308 Fed. Appx. 777, 779 (5th Cir. 2009) (unpublished) (citing *March v. IRS*, 335 F.3d 1186, 1188-189 (10th Cir. 2003); *Roberts v. Commissioner*, 329 F.3d 1224, 1228 (11th Cir. 2003).) "The RACS report, like the Form 23C, provides, when coupled with 'supporting records,' the information set forth in Treasury Regulation § 301.6203-1." Rev. Rul. 2007-21, 2007-1 C.B. 865, 866.

Section 6203 requires the IRS to furnish the taxpayer a copy of the "record of assessment." Under this provision, the IRS is not required to provide either the 23C originals or the RACS to the taxpayer but may furnish some other document such as the IRS transcript or Form 4340. See *Best v. Commissioner*, T.C. Memo. 2014-72, at *14-*24 (citing authority and holding (i) sanctioning the taxpayer for arguing otherwise and issuing a show cause order for possible sanction of the taxpayer's attorney).

²⁸⁶³ *March v. IRS*, 335 F.3d 1186, 1188 (10th Cir. 2003); and *United States v. Gershon*, 2016 U.S. Dist. LEXIS 167987 (D. Conn. 2016).

²⁸⁶⁴ *Tucker v. Commissioner*, T.C. Memo. 2012-30, at *8 ("A taxpayer receiving a copy of Form 4340 has been provided with all the documentation to which he or she is entitled under section 6203 [and Reg. § 301.6203-1]."), *aff'd*, 506 F. App'x 166 (3^d Cir. 2012).

²⁸⁶⁵ E.g., *United States v. Fior D'Italia, Inc.*, 536 U.S. 238, 242-43 (2002); *March v. IRS*, 335 F.3d 1186, 1188 (10th Cir. 2003); *Hefli v. IRS*, 8 F.3d 1169, 1172 (7th Cir. 1993); *Ford v. Pryor*, 552 F.3d 1174, 1178 (10th Cir. 2008); *Roberts v. Commissioner*, 329 F.3d 1224, 1228 (11th Cir. 2003); *Cole v. Commissioner*, 637 F.3d 767, 773 (7th Cir. 2011).

(continued...)

however, the Form 4340 is not regular on its face or, as to one of its component items (e.g., it states an assessment but does not provide the 23C date), a court might require the IRS to prove the assessment by more direct evidence than the Form 4340.²⁸⁶⁶

I have described the federal income tax system as a “self-assessment” system. As the Supreme Court noted “[t]he word ‘self-assessment,’ however, is not a technical term; as §6201(a) indicates, the IRS executes the formal act of income-tax assessment.”²⁸⁶⁷ The taxpayer reports the amount on the return, and the IRS assesses that amount.²⁸⁶⁸ But the filing of a return showing a tax due is not the assessment; rather the IRS must make the assessment based on the return which, necessarily, occurs sometime after the mailing of a return (a deemed filing date) or even after the IRS actually receives the return.²⁸⁶⁹

B. Effect of Assessment.

1. Assessment Does Not Determine Liability.

An assessment does not mean that the taxpayer owes the tax. It just means that, administratively, the IRS acts as if the taxpayer owes the assessed tax (as well as interest and penalties).²⁸⁷⁰ Most importantly, this means that the IRS will send the taxpayer a bill (called a notice and demand for payment) and, failing payment, will take collection measures. If the taxpayer litigated the issue in the Tax Court prior to assessment, the taxpayer owes the tax, and that is the end of the matter in terms of his liability for the tax. If, however, by the time of assessment, the taxpayer has not yet litigated the liability for the tax, the taxpayer can still litigate the liability if he can meet jurisdictional requirements for litigation. Of course, except in the case of jeopardy and termination assessments, the taxpayer can't litigate in the Tax Court because, generally, the Tax Court is a preassessment remedy (i.e., a remedy made in response to a notice of deficiency which precedes the

²⁸⁶⁵(...continued)

Cir. 2011); *Cropper v. Commissioner*, 826 F.3d 1280, 1287 (10th Cir. 2016); *Davis v. Commissioner*, 115 T.C. 35 (2000); and *United States v. White*, 466 F.3d 1241, 1248 (11th Cir. 2006). Forms 4340 is "are generally regarded as being sufficient proof, in the absence of evidence to the contrary, of the adequacy and propriety of notices and assessments that have been made." *Gentry v. United States*, 962 F.2d 555, 557 (6th Cir. 1992); see also *Davis v. Commissioner*, 115 T.C. 35, 40 (2000).

²⁸⁶⁶ For a good discussion of the general issues see ILM 200048043 (10/16/2000).

²⁸⁶⁷ *Hibbs v. Winn*, 542 U.S. 88, 100 n. 3 (2004).

²⁸⁶⁸ As Justice Kennedy noted in his *Hibbs* dissent (a point as to which there was no disagreement with the majority):

Whether the Secretary or his delegate (today, the Commissioner) makes the recording [of the assessment] on the basis of a taxpayer's self-reported filing form or instead chooses to rely on his own calculation of the taxpayer's liability (e.g., via an audit) is irrelevant. The recording of the liability on the Government's tax rolls is itself an assessment.

²⁸⁶⁹ *Remington v. United States*, 210 F.3d 281, 284 (5th Cir. 2000) (holding that the statute of limitations is based on the date of assessment rather than the earlier date the return was filed); and *United States v. Bishop*, 570 F. App'x 224, 226 (3d Cir. 2014).

²⁸⁷⁰ The Supreme Court has said that “The assessment is given the force of a judgment.” *Bull v. United States*, 295 U.S. 247, 260 (1935). That is not quite right, at least in nuance. Normally, a judgment would have issue preclusive effect as to the liability. An assessment does not preclude the taxpayer from contesting the liability. All it does is permit the IRS to use its nonjudicial enforcement tools (lien and levy) as if the taxpayer owed the liability, as discussed in the text.

assessment). The taxpayer subject to an unpaid assessment may litigate liability in a refund action, provided he meets the payment and claim for refund requirements. He may also litigate liability in a collection suit filed by the Government. Finally, as discussed in Ch. 12 on Collection Procedures, the taxpayer may be able to litigate the liability in a Collection Due Process (“CDP”) case in the Tax Court after the IRS starts procedures to collect the assessment.

To encourage taxpayers to litigate in the Tax Court, § 6404(b) prohibits claims for abatement of assessments in the types of cases where a Tax Court remedy was available (here, income and estate and gift taxes).²⁸⁷¹ Although the statute prohibits claims for abatement in these cases, the IRS is authorized to abate if it determines an assessment to be excessive²⁸⁷² and thus may consider a claim for abatement.²⁸⁷³ Accordingly, although not preferred, formal or informal claims for abatement (e.g., on Form 843, Claim for Refund and Request for Abatement) may actually grab the IRS's attention and result in an abatement of the assessment if clear error is shown, despite the statutory prohibition on claims for abatement.²⁸⁷⁴ Of course, if the abatement in tax assessed results in the taxpayer having paid more than the reduced assessment, the refund can be made only if a timely claim for refund has been made; the value of the abatement after the refund statute has expired for all payments is to reduce an unpaid excessive assessment.

Furthermore, for some of the divisible taxes offering easy access to a minor payment and claim for refund (employment and excise taxes), if the assessment was made after an examination, the IRS generally will not consider a claim for abatement except in unusual circumstances (such as in a jeopardy assessment).²⁸⁷⁵ Generally, if the IRS denies a claim for abatement there is no remedy for the denial. The taxpayer will then have to posture his or her grievance as a refund suit or, if possible, await a collection suit by the Government. Alternatively, the taxpayer can file an offer to compromise an outstanding unpaid assessment asserting doubt as to liability as a basis for compromise. (We cover offers in compromise in the next chapter, so I defer detailed discussion here.) Finally, if the tax assessed arose from an audit, the taxpayer may be able to obtain audit reconsideration relief²⁸⁷⁶ that might result in an abatement of the assessment. (See discussion of audit reconsideration below beginning p. 720.)

You will have noticed that I said the taxpayer can litigate in a collection suit brought by the Government. So, you may ask, why doesn't a taxpayer who feels the IRS assessment was erroneous simply sit back and await a collection suit and then get his or her remedy? The reason is that the

²⁸⁷¹ Since income tax is exempted from claims for abatement, so is claims for abatement for interest on income tax. *Urbano v. Commissioner*, 122 T.C. 384, 395 (2004), and *Kersh v. Commissioner*, T.C. Memo. 2009-260 (2009).

²⁸⁷² The assessment that may be abated may include tax, penalty and interest and may even include a paid assessment. CCA 201520010 (5/15/2015).

²⁸⁷³ § 6404(a)(1).

²⁸⁷⁴ See e.g., 25.6.1.10.1 (10-01-2013), Requests for Abatement.

²⁸⁷⁵ IRM 1.2.13.1.31 (04-10-1967), Policy Statement 4-103; IRM 4.24.8.19 (12-16-2020), Overview of Examination Assessment for Claims (citing Policy Statement 4-103 and the exception for abatement claims for jeopardy assessments). Where the assessment results from a substitute for return under § 6020(b), if the taxpayer thereafter files a return indicating less tax than assessed and the IRS agrees, the IRS will abate the assessment down to the amount of tax to which it agrees. See IRS CCA 200149032 (10/22/01), republished at 2001 IRS CCA LEXIS 222 (12/7/01).

²⁸⁷⁶ See discussion of audit reconsideration below beginning on p. 720.

IRS has a vast arsenal of nonjudicial remedies to collect on the assessment. We study these below, but for here just know that they include, with little more than a stroke of the pen (OK, several pens, all within the IRS), the power to levy—i.e., seize or require the taxpayer or third party to turn over—most all of the taxpayer’s property (e.g., financial accounts and other tangible and intangible assets) and place a lien which, particularly in the case of real estate, will effectively deny the taxpayer the power to alienate the property without settling with the IRS. Given these nonjudicial remedies, the Government generally pursues a collection suit only toward the end of the collection statute of limitations for the assessment (10 years) to refresh the collection statute of limitations by obtaining a judgment lien that then, as a judgment, has a separate and new statute of limitations. Those of you who read and understood the foregoing materials will also remember that the Government will bring a collection suit as a counterclaim to a refund suit in divisible penalty cases such as the responsible person or trust fund penalty cases under § 6672 where the IRS will generally not pursue its nonjudicial collection remedies pending the outcome of the case. But, except in those cases, the IRS will pursue its nonjudicial collection remedies before filing a collection suit; hence, a taxpayer faced with an unpaid assessment as to which he has a basis for claiming that he is not liable for the underlying tax, should explore the alternative methods—offer in compromise and, although less favored and not certain to work, claim for abatement or audit reconsideration.

The IRS may consider claims for abatement of interest and, in some cases, there are judicial remedies available for the denial, although prepayment may be required. See discussion of abatement of interest p. 277.

2. Assessment Permits Collection Measures.

The Supreme Court has tied the importance of the assessment to the Government’s collection measures:

The IRS may employ administrative enforcement methods such as tax liens and levies to collect the outstanding tax, see 26 U.S.C. §§6321-6327, 6331-6344; and the time within which the IRS may collect the tax either administratively or by a proceeding in court is extended [from 3 years] to 10 years after the date of assessment,” see §§6501(a), 6502(a). The Government thus made clear in briefing *Galletti* that, under the IRC definition, the tax “assessment” serves as the trigger for levy and collection efforts.²⁸⁷⁷

The Court of Federal Claims (Judge Allegra) summarized this law:

Cases analyzing these provisions have characterized assessments as serving a “collection-propelling function”—one that facilitates the collection of unpaid taxes. Whereas the IRS may enforce a taxpayer's tax obligations in various ways, its broadest enforcement powers, such as the use of liens and levies, are available only when an assessment is made. See 26 U.S.C. §§ 6331(a), 6322 (lien shall arise "at the time the assessment is made"), 6502. Moreover, where the assessment of any tax

²⁸⁷⁷ *Hibbs v. Winn*, 542 U.S. 88, 102 (2004) (cleaned up).

imposed by this title has been made within the period of limitation properly hereto, the period in which such tax may be collected by levy or by a proceeding in court is extended from three years to 10 years after the assessment. 26 U.S.C. § 6502. Ascribing further significance to the concept, the Supreme Court has long held that the assessment supersedes the pleading, proof, and judgment necessary in an action at law, and has the force of such a judgment. And because an assessment is entitled to a legal presumption of correctness, it can help the government prove its case against a taxpayer in court.²⁸⁷⁸

The assessment for this purpose is the assessment of the tax itself. The assessment will identify the taxpayer but it is the assessment of the tax that is key. Thus, if the assessment is against a general partnership for employment tax (including employee withholding), the general partners in the partnership, may be liable under local law making general partners liable for partnership debt, even without separate assessment against the general partners individually, thus permitting the IRS to pursue collection from the general partners.²⁸⁷⁹

IV. Erroneous Refunds.

See discussion of erroneous refunds beginning p. [248](#).

²⁸⁷⁸ *Principal Life Insurance Co. v. United States*, 95 Fed. Cl. 786 (2010) (cleaned up).

²⁸⁷⁹ *United States v. Galletti*, 541 U.S. 114 (2004).

Ch. 12. Collection Procedures.

I. Introduction.

Once assessed, the tax is shown on the IRS's books as due. The focus of this chapter is the procedural aspects of collecting tax that the IRS's books show as due. (It is important to note that the critical event showing the tax due is the assessment, but the assessment itself is not preclusive of whether the taxpayer actually owes the assessed tax.)

As you can imagine, the IRS collection function is big and complex. Meaningful action to collect unpaid tax with limited resource allocation can be quite daunting and requires significant potential interaction between the IRS and taxpayers. I present in this Chapter some of the details of the collection function that the practitioner needs to know. At this point, however, I want you to see the big picture. This is just a debt collection process that must be managed as efficiently as possible, balancing costs of collecting against benefits to be derived. Imagine the functional steps the IRS would need to go through to collect a tax debt.

- *Assessment.* In order to collect a debt there must be a debt. In tax parlance, while the taxpayer may owe the tax in a general sense from the due date of the return (or other date of liability), for collection purposes, the debt generally must be assessed in order for the IRS to invoke its Collection Tools noted below.
- Request / Demand Payment from the Taxpayer. Upon assessment, the IRS generates correspondence to the taxpayer notifying the taxpayer of the assessment and demanding payment of the assessment. The initial requests / demands are computer generated communications, followed by a series of letters, then by telephone contact, and then in person contact by an IRS employee commonly referred to as a collection officer (or revenue officer). Some of these contacts will advise the taxpayer of the IRS tools that might be employed to collect the tax due and owing if the taxpayer does not pay promptly or work with the IRS in determining a fair resolution of the tax liability. During this phase, there is little need for active practitioner activity, because these are just requests, and there is no immediate compulsory action that might prejudice a taxpayer. The practitioner might be called upon to advise of consequences of not paying and what action might be taken to mitigate the damage.
- Collection Tools. If the foregoing series of requests / demands do not resolve the matter, then the IRS will consider its array of collection tools which are principally, liens, levies and setoffs. During this phase, there often is need for active practitioner involvement to mitigate the damage.
- Related Functions. If these tools do not full collect the tax debt, the IRS has related functions that offer installment plans, compromises of the tax debt and write off of the tax debt. These are all worked through the IRS collections procedures.

The key IRS line player with whom taxpayers and their representatives deal in the collection function is usually referred to as the collection officer. Because of certain risks in the collection of taxes, some IRS personnel may be identified via pseudonyms rather than with their real names.²⁸⁸⁰

II. Assessment.

I have discussed the Assessment Procedures in Chapter 11 beginning p. 658. Suffice it to say here that an assessment is generally required for the IRS to invoke collection tools.²⁸⁸¹

III. Notice and Demand for Payment.

As soon as practicable and within 60 days after the assessment, the IRS must send notice to the taxpayer of the assessment and demand payment. § 6303(a).²⁸⁸² (This is often referred to as “the notice and demand for payment” or simply “notice and demand.”)²⁸⁸³ Like the requirement discussed earlier for the notice of deficiency, the notice and demand must be sent properly to the taxpayer; it need not be received by the taxpayer.²⁸⁸⁴

The IRS has administrative procedures that ensure that the notice and demand is automatically sent contemporaneously with the assessment. These procedures sometimes fail, and the notice and demand is sometimes not sent or not sent within the required 60 days. Does that mean that the assessment is invalid? The answer is no. The assessment is valid. Is there a “cost” or “penalty” to the IRS for failure to satisfy the statutory command provide the notice or to provide it timely. The cost to the IRS for not providing notice at all is that the IRS may not use the administrative collection remedies (most prominently levy and filed lien, that I discuss below), but the IRS can sue to reduce the assessment to judgment and then collect on the judgment.²⁸⁸⁵ But, if

²⁸⁸⁰ A noncodified statute permits the use of pseudonyms. See § 7804, Note, referring to Pub. L. 105–206, title III, § 3706, July 22, 1998, 112 Stat. 778; IRM 10.5.7 Use of Pseudonyms by IRS Employees. Use of pseudonyms must be approved by the employee’s supervisor in advance. 10.5.7.4 (08-13-2021), Requesting an IRS Pseudonym . The taxpayer and the representative will not be advised of the use of the pseudonym, but there is really no reason to advise because the actions taken and consequences are not affected by the name used. If the agent using a pseudonym testifies in court or signs court documents, the document or testimony must indicate that the name is a pseudonym. IRM 10.5.7.9 (11-19-2010), Pseudonym Holders, the Courts and Legal Matters.

²⁸⁸¹ The exception appears to be for unassessed interest on a tax debt that has been assessed. *Stevens v. United States*, 49 F.3d 331 (7th Cir. 1995); see also Bryan Camp, Lesson From The Tax Court: A Lesson Of Interest (Tax Prof Blog 6/21/21) (discussing *Stevens* as an affirming the aberrational rule that assessment of interest is not required for collection activity).

²⁸⁸² The IRS sends Publication 594 with its notice of tax due and demand for payment. That publication advises the taxpayer of the collection process in straightforward nontechnical manner.

²⁸⁸³ The notice and demand requirement is satisfied by IRS notice of a balance due. *Craig v. Commissioner*, 119 T.C. 252, 260-61 (2002).

²⁸⁸⁴ *Hansen v. United States*, 7 F.3d 137, 138 (9th Cir. 1993); and *United States v. Chila*, 871 F.2d 1015, 1019 (11th Cir. 1989). The IRS usually proves the proper sending of the notice by Form 4340, which raises a presumption that the notice was sent as reflected on the Form 4340 which the taxpayer must then rebut. *Chila*, p. 1019.

²⁸⁸⁵ *United States v. McCallum*, 970 F.2d 66,69-70 (5th Cir. 1992); and *United States v. Berman*, 825 F.2d 1053 (6th Cir. 1987); and cf. *Jersey Shore State Bank v. United States*, 479 U.S. 442 (1987) (involving third party lender liability under § 3505).

the IRS provides the notice outside the 60 day period, there appears to be no cost or penalty because the IRS can use the administrative collection tools.²⁸⁸⁶

The notice and demand for payment triggers three key consequences. First, a lien arises in favor of the IRS.²⁸⁸⁷ This lien is sometimes referred to as the general tax lien, the automatic tax lien or even the secret or silent tax lien, because it arises upon the mere assessment, demand for payment, and nonpayment of the tax and requires no other filing anywhere or even notice to the taxpayer or to third parties.²⁸⁸⁸ Second, the notice and demand permits the IRS to use its administrative collection measures, including filed tax lien and levy. I discuss those measures in this chapter: they are formidable indeed. Note that the notice and demand is not a predicate for other actions, particularly judicial actions for the tax liability in a collection suit (or its equivalent, a counterclaim in a refund suit).²⁸⁸⁹ Third, the failure to pay penalty discussed earlier will accrue from the date of notice and demand unless the assessed amount is paid within 21 days.²⁸⁹⁰ The failure to pay penalty may be avoided by showing that the failure to pay is due to reasonable cause and not willful neglect. § 6651(a)(2).

If the issue of notice and demand for payment arises in litigation, the IRS will usually rely upon a Form 4340, Certificate of Assessments and Payments, which is a formal certification by an IRS official reporting the key events in underlying IRS records related to the liability (e.g., the assessment, notice and demand for payment, all payments made, etc.). The Form 4340 is not the underlying record itself, but simply summarizes the underlying records. To rebut the Form 4340, the burden will then be upon the taxpayer to introduce that the notice and demand was not sent.²⁸⁹¹

After assessment and not less than annually, the IRS must send the taxpayer a notice of the balance due as of the date of the notice.²⁸⁹²

²⁸⁸⁶ See Reg. § 301.6303-1(a) (“However, the failure to give notice within 60 days does not invalidate the notice.”); and PMTA 2011-25 (8/3/11) (concluding “notice and demand provided outside the 60-day period is still valid, and administrative collection can still proceed.”).

²⁸⁸⁷ §§ 6321 & 6331. See *United States v. Coson*, 286 F.2d 453 (9th Cir. 1961); *United States v. Berman*, 825 F.2d 1053 (6th Cir. 1987) (but holding that, despite the nonexistence of the lien because no notice of deficiency, the IRS may sue on the tax liability and obtain judgment, although it could not use its administrative powers); *United States v. Chila*, 871 F.2d 1015 (11th Cir. 1989), cert. denied, 493 U.S. 975 (1989) (same).

²⁸⁸⁸ § 6321.

²⁸⁸⁹ E.g., *Anuforo v. Commissioner*, 614 F.3d 799, 805 (8th Cir. 2010) and cases cited therein.

²⁸⁹⁰ § 6651(a)(3) (discussed beginning p 372).

²⁸⁹¹ The Government would have the burden of proof on the issuance of a proper notice and demand for payment. The use of the Form 4340 serves to do that by, in effect, shifting from the Government to the taxpayer some burden to prove that the notice and demand was not sent. The precise burden shifted to the taxpayer is not clear in my mind. Some courts say that the Form 4340 indication of timely mailing prevails unless the taxpayer establishes affirmatively that the notice and demand required by § 4340 was not sent. E.g., *United States v. Chila*, 871 F.2d 1015, 1019 (11th Cir. 1989). This would suggest that the Form 4340 shifts the burden of persuasion to the taxpayer. Other courts suggest that the Form 4340 is presumptive or prima facie proof of notice and demand, which uses language that something like a production burden on the issue is shifted to the taxpayer. E.g., *Davis v. Commissioner*, 115 T.C. 35, 40 (2000). It seems to me that the latter nuance is the proper one since it is the Government’s burden to prove proper notice and demand under § 6303.

²⁸⁹² § 7524.

IV. Payment Issues.

If the taxpayer can pay after receipt of the notice and demand, the taxpayer should do so. Paying will avoid (i) the late payment penalties from accruing,²⁸⁹³ (ii) further accrual of interest and (iii) the taxpayer being subject to IRS collection measures. Payment will pretty much conclude the matter except where the taxpayer desires to file a claim for refund and, if denied, then sue for refund.

Most of this chapter will deal with the taxpayer who does not pay the assessment in full.

Some taxpayers otherwise able to pay some or all may seek your advice on how to hold off payment so that they can use their funds in what they perceive for more rewarding purposes. You will have to advise them of the costs of doing so—most specifically, the failure to pay penalty and the interest costs discussed in earlier chapters. You might also warn them that the Government and ultimately a jury may believe that the taxpayer’s perception of more rewarding purposes was really just an attempt to evade payment, which as noted above is a felony crime with significant penalties. Neither you nor the client will want to take that risk if you can avoid it.

I focus now on the issues confronting the taxpayer in making the payment of less than the amount of the IRS assessment. The question here is whether the taxpayer can designate as among the various components of aggregate tax owed (e.g., as among years or within the same year as among taxes, penalties and interest).

The taxpayer is permitted generally to so designate the allocation of a voluntary payment to the IRS between or among the tax liabilities involved.²⁸⁹⁴ Voluntary for this purpose means any payment not resulting from the Government’s compulsory collection measures (e.g., levy) discussed later in this chapter.²⁸⁹⁵ If the payment is not voluntary or the taxpayer fails to designate the application of the payment, the IRS can apply the payment as it sees fit.²⁸⁹⁶

²⁸⁹³ § 6651(a)(3) (failure to pay after notice and demand).

²⁸⁹⁴ Rev. Proc. 2002-26, 2002-1 C.B. 746. See *United States v. Energy Resources Co.*, 495 U.S. 545, 548 (1990); and *Dixon v. Commissioner*, 141 T.C. 173 (2013) (for an extreme application of this concept to permit the taxpayer to designate the application of the payment); but see nonacquiescence to the holding in *Dixon*, AOD 2014-01; 2014-38 I.R.B. 1).

This voluntary payment rule does not apply to an overpayment which, pursuant to § 6402(a), the IRS credits to another tax liability rather than refunds to the taxpayer. *Bryant v. Commissioner*, T.C. Memo. 2009-78.

²⁸⁹⁵ See *Amos v. Commissioner*, 47 T.C. 65 (1966). See IRM 1.2.14.1.3 (06-09-2003), Policy Statement 5-14 (Formerly P-5-60) (For the trust fund recovery penalty (“TFRP”), “[t]he taxpayer, of course, has no right of designation of payments resulting from enforced collection measures.”). In *Melasky v. Commissioner*, 151 T.C. 93 (2018), aff’d 803 Fed. Appx. 732 (5th Cir. 2020), the taxpayer attempted a voluntary payment by sending a check to the IRS when there were sufficient funds to clear. Before the check cleared, the IRS levied on the account, thus causing the account to have insufficient funds, so it bounced back to the IRS. A levy is not a voluntary payment. The taxpayer complained that the IRS should honor the voluntary payment by check because its levy caused the check to bounce. The Tax Court declined to order the IRS to treat the check as a voluntary payment. The concurring opinion notes that the taxpayer could have achieved the result by cashier’s check, which would make the funds behind the check unleviable.

²⁸⁹⁶ See *Estate of Baumgardner v. Commissioner*, 85 T.C. 445 (1985); *United States v. Schroeder*, 900 F.2d 1144, 1149 (7th Cir. 1990); and *Sotir v. United States*, 978 F.2d 29, 30 (1st Cir. 1992).

Designation may be critical in certain cases. I give examples which are by no means exhaustive, but should illustrate the concepts:

Example 1: We considered above that a taxpayer unable to pay the total amount assessed (tax, penalties and interest) may be able to satisfy the jurisdictional prerequisite for income tax refund litigation by paying only the tax or only the penalty. When that “partial” payment for the year is employed to establish jurisdiction, it is important for the taxpayer to designate the application of the payment to the tax or penalty to meet *Flora*’s full payment requirement.

Example 2: A taxpayer subject to a trust fund tax recovery penalty under § 6672 (“TFRP”) who desires to contest the liability with the minimum payment must ensure that he meets the required minimum payment for at least one quarter. The standard technique is to pay for one quarter, with a specific payment designation (see text at p. 793). If he fails to do so, the IRS may apply any payment as it sees fit, and, as applied, the minimum jurisdictional amount paid may not be satisfied.

Example 3: In planning at the employer level to minimize the potential application of the TFRP, the employer in making payments to the IRS should consider designating that the payments are for the trust fund taxes rather than any other taxes or penalties (even employer penalties for failure to pay the trust fund taxes) the employer may owe.²⁸⁹⁷ To illustrate, if a corporate employer owes delinquent corporate income taxes and penalties as well as trust fund taxes, the corporate employer should consider designating payments to the trust fund taxes. The reason is that, if the corporation goes belly up, its nontrust fund taxes will be collectible only from the corporate assets based upon bankruptcy priorities (and thus may not be collectible at all), but its trust fund taxes will follow and be collectible from the responsible persons.²⁸⁹⁸

Example 4: The taxpayer may desire to designate some or all of the payment as interest rather than as principal. One reason the taxpayer may do so is to get a current deduction for the interest.²⁸⁹⁹

²⁸⁹⁷ See as to trust fund taxes, IRS Policy Statement P-5-14(10) (“Any payment made on the business account is deemed to represent payment of the nontrust fund portion of the tax liability (e.g., employer’s share of FICA) unless designated otherwise by the taxpayer.”).

²⁸⁹⁸ Barring some other consideration, in a single type of tax situation (e.g., income tax), the IRS generally applies payments first to tax, penalty and interest, in that order, for the earliest year involved, and then to tax penalty and interest, in that order, for each successive period. Rev. Proc. 2002-26, 2002-1 C.B. 746. However, where the IRS may maximize the revenue by some other allocation, it may make that allocation. *Id.* Undesignated payments may be applied as the IRS deems in its best interest with the payments first going to the nontrust fund portion. Furthermore, even if the payment is designated to trust fund taxes without designating the quarters, the IRS may allocate among the quarters in a way to maximize its collection potential and even may re-allocate if its first allocation did not achieve the best result for the IRS. See *Davis v. United States*, 961 F.2d 867 (9th Cir. 1992) (noting that the taxpayer waived any interest in the allocations because of his failure to designate the quarters); *Thomas v. United States*, No. 961488, 1998 WL 892617, at 14-*6 (C.D. Ill. Sept. 16, 1998). For an example of the IRS applying undesignated payments to the employer’s penalties rather than the trust fund taxes, see *In re: Southeast Waffles, LLC v. United States*, 2012 U.S. App. LEXIS 24991 (6th Cir. 2012) (although not discussed, the net effect of this is to expose the responsible persons to the § 6672 penalty where by designating to paying the trust fund taxes they could have avoided that penalty); *Westerman v. United States*, 718 F.3d 743 (8th Cir. 2013) (no legal or equitable requirement to apply undesignated payments to the trust fund penalty portion); see also *Gann v. United States*, 2017 U.S. Claims LEXIS 222 (2017) (citing *Westerman*).

²⁸⁹⁹ Deficiency interest is not deductible to the individual taxpayer but would be to the corporate taxpayer.

Example 5: The taxpayer may desire to designate the years to which the payment is to be applied. To use an extreme example, a taxpayer owing taxes for years 1 and 2 which were assessed 9 and 8 years ago, respectively, might consider making a payment of the Year 2 tax in the hope that the IRS will allow the statute of limitations to lapse on Year 1 without pursuing a collection suit to reduce the assessment to judgment.

How does the taxpayer make the designation? The designation should be in a written transmittal letter accompanying the payment, as well as being indicated on the check.²⁹⁰⁰

In the foregoing discussion, I have assumed that the payment occurs after assessment. As discussed above, however, a taxpayer facing an audit may desire to make a pre-assessment payment. Can the taxpayer designate how a pre-assessment payment is made? Generally, advance payments should be applied according to the taxpayer's instructions.²⁹⁰¹

V. Administrative Follow-Throughs; Notice of Intent to Levy.

If the taxpayer does not pay promptly after the notice and demand is sent, the IRS's computers generate a series of letters reminding the taxpayer that the taxpayer owes the tax debt and should pay. The final of the series of three or four letters advises the taxpayer that the IRS intends to use its nonjudicial remedies (e.g., levy) to collect the tax liability. Except in case of jeopardy, the formal written notice of intent to levy at least 30 days in advance is a condition precedent to an actual levy. § 6331(d).²⁹⁰² The IRS must include in the notice certain information regarding the levy, including the Code provisions and procedures regarding levy, the administrative appeals, including Collection Due Process ("CDP"), available, collection alternatives such as installment agreements and offers in compromise.²⁹⁰³ Suffice it to say at this point, the administrative effort is designed to encourage the taxpayer to pay without further action by the IRS.

In addition to the series of letters, the IRS has an Automated Collection System ("ACS") which automates telephone contacts with taxpayers. I won't get into the mechanics of that system, but it is designed to have the taxpayers talk with live IRS employees who have their information on a screen when the taxpayers answer the call.

As we will see, the IRS has several collection measures that it can marshal against the taxpayer and make the taxpayer uncomfortable. The goal in collection representation is to encourage the IRS not to be draconian and to be as nice as possible to the taxpayer. The best thing the taxpayer can do is to present himself or herself as a reasonable person, seriously concerned about this liability but simply unable to pay it. Accordingly, although the series of demand letters are for payment and not for excuses, the taxpayer is well advised to write the computer back asking that the case be

²⁹⁰⁰ Verbal designations are risky. *Kinnie v. United States*, 994 F.2d 279 (6th Cir. 1993). The IRM states that the "the request or designation for the application of the payment must be specific, in writing, and made at the time of the [voluntary] payment." IRM 8.25.2.4.4.2 (09-05-2018), Voluntary Payments (for TFRP payments).

²⁹⁰¹ See e.g., Rev. Proc. 84-58, 1984-2 C.B. 501 (relating to payment/deposit designations).

²⁹⁰² A parallel and overlapping notice requirement is in § 6330(a). For useful information as to current IRS practice for the overlapping requirements, see Keith Fogg, Misleading Taxpayers with Collection Letter (Procedurally Taxing Blog 12/2/16).

²⁹⁰³ § 6331(d)(4).

assigned to a real live Revenue Officer to discuss the matter. The letter likely will not be read at the Service Center by anyone who really cares, but it may be part of the files when it gets to a Revenue Officer. The Revenue Officer will see that this taxpayer is concerned enough to try to do the right thing even though he or she cannot now pay the liability. By contrast, Revenue Officers commonly encounter taxpayers who ignore the demand letters and that gives a bad taste from the start. The simple act of writing back may set a helpful tone for the collection activity.

That same tone should be set throughout the collection activity after a Revenue Officer contacts the taxpayer. In all dealings with the Revenue Officer, the taxpayer or his or her representative should respond timely, should not be evasive, and should be cooperative. If the Revenue Officer ever begins to believe that the taxpayer or the representative is not acting in good faith, there are a host of responses the Revenue Officer can take, many of which are not in the taxpayer's best interest.

VI. The Tax Lien.

A. General “Secret” Lien Upon Assessment and Failure to Pay.

A tax lien—called a federal tax lien (“FTL”)—arises by operation of law against all of the taxpayer's property, including after-acquired property, upon assessment, notice of assessment and failure to pay. § 6321.²⁹⁰⁴ The FTL itself does not affect ownership or possession of the property; rather, the purpose of the lien is to determine priorities between or among creditors.

The amount of the FTL is the unpaid tax plus “any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto.”²⁹⁰⁵ The scope of the lien “is broad and reveals on its face that Congress meant to reach every interest in property that a taxpayer might have.”²⁹⁰⁶ This lien is frequently referred to as the “general tax lien,” to distinguish it from the special subcategory of the filed tax lien—i.e., the general tax lien (FTL) that is filed to give public notice of the lien and to give the IRS preference from most claimants whose rights and preferences accrue after the filing. The general tax lien continues until the tax giving rise to the lien is paid or becomes unenforceable pursuant to the statute of limitations (which discussed below). § 6322.²⁹⁰⁷

²⁹⁰⁴ This act and related provisions are often referred to as the Federal Tax Lien Act.

²⁹⁰⁵ Id.

²⁹⁰⁶ *United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 719-720 (1985).

²⁹⁰⁷ § 6322 doesn't say statute of limitations but says that the lien continues until it “becomes unenforceable by reason of lapse of time.” This language is interpreted to mean the lapse of the collection statute of limitations. IRM 5.17.2.2.2(1) (03-27-2012), Duration of the Federal Tax Lien (“The federal tax lien continues until the liability for the amount assessed is satisfied or becomes unenforceable by reason of lapse of time, i.e., passing of the collection statute expiration date (CSED)”; CSED is the IRS acronym for the collection statute expiration date for assessments. IRM 5.1.19.1.1 (02-07-2020), Background (“The collection statute expiration ends the government's right to pursue collection of a liability.”).

The tax lien must be “choate”²⁹⁰⁸ to be valid. A lien is choate if the following are known: (1) the identity of the lienor, (2) the property subject to the lien, and (3) the amount of the lien.²⁹⁰⁹ Generally, tax liens easily meet this requirement. The assessment itself identifies the taxpayer and the amount. All of the taxpayer’s property is subject to the lien. There is no requirement that the taxpayer’s property be identified in the assessment or in the IRS’s records. All that is required is that the property be identifiable.

What does the general tax lien do in the real world? To address that issue, we must understand the difference between an unfiled tax lien and a filed tax lien. The automatic lien upon assessment, notice of demand and nonpayment is an unfiled tax lien. Third parties have no notice of this lien. For this reason, the general, unfiled lien is sometimes referred to as a secret lien.²⁹¹⁰ Only the IRS and the taxpayer know about it (assuming of course that the taxpayer actually receives the notice and demand for payment). Another consequence is the potential for the perception of stigma to existence of a tax lien—because it arises only after a taxpayer has failed to meet the obligation to pay. Most of the familiar liens in the creditors’ universe—such as purchase money mortgages—arise before the debtor has failed in meeting his payment obligations. But the mere existence of the tax liens indicates a debtor in default, which may have a certain stigma. So long as the lien is secret, this may not be that much of a problem. So, we discuss below the filed tax lien placing the public on notice or constructive of the lien.²⁹¹¹

B. Lien is Not Self-Executing.

A lien is not self-executing; it simply represents a claim against property and the IRS must take further action to enforce the lien, such as filing the lien, a levy (i.e., a seizure of property subject to the lien) or a judicial action to foreclose on the lien.²⁹¹² In the meantime before such further action, however, the existence of a **filed** tax lien can impair the taxpayer’s ability to deal with the property, although as we will note certain persons acquiring an interest in a taxpayer’s property after the lien arises may be able to stand ahead of the IRS’s claim pursuant to the lien.

C. The Filed Tax Lien.

The IRS can gain additional protection for its lien by filing a Notice of Federal Tax Lien (“NFTL”).²⁹¹³ The NFTL must be filed in the appropriate county or state records to put third parties on notice of the IRS’s claim so as to protect the IRS from the claims of parties who reasonably could

²⁹⁰⁸ The term choate has become a term of art in the law, although Judge Posner has pithily noted that it “is a barbarism.” *Bloomfield State Bank v. United States*, 644 F.3d 521 (7th Cir. 2011) (providing the etymology and use and misuse of the word).

²⁹⁰⁹ *United States v. City of New Britain*, 347 U.S. 81(1954).

²⁹¹⁰ See *Wadleigh v. Commissioner*, 134 T.C. 280, 289-290 n. 8 No. 14 (2010), citing *Hult v. Commissioner*, T.C. Memo. 2007-302.

²⁹¹¹ Shu-Yi Oei, The Uneasy Case Against Tax Lien Subordination, 11 Pitt. Tax Rev. 241, 249 at n. 19 (2014) (citing “numerous adverse effects on a taxpayer’s financial viability (in terms of job applications, loan applications, ability to rent property, or ability to refinance) that follow an NFTL filing.”)

²⁹¹² *EC Term of Years Trust v. United States*, 550 U.S. 429, 430 (2007).

²⁹¹³ § 6326(a) & 6236(f). The form for this filed notice is Form 668(Y)(c), Notice of Federal Tax Lien (“NFTL”).

have been on notice of the IRS's lien by checking the records. The filing of the NFTL puts third parties on constructive notice of the tax lien.²⁹¹⁴ The principal significance of filing the lien relates to priorities between the IRS and third parties claiming interests in the taxpayer's assets²⁹¹⁵ I cover priorities beginning p. 700).

I discuss below the role of tax lien filings in the system. Suffice it to say here that public filing can have serious effects on a taxpayer's credit and business reputation generally because the fact of the tax delinquency is available to creditors and others (e.g., credit services) willing to check the records. Given these consequences, which can be serious, Congress has given taxpayers certain rights with respect to the filing of tax liens. The IRS must notify the taxpayer in writing of the filing of the tax lien²⁹¹⁶ and in the notice must:

- explain, in simple terms, the amount of unpaid tax, administrative appeal rights available to the taxpayer, and provisions of the law and procedures relating to the release of the lien on the property (including the possibility of “denial, revocation, or limitation” of the taxpayer’s passport for “seriously delinquent tax debts” under § 7345).²⁹¹⁷
- advise the taxpayer of the right for a CDP hearing under § 6320 (including the procedural steps require to invoke the right, including the critical 30-day period to invoke the right. I deal in more detail with these rights below under the heading Collection Due Process.
- give the taxpayer the notice in person, leave the notice at the taxpayer’s home or business address, or send the notice by certified or registered mail to the taxpayer’s last known address.²⁹¹⁸

²⁹¹⁴ Normally, state law governs the adequacy of the notice to the public via a lien filing. However, the adequacy of federal tax liens is governed by federal law rather than state law. Reg. § 301.6323(f)-1(d); and *United States v. Union Cent. Life Ins. Co.*, 368 U.S. 291, 296 (1961). For example, in *United States v. Crestmark Bank*, 412 F.3d 653 (6th Cir. 2005), the state had a computer based search system for its lien filings. The search system was an exact name search that did not take into account common variations in spelling or common abbreviations. The creditor searched only for the exact name. Had the creditor searched for common variations and abbreviations, the creditor would have discovered the tax lien. Apparently, for state law purposes, the creditor’s search would have been adequate to avoid notice of the prior lien. For federal tax law purposes, it was not. Here, of course, the question was whether the search under the circumstances was reasonable and the court found it lacking. This particular problem will likely be unimportant into the future as database search systems now usually permit fuzzy searching. See *United States v. Montesinos*, 2012 U.S. Dist. LEXIS 134328 (S.D. N.Y. 2012) (sustaining the priority of the federal tax lien where only minor misspelling that would have been picked up via multiple field searches and “sounds like” searches that was available and would have put the creditor on noticeable; this is a well written opinion of substantial compliance). However, the point is that federal law, not state law, p adequacy of the search.

²⁹¹⁵ *Romano-Murphy v. Commissioner*, 152 T.C. 278, 294-295 (2019).

²⁹¹⁶ § 6320(a)(1). The notice is by Form 668(Y), Notice of Federal Tax Lien. The Notice is accompanied by Letter 3172, Notice of Federal Tax Lien Filing and Your Rights to a Hearing Under I.R.C.3 6320. The notice is given to the taxpayer, “the person liable to pay the tax due after notice and demand who refuses or neglects to pay the tax due (hereinafter, referred to as the taxpayer).” Reg. § 301.6320-1, Q&A A-1.

²⁹¹⁷ § 6320(a)(3). § 7345 is discussed beginning p. 729,

²⁹¹⁸ § 6320(a)(2). This parallels the requirement of many notices the IRS is required to give taxpayers. Most prominently, the issue has arisen over the years with respect to the notice of deficiency, which, like the NFTL, gives notice of the taxpayer’s right to proceeding (the notice of deficiency the right to the Tax Court and the NFTL the (continued...)

Where is the filing made? That is determined by state law.²⁹¹⁹ Most states have adopted the Uniform Federal Tax Lien Registration Act, but there may be some differences among the states. Generally, notices of tax liens for real property are filed in the county in which the real property is located;²⁹²⁰ notices for other property (personal property) are generally filed in the county of the individual taxpayer's residence (not necessarily the same as last known address)²⁹²¹ or, in some cases, the office of the state's Secretary of State (or equivalent state office) or other central filing office designated by state law. State law should be consulted. For the rights secured to the IRS by filing the tax lien, the tax lien is deemed filed and perfected by filing whether or not the office in which it is filed properly files the notice or properly indexes it (meaning that, if misfiled or mis-indexed, it does not put the public on notice, but the public is deemed to have notice).²⁹²² Stated otherwise, the risk of being misfiled or mis-indexed is on those parties who could otherwise benefit from actual notice by checking the records.

This hodge-podge of state law and the resulting inefficiencies to both the IRS and to third parties who have to check the public filings have generated a call for a National Tax Lien Registry that would be more easily accessible—e.g., over the internet.²⁹²³ As envisioned, the National Tax Lien Registry would achieve significant efficiencies that will result in savings to the IRS and to third parties having to check for such public notices. From my perspective, this proposal seems like a “no brainer” to improve the efficiency of the system, but then there will be politics involved that may interfere with efficient decision making on the subject.

²⁹¹⁸(...continued)

right to a CDP hearing that then can be appealed to the Tax Court). This notice requirement of mailing to the last known address does not assure that the taxpayer receives the notice—just that it be properly sent. So, the taxpayer may not invoke the procedure timely simply because he did not receive the notice. With respect to the NFTL, the fallback remedy for a taxpayer who did not receive notice is a request for “equivalent hearing proceeding” which will permit a procedural administration appeal but will not give the taxpayer access to the Tax Court. Because this fallback remedy does not include judicial review, TIGTA has sparred with IRS management over the importance of re-sending the notice if there is an indication that the taxpayer did not receive it (most commonly, a return to IRS marked undelivered). TIGTA, Fiscal Year 2017 Statutory Review of Compliance with Notice of Federal Tax Lien Filing Due Process Procedures 4-7 (Ref 2017-30-070 9/18/17).

²⁹¹⁹ § 6323(f)(1).

²⁹²⁰ § 6323(f)(2)(A) (Situs of real property).

²⁹²¹ § 6323(f)(2)(B) (establishing situs in the county of residence, but presumably state law could provide some alternative place of filing). Residence was chosen over domicile (the prior test) because of the difficulty of determining domicile. *Corwin Consultants, Inc. v. Interpublic Group of Cos.*, 512 F.2d 605, 608 (2d Cir. 1975). Residence for this purpose is not the same as the taxpayer's last known address to some statutory notices are sent. See *In re Stephenson*, No. 21-22684-H, 2022 Bankr. LEXIS 1906 (Bankr. W.D. Tenn. June 17, 2022). Taxpayer used her mother's address for return filing because of taxpayer's periodic changes of residence; the IRS filed the federal tax lien in the county of her mother's residence (the address on taxpayer's most recent tax return, thus being her last known address) rather than in the county of taxpayer's residence in another state; thus, IRS was a general unsecured claim in the bankruptcy); see also Bob Probasco (Guest Blogger), Filing a Notice of Federal Tax Lien For Personal Property (Procedurally Taxing Blog 7/15/22) (discussing *Stephenson*).

²⁹²² *Tracey v. United States*, 394 B.R. 635 (1st Cir. Bkr. Panel 2008) (citing inter alia *Hanafy v. United States*, 991 F. Supp. 794 (S.D. Tex. 1998) (involving failure to properly index a filed tax lien; IRS not required to ensure that lien is properly indexed)); and *Adams v. United States*, 420 F. Supp. 27 (S.D.N.Y. 1976).

²⁹²³ See Levin Announces Bill to Modernize Lien System, 2007 TNT 75-38; and T. Keith Fogg, National Tax Lien Registry, 120 Tax Notes 783 (Aug. 25, 2008)

Finally, § 6323(j)(1) gives the IRS discretionary authority to withdraw the NFTL if it determines.²⁹²⁴

- the filing of the lien was “was premature or otherwise not in accordance with administrative procedures.”
- the taxpayer has entered into an offer in compromise to satisfy the taxpayer in installment payments.
- the withdrawal “will facilitate the collection of the tax liability.”
- the withdrawal “would be in the best interests of the taxpayer (as determined by the National Taxpayer Advocate) **and** the United States,” provided that either the taxpayer or the TAS consents.

If the NFTL is so withdrawn, the collection procedures “shall be applied as if the withdrawn notice had not been filed.”²⁹²⁵ That is to say that the collection procedures are authorized by the general tax lien and not the NFTL.

VII. Statute of Limitations.

We previously covered the statute of limitations on collections (beginning p. 215). The general rule is that the statute of limitations is 10 years from the date of assessment. § 6502(a). As with the statute of limitations on assessment, the statute of limitations on collection is suspended by certain events suspending collection measures or making collection more difficult, the most significant of which are:

1. Filing of an offer in compromise.²⁹²⁶ I discuss offers in compromise below. During the pendency of the offer, the IRS generally is prohibited from taking collection measures, so there is a corollary suspension of the statute of limitations while an OIC is pending.²⁹²⁷

2. Filing of a CDP Proceeding. Collection measures are generally suspended during CDP proceedings. The collection statute of limitations is suspended on while a CDP proceeding and any appeals are pending and for a period of 90 days after the proceeding become final.²⁹²⁸

3. Extended absence from the United States. If the taxpayer is outside the United States for a period of at least 6 continuous months, the statute is extended during the period of absence.²⁹²⁹ Further, to provide the IRS time to act upon the taxpayer’s return after such absence from the United States, the statute of limitations will not expire before 6 months after his or her return.²⁹³⁰

²⁹²⁴ The Tax Court has described the authority as “permissive.” *Banks v. Commissioner*, T.C. Memo. 2019-166, at *14.

²⁹²⁵ Id.

²⁹²⁶ Reg. § 301.7122-1T(h)(2).

²⁹²⁷ § 6331(k)(1).

²⁹²⁸ § 6330(c), (d) and (e) and § 6320(c).

²⁹²⁹ § 6503(c).

²⁹³⁰ Id.

4. Filing for bankruptcy. To the extent that the taxpayer's tax liability is not discharged in the bankruptcy proceeding, the statute of limitations is suspended (a) during the period of the stay preventing the IRS from collecting outside the bankruptcy and (b) 6 months thereafter.²⁹³¹

5. Extended Estate Tax Payment Period. As discussed elsewhere, the Code in some instances permits an extended period for paying the estate tax. The most commonly encountered instance is under § 6166 permitting deferral of the portion of the estate tax attributable to closely held businesses where they are a major asset of the estate. The collection period of limitations is suspended during the period of the extended payout period.²⁹³²

6. Extensions by Agreement. The IRS and taxpayers may extend by agreement if the extension is (1) agreed to at the same time as an installment agreement between the taxpayer and the Service, or (2) agreed to prior to a release of levy under § 6343 which occurs after the expiration of the statutory ten-year period for collection.²⁹³³

After the application of the foregoing rules, the IRS can further extend its ability to collect by obtaining judgment on the lien, whereupon the underlying liability is then subject to the 10 year statute of limitations for judgment liens.²⁹³⁴ The suit to obtain judgment must be filed within the collection period of limitations under the foregoing rules.²⁹³⁵ Note that, technically, this does not extend the collection of the tax but creates a new debt—the judgment which has an independent statute of limitations.

VIII. Setoffs/Offsets.

A. Statutory Right to Setoff Overpayments / Refunds.

The Code gives the IRS discretionary authority to credit refunds, referred to as overpayments, otherwise due to the taxpayer against tax liabilities that the taxpayer owes. §

²⁹³¹ § 6503(h).

²⁹³² § 6503(d).

²⁹³³ § 6502(a) (after amendment). In *Jordan v. Commissioner*, 134 T.C. 1 (2010), the Tax Court held that the taxpayer seeking to assert the bar on collection bears the ultimate burden of persuasion as to the nonexistence or non-validity of a consent, but affirmed the procedural rules in *Adler v. Commissioner*, 85 T.C. 535, 541 (T.C. 1985) as to the procedural and production burdens encountered at trial where the issue of the bar on collection is in play.

²⁹³⁴ § 6502(a).

²⁹³⁵ Id.

6402(a).²⁹³⁶ This process is called setoff or offset, either of which may be used in in this book.²⁹³⁷ An example of the most commonly encountered situation is where the IRS applies a refund from one year to an unpaid tax assessment for another year. To illustrate, where a taxpayer has an unpaid assessment for Year 1 and files a return for Year 3 claiming a refund, the IRS may apply the claimed refund against the assessed tax due.²⁹³⁸ The offset is an administrative collection activity.²⁹³⁹

This right of offset is in the discretion of the IRS regardless of any directions the taxpayer may have given as to the application of the refund being applied. For example, where the taxpayer makes a voluntary payment of tax, the taxpayer can ordinarily designate how the taxes are to be applied, but that rule does not apply where the IRS applies a refund otherwise due the taxpayer.²⁹⁴⁰

An example that many taxpayers encounter is the election to apply a refund due for tax or estimated tax due for following year.²⁹⁴¹ Example: A files a return for year 01 on 4/15/02 reporting

²⁹³⁶ Section 6402 is a codification of the common law right of setoff which may also apply to the § 6402 setoff. *United States v. Munsey Trust Co.*, 332 U.S. 234, 239 (1947). The credit of a refund to another tax liability is deemed to be a refund of the overpayment and payment of the tax liability to which the overpayment is made. Cf. § 7422(d) (providing that for purposes of refund the payment via credit is deemed made on the date the credit is made). Under 31 U.S.C. § 3720A, titled “Reduction of tax refund by amount of debt,” tax refunds may be reduced by debts to federal agencies; under 31 U.S.C. § 3728, titled “Setoff against judgment,” the Secretary shall “shall withhold paying that part of a judgment against the United States Government presented to the Secretary that is equal to a debt the plaintiff owes the Government.” Note that the authority in § 6402(a) is not mandatory—the language is permissive (“may credit”).

²⁹³⁷ I polled two academic colleagues working extensively in tax procedure as to whether there was a difference between the two terms. Both said they were not aware of any difference in meaning in this context. And each of the two showed slightly different preferences, one defaulting to setoff and the other to offset. So, in this text, I use both terms interchangeably, without meaning any difference. My justification for inconsistency? None. But I am reminded of Ralph Waldo Emerson’s famous saying: “A foolish consistency is the hobgoblin of little minds, adored by little statesmen and philosophers and divines.”

²⁹³⁸ For a similar example in a bankruptcy context and a discussion of the common-law roots of the concept, see *Wood v. United States HUD (In re Wood)*, 993 F.3d 245 (4th Cir. 2021).

²⁹³⁹ *Campbell v. Commissioner*, 121 T.C. 290, 292 (2003); and *McGee v. Commissioner*, 123 T.C. 314 (2004),

²⁹⁴⁰ The statute explicitly states that the IRS may credit against “any tax liability” without any limitation; the underlying regulations are consistent. The IRS thus is given the IRS “discretion to apply overpayments to any tax liability.” *N. States Power Co. v. United States*, 73 F.3d 764, 767 (8th Cir. 1996). Application of overpayments is not voluntary payment for this purpose. *In re Ryan*, 64 F.3d 1516, 1523 (11th Cir. 1995).

²⁹⁴¹ § 6402(b) (authorizing regulations for providing the credit for an overpayment in a preceding taxable year); see Reg. § 301.6402-3(a)(5) (providing that a taxpayer may elect on a refund due return to apply all or part of the refund to the following year) and Reg. § 301.6611-1(h)(2)(vii) (providing that no interest will be paid on the overpayment credited to the subsequent year). The concept of the credit elect transfer sounds simple, but there are significant complexities. See e.g., Bob Probasco, [Don’t Leave Money on the Table! IRS \[Mis\]computation of Interest 12-13](#) (Outline presented to Texas State Bar Undated), here; Bob Probasco, [Complications With Rolling Credit Elect Transfers – Part 1](#) (Procedurally Taxing Blog 2/4/21); and Bob Probasco, [Complications With Rolling Credit Elect Transfers – Part 2](#) (Procedurally Taxing Blog 2/5/21); see *Goldring v. United States*, 15 F.4th 639 (5th Cir. 2021) (apply use of money principle to solve a possible problem with rolling credit elect transfers) (discussed and explained in Bob Probasco (Guest Blogger), [Goldring Is Back – With a Circuit Split](#) (Procedurally Taxing Blog 1/7/22)). For some examples where the credit elect may tempt taxpayers to play games with past due tax or other obligations that may be offset if there is a current year tax due, see Keith Fogg, [Credit Elect Carry Forward vs. Offset](#) (Procedurally Taxing Blog 3/3/21). As to the taxpayer’s right to require the IRS to credit past year overpayments toward the current year estimate rather than some other liability, see Reg. 301.6402-3(a)(6) (IRS “may credit any overpayment of individual . . . income (continued...)”).

an overpayment of \$1,000 and elects to transfer the overpayment to year 02 estimated tax payments. This is called a “credit elect transfer.”

The IRS takes the position that the right to credit does not require an actual assessment for the year to which the credit is applied (Year 1 in the example); rather, the IRS asserts it can make the credit in at least two such cases—(i) if a notice of deficiency has been issued for the year to which the credit is applied and (ii) if the IRS has filed a proof of claim asserting the tax liability in a bankruptcy proceeding.²⁹⁴² The Tax Court sustained the position with respect to an unassessed tax where the notice of deficiency had been issued (thus assuring the taxpayer a Tax Court remedy).²⁹⁴³ This position raised interesting statutory issues. Section 6213(a) plays a central role in the tax system by prohibiting tax assessments until the notice of deficiency has been issued and the lapse of a period of 90 days or until a Tax Court decision becomes final. Making the credit prior to assessment is the functional equivalent of making an assessment before the time allowed under § 6213(a); correspondingly, since the assessment is the predicate to levy and the credit by offset is the equivalent to levy, this seems to violate the structure of the Code. In the ruling, the IRS mitigates the § 6213(a) concern in part by applying the credit only after issuance of a notice of deficiency that gives the taxpayer a ticket to the Tax Court. But that does not address the issue of whether the action flies in the face of the express prohibition in § 6213(a). The Tax Court’s answer was that an offset was not a levy. The position is controversial.²⁹⁴⁴

One question is whether the right of setoff applies independently of the statutes of limitations that would otherwise apply. I pose some examples to frame some of the issues that might arise.

Example 1: On January 1 of Year 06, the IRS discovers that the taxpayer underpaid his or her Year 01 tax in the amount of \$100 that has not yet been assessed. Assume that the normal 3-year statute of limitations on assessment applies and that the taxpayer timely filed his Year 01 return on April 15 of Year 02, so that the Year 01 tax is now time barred for assessment. The IRS is aware that the taxpayer has a Year 04 overpayment. Can the IRS nevertheless apply the Year 04 overpayment to the Year 1 unassessed tax? I hope that you instinctively understand that the system is not suited to opening up a barred year upon the mere fortuity of an overpayment of tax in a later open year. Keep in mind that, under the common law right of offset, what is sauce for the goose is sauce for the gander; the taxpayer could make the same equitable argument for the right to offset a tax in an open year with an unclaimed overpayment in a barred year. Accordingly, neither the IRS nor the taxpayer can use the right of offset to open up a barred year.

²⁹⁴¹(...continued)

tax, including interest thereon, against” tax and non-tax debts and liabilities in the following order: (1) any outstanding tax liability; (2) past-due support assigned to a State; (3) past-due and legally enforceable debts owed to federal agencies; and (4) past-due support not assigned to a State.

²⁹⁴² Rev. Rul. 2007-51, 2007-37 I.R.B. 573 (notice of deficiency) and 2007-52, 2007-37 I.R.B. 575 (proof of claim). See also IRS CCA 200217005 (no offset against unagreed, proposed deficiency without a stat notice). See also PMTA 2011-035 (8/8/11).

²⁹⁴³ *Perry v. Commissioner*, T.C. Memo. 2010-219.

²⁹⁴⁴ Sam Young, Tax Court Opinion on Individual Overpayments Brings Practitioner Fears to Life, 2010 TNT 201-3.

Example 2: Same example, but for some reason Year 01 remains open for assessment (e.g., the taxpayer has given consents to extend the statute of limitations). The IRS is sure that the taxpayer owes the additional amount for Year 01 but has not yet assessed the tax. Can the IRS offset the Year 04 overpayment? Yes, at least if the IRS has issued a notice of deficiency for year 01.

Example 3: In a variation of Example 1, that the taxpayer reports \$100 tax liability for Year 01 on April 15 of Year 02 but does not pay the reported liability. On April 19 of Year 02, the IRS formally assesses the reported tax. Can the IRS offset the Year 04 overpayment against the Year 01 unpaid assessment? The IRS can make the offset so long as the collection statute of limitations has not run. Since the collection statute of limitations is 10 years, the IRS can offset until April 19 of Year 12.

Tricky questions of state law apply where an overpayment of a community property refund is used to offset the separate liability of one of the spouses. I do not require you to know these rules but do cite authority in the footnote.²⁹⁴⁵

It is perhaps obvious that the IRS is not permitted to offset one taxpayer's overpayment against another taxpayer's tax liability.²⁹⁴⁶ I won't get into the detail in the student text, but just urge students to keep that obvious point in mind and be prepared to do further research if the phenomenon is encountered.

The IRS also may setoff a tax overpayment otherwise due against nontax federal liabilities (such as FBAR civil penalty assessments) and certain state liabilities, as well as support obligations certified by a state agency.²⁹⁴⁷ Any such offset is in effect a payment of the liability against which the tax overpayment is offset, and the taxpayer's remedy, if any, is against the agency rather than in a tax refund suit.²⁹⁴⁸ This nontax offset authority is maintained through a Treasury program, titled Treasury Offset Program ("TOP") which manages payment of amounts owed by the federal government and offsets debts due the federal government or state agencies against the amounts that would otherwise be paid. Thus, a scheduled refund will be vetted through the TOP system and the appropriate credit against the liability made.

²⁹⁴⁵ See Rev. Rul. 2004-74; 2004-30 I.R.B. 84 (Texas); Rev. Rul. 2004-71; 2004-30 I.R.B. 7 (Arizona & Wisconsin); Rev. Rul. 2004-72; 2004-30 I.R.B. 77 (California, Idaho & Louisiana); Rev. Rul. 2004-73; 2004-30 I.R.B. 80 (Nevada, New Mexico & Washington).

²⁹⁴⁶ In *Laird v. United States*, No. 18-60735 (5th Cir. Oct. 28, 2019) (Unpublished), a person potentially subject to the Trust Fund Recovery Penalty remitted funds to the IRS with directions to apply only to the trust fund portion of the corporation's tax liability. The funds remitted exceeded the trust fund tax liability. The IRS applied the excess to the corporation's nontrust fund portion of the corporation's tax liability. The Court held that, under the facts (which were uncertain), the funds remitted could have been the funds of the remitter rather than the corporate taxpayer and, while the IRS clearly properly applied the funds up to the amount of the trust fund liability, any excess might be the remitter's funds rather than the corporate taxpayer's liability and thus could not be applied to offset the corporate tax liability. The Fifth Circuit remanded to clarify the facts as to whether the excess represented the corporate taxpayer's funds or the remitter's funds. For use of this technique whereby a responsible person other than the corporate taxpayer might remit funds to pay the trust fund tax liability of the corporation, see p. 818, below.

²⁹⁴⁷ § 6402(d)(1)(A) ("[u]pon receiving notice from any Federal agency that a named person owes a pastdue legally enforceable debt . . . to such agency, the [IRS] shall reduce the amount of any [tax] overpayment payable to such person by the amount of such debt."); see also 31 U.S.C. §§ 3711(g) and 3716(a).

²⁹⁴⁸ § 6402(g).

Finally, the IRS may forego offset in cases of hardship.²⁹⁴⁹ The IRS has a procedure called Offset Bypass Refund (“OBR”) that permits a taxpayer who might suffer hardship if the refund is not made may request that the refund not be credited to certain types of liabilities including taxes.²⁹⁵⁰ The Taxpayer Advocate Service may issue an Offset Bypass Refund that permits the refund without offset where the liability involved is only tax liability (rather than some of the other types of liabilities subject to § 6402 offset).

B. General Equitable Right of Setoff.

The common law long recognized a debtor’s right to setoff against the debt any amounts that the debtor owed the creditor. Section 6402(a) is just a codification of that right in the limited context of setting off taxpayer tax overpayments against taxpayer liabilities.²⁹⁵¹ Accordingly, the IRS may setoff non-tax debts that the United States (including any agency thereof) owes the taxpayer against a tax liability.²⁹⁵²

C. Procedural Issues.

The setoff is an administratively enforced collection measure. As we see in the next sections, Congress has provided significant safeguards of prior notice and right to judicial review of IRS collection measures—called levies—against third persons. The question has arisen whether setoffs are subject to these safeguards.

The law is sparse on the question. The case authority is consistent that a setoff of a tax overpayment against a tax liability under § 6402(a) is not a levy and thus not subject to the safeguards attaching to levies.²⁹⁵³ Thus, the IRS may setoff overpayments by just making the determination to do so.

Courts have divided as to whether a setoff of a non-tax debt which the United States owes a taxpayer against a tax liability is a levy subject to the safeguards.²⁹⁵⁴ This is a conceptual debate about the interface between the historical equitable nature of the setoff remedy and its interface with the safeguards for levies and how or if the courts should flesh out Congress’ failure to directly

²⁹⁴⁹ As noted above § 6402 authority to credit is permissive rather than mandatory.

²⁹⁵⁰ IRM 21.4.6.5.11.1 (11-08-2017), Offset Bypass Refund (OBR); IRM 21.4.6.5.5 (09-22-2017), Hardship Refund Request.

²⁹⁵¹ *United States v. Munsey Trust Co.*, 332 U.S. 234, 239 (1947).

²⁹⁵² This statement perhaps sweeps too broadly for every situation. Nuance is important. In *Stanley v. United States*, 140 F.3d 1023, 1028 (Fed. Cir. 1998), involving an erroneous refund, the taxpayer had made a deposit in the nature of a bond to mitigate the interest if the Government prevailed on the erroneous refund claim. The court held that, because the IRS held the funds under bond rather than in a debtor-creditor relationship, there was no right of offset because there was no mutuality.

²⁹⁵³ See e.g., *Boyd v. Commissioner*, 451 F.3d 8 (1st Cir. 2006).

²⁹⁵⁴ See e.g., *Boyd v. Commissioner*, 451 F.3d 8 (1st Cir. 2006) (equitable setoff does not invoke procedural safeguards attaching to levies); and *United Sand and Gravel Contractors, Inc. v. United States*, 624 F.2d 733(5th Cir. 1980) (when IRS levies another agency to effect the equitable setoff, the safeguards attaching to levies apply). As noted in the text immediately below, the IRS practice is to proceed by levy when seeking to setoff an amount owed by another United States agency. *United Stand* did not address the issue of whether the IRS was required to proceed by levy against the other agency. Hence the two decisions may not be as far apart as first appears.

address the issue. Suffice it to say here, however, that the IRS by practice does serve a levy upon other United States agencies that owe the taxpayer money when it proceeds,²⁹⁵⁵ so given this practice the debate may be principally an intellectual exercise.

IX. Administrative Levy and Judicial Enforcement.

A. Administrative Levy and Sale.

1. General Rules of Levies.

The IRS has the power to levy and, when appropriate sell a taxpayer's property for **assessed** tax liabilities.²⁹⁵⁶ § 6331(b) (levy); § 6335 (rules for sale). Levy includes the power to seize²⁹⁵⁷ and sell the taxpayer's property (including interests in property and personal service compensation, such as wages). A levy—often referred to as a seizure²⁹⁵⁸—is a “summary, non-judicial process, a method of self- help authorized by statute which provides the Commissioner with a prompt and convenient method for satisfying delinquent tax claims.”²⁹⁵⁹ The Supreme Court has said: “The IRS need never go into court to assess and collect the amount owed; it is empowered to collect the tax by non-judicial means . . . without having to prove to a court the validity of the underlying tax liability.”²⁹⁶⁰

The IRS levy can involve a direct seizure of the property but more often the levy is accomplished by notice of levy to the taxpayer or third parties requiring them to turn over the taxpayer's property in their possession which is the equivalent of seizure.²⁹⁶¹ Thus, the IRS can serve notice of levy a bank to obtain the funds in the taxpayer's bank account or can levy a brokerage firm to obtain the investments in the taxpayer's bank account. The IRS can also levy persons or entities who appear to be third parties, asserting that they are nominees or alter egos of the taxpayer. (I cover nominee and alter ego liability later in this Chapter.)

²⁹⁵⁵ See *Boyd v. Commissioner*, 451F.3d 8 (1st Cir. 2006).

²⁹⁵⁶ The IRS may not levy for **unassessed** tax liabilities. The IRS may use jeopardy and termination assessments at least relatively contemporaneously to justify seizures, but there does have to be an assessment.

The IRS may invoke a lock-in letter procedure for **unassessed** employment tax withholding that is arguably functionally equivalent to levy if the IRS believes that an employee has provided an employer a W-4, Employee's Withholding Certificate, that, on its face, would permit less tax withholding than appropriate for the employee (e.g., by claiming significantly too many exemptions). The lock-in letter is not a levy and thus not subject to the rules applicable to levies. I discuss the lock-in letter at p. 162.

²⁹⁵⁷ See *Wagner v. United States*, 545 F.3d 298 (5th Cir. 2008) (and cases cited).

²⁹⁵⁸ At least for purposes of the statute of limitations on collection, a levy by seizure is made by on the date the IRS provides the taxpayer the notice of seizure under § 6335(a) (notice as soon as “practicable” after the seizure). See § 6502(b). Thus, the statute of limitations continues to run after the Notice of Intent to Levy until the Notice of Seizure. *United States v. Weiss*, 52 F.4th 546, 548 (3d Cir. 2022).

²⁹⁵⁹ *United States v. Sullivan*, 333 F.2d 100, 116 (3d Cir. 1964) (citations omitted), quoted in *United States v. Ryals*, 480 F.3d 1101 (11th Cir. 2007).

²⁹⁶⁰ *United States v. Baggot*, 463 U.S. 476, 481 (1983).

²⁹⁶¹ Reg. § 301.6331-1(a)(1) (“levy may be made by serving a notice of levy on any person in possession of or obligated with respect to property” belonging to the taxpayer); and *Phelps v. United States*, 421 US 330, 337 (1975) (“[h]istorically, service of notice has been sufficient to seize a debt and notice of levy and demand are equivalent to seizure”).

As noted, the IRS often levies on third parties by issuing “notice of levy,” which, like the IRS summons studied earlier, is simply a form that the IRS collection officer fills out and delivers to the person upon whom levy is made.²⁹⁶² Once the person is given the notice of levy, the IRS has the right to the property levied.²⁹⁶³ As to the property, the person receiving the notice of levy holds the property in a form of custodial relationship to the IRS.²⁹⁶⁴ The timing of the required turnover pursuant to the levy depends upon the circumstances, but banks are required to turnover “only after 21 days after service of levy.”²⁹⁶⁵

The person receiving the notice of levy takes substantial risks in not responding to the levy. The person receiving a levy is liable for the value of the property levied upon and not turned over, plus a penalty of 50%. § 6332(d). The defenses available to the party levied to avoid the levy are quite limited.²⁹⁶⁶ Non-possession of the taxpayer’s property is a defense.²⁹⁶⁷ However, the “validity of the levy and competing claims to the ownership of the funds are not valid reasons for refusing to honor a levy.”²⁹⁶⁸ The person can be relieved from the 50% penalty for reasonable cause, which would be something beyond the person’s control that prevents compliance.²⁹⁶⁹ The IRM advises agents to be judicious in assertion of the penalty,²⁹⁷⁰ and courts also may give a liberal application of reasonable cause where the taxpayer is already penalized by liability for the value of the property that he may have turned over to the taxpayer.²⁹⁷¹ To protect the levied party, the levied party responding to the levy by delivering the property to the IRS is “discharged from any obligation or liability to the delinquent taxpayer and any other person with respect to such property or rights to property arising from such surrender or payment.” § 6332(e).²⁹⁷² As a result, practically speaking,

²⁹⁶² A levy upon property is effected “by the sole act of serving notice of levy upon the third party holding the property.” *Kane v. Capital Guardian Trust Co.*, 145 F.3d 1218 (10th Cir. 1998) (citing *G.M. Leasing Corp. v. United States*, 429 U.S. 338, 350 (1977); *Resolution Trust Corp. v. Gill*, 960 F.2d 336, 340 (9th Cir. 1992) (“[A] levy is effective upon the IRS’s service of the notice of levy.”); see also *United States v. Rodgers*, 461 U.S. 677, 682 (1983) (the notice of levy “does not require any judicial intervention.”)).

²⁹⁶³ *United States v. Eiland*, 223 F.2d 118, 121 (4th Cir. 1955). Although until it is turned over to the IRS, the property may be in the physical possession of the third party, it is deemed to be in the constructive possession of the IRS. *Phelps v. United States*, 421 U.S. 330, 334 (1975).

²⁹⁶⁴ *Phelps v. United States*, 421 U.S. 330, 334 (1975).

²⁹⁶⁵ § 6332(c).

²⁹⁶⁶ To avoid the liability, the party levied must act quickly to freeze the property. See *United States v. JPMorgan Chase Bank NA*, 2014 U.S. Dist. LEXIS 113896 (C.D. Cal. 2014) (levied bank’s central processing unit did not act promptly, and the taxpayer withdrew funds; held bank liable for the amount levied, but apparently did not get the 50% penalty).

²⁹⁶⁷ *United States v. Sterling Nat’l Bank & Trust Co.*, 494 F.2d 919, 921 (2d Cir. 1974),

²⁹⁶⁸ *United States v. Daccarett*, 6 F.3d 37, 59 (2d Cir. 1993).

²⁹⁶⁹ § 6332(d)(2). For example, in *United States v. Sterling National Bank*, 494 F.2d 919 (2d Cir. 1974), the court determined that a bank could not set off a taxpayer deposit against a taxpayer debt to the bank after receiving a levy. The court nevertheless declined to impose the penalty, but warned that, in the future, reasonable cause would not exist for such self-help offset to an IRS levy.

²⁹⁷⁰ IRM 5.17.4.12.3 (03-25-2022), Liability for Failure to Comply (“In view of the severity of the 50-percent penalty, the recommendation for its assertion should generally be made only when the failure or refusal to surrender the property levied upon is arbitrary or capricious, or when the alleged dispute over the amount owing or the legal effectiveness of the levy is frivolously raised.”)

²⁹⁷¹ See Keith Fogg, Imposition of an Extra 50% Penalty for Failing to Honor Levy—Is the Levy Form Inadequately Descriptive (Procedurally Taxing Blog 3/12/14).

²⁹⁷² Because the party levied is relieved of liability to competing claimants upon delivering to the IRS
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the levied party “has two, and only two, possible defenses for failure to comply with the demand: that it is not in possession of property of the taxpayer, or that the property is subject to a prior judicial attachment or execution.”²⁹⁷³

What if a third party upon whom a levy is served claims to have an interest in or even ownership of the property or, alternatively, is aware that some other third party (other than the taxpayer) claims ownership of the property? In the nontax world when there are two or more claimants on property, the possessor can interplead the property²⁹⁷⁴ and let the claimants duke it out. Interpleader is generally not an option to an IRS levy since § 6332(d) offers no relief for the penalty if the person levied interpleads the property. In appropriate cases, the IRS will consider interpleader to be reasonable cause. The reason interpleader may not avoid the penalty is the person levied upon is otherwise protected from liability to the taxpayer or third parties. § 6332(e). And, if the possessor who is levied also claims an ownership interest in the property, the possessor has a post-levy remedy via the wrongful levy suit in § 7426 discussed later beginning p. 748.

Generally, an administrative levy on a third party applies “only to property possessed and obligations existing at the time thereof.”²⁹⁷⁵ For example, if the IRS levies a bank account, the bank must turn over the balance on the date of the levy.²⁹⁷⁶ If the taxpayer makes a deposit the next day, that amount of the new deposit need not be turned over by the bank.²⁹⁷⁷

Notwithstanding this general moment in time nature of a levy, a levy on recurring “salary or wages” and personal service compensation (often called garnishments in other contexts) are continuing from the date of levy until the levy is released (including the expiration of the CSED). § 6331(e).²⁹⁷⁸ The Regulations define the statutory terms “salary or wages” very broadly to include

²⁹⁷²(...continued)

pursuant to the levy, the party levied does not have the type of risk that would permit that party to file an interpleader. See *Garrity, Levin & Muir LLP v. United States*, 2016 U.S. Dist. LEXIS 25148 (D. Mass. 2016) (“Here there is no true interpleader, as GLM can incur liability to only one party -- the United States, by failing to honor the levy.”)

²⁹⁷³ *United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 727 (1985), citing *United States v. Sterling National Bank & Trust Co. of New York*, 494 F.2d 919, 921 (2nd Cir. 1974); and *Gold Forever Music, Inc. v. United States*, 920 F.3d 1096, 1098 (6th Cir. 2019) (citing *Nat'l Bank of Commerce*). Even if the levy is or is arguably invalid, the party levied must turn over the property. E.g., *United States v. Moskowitz, Passman & Edelman*, 603 F.3d 162, 166 (2^d Cir. 2010) (“[q]uestions about the validity of the levy are not valid reasons for refusing to honor a levy.” (internal quotation marks and citation omitted)).

²⁹⁷⁴ See FRCP 22, titled Interpleader. True interpleader involves a person in possession of property but having no claim to the property suing or counterclaiming so that the claimants can duke it out. If the person in possession of property also has a claim, that person may bring suit in the nature of interpleader to establish his or her claim.

²⁹⁷⁵ § 6331(b); see Reg. § 301.6331-1(a)

²⁹⁷⁶ Reg. § 301.6331-1(a)(1). In the case of a bank, a levy does not apply to deposits on the date of levy made after the levy is served on the bank. See CCA 2020021009262241 (2/10/20) (noting a concern that, because the bank has 21 days after the date of levy to surrender property to the IRS pursuant to § 6332(c), the bank may key the amount to the closing amount on the date rather than the amount at the time the levy was served; post-levy deposits on the same date are not in the scope of the levy).

²⁹⁷⁷ Id.

²⁹⁷⁸ The continuing levy on wage type payments releases on expiration of the CSED because such payments are not the type of fixed and determinable income stream to which a levy prior to expiration of the CSED can apply after the expiration of the CSED. Leslie Book, *CCA Distinguishes Between Continuous Levies on Wages and*

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“compensation for services paid in the form of fees, commissions, bonuses, and similar items.”²⁹⁷⁹ The courts have blessed this broader reading, sustaining, for example, continuous levies on payments to (i) independent contractors, such as commissioned agents,²⁹⁸⁰ (ii) partners as distributions,²⁹⁸¹ and (iii) members of an LLC as distributions.²⁹⁸² Similar continuous levies, subject to restrictions in amount, may be made with respect to some other federal payments.²⁹⁸³ The IRS can, of course, make successive levies where the original levy is not a continuous levy and thereby reach the property of the taxpayer as of each levy. § 6331(c).

There is an important nuance to the normal levy (not the continuous levy authorized by statute) in the case of future payments. The normal levy reaches an existing right to future payments if the right is fixed and determinable on the date of the levy.²⁹⁸⁴ For example, if the taxpayer has the current right to a payment or payments in the future, the IRS can serve the levy on the payor who then must pay to the IRS as the future payment(s) fall due. Say I have a right to receive \$10,000 a year from now and the payor does not have to pay until that year period is up. The IRS can levy today on the payor and, when the payment is due, the payor would have to pay the IRS pursuant to the levy. The key requirement is that the rights are fixed and determinable on the date of the levy; if so, that right to future payments is property within the scope of the levy on the date of the levy. Perhaps the classic example is a simple note or obligation to pay in the future, consistent with the example. Another common example is a vested right in a pension or retirement plan (including Social Security) that is fixed and determinable on the date of the levy, albeit to be paid in the future and over time. The IRS levies on the payor and the payor pays the retirement benefits to the IRS as they are otherwise payable as due under the plan.²⁹⁸⁵ For certain types of retirement payments, the IRM has discretionary rules advising collection officers to use levies in moderation and as a last resort.²⁹⁸⁶ A related consequence of levy on such fixed and determinable rights to future payments

²⁹⁷⁸(...continued)

Levies on Social Security Income (Procedurally Taxing Blog 8/13/21).

²⁹⁷⁹ Reg. § 301.6331-1(b)(1).

²⁹⁸⁰ *United States v. Jefferson-Pilot Life Ins. Co.*, 49 F.3d 1020 (4th Cir. 1995) (reasoning that the underlying purpose of the provision is to permit levy upon the recurring remuneration to the taxpayer for personal services).

²⁹⁸¹ *United States v. Moskowitz, Passman & Edelman*, 603 F.3d 162 (2d Cir. 2010).

²⁹⁸² *United States v. 911 Mgmt., LLC*, 2014 U.S. Dist. LEXIS 289 (D. Or. 2014) (although not discussing the issue, but assuming that such a continuous levy was proper); see also CCM 20836002 (4/23/08) (taking the position that LLC distributions to member are subject to continuous levy).

²⁹⁸³ § 6331(h). The levies on “specified payments” may be continuous. § 6331(h)(1). A specified payment includes most periodic federal payments other than some type of means tested payment. (See the statute for the precise enumeration.) § 6331(h)(2) The continuous levy may apply only up to (i) 15% of the payment or (ii) 100% in case of a vendor to the government. § 6331(h)(1) and (3).

²⁹⁸⁴ Reg. § 301.6331-1(a)(1) (provide that a levy “extends only to property possessed and obligations which exist at the time of the levy” and that “[o]bligations exist when the liability of the obligor is fixed and determinable although the right to receive payment thereof may be deferred until a later date.” See *Gold Forever Music, Inc. v. United States*, 920 F.3d 1096 (6th Cir. 2019).

²⁹⁸⁵ IRM 5.11.6.2 (05-26-2021), Retirement Income, stating that once a taxpayer has a fixed and determinable right to the payments, even if payable in the future, the levy can apply to require the payor to pay the IRS as the payments fall due in the future. If the levy was timely and properly covered future payments, the levy remains effective after the statutory period for collection. Id.

²⁹⁸⁶ IRM 5.11.6.2 (05-26-2021), Retirement Income; and IRM 5.11.6.3 (05-26-2021), Funds in Pension
(continued...)

being effective as of the date of the levy rather than the later payment is that the levy remains effective as to those future payments even after the collection statute of limitations expires.²⁹⁸⁷

Unlike the other enforced collection tool—the judicial suit for foreclosure—the levy is a provisional remedy. It does not determine that the Government is entitled to the property levied vis-a-vis other claimants or even the taxpayer. It simply seizes the property and prevents the property from dissipation while parties, including the taxpayer, claiming an interest in the property have the opportunity to pursue remedies available to them to determine the priority of their claims as against the Government. The levy power is “an essential part of our self-assessment tax system,” for it “enhances voluntary compliance in the collection of taxes.”²⁹⁸⁸ “Among the advantages of administrative levy is that it is quick and relatively inexpensive,²⁹⁸⁹ and it has easily cleared constitutional challenges.²⁹⁹⁰

Once the IRS takes possession of property pursuant to levy, the IRS must then decide what to do with the property—store the property pending further events, sell the property (particularly if perishable property), deposit the property if it is cash into IRS accounts, etc. Section 6331(b) authorizes the IRS to sell the property seized. The IRM provides details on the process of how the IRS disposes of the property to maximize payment against the tax liability.²⁹⁹¹ Basically, the rules are to turn the seized property to cash to be applied to the tax debt as soon as reasonably possible, providing such storage and maintenance as the nature of the property requires to retain value for the ultimate sale.²⁹⁹²

2. Exemptions or Limitations on Levies.

State law provides debtor-protections preventing creditors from enforcing their claims against certain types of assets. For example, Texas and some other states have homestead exemptions designed to protect the family from a profligate husband’s excesses. These protections do not prevent the IRS from collecting tax debts, via levy or judicial enforcement, as appropriate.²⁹⁹³

²⁹⁸⁶(...continued)

or Retirement Plans.

²⁹⁸⁷ Id.; see *Dean v. United States*, 2021 U.S. App. LEXIS 19395 (11th Cir. 6/30/21) (levy on social security payment rights while collection statute is still open survives for payments after the collection statute closes); see Keith Fogg, [Social Security Levies and the Statute of Limitations](#) (Procedurally Taxing Blog 12/14/22),

²⁹⁸⁸ *G. M. Leasing Corp. v. United States*, 429 U.S. 338, 350 (1977).

²⁹⁸⁹ *United States v. Rodgers*, 461 U.S. 677, 699 (1983).

²⁹⁹⁰ *Phillips v. Commissioner*, 283 U.S. 589, 595. See *G. M. Leasing Corp. v. United States*, 429 U.S. 338, 352 n. 18 (1977).

²⁹⁹¹ IRM 5.17.3.7 (01-07-2011), Sale -- Authority and following provisions in the IRM.

²⁹⁹² For a discussion of some of the preservation of value issues revenue officers may face on levy and the use of a receiver in certain cases, see Keith Fogg, [Appointing a Receiver to Protect Value and Innocent Third Parties](#) (Procedurally Taxing Blog 4/16/21). For an example involving currency where, pursuant to the IRM, the IRS officer quickly deposited into an IRS account, see *Willis v. Boyd*, 993 F.3d 545 (8th Cir. 2021), the IRS seized currency and, not knowing that the currency might be collectible currency having value in excess of face value, deposited into the IRS account thus realizing only the face value applied to the tax debt; held FTCA gave no remedy for any excess value of the currency over face value even though IRM provision said that “collectibles” were not to be deposited).

²⁹⁹³ See e.g., *United States v. Rodgers*, 461 U.S. 677, 699 (1983).

The Code provides exemptions from levy for certain types of property Congress deemed to be bare essentials that should not be subject to levy. § 6334. Thus, the IRS may not seize wearing apparel or school books, fuel, furniture or personal property up to a value of \$6,250, business assets up to a value of \$3,125, and so forth.²⁹⁹⁴ Similarly exempt are wages and salaries up to an amount equaling the standard deduction and deductions for personal exemptions pro-rated to the wage or salary payment period involved.²⁹⁹⁵

Residences and businesses are not generally exempt from levy. However, the 1998 Restructuring Act exempted residences from levy for small deficiencies (\$5,000 or less).²⁹⁹⁶ Moreover, principal residences are exempt unless the IRS exhausts other payment options and a judge or magistrate judge of district court approves.²⁹⁹⁷

Also, although retirement-type assets (e.g., pension plan, IRAs, regular Social Security payments) are exempt or partially exempt under state and federal laws from ordinary creditors' claims,²⁹⁹⁸ they are not exempt from IRS levy, notwithstanding ERISA's Anti-Alienation provision.²⁹⁹⁹ If the taxpayer has a present right to a lump sum distribution, the IRS may levy all the assets in the plan subject to the right to a lump sum distribution; if, instead, the taxpayer has only

²⁹⁹⁴ See the list in § 6334(a).

²⁹⁹⁵ § 6634(a)(9) & (d). The employer figures the amount exempt from levy to avoid withholding that amount from the employee.

²⁹⁹⁶ § 6334(a)(13).

²⁹⁹⁷ § 6334(a)(13) and § 6334(e)(1). Alternatively, the IRS may sue under § 2403 to foreclose on a tax lien. See generally Christine Speidel, *Will the IRS Take My Home?* (Procedurally Taxing Blog 2/13/19).

The procedure for the judicial proceeding under § 6634(e)(1) is set forth in Reg. § 301.6334-1(d). The petition must show "the underlying liability has not been satisfied, the requirements of any applicable law or administrative procedure relevant to the levy have been met, and no reasonable alternative for collection of the taxpayer's debt exist." An illustration of the procedure is contained in *United States v. Gower*, 2018 U.S. Dist. LEXIS 114633 (M.D. Fla. 2018), a decision by a magistrate judge authorized to enter the order, which focuses on the alternative methods of collection requirement. In *United States v. Brabant-Scribner*, 900 F.3d 998 (8th Cir. 2018), the court held, under Reg. § 301.6334-1(d)(1), that a taxpayer's offer in compromise is not a reasonable alternative to collection of the tax debt.

²⁹⁹⁸ This is a large subject, but generally, as I understand the rules, they are: (i) Employer-sponsored individual retirement accounts (IRAs) are protected without dollar limit in bankruptcy proceedings, but other traditional and Roth IRAs are protected up to an inflation-adjusted \$1 million; Owner-only plans may be subject to attachment by creditors outside bankruptcy; (ii) Eligible rollover distributions from qualified retirement plans retain their protection, but required minimum distributions and hardship distributions may not; (iii) an IRA inherited by an heir other than a surviving spouse is part of the bankruptcy estate and is not exempt from creditor's claims (*Clark v. Rameker*, 573 U.S. 122 (2014)); and (iv) a prohibited transaction may cause an IRA to lose its status and become subject to attachment by creditors. The foregoing summary is cut and paste (hence verbatim except for layout) from the AICPA Tax Adviser page. Richard A. Naegele, Mark P. Altieri, and Donald W. McFall Jr., Protection From Creditors for Retirement Plan Assets (The Tax Adviser 1/1/14).

²⁹⁹⁹ § 6334(c) (providing that no property is exempt other than specifically mentioned in § 6334(a) and Social Security payments are not exempt); see also See TIGTA Report 2017-30-082, titled Procedures for Retirement Account and Thrift Savings Plan Levies Are Not Always Followed by Revenue Officers, p. 1-2 (9/26/17); and the excellent series of Procedurally Taxing blog entries by Keith Fogg inspired by this TIGTA report: Keith Fogg, Levies on Retirement Accounts – Part 1 of 3 Pension Plans and IRAs (Procedurally Taxing Blog 12/4/17); Keith Fogg, Levies on Retirement Accounts – Part 2 of 3 Social Security (Procedurally Taxing Blog 12/5/17); Keith Fogg, Collection from Retirement Accounts Part 3 – IRS Pushes Hard to Collect from F. Lee Bailey (Procedurally Taxing Blog 12/6/17). See for further discussion my Tax Procedure Blog entry titled, Restitution And Tax Collection from Retirement Accounts - Anti-Alienation (11/28/12).

the right to income (including future income) the IRS can levy on that income stream.³⁰⁰⁰ The levied party's remittance pursuant to the levy will be deemed a taxable distribution to the taxpayer.³⁰⁰¹

Business assets are not subject to levy except upon determination of a high level IRS official and the Secretary or his delegate finds that collection of the tax is in jeopardy.³⁰⁰²

The IRS may not make an uneconomical levy, defined as one where the estimated expenses the IRS will incur exceeds the fair market value of the property.³⁰⁰³

The IRS may release a levy in certain circumstances where the collection of the liability may not be in jeopardy or the levy creates economic hardship on the individual taxpayer.³⁰⁰⁴

3. Notice of Levy and Sale of Levied Assets.

The IRS is required to give the taxpayer notice of the seizure of assets and then, upon giving notice of sale of the property, may sell the property it obtains by levy.³⁰⁰⁵ The IRS must apply the net proceeds (after costs of the sale) to the taxpayer's liability and refund any excess. The problem is that an administrative sale by the IRS may not produce buyers willing to pay anything near the fair market value of the property interest being sold.³⁰⁰⁶ In particularly troublesome cases, the IRS may invoke the judicial sale remedy³⁰⁰⁷ rather than the administrative sale remedy, for various reasons including: (i) an imminent collection statute expiration date ("CSED") or (ii) because buyers may be more willing to buy with and pay more for the protections perceived for the judicial remedy.³⁰⁰⁸ Nevertheless, the IRS should generally use the administrative levy and sale procedures

³⁰⁰⁰ TIGTA Report 2017-30-082, titled Procedures for Retirement Account and Thrift Savings Plan Levies Are Not Always Followed by Revenue Officers, p. 1-2 (9/26/17).

³⁰⁰¹ IRS levies are exempt from the 10% tax on early distributions, but not from the income tax on the distribution resulting from the levy. § 72(t).

³⁰⁰² § 6331(e)(2).

³⁰⁰³ § 6331(f).

³⁰⁰⁴ § 7343(a). The economic hardship exception in subsection (D) applies only for taxpayers who are individuals. *Seminole Nursing Home, Inc. v. Commissioner*, 12 F.4th 1150 (10th Cir. 2021) (sustaining the regulations interpretation the authority to release levies based on economic hardship due to the financial condition of the taxpayer applies only to individual taxpayers and not taxpayers which are entities; this interpretation was sustained under *Chevron* despite the more expansive definition elsewhere in the Code, e.g., § 7701(a)(14)).

³⁰⁰⁵ §§ 6335 & 6336. See *Grable & Sons Metal Products, Inc. v. Darue Engineering & Manufacturing*, 126 S.Ct. 2363 (2005) (holding that the issue of whether the IRS gave proper notice to the taxpayer under § 6335 is a sufficient federal issue to justify removal to federal court in a state court quiet title action commenced against the purchaser in the IRS).

³⁰⁰⁶ If the property interest is indivisible, a classic case where buyers would not be willing to pay a pro rata amount for the interest, the IRS is given the power to sell the whole property. § 6335(c).

³⁰⁰⁷ §§ 7401, 7402, and 7403.

³⁰⁰⁸ For discussion of the differences between the judicial foreclosure sale and the levy and administrative sale, see TIGTA, [The IRS Primarily Uses Lien Foreclosures When Pursuing Principal Residences, Which Do Not Provide the Same Legal Protections as the Seizure Process 2-5](#) (Report 2022-03-026 3/28/22) (for example judicial foreclosure does not have redemption rights). The TIGTA report indicates that, in year ending 6/30/20, the IRS conducted only 3 levies, but referred 21 cases to the IRS for judicial foreclosure.

rather than judicial foreclosure because taxpayers have more rights and protections in the administrative levy and sale procedures.³⁰⁰⁹

The taxpayer has the right to redeem all property before sale and to redeem real estate even after sale.³⁰¹⁰

The taxpayer must be notified of the amount applied from the sale to the taxpayer's liability and the balance due.³⁰¹¹

The IRS asserts that its power to levy and sell apply regardless of certain restrictions on transfer that would otherwise be binding on the taxpayer.³⁰¹²

Finally, if the IRS determines that any levied property "is liable to perish," the IRS may appraise the value of the property and offer it for sale to the owner (taxpayer) at the appraised value or give bond to ensure payment of the appraised value.³⁰¹³ If the owner does not respond, the IRS may sell as soon as possible as prescribed in regulations.³⁰¹⁴

4. Discovery of Leivable Property.

The IRS can use the summons power to discover leivable property.³⁰¹⁵ I noted above that the IRS can summons the taxpayer to attempt through a Q&A to discover the taxpayer's leivable property.

In addition, the Code requires that persons having custody of the records relating to property shall, upon demand, "exhibit" them.³⁰¹⁶

5. Constitutional Limitations on Levies.

³⁰⁰⁹ TIGTA, The IRS Primarily Uses Lien Foreclosures When Pursuing Principal Residences, Which Do Not Provide the Same Legal Protections as the Seizure Process (Report 2022-03-026 3/28/22) (with TIGTA recommending at pp.7-8 that Treasury "consider a legislative proposal to amend the law (I.R.C. § 7403) so that taxpayers are afforded the same rights and protections whether the IRS is conducting a Federal tax lien foreclosure or a seizure on their property; IRS Management disagreed (p. 8) because, while the two procedures are different, one is not more protective of taxpayer rights than the other because a court has broad equitable authority to insure a fair process).

³⁰¹⁰ § 6337.

³⁰¹¹ § 6340(c).

³⁰¹² For example, Chief Counsel Advice Memo 200926001 (6/29/09), reproduced at 2009 TNT 122-27, reasoned the IRS could seize and sell certain options free of contractual and even statutory restrictions. The stock options were employee non-qualified stock options which were subject to contractual restrictions and incentive stock options including transfer restrictions required under § 422.

³⁰¹³ § 6336(1), as amended by Taxpayer First Act of 2019, § 1404, P.L. 116-25, 133 Stat 981 (July 1, 2019) (which eliminated the language applying the section to levied property that could become greatly reduced in price or value or cannot be kept without great expense.)

³⁰¹⁴ § 6336(2).

³⁰¹⁵ § 6331(g), however, precludes the IRS from levying on the day that the taxpayer (or officer of taxpayer) has been summoned in connection with collection.

³⁰¹⁶ § 6333. IRM 5.11.2.2.8 (12-21-2020), Examination of Books and Records.

The IRS's ability to enter into private areas to seize assets is subject to the Fourth Amendment's prohibition of unreasonable searches and seizures. The question generally is whether the individual (as opposed to the artificial corporate entity) has a reasonable expectation of privacy with respect to the area. Certainly, for example, an individual generally has a reasonable expectation of privacy in his or her home. Similarly, for those portions of business premises not generally open to the public, an occupant may have a reasonable expectation of privacy.³⁰¹⁷ Accordingly, the IRS may not enter these areas to locate and seize property without a warrant, often referred to as a writ of entry. Only the private areas in which there is a reasonable expectation of privacy implicate the Fourth Amendment's guarantee.

What if the property is in an area where there is no such reasonable expectation of privacy? The IRS takes the position that an automobile may be seized by administrative levy without a search warrant if the automobile is parked in an unobstructed driveway or front yard, and the courts have sustained that position.³⁰¹⁸ Under the doctrine of curtilage, however, if the automobile were within and completely enclosed by a fence and gate, the automobile may be within a zone of privacy requiring a judicial writ of entry prior to seizure.

The precise standard that must be met to obtain a writ of entry to seize assets is not settled. Some courts use the standard for search warrants (probable cause) and others use the less strict standard for administrative searches.³⁰¹⁹ Then, of course, as in the case of search warrants, the question of scope of the search upon entry by writ arises. The IRS takes the position that, once it is lawfully on the premises by virtue of the writ of entry, § 6331 authorizes it to levy on any property determined to be the taxpayer's property.³⁰²⁰ Some courts, however, in issuing the writ will specify the property that the IRS is authorized to seize.³⁰²¹ And the documents seeking the writ of entry and representations the Government makes to the Court may, practically, limit what it may seize under the writ. The IRS illustrates:

If the discovery of or entry into these items was not contemplated by the court when it authorized the initial entry into the warehouse, the officer should not search the items without further permission. A writ authorizing entry into an office to search for bearer bonds probably does authorize the Revenue Officer to search any locked containers, e.g., desks, filing cabinets, brief cases or safes, that might contain the assets that are the subject of the authorized search.³⁰²²

³⁰¹⁷ *G. M. Leasing Corp. v. United States*, 429 U.S. 338 (1977).

³⁰¹⁸ *United States v. Roccio*, 981 F.2d 587 (1st Cir. 1992); and *Rogers v. Vicuna*, 264 F.3d 1 (1st Cir. 2001).

³⁰¹⁹ Compare e.g., *United States v. Condo*, 782 F.2d 1502 (9th Cir. 1986) (probable cause) with *Carlson v. United States*, 580 F.2d 1365 (10th Cir. 1978).

³⁰²⁰ LGM GL-40 (June 27, 1996). LGM is the initialism for Litigation Guideline Memorandum, an internal guidance device last used in 1999 and now discontinued, with prior LGMs obsoleted. See CCN 2017-001 (11/2/16). In discontinuing and formally obsoleting existing LGMs, the IRS said: "they can serve as useful research tools and historical records of positions previously taken by the Office of Chief Counsel on issues in litigation."

³⁰²¹ E.g., *In re Stubblefield, Inc.*, 810 F. Supp. 227 (E.D. Cal. 1992).

³⁰²² LGM GL-40 (June 27, 1996). This LGM is quite useful for its discussion of other subtleties related to the writ of entry for IRS collection efforts.

I discuss below the issue of constitutional protections potentially applicable when the IRS levies against property nominally titled to persons other than the taxpayer.

6. Procedural Predicates to Levy.

The IRS may not levy until it has given the taxpayer 30-days' notice that it intends to make a levy unless collection is determined to be in jeopardy. § 6331(d). The notice of levy occurs at the end of a series of demand letters automatically generated by computer and sent to the taxpayer from the Service Center. The final automatic letter will advise of the IRS's intent to levy and the taxpayer's rights with respect thereto³⁰²³ (see Collection Due Process, discussion beginning on p. 733), thus meeting the statutory predicate when the IRS finally does get around to actually levying. Further, before making a levy, the IRS is required to complete "a thorough investigation of the status of such property."³⁰²⁴ Some courts have held that the seizure of a third party's property implicates serious Fourth Amendment issues and some have held that in a subsequent proceeding contesting the levy the Government is required to show probable cause. I will return to this issue beginning on p. 748 in addressing remedies for wrongful levy.

If the collection of the tax is in jeopardy, the IRS may with a determination of jeopardy make an immediate levy, often referred to as a jeopardy levy.³⁰²⁵ A taxpayer suffering a jeopardy levy may have either or both a CDP remedy discussed below³⁰²⁶ or the special administrative and judicial review afforded jeopardy levies under § 7429.

B. Judicial Enforcement.

1. Civil Collection Suits.

In addition to or as an alternative to levy, the Government may bring judicial enforcement proceedings to obtain judicial seizure of the property or extend the period for collection by obtaining a judgment on the tax debt with a new statute of limitations.³⁰²⁷ Similarly, in lieu of assessment, the Government may bring a judicial enforcement proceeding to collect illegally assessed tax within the assessment period of limitations³⁰²⁸ or even unassessed tax provided within the assessment period.³⁰²⁹

³⁰²³ The final letter is Letter 1058 Final Notice of Intent to Levy and Notice of Your Rights to a Hearing.

³⁰²⁴ § 6331(j).

³⁰²⁵ § 6331(a) provides:

If the Secretary makes a finding that the collection of such tax is in jeopardy, notice and demand for immediate payment of such tax may be made by the Secretary and, upon failure or refusal to pay such tax, collection thereof by levy shall be lawful without regard to the 10-day period provided in this section.

³⁰²⁶ See § 6330(f)(1).

³⁰²⁷ §§ 7401, 7402, and 7403. For a summary of the collection suit process, including authority, jurisdiction, etc., for such suits, see IRM 5.17.4 Suits by the United States; and TIGTA, The IRS Primarily Uses Lien Foreclosures When Pursuing Principal Residences, Which Do Not Provide the Same Legal Protections as the Seizure Process (RepOrt 2022-03-026 3/28/22). The TIGTA report that, for the year ending 6/30/20, the IRS referred 21 cases to DOJ for judicial foreclosure.

³⁰²⁸ For discussion of the limitations period for such suits by reference to the assessment limitations period, see discussion above at p. 185. Based on a recent case, one tax-related liability cannot be assessed (hence no assessment (continued...))

The judicial proceeding is a collection suit. If the collection suit is against the taxpayer and the taxpayer has not yet litigated his or her liability for the tax, the liability issue can be litigated in the collection suit.³⁰³⁰ And, if the Government obtains judgment in the case, it will then have a judgment lien against the taxpayer that can then be judicially enforced against after-acquired property or property subsequently located.

If the suit is against a third party who the Government alleges to hold property of the taxpayer, the third party can raise the defense that the taxpayer has no interest in the property upon which collection is sought or, if the taxpayer does have such interest, the third party's interest is superior to the taxpayer's. In the latter event, the Government might be trying to force a sale of the taxpayer's interest to realize as much as it can. *United States v. Rodgers* is a case where the Government used this type of suit. I discuss *Rodgers* in the next section.

2. Writ of Ne Exeat Republica - Constraining the Person.

The United States does not generally allow imprisonment—or, more broadly, constraining a person's liberty—for the nonpayment of debt.³⁰³¹ The exception for purposes of tax matters is the statutory approval in § 7402(a) for the writ of ne exeat republica. The Latin is “let him not go out of the republic,” and was developed in England as a Chancery writ. The writ is sometimes used in domestic relations contexts to restrain someone from leaving the jurisdiction. In tax collection contexts:

The writ ne exeat republica is an extraordinary remedy and should only be considered when all other administrative and judicial remedies would be ineffective. In appropriate cases, the writ ne exeat may be used as a collection device against a United States taxpayer who is about to depart from the territorial jurisdiction of the United States, or who no longer resides but is temporarily present in the United States and who has transferred his assets outside of the United States in order to avoid payment of his federal tax liabilities. The writ ne exeat is a court order which generally commands a marshal to commit to jail a defendant who fails to post bail

³⁰²⁸(...continued)

period of limitation), so that the only collection tool is the collection suit rather than assessment. *Fahry v. Commissioner*, 160 T.C. ___, No. 6 (2023) (held the § 6038(b) penalties for failure to file Form 5471 cannot be “assessed” and therefore the only collection measure is the collection suit which be subject to the general government suit for penalties 5-year limitations period in 28 U.S.C. § 2462 (the 5-year period starts when the liability for the penalty accrues). See for further discussion of this aspect of *Fahry* [Tax Court Holds that IRS Has No Authority to Assess § 6038\(b\) Penalties for Form 5471 Penalties](#) (Federal Tax Procedure Blog 4/3/23; 4/4/23).

³⁰²⁹ *In United States v. Liberty Global, Inc.* (D. Colo. Dkt. 22-cv-02622 Order on Motion to Dismiss Dkt. 29 6/1/23), the court held that the Government could sue for tax due without an assessment (actually without the § 6213(a) notice of deficiency required as a predicate to assessment) so long as the suit is commenced in the period of limitations for assessment. I expect that Liberty Global will raise the issue on appeal. In this regard, after the Motion, Liberty Global filed an Answer to the Amended Complaint where it asserted the issue as an affirmative defense. See Dkt. Entry 31 filed 6/15/23, pp. 15-16, ¶¶ 41-45.

³⁰³⁰ E.g., *United States v. O'Connor*, 291 F.2d 520 (2d Cir. 1961),

³⁰³¹ See generally Anthony E. Rebollo, [The Civil Arrest and Imprisonment of Taxpayers: An Analysis of the Writ of Ne Exeat Republica](#), 7 Pitt. Tax Rev. 103, 145-153 (2010) (discussing some of the legal and constitutional issues specifically in the context of restraint for taxation).

or other security in a specified amount. The authority for the United States District Courts to issue writs ne exeat in tax cases is found in I.R.C. section 7402(a) and 28 U.S.C. section 1651.

The debt relied on to support the writ must be enforceable against the defendant, be of a pecuniary nature and be presently payable. Thus, in tax cases, an assessment should be outstanding against the taxpayer.

The purpose of the writ in tax cases is to prevent taxpayers from defeating the collection of tax liabilities by removing themselves and their assets from the territorial jurisdiction of the United States. As a practical matter collection by administrative means is ineffective where the taxpayer has either secreted his assets or removed them from the United States. If the taxpayer leaves the United States, judicial remedies may be likewise defeated since the court would then be powerless in most cases to enforce its orders or judgments against the taxpayer or his property, if located outside of the United States. Thus, the writ ne exeat ensures the continuing submission of the taxpayer to the jurisdiction of the court.³⁰³²

The writ may be used in conjunction with the appointment of a receiver.³⁰³³

The writ, which constrains the person, can be used in conjunction with jeopardy or termination assessment or jeopardy levy to grab assets. Usually, the writ is used after the assessment has been made for some time and leviable assets are not available, perhaps even overseas.

The writ is very, very rarely used. I have never encountered it in my practice nor, anecdotally, have I heard of my colleagues' encountering it. The cases are sparse.³⁰³⁴

X. Property Subject to Lien and Levy - the Taxpayer's Property.

³⁰³² LGM Intl-2, reproduced at 1999 TNT 225-22 (case citations omitted). LGM is the initialism for Litigation Guideline Memorandum, an internal guidance device last used in 1999 and now discontinued, with prior LGMs obsoleted. See CCN 2017-001 (11/2/16). In discontinuing and formally obsoleting existing LGMs, the IRS said: "they can serve as useful research tools and historical records of positions previously taken by the Office of Chief Counsel on issues in litigation."

³⁰³³ LGM Intl-3 (4/9/90), reproduced at 1999 TNT 225-23. LGM is the initialism for Litigation Guideline Memorandum, an internal guidance device last used in 1999 and now discontinued, with prior LGMs obsoleted. See CCN 2017-001 (11/2/16). In discontinuing and formally obsoleting existing LGMs, the IRS said: "they can serve as useful research tools and historical records of positions previously taken by the Office of Chief Counsel on issues in litigation."

³⁰³⁴ See e.g., Order in *United States v. Barrett* (D. Colo. 2010), unofficially reproduced at 2010 TNT 233-27 (2010). For a good article, see Anthony E. Rebollo, The Civil Arrest and Imprisonment of Taxpayers: An Analysis of the Writ of Ne Exeat Republica, 7 Pitt. Tax Rev. 103 (2010).

The tax lien applies to the taxpayer's property—all of the taxpayer's property.³⁰³⁵ The taxpayer's property is determined under state law; federal law then determines whether the lien attaches to the property.³⁰³⁶ The Supreme Court has characterized the inquiry:

A common idiom describes property as a “bundle of sticks” -- a collection of individual rights which, in certain combinations, constitute property. State law determines only which sticks are in a person's bundle. Whether those sticks qualify as “property” for purposes of the federal tax lien statute is a question of federal law.³⁰³⁷

In most cases the taxpayer's property right to which the lien attaches is apparent, but in some cases it is less apparent. I attempt to give you a sense of the parameters from a brief discussion of key cases in the area.

First, let's consider a simple case. Assume a taxpayer owns a car that is titled in his name. The federal tax lien attaches to the car and, upon filing the tax lien, the IRS secures its rights against third parties. The IRS also has the right to seize the car as a means of collecting the underlying tax liability. The IRS can levy upon—i.e., seize—the car even if it is in the possession of a third party. This is the easy case.

Let's consider variations on the easy case to set the tougher cases up. Take the same facts, except the car, although equitably owned by the taxpayer, is titled in another person's name—e.g., his spouse or girlfriend. Under state law, the car is still the property of the taxpayer; the nominal titling of the property in another's name will not deny the IRS the right to seize the car.³⁰³⁸ Practically, the IRS will not discover taxpayer's interest in the car by an automobile title search and thus will need some other way to determine that the taxpayer equitably owns the car. Then, take those facts and reverse them—the car is equitably owned by another, but is titled in the taxpayer's name. The IRS should not seize the property because the taxpayer has no beneficial property right in the property.³⁰³⁹ Practically speaking, however, if the car is titled in the taxpayer's name easily determined by a search of state records, the IRS may likely to levy and leave the equitable owner to his or her right to return of wrongfully levied property.

Now let's turn to tougher cases, principally illustrated by a series of Supreme Court cases which are presented in chronological order.

In *United States v. Rodgers*, 461 U.S. 677 (1983), involving Texas' community property laws, the husband owed tax that was his separate liability. The IRS had, of course, the automatic lien

³⁰³⁵ *United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 719-720 (1985) (noting that § 6321's scope “is broad and reveals on its face that Congress meant to reach every interest in property that a taxpayer might have.”).

³⁰³⁶ The Supreme Court reiterated this formula in a line of cases culminating in *United States v. Craft*, 533 U.S. 274, 278 (2002).

³⁰³⁷ *U.S. v. Craft*, 535 U.S. 274, 279 (2002) (citations omitted).

³⁰³⁸ The IRS may levy via a nominee theory discussed later in the text.

³⁰³⁹ Cf. *United States v. Williams*, 514 U.S. 527 (1995). As discussed beginning onp. 749 the IRS's tax lien may cloud the title of a non-owner, but then the issue is one of remedies and not whether the IRS has the right collect the taxpayer's tax from a nontaxpayer's property.

against the taxpayer's property and had filed a tax lien thus putting third parties on notice. Prior to the IRS filing of the tax lien, the taxpayer and his wife (who was not liable for the tax) acquired a residence which, under Texas law, was both community property (each owning a ½ undivided interest) and a homestead (each having the right to reside in the homestead until the survivor's death). The IRS moved to foreclose on the taxpayer's interest in the home.³⁰⁴⁰ The Supreme Court held, not surprisingly, that the IRS could collect a separate tax liability from the property of the spouse owing that separate tax liability. The Supreme Court further held that the IRS could generally force a sale of the jointly owned property (community or otherwise) and could do so in this particular case involving a homestead, even though, under Texas law, the husband through whom the IRS claimed had no right to force a sale of the property. Note that, based on federal law concerns to collect revenue, the IRS which stepped into the taxpayer's shoes acquired a right the taxpayer did not have—that is, to force a sale of the property. Then, finally, the Court focused on the economic value of the taxpayer-husband's property rights. The Supreme Court held, in the case of homestead community property, the husband's property interest was one-half but that one-half was burdened by the other spouse's right to live in the homestead for life. Using actuarial tables based on the wife's life expectancy, the husband's one-half interest in the property would be substantially diminished. (The Court gave some percentages as examples, depending upon life expectancy.) Finally, the Court said that the trial court in such a case is not required to force the sale of the property³⁰⁴¹ and split the net cash according to the indicated interests of the taxpayer and the nonliable spouse; the trial court could consider common sense and special circumstances that would make a forced sale inequitable.

The key point of *Rodgers* in the current context is to focus carefully on what the taxpayer owns under state law and factor in any burdens on that property and special equitable circumstances so as to achieve the maximum benefit for other claimants to the property.³⁰⁴² *Rodgers* arose in a marital context with competing claims that need to be considered in fashioning the appropriate remedy. However, the principle applies in all contexts where a party other than the taxpayer subject to the tax debt claims an interest. The question is how those third party interests are to be recognized in the United States' suit to foreclose.

³⁰⁴⁰ § 7403.

³⁰⁴¹ § 7403(c) says that the court “may decree a sale of such property.” “May” is not mandatory, so that special equitable factors could be considered that mitigate against a sale.

³⁰⁴² A variation on the *Rodgers* theme is where a taxpayer has pension benefits in which the wife, under state law, has an interest. Pension benefits, like the homestead, are often accorded protection from creditors under state law. But that does not accord protection from the IRS. In *McIntyre v. United States*, 222 F.3d 655 (9th Cir. 2000), the IRS assessed taxes only against the husband. The husband had a pension plan with accrued benefits. California law gave the wife a community property interest in the pension. The wife urged that she had a present interest in one-half the pension and that her interest at least was not subject to levy for the husband's tax liability. *Rodgers*, of course, usually makes that a viable argument. However, California law provides that community property is liable for the debt of either spouse incurred before marriage or during marriage (here the husband was clearly liable for the federal taxes), whether or not the other spouse was independently liable for the debt (here the wife was not otherwise liable for the taxes). Based on this California law, the Court held that the Government like any other creditor could go against community property. The Court distinguished (as it had in an earlier case) contrary holdings under other states' laws where the state law did not permit a creditor to go against one spouse's share of community property in satisfaction of the other spouse's premarital debts. Ordinarily, of course, state law exempts retirement plans from creditors remedies, but the IRS is not an ordinary creditor. Once it was established that it was property subject to levy, the IRS could get it. This case illustrates the crucial importance of state law creditors rights upon which may assist or limit the IRS in collecting tax liabilities.

Addressing the special equitable factors presented in the marital context in *Rodgers*, the Court gave examples that might apply:

First, a court should consider the extent to which the government's financial interests would be prejudiced if it were relegated to a forced sale of the partial interest actually liable for the delinquent taxes. Second, a court should consider whether the third party with a non-liable separate interest in the property would, in the normal course of events (leaving aside § 7403 and eminent domain proceedings, of course), have a legally recognized expectation that that separate property would not be subject to forced sale by the delinquent taxpayer or his or her creditors. Third, a court should consider the likely prejudice to the third party, both in personal dislocation costs and in practical undercompensation. Fourth, a court should consider the relative character and value of the non-liable and liable interests held in the property. Those factors come with the caution that, because they do not constitute an exhaustive list, they should not be used as a 'mechanical checklist' to the exclusion of common sense and consideration of special circumstances. At the same time, however, the limited discretion accorded by § 7403 should be exercised rigorously and sparingly, keeping in mind the government's paramount interest in prompt and certain collection of delinquent taxes.³⁰⁴³

In *Drye v. United States*, 528 U.S. 49 (1999), which you should read now, the taxpayer was the sole heir of his mother's intestate estate. The taxpayer also owed substantial federal taxes, as to which liens existed and had been filed. The taxpayer filed a written disclaimer under state (Arkansas) law to avoid having the estate dissipated to pay his outstanding federal taxes. Arkansas law imputes a legal fiction upon such a disclaimer—the fiction is that the disclaimant had died before the testator, so that the disclaimant is no longer entitled to take from the estate and the estate passes from the testator, through the estate to the alternative beneficiaries, the next in line who was the taxpayer's daughter. With the proceeds of the estate, the daughter created a trust, styled the Drye Family 1995 Trust, which had as its beneficiaries the daughter and her parents (one of whom was the taxpayer). However, the taxpayer was only a discretionary beneficiary of the trust and thus, looking solely to the terms of the trust, the IRS had no right to treat any portion of the trust as the taxpayer's property subject to levy. The IRS tried a different tack—treating the disclaimer as ineffective to defeat the IRS's ability to go against the estate and the transferee of the estate. In holding that the disclaimer could not defeat the IRS's interest, the Court reasoned that the characteristics of the interest are indeed determined under state law, but that whether those characteristics add up to “property” to which the lien attaches under § 6321 was a matter of federal law. As to the disclaimed interest, the Court noted that the disclaimant exercised dominion and control over the property after the decedent's death and that dominion and control added up to a property right for § 6321 purposes, despite the ex post facto characterization of the state legal fiction.

³⁰⁴³ This is a quote from *United States v. Cardaci*, 856 F.3d 267, 274 (3d Cir. 2017), with the key points in the quote being quotes from *Rodgers*. For easier readability, I have stripped out the quotation marks and the page citations to *Rodgers*.

In *Craft v. United States*, 535 U.S. 274 (2002), the Supreme Court again visited the interface between state and federal law in determining what is the taxpayer's property. The IRS sought to collect on a federal tax lien against real property held by the taxpayer and his wife under Michigan law as tenants by the entirety. The Court set up its analysis by first positing the "bundle of sticks" analysis quoted above. The Court then discussed the forms and characteristics (the sticks, if you will) of the types of ownership at common law—tenants in common, joint tenancies, and tenancies by the entirety. Basically, in part here pertinent, tenancies in common are a form of fractional ownership, whereas joint tenancies are deemed ownership of the whole subject to right of survivorship, meaning that the property passes to the survivor by virtue of the joint tenancy rather than by probate or other form of testamentary transfer. At common law, tenancies in common may be alienated by each of the tenants (because it is a fractional share ownership), but joint tenancies could not be alienated without first being severed in a judicial proceeding or by deed. Tenancies by the entirety, by contrast to both, was like a joint tenancy in some respects, but rested on the fiction that husband and wife were one and therefore owned the property as a unity, thus initially requiring the consent of both to alienate but giving the husband such broad control (it was a man's world, after all) that eventually the common law recognized his right to alienate subject to the survivor's right to a survivorship interest. Michigan had statutorily changed some the features of the tenancy by the entirety. In pertinent part, each spouse was given an inseparable unified interest in the property with right of survivorship and, upon divorce, each acquired a divisible one-half interest subject to provision to the contrary in the divorce decree. The question, of course, was whether the husband had a property interest that could be levied upon.

The Court said it first looked to the husband's interest under state law which it characterized:

According to Michigan law, respondent's husband had, among other rights, the following rights with respect to the entireties property: the right to use the property, the right to exclude third parties from it, the right to a share of income produced from it, the right of survivorship, the right to become a tenant in common with equal shares upon divorce, the right to sell the property with the respondent's consent and to receive half the proceeds from such a sale, the right to place an encumbrance on the property with the respondent's consent, and the right to block respondent from selling or encumbering the property unilaterally.

Thus, characterizing the husband's interest, the Court then looked to federal law to determine whether those characteristics added up to "property" under § 6321. The Court concluded that the husband's rights (as described in the quote above) were significant. The only material burden was that he did not have the right to unilateral alienation, but the right to unilateral alienation could not alone defeat federal "property" status (as *Rodgers* held). Accordingly, the husband's interest was property and, as in *Rodgers*, could be foreclosed upon. In so holding, the Court declined to express a view as to the valuation of the husband's interest, for which it remanded.³⁰⁴⁴

³⁰⁴⁴ For discussion of some valuation issues raised by *Craft*, see Steve R. Johnson, *After Craft: Implementation Issues*, 96 Tax Notes 553 (7/22/02); for the IRS's position on the application of *Craft* in various scenarios, see Notice 2003-60, 2003-39 I.R.B. 643.

The Sixth Circuit addressed a situation like *Craft* but deciding the valuation issue for tenancies by the entirety in Michigan.³⁰⁴⁵ The husband had a separate property income tax debt for which the wife was not liable. They owned property as tenants by the entirety. Under Michigan law, each had a right of survivorship and a right to refuse to sell the property but, in a divorce situation, the interests of each spouse would be valued at ½ the value of the property. The issue in contention was not whether the Government could force a sale, but whether the wife's interest was greater than one-half. Reasoning that each had an equal and identical interest in the property, their interests must necessarily be equal in value, so that ½ of the whole sales value is the amount the innocent spouse receives. The Court distinguished *Rodgers* because in that case state law conferred a life estate in the surviving spouse, reasoning (such as it is):

This kind of actuarial calculation is not appropriate in the present case. *Rodgers* used actuarial valuation only out of necessity: one cannot determine the value of a life estate—which is effectively what *Rodgers* possessed—without estimating the length of the measuring life. The Supreme Court thus based its choice of valuation method on the fact that "any calculation of the cash value of a homestead interest must of necessity be based on actuarial statistics." *Id.* at 704. No such necessity exists here, and Mrs. Barr presents no compelling reason why this court should not apply the presumption of equal spousal life expectancy implicit in Michigan law.³⁰⁴⁶

Now, consider the following scenarios.

Example 1: The taxpayer is the beneficiary of a trust established by his father. The taxpayer has the right to \$100,000 distribution per year during his life, with remainder to the taxpayer's heirs. The trust has the standard spendthrift clause preventing the beneficiary (taxpayer here) from alienating his interest and declining to recognize such an alienation if the beneficiary attempts to do so. The taxpayer has a federal tax lien of \$1,000,000. Can the IRS go against the property in the trust? Can the IRS go against the taxpayer's interest in the trust (i.e., his right to distribution of \$100,000 per year during his life)? How does the IRS do that?³⁰⁴⁷

Example 2: The taxpayer is the beneficiary of a trust established by his father. The trust agreement charges the trustee to distribute for the taxpayer's needs and welfare up to \$100,000 per year, with remainder to the taxpayer's heirs. The taxpayer has a federal tax lien of \$1,000,000. Can

³⁰⁴⁵ *United States v. Barr*, 617 F.3d 370 (6th Cir. 2010),

³⁰⁴⁶ The dissent forcefully attacks the reasoning, such as it is. The dissent would, I think, have given her substantially the same relief as the innocent spouse in *Rodgers*. For a holding like the majority, see *United States v. Davis*, 815 F.3d 253 (6th Cir. 2016) (rejecting a claim that practical undercompensation because the split may not reflect the real life expectancies might prevent the forced sale of the property).

³⁰⁴⁷ In *Orr v. Commissioner*, 180 F.3d 656 (5th Cir. 1999), cert. denied, 529 U.S. 1099 (2000), the court held that the federal tax lien attached to the equitable interest of a beneficiary entitled to all of the net income of a trust despite the presence of a spendthrift trust provision, thus entitling the IRS to levy on future net income distributions despite the taxpayer's discharge of personal liability in bankruptcy. In *United States v. Harris*, 854 F.3d 1053 (9th Cir. 2017), the Court held that the beneficiary of two discretionary support trusts giving the trustees absolute discretion as to whether to distribute had a property interest in the trust under state law and thus could be subjected to federal garnishment when and if distributions were made. In that case, the underlying federal debt was for restitution in a nontax criminal case, but the statute treats restitution as if it were a liability assessed under the Code. 18 U.S.C. § 3613(c).

the IRS go against the property in the trust? Can the IRS go against the taxpayer's interest in the trust? In answering that question, you need to focus on what the taxpayer's interest in the trust is. Is the payment of the beneficiary's federal tax debts a valid need for purposes of the trustee making a distribution?

Example 3: The taxpayer in anticipation of the IRS assessing additional tax but, before it does so, creates a trust naming his wife as trustee and himself as the lifetime beneficiary with distributions, in the discretion of the trustee, for his needs and welfare. Can the IRS go against the property in the trust? Can the IRS go against the trust interest? What is the trust interest?

XI. Priority of Tax Liens.

Like other creditor liens, the § 6321 tax lien is designed to give the IRS as lienholder priority rights over the claims of some persons who, after creation of the lien, obtain an interest in property subject to the lien. Remember that the original § 6321 tax lien -- the unfiled lien -- is a silent or secret lien. Only the IRS knows about it originally and then, presumably, the taxpayer knows about it when he receives notice and demand for payment and does not pay. But third parties dealing with the taxpayer usually will not know about the lien.

This creates a problem that is not unique to the tax laws. When should third parties obtaining an interest in property subject to a pre-existing claim (such as a lien) be primed by (or subordinated to) that pre-existing claim? Anglo-Saxon jurisprudence has developed the concept of the bona fide purchaser ("BFP") who may prime--stand ahead of--a pre-existing lien or other interest in property. A more elaborate, if somewhat redundant, statement of the BFP concept is that the subsequent acquirer of an interest must be a bona fide purchaser for value without notice of the prior claim. Notice may be actual notice or a deemed notice via filing in a local filing office. (Note that I am now summarizing our general concepts of notice; the Code does provide some counterintuitive divergences.) Section 6323 tells us when a third party may acquire an interest that primes the federal tax lien.

The tax rules may be summarized:

First, the general tax lien arising upon assessment under § 6321 gives the IRS an interest prior to interests acquired after the lien comes into effect, except where the Code gives preference to such subsequently acquired interests. Section 6323(a) provides that, before the tax lien is filed (thus publicly giving notice of the lien), the general tax lien under § 6321 is not valid against four preferred categories of claimants (who I call acquirers because they acquire their claims after the general tax lien). These categories of acquirers (generally creditors), sometimes called the "four horsemen," are "(1) purchasers of the property for "adequate and full consideration in money or money's worth"³⁰⁴⁸ perfected under state law,³⁰⁴⁹ (2) holders of security interests in the property

³⁰⁴⁸ "Adequate and full consideration" means relationship to true value--"the consideration and the property value in this equation [must] be relatively close." *United States v. McCombs*, 928 F. Supp. 261, 268 (W.D. N.Y. 1995).

³⁰⁴⁹ The Code says even a purchaser for adequate and full consideration must have an interest "which is valid under local law against subsequent purchasers without actual notice." § 6323(h)(6) (emphasis supplied). So local
(continued...)

acquired for value perfected under state law at the time the tax lien was filed,³⁰⁵⁰ (3) holders of judgment liens perfected against the property,³⁰⁵¹ and (4) holders of perfected mechanic's liens.³⁰⁵² The priority granted such subsequent acquirer over the general tax lien applies even if the acquirer has **actual notice** of the unfiled general tax lien.³⁰⁵³ This may be a divergence from general state law that might not accord priority to a third party claimant whose claim arose when he or she had actual notice. I want you to trace through the statutory language that justifies the foregoing conclusion that, for example, the purchaser for full and adequate consideration primes the seller's federal tax lien even if the purchaser is aware of the tax lien. Of course, persons who acquire without paying value (such as donees) stand behind the unfiled federal tax lien whether or not they knew of the tax lien.

³⁰⁴⁹(...continued)

law is a critical factor and the key determinant is when the purchaser gets priority against subsequent purchasers. For example, a purchaser has no priority over the IRS under the following facts: (i) the IRS assesses the tax, thus creating the quiet lien, (ii) the purchaser buys the real property for adequate and full consideration, (iii) the purchaser carries in filing the deed, (iv) the IRS files its tax lien, and (v) the purchaser then files his deed. If the purported purchaser is not protected under local law against subsequent purchasers until the purported purchaser files his deed, then the IRS's intervening filing of the tax deed will prime that purchaser. See *Moco Investments Inc. v. United States*, 2010 U.S. App. LEXIS 1687 (3d Cir. 2009) (Not Precedential).

³⁰⁵⁰ § 6323(h)(4) (requiring that the holder have an interest perfected under state law and that the holder have “parted with money or money’s worth.” See *Equity Investment Partners LP v. Lenz*, 594 F.3d 1339 (11th Cir. 2010) for a good discussion of the perfected lien requirement.

There is one key nonstatutory exception to the perfected lien requirement—the purchase money mortgage is given priority. See Rev. Rul. 68-57 and *Slodov v. United States*, 436 U.S. 238, 259 (1978) (“A federal tax lien is subordinate to a purchase-money mortgagee’s interest notwithstanding that the agreement is made and the security interest arises after notice of the tax lien.”); and *United States v. Heptner*, 2016 U.S. Dist. LEXIS 78237 (W.D. Fla. 2016). For a discussion of this exception, see Keith Fogg, [The Non-Statutory Priority of the Purchase Money Mortgage Over the Federal Tax Lien](#) (Procedurally Taxing Blog 7/11/16).

³⁰⁵¹ T. Keith Fogg, [National Tax Lien Registry](#), 120 Tax Notes 783 (Aug. 25, 2008). A trap for the unwary judgment creditor is discussed *Collier v. United States*, 432 F.3d 300 (4th Cir. 2005). The majority and minority decision discuss some fine points of the English language as reflected in the Reg. § 301.6323(h)-1(g) which defines judgment lien creditors as “a person who has obtained a valid judgment, in a court of record and of competent jurisdiction, for the recovery of specifically designated property or for a certain sum of money,” and who “has perfected a lien under the judgment on the property involved.” Bottom line, the IRS lien in that case was filed after the foreign judgment was domesticated under state law but before the judgment lien was recorded. The state law generally gave the judgment lien priority from the date the judgment was obtained, but there was one class of creditors as to whom it did not give priority. The Court read the regulations to require that the IRS lien primes the state judgment lien. The dissent starts its analysis:

I have no idea what the Treasury Department intended when it promulgated the regulation that is before us today. However, whatever its intent, I suspect the Department drafted the regulation against a background belief that state recordation laws do not generally distinguish among third-party creditors. But whether or not this was its belief, I am confident as to the most defensible reading of the language that the Department chose to effectuate whatever its intent was (and, incidentally or not, that reading is consistent with what I suspect was the Department's background belief).

³⁰⁵² § 6323(a) and § 6323(h)(2).

³⁰⁵³ Rev. Rul. 2003-108 (2003), 2003-44 I.R.B. 963 (holding “For purposes of I.R.C. § 6323(a), a purchaser, holder of a security interest, mechanic's lienor or judgment lien creditor is protected against a statutory tax lien for which a notice of federal tax lien has not been filed notwithstanding actual knowledge of the statutory tax lien.”); see also *United States v. Allahyari*, 980 F.3d 684 (9th Cir. 2020) (actual notice unimportant for priority; and Congress “explicitly rejected” protection where acquirer of security interest had actual knowledge, citing *TKB Int'l, Inc. v. United States*, 995 F.2d 1460, 1466 (9th Cir. 1993); and holding “that § 6323(a) protects security interests acquired with or without knowledge of unfiled or later filed tax liens.”).

Second, after the filing of the tax lien, the acquirer is generally charged with notice that he could have received by checking the appropriate records and therefore generally will have his interest subordinated to the filed lien of the IRS. There is a bit of an anomaly here. The IRS primes an acquirer for value on the basis of the constructive knowledge of the filed tax lien (whether or not the acquirer had actual knowledge), whereas, before filing, an acquirer may prime the IRS even though he had actual knowledge of the unfiled tax lien. The second anomaly is that the filing may not in fact give notice because of mis-filing or mis-indexing; the filed tax lien is nevertheless entitled to priority even though the filing may not as a practical matter alert third parties dealing with the taxpayer.

Third, even as to filed liens which can prime even acquirers for value, Congress legislated a number of exceptions to permit our economy to function. These exceptions require that the person acquiring an interest in the property subject to the lien “for adequate and full consideration in money or money’s worth.”³⁰⁵⁴ For example, purchasers of stock on stock exchanges do not check the filing records (even if they could identify the seller) and it would be an unacceptable burden on commerce to expect them to do so or to subject securities transactions to this risk. Accordingly, there is an exception for purchase of “securities,” defined to include stock, unless the purchaser has actual knowledge or notice of the tax lien.³⁰⁵⁵ Encompassed by the same exemption is the “purchase” of “money” by a seller’s or service provider’s receipt of cash from the seller.³⁰⁵⁶ Another exception: purchasers of retail goods do not have to check the records to ensure that there is not a filed tax lien that might prime their interest in the property.³⁰⁵⁷ Scan § 6323(b) for a laundry list of other exceptions.³⁰⁵⁸ These exceptions to the priority of the filed federal tax lien are often referred to as “**superpriorities.**” If you will consider the nature of the exception, I hope you can recognize the

³⁰⁵⁴ § 6323(h)(1) and (6). Thus, gift transfers are not protected.

³⁰⁵⁵ § 6323(b)(1)(A) (exempting purchase of a security except where the purchaser has actual knowledge of the existence of the lien which knowledge would not exist for purchases of stock on the exchanges) and § 6323(h)(4) (defining security to include stock).

³⁰⁵⁶ Id. § 6323(h)(4) defines security to include “money,” thus subjecting the taxpayer’s cash payment to the rule for securities. The purchase of money may seem odd, but a “purchaser” is defined to mean “a person who, for adequate and full consideration in money or money’s worth, acquires an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice.” § 6323(h)(6). Thus, the taxpayer’s cash is subject to the general lien and, after filing of the NFTL, the cash when paid to a provider of goods or services is subject to the lien but only if that provider has actual notice of the tax lien. Obviously, this rule is required because subjecting ordinary dealings where the taxpayer pays cash for goods and services to the federal tax lien on the cash in the hands of the seller or service provider would put a debilitating burden on commerce.

Query the application of this exception to a lawyer paid by the taxpayer with cash for representing the taxpayer as to the filed tax lien. The lawyer certainly has actual notice or knowledge of the lien and thus seems not to qualify for the exception. The lawyer thus takes the cash subject to the lien. Now, whether the IRS would seek to collect from the lawyer is a separate matter.

³⁰⁵⁷ § 6323(b)(3).

³⁰⁵⁸ One lawyers will particularly love is an exception for an attorney’s lien on proceeds recovered in settlement of a cause of action “to the extent of his reasonable compensation for obtaining such judgment or procuring such settlement.” § 6323(b)(8). See Keith Fogg, How the Federal Tax Lien Prefers Lawyers over Doctors (Procedurally Taxing Blog 3/6/14). As stated in *Spencer v. Kirkpatrick*, 883 F. Supp. 588, 590 (W.D. Okla. 1995), this section:

only awards superpriority to the liens of those attorneys whose efforts have contributed to the judgment and in so doing, have helped create an asset from which the government can recover delinquent taxes. By granting attorney’s liens superpriority, attorneys are thus encouraged to bring (or, as in this case, continue to provide representation in) suits that ultimately may benefit the United States Treasury.

commercial reasons why Congress would subordinate the tax lien to third parties in such circumstances.

There may be special situations where, even if the IRS were entitled to priority under the foregoing rules, it might not exercise its priority rights when statutory liens are not involved. For example, a Tax Division Directive states certain instances where it “will recognize the priority of the claim of the investor or victim.”³⁰⁵⁹ The Directive is based on equitable principles, noting that courts may tend to favor the investor or victim if litigated, so the Tax Division will “endeavor to reach reasonable settlement in these cases, rather than presenting unsympathetic claims to the court.” Where statutory liens are involved, including liens for restitution, the Tax Division recognizes the general rule, consistent with the above priorities, that first in time is first in right.”

Finally, in determining lien priorities it is important to focus on the particular property to which the lien attaches and the timing of the competing liens or claims. For example, assume that the taxpayer has a home subject to a mortgage lien and the IRS thereafter files a tax lien. The lender on the mortgage is entitled to priority over the IRS. If the home is then destroyed and insurance proceeds are payable, who then has priority to the proceeds? Often, property insurance proceeds are made payable to the lender with respect to its priority mortgage interest in the home and that should suffice to give priority to the lender. But, if for some reason the lender is not named on the policy, the lender often under state law has an equitable lien on the proceeds. But the IRS lien attaches at the same time and, as to competing in time liens, the IRS lien takes priority.³⁰⁶⁰

XII. Third Party Claimant Sales and IRS Right of Redemption.

Third parties having a claim to property may conduct judicial and nonjudicial sales of the property to protect their claims. If the IRS has filed its tax lien, the IRS should be given notice of the sale and given an opportunity to protect its interest according to the priorities set forth above.³⁰⁶¹ Failure to give the notice will mean that the lien will continue despite the sale.³⁰⁶² If the IRS has a filed tax lien and either (i) the property is sold at such a proceeding to satisfy a claim prior to the IRS or (ii) the IRS was not given proper notice, the IRS has the right to redeem the property for up to 120

³⁰⁵⁹ See DOJ Tax Division Settlement Reference Manual 102 (Rev. Sept. 2012), citing Tax Division Directive No. 137 (11/3/08) which is published as App. D-2 of the Manual, along with further discussion of the issues and considerations in these cases in App. Z.

³⁰⁶⁰ See *Wolinsky v. Frye (In re Frye)*, 2020 Bankr. LEXIS (Bankr. D. Vt. Aug. 31, 2020) (in the case, the IRS had subordinated its filed lien on the home to a second mortgage holder, thus giving that second mortgage holder a prior lien position to the IRS; but, since the second lien holder did not require the taxpayer to name the second lien holder on the insurance, the second lien holder’s prior lien interest in the home attached as an equitable lien to the insurance proceeds at the same time as the IRS lien previously subordinated, thereby giving the IRS priority; the court noted that that was the law but was troubling).

³⁰⁶¹ § 7425(b).

³⁰⁶² § 7425(b) & § 7425(c).

days for the amount paid by the purchaser,³⁰⁶³ plus interest since the date of payment, and plus the purchaser's expenses (net of income) from the property.³⁰⁶⁴

XIII. Alternatives to Immediate Full Payment.

A. Introduction.

If the taxpayer does not have the type of assets that will permit immediate payment or there is some other hardship factor, the IRS has several alternatives. I discuss these alternatives below, but the key issue in collection is what the taxpayer can afford to pay toward the debt due and owing to the Government for taxes (including interest and penalties).

The IRS usually determines the availability of alternatives to prompt full payment on the basis of the taxpayer's financial ability. The IRS requires the taxpayer to use special forms—Forms 433-A (Collection Information Statement for Wage Earners and Self-Employed Individuals) and 433-B (Collection Information Statement for Businesses). These forms are combined financial statements showing assets, liabilities, income, expense, cash flow, etc. The forms show what assets the taxpayer has and how the IRS can get to them if it has to and attempt to project by the income and cash flow statements how much the taxpayer can pay over time on the liability. The IRS will ask the taxpayer to fill out the forms. If the taxpayer refuses to do so, the IRS may issue a summons to the taxpayer or third parties to develop the information that should be included on the forms, but if the taxpayer is not cooperating, it is unlikely the IRS will agree to a favorable payment alternative for the taxpayer.

The IRS will evaluate the information. If the forms indicate that the taxpayer has assets from which full payment can be made, the IRS will require the taxpayer to pay. If some of the taxpayer's assets are not liquid, the IRS will attempt to negotiate a plan whereby the taxpayer will take steps to turn the assets to cash in a reasonable time frame. Where the taxpayer cannot make full payment from his then assets, the IRS must then carefully assess the information to determine when, if ever, the taxpayer can do so.

The alternatives to collection generally require that the taxpayer be compliant with current filing and estimated tax payment requirements.³⁰⁶⁵ And, as will be noted, obtaining an alternative by installment agreement or offer in compromise will require future compliance for some period.

³⁰⁶³ If the purchaser was the creditor foreclosing on the property, then some states permit the debtor to have credit against the debt in the amount of the fair market value of the property foreclosed when the purchaser bids less than fair market value. In that circumstance, the creditor-purchaser is deemed to have paid the amount of the credit that the debtor is entitled to. This assures that, based on state law, the creditor's priority position is protected vis-a-vis the IRS.

³⁰⁶⁴ § 7425(d) and 28 U.S.C. § 2410(d).

³⁰⁶⁵ *Reed v. Commissioner*, 141 T.C. 248, 256-257 (2013); *Cox v. Commissioner*, 126 T.C. 237, 257 (2006), rev'd on other grounds, 514 F.3d 1119 (10th Cir. 2008); and *Hennessey Manor Nursing Home, Inc. v. Commissioner*, T.C. Memo. 2017-97.

B. Currently Not Collectible or Collection Suspense.

If the information indicates that the taxpayer is currently unable to make any payments, the IRS can suspend collection activity. The status is called “currently not collectible” or “CNC.”³⁰⁶⁶

Suspension or CNC does not mean that the debt is forgiven. Rather, the IRS may pick up the case again at some future time to reassess whether the taxpayer can then make any meaningful payments toward the tax liability. Even during CNC status, the IRS can still take measures such as the filing of a notice of federal tax lien or maintenance of a previously filed notice of federal tax lien.³⁰⁶⁷

C. Installment Agreements.

In the real world, when debtors can't pay their creditors, debtors and creditors often enter installment payment agreements (also called payment plans) to work through the problem or, some cases, forgive a portion of the debt. As a creditor, the IRS will also work with taxpayers in appropriate cases via installment payment agreements pursuant to which some or all of the taxes, penalties and interest are paid. The key difference between the IRS and ordinary creditors is that the IRS has a panoply of remedies unavailable to ordinary creditors and, as noted above, can reach assets (such as residence or retirement plan) that state law may make unreachable to ordinary creditors.

Section 6159 authorizes the IRS to enter “written agreements” allowing the taxpayer to pay “in installment payments” as IRS determines necessary to facilitate “full or partial collections” of the tax liability.

The IRS has several types of installment or payment plans.³⁰⁶⁸ For example, § 6159(c) has a mandatory IA for payment in full in 3 years if the liability does not exceed \$10,000 and the taxpayer has been compliant in the past 5 years.³⁰⁶⁹ The IRS offers discretionary plans with terms pre-set or as negotiated.³⁰⁷⁰ **A predicate requirement of the discretionary plan is that the taxpayer meet the current compliance requirement under § 6159(c).**³⁰⁷¹ For negotiated agreements, the IRS, like any creditor, is looking to collect as much as possible over a relatively short period of time. The IRS will require extensive financial information about the taxpayer's assets, liabilities, income and expenses. If that information indicates that the taxpayer can meet a plan with full payment in six

³⁰⁶⁶ See generally IRM Part 5. Collecting Process, Chapter 16. Currently Not Collectible and subparts of that IRM section. **The IRM notes that the transaction code for CNC is 530. IRM 5.16.1.2 (11-14-2023), Currently Not Collectible Procedures, and practitioners often use 530 to indicate CNC status.**

³⁰⁶⁷ *Durda v. Commissioner*, T.C. Memo. 2017-89.

³⁰⁶⁸ These are summarized in a table at IRM Exhibit 5.14.1-5, Installment Agreement Table; see also See IRS Web page titled “Topic 202 - Tax Payment Options” (Page Last Reviewed 6/30/22 and viewed 7/23/22).

³⁰⁶⁹ See also IRM 5.14.5.3 (10-14-2021), Guaranteed Installment Agreements.

³⁰⁷⁰ I refer practitioners to the following current web pages which offer an entry into the various plans: “Additional Information on Payment Plans” (last reviewed or updated 11/3/23 and viewed on 11/11/22).

³⁰⁷¹ **Bryan Camp, Lesson From The Tax Court: The Limits Of Collection Due Process (Tax Prof Blog 10/16/23) (discretionary plan requirement is not statutory as with the mandatory payment plan, but is an IRS discretionary requirement consistent with the mandatory plan requirements.)**

years, the IRS will do so without negotiating over the taxpayer's expenses.³⁰⁷² If not, the IRS will negotiate a plan allowing the taxpayer only reasonable expenses as determined by the financial information. Reasonable expenses will be based on certain standards developed by the IRS.³⁰⁷³

I offer the following which are common attributes of settlement agreements:

First, installment agreements do not have to provide for full amount of accrued taxes, penalties and interest.³⁰⁷⁴ Hence, the installment agreement may have some of the attributes of an offer in compromise where it is expected that the statute of limitations on further collection will expire before full payment.³⁰⁷⁵

Second, the penalty for failure to pay under § 6651 (beginning on p. 372) is reduced to .25 % per month (rather than the general rate of .5% per month) during the period that an installment agreement is outstanding.³⁰⁷⁶

Third, the IRS is authorized to collect a fee on entering the agreement and for modifying the agreement if that becomes necessary. The fee for agreements as of 2023 for regular installment

³⁰⁷² IRM 5.14.1.4.1 (01-01-2016), Six-Year Rule and One-Year Rule (“All expenses may be allowed if the taxpayer establishes that he or she can stay current with all paying and filing requirements, the tax liability, including projected accruals, can be fully paid within six years and within the CSED, and the expense amounts are reasonable,” but the agreement is not allowed if the expenses “are unreasonable.”)

³⁰⁷³ See IRS web page titled Collection Financial Standards (last Reviewed or updated 4/29/21; viewed 7/27/21), stating:

Collection Financial Standards are used to help determine a taxpayer's ability to pay a delinquent tax liability. Allowable living expenses include those expenses that meet the necessary expense test. The necessary expense test is defined as expenses that are necessary to provide for a taxpayer's (and his or her family's) health and welfare and/or production of income.

The web page discusses and has links to information on national standards for food, clothing, health care, housing, utilities, and transportation. For an exception to permit expenses in excess of the standards, a “Six Year Rule for Repayment of Tax Liability” is described as follows:

The six-year rule allows for payment of living expenses that exceed the Collection Financial Standards, and allows for other expenses, such as minimum payments on student loans or credit cards, as long as the tax liability, including penalty and interest, can be full paid in six years.

³⁰⁷⁴ Congress amended § 6159(a) in the 2004 Jobs Creation Act to permit installment agreements that do not necessarily provide for full payment. In the past, the IRS had read the Code as permitting installment agreements only where full payment was contemplated. Thus, for example, if the taxpayer owes \$1,000,000 in tax and his current and projected economic circumstances permit only a payment of \$1,000 per month, that taxpayer not pay off the tax liability (with accruing interest) even in 10 years. Previously, that taxpayer not able or expected to be able to pay the full amount could get relief only by an offer in compromise, but now some type of deferred payment having the practical effect of an offer in compromise is permissible. However, since in a deferred payout the IRS is not committed to collecting less than the full amount, the IRS is required to review the agreement and update the economic assumptions once every two years. § 6159(d). Assuming there is no material improvement in the taxpayer's economic circumstances, the statute of limitations on collection will eventually wipe out the remaining unpaid liability.

³⁰⁷⁵ This is referred to as a Partial Payment Installment Agreement (“PPIA”).

³⁰⁷⁶ § 6651(h). However, the 25% aggregate for failure to pay penalties in § 6651(a) is not reduced so, so that the aggregate is reached in case of an installment agreement after 10 months rather than 5 months. Hence, for many, perhaps most, installment plans involving the failure to pay penalty, the statutory reduction to .25% may be irrelevant or not material.

agreements (discussed below) is \$225 and scaling down from there for other agreements.³⁰⁷⁷ Lesser or no fees may be required for low income taxpayers, and for the most basic agreement (full payment within 120 days), there is no fee.

Fourth, during the period that an installment agreement request is pending, the IRS may not levy on the taxpayer's property.³⁰⁷⁸

Fifth, before applying for an installment agreement, the taxpayer must be in compliance with current filing and estimated tax payment requirements and must remain current during the period of the installment agreement.³⁰⁷⁹

I mention only in passing an IRS's "short-term payment plan" for full pay within 180 days which will forego collection activity within that period but interest and penalties continue to accrue.³⁰⁸⁰ This is not an installment agreement but, if requested, simply has the IRS forego collection activity during that period of time. This opportunity is requested either in the online payment website or by calling the IRS.

D. Offer in Compromise ("OIC").

1. Concept and Goals of the Program.

The IRS is authorized to compromise tax liability. § 7122(a). Pursuant to this authority, the IRS has an Offer-in-Compromise ("OIC") program to settle tax liabilities.³⁰⁸¹ The IRS's policy goal for the program is to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the government while providing taxpayers with a fresh start toward future voluntary compliance.³⁰⁸² **The OIC is described as "win-win for the government and taxpayers."³⁰⁸³ **The benefit to the taxpayer is that the amount is less than the taxpayer owes and often involves some****

³⁰⁷⁷ IRM 5.14.1.2 (03-31-2023), Installment Agreements and Taxpayer Rights, subparagraph (10) with Current User Fee Rates.

³⁰⁷⁸ § 6331(k)(2). The provision just prevents the levy; the IRS may still issue a notice of intent to levy. *Eichler v. Commissioner*, 143 T.C. 30, 37-38 (2014).

³⁰⁷⁹ IRM 5.14.1.2(11)d. (09-22-2021), Installment Agreements and Taxpayer Rights ("Current returns for taxes must be filed and current deposits paid before an installment agreement can be approved and the taxpayer must remain tax compliant for the entire term of the installment agreement, or he/she will default the agreement.") . *Reed v. Commissioner*, 141 T.C. 248, 256-257 (2013).

³⁰⁸⁰ See IRS Web page titled "Topic 202 - Tax Payment Options" (Page Last Reviewed 6/30/22 and viewed 7/23/22).

³⁰⁸¹ IRM Part 5, Chapter 8 Offers in Compromise. For an interesting discussion of how the increase in the collection statute of limitations from 6 years to 10 years in 1990 caused the IRS to invigorate its OIC program to deal with the increased outstanding receivables that will inevitably result (e.g., assessments that have not been collected in 6 years are not likely to be collected in 10). See Keith Fogg, [Affordable Living Expense Standard](#) (Procedurally Taxing Blog 8/23/17).

³⁰⁸² See generally IRM Part 4. Examining Process, Chapter 18. Exam Offer-In-Compromise; IRM Part 8. Appeals, Chapter 23. Offer in Compromise; and IRM Part 5. Collecting Process, Chapter 8. Offer in Compromise.

³⁰⁸³ **Bryan Camp, [Lesson From The Tax Court: A Lesson In Pathfinding](#) (Tax Prof Blog 11/20/23) ("The government gets some money now rather than nothing later and, more importantly, brings non-compliant taxpayers back into compliance....at least for five years...at least in theory," citing the [NTA 2018 Annual Report to Congress 266](#), but noting and explaining why "OIC's are not always a win-win for the taxpaying public.").**

payout period when the IRS is not seeking enforced collection via lien or levy; the benefit to the IRS is that the IRS gets something sooner than it would have otherwise and the taxpayer's obligation for the OIC to comply with tax obligations for 5-years.³⁰⁸⁴

The IRS's acceptance of an OIC conclusively settles the liability, absent fraud or mutual mistake.³⁰⁸⁵ Of course, this assumes that the taxpayer meets the obligations imposed by the OIC, including the 5-year compliance period..

The IRS is not authorized to settle taxes which are in litigation handled by DOJ.³⁰⁸⁶

I discuss in this section the key features of the OIC. The IRS offers helpful web site discussions including FAQs³⁰⁸⁷ and a special "Pre-Qualifier" Tool³⁰⁸⁸ that steps users through questions related to the key features of the OIC.

2. OIC as Contract; Acceptance.

The compromise is a contract between the IRS and the taxpayer to settle a tax liability for less than the full amount due (taxes, penalties and interest). Hence, the scope of the compromise is determined under contract law principles.³⁰⁸⁹ The compromise process is started by the taxpayer making an offer in compromise which then permits appropriate negotiations (offers and counter-offers) to conclude a final agreement if possible.

The OIC is not accepted until the IRS notifies the taxpayer (including taxpayer's representative) in writing of the acceptance.³⁰⁹⁰ Exception: an OIC pending over 24 months (not

³⁰⁸⁴ Taxpayers have a compliance obligation anyway, but this 5-year rule commits "the taxpayer [to] timely file all tax returns and timely pay all taxes for 5 years from the date of acceptance of the OIC;" otherwise the IRS may terminate the OIC permitting the IRS to "collect the amounts originally owed (less payments made), plus interest and penalties." IRS web page "Topic No. 204, Offers in Compromise" (last reviewed or updated 3/29/23; and viewed 12/3/23).

³⁰⁸⁵ Reg. § 301.7122-1(d)(5); *Estate of Jones v. Commissioner*, 795 F.2d 566, 574 (6th Cir. 1986); *Timms v. United States*, 678 F.2d 831, 833 (9th Cir. 1982); and *Dutton v. Commissioner*, 122 T.C. 133 (2004).

³⁰⁸⁶ § 7122(a); see also IRM 5.8.1.6.1 (04-20-2021), Tax Cases Controlled by Department of Justice (DOJ); IRS Authority to Settle After Referral to DOJ Tax (Federal Tax Crimes Blog 11/11/13); and IRS Has No Authority To Settle Cases Referred to DOJ Tax Even After They Are Returned (Federal Tax Crimes Blog 8/3/13).

³⁰⁸⁷ IRS Web page titled "Offer in Compromise - Frequently Asked Questions" (last reviewed and updated 6/6/22 and viewed 7/24/22).

³⁰⁸⁸ IRS Web page titled "Offer In Compromise Pre-Qualifier" (viewed on 7/24/22).

³⁰⁸⁹ *United States v. Begner*, 428 F.3d 998, 1004 (11th Cir. 2005); *United States v. Donovan*, 348 F.3d 509 (6th Cir. 2003); *Dutton v. Commissioner*, 122 T.C. 133 (2004).

³⁰⁹⁰ Reg. § 301.7122-1(e)(1). The IRS may cash the check accompanying the OIC and deposit it into a deposit account while it considers the taxpayer's offer; if the IRS rejects the offer, the amount will be returned to the taxpayer. The cashing of the check, even with an endorsement that cashing it settles the liability is not the legal equivalent of a settlement based on the terms of the proffered OIC; rather, the OIC is accepted only when and if the IRS formally accepts or takes some action that is the equivalent. See *Whitesell v. Commissioner*, T.C. Memo. 2017-84 (also rejecting UCC concepts as to deemed acceptance).

including periods in which the underlying tax is in litigation) is deemed accepted (sometimes called an “aging-into” rule”).³⁰⁹¹ The contract in that case is the OIC with an unconditional acceptance.

3. Bases for Compromise.

a. General.

OICs may be accepted only on the following bases:

- Doubt as to collectibility (sometimes “DATC”)³⁰⁹²
- Doubt as to liability (sometimes “DATL”),³⁰⁹³
- Effective Tax Administration (“ETA”) when DATC and DATL do not apply.³⁰⁹⁴

I discuss these separately below.

b. Doubt as to Collectibility (DATC).

The general rule is that the payment contemplated via a doubt as to collectibility offer “must equal or exceed a taxpayer's reasonable collection potential (“RCP”) to be considered for

³⁰⁹¹ § 7122(f); *Brown v. Commissioner*, T.C. Memo. 2019-121, at *15-*16 (citing IRM 8.23.3.1.1.1(6) (08-18-2017), Processability Criteria and General Changes Resulting from TIPRA (240 month period ends “when Compliance rejects or returns the offer or when the offer is withdrawn or treated as withdrawn under IRC 7122(c)(1)(B)(ii) because the taxpayer failed to make the second or later installment payment due on a periodic payment OIC”). (*Brown* was reversed and remanded on other grounds 826 F. App’x 673 (9th Cir. 2020)). In addition, if closed for reasons indicating the equivalent of finality (“return” rather than “reject”), even without the magic words rejection, the indication of finality may constitute a rejection. *Brown v. Commissioner*, 158 T.C. ___, No. 9 (2022), aff *Brown v. Commissioner*, 58 F. 4th 1064 (9th Cir. 1/24/23). See also IRM 5.8.7.3 (06-23-2022), Return Reconsideration (“Notice 2006-68 states that an offer will not be deemed accepted under section 7122(f) if the offer is rejected, returned, or voluntarily or involuntarily withdrawn within the 24-month period”; but in Note saying that IRS reconsideration at taxpayer’s request after the offer was returned to the taxpayer will not be subject to the 24-month rule because the offer was returned. The 2022 *Brown* T.C. opinion spawned much discussion that readers interested in the warp and woof of § 7122(f) might want to read a series of blogs by Caleb Smith on the Procedurally Taxing Blog: [The Age of Offers: Pitfalls and Possibilities for “Aging Into” Offer Acceptance \(7/20/22\)](#); [Aging Offers into Acceptance: When Does the Clock Stop? \(7/21/22\)](#); [Administrative Law in Practice: Deemed Offer Acceptance and IRS Notice 2006-68 \(7/22/22\)](#); and [Contract Law and Rejecting Offers in Compromise \(7/25/22\)](#). See also Bryan Camp, [Lesson From The Tax Court: The Difference Between Rejecting An OIC And Reviewing A Rejection \(Tax Prof Blog 7/18/22\)](#)

If the taxpayer believes the OIC has been accepted under this “aging into” rule without a rejection but the IRS disagrees, the taxpayer may find opportunities to litigate the issue limited because of the AIA, § 7421(a), the Declaratory Judgment Act exception for tax, and other limitations. See Keith Fogg, [Limitation of 24 Month Offer in Compromise \(Procedurally Taxing Blog 3/6/20\)](#) (discussing *RAJMP Inc. v. United States*, No. 3:19-cv-00876 (S.C. Cal. 2020) and noting the litigation opportunities may be the refund remedy (not often available in OIC situations because of full payment requirement), the collection suit which the Government may not file for years, the CDP proceeding if still available by the time of the OIC, or a Tucker Act case in the Court of Federal Claims; commentators to the blog entry suggested also a possible § 7433 action or a quiet title action).

³⁰⁹² Reg. § 301.7122-1(b)(1).

³⁰⁹³ Reg. § 301.7122-1(b)(2).

³⁰⁹⁴ Reg. § 301.7122-1(b)(3). See also H.R. Conf. Rep. No. 105-599, 105th Cong., 2d Sess., 289 (1998) approving consideration of factors other than doubt as to collectibility or liability.

acceptance.”³⁰⁹⁵ Basically, the RCP is the reasonable amount that the IRS thinks it can get from the taxpayer’s assets and income.³⁰⁹⁶

The RCP is calculated as the sum of: (i) the “net realizable equity” in the taxpayer’s assets,³⁰⁹⁷ (ii) the amount collectible from future income less living expenses,³⁰⁹⁸ (iii) the amount collectible from third parties through administrative or judicial action such as transferee, nominee or fraudulent conveyance,³⁰⁹⁹ and (iv) assets available to the taxpayer but beyond the reach of the government (such as assets outside the country).³¹⁰⁰ If the RCP calculation indicates that the taxpayer can full pay through an installment agreement, that is the relief for the taxpayer. But, if the OIC is appropriate, the RCP becomes the benchmark for the terms of the OIC that the IRS will accept.

The IRS may reject an OIC that

- is substantially below the RCP in the absence of special circumstances of economic hardship or compelling public policy or equity considerations;³¹⁰¹ or
- has any portion of the offer as a frivolous submission.³¹⁰²

³⁰⁹⁵ IRM 5.8.1.2.2 (04-20-2021), Policy. The RCP concept is not expressly in the statute or regulations, although something like it is surely implicit.

³⁰⁹⁶ *Alphson v. Commissioner*, T.C. Memo. 2016-84. The appeals officer need not calculate the RCP if it is clear that the offer is below the RCP, however computed. *Estate of Duncan v. Commissioner*, T.C. Memo. 2016-204, at 22 n. 5 (“Determination of their exact RCP would be a meaningless exercise where (as here) the taxpayers admitted that their RCP exceeded their offer by at least 1,250%.”), aff’d 2018 U.S. App. LEXIS 12257 (5th Cir. 2018) (unpublished) (“meaningless exercise”).

³⁰⁹⁷ IRM 5.8.5.4.1 (09-30-2013), Net Realizable Equity (Net realizable equity is the “quick sale value (QSV) less amounts owed to secured lien holders with priority over the federal tax lien, if applicable, and applicable exemption amounts.”; QSV is “an estimate of the price a seller could get for the asset in a situation where financial pressures motivate the owner to sell in a short period of time, usually 90 calendar days or less,” which is typically “an amount less than fair market value.”). The IRM provides detailed instructions on how to consider certain categories of assets, including jointly held assets, assets held by others such as transferees, nominees or alter egos, closely held businesses, life insurance, furniture and fixtures, etc. One category of asset requiring special consideration is going concern value of a business. See IRM 5.8.5.17(5) (03-23-2018), Business as a Going Concern (providing that, generally, the going concern value of a “viable ongoing business” is not included in RCP “unless the value is substantially greater than the income produced by the business.”).

³⁰⁹⁸ IRM 5.8.5.20 (09-24-2021), Future Income.

³⁰⁹⁹ IRM 5.8.4.3.1 (04-30-2015) Components of Collectibility. The assets subject to such potential remedies may be included in the RCP even without the IRS pursuing the remedy. IRM 5.8.5.6 (03-23-2018), Assets Held By Others as Transferees, Nominees, or Alter Egos.

³¹⁰⁰ IRM 5.8.4.3.1 (04-30-2015) Components of Collectibility.

³¹⁰¹ *Johnson v. Commissioner*, 136 T.C. 475, 486 (2011), aff’d, 502 F. App’x 1 (D.C. Cir. 2013); *Fairlamb v. Commissioner*, T.C. Memo. 2010-22; *Estate of Duncan v. Commissioner*, T.C. Memo. 2016-204, at *22 n. 5 (citing Rev. Proc. 2003-71, sec. 4.02(2), 2003-2 C.B. 517, 517), aff’d 2018 U.S. App. LEXIS 12257 (5th Cir. 2018) (with Fifth Circuit holding that, where the offer is so low that it clearly does not reflect RCP, the IRS is not required to do the substantial valuation work to compute actual RCP because to do so would be meaningless); *Murphy v. Commissioner*, 125 T.C. 301, 320 (2005), aff’d, 469 F.3d 27 (1st Cir. 2006); and *Gustashaw v. Commissioner*, T.C. Memo. 2018-215 (finding harmless error in inclusion of an asset because, even omitting the asset, the taxpayer’s RCP still exceeded their final offer).

³¹⁰² § 7122(g), incorporating frivolous submission test of § 6702(b)(2)(A),

RCP requires consideration of the taxpayer's assets, potential earnings and reasonable living expenses.³¹⁰³ As to reasonable living expenses, the IRS is required to publish national and local standards for determining basic living expenses that should be allowed in determining reasonable collection potential.³¹⁰⁴ The IRS's application of these national and local standards in considering and OIC are generally considered reasonable in a CDP contest of the application of the standards.³¹⁰⁵ These are, however, just guides and may be departed from if the facts and circumstances warrant.³¹⁰⁶

One issue presented in the calculation of RCP is the consideration of improperly dissipated assets that were frittered away prior to the taxpayer requesting an OIC to prevent a taxpayer from having assets to pay the tax. Obviously, if the assets are gone, they are not available to pay the tax. Should the dissipation of the assets in advance of an OIC be considered. For example, if a taxpayer owes a \$1,000,000 tax liability and has \$1,000,000 in assets that he spends on a lavish lifestyle to avoid paying the tax debt, can he then claim \$0 in assets in the RCP calculation to achieve a minimal OIC payment? The Tax Court has addressed the phenomenon:

Ascribing dissipated assets to someone results in a legal fiction that may seem harsh: It treats a taxpayer as having money that he actually doesn't. But not including dissipated assets in RCP would create a perverse incentive to be profligate: A taxpayer with a large tax debt could waste his money on nonessential goods and then plead poverty when the taxman came. Including dissipated assets in RCP solves this chutzpah problem. See Alex Kozinski & Eugene Volokh, "Lawsuit, Shmawsuit," 103 Yale L.J. 463, 467 (1993) (defining "chutzpah").³¹⁰⁷

Accordingly, dissipated assets can be included in the RCP "in situations where it can be shown the taxpayer has sold, transferred, encumbered or otherwise disposed of assets in an attempt to avoid the payment of the tax liability."³¹⁰⁸ Further, generally, the IRS considers a three year time frame in its RCP analysis for dissipated assets.³¹⁰⁹

Doubt as to collectibility compromises generally contain a term that waives refunds for all years through the year the offer is accepted.³¹¹⁰

³¹⁰³ RCP is determined under IRM 5.8.5 Financial Analysis.

³¹⁰⁴ § 7122(d)(2)(A).

³¹⁰⁵ *Walker v. Commissioner*, T.C. Memo. 2016-75.

³¹⁰⁶ *Walker v. Commissioner*, T.C. Memo. 2016-75, at *18:

Appeals officers may deviate from national and local standards when a taxpayer demonstrates with reasonable substantiation and documentation that he or she would not have adequate means to provide for basic living expenses. See sec. 7122(d)(2)(B); *Marascalco v. Commissioner*, T.C. Memo. 2010-130, aff'd, 420 F. App'x 423 (5th Cir. 2011).

³¹⁰⁷ *Alphson v. Commissioner*, T.C. Memo. 2016-84, at *10.

³¹⁰⁸ IRM 5.8.5.18(1) (09-24-2021), Dissipation of Assets. For an application of the RCP to dissipated assets, see *Alphson v. Commissioner*, T.C. Memo. 2016-84 (involving a prior version of the IRM, but focusing on the taxpayer's inability to explain the expenditure of over \$1,000,000 in a short period prior to making the offer in compromise); and *Estate of Duncan v. Commissioner*, T.C. Memo. 2016-204 in fn. 7, aff'd 2018 U.S. App. LEXIS 12257 (5th Cir. 2018) (unpublished).

³¹⁰⁹ IRM 5.8.5.18(2) (09-24-2021), Dissipation of Assets.

³¹¹⁰ IRM 5.8.6.4 (10-04-2017), Waiver of Refunds. This waiver is not required for compromises based (continued...)

Finally, the IRS may in some “special circumstances” accept less than RCP OIC’s based on doubt as collectibility, with the acronym being “DATCSC.”³¹¹¹

c. Doubt as to Liability (DATL).

OICs may also be made for doubt as to liability.³¹¹² Usually, if the taxpayer has a good defense as to his or her liability, the taxpayer will have had an opportunity to present that defense before the IRS makes the assessment. We covered above the system whereby, through the requirement for a notice of deficiency, the taxpayer may contest liability in the Tax Court. The taxpayer also could have judicially contested liability in a refund, in a collection suit or in a CDP proceeding (discussed below). Once the liability is judicially contested, the IRS will not consider offers in compromise based upon doubt as to liability.³¹¹³

Administratively, also, the taxpayer will have had some procedural avenues, including invoking Appeals Office consideration or audit reconsideration,³¹¹⁴ to contest liability. Nevertheless, there are many taxpayers who have not had effective judicial reviews of their liabilities for the assessed taxes.³¹¹⁵ They may not owe the taxes. Those taxpayers can use OICs to contest their liability for the underlying taxes.

Sometimes the taxpayer will make an OIC based upon a combination of doubt as to collectibility and doubt as to liability. The IRS will process the OIC first on doubt as to collectibility, because if the offer is acceptable on that basis, the issue of liability is moot.

d. Effective Tax Administration (ETA).

The IRS is now authorized by regulation to compromise to promote effective tax administration.³¹¹⁶ In the absence of doubt as to collectibility or liability, the IRS may settle (1) where, in the case of individuals, collection of the full tax liability would create economic hardship,³¹¹⁷ or (2) regardless of the taxpayer's financial condition, exceptional circumstances of

³¹¹⁰(...continued)

on doubt as to liability, effective tax administration or doubt as to collectibility with special circumstances. *Id.*

³¹¹¹ Rev. Proc. 2003-71, 2003-36 I.R.B., ¶ 4.02(2) (“ In some cases, the Service may accept an offer of less than the total reasonable collection potential of a case if there are special circumstances”; there is no indication or guidance as to what “special circumstances” are); and IRM 5.8.4.2, Effective Tax Administration (ETA) and Doubt as to Collectibility with Special Circumstances (DATCSC). This type of OIC may function like an ETA which permits paying less than owed where there is no doubt as to collectibility or liability.

³¹¹² The internal acronym is OIC-DATL.

³¹¹³ Reg. § 301.7122-1(b)(1).

³¹¹⁴ See discussion of audit reconsideration below beginning p. 720.

³¹¹⁵ For example, I have used the OIC process based on doubt as to liability for so-called assessable penalties—penalties that may be assessed without any predicate notice of deficiency. That gambit worked even in a case where the taxpayer had full ability to pay the assessed penalty and sue for refund.

³¹¹⁶ Reg. § 301.7122-1(b)(3) see generally see IRM 5.8.11.2 (10-04-2019), Overview; and IRM 5.8.11 Effective Tax Administration. The internal acronym is OIC-ETA.

³¹¹⁷ Economic hardship permits acceptance “even though the tax could be collected in full.” Rev. Proc. 2003-71, § 4.02(3)(a), 2003-2 C.B. 517; and IRM 5.8.11.3.1 (10-04-2019), Economic Hardship.

compelling public policy or equity considerations exist such that collection of the full liability would be detrimental to voluntary compliance by taxpayers.³¹¹⁸ Examples of ETA are:

(1) a long-term illness, medical condition, or disability that renders the taxpayer incapable of earning a living, where it is “reasonably foreseeable that taxpayer’s financial resources will be exhausted providing for care and support during the course of the condition:” (2) a situation where the taxpayer’s monthly income is exhausted by providing for care of dependents without other means of support; and (3) a situation where liquidation of assets would render the taxpayer unable to meet basic living expenses.³¹¹⁹

This is not a panacea for taxpayers, however, because the circumstances would be rare that a taxpayer clearly owed the tax and could pay it, but some equitable factors would justify the IRS foregoing collection.³¹²⁰

One negative factor is where some substantial amount of the tax liability the taxpayer seeks to compromise arises from an abusive tax shelter.³¹²¹ In some of the more abusive tax shelters, the taxpayers avoided millions of dollars in tax and had to pay years later (with penalties and interest). By the time the bill came due, the taxpayers often no longer had sufficient assets to pay. As one court said:

The [taxpayer’s] liabilities are the result of participation in a tax shelter; acceptance of the offer would place the Government in the unenviable role of an insurer against poor business decisions by taxpayers and it would be particularly inappropriate for the Government to play that role here. Reducing the risks associated with tax shelters would undermine compliance with the tax laws; therefore the settlement officer’s rejection of the offer was appropriate.³¹²²

³¹¹⁸ Reg. § 301.7122-1(c)(3) (offering examples); IRM 5.8.11.3.2 (08-05-2015), Public Policy or Equity Grounds (referring to this ground as non-economic hardship basis (acronymed to NEH-ETA); and IRM 5.8.11.3.2.1 (10-04-2019), Public Policy or Equity Compelling Factors (discussing the general standard and offering examples).

³¹¹⁹ Reg. § 301.7122-1(b)(3)(i) & (ii); IRM 5.8.11.3.1 (10-04-2019), Economic Hardship; see also H.R. Conf. Rep. No. 105-599, 105th Cong., 2d Sess., 289 (1998). *Estate of Duncan v. Commissioner*, T.C. Memo. 2016-204, *23 n. 6, aff’d 2018 U.S. App. LEXIS 12257 (5th Cir. 2018) (unpublished) (citing Reg. § 301.7122-1(c)(3)(i) and a prior version of IRM 5.8.11.2.1 (08-05-2015), Economic Hardship. The IRM provides, logically, that the economic hardship for closing agreements only applies to individuals.

³¹²⁰ See David M. Fogel, *‘The Effective Tax Administration’ Offer in Compromise*, 2005 TNT 163-34 (8/24/05) (reporting inter alia that less than 1% of total offers accepted are based on this effective tax administration relief provision). See for an extreme example, *Keller v. Commissioner*, 568 F.3d 710 (9th Cir. 2009) (involving a number of partners in the Hoyt tax shelter cattle partnerships where Hoyt allegedly defrauded the investors; held, IRS determination of no relief sustained even though the taxpayers were victim of Hoyt’s fraud and it took the IRS a long time to untangle the web of partnerships and process the audit and resulting litigation (20 years)).

³¹²¹ IRM 5.8.11.3.2.1 (10-04-2019), Public Policy or Equity Compelling Factors, second example in subparagraph (7) stating “Furthermore, reducing the risks of participating in tax shelters would encourage more taxpayers to run those risks, which would undermine compliance,” but noting that depending on facts and circumstances the taxpayer may still qualify for a doubt as to collectibility OIC.

³¹²² *Gustashaw v. Commissioner*, T.C. Memo. 2018-215, at *17-*18 (cleaned up), with the tax shelter litigated and lost by the taxpayer in *Gustashaw v. Commissioner*, 696 F.3d 1124 (11th Cir. 2012).

The IRM notes the same consideration but also states that the OIC can still be considered on doubt as to collectibility which requires an RCP determination³¹²³ or because collection in full would cause economic hardship.³¹²⁴

e. Not in the Best Interest of the Government (“NIBIG”).

Implicit in the IRS overall Policy Statement P-500 permitting OICs if in the interest of the taxpayer the IRS, even if an offer is in the amount of the RCP, the IRS may reject if “not in the best interest of the government.”³¹²⁵ The exception is stated separately in the IRM but may substantially overlap with the ETA exception noted in the preceding paragraph.³¹²⁶

4. Independent Review.

The IRS must provide for independent administrative review of a proposed rejection of the OIC and an appeal to the IRS’s Appeals Office.³¹²⁷ The IRS may thus not reject an OIC until this independent administrative review has occurred.³¹²⁸ Then, if the IRS rejects the offer, the taxpayer may appeal to the Appeals Office.³¹²⁹

5. Administrative Procedures.

Section 7122(d)(1) provides that the IRS “shall prescribe guidelines for officers and employees of the [IRS] to determine whether an offer-in-compromise is adequate and should be accepted to resolve a dispute.” The procedures require that that OIC not be for the purpose of delay and be otherwise processable (such as being on the required form with a good faith effort to complete and provide the information requested).³¹³⁰ The IRS does not consider an OIC as to past assessed taxes unless the taxpayer is current –meaning the taxpayer has filed required returns and made certain tax deposits.³¹³¹

³¹²³ In *Gustashaw*, cited in the preceding footnote, the Court rejected doubt as to collectibility because the taxpayer’s offer was well below the RCP.

³¹²⁴ IRM 5.8.11.3.2.1 (10-04-2019), Public Policy or Equity Compelling Factors.

³¹²⁵ IRM 5.8.7.7.1 (06-23-2022), Not in the Best Interest of the Government Rejection (noting that Policy Statement P-100 states that “an offer will only be accepted if it is determined to be in the best interest of both the taxpayer and the Service.”); IRM 5.8.7.7 (06-23-2022), Rejection (noting the not in best interest has the inevitable acronym, NIBIG) and stating that the rejection letter should advise the taxpayer subject to a NIBIG rejection of the specific issues upon which the rejection is based).

³¹²⁶ Keith Fogg, Public Policy and Not in the Best Interest of the Government Offer in Compromise Rejections (Procedurally Taxing Blog 3/28/22).

³¹²⁷ § 7122(e).

³¹²⁸ Reg. § 301.7122-1(f)(2).

³¹²⁹ Reg. § 301.7122-1(f)(5).

³¹³⁰ Reg. § 301.7122-1(d)(2).

³¹³¹ The IRS web page titled “Offers in Compromise” (Last Reviewed or Updated 11/13/18 and accessed 11/19/18) cautions

Beginning with Offer applications received on or after March 27, 2017: The IRS will return any newly filed Offer in Compromise application if you have not filed all required tax returns. Any application fee included with the OIC will also be returned. Any initial payment required with the returned application will be applied to reduce your balance due. This policy does not apply to current year tax

(continued...)

The OIC is submitted by Form 656, Offer in Compromise.

Minimum nonrefundable payments (sometimes referred to as TIPRA payments, the acronym for the statute enacting the minimum payments requirement³¹³²) are required with the submission of OICs. A lump sum payment OIC (defined as payments of five or fewer installments) must be accompanied by nonrefundable payment of 20% of the amount of the offer.³¹³³ A periodic payment OIC must be accompanied by nonrefundable payment of the first proposed installment.³¹³⁴ The minimum payment requirement does not apply for doubt as to liability OICs.³¹³⁵ The minimum payment requirement also does not apply to low-income taxpayers,³¹³⁶ and the IRS may be regulation waive the payment requirements.³¹³⁷

Voluntary payments in excess of the minimum payments are treated as refundable deposits; if the OIC is denied, the deposit will be returned to the taxpayer without interest.³¹³⁸

³¹³¹(...continued)

returns if there is a valid extension on file.

Reg. § 301.6320-1(d)(2), Q&A-D8. The reasoning for the requirement that taxes be current before considering compromising old tax assessments was stated in *Orum v. Commissioner*, 412 F.3d 819, 821 (7th Cir. 2005):

It would not do the Treasury any good if taxpayers used the money owed for 2004 to pay taxes due for 1998, the money owed for 2005 to pay taxes for 1999, and so on. That would spawn more collection cycles yet leave a substantial unpaid balance. The Service's goal is to reduce and ultimately eliminate the entire tax debt, which can be done only if current taxes are paid while old tax debts are retired.

³¹³² The Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222, sec. 509(a), 120 Stat. at 362, enacting § 7122(c). See IRM 8.23.3.1.1 (11-21-2013), The Tax Increase Prevention and Reconciliation Act of 2005; and *Brown v. Commissioner*, T.C. Memo. 2019-121, at *6-*7 (“With his OIC petitioner included a Tax Increase Prevention and Reconciliation (TIPRA) payment of \$80,000 (20% of the total OIC”), aff’d in part, vacated in part, and remanded, 826 F. App’x 673 (9th Cir. 2020), on remand *Brown v. Commissioner*, T.C. Memo. 2021-112, aff’d 58 F. 4th 1064 (9th Cir. 1/24/23) (quoting the submission form as including “I voluntarily submit the payments made on this offer and understand that they will not be returned even if I withdraw the offer or the IRS rejects or returns the Offer” and holding that Brown was not entitled to a refund of the TIPRA payment after the IRS returned the proffered OIC on the ground that processing the OIC was inappropriate because of audits making the overall liability uncertain).

³¹³³ § 7122(c)(1)(A). Any OIC payable in five or fewer payments is considered a lump-sum payment for purposes of this requirement. § 7122(c)(1)(A)(ii). The payment is treated as a payment of tax rather than a deposit. *Brown v. Commissioner*, T.C. Memo. 2019-121, at *19-*20 (citing Notice 2006-68, sec. 1.02, 2006-2 C.B. 105, 1059), rev’d and remanded on other grounds, 826 F. App’x 673 (9th Cir. 2020), on remand *Brown v. Commissioner*, T.C. Memo. 2021-112, aff’d 58 F. 4th 1064 (9th Cir. 1/24/23). If the OIC is not accepted, the payment will be applied as the taxpayer directed in making the OIC (§ 7122(c)(2)(A) or, failing such direction, as the IRS determines. The current regulation, Reg. § 301.7122-1 state that payments with OICs are treated as deposits, but this regulation pre-dates the enactment of the TIPRA minimum payment requirements in 2005.

³¹³⁴ § 7122(c)(1)(B).

³¹³⁵ IRM 8.23.3.1.1(3) (11-21-2013), The Tax Increase Prevention and Reconciliation Act of 2005 (citing Notice 2006-68.)

³¹³⁶ § 7122(c)(3).

³¹³⁷ § 7122(c)(2)(C).

³¹³⁸ Notice 2006-68, 2006-31 I.R.B. 105, at par. 1.02 (citing Regs § 301.7122-1(h) (which provides that the payments are deposits but note that the regulation precedes the enactment of § 7122(c), so per the Notice the regulation only applies to amounts paid in excess of the minimums required by § 7122(c)).

An issue has been what to do with any refunds for which the taxpayer may be entitled extending through the year the OIC. The concern is that the taxpayer might overpay tax liability, file the OIC and then claim the refund. For a number of years, the OIC form has specifically required the taxpayer to agree that the IRS can take (by offset) any refund for those years and cannot apply to estimated tax payment for the following year or to the offer amount in the OIC. Effective 11/1/21, the IRS will no longer offset or recoup refunds for the year the offer is accepted.³¹³⁹ So, the IRS may still offset refunds for pre-acceptance years. The new policy includes an opportunity for an Offset Bypass Refund (“OBR”) in appropriate hardship cases.³¹⁴⁰

The OIC requires a “user fee” that is currently \$205 except if the offer is based solely on doubt as to liability or made by a low-income taxpayer.³¹⁴¹

The payment requirement and the user fee are waived for OICs by individuals with “adjusted gross income, as determined for the most recent taxable year for which such information is available, which does not exceed 250 percent of the applicable poverty level (as determined by the Secretary).”³¹⁴²

6. IRS Counsel Review.

An opinion of IRS counsel is required in all cases where the unpaid tax (including interest, penalties and additions) is \$50,000 or more.³¹⁴³ The Counsel review consists of both legal and policy review. Counsel’s review is, however, not a veto power, although few revenue offers would settle in the face of a negative Counsel review.

7. Collateral Agreements.

The IRS may condition acceptance of an OIC on a collateral agreement.³¹⁴⁴ “A collateral agreement enables the government to collect funds in addition to the payments offered in Form 656 or to add additional terms not included in the standard Form 656 agreement, thereby recouping part of the difference between the amount of the offer or additional terms of the offer and the liability compromised.”³¹⁴⁵

³¹³⁹ NTA Blog: [IRS Initiates New Favorable Offer In Compromise Policies](#) (11/15/21).

³¹⁴⁰ On the OBR, see p. 682.

³¹⁴¹ Reg. § 300.3(b)(1)(as amended, with the effective date for fee 4/27/20; prior to that date the fee was \$186). See IRS web page “Offer in Compromise” (last revised 7/22/22 and reviewed 7/13/22). If the fee is charged and the offer is then accepted to promote effective tax administration or based on doubt as to collectibility and the IRS determines that collection of an amount greater than offered would create economic hardship, the user fee may be applied against the offer amount or refunded. § 300.3(b)(2).

³¹⁴² § 7122(c)(3), as added by Taxpayer First Act of 2019, § 1102, P.L. 116-25, 133 Stat 981 (July 1, 2019).

³¹⁴³ § 7122(b).

³¹⁴⁴ Reg. § 301.7122-1(e)(2); see IRM Part 5. Collecting Process, Chapter 8. Offer in Compromise, Section 6. Collateral Agreements.

³¹⁴⁵ IRM 5.8.6.1 (06-25-2021), Program Scope and Objectives.

For example, if the RCP indicates that the taxpayer can only make payments in a certain amount but the taxpayer has a potential to significantly increase his or her income over a relatively short period of time, the IRS may require that the taxpayer agree to pay over a certain percentage of future income in excess of the negotiated amount.³¹⁴⁶ Let's illustrate this with an example that some lawyers would care about: if the taxpayer were a lawyer having a major case on a contingency fee with substantial work yet to be done (so that the value of the fee cannot be determined at the time of compromise in an economic sense), the IRS might require that, if the case resolves within a certain number of years (e.g., 5 years), the IRS would get 25% or 50% of the amount in excess of say \$100,000.³¹⁴⁷ The precise terms that such a collateral agreement would depend upon the unique facts.

Collateral agreements may include waiver of net operating losses, capital losses and unused business credits incurred before the offer is accepted, which can because of the benefits in the future year when the losses or credits would otherwise be claimed, effectively reduce or economically eliminate the amount being compromised.³¹⁴⁸

8. Possibility of Collection from Others.

A taxpayer who is liable for the tax but who desires to compromise the amount that he or she owes may assert that the amount of the compromise should take into consideration that the IRS could collect from third parties. Logically, the ability to collect from third parties is not a factor in compromising the taxpayer's liability.³¹⁴⁹ Once a proper compromise agreement is reached based

³¹⁴⁶ IRM 5.8.6.2.1 (06-25-2021), Future Income; and IRM 5.8.5.21 (09-30-2013), Future Income Collateral Agreements.

³¹⁴⁷ For a case concerning the application of such a collateral agreement, see *Begner v. United States*, 428 F.3d 998 (11th Cir. 2005). The lawyer example in the text is a variation on an example in IRM 5.8.6.2.1.1 (06-25-2021), Form 2261/2261-A Completion (taxpayer involved in multi-million dollar developments and there is "a reasonable basis to determine that the taxpayer may receive a substantial payment from a **future** development within the next 24 to 48 months.").

³¹⁴⁸ IRM 5.8.6.2.3 (06-25-2021), Waiver of Losses; and IRM 5.8.6.2.1.1 (06-25-2021), Form 2261/2261-A Completion. The Form 2261 is titled Collateral Agreement — Waiver of Net Operating Losses, Capital Losses, and Unused Business Credits. See *McAvey v. Commissioner*, T.C. Memo. 2018-142 (rejecting the taxpayer's argument that such a collateral agreement should not be required where the waiver of the carryforward benefits would effectively full-pay the liability with the result that, in taxpayer's view, there is no "compromise").

³¹⁴⁹ Cf. *Snipes v. Commissioner*, T.C. Memo. 2018-184 (rejecting claim that IRS may be compelled to conduct an expedited transferee liability investigation to collect from third parties).

There is an issue of whether third party assets that the IRS could pursue for the liability under transferee liability or similar concepts should be included in determining RCP. Consider these facts. Taxpayer has an assessed tax liability of \$1,000,000. Taxpayer has \$100,000 in RCP considering only the taxpayer's assets. The taxpayer, however, transferred assets in a way that would give the IRS the right to pursue under § 6901 and the remedies available thereunder. In a sense, if the transferred assets are available for collection and application to the tax debt in issue, they are RCP for which an offer should not be accepted. Should the IRS accept a \$100,000 doubt as to collectibility OIC from the taxpayer because that is all the taxpayer can pay? In a sense, provided that the taxpayer cannot get those assets back from the transferee, then the taxpayer has no ability to pay more and perhaps there should be an OIC. But, as noted above with respect to dissipation of assets, the dissipated assets are included in RCP for determining what the taxpayer must pay to settle. A background issue is whether the acceptance of a \$100,000 OIC under these facts reduces the actual tax liability to \$100,000 so that there is then no tax liability that the IRS can pursue under transferee liability. I don't know the answer to that question.

(continued...)

on RCP and other appropriate factors, then if the IRS does collect from other parties, the amount will be credited to reduce the taxpayer's liability if that is what the installment agreement provides.³¹⁵⁰ Although the possibility of collection from transferees will likely not be considered, the IRS could certainly defer collection of the liability as otherwise compromised to pursue transferee liability.

9. Litigation Regarding OICs.

a. Compliance with Accepted OICs.

I noted above that OICs are contracts. This raises an issue of the nature of the judicial remedy, if any, for a dispute between the taxpayer and the IRS as to compliance with an OIC. Traditional analysis would suggest that, since the taxpayer's claim of compliance is a contract claim, the taxpayer must pursue that claim just as any other contractual claim against the United States. Under the Tucker Act,³¹⁵¹ contractual claims in excess of \$10,000 must be brought in the Court of Federal Claims. The Government's position is that such claims must be brought under the Tucker Act. However, a court of appeals held that, where, pursuant to the disputed interpretation, the taxpayer paid the additional amount claimed by the IRS, the taxpayer could pursue a refund remedy because, even though the dispute arose over a contract, the amount paid was still a tax and, given the broad reading of the refund remedy in *United States v. Williams*, 514 U.S. 527, 529 (1995) (discussed below), the amount could be viewed as a tax "erroneously * * * collected."³¹⁵² For those seeking a judicial remedy, I would think that the better part of wisdom except perhaps in that circuit would be to sue in the Court of Federal Claims, alleging jurisdiction under both the Tucker Act and the refund statute.³¹⁵³

³¹⁴⁹(...continued)

Consider another set of facts: Taxpayer, an employer, has Trust Fund Tax ("TFT") assessed of \$1,000,000. The taxpayer enters an OIC with IRS for \$100,000. One or more responsible persons are assessed the Trust Fund Recovery Penalty ("TFRP"). If the TFRP assessment(s) have not been made by the time of the employer's compromise, can the IRS assess the TFRP entire unpaid \$900,000 although it has been abated as to the employer by the OIC. Or, if the TFRP had already been assessed before the OIC with the employer, must the IRS abate the TFRP down to zero because it has been paid the TFT as abated has been paid?

³¹⁵⁰ For example, assume the tax liability is \$100, the IRS compromises for \$80 and the taxpayer pays the \$80 compromise amount. Presumably, the IRS could exercise its transferee liability authority to collect the compromised \$20 amount. I think there may, however, be an issue as to whether the IRS could pursue the compromised portion of the tax liability. I have just not chased that issue down.

³¹⁵¹ 28 U.S.C. § 1491(a)(1) which is referred to as the Tucker Act. The Tucker Act grants jurisdiction to the Court of Federal Claims. As the Court noted in *Begner v. United States*, 428 F.3d 998, 1002 n. 5 (11th Cir. 2005), "The Tucker Act has a sibling, known as the Little Tucker Act, 28 U.S.C. § 1346(a)(2), which 'grants concurrent jurisdiction to both U.S. district courts and the Court of Federal Claims for contractual claims against the United States not exceeding \$10,000.'"

³¹⁵² *Begner v. United States*, 428 F.3d 998 (11th Cir. 2005).

³¹⁵³ 28 U.S.C. § 1346(a)(1).

b. IRS Rejection of an OIC.

The taxpayer can appeal the rejection of an OIC to the Appeals Office.³¹⁵⁴

There is no court review of the IRS's rejection of an OIC, except if the OIC is submitted in the CDP process in which case it will be considered in that process.³¹⁵⁵ If the IRS denies the OIC, the Tax Court may review the denial for abuse of IRS discretion, meaning that the IRS acted "arbitrarily, capriciously or without sound basis in fact or law."³¹⁵⁶ For example, the IRS may deny an OIC by applying the IRS's local and national standards for the taxpayer's living expenses in testing whether the OIC is acceptable.³¹⁵⁷

10. Other Aspects of OICs (Statutes of Limitations; 5-Year Compliance).

Although offers are not a part of my current practice (I refer them out to enrolled agents who regularly process OICs with the IRS), I have heard of some very good deals being struck by taxpayers in the offer in compromise process, so any time there is a tough collections process, it should seriously be considered.

The statute of limitations on collection is suspended during the period the offer is pending while the IRS is prohibited from making a levy.³¹⁵⁸ In appropriate cases, the IRS may require the taxpayer to extend the period for assessment.³¹⁵⁹ Should the taxpayer default on his or her obligation under the OIC, the IRS can collect the entire amount that was compromised. For compromises based on doubt as to collectibility and effective tax administration, the OIC requires that, after the terms are otherwise satisfied, the taxpayer comply with all provisions of the Code for 5 years.³¹⁶⁰

³¹⁵⁴ See e.g., IRS web page titled "Appeal Your Rejected Offer in Compromise (OIC)" (last reviewed or updated 5/25/22 and viewed 7/24/22).

³¹⁵⁵ See Keith Fogg, Oversight of Offers—Response to Comment raising Thornberry v. Commissioner (Procedurally Taxing Blog 12/6/13) (offer and denial can be considered in CDP process, but there is no such process for consideration outside the CDP process; moreover, the review is not de novo, but whether the IRS followed a valid rule; "That type of review, however, does not allow the Tax Court to substitute its own judgment regarding the decision to accept or deny an offer except where the IRS has abused discretion in following the guidelines established by the IRS itself.").

³¹⁵⁶ *Lunsford v. Commissioner*, 117 T.C. 183, 185 (2001); *Goza v. Commissioner*, 114 T.C. 176, 181-182 (2000); *Woodral v. Commissioner*, 112 T.C. 19, 23 (1999).

³¹⁵⁷ *Walker v. Commissioner*, T.C. Memo. 2016-75.

³¹⁵⁸ § 6331(k)(3), referring to the provisions of § 6331(i)(5), except during the period an installment agreement is in effect. Note that, during the period the OIC is pending, the IRS is prohibited from levying. § 6331(k)(1). For a case holding that, pursuant to the terms of the OIC form (Form 656), the offer is pending through the date the IRS acknowledges that the taxpayer has withdrawn the offer (rather than the date of the withdrawal), see *United States v. Donovan*, 348 F.3d 509 (6th Cir. 2003). Also, the statute is suspended while OIC was in process even if the OIC is flawed by the taxpayer's own making (e.g., offer not accompanied by fee and signed only by representative) or even if the IRS takes significant time to process. *United States v. Ward*, No. 3-21-cv-00056-JWS, 2022 U.S. Dist. LEXIS 119673 (D. Alaska July 6, 2022).

³¹⁵⁹ Reg. § 301.7122-1(i)(2).

³¹⁶⁰ IRM 5.19.7.13 (07-09-2020), 5-Year Monitoring Status (noting that taxpayers must agree to future compliance—filing all tax returns and paying all taxes for 5-years (referred to as the compliance period); IRM 5.19.7.13.1 (07-09-2020), Compliance Monitoring Status (5M); IRM 5.19.7.14.4 (07-09-2020), Failure to Adhere to Compliance Terms. Thus, even if the taxpayer pays the full agreed amount in the OIC, if the taxpayer fails to meet the 5-year

(continued...)

The public is entitled to review certain return information on accepted offers in compromise under § 7122 for a period of one year after acceptance.³¹⁶¹ The information is maintained in a Public Inspection File (“PIF”) which contains limited information regarding accepted OICs such as the taxpayer name, city/state, liability amount, and offer/terms.³¹⁶²

E. Audit Reconsideration.

The IRS has an audit reconsideration process for reconsidering the merits of tax deficiency assessments.³¹⁶³ The IRS defines the process as follows:

An audit reconsideration is the process the IRS uses to reevaluate the results of a prior audit where additional tax was assessed and remains unpaid, or a tax credit was reversed. If the taxpayer disagrees with the original determination, he/she must provide new information for the audited issue(s) that was not previously considered during the original examination. It is also the process the IRS uses when the taxpayer contests a substitute for return (SFR) determination by filing an original delinquent return or when there is a n IRS computational or processing error in assessing the tax.³¹⁶⁴

The IRS is not statutorily required to have this audit reconsideration process. You will recall that, although the IRS is not required to consider claims in abatement in taxes subject to the deficiency procedure, it always has the discretionary authority to abate if the assessment exceeds the correct liability.³¹⁶⁵ The general denial of a claim for abatement for these taxes is designed to channel taxpayers into participation in the audit and appeals process and Tax Court litigation, with refund litigation and CDP as the only alternatives to contest liability. Nevertheless, the IRS has this audit reconsideration process based on its discretionary authority to provide relief to taxpayers who may have fallen through the cracks on the normal process.

The IRS does impose some conditions—e.g., that the taxpayer have filed a return (including a delinquent return after an SFR), the assessment (or some portion) is unpaid (otherwise the taxpayer

³¹⁶⁰(...continued)

compliance requirement (often called keeping current during the 5-years), the taxpayer will be in default and can be liable for the entire amount the taxpayer had compromised. *Sadjadi v. Commissioner*, 816 Fed. Appx. 997 (5th Cir. 2020). See Keith Fogg, Failing to Keep Current After Obtaining an Offer in Compromise (Procedurally Taxing 8/7/20) (I recommend that readers who go to that blog entry also read the comments).

³¹⁶¹ § 6103(k)(1); Reg. § 601.702(d)(8). The statute is derived from President Truman’s following executive order 10386, dated 8/20/52, and related Treasury Decision, which, in turn, arose from a scandal—sometimes referred to as the Delaney scandal—regarding improper granting of offers in compromise. *Delaney v. United States*, 199 F.2d 107 (1st Cir. 1952). For general background, see TIGTA Report titled “Management of the Offer in Compromise Public Inspection Program Continues to Be a Concern” (Ref. Num. 2019-IE-R001 10/22/18).

³¹⁶² IRM 5.8.8.9 (12-17-2019), Public Inspection File (noting that the Form 7249, Offer Acceptance Report, completed upon acceptance of the offer serves this function). The request to inspect is made on Form 15086, Offer in Compromise Public Inspection File Request.

³¹⁶³ See generally, IRM Part 4. Examining Process, Chapter 13. Audit Reconsideration. The information in this section is taken from this IRM provision. See also IRS Pub 3598, titled “The Audit Reconsideration Process.”

³¹⁶⁴ IRM 4.13.1.2 (12-16-2015), Definition of an Audit Reconsideration.

³¹⁶⁵ IRM 4.13.1.6 (12-16-2015), Authority, citing § 6404(a).

could file a claim for refund contesting liability), the taxpayer must identify the adjustments the taxpayer contests, the taxpayer provide new information not previously considered, the assessment is not pursuant to Tax Court decision or accepted offer in compromise, etc.³¹⁶⁶

If the IRS accepts the matter for audit reconsideration, the taxpayer may appeal an adverse determination to the Appeals Office.³¹⁶⁷

An alternative to audit reconsideration is an offer in compromise based on doubt as to liability.

F. Bankruptcy.

1. Introduction.

I cover the Bankruptcy Court's role as a determiner of tax disputes on the merits. (See discussion beginning on p.597.) The Bankruptcy Court's principal role in tax disputes, however, is to determine whether tax debts are dischargeable.

The dischargeability rules are complex, so I offer some of the more frequently encountered rules and examples, so that you can get a flavor for the dischargeability rules for taxes. I do caution students to treat this discussion as an introduction to the concepts and not as a definitive guide to the resolution of these problems.

2. The Automatic Stay.

The Bankruptcy Code imposes an automatic stay on certain proceedings by creditors against debtors upon filing the bankruptcy.³¹⁶⁸ For example, it does stay collection IRS actions such levy, and lien.³¹⁶⁹ It does not stay some actions, such as:

- to criminal proceedings;³¹⁷⁰
- to tax audits and related matters, such as the issuance of a notice of deficiency;³¹⁷¹
- to IRS setoffs of prepetition tax refunds against prepetition tax liabilities where the refunds and liabilities relate to the same types of tax (e.g., income tax).³¹⁷²

³¹⁶⁶ IRM 4.13.1.4 (12-16-2015), Criteria for Reconsideration; IRM 4.13.1.8 (12-16-2015), Non-Acceptance of Request; and IRM 5.1.15.4.6.4 (04-16-2010), Appeal Rights on Reconsiderations.

³¹⁶⁷ IRM 5.1.15.4.6.4 (04-16-2010), Appeal Rights on Reconsiderations.

³¹⁶⁸ 11 U.S.C. § 362.

³¹⁶⁹ The IRS's right to setoff under § 6402 is apparently not subject to the stay. See 11 U.S.C. §§ 362(b)(26) and 553(a).

³¹⁷⁰ 11 U.S.C. § 362(b)(1).

³¹⁷¹ 11 U.S.C. § 362(b)(9).

³¹⁷² 11 U.S.C. § 362(b)(26). Where tax liability and tax refund related to different types of tax liabilities, the IRS may be able to freeze the refund for later resolution. Keith Fogg, [Freezing Refund Did Not Violate The Automatic Stay](https://www.taxnotes.com/analysis/insights/freezing-refund-did-not-violate-the-automatic-stay) (Procedurally Taxing Blog 12/22/22).

If the IRS “willfully violates” the stay, the debtor-taxpayer may recover damages.³¹⁷³

3. Determination of Tax Liability.

A bankruptcy court generally can determine liability for tax, fine or penalty related to tax or addition to tax unless it has been previously adjudicated.³¹⁷⁴ The exceptions are for (i) such liabilities determined by a court of competent jurisdiction before the commencement of the bankruptcy and (ii) tax refunds before the trustee has requested the refund and waited 120 days or received a denial of the claim.³¹⁷⁵

4. Discharge of Tax Liability.

a. Corporate Taxes.

Income taxes of corporations and some other business entities are not dischargeable.

b. Individual Taxes.

Income taxes of individuals are **not** discharged for taxes in the following categories:³¹⁷⁶

(i) (a) taxes where the due date for the return is within three years of the date the bankruptcy petition was filed (a three-year lookback rule);³¹⁷⁷ or (b) taxes assessed within 240 days of 11 U.S.C. § 362(b)(26). Where tax liability and tax refund related to different types of tax liabilities, the IRS may be able to freeze the refund for later resolution. Keith Fogg, Freezing Refund Did Not Violate The Automatic Stay (Procedurally Taxing Blog 12/22/22). the date of filing the bankruptcy petition (the

³¹⁷³ § 7433(e); 11 U.S.C. § 362(k). For a good discussion of “willfully violates,” see *IRS v. Murphy*, 892 F.3d 29 (1st Cir. 2018) (adopting the majority view that intentional action knowing of the stay is actionable regardless of good faith).

There is a split of authority as to whether emotional distress damages are recoverable against the IRS. *Hunsaker v. United States*, 902 F.3d 963 (9th Cir. 2018) (holding that emotional distress damages but noting contrary authority in an analogous case, *United States v. Torres*, 432 F.3d 20 (1st Cir. 2005). Punitive damages are not allowed against the Government. 11 U.S.C. 106(a)(3) (waiving sovereign immunity for “money recovery, but not including an award of punitive damages.”).

³¹⁷⁴ 11 U.S.C. § 505(a).

³¹⁷⁵ 11 U.S.C. § 505(a)(2). There is another exception for property or ad valorem tax that is not relevant to this text.

³¹⁷⁶ The categories below are my own synthesis of the rules of discharge. Other syntheses can offer different categorizations. See Bryan Camp, Lesson From The Tax Court: Counting The Days (Tax Prof Blog 11/19/18) (offering a three-bucket category list). I have incorporated some relevant concepts from Professor Camp’s article into my list.

³¹⁷⁷ 11 U.S.C. § 523(a)(1), by reference to § 507(a)(8)(A)(i). Note that this exception keys to the due date of the return, including extensions. You will recall that returns on extension that are received by the IRS before the extended due date are filed on that date and not on the extended date for tax purposes, but the wording of the bankruptcy provision apparently keys from the extended due date. For example, assume the taxpayer gets the extension and the IRS receives the year 01 return on 6/1/02. The 3 year tax statute of limitations closes on 6/1/05. However, the bankruptcy provision would deny discharge if the taxpayer files for bankruptcy before 10/15/05.

240 day lookback rule).³¹⁷⁸ Both of these lookback rule time periods are suspended for any period that the IRS is prohibited from collecting the tax, plus 90 days.³¹⁷⁹

(ii) taxes due for a year for which no return was filed;³¹⁸⁰

(iii) taxes (but not penalties) attributable to a fraudulent return or a willful attempt to evade or defeat the tax;³¹⁸¹ and

(iv) taxes for a year for which a “return, or equivalent report or notice” was filed after the due date and within 2 years of the bankruptcy petition date³¹⁸² (although this provision might be overridden by the flush language of § 523(a), called a “hanging

³¹⁷⁸ § 523(a)(1), by reference to § 507(a)(8)(A)(ii), (iii).

³¹⁷⁹ § 507(a)(8)(flush language).

³¹⁸⁰ § 523(a)(1)(B)(i). A question under this statute is whether a delinquent return filed by a taxpayer after the IRS has audited and assessed tax for the year is a return that avoids this exception to discharge. This raises the issue of whether the delinquent return is a “return” for purposes of this discharge. The weight of authority is that it is not. E.g., *In re Giacchi*, 856 F.3d 244 (3d Cir. 2017). The issue of whether the delinquent return is a return for this exception parallels the same issue in the application of the next exception under § 523(a)(1)(B)(ii). I provide more discussion of this common issue in the footnotes to the text in the next paragraph.

³¹⁸¹ § 523(a)(1)(C). The second part – “willfully attempted in any manner to evade or defeat such tax” – is stated much as the crime of tax evasion in § 7201. Some key issues in application of this exception to discharge:

(1) The “evade or defeat” language is mirrored from the tax evasion statute, § 7201. Does that mean that the tax is nondischargeable only if the taxpayer had a specific intent to violate a known legal duty (the *Cheek* standard for evasion). Or is some lesser level of intent apply, say, for example, willfully as used in the TFRP, § 6672? The Ninth Circuit says that the bankruptcy nondischarge requires the *Cheek* elements; other Circuits hold otherwise. See A. Lavar Taylor, What Constitutes An Attempt To Evade Or Defeat Taxes For Purposes Of Section 523(a)(1)(C) Of The Bankruptcy Code: The Ninth Circuit Parts Company With Other Circuits (Part 1) (Procedurally Taxing Blog 9/18/14); and A. Lavar Taylor, What Constitutes An Attempt To Evade Or Defeat Taxes For Purposes Of Section 523(a)(1)(C) Of The Bankruptcy Code: The Ninth Circuit Parts Company With Other Circuits (Part 2) (Procedurally Taxing Blog 9/19/14).

(2) The Government must prove nondischargeability. If the issue is presented in a bankruptcy proceeding, the Government has the burden to prove this exception to discharge by a preponderance of the evidence rather than the usual burden of establishing fraud by clear and convincing evidence. See *Grogan v. Garner*, 498 U.S. 279 (1991); *United States v. Storey*, 640 F.3d 739, 743-744 (6th Cir. 2011) (although *Storey* shows how unwilling the court was to find a preponderance). Presumably, that same burden would apply in other proceedings outside bankruptcy where dischargeability is in issue. Cf. *United States v. Coney*, 680 F.3d 365, 368-373 (5th Cir. 2012).

(3) The Government may meet its burden by collateral estoppel (claim preclusion) if the taxpayer has been convicted of a tax crime that has an element of the crime of fraudulent return or tax evasion. Conviction for tax evasion, § 7201, will estop the taxpayer on dischargeability. Other crimes (such as tax perjury, § 7206(1)) that do not have tax evasion as an element of the crime may not estop the taxpayer. See Keith Fogg, False Return Conviction Provides Basis for Collateral Estoppel to Prevent Discharge (Procedurally Taxing Blog 4/21/17).

(4) An extravagant or wasteful life-style before assessment that diminishes the taxpayer’s ability to pay the assessment when made may cause this exception to apply. E.g., *United States v. Mitchell (In re Mitchell)*, 633 F.3d 1319, 1329 (11th Cir. Ga. 2011); and *In re Bryen*, 2011 U.S. App. LEXIS 22349 (3d Cir. 2011).

(5) The exception does not appear to allow a partial discharge if the elements for nondischargeability apply. *United States v. Brown (In re Brown)*, 2012 WL 1970249, at *7 (Bankr. D. Utah May 31, 2012); and *Carlin v. United States (In re Carlin)*, 318 B.R. 556, 566 (Bankr. D. Kan. 2004), aff’d, 328 B.R. 221 (B.A.P. 10th Cir. 2005).

(6) Tax penalties may be discharged even when the tax is not. E.g., *McKay v. United States*, 957 F.2d 689 (9th Cir. 1992)

(7) FBAR penalties appear not to be dischargeable because they are not tax penalties. See *United States v. Simonelli*, 614 F. Supp. 2d 241 (D. Conn. 2008).

³¹⁸² § 523(a)(1)(B)(ii).

paragraph,³¹⁸³ which, as some courts (perhaps the trend) read it, denies “return” status and hence discharge to tax reported on a delinquent return other than a subscribed § 6020(a) SFR and a written stipulation of tax in a judicial proceeding).³¹⁸⁴

(v) although apparently rarely invoked in tax cases,³¹⁸⁵ individual discharges in a Chapter 7 bankruptcy may be denied if

- (i) the debtor “transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed— (A) property of the debtor, within one year before the date of the filing of the petition; or (B) property of the estate, after the date of the filing of the petition”;³¹⁸⁶
- (ii) the debtor “concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor’s financial condition or business transactions might be

³¹⁸³ This flush language in § 523(a)(3) is often referenced as § 523(a)(*).

³¹⁸⁴ The hanging paragraph provides:

For purposes of this subsection, the term "return" means a return that satisfies the requirements of applicable nonbankruptcy law (including applicable filing requirements). * * * *

The controversy is whether the parenthetical in the quote requires a timely return for return status required for discharge. At present, the trend in the courts of appeals is to read the provision literally to require a timely filed return for discharge. See *In re Fahey v. Mass. Dep't of Revenue*, 779 F.3d 1 (1st Cir. 2015) discussing the cases and noting that one taxpayer raised the issue that, although not a “return” because of the hanging paragraph, the delinquent return might be an equivalent report or notice under § 523(a)(1)(B)(ii) but had failed to preserve that issue below. *Id.*, p. 4, n3. There is a strong dissent in *Fahey* that would coordinate the hanging paragraph with the clear intent of § 523(a)(1)(B)(ii) to permit a delinquent return filed before two years of bankruptcy to qualify for discharge. In *Kriss v. United States*, 53 F.4th 726 (1ST Cir. 2022), the Court noted that *Fahey* involved Massachusetts state law that may not be the same as the hanging paragraph but declined to decide the proper interpretation of the hanging paragraph because the taxpayer there filed the return after the IRS filed the SFR, thus failing the *Beard* test for a return. See [First Circuit Sustains Holding That Late Filed Return Is Not a Return for Bankruptcy Discharge](#) (Federal Tax Procedure Blog 11/25/22).

In *United States v. Martin (In re Martin)*, 2015 Bankr. LEXIS 4237 (9th Cir. BAP 2015), the Ninth Circuit Bankruptcy Appellate Panel rejected the reasoning of the majority opinion in *Fahey*, rejected the IRS’s intermediate position that a delinquent return after an SFR assessment, and held that an untimely filed return, even after the IRS’s assessment of the tax, could qualify for discharge. There is thus a continuing split in the Circuits on this issue. See Keith Fogg, [Another Circuit Weighs in on the Discharge of Unfiled Returns](#) (Procedurally Taxing 5/31/17). Finally, in *Mass. Dep't of Revenue v. Shek (In re Shek)*, 947 F.3d 770 (11th Cir. 1/23/20), the Eleventh Circuit reached the conclusion that, as to the state return involved there, late filing was not precluded for discharge by the hanging paragraph.

³¹⁸⁵ Keith Fogg, [General Discharge Denial in Chapter 7 Based on Taxes](#) (Procedurally Taxing Blog 3/21/22) noting that one explanation these do not get on the radar screen often is

One reason I may not have seen a BC 727 case heavily basing the decision on taxes is that to deny a discharge under BC 727 the taxing authority must affirmatively act within a specified period of time to bring the discharge issue before the court. For exceptions to discharge, the IRS does not need to do anything during the bankruptcy case if one or more of the exceptions apply. Discharge fights under BC 523 typically play out after the bankruptcy case when the IRS starts collecting again and the debtor thinks the tax or penalty the IRS seeks to collect after bankruptcy was discharged. The debtor then brings an action that the IRS has violated the discharge injunction and the parties fight it out, but the IRS did not need to do anything affirmatively.

³¹⁸⁶ 11 U.S.C. § 727(a)(2).

ascertained, unless such act or failure to act was justified under all of the circumstances of the case.”³¹⁸⁷

Consider the following examples:

Example 1 (Category (i)). Taxpayer files a return for Year 01 on April 15 of Year 02 reporting a tax liability but not paying it. On April 15 of Year 04, taxpayer files bankruptcy. The tax debt for Year 01 is not discharged. The tax debt would be discharged if the taxpayer holds off the filing of bankruptcy until April 16 of Year 5.

Example 2 (Category (iii)). Taxpayer files a nonfraudulent return for Year 01 reporting substantial tax due but not paying the tax. The taxpayer earns substantial income in later years (years 02 through 06) but (i) keeps his taxes properly reported and paid in those later years and (ii) lives extravagantly in those later years accumulating no assets. The IRS attempts collection of the Year 01 taxes but is unsuccessful because the taxpayer spent what he made. At the end of Year 06, the taxpayer files bankruptcy and seeks discharge of the Year 01 taxes. The IRS can take and may prevail on the position that the taxpayer’s extravagant lifestyle during Years 02-06 when the tax was due and owing was an attempt to evade or defeat the tax and thus is nondischargeable.³¹⁸⁸

Example 3 (Category (i)(a) & (b)). Assume that, on April 15 of Year 02, a taxpayer files a nonfraudulent return reporting Year 01 income tax of \$100 but does not pay the tax. On April 14 of Year 05, just within the assessment statute of limitations, the IRS sends the taxpayer a notice of deficiency for an additional \$50 tax for Year 01. The taxpayer does not contest the notice, and the deficiency is duly assessed on September 1 of Year 05. The taxpayer files for bankruptcy on December 1 of Year 05. The taxpayer will be relieved of the \$100 tax originally reported and not paid; the taxpayer will not be relieved of the \$50 deficiency tax assessed within the 240 day period before bankruptcy.

Example 4 (Categories (ii) and (iv)). Assume the same facts as Example 3 except that the taxpayer files no return for Year 01, the IRS prepares a year 01 substitute for return (“SFR”) under § 6020(b) on April 1 of Year 05, sends the taxpayer a notice of deficiency for year 01 for \$150 tax on April 14 of Year 5, assesses the year 01 tax on September 1 of Year 5, and, before paying the tax, the taxpayer files for bankruptcy on April 10 of Year 8. The issue raised by this example addresses the requirements that the taxpayer have filed a return and that a late filed return be filed more than 2 years before the petition date. Is the SFR a return for these purposes? The answer is that it depends. If the SFR is prepared under § 6020(a) which is signed by the taxpayer, the SFR is a return that will permit bankruptcy discharge; if, however, the SFR is prepared under § 6020(b), the SFR is not a return.³¹⁸⁹ For purposes of this rule, even if the procedure the IRS uses appears not to qualify

³¹⁸⁷ 11 U.S.C. § 727(a)(2).

³¹⁸⁸ See e.g., *In Re Fegely*, 118 F.3d 979 (3d Cir. 1997).

³¹⁸⁹ See § 523(a) (flush language, added by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”). For cases involving pre-2005 years to similar effect, see, e.g., *Bergstrom v. United States*, 949 F.2d 341 (9th Cir. 1991); *In re Mathis*, 87 AFTR2d Par. 2001-474 (S.D. Fla. 2001); Rev. Rul. 74-203. See also *Spurlock v. Commissioner*, 118 T.C. 155 (2002), holding that the SFR under § 6020(b) is not a return for purposes of the deficiency definition in § 6211(a). Some of the nuances of the statement in the text and the relationship between the

(continued...)

under § 6020(a) because the IRS bases the SFR assessment on information other than that provided by the taxpayer, the SFR may constitute a return if the taxpayer signs a Form 870 or Form 4549 when accompanied by schedules disclosing the data from which the tax was computed.³¹⁹⁰ But, if those special circumstances are not present, the IRS takes the position that the taxes assessed pursuant to the SFR are not dischargeable in bankruptcy because no return was filed.³¹⁹¹

Example 5 (Category (ii)). Now what if, in the same example, after the IRS sends the § 6020(b) SFR on April 1 of Year 05 following which the assessment is made in Year 05, the taxpayer files a delinquent year 01 return on April 1 of Year 06 and then seeks discharge of the year 01 tax on April 10 of Year 8. In this case, the taxpayer has filed an untimely return and the bankruptcy filing is outside the two year period for delinquent returns. Is the taxpayer discharged? The trend in holdings seems to be that the late filed return will not qualify for discharge unless it is a § 6020(a) return.³¹⁹²

The discharge does not apply to taxes that are still assessable after the date of discharge.³¹⁹³ This can be a trap for the unwary for taxes due in prior years where the individual is a partner in a TEFRA partnership that has effective consents to extend the statute of limitations well beyond the normal statute of limitations.³¹⁹⁴

c. Trust Fund Tax and Penalty.

The debtor's trust fund taxes are usually not dischargeable.³¹⁹⁵ For example, the trust fund recovery penalty ("TFRP") (often also called the "responsible person" tax penalty) under § 6672 is not dischargeable.³¹⁹⁶ Can you articulate a policy rationale why trust fund taxes generally are not dischargeable and, specifically, why the TFRP penalty is not dischargeable? Please refer to the responsible person penalty materials (beginning p. 793).

³¹⁸⁹(...continued)

two § 6020 subsections are discussed in Bryan T. Camp, The Never-Ending Battle, 2006 TNT 74-30.

³¹⁹⁰ ILM 200113026, reprinted in 2001 TNT 63-36; see also Bryan T. Camp, The Never-Ending Battle, 2006 TNT 74-30.

³¹⁹¹ SBSE-05-1010-052, reprinted at 2010 TNT 192-8 (10/1/10).

³¹⁹² As previously noted, the trend in cases seems read the flush language of § 523(a)—the so-called hanging paragraph—to require a timely return except, in the language of the hanging paragraph text, when the tax is pursuant to “a return prepared pursuant to section 6020(a)” or a “written stipulation to a judgment or a final order entered by a nonbankruptcy tribunal.” See *In re Fahey v. Mass. Dep't of Revenue*, 779 F.3d 1 (1st Cir. 2015), with a strong dissent that would not read the hanging paragraph to override the clear intent of § 523(a)(1)(B)(ii) to permit discharge for a late filed return filed more than two years before bankruptcy. Assuming a delinquent return can qualify, there is still the issue of whether delinquent return filed after a § 6020(b) SFR can qualify as a return to the extent that it just reports tax determined in the § 6020(b) SFR or, alternatively, whether the discharge would be limited to the amount reported on the delinquent return in excess of the amount determined in the § 6020(b) SFR .

³¹⁹³ *United States v. Martinez*, 564 F.3d 719 (5th Cir. 2009).

³¹⁹⁴ See *United States v. Martinez*, 564 F.3d 719 (5th Cir. 2009).

³¹⁹⁵ The principal trust fund tax that I deal with in this course of the trust fund taxes that the employer withholds from employee compensation for the employee's income tax and the employee's share of the FICA tax. The trust fund tax concept is broader than that and, thus, denial of dischargeability will apply to other types of tax including state tax that functions like a trust fund tax withheld from others. See *In re: Calabrese*, 689 F.3d 312, 2012 U.S. App. LEXIS 14897 (3d Cir. 2012) (treating state sales tax withheld from purchasers as a trust fund tax for purposes of denying dischargeability).

³¹⁹⁶ § 523(a)(1)(A), referring to § 507(a)(8)(C).
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d. What Must Happen for a Discharge of Federal Tax.

Some debts are discharged automatically in bankruptcy without a specific bankruptcy court determination that the debts are discharged. In those cases, the creditor desiring to collect the debt must request a specific determination of nondischarge. Federal tax debts, however, require a specific bankruptcy court determination that they are discharged and, therefore, in a later proceeding the IRS may assert the tax liability if the bankruptcy court did not determine specifically that they were discharged.³¹⁹⁷

e. Discharge and the Federal Tax Lien.

If taxes are discharged in bankruptcy, what is the effect, if any, of the federal tax lien on the taxpayer's property? The discharge only relieves the taxpayer of in personam personal liability for the tax, so that the lien against the taxpayer's property survives the discharge.³¹⁹⁸ Of course, to the extent that property goes into the bankruptcy estate, the IRS and other creditors may fight out their lien priorities among themselves and the taxpayer has no further interest in the matter. However, various property may be exempt or even excluded from the bankruptcy proceeding and, to the extent thereof, may remain with the taxpayer after the bankruptcy. The Tax Court summarized the law regarding the IRS's rights to the property remaining with the taxpayer even after his general personal liability has been discharged in bankruptcy:³¹⁹⁹

Title 11 U.S.C. sec. 522 allows a debtor to exempt from his bankruptcy estate a personal residence, a car, certain property used in a trade or business, retirement funds, and certain other assets, to ensure that the debtor has at least some property with which to make a fresh start. Exempt property initially is part of the debtor's bankruptcy estate, but is removed from the bankruptcy estate (and is therefore unavailable to satisfy creditors' claims) for the benefit of the debtor as a result of the debtor's exemption. Property that is exempt from the bankruptcy estate pursuant to 11 U.S.C. sec. 522 is not available to satisfy pre-petition debts during or after the bankruptcy, except debts secured by liens that are not avoided in the bankruptcy and section 6321 liens with respect to which an NFTL [Notice of Federal Tax Lien] has been filed. 11 U.S.C. sec. 522(c).³²⁰⁰

Unlike exempt property, which is part of a debtor's bankruptcy estate but is unavailable to satisfy creditors' claims, excluded property never becomes part of the bankruptcy estate and is therefore never subject to the bankruptcy trustee's or the debtor's power to avoid the section 6321 lien. Thus, if a section 6321 lien [the secret

³¹⁹⁷ *Swanson v. Commissioner*, 121 T.C. 111 (2003).

³¹⁹⁸ *Bussell v. Commissioner*, 130 T.C. 222, 235 (2008); and *Iannone v. Commissioner*, 122 T.C. 287, 292-293 (2004).

³¹⁹⁹ *Wadleigh v. Commissioner*, 134 T.C. 280, 292 (2010). In the quoted portion presented in the text, most case citations and the sole footnote appearing in the case itself has been omitted.

³²⁰⁰ [Not in original case] The survival of the filed tax lien reflects the doctrine of lien pass through announced in *Long v. Bullard*, 117 U.S. 617 (1886). The filed tax lien survives the bankruptcy. See *In re Wrenn*, 40 F.3d 1162, 1164 (11th Cir. 1994) (citing *Dewsnup v. Timm*, 502 U.S. 410, 417-418 (1992); *In re Isom*, 901 F.2d 744, 745 (9th Cir. 1990).

unfiled lien] on excluded property has not expired or become unenforceable under section 6322, it survives the bankruptcy.

Petitioner was granted a discharge in bankruptcy on December 8, 2005. The discharge included petitioner's 2001 tax liability. On schedule C of his bankruptcy petition, petitioner contended that his pension was excluded from the bankruptcy estate pursuant to 11 U.S.C. sec. 541(c)(2) and *Patterson v. Shumate*, 504 U.S. 753 (1992). Alternatively petitioner claimed that his pension was exempt property, but only if and to the extent that his pension was includable in the bankruptcy estate. On the basis of the record before us and our review of 11 U.S.C. sec. 541, we conclude that petitioner's pension was properly excludable from his bankruptcy estate under 11 U.S.C. sec. 541(c)(2) and *Patterson v. Shumate, supra* at 765, and that petitioner excluded the pension from his bankruptcy estate. As a result, the section 6321 lien [the secret unfiled federal tax lien] that attached to the pension before bankruptcy continued to attach to petitioner's interest in his pension even after petitioner's personal liability for his 2001 tax liability was discharged in bankruptcy.

In one case,³²⁰¹ the Court held that the federal tax lien against the taxpayer's beneficial interest in a spendthrift trust created by his grandmother survived the taxpayer's bankruptcy. Under that trust, the taxpayer was entitled to the net trust income after he reached the age of 35. His right, however, was subject to a standard spendthrift provision denying the beneficiary the right to alienate his interest. The taxpayer was discharged from personal liability for past due taxes. In this case, the taxpayer sought to prevent the Government from levying on future income distributions. There was no question that the federal tax lien survived bankruptcy. The issue was whether the taxpayer had pre-bankruptcy property against which the lien could be enforced. Specifically, the issue presented, as formulated by the Court, was whether the taxpayer's equitable right to future income distributions was property within the federal tax lien's broad definition, thus permitting the IRS to levy on the distributions as the taxpayer became entitled to them. Under Texas law, the courts held that ordinary creditors could not use a pre-existing lien to go after post-bankruptcy discharge distributions from a spendthrift trust. But, the court reasoned, the Government is no ordinary creditor and the cases consistently held that the lien attached to a taxpayer's property broadly defined, without the limitations and peculiarities of state law. Accordingly, the court held, even though the taxpayer was no longer personally liable for the tax because of the discharge in bankruptcy, the tax lien could permit levies on the future net income distributions as they were made.

5. Priority Rules.

Debtors are vitally interested in the dischargeability rules. Creditors may be interested in the dischargeability rules, but often they perceive the possibility of any material ability to collect nondischargeable debts after bankruptcy as being remote. Creditors are usually much more interested in the priority rules (determining who gets paid from a pot of limited assets).³²⁰² Debtors and related parties may have some interest in priority, particularly if the pot is allocated to taxes that

³²⁰¹ *Orr v. Commissioner*, 180 F.3d 656 (5th Cir. 1999), cert. denied, 529 U.S. 1099 (2000).

³²⁰² The priority rules relevant to taxes are in § 507. Generally, the taxes which are dischargeable are given priority, although not the highest level of priority.

might otherwise not be dischargeable or, like the responsible person penalty, might be asserted against related parties.

6. Miscellaneous.

In addition to discharge and priority rules that can vitally affect the parties interested in the bankrupt estate, there are significant tax issues lurking in the bankrupt estate and these may affect the debtor. For example, the ability of a debtor to allocate payments required under a Chapter 11 or Chapter 13 plan can significantly affect the debtor. Under its broad discretion to promote the effectiveness of plans approved in bankruptcy, bankruptcy courts have some discretion to permit the debtor to allocate such payments in a debtor tax efficient way.³²⁰³

XIV. Denial or Revocation of Passport for Seriously Delinquent Tax Debt.

Section 7345 and 22 U.S.C. § 2714a, added in 2015,³²⁰⁴ require that, upon the IRS certification transmitted to the Secretary of State (through the Secretary of the Treasury) that an individual has “a seriously delinquent tax debt,” the Secretary of State “shall not issue a passport” to the individual and, if a passport has already been issued, “may revoke” the individual’s passport.³²⁰⁵ A “seriously delinquent tax debt” is an aggregate assessed tax debt³²⁰⁶ greater than \$50,000 (as adjusted for inflation, \$59,000 for calendar year 2023)³²⁰⁷ if a notice of tax lien has

³²⁰³ *United States v. Energy Resources Co., Inc.*, 495 U.S. 545 (1990) (chapter 11); and *In re Fielding*, 2014 Bankr. LEXIS 5201 (Bankr. N.D. Tex. 2014) (chapter 13).

³²⁰⁴ Section 32101 of Fixing America’s Surface Transportation Act, P.L. 114-94 (“FAST Act”). The legislation was prompted by a GAO study, titled Potential for Using Passport Issuance to Increase Collection of Unpaid Taxes, GAO-11-272 (3/10/11) which recommended that passports could be used as leverage to collect seriously delinquent tax debts. For details, some of which I discuss in the text section, see IRS web page titled “Revocation or Denial of Passport in Case of Certain Unpaid Taxes” (last reviewed or updated 6/30/22 and viewed 7/25/22).

³²⁰⁵ § 7345(a); and 22 U.S.C. § 2714a(e)(1). The certification information is only the taxpayer’s identity and the amount of the seriously delinquent tax debt. § 6103(k)(11). The statutory language appears mandatory, however the IRM says that the State Department, upon receiving the certification, is “**generally** required to deny the certified individual a U.S. passport (or renewal of a U.S. passport) or may revoke any U.S. passport previously issued to that individual.” IRM 5.19.25 Passport Program. Further, “Whether a passport will be revoked or limited is left solely to the discretion of the State Department.” *Id.* In *Rowen v. Commissioner*, 156 T.C. 101 (2021), the Court emphasized that there are two actors—Treasury and the State Department. The Treasury is solely responsible for the certification and has no control over what the State Department does with the certification. The Court further held that the Treasury’s certification process is constitutional and does not violate the Universal Declaration of Human Rights (UDHR).

The Tax Court noted that the statute states “a two-step procedure”—IRS sends a certification to the Secretary of Treasury who then transmits it to the Secretary of State. “In practice, the IRS follows a one-step procedure whereby the Commissioner, as the Secretary’s delegate, transmits the certification directly to the State Department.” *Ruesch v. Commissioner*, 154 T.C. 289, 292 n. 3 (2020) (citing sec. 7701(a)(11); IRM pt. 5.1.12.27.1, 6, 8 (Dec. 20, 2017) [Note the IRM provisions for passports have been moved to 5.19.25 Passport Program]).

³²⁰⁶ The amount is “the aggregate unpaid balance of assessment. The unpaid balance of assessment includes tax and assessed interest and penalties. It does not include accrued interest and penalty.” IRM 5.19.25.3(2) (08-12-2020), Seriously Delinquent Tax Debt. The amount includes, but is not limited to, tax assessments made under an individual taxpayer’s identification number (SSN or EIN) such as U.S. individual income taxes, trust fund recovery penalties, business taxes for which the individual is liable and other civil penalties. *Id.* The amount does not include certain items, including criminal restitution assessments. *Id.*

³²⁰⁷ § 7345(f) (inflation adjustment, which is rounded to the nearest multiple of \$1,000). For the amount as adjusted for inflation, see Rev. Proc. 2022-38; 2022-45 I.R.B. 1 § 3.59.

been filed with CDP rights exhausted or lapsed or a levy under § 6331 has been made.³²⁰⁸ The certification is made by the Commissioner to Secretary of State.³²⁰⁹ Once certified, paying on the certified assessments below the threshold amount will not result in decertification.³²¹⁰

The statute excepts debts that are being paid “in a timely manner” pursuant to installment or compromise agreement with the IRS or which are subject to either a CDP hearing or an election for innocent spouse relief under § 6015.³²¹¹ The IRS, acting on its discretion under § 7345, has exempted certain categories (such as currently not collectible (“CNC”), debt of taxpayer in bankruptcy, debt in pending OIC, and debt included in a pending installment agreement).³²¹² Certification is postponed for taxpayers serving in a combat zone.³²¹³

The Secretary of State may approve exceptions to these requirements in “emergency circumstances” or for “humanitarian reasons”³²¹⁴ or may limit the passport only for return to the U.S.³²¹⁵

The IRS must “contemporaneously notify an individual of any certification under subsection (a).”³²¹⁶ The notice of the certification must include notice of the right to bring a civil action in the

³²⁰⁸ § 7345(b)(1). Even if the NFTL has expired by its terms but the general tax lien is still effective because the collection statute has not run, the continuing debt is a seriously delinquent tax debt. See *Mattson v. Commissioner*, T.C. Memo. 2022-118.

Nontax debts, such as FBAR penalties, are not included. Note, however, the payment of the miscellaneous offshore penalty in the IRS voluntary compliance programs to resolve potential FBAR penalties, the miscellaneous offshore penalty is a tax that is subject to this provision. Also, Equivalent Hearings where the taxpayer did not timely request CDP will not prevent a liability from being considered a seriously delinquent tax debt. 5.19.25.4(1)(d) (08-12-2020), Statutory Exclusions from Certification.

³²⁰⁹ § 7345(a). The statute says that the certification by the Commissioner is to the Secretary of Treasury who then certifies to the Secretary of State. “In practice, the IRS follows a one-step procedure whereby the Commissioner, as the Secretary’s delegate, transmits the certification directly to the State Department.” *Adams v. Commissioner*, 160 T.C. ___ No. 1 (2023) (Slip Op. at 7 n. 4, citing See I.R.C. § 7701(a)(11); Internal Revenue Manual 5.1.12.27.1, .6, .8 (Dec. 20, 2017).),

³²¹⁰ IRM 5.19.25.3(2) (08-12-2020), Seriously Delinquent Tax Debt; and IRM 5.19.1.5.19.9 (12-26-2017), Reversal of Certification (requiring either full satisfaction of the debt, the debt is legally unenforceable, or the debt meets the statutory exclusions in § 7345(b)(2). IRM 5.19.25.10 (08-12-2020), Reversal of Certification.

³²¹¹ § 7345(b)(2). See IRM 5.19.1.5.19.3 5.19.25.4 (08-12-2020), Statutory Certification Exclusions; and IRM 5.1.12.27.3 (12-20-2017), Statutory Exclusions from Certification. Filing a “processable” OIC “serves as a basis for decertification of the passport revocation, leaving them [taxpayers] clear to travel in the short term.” *Garcia v. Commissioner*, 157 T.C. 1, 7 & 9 (2021) (reversal of certification upon making processable OIC, citing IRM 5.1.12.27.4(1)(e), Discretionary Exclusions from Certification (excluding a “[d]ebt that is included in a pending Offer in Compromise”).

³²¹² IRM 5.19.25.5 (08-12-2020), Discretionary Exclusions from Certification,

³²¹³ IRM 5.19.25.4(2) (08-12-2020), Statutory Exclusions from Certification (citing § 7508(a)).

³²¹⁴ 22 U.S.C. § 2714a(e)(1)(B) & (f)(1)(B); and § 6331(d)(4)(G).

³²¹⁵ 22 U.S.C. § 2714a(f)(2)(B).

³²¹⁶ § 7345(d). In *McNeil v. United States*, 2021 U.S. Dist. LEXIS 50632 (D. D.C. 2021), the Court held that there was no predicate requirement that the taxpayer receive the notice for the certification to the State Department to be valid. The IRS notifies the taxpayer of certification to the State Department by CP508C Notice. See the IRS web page, titled “Understanding Your CP508C Notice” (last reviewed or updated 11/14/18 and viewed 3/2/19). IRM 5.19.25.8 (08-12-2020), Taxpayer Notification. The only prior notice the taxpayer receives is in the CDP hearing notice which is not the notice of certification but simply a notice that certification may occur if the tax delinquency is not

(continued...)

district court or Tax Court to contest whether the certification was erroneous.³²¹⁷ In the judicial proceeding,³²¹⁸ the issue is only whether the certification was procedurally erroneous, not whether the taxpayer actually was liable for the assessed delinquent taxes so certified³²¹⁹ or that the tax was properly assessed from a procedural perspective.³²²⁰ Further, the Tax Court has no jurisdiction to consider the constitutionality of the Secretary of State’s action on the certification, although the district courts may have jurisdiction under the Administrative Procedure Act.³²²¹ The certification must be reversed if the certification was erroneous, the tax debt is fully satisfied, or the tax debt ceases to be a seriously delinquent tax debt as defined.³²²² This judicial remedy is the sole remedy for improper certification or failure to reverse a certification; the taxpayer may request IRS administrative relief but does not have an Appeals Office review of any action or nonaction pursuant to the request.³²²³

³²¹⁶(...continued)

resolved.

³²¹⁷ § 7345(e). There is no deadline or statute of limitations stated for the judicial action. *Rowen v. Commissioner*, 156 T.C. 101 (2021) (slip op. at 13); *Ruesch v. Commissioner*, 154 T.C. 289, 295 (2020), aff’d 25 F.4th 67 (2d Cir. 2022). In CC-2018-005 (April 5, 2018), the IRS provided preliminary guidance for Chief Counsel attorneys handling cases under § 7345. Chief Counsel attorneys will handle the cases in the Tax Court. The following are key points of the CC: (i) the underlying tax liability is not in issue in the cases; (ii) the provision does not specify a statute of limitations for the action, so the general six-year statute (28 U.S.C. § 2401(a)) applies; (iii) the provision does not provide a standard of review; (iv) review should be on the administrative record with the standard being abuse of discretion. The CC then provides specific actions that may be taken in the case in the Tax Court. Section 2401(a)’s six-year statute is not jurisdictional, meaning that equitable tolling extending the six-year period may apply. *Jackson v. Modly*, 949 F.3d 763 (D.C. Cir. 2020), discussed in Keith Fogg, Travel Restrictions of a Non-COVID Different Kind (Procedurally Taxing Blog 3/31/21).

³²¹⁸ In *Garcia v. Commissioner*, 157 T.C. 1, 4-6 (2021), the Court held that married taxpayers receiving separate but substantially identical certification notices arising from the same joint liability may file a joint petition under for Tax Court review under § 7345(e). Presumably, the same result would be reached if the taxpayers filed for review in the district court.

³²¹⁹ *Adams v. Commissioner*, 160 T.C. ___ No. 1 (2023) (Slip Op. at 8, 10-13). Readers interested in the nuance of the holding, *Adams* discusses the Tax Court prior holding to the same effect in *Ruesch v. Commissioner*, 154 T.C. 289, 295-298 (2020) aff’d in part and vacated in part 25 F.4th 67 (2d Cir. 2022), with the vacatur relating to the Tax Court’s holding so that *Ruesch*’s holding was persuasive authority rather than precedential authority. The Second Circuit also noted (p. 71): “Even if the Tax Court had jurisdiction to assess the validity of *Ruesch*’s underlying debt, *Ruesch* had already received the only relief she could obtain under the statute, namely, reversal of her certification as an individual with ‘seriously delinquent tax debt.’”; *Garcia v. Commissioner*, 157 T.C. 1, 10 (2021) (citing *Ruesch*); and *McNeil v. United States*, 2021 U.S. Dist. LEXIS 50632 (D. D.C. 2021).

³²²⁰ *Adams v. Commissioner*, 160 T.C. ___ No. 1 (2023), Slip Op. at *8, *13-*15 (“The text of section 7345 refutes Mr. Adams’s argument. Section 7345 requires simply that the liability ‘has been assessed,’ not that the liability ‘has been properly assessed.’”).

³²²¹ *Adams v. Commissioner*, 160 T.C. ___ No. 1 (2023) (Slip Op. at *8, *15-*18, see particularly *16-*17, nns. 9 and 10).

³²²² § 7345(c)(1) (reversal of certification if error or debt paid or ceases to be a seriously delinquent tax debt) & (e)(2) (judicial determination of erroneous certification); 22 U.S.C. § 2714a(g). Since the reduction of the tax debt below the statutory (as indexed) amount will not result in decertification, the latter category (“ceases to be seriously delinquent tax debt”) means that the taxpayer moved into one of the categories of exclusions. IRM 5.19.25.10 (08-12-2020), Reversal of Certification.

³²²³ Notice 2018-1, 2018-3 I.R.B. 299 (the judicial action is “Generally, the sole remedy “the taxpayer may request administrative consideration by responding to the Notice CP508C but will not have an Appeals Office review.); IRM 5.19.25.13 (08-12-2020), Appeals Process and Judicial Review of Certification (also noting that certification is not a collection action entitling a taxpayer to Collection Appeals Program (“CAP”) rights).

The required earlier notices of tax liens and notices of levy must include notice of § 7345's authority to deny or revoke passports.³²²⁴

If the taxpayer who has been certified applies for a passport, the State Department “sends the taxpayer a notice and holds the application for 90 calendar days * * * * to allow the taxpayer time to make full payment of the tax debt, enter into a satisfactory payment alternative with the IRS, or resolve any erroneous certification issues to avoid their passport application being denied.”³²²⁵

Apart from a seriously delinquent tax debt certification, the Secretary of State may deny a passport for failure to provide a valid Social Security Number.³²²⁶

The certification will not prevent return travel to the U.S., although the passport may be confiscated upon re-entry.

The IRS and State Department procedures have survived constitutional attack.³²²⁷

XV. Protection from Collection Abuses -- Appeals and Judicial Remedies.

A. Introduction.

The IRS has great powers. The IRS can file federal tax liens that have the practical effect of preventing a taxpayer from dealing with much of his property, except those lucky enough to be able to sell under the superpriority provisions of § 6323. Even more intrusively, the IRS can levy upon taxpayer's property and can garnish wages without judicial intervention in most cases. We studied the prohibitions against injunctions (§ 7421(a) and *Enochs v. Williams Packing*), and so there have been historically few effective and consistent judicial checks on these broad powers.

In this section, I discuss procedures designed to mitigate the abuse of those powers.

B. Collection Appeals Program (“CAP”).

The IRS provides internal appeals from IRS Collection actions -- a Notice of Federal Tax Lien (“NFTL”), levy, seizure, or denial or termination of an installment agreement under these

³²²⁴ FAST Act § 32101(b), amending § 6320(a)(3) and § 6331(d)(4) to add this requirement.

³²²⁵ TIGTA report titled, Implementation of the Passport Provisions of the FAST Act Was Generally Successful, and the Internal Revenue Service Is Working on Objective Criteria for Passport Revocations 3 (Ref. No. 2019-30-068 9/19/19).

³²²⁶ 22 U.S.C. § 2714a(f)(1).

³²²⁷ *Maehr v. United States*, 5 F.4th 1100 (10th Cir. 2021) (held the Secretary of State's revocation of passport did not violate a constitutional right to travel and is not subject to the procedures for the writ ne exeat republica (essentially denying a person the right to leave the country); *Franklin v. United States*, 49 F.4th 429 (5th Cir. 2022) (held the travel restriction impact by passport revocation does not violate substantive due process because travel is not a fundamental right, the restriction had a rational basis in the need to collect tax; and the provision was an “arrow” rather than a “bazooka” in terms of its target,); and *Rowen v. Commissioner*, 156 T.C. 101 (2021) (rejected claims that the IRS certification process violated the Due Process Clause and the Universal Declaration of Human Rights because all the IRS does is to certify the tax debt; what the Secretary of State does with the certification is not a matter the IRS or Tax Court can consider.).

procedures. The appeal is taken under the IRS Collection Appeals Program (“CAP”).³²²⁸ The IRS administratively requires first that the taxpayer discuss the problem with the Collection Manager.³²²⁹ If that discussion (called a conference) is still not acceptable, the taxpayer may take a CAP appeal to the Appeals Office.³²³⁰

Appeals Officers treat CAP appeals as a “first priority,” with a goal of closing within 5 business days.³²³¹ This short time frame is required “to give taxpayers an almost immediate decision” to ensure that taxpayers do not appeal for delay and to avoid inconveniencing third parties.³²³²

The key difference between the CAP and the CDP (discussed immediately below) is that a CAP appeal does not allow further appeal to a court from denial of the appeal, whereas the CDP appeal does allow Tax Court review.³²³³ Furthermore, CAP is available in more situations than CDP. Finally, there are some exclusions in the IRM, most prominently that the taxpayer may not contest liability in a CAP proceeding.³²³⁴

C. Collection Due Process (“CDP”).

1. Introduction.

In 1998, Congress enacted certain collection due process rights, called Collection Due Process (“CDP”), to address perceived abuses or potential for abuses in the IRS collection system. The CDP remedy offers a review of certain collection actions within the IRS (via Appeals) and then in the Tax Court. In Appeals, certain predicate matters are addressed (such as the proper procedure in assessing the underlying tax (such as valid notice of deficiency and statutes of limitation)), but basically the review focuses on whether the IRS abused its discretion in exercising its collection tools. The standard is “whether any proposed collection action balances the need for the efficient

³²²⁸ IRM 8.24.1(8) Collection Appeals Program (CAP). The IRS explains the collection appeals rights, including CAP, in IRS publication 1660, titled Collection Appeals Rights. The publication addresses both CAP and CDP (discussed below). In *Tucker v. Commissioner*, 135 T.C. 114, 137 (2010), aff’d 676 F.3d 1129 (D.C. Cir. 2012), cert. den. 568 U.S. 1026 (2012), the Tax Court described the process (citations and quotation marks omitted for readability):

CAP is an administrative review program not required by statute. In 1996 the IRS created CAP to provide taxpayers with the right to appeal lien, levy, and seizure actions. In 1997 CAP was expanded to implement the Taxpayer Bill of Rights 2 in order to provide taxpayers with the right to appeal the proposed termination of installment agreements. Although Congress did not codify CAP, the legislative history of the RRA [IRS Restructuring and Reform Act of 1998] shows that Congress was aware of CAP when it enacted the CDP regime.

³²²⁹ IRM 8.24.1.3(10) (09-28-2021), CAP Appeals.

³²³⁰ IRM 8.24.1.3(10) (09-28-2021), CAP Appeals; IRM 8.24.1.3.5 (09-03-2019), Collection Field CAP Cases (noting strict time periods and procedures the taxpayer must take after an unsuccessful conference); see also § 6326(a). The Request is made on Form 9423.

³²³¹ IRM 8.24.1.3.8 (09-28-2021), Case Procedures under CAP (but noting that cases with complex issues may require more time).

³²³² IRM 8.24.1.3.8(4) (09-28-2021), Case Procedures under CAP.

³²³³ The IRS explains the CAP Process in Publication 1660, at pages 3 and 4 thereof.

³²³⁴ IRM 8.24.1.3.3 (09-28-2021), Exclusions from CAP (“Challenges to the existence or amount of a liability (liability issues are addressed under CDP.”). Note in this regard that contest of the liability is not permitted in CDP proceedings if the taxpayer had a prior opportunity to contest. Since CAP cannot consider liability, the right to pursue and the pursuit of CAP will not foreclose contesting liability in the CAP.

collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary”,³²³⁵ this is essentially a balancing test³²³⁶ where, necessarily, the IRS has some discretion in striking the balance.

2. CDP Administrative Proceeding.

a. General.

An IRS notice that it intends to take certain action—filing of a tax lien or levy—triggers the taxpayer’s right to invoke the CDP process by filing a written request for CDP review.³²³⁷ The request for CDP review must be filed with the IRS³²³⁸ within 30 days of the notice giving rise to the right for CDP review—i.e., the notice of federal tax lien or the notice of intent to levy.³²³⁹ The CDP

³²³⁵ § 6330(c)(3)(C). A good short opinion example showing the type of review is *Colacurcio v. Commissioner*, 2018 U.S. App. LEXIS 15480 (D.C. Cir. 2018) (unpublished).

³²³⁶ See *Trout v. Commissioner*, 131 T.C. 239, 254-256 (2008).

³²³⁷ §§ 6330(b)(1) and 6320(b)(1). IRM 8.22.4 Collection Due Process Appeals Program. The notice must be in writing and delivered in person, at the dwelling or usual place of business, or by certified or registered mail, return receipt requested to the taxpayer’s “last known address.” § 6330(a)(2). If the IRS determines that it failed to send the notice to the last known address, the IRS “will promptly provide the taxpayer with a substitute CDP Notice and provide the taxpayer with an opportunity to request a CDP hearing.” Reg. § 301.6330-1(a)(3), Q&A A10.

Other actions which have a cash flow effect like a levy may not be a levy per se. For example, the IRS upon determining that a taxpayer has a pattern of underpayment of withholding by virtue of incorrect W-4s may issue a “lock-in” letter to the employer of that taxpayer to withhold greater amounts. Both the employer and the taxpayer-employee are notified of the lock-in, but the lock-in is not a notice of levy giving rise to the CDP procedures. See *Cleveland v. Commissioner*, 600 F.3d 739 (7th Cir. 2010).

³²³⁸ The IRS notice invoking the right to request a CDP hearing requires that the request be mailed to a particular office other than the office generating the notice or the office to which payment should be made. Accordingly, some taxpayers have been confused and sent the CDP request to the wrong address. The IRS previously insisted that the CDP request be timely mailed to the correct IRS office, but changed its policy to treat a CDP request in the 30 day period mailed to an office identified in the notice as timely. PMTA 2020-002 (12/12/19), indicating that a change would be made to IRM 8.22.5.2.3 (08-11-2017), Imperfect Hearing Request.

A request filed on Form 12153, Request for a Collection Due Process or Equivalent Hearing, filed within the 30 day period will be a request for CDP rather than an Equivalent Hearing even if the taxpayer desired the Equivalent Hearing rather than CDP. *Ruhaak v. Commissioner*, 157 T.C. ___, No. 9 (2021).

³²³⁹ §§ 6320(a)(3)(B) and (b) (as to notice of federal tax lien) and 6330(a)(3)(B) and (b) (as to notice of intent to levy). One issue is whether the 30-day filing period is “jurisdictional,” meaning that there is no authority to consider equitable tolling for a late-filed request. In *Organic Cannabis Foundation LLC v. Commissioner*, 161 T.C. ___, No. 4 (2023), reviewed opinion (14-3), the Court held that the § 6320(a)(3)(B) is not jurisdictional and thus is subject to equitable tolling.

In *Weiss v. Commissioner*, 147 T.C. 179 (2016), aff’d 2018 U.S. App. LEXIS 13934 (D.C. Cir. 2018), reh. den. 2018 U.S. App. LEXIS 20966 (2018), reh. en banc denied 2018 U.S. App. LEXIS 20966, cert. den. ___ U.S. ___, 139 S. Ct. 612 (2018), the Tax Court held and the Court of Appeals affirmed that where the notice is dated earlier than date of actual mailing, the date of mailing is the date triggering the 30-day filing period and that a stated date earlier than the date of mailing does not invalidate the notice.

The 30-day period runs from the date of the required notice—which may be in person, by physical delivery to the residence or place of business or by certified or registered mail. § 6330(a)(2) & § 6330(a)(3)(B). In the latter two types of delivery (mailing being the usual type), actual receipt by the taxpayer is not required by the statutory text. *Mannella v. Commissioner*, 132 T.C. 196, 200 (2009), rev’d and remanded on other issue, 631 F.3d 115 (3d Cir. 2011); *Ramey v. Commissioner*, 156 T.C. 1 (2021). However, the Eleventh Circuit has flagged two possible arguments—due process and legislative history—that might require actual receipt in some cases; the court did not decide those issues because the taxpayer had not timely raised them, but it did publish the opinion because the arguments “may deserve (continued...) ”

review is initially an administrative review in appeals by a Settlement Officer (“SO”) (which is a different category than Appeals Officer).³²⁴⁰ The Appeals Office will state its conclusions from that review in a Notice of Determination (or Determination Letter) sent to the taxpayer which, if the taxpayer is unsatisfied, will constitute the taxpayer’s jurisdictional ticket to Tax Court review of the determination.³²⁴¹ The taxpayer invokes the Appeals review by making a request for a hearing.³²⁴² I deal in this section with the administrative review; I discuss judicial review in the next section.³²⁴³

CDP is available only for the taxpayer. Third parties affected by the collection actions have no CDP rights, but may have other procedural opportunities such as wrongful levy actions discussed elsewhere in this text.³²⁴⁴

Section 6702(b)(2)(B) provides a penalty for a specified frivolous submissions in CDP review.

b. Events Triggering Right to CDP Proceeding.

(1) Notice of Tax Lien (“NFTL”).

The IRS may file a tax lien. The tax lien exists before it is filed, but before it is filed, the tax lien is no great impediment to the taxpayer, for although the taxpayer cannot defeat the lien by giving away his property, he can deal with third party purchasers for value who can acquire the property free of the lien. The filed tax lien, however, can be quite burdensome to the taxpayer. As noted above with respect to priorities, even third parties acquiring an interest in the taxpayer’s property for value may find their positions subordinated to the position of the IRS after the filing. Moreover, the filing of the tax lien will be reported by credit agencies and may adversely affect a taxpayer’s credit. Bottom-line, this means that the taxpayer is substantially burdened by the filing of the tax lien.

The IRS is required to notify the taxpayer of the filing of the general § 6321 tax lien. § 6320(a). The notice is called the NFTL. The NFTL requirement does not apply to tax liens arising under other sections (§§ 6324A (special lien for estate tax) and 6324B (special lien for estate tax attributable to special valuation)).

³²³⁹(...continued)
attention from the bench and bar.” *Berkun v. Commissioner*, 890 F.3d 1260 (11th Cir. 2018).

³²⁴⁰ IRM 8.22.4.5 (08-09-2017), Appeals Employees in CDP (also identifying Appeals account resolution specialists and Appeals team managers as being involved, but the actual review is done by the Settlement Officer).

³²⁴¹ The Notice of Determination should address the issues presented and considered at the hearing and the Appeals Officers determinations. *Goza v. Commissioner*, 114 T.C. 176 (2000). The Notice of Determination must be sent to the taxpayer’s last known address. The last known address is a requirement for several types of notices that the IRS must give—probably most prominently, the notice of deficiency. Accordingly, the interpretation of the last known address requirement is the same. For that interpretation, see the discussion beginning p. 509. See also *Bongam v. Commissioner*, 146 T.C. 52 (2016). Also, although not named a Notice of Determination, any IRS decision letter functioning like a notice of determination will be treated as such. *Craig v. Commissioner*, 119 T.C. 252 (2002).

³²⁴² § 6330(b)(1) and (a)(3)(B).

³²⁴³ For a description of the process, see TIGTA Report titled Review of the Independent Office of Appeals Collection Due Process Program (Ref. No. 2020-10-054 8/21/20).

³²⁴⁴ See discussion beginning p. 748.

The IRS must give the NFTL in writing no later than 5 days after filing the tax lien.³²⁴⁵ The NFTL must state in simple terms the amount of the tax and the taxpayer's appeals rights.³²⁴⁶ The NFTL is left at the taxpayer's dwelling place or usual place of abode or sent to his last known address by certified or registered mail.³²⁴⁷

The taxpayer invokes his right to a hearing—referred to as a “due process hearing”—by filing a request within 30 days after the expiration of the IRS's notice period after the filing (i.e., 5 days after the filing of the tax lien).³²⁴⁸ If the taxpayer fails to request the CDP hearing in the 30-day period, the taxpayer forfeits the right to the CDP hearing, but may obtain an “equivalent hearing” which is not subject to judicial review.³²⁴⁹

(2) Notice of Intent to Levy.

Before the IRS may levy, the IRS must give the taxpayer notice of intent to levy.³²⁵⁰ I discuss the Notice of Intent to Levy beginning p. 672. Significantly, the taxpayer must be notified of the taxpayer's right to a due process hearing on the levy action and other taxpayer rights with respect to levies.³²⁵¹

The taxpayer must request the hearing within 30 days after the required notice is given or sent.³²⁵² As with the federal tax lien notice, if the taxpayer does not request the hearing within 30

³²⁴⁵ § 6320(a)(2). However, if the federal tax lien is actually filed after the notice to the taxpayer and the taxpayer timely requests a CDP hearing based on the notice, the failure to meet the requirement that the notice be sent after the filing of the lien is harmless error. See *Graham v. Commissioner*, T.C. Memo. 2008-129; and *Golub v. Commissioner*, T.C. Memo. 2008-122.

³²⁴⁶ § 6320(a)(3).

³²⁴⁷ § 6320(a)(2).

³²⁴⁸ § 6320(a)(3). A CDP hearing request may be made on Form 12153, Request for a Collection Due Process or Equivalent Hearing, but any reasonable written communication requesting the hearing should suffice (the better part of wisdom, of course, is to use the IRS Form). The request is filed with the IRS office that issued the notice, which office should appear on the notice itself. There is no extension of the base period if the notice is mailed outside the country. *Sarrell v. Commissioner*, 117 T.C. 122 (2001) (comparing this to Section 6213(a) which gives an additional 60 days for filing the petition if the notice of deficiency is sent outside the United States). The right to a CDP hearing applies only to the notice with respect to the first lien filing. *Inv. Research Assocs., Inc. v. Commissioner*, 126 T.C. 183 (2006) (citing Reg. 301.6320-1(b)(1) and (2) and noting that federal tax liens may be filed in multiple places with the notice of the first filing being the one that may be contested in a CDP proceeding). If the request is made during the 30-day period, the request will be processed as a CDP request and in any subsection proceeding will be treated as a CDP request (rather than Alternative Hearing. *Ruhaak v. Commissioner*, 157 T.C. ___, No. 9 (2021).

³²⁴⁹ Reg. § 1.6320-1(i)(1) (providing that, at the conclusion of the equivalent hearing, the IRS will issue a Decision Letter which is not the Notice of Determination required in a CDP case; the Notice of Determination is the document giving the Tax Court jurisdiction in a CDP case). See *Graham v. Commissioner*, T.C. Memo. 2008-129 (succinctly stating the rules and citing *Craig v. Commissioner*, 119 T.C. 252, 258-259 (2002) and *Kennedy v. Commissioner*, 116 T.C. 255, 261 (2001)).

³²⁵⁰ § 6330(a)(1).

³²⁵¹ § 6330(a)(3).

³²⁵² § 6330(a)(3)(B) and (b). In *Weiss v. Commissioner*, 147 T.C.179 (2016) , aff'd 2018 U.S. App. LEXIS 13934 (D.C. Cir. 2018), reh. den. 2018 U.S. App. LEXIS 20967 (2018), cert. den. ___ U.S. ___, 139 S. Ct. 612 (2018), the Tax Court held that where the notice is dated earlier than the date of actual mailing, the date of mailing is the date triggering the 30-day filing period and that a stated date earlier than the date of mailing does not invalidate the notice.

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days, he or she forfeits the CDP hearing, but is entitled administratively to an Equivalent Hearing for which there is no judicial review.

At the conclusion of the hearing, the Appeals Office issues a Notice of Determination which, if the taxpayer remains unsatisfied, is the taxpayer's ticket to judicial review.³²⁵³

The right to a CDP hearing discussed in this section applies only to notice of levy. The IRS's offset of an overpayment for one year against an unpaid assessed liability for another pursuant to the IRS's common law right of offset or codification in § 6402(a) is not a levy, although it has the practical effect of a levy in the sense that it seizes property to which the taxpayer is entitled to apply against the taxpayer's unpaid tax liability.³²⁵⁴

c. Taxpayer Otherwise in Compliance.

The IRS may exercise discretion not to consider a CDP request if the taxpayer is not otherwise in compliance (e.g., filed all relevant tax returns) and the Courts may sustain that exercise of discretion, particularly where accompanied with other foot faults in the CDP process.³²⁵⁵

d. Collection Suspended; Statute of Limitations.

From the taxpayer's perspective, the immediate benefit of filing the CDP hearing request is that further IRS collection action is suspended.³²⁵⁶ The downside is that the statutes of limitation are suspended on (1) collection suits, (2) criminal prosecution and (3) refund, erroneous refund, and wrongful levy suits, that would otherwise apply under §§ 6502, 6531, and 6532, respectively.³²⁵⁷ Those statutes are suspended until 90 days after: (i) any final determination in any ensuing Tax Court CDP proceeding; or (ii) if the taxpayer does not appeal the determination to the Tax Court, 30 days after final determination in the Appeals hearing (which 30-day period is the period the taxpayer could have appealed).³²⁵⁸ Note that it is important that the IRS make a determination in every case, even if the taxpayer otherwise decides to withdraw the request, because the statutes of limitation will be suspended indefinitely.

³²⁵³ See *Adolphson v. Commissioner*, 842 F.3d 478, 484 (7th Cir. 2016) (the "notice of determination is a taxpayer's 'ticket' to tax court," citing 14 Mertens, Law Of Federal Income Taxation, § 50:22 (Jane C. Bergner ed., 2016); in this sense, it is like the notice of deficiency that is the traditional ticket to the Tax Court.)

³²⁵⁴ *Bullock v. Commissioner*, T.C. Memo. 2003-5.

³²⁵⁵ *Assured Source, Inc. v. Commissioner*, T.C. Memo. 2010-243.

³²⁵⁶ § 6330(e).

³²⁵⁷ § 6320(c), referring to § 6330(c), (d) and (e). A legislative proposal to reform the bankruptcy code (11 U.S.C.) included a provision that would suspend the three-year period for tax discharge in bankruptcy during the period of a collection due process proceeding. The suspension would be in the bankruptcy code rather than in the Internal Revenue Code. I would suspect that, at some point, this proposal would pass but would hope that there will be a reference in the Internal Revenue Code or, certainly, in the Regulations.

³²⁵⁸ § 6330(e)(1). As to the rule in (ii), see Reg. § 301.6330-1(g)(1); and *United States v. Kollman*, 774 F.3d 592 (9th Cir. 2014) (sustaining the Regulation on the basis of Step Two of the *Chevron* framework). In *United States v. Gilliam*, 737 Fed. Appx. 660 (4th Cir. 2018), the Court held that the suspension applied to a timely CDP request even during the initial period when the IRS believed that the request was untimely.

e. The Administrative CDP Proceeding.

(1) § 6330(c) Matters That May Be Considered.

The matters that may be considered at the meeting are set forth in § 6330(c) and are:

(1) The Appeals Officer must obtain an IRS “verification” that applicable law and administrative procedures for the assessment have been met.³²⁵⁹ I generally use the term Appeals Officer for the Appeals employee presiding over CDP Proceedings.³²⁶⁰ For example, The Appeals employee must determine that the assessment was properly mailed, which includes in cases requiring a predicate notice of deficiency or some other predicate notice that the notice has been properly mailed to the taxpayer and that the assessment or other administrative action (such as assessment of the TFRP) has been properly made.³²⁶¹ Similarly, in cases where a penalty was asserted by the IRS, the Appeals employee must verify compliance with § 6751(b)’s written approval requirement.³²⁶² This process is not a review and verification of the underlying merits of the tax liability in the assessment.

(2) The taxpayer may raise any appropriate defense, including spousal defenses, the propriety of IRS collection measures and alternatives to collection measures (posting bond, substitution of collateral, installment agreements, etc.). Virtually everything is on the table except

³²⁵⁹ § 6330(c)(1); This verification is typically done by a MFRTX transcript or by Form 4340 from the Service Center. CC-2001-038, *supra*, pp. 12-13; see *Davis v. Commissioner*, 115 T.C. 35 (2000) (Form 4340).

³²⁶⁰ The statute refers to “Appeals Officer.” § 6330(c)(1). The IRM Appeals Officer and Settlement Officer to describe the role of the Appeals employee that may be involved in CDP Appeals Hearings. E.g., IRM 8.22.4.5 (08-26-2020), Appeals Employees in CDP (Appeals Officer) and IRM 8.22.4.5.1 (08-26-2020), Appeals Officers (AO) (Appeals Officer). Some of the cases refer to “Settlement Officers.” E.g., *ATL & Sons Holdings, Inc. v. Commissioner*, 152 TC 138, 141 (2019) (acronymed to “SO”). I suppose that, certainly for purposes of the statute, an SO is an Appeals Officer. I will generally use the term Appeals Officer, the statutory term, unless quoting or distinction is needed.

³²⁶¹ *Lee v. Commissioner*, 144 T.C. 40 (2015), the Court held that the verification issue can and should be determined by the Court even if the petitioner does not raise the issue at the hearing. The required procedure in *Lee* was the issuance of the predicate Letter 1153 notifying the taxpayer of the proposed assessment of the TFRP and advising of the right to an Appeals hearing. Previously, in *Hoyle v. Commissioner*, 131 T.C. 197, 205 (2008), supplemented by 136 T.C. 463 (2011), the Court permitted the taxpayer to raise the issue of whether a notice of deficiency had been properly mailed. For internal guidance on how this showing of procedural regularity is made in a Trust Fund Recovery Penalty case, see PMTA 2009-163 (12/18/09), reproduced at 2010 TNT 60-22. IRM 8.22.8.3(5) (09-23-2014), provides that, if in a CDP appeal, the officer “determine[s] the SNOD was not properly mailed to the last known address by certified/registered mail and the taxpayer did not receive the SNOD in time to petition Tax Court, the assessment is invalid and must be abated.” An interesting case where the IRS stipulated that it could not find the proof of mailing the SNOD (the USPS Form 3877), the IRS was held to the stipulation (even though it subsequently found and proffered the Form), thus giving the taxpayer a victory on the verification requirement in the CDP proceeding. See *Kearse v. Commissioner*, T.C. Memo. 2019-53. (A question not answered is whether the stipulation and resulting holding invalidates the notice of deficiency for purposes of the assessment.)

³²⁶² *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner*, 154 T.C. 68, 76-77 (2020) (citing § 6330(c)(1), (3)(A)), rev'd on other grounds 29 F.4th 1066 (9th Cir. Mar. 25, 2022), and *ATL & Sons Holdings, Inc. v. Commissioner*, 152 T.C. 138, 144 (2019); see *Rosendale v. Commissioner*, T.C. Memo. 2018-99, at *14.; see also CCN 2018-006 (6/6/18) (although noting that such compliance is not required if the penalty has been previously determined in a manner constituting collateral estoppel (issue preclusion) or res judicata (claim preclusion)).

frivolous arguments or arguments intended to delay the administration of the tax laws.³²⁶³ The key **exceptions** to this plenary Appeals Office consideration are:

(a) any issue “raised and considered” in a CDP hearing or in a prior administrative or judicial proceeding in which the taxpayer participated meaningfully.³²⁶⁴

(b) the “**underlying tax liability**” (including penalties and additions to tax and any resulting interest)³²⁶⁵ **unless** the taxpayer (i) “did not receive any statutory notice of deficiency for such tax liability or³²⁶⁶ [(ii)] did not otherwise have an opportunity to dispute such tax liability.”³²⁶⁷

(1) Under the first exception (i), the taxpayer’s **actual receipt** of a notice of deficiency precludes review because the taxpayer had a straight-forward path to a prepayment remedy including judicial review simply by filing a petition for redetermination in the Tax Court.³²⁶⁸

³²⁶³ § 6330(c)(4)(b), by reference to § 6702(c) which, for purposes of the frivolous return penalty, directs the IRS to publish a list of frivolous positions which it has done by Notice 2010-33, 2010-17 I.R.B. 609. If the IRS denies the CDP for this reason, the Tax Court has the jurisdiction to determine whether the IRS properly denied review. *Ryskamp v. Commissioner*, 797 F.3d 1142 (D.C. Cir. 2015), reh. en banc, denied, 2015 U.S. App. LEXIS 15421 (D.C. Cir. 2015), cert. den. 577 U.S. 1067 (2016).

³²⁶⁴ § 6330(c)(4)(A). Section 6015(g)(2), titled “Res judicata,” bars innocent spouse relief if, in a prior proceeding for the same taxable year, the following **conjunctive** requirements are met: (i) innocent spouse was not in issue in the prior proceeding; **and** (ii) the requesting spouse did not meaningfully participate in the prior proceeding. See *Kechjian v. Commissioner*, T.C. Memo. 2022-127 (held res judicata barred the spouse after the spouse meaningfully participated in a prior Tax Court deficiency proceeding for the tax in issue; participation through an attorney in the prior deficiency proceeding is meaningful participation, although there might be circumstances where a attorney representing requesting and culpable spouse might not be meaningful participation). In *Loveland v. Commissioner*, 151 T.C. 78 (2018), negotiation with a collection agent over an OIC which was denied but was not appealed (in a CDP proceeding or otherwise) was not an “administrative or judicial proceeding” that would foreclose the taxpayer from raising the OIC issues in a later CDP proceeding.

³²⁶⁵ *Katz v. Commissioner*, 115 T.C. 329, 339 (2000).

³²⁶⁶ This “or” is not disjunctive in the sense that, if the taxpayer did receive a notice of deficiency but did not otherwise have an opportunity to dispute, the taxpayer can contest the merits in the CDP proceeding. See *Patrick’s Payroll Services, Inc. v. Commissioner*, 2021 U.S. App. LEXIS 6336 (6th Cir. 2021) (discussing how to determine the function of the word “or” from context).

³²⁶⁷ § 6330(c)(2)(B). A CDP proceeding raising only the issue of how the IRS applies or credits collection proceeds is not a dispute as to the liability itself. *Melasky v. Commissioner*, 151 T.C. 93 (2018), aff’d 803 Fed. Appx. 732 (5th Cir. 2020) (the consequence is that, in such a case, the review standard is abuse of discretion).

³²⁶⁸ If the taxpayer received the notice of deficiency in sufficient time to petition the Tax Court, he cannot contest the merits in the CDP proceeding. *Kuykendall v. Commissioner*, 129 T.C. 77 (2007); see, however, *Onyango v. Commissioner*, 142 T.C. 425 (2014) (holding that the taxpayer “may not decline to retrieve his USPS mail, when he was reasonably able and had multiple opportunities to do so, and thereafter successfully contend that he did not receive for purposes of section 6330(c)(2)(B) the 2006-2007 notice of deficiency”); and *Rivas v. Commissioner*, T.C. Memo. 2017-56, at *21-*22 (finding that the taxpayer “failed to accept and/or refused delivery” of the notice, thus precluding merits review). The nonreceipt of the notice of deficiency permits the taxpayer to contest the merits of the underlying tax liability in the CDP Appeals Office and in the CDP Tax Court litigation; as I noted in discussing the requirement that a notice of deficiency be mailed, nonreceipt does not invalidate the notice of deficiency. See also *Gentile v. Commissioner*, 2014 U.S. App. LEXIS 22435 n. 1 (11th Cir. 2014). If the IRS can show an otherwise valid the notice of deficiency, the taxpayer will have to show nonreceipt; proving a negative in this type of case would generally require the taxpayer to testify credibly that he or she did not receive the notice which might be difficult because of the general

(continued...)

(2) The second exception (ii) for a **prior opportunity to dispute** is the one that has generated the most commotion. The prior opportunity generally focuses on the opportunity for an Appeals Office hearing, whether offered before or after the assessment of the liability.³²⁶⁹ There has been significant litigation concerning the meaning of the prior opportunity limitation on CDP consideration of the merits of the tax liability. I just bullet point the key points:

- The mere prior opportunity for the Appeals Office hearing on the merits of the tax liability forecloses CDP merits review of the tax liability, whether or not the taxpayer took the opportunity.³²⁷⁰ Accordingly, if the taxpayer “received” a prior CDP-entitled notice (e.g., an NFTL) that would have permitted Appeals review and then receives a second CDP-entitled notice (e.g., a levy notice), the first CDP notice, the NFTL, is a prior opportunity to contest that forecloses consideration of the merits of the tax liability if CDP is pursued in response to the second notice.³²⁷¹
- The Regulations state that an opportunity for an Appeals Hearing prior to a notice of deficiency (e.g., by a 30-day letter in an income tax case) is not a prior opportunity to dispute the merits of the tax.³²⁷² The notice of deficiency, **if received**, will foreclose review of the merits of the tax liability in the CDP hearing because the notice of deficiency, the ticket to the Tax Court, is a prior opportunity to contest the merits.

³²⁶⁸(...continued)

presumption of receipt from proper mailing. *Garrett v. Commissioner*, T.C. Memo. 2015-228, at *15 n. 3). Reg. § 301.6330-1(e), Q&A E2. As to deficiency type taxes, “An opportunity for a conference with Appeals prior to the assessment of a tax subject to deficiency procedures is not a prior opportunity for this purpose.” *Id.* As to a waiver of the notice of deficiency precluding consideration of the merits of the tax liability, see *Aguirre v. Commissioner*, 117 T.C. 324, 327 (2001) (Form 4549 waiver of restrictions on assessment which has the equivalent effect of the Form 870). A Notice of Determination of Worker Classification is treated as a notice of deficiency because of § 7436(d)(1) which so treats the notice. *Hampton Software v. Commissioner*, T.C. Memo. 2016-38. Note that the two exceptions to CDP merit review are disjunctive, so if the type of tax requires a notice of deficiency that the taxpayer did not receive, CDP merits review is available even if the taxpayer previously had an Appeals hearing or had an opportunity for an Appeals hearing; that might have been interpreted differently, but that is what the regulations state. Finally, in a CDP proceeding, if the Appeals Officer cannot establish that the taxpayer received the notice of deficiency, the taxpayer may contest the liability. *Weber v. Commissioner*, T.C. Memo. 2017-225. Query though, what would happen if the Appeals Officer considered liability because no evidence of nonreceipt, but in the ensuing Tax Court CDP case, the evidence of actual receipt comes out?

³²⁶⁹ Reg. 301.6330-1(e)(3), Q&A-E2 (“An opportunity to dispute the underlying liability includes a prior opportunity for a conference with Appeals that was offered either before or after the assessment of the liability.”); and see *Lewis v. Commissioner*, 128 T.C. 48, 50-61 (2007) (approving the regulations interpretation).

³²⁷⁰ *Keller Tank Services II, Inc. v. Commissioner*, 848 F.3d 125 (10th Cir. 2017); *Jeffers v. Commissioner*, 992 F.3d 649 (7th Cir. 2021); *James v. Commissioner*, 850 F.3d 160, 167 (4th Cir. 2017). For example, under the TEFRA rules (now superseded), certain partners could participate in TEFRA proceedings and that would be a prior opportunity to contest for partnership item adjustments. *Hudspath v. Commissioner*, T.C. Memo. 2005-83; *Davison v. Commissioner*, T.C. Memo. 2019-26, at *13-*14 (citing *Hudspath*); and *Pettennude v. Commissioner*, T.C. Memo. 2022-79 at * 5 (also citing *Hudspath*). The key here is that if there is some way the taxpayer could have contested the liability, he will be foreclosed in the CDP Proceeding from doing so.

³²⁷¹ Reg. §301.6330-1(e)(3) A-E7.

³²⁷² Reg. § 301.6330-1(e), Q&A E2.

- A taxpayer’s waiver of a right to receive a notice that would have given the taxpayer a prior opportunity to contest (e.g., by executing Forms 870 or 870-AD to waive a notice of deficiency) is a prior opportunity foreclosing review of the merits in a CDP proceeding.³²⁷³
- Any other opportunity for Appeals Office review of the merits of the tax liability (other than a 30-day letter for a tax requiring a deficiency notice is a prior opportunity.³²⁷⁴ For example, if the tax is **not** a type that requires notice of deficiency (or equivalent), the prior opportunity to have an Appeals hearing on the merits (whether or not taken) precludes CDP merits review even if the Appeals Office hearing, if taken, offered no preassessment opportunity to **litigate** the merits.³²⁷⁵ The problem with that interpretation of the prior opportunity prohibition is that, for assessments for liabilities not requiring a notice of deficiency (such as some penalties³²⁷⁶), the party against

³²⁷³ E.g., *Estate of Deese v. Commissioner*, T.C. Memo. 2007-362; and *Potts v. Commissioner*, T.C. Memo. 2017-228, at *10 (citing *Deese*).

³²⁷⁴ If the taxpayer had a prior opportunity to go to Appeals and took the opportunity but Appeals had not yet acted when the taxpayer received CDP notice of an intent to levy, then the taxpayer has not had a prior opportunity to contest. *Perkins v. Commissioner*, 129 T.C. 58 (2007).

³²⁷⁵ Reg. § 301.6330-1(e), Q&A E2; *McClure v. Commissioner*, T.C. Memo. 2008-136 (citing *Lewis v. Commissioner*, 128 T.C.48, 50-61 (2007), which held that a prior opportunity to dispute a liability, for purposes of § 6630(c)(2)(B) does not require an opportunity for judicial review of the liability); *Our Country Home Enterprises, Inc. v. Commissioner*, 855 F.3d 773 (7th Cir. 2017); *James v. Commissioner*, 850 F.3d 160 (4th Cir. 2017); *Keller Tank Services II, Inc. v. Commissioner*, 848 F.3d 125 (10th Cir. 2017); and *Lander v. Commissioner*, 154 T.C. 104, 121-122), No. 7 (2020) (Appeals review after audit reconsideration was a prior opportunity, but Court did say, quoting *Lewis v. Commissioner*, 128 T.C. 48, 60-61 (2007) : “Ultimately, while it is possible to interpret section 6330(c)(2)(B) to mean that every taxpayer is entitled to one opportunity for a precollection judicial review of an underlying liability, we find it unlikely that this was Congress’s intent.”). Thus, for example, in TFRP cases, prior to assessment, the IRS sends Letter 1153 which gives the taxpayer the opportunity to contest by filing a protest within 60 days. Receipt of that Letter is the opportunity to dispute that will preclude consideration of the substantive liability in the CDP Proceeding whether the person did pursue Appeal or did not pursue Appeal; either way it was an opportunity to contest. *McClure v. Commissioner*, T.C. Memo. 2008-136 (citing *Lewis v. Commissioner*, 128 T.C.48, 50-61 (2007) (§ 6672 liability, Appeal requested); *Solucorp, Ltd. v. Commissioner*, T.C. Memo. 2013-118 (§ 6672 liability, no Appeal requested); *Thompson v. Commissioner*, T.C. Memo. 2012-87 (“A taxpayer has the opportunity to dispute his liability for a trust fund recovery penalty when he receives a Letter 1153.”). However, in *Barnhill v. Commissioner*, 155 T.C. ___, No. 1 (2020), the Court held that, although the taxpayer received Letter 1153 and took the opportunity to appeal, but did not receive the follow through Letter 5157 to schedule a conference and the IRS then made the assessment without the conference, the taxpayer had not had a prior opportunity to contest.

In the text, I say that a prior opportunity to dispute will generally prevent review; the IRS may, in its sole discretion, review the substantive liability in the CDP proceeding, but there is no recourse to the Tax Court if the IRS does not exercise that discretion. See Reg 301.6330-1(e) Q&A11 (authorizing discretionary consideration); and *Cox v. Commissioner*, T.C. Summary Opinion 2016-53 (holding that IRS declining to consider precludes Tax Court from ordering consideration); see Leslie Book, [A Day Late and a Chance For Wise Tax Administration Wasted](#) (Procedurally Taxing Blog 9/14/16). And, in discretionary liability review in the CDP Appeals hearing, I am not sure that in the following Tax Court proceeding the Appeals’ Office determination could be reviewed de novo although it presumably could for abuse of discretion.

Finally, as the Tax Court has noted, even if the taxpayer is precluded from judicially contesting the merits of the tax liability by a prior opportunity to review, the taxpayer can still seek judicial review in a refund suit which as to divisible taxes such as the § 6672 Trust Fund Recovery Penalty can be minimal indeed. *Bishay v. Commissioner*, T.C. Memo. 2015-105. I discuss the divisible tax as minimum payment for refund suit beginning p. 813.

³²⁷⁶ Two prominent instances of potentially very large liabilities not requiring a notice of deficiency are (continued...)

whom the liability is asserted has no prepayment judicial remedy if, prior to the CDP proceeding, he had the prior opportunity for an Appeals Office hearing whether exercised or not.³²⁷⁷

- A tax liability the taxpayer reports on a return but does not pay (hence a collection action) can be contested because the taxpayer has not had an opportunity to contest.³²⁷⁸
- The opportunity to pay tax and claim a refund which might lead to an Appeals hearing is not a prior opportunity because prior opportunity means a prepayment opportunity.³²⁷⁹ Hence, when a partner receives a computational adjustment which does not permit a prepayment opportunity, the ability to pursue by refund is not an opportunity to dispute, so that in a CDP proceeding the partner may dispute the underlying liability.³²⁸⁰

(3) Whether the proposed collection action balances the need for efficient tax collection with the legitimate concern of the taxpayer that collection action not be more intrusive than necessary.³²⁸¹

(2) Miscellaneous Features.

Some other features of the CDP hearing in Appeals.³²⁸²

³²⁷⁶(...continued)

the Trust Fund Recovery Penalty (discussed beginning p. 793) and the § 6707A penalty for failure to disclose a reportable transaction (discussed beginning p. 859). In addition, under the old TEFRA provisions, when a penalty is asserted at the partnership level and made as a computational adjustment to the partner, the partner receives no notice of deficiency (§ 6230(a)(2)(A)(i)); thus, the partner may contest the penalties in CDP proceeding because the partner has had no prior opportunity to contest the penalty. *McNeill v. Commissioner*, 148 T.C. 481, 489 (2017). (Note the partner may also contest the penalty in a refund suit.)

³²⁷⁷ *Our Country Home Enterprises, Inc. v. Commissioner*, 855 F.3d 773 (7th Cir. 2017) (“Moreover, the CDP process is the only way that Our Country Home could have obtained prepayment judicial review of its § 6707A penalty. * * * In fact, the only other way that Our Country Home could have obtained any sort of judicial review would have been to pay the penalty in full and sue for a refund.”). See also *Lander v. Commissioner*, 154 T.C.104, 122-123 (2020) (holding that an appeal after audit reconsideration which offered no path to judicial review was still a prior opportunity to contest that foreclose CDP review of the merits of the tax liability); and *Shepherd v. Commissioner*, T.C. Memo. 2020-45 (receipt of CDP Notice with Notice of Federal Tax Lien is prior opportunity precluding CDP review on merits on subsequent receipt of CDP Notice with Notice of Intent to Levy).

³²⁷⁸ *Montgomery v. Commissioner*, 122 T.C. 1, 8-9 (2004); see CC-2006-005 (11/21/05), reproduced at 2005 TNT 229-7, and AOD 2005-03, accepting *Montgomery*; and *Poindexter v. Commissioner*, 122 T.C. 280 (2004).

³²⁷⁹ *Gluck Irrevocable Trust v. Commissioner*, 154 T.C. 259, 266-267(2020) (citing *CreditGuard of Am., Inc. v. Commissioner*, 149 T.C. 370, 375 (2017); *Sugarloaf Fund LLC v. Commissioner*, 141 T.C. 214, 217 n.2 (2013); *Greene-Thapedi v. Commissioner*, 126 T.C. 1, 20 (2006)).

³²⁸⁰ *Gluck Irrevocable Trust v. Commissioner*, 154 T.C. 154, 267 (2020).

³²⁸¹ § 6330(c)(3).

³²⁸² This excerpt is from the United States’ Brief in Opposition to the Petition for Certiorari filed in *Tucker v. Commissioner*, 676 F.3d 1129 (D.C. Cir. 2012), cert. den. 568 U.S. 1026 (2012), pp. 2-3. In the following bulleted list the items are from this Brief in Opposition. I do not include quotation marks to indicate exact quotes.

- The CDP Hearing conducted by an Appeals Officer who has had no prior involvement with respect to the unpaid tax at issue.³²⁸³
- CDP hearings are informal and nonadversarial.
- CDP hearings are often conducted by telephone or correspondence, and they need not be transcribed or recorded.³²⁸⁴
- If an Appeals Officer sustains a collection activity, the decision is reviewed (and may be overruled) by an Appeals Team Manager.³²⁸⁵
- The hearing must be conducted by an impartial Appeals Officer with no prior involvement in the matter.³²⁸⁶
- The taxpayer has no right to subpoena or examine witnesses but may submit facts via affidavits or declarations under penalty of perjury.³²⁸⁷
- The taxpayer may record the hearing.³²⁸⁸

(3) Disposition - Determination Notice.

At the conclusion of the hearing, if the taxpayer prevails in full, the collection action will be stopped or reversed, as appropriate. If the taxpayer does not prevail in whole or in part, the IRS sends the taxpayer “Notice of Determination Concerning Collection Action(s) under Section 6320 and/or 6330.”

In terms of judicial review, the Notice of Determination serves the same purpose as a Notice of Deficiency in that it offers the taxpayer entry to the Tax Court for judicial review.³²⁸⁹ I cover the judicial process below.

f. Retained Jurisdiction.

The Appeals Office retains jurisdiction with respect to the matter even after its determination.³²⁹⁰ The retained jurisdiction relates to how the determinations are implemented and changed circumstances.³²⁹¹ The retained jurisdiction will not further suspend the statute of

³²⁸³ §§ 6320(b)(3) and 6330(b)(3).

³²⁸⁴ See also e.g., *Murphy v. Commissioner*, 469 F.3d 27, 30 (1st Cir. 2006); *Living Care Alternatives of Utica, Inc. v. United States*, 411 F.3d 621, 624 (6th Cir. 2005).

³²⁸⁵ IRM 8.22.4.5.3 (05-12-2022), Appeals Team Managers (ATM).

³²⁸⁶ § 6320(b). The statute requires that the Appeals Officer have had “no prior involvement” with respect to the taxpayer’s tax liabilities. § 6330(b)(3). See *Cox v. Commissioner*, 514 F.3d 1119 (10th Cir. 2008).

³²⁸⁷ *Davis v. Commissioner*, 115 T.C. 35 (2000); *Katz v. Commissioner*, 115 T.C. 329 (2000); *Konkel v. Commissioner*, 86 AFTR2d 5545 (M.D. Fla. 2000); see Reg. 301.6330-1(d)(2), Q&A-D6.

³²⁸⁸ This entitlement is through the general requirement in § 7521. See *Keene v. Commissioner*, 121 T.C. 8 (2003).

³²⁸⁹ *Lunsford v. Commissioner*, 117 T.C. 159 (2001). See *Adolphson v. Commissioner*, 842 F.3d 478, 484 (7th Cir. 2016) (the “notice of determination is a taxpayer’s ‘ticket’ to tax court,” citing 14 Mertens, Law Of Federal Income Taxation, § 50:22 (Jane C. Bergner ed., 2016)).

³²⁹⁰ § 6330(d)(3). See *Tucker v. Commissioner*, 135 T.C. 114, 143 (2010), *aff’d*, 676 F.3d 1129 (D.C. Cir. 2012).

³²⁹¹ E.g., *Ansley v. Commissioner*, T.C. Memo. 2019-46, at *18 n. 10 (“petitioner is free to submit another OIC if his circumstances legitimately warrant it. See sec. 6330(d)(3)(B).”); and *Webb v. Commissioner*, 2021 TC Memo 105, at *10 n. 5 (noting that the retained jurisdiction permits Appeals to “consider changes to petitioner’s circumstances (continued...)”).

limitations and does not cause IRS collection action to be barred. The IRS also takes the position that there is no judicial review from the retained jurisdiction, of the type the taxpayer was entitled with respect to the original hearing.

3. Judicial Review by the Tax Court.

The taxpayer has the right to judicial review by the Tax Court of the IRS's CDP determinations.³²⁹² The judicial appeal must be taken within 30 days of the Appeals Office Notice of Determination, although the Supreme Court held in 2022 that the 30-day period was not jurisdictional and thus could be subject to equitable tolling.³²⁹³ As with a notice of deficiency, in determining its jurisdiction, (i) the Tax Court will not “look behind” the notice of determination to determine whether it was validly issued,³²⁹⁴ and, so long as the Notice is valid (e.g., sent to the last known address), the date of mailing the Notice of Determination governs the 30-day time period, regardless of whether the taxpayer receives the Notice.³²⁹⁵

The Code itself offers no guidance on the standard of review.³²⁹⁶ The legislative history addressed the issue and the courts seem to follow the legislative history: (1) if properly before the court,³²⁹⁷ the amount of the liability, if any, will be considered de novo, with the taxpayer bearing the usual burden of proof; and (2) as to the propriety of the collection activity, the court will review

³²⁹¹(...continued)

after she exhausts other remedies, thereby providing reconsideration to her request that her account be placed into CNC status.”).

³²⁹² § 6330(d)(1). Prior to an amendment effective 10/17/06, the district court had some residual jurisdiction with respect to CDP determinations. In addition, the amendment expanded the Tax Court’s review to include taxes and penalties not subject to the notice of deficiency requirement. *Yari v. Commissioner*, 143 T.C. 147 (2014) (citing *Williams v. Commissioner*, 131 T.C. 54, 58 n.4 (2008), aff’d 2016 U.S. App. LEXIS 18468 (9th Cir. 2016); *Callahan v. Commissioner*, 130 T.C. 44, 48 (2008). For a discussion of these changes, see CC-2007-001, reproduced at 2006 TNT 201-7.

One result of this amendment was with respect to the trust fund recovery penalty (“TFRP”) which I discuss later in this chapter. Prior to the change to allow CDP, the taxpayer could not contest the TFRP in a Tax Court proceeding. See *Ginsberg v. Commissioner*, 130 T.C. 88 (2008).

³²⁹³ § 6330(d)(1); and *Boechler, P.C. v. Commissioner*, 596 U.S. ___, 142 S. Ct. 1493 (2022) (holding that the 30-day time period is not jurisdictional, but rather a time period to which equitable tolling may apply to permit an out of time petition). Taking a practical view of this equitable late-filing jurisdiction, an astute observer has noted that (i) future CDP opinions litigating the jurisdiction will be few, as the IRS failure to raise the timeliness issue, thus constituting a waiver, will be the more common path to equitable jurisdiction in CDP cases but (ii) the Tax Court will have the opportunity through decided cases to flesh out how it will apply the expanded jurisdiction in contested cases. Keith Fogg, 2022 Year in Review – Jurisdiction to Litigate Your Tax Dispute (Procedurally Taxing Blog 1/3/22),

³²⁹⁴ *Lunsford v. Commissioner*, 117 T.C. 183 (2001) (jurisdiction is based on the notice regardless of whether the required hearing was held).

³²⁹⁵ *Woody v. Commissioner*, T.C. Memo. 2016-201 relying on the reasoning of *Weber v. Commissioner*, 122 T.C. 258 (2004) and *Bongam v. Commissioner*, 146 T.C. 52 (2016).

³²⁹⁶ *Estate of Duncan v. Commissioner*, T.C. Memo. 2016-204, *13, aff’d 2018 U.S. App. LEXIS 12257 (5th Cir. 2018) (unpublished).

³²⁹⁷ The Tax Court held in *Giamelli v. Commissioner*, 129 T.C.107 (2007) that, if the taxpayer did not raise the issue of the proper amount of the assessment in the CDP Appeals Hearing, the taxpayer cannot raise that issue in the Tax Court review of the CDP Hearing. The Court was careful to leave open the issue of whether the taxpayer, having raised the issue of the proper amount, could change theories or bases for redetermining the amount. 129 T.C. at 114 fn. 5. See also *Thompson v. Commissioner*, 140 T.C. 173, 178 (2013) (“A taxpayer is precluded from disputing the underlying liability if it was not properly raised in the CDP hearing.”).

for abuse of discretion (arbitrary, capricious or without sound basis in fact or law), a review designed not to correct mere error but to correct arbitrary action.³²⁹⁸

In applying the abuse of discretion standard to the propriety of the collection action, a significant issue is whether the Tax Court is limited to the administrative record. Logic might suggest that, if the proceeding tests the IRS's exercise of discretion in the CDP hearing, only the administrative record before the IRS should be considered. Nevertheless, the Tax Court permits the taxpayer (and presumably the IRS) to introduce new information in testing discretion, but Courts of Appeals in the three cases considering the issue limit consideration to the administrative record alone.³²⁹⁹ Under the *Golsen* rule, the Tax Court will apply the "record rule" and limit review to the record in cases appealable to those three Circuits. Accordingly, at least in cases appealable to those Circuits and as protection against other Circuits adopting the record rule, practitioners should be careful to ensure that the administrative record includes all information favorable to the taxpayer.³³⁰⁰

The Tax Court has cautioned taxpayers that it will impose the § 6673 penalty (up to \$25,000) for frivolous CDP cases.³³⁰¹

³²⁹⁸ *Goza v. Commissioner*, 114 T.C. 176, 181-182 (2000); *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner*, 154 T.C. 68, 75 n 8 (2020) (citing *Goza*), rev'd on other grounds 29 F.4th 1066 (9th Cir. Mar. 25, 2022) and *Hinerfeld v. Commissioner*, T.C. Memo. 2019-47, *13-*14 (noting that the abuse of discretion is under 5 U.S.C. § 706(2)(A) (arbitrary, capricious or without sound basis in law or fact); *Giamelli v. Commissioner*, 129 T.C. 107, 111 (2007). See *Dalton v. Commissioner*, 682 F.3d 139 (1st Cir. 2012) ("In sum, a court's job is not to review the IRS's CDP determinations afresh. Rather, its job is twofold: to decide whether the IRS's subsidiary factual and legal determinations are reasonable and whether the ultimate outcome of the CDP proceeding constitutes an abuse of the IRS's wide discretion."); *Sego v. Commissioner*, 114 T.C. 604, 609-10 (2000); *Murphy v. Commissioner*, 125 T.C. 301, 320 (2005), aff'd, 469 F.3d 27 (1st Cir. 2006); and *Estate of Duncan v. Commissioner*, T.C. Memo. 2016-204, *14, aff'd 2018 U.S. App. LEXIS 12257 (5th Cir. 2018) (unpublished). An Appeals determination that the Tax Court finds is based on an error of law is an abuse of discretion. *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner*, 154 T.C. 68, 75-76 (2020) (citing prior authority), rev'd on other grounds 29 F.4th 1066 (9th Cir. Mar. 25, 2022). In reviewing for abuse of discretion, the Court will not supply a reasoned basis for the determination that the IRS SO did not provide (this is the administrative law *Chenery* Rule, *SEC v. Chenery Corp.*, 332 U.S. 194, 196-197 (1947)), but will attempt to determine whether the IRS SO's actions can be reasonably discerned. *Melasky v. Commissioner*, 151 T.C. 93 (2018), aff'd 803 Fed. Appx. 732 (5th Cir. 2020).

³²⁹⁹ The Tax Court originally held by reviewed opinion that its consideration of abuse of discretion was not limited to the record in the CDP administrative hearing. *Robinette v. Commissioner*, 123 T.C. 85 (2004) (reviewed opinion), rev'd. 439 F.3d 455 (8th Cir. 2006). The Eighth Circuit reversed the Tax Court on that point and two Circuits—the 1st and 9th have held consistently with the Eighth Circuit. *Keller v. Commissioner*, 568 F.3d 710, 718 (9th Cir. 2009); and *Murphy v. Commissioner*, 469 F.3d 27, 31 (1st Cir. 2006). These appear to be the only Circuits to have considered the issue. *Hinerfeld v. Commissioner*, T.C. Memo. 2019-47, at *17 ("all three Courts of Appeals that have considered the issue have rejected our position that the record rule is inapplicable to CDP cases.") Notwithstanding, *Robinette* remains good law in the Tax Court except pursuant to the *Golsen* rule where the appeals are to those circuits. However, Judge Halpern in *Hinerfeld* (*17-*19) said that the Tax Court has called its *Robinette* holding in question in subsequent cases, suggesting that the Tax Court might revisit the issue and come into line with the Courts of Appeals.

³³⁰⁰ See *Brown v. Commissioner*, T.C. Memo. 2019-121 where the taxpayer sought to introduce in the Tax Court proceeding his counsel's notes of telephone conferences with collection personnel. *Brown* was rev'd and remanded on other grounds in 826 F. App'x 673 (9th Cir. 2020). The taxpayer had not made placed those notes in the administrative record before or during the Appeals Office consideration. The Court therefore excluded the notes based on appellate venue in the Ninth Circuit which has adopted the record rule.

³³⁰¹ *Pierson v. Commissioner*, 115 T.C. 576 (2000).

Finally, the jurisdiction in CDP cases is only with respect to the collection action in issue. The taxpayer may not raise in the CDP case an argument that, not only does he not owe the tax, but he is entitled to a refund.³³⁰²

4. Jeopardy Permitting Collection Actions While CDP Pending.

Collection actions are normally suspended pending final determination of the hearings. However, there are two significant exceptions: (1) the IRS has determined collection of the tax to be in jeopardy (in much the way that it makes the determination for a jeopardy assessment or tax year termination under §§ 6851 and 6861), although the taxpayer will be provided a post-levy opportunity for hearing;³³⁰³ and (2) after a trial level CDP hearing, if the merits of the tax liability are not in issue and the court determines that the IRS has shown “good cause.”³³⁰⁴

5. CDP as “Collection Delay Process”?

Professor Bryan Camp refers to CDP as “Collection Delay Process” because of the delays in collection (except for the jeopardy procedures, rarely invoked) mandated while the CDP proceeding is in process (first in Appeals, then in the Tax Court with any appeals therefrom).³³⁰⁵ Professor Camp uses two Tax Court cases that suggest “the fastest CDP resolution one can reasonably expect is 2 years, but one can push that to 7-8 years depending on the complexity of the case and persistence of the taxpayer.”³³⁰⁶ Most of the delay, he notes, comes from the Tax Court review. Of course, the statute of limitations on collection is suspended during the process. Further, interest continues to run during that delay period and the Tax Court may impose penalties for frivolous proceedings in the Tax Court. But a taxpayer with a modicum of a claim in the CDP proceeding, even if not ultimately successful, can achieve significant delay. As creditors know delay in the collection of debts often substantially diminishes the collection potential for the debt. From the taxpayer perspective, except for the cost of the additional interest (fairly low compared to the market for commercial debt), delay can be valuable just on the interest arbitrage, and there is always the possibility that the taxpayer’s circumstances could change for the worse so that the federal fisc rather than the taxpayer bears the economic cost of the tax that could have been collected had there been no delay.

I do not mean to suggest that delay attending the CDP proceedings (either in Appeals of the Tax Court) is inappropriate. Taxpayers may have meritorious positions in CDP and resolving them takes time. Further, as one astute observer notes, “the main purpose of CDP is to delay IRS collection so taxpayers can work out some alternative to indiscriminate use of the three collection

³³⁰² See *Greene-Thapedi v. Commissioner*, 126 T.C. 1 (2006); and *McLane v. Commissioner*, 24 F. 4th 316 (4th Cir. 2022).

³³⁰³ § 6330(f). The Tax Court has jurisdiction to review jeopardy levy determinations under § 6330(f)(1). *Dorn v. Commissioner*, 119 T.C. 356 (2002).

³³⁰⁴ § 6330(e)(2). The merits of the tax liability are not at issue merely because the taxpayer seeks to contest them if the court is otherwise without jurisdiction as, for example, where the taxpayer previously had an opportunity to contest. *Burke v. Commissioner*, 124 T.C. 189 (2005). And, although the statute does not define good cause, the IRS may show good cause “where the taxpayer has used the collection review procedure to espouse frivolous and groundless arguments and otherwise needlessly delay collection.” *Id.* pp. 1956-197.

³³⁰⁵ Bryan Camp, Lesson from the Tax Court: The Long and Short of CDP (Tax Prof Blog 4/6/20).

³³⁰⁶ *Id.*

tools.”³³⁰⁷ The “breathing room” and process required in the CDP proceedings can permit more focused attention by the parties on what collection processes, including possibly compromise or installment payments, are required.

6. Equivalent Hearing (“EH”).

If the taxpayer's appeal is not timely, the IRS may still grant the taxpayer an “Equivalent Hearing.”³³⁰⁸ Generally, the taxpayer must submit the EH request within one year of the CDP notice or NFTL.³³⁰⁹ The Appeals Office will provide the functional equivalent of a CDP hearing in terms of the issues and relief considered,³³¹⁰ but there are certain key distinctions:

- The written request for an equivalent hearing must be sent within one year of the date of the CDP notice issued under § 6330,³³¹¹
- Appeals will issue a decision letter rather than a notice of determination; the decision letter will contain the same information as a notice of determination;³³¹²
- There is no judicial review of the EH except as to certain spousal defenses under § 6015(b) or (c);³³¹³
- The IRS is not prohibited by statute from further levies during the time the EH appeal is pending, but it will generally forego such measures;³³¹⁴ and
- The collection statute of limitations is not suspended.³³¹⁵

³³⁰⁷ Bryan Camp, Lesson From The Tax Court: Appeals Can Change Its Mind (Tax Prof Blog 5/26/20).

³³⁰⁸ A request via Form 12153, Request for a Collection Due Process or Equivalent Hearing, filed within the-30 day period for a CDP Hearing will be treated as a request for CDP rather than an Equivalent Hearing even if the taxpayer desired the Equivalent Hearing rather than CDP. *Ruhaak v. Commissioner*, 157 T.C. ___, No. 9 (2021).

Reg. § 1.6320-1(i)(1) (providing that, at the conclusion of the equivalent hearing, the IRS will issue a Decision Letter which is not the Notice of Determination required in a CDP case; the Notice of Determination is the document giving the Tax Court jurisdiction in a CDP case); and IRM 5.1.9.3.2.2 (02-07-2014), Equivalent Hearing (EH) and Timeliness of EH Requests. See also *Graham v. Commissioner*, T.C. Memo. 2008-129 (succinctly stating the rules and citing *Craig v. Commissioner*, 119 T.C. 252, 258-259 (2002) and *Kennedy v. Commissioner*, 116 T.C. 255, 261 (2001)).

³³⁰⁹ IRM 5.1.9.3.2.2.2 (02-07-2014), Equivalent Hearing (EH) and Timeliness of EH Requests.

³³¹⁰ Reg. § 301.6330-1(i)(2), Q&A-I2.

³³¹¹ Reg. § 301.6330-1(i)(2), Q&A-I11.

³³¹² Reg. § 301.6330-1(i)(2), Q&A-I1 & Q&AI5.

³³¹³ IRM 5.1.9.3.2.2 (02-07-2014), Equivalent Hearing (EH) and Timeliness of EH Requests. See *United States v. Gilliam*, 737 Fed. Appx. 660, 2018 U.S. App. LEXIS 17209 (4th Cir. 2018).

³³¹⁴ Reg. § 301.6330-1(i)(2), Q&A-I4; IRM 5.1.9.3.5.1 (04-18-2016), Levy Action during the Period of the CDP or EH.

³³¹⁵ Reg. § 301.6330-1(i)(2), Q&A-I3; and IRM 5.1.9.3.6 (02-07-2014), Suspension of Collection Statute of Limitations. See *United States v. Gilliam*, 737 Fed. Appx. 660, 2018 U.S. App. LEXIS 17209 (4th Cir. 2018). Avoiding the suspension of the statute of limitations may turn out to be taxpayer friendly if, for whatever reasons, the IRS does not act timely to collect the tax assessed. See Bryan Camp, Lesson From The Tax Court: The CDP Silver Linings Playbook (Tax Prof Blog 1/19/21) (“the taxpayer’s equivalent hearing still got the delay benefits of CDP, and that delay did not count against Mr. Ramey should he file bankruptcy and seek a discharge of the tax liabilities at issue. Practitioners would not be crazy to put this lesson in a Playbook, a CDP Silver Linings Playbook.”).

D. NonTaxpayer Remedies.

1. Wrongful Levy.

I noted above that the IRS has broad power to levy on the taxpayer's property administratively without seeking the advance approval of a court. Sometimes the IRS levies on property belonging to third parties who do not owe the tax in question.

Example: the IRS levies on the Mercedes registered in the taxpayer's girlfriend's name. The IRS bases this action on its conclusion that the taxpayer has beneficial ownership of the Mercedes which was titled in the girlfriend's name. The IRS can seize the car by serving levy on the girlfriend if it believes that the taxpayer is the beneficial owner of the car. (As noted below, the IRS can also file a nominee lien or sue to foreclose on the car.) Levy in this case would be by seizing the automobile.

Similarly, if the girlfriend had a bank account in which the IRS believed taxpayer has beneficial ownership, the IRS can levy the girlfriend's bank account by serving notice of levy on the bank. The bank, having no interest in the dispute, will deliver pursuant to the levy.

I hope you have sensed that there may be some Constitutional issues inherent in such seizures. In the arguably analogous situations of jeopardy and termination assessments, responding to these concerns, Congress enacted §§ 6851 and 6861 to provide prompt judicial review (discussed beginning p. 523).³³¹⁶

When the IRS makes a wrongful levy, the IRS may admit its error and return the property or the proceeds from sale of the property (plus interest) at any time within 2 years of the date of levy.³³¹⁷ But, many times, the IRS is not willing to return the property. Section 7426 provides “the exclusive remedy for an innocent third party whose property is confiscated by the IRS to satisfy another person's tax liability.”³³¹⁸ The limitations period for the wrongful levy suit is two years, except that, if an administrative request is made, the period is extended for 12 months from the date of the request or 6 months from the denial of the request, whichever is shorter.³³¹⁹

³³¹⁶ Those provisions were enacted after the Supreme Court, in *Commissioner v. Shapiro*, 424 U.S. 614 (1976) and *Laing v. United States*, 423 U.S. 161 (1976), expressed grave constitutional concerns about jeopardy and termination assessments without affording prompt review.

³³¹⁷ § 6343(b) & (c). Section 6343(b) was revised by the TCJA Pub. L. 115–97, title I, § 11071(a), Dec. 22, 2017, 131 Stat. 2091.

³³¹⁸ *EC Term of Years Tr. v. United States*, 550 U.S. 429, 433 (2007) (cleaned up).

³³¹⁹ § 6532(c), as revised by the TCJA 2017, Pub. L. 115–97, title I, § 11071(b), Dec. 22, 2017, 131 Stat. 2091. There is a split of authority under the pre-TCJA version of § 6532(c) as to whether the then 9-month time limit was jurisdictional and, if not, equitable tolling might apply. See *Volpicelli v. United States*, 777 F.3d 1042 (9th Cir. 2015), applying equitable tolling and rejecting other Circuits' contrary holdings (see *Becton Dickinson & Co. v. Wolckenhauer*, 215 F.3d 340, 351-52 (3d Cir. 2000) (collecting cases)); and *Mottahedeh v. United States*, 794 F.3d 347 (2d Cir. 2015) (declining to address the issue because the pled facts did not meet the requirements that the person have pursued the rights diligently and some extraordinary circumstance prevented timely filing). There is no indication that the new provision forecloses this issue.

The *Drye* case covered above is a good example of a § 7426 case. There the third party did not prevail because the Court held the trust assets to be the taxpayer's property for purposes of the tax lien. But still the procedure was correct.

The § 7426 action has the following features:

1. Elements of the Action.
 - a. The IRS levied against property owned by a person who is not the taxpayer with respect to the liability (“nontaxpayer”).³³²⁰
 - b. The nontaxpayer owned the property or had an interest in the property that was superior to the taxpayer and thus superior to the IRS.
2. Proof Issues.
 - a. The nontaxpayer must show an interest in the property to establish standing.
 - b. The IRS must then show a nexus between the property and the taxpayer. This showing must be made substantial evidence.
 - c. The nontaxpayer must then show that the levy was wrongful.
3. Interest.
 - a. The **non**taxpayer may recover interest by reference to the overpayment rates provided for taxes.³³²¹ We covered the overpayment interest rates above.³³²² The principal “gotcha” here is, of course, the special 2.5% reduction applying to corporate overpayments exceeding \$10,000. That reduction applies to corporate recoveries for wrongful levies.³³²³

2. Other Remedies.

In *United States v. Williams*, 514 U.S. 527 (1995), the Supreme Court created a refund remedy for a person other than the taxpayer principally, I think, because the circumstances were egregious and there was no other fix for the problem. The owner of a house desired to sell her house. There was, however, an outstanding tax lien against her ex-husband that clouded the title on the house. To make the sale, the owner had to make peace with the IRS and the cost of peace was to apply to her ex-husband's taxes a portion of the sales proceeds she was otherwise entitled to. In other words, she was forced to pay her ex-husband's taxes to complete the sale. She then filed a suit for refund of the taxes paid. The Government took the position that she could not sue because she was not the taxpayer to whose tax liability the sales proceeds were applied. This has been the Government's position, generally sustained, since the inception of the income tax laws. The district court held for the Government; the Court of Appeals reversed, holding for Mrs. Williams; and the Supreme Court also held for Mrs. Williams.

³³²⁰ A levy can precede the actual taking of possession by the IRS. For example, the IRS can levy a bank account by serving notice of levy on the bank, even though the actual delivery of the proceeds is later. Hence, the levy and the resulting accrual of the § 7426 cause of action accrues on the date of the levy, not the subsequent delivery or even the subsequent sale. *Mottahedeh v. United States*, 794 F.3d 347 (2d Cir. 2015),

³³²¹ § 7426(g).

³³²² Beginning p. 288.

³³²³ *Steven N.S. Cheung, Inc. v. United States*, 545 F.3d 695 (9th Cir. 2008).

The decision contains esoteric statutory analyses of the relevant code sections—28 U.S.C. § 1346(a)(1) (the general refund jurisdiction statute), and Code §§ 7422 (the Code refund provision), 6511 (the refund limitations provision), and 7701(a)(14) (the definition of taxpayer). Bottom line, however, the Court seemed to be influenced by the equities (i.e., the IRS should not have collected these taxes) and the fact that there was no other readily apparent relief for this taxpayer who had been wronged. In this regard, § 7426 provides judicial relief for a person who is subject to an IRS levy to pay taxes of another person's tax liability, but here there was no levy. In *Williams*, the IRS just forced the taxpayer to pay to release the cloud on title on sale of the house. The IRS did not technically “levy” on the funds, although its position was fully as forceful as a levy (given that Mrs. Williams needed to sell the residence). Therefore, *Williams* permitted a person to bring a refund suit for amounts collected and applied to another person's tax liability if there is no other available remedy. The statutory basis for the broader reading was interpreting the definition of “taxpayer” in § 7701(a)(14) to include a nontaxpayer in Mrs. Williams’ position.³³²⁴

In the 1998 Restructuring Act, however, Congress enacted an administrative and judicial remedy to solve the problem presented in *Williams* where there was no judicial remedy other than the one carved out by *Williams* which may be of uncertain scope.³³²⁵ This statutory remedy, if available, specifically precludes any other remedy, thus pre-empting the operation of *Williams*.³³²⁶ And the Supreme Court held that a *Williams*-type remedy will not apply in wrongful levy situations where the person could have brought a § 7426 wrongful levy action, so the strong inference is that the *Williams* remedy would not be available where a statutory remedy is available.³³²⁷ The statutory remedy generally will have different administrative requirements and a shorter period for pursuing a judicial remedy than would be required for a refund suit.

It is conceivable that in cases not covered by the new legislation or any other remedy such as § 7426, equitable factors could compel a court to allow a refund remedy using the *Williams* reasoning or even a due process analysis.³³²⁸ The continuing viability of at least the interpretive spirit

³³²⁴ At least this is the interpretation of *Williams* in *Rothkamm v. United States*, 802 F.3d 699, 705 (5th Cir. 2015), acq. on this point IRM 2020-03 (4/20/20).

³³²⁵ § 6325(b)(4) (administrative remedy) and § 7426(a)(4) (judicial remedy). Basically, under § 6325(b)(4), at the request of the owner of property other than the taxpayer subject to the assessment, the IRS must issue a certificate of discharge of the lien if the owner deposits with the IRS or bonds to the IRS the amount of the Government’s interest in the property. If the taxpayer’s interest in the property is zero, the person owning the property should get a complete release of the property. However, the IRS may determine that the taxpayer’s interest is greater than zero and require that, for release of the lien, the owner pay in the cash or make the bond. Under § 7426(a)(4), the owner then has 120 days to contest the determination as to the amount of the taxpayer’s interest in the property.

³³²⁶ § 7426(a)(4) says that “no other action may be brought by such person for such a determination.” See e.g., *Munaco v. United States*, 522 F.3d 651, 657 (6th Cir. 2008) (“Munaco had access to a post-deprivation administrative remedy under § 6325(b)(4) and a judicial remedy under § 7426(a)(4),” thus pre-empting the field; and Rev. Rul. 2005-50, 2005-30 I.R.B. 124, citing §§ 6325(b)(4) and 7426(a)(4), enacted as part of the 1998 Restructuring Act in response to the inadequate remedy problem identified by the Supreme Court in *United States v. Williams*, 514 U.S. 527 (1995); and *Portsmouth Ambulance, Inc. v. United States*, 756 F.3d 494 (6th Cir. 2014) (affirming *Munaco*).

³³²⁷ *EC Term of Years Trust v. United States*, 127 S. Ct. 1763 (2007); see also *First American Title Ins. Co. v. United States*, 520 F.3d 1051, 1053 (9th Cir. 2008) (in light of *EC Term of Years Trust*, “there can no longer be a good argument for allowing a third-party challenge to an assessment, barred by § 7426, to be made under § 1346.”); and *Wagner v. United States*, 543 F.3d 298 (5th Cir. 2008). See also Rev. Rul. 2005-50, 2005-30 I.R.B. 124.

³³²⁸ Cf. *Begner v. United States*, 428 F.3d 998 (11th Cir. 2005) (interpreting the refund suit broadly and reading *Williams* as “stating that section 1346(a)(1) contains ‘broad language,’ which the Court then applied to a person

(continued...)

of *Williams* is demonstrated in an opinion from the Fifth Circuit in 2015.³³²⁹ In the case, an owner of a bank certificate of deposit had the certificate levied upon for her husband's separate liability taxes. That owner had a remedy under the wrongful levy provision, § 7426, but that provision requires that the claimant bring the court action within 9 months.³³³⁰ If an administrative claim for return of the property is filed, the 9-month period is suspended while the claim is pending.³³³¹ In this case, the owner filed the administrative claim but only after the 9-month statute of limitations had expired—except that, during the 9-month period, the owner applied for a Taxpayer Advocate Service (“TAS”) relief. Section 7811(d) suspends a statute “beginning on the date of the taxpayer’s application” to the TAS. The Fifth Circuit held that the TAS application suspended the statute for the wrongful levy suit, interpreting “taxpayer” requirement in § 7811(d), consistent with *Williams*, to include an owner whose property is applied to the taxpayer’s taxes. Hence, the Fifth Circuit concluded, § 7811(d) suspended the 9-month statute of limitations and the owner’s wrongful levy suit was timely when the combined suspensions for filing for TAS relief and the administrative claim were considered.³³³²

Of course, if the party paying the tax of another taxpayer voluntarily makes the payment with no compulsion, then the *Williams* equitable factors would not be in play and the person would have no refund remedy. That person has, in effect, made a gift to the taxpayer, paid compensation to the taxpayer or made a loan to the taxpayer through the medium of the tax payment and that taxpayer should then have whatever refund remedy may be available.³³³³

³³²⁸(...continued)

who paid a tax “even though the tax she paid was assessed against a third party.”). In *First American Title* (preceding footnote), the Ninth Circuit construes the nontaxpayer refund suit narrowly in light of *EC Term of Years Trust*.

See also *Scheafnocker v. Commissioner*, 642 F.3d 428 (3d Cir. 2011) finding a due process remedy in a wrongful levy where the Government did not give the claimant notice of the levy and she did not discover it until after the period to file a § 7426 claim had expired.

³³²⁹ *Rothkamm v. United States*, 802 F.3d 699 (5th Cir. 2015), nonacquiescence on this point, I.R.B. 2020-03 (4/20/20).

³³³⁰ §§ 7426(i) and 6532(c).

³³³¹ §§ 6343(b) and 6532(c)(1).

³³³² *Garlovsky v. United States*, 211 F. Supp. 3d 1084 (N.D. Ill. 9/26/16) (with a good discussion citing both *Williams* and *Rothkamm*).

³³³³ This makes sense from traditional tax analyses. There are several odd cases in this general area predating *Williams* but one of the odder ones, in my opinion, is *Bruce v. United States*, 759 F.2d 755 (9th Cir. 1985), where, pursuant to the original agreement, the tax shelter attorney who promoted the taxpayer into the transaction paid the tax, penalty and interest when the shelter failed on audit. The payment was not a deemed loan to the taxpayer because there was apparently no obligation to repay. The taxpayer sued for refund, but if successful the refunded proceeds would apparently go to the promoter. The district court held that the taxpayer lacked standing because he had no financial interest in the refund litigation. The Court of Appeals affirmed, saying cryptically at the end of its reasoning (such as it was): “Whether Margolis [the tax shelter attorney] would have standing to obtain a refund is not before us.” (P. 759.) In paying the tax, the tax shelter attorney was under no compulsion such as Mrs. Williams faced in *Williams*, although he apparently had a contractual legal obligation to front the costs and, if unsuccessful, bear the full economic costs. But I doubt that this private contractual compulsion that would be sufficient to permit the tax shelter attorney to bring a refund suit under *Williams*. If my reading of *Williams* is correct, therefore, and if *Bruce* is still good law denying the taxpayer the refund remedy, it would appear that, if indeed there is an overpayment of the tax, neither the taxpayer nor third party funding the tax could sue, so that the IRS gets a windfall. Something seems wrong with that possibility. And consider this possibility, taxpayer son has a tax assessed. Nontaxpayer parent pays the tax for son, with the understanding—even legal commitment—that taxpayer son will return any refund to nontaxpayer parent. Does the son have standing to sue? I would think so, particularly if there has been no attempt to assign the refund claim or benefit

(continued...)

If the person paying the tax believes that he is paying his own tax but the IRS applies the tax to the liability of another taxpayer, the taxpayer may be afforded a refund remedy.³³³⁴

There are some cases in the employment tax area where an employer pays taxes of the employees is permitted to seek a refund provided that certain conditions are met.³³³⁵

There are a number of cases in which courts have fashioned a refund or refund-like remedy in various circumstances where equitable factors like *Williams* may have been in play to some extent. Most of the cases pre-date *Williams*, so that *Williams* will be the principal case to consider and their continuing viability must be filtered through the *Williams* analysis. I don't discuss or even cite those cases here. I just urge the reader to apply the *Williams* analysis and the subsequent cases before attempting to mine any gold from the older cases.

Consider the following: Suppose that the IRS levies on cash of the nontaxpayer and applies the amount to the taxpayer's tax liability. The nontaxpayer does not pursue the wrongful levy remedy, so is shut out of making any claim (even a *Williams*-type refund claim because his remedy that he failed to pursue was adequate). Can the taxpayer bring a refund suit? If there is a refund, can the nontaxpayer then claim from the taxpayer the proceeds of the refund (at least up to the amount applied to the taxpayer's tax liability)? This latter question is a question of state law but is probably not a viable issue in most cases because, I suspect, there is rarely an overpayment of the taxpayer's liability even with the application of the nontaxpayer's proceeds.

E. Fair Tax Collection Practices.

The Fair Debt Collection Practices Act ("FDCPA") imposes upon general creditors certain standards and prohibitions in pursuing debt collection.³³³⁶ Congress made certain of these standards and prohibitions applicable to IRS collection efforts, principally in § 6304, titled Fair Tax Collection Practices ("FTCP").³³³⁷ Congress felt that the IRS should be at least as considerate to taxpayers as private creditors are required to be with their customers.³³³⁸ The FTCP thus requires that debt

³³³³(...continued)

of the refund claim to the nontaxpayer parent.

³³³⁴ In *Schoenherr v. United States*, 566 F. Supp. 1365 (E.D. Wash. 1983), the taxpayer had mistakenly been warned by IRS agents that he was personally responsible and, in response, paid taxes properly assessed against various corporations. The court permitted the refund suit, applying because: (1) taxpayer believed he was personally liable for the taxes; (2) his belief was reasonable under the circumstances; and (3) he did not intend by paying the taxes to benefit a third party. *Schoenherr* is a pre-*Williams* case but *Williams* should not change the result where the three conditions are met.

³³³⁵ See Reg. 31.6402(a)-2(a)(2), requiring that, in the refund claim, the employer state that "the employer has repaid or reimbursed the tax to its employee or has secured the employee's written consent to allowance of the filing of the claim for refund except to the extent that the taxes were not withheld from the employee." But there may even be a work-around there. See *First National Bank of Chicago v. United States*, 964 F.2d 1137 (Fed. Cir. 1992).

³³³⁶ 15 U.S.C. §§ 1601 note, 1692-1692o.

³³³⁷ § 6304 was added by the IRS Restructuring and Reform Act of 1998, 2 Pub. L. No. 105-206, 112 Stat. 685, § 3466.

³³³⁸ Fiscal Year 2022 Statutory Review of Potential Fair Tax Collection Practices Violations (TIGTA # 2022-30-056 9/13/22).

collectors make their contacts at reasonable times and places,³³³⁹ avoid “any conduct the natural consequence of which is to harass, oppress, or abuse any person in connection with the collection of any unpaid tax,”³³⁴⁰ and, if the taxpayer has a representative, deal through the taxpayer’s representative.³³⁴¹ IRS employees violating the FTCP are subject to disciplinary action.³³⁴² Further, the taxpayer is given a remedy for violations of the FTCP.³³⁴³

IRS contracts with private collection agencies (“PCAs”) under § 6306 (discussed beginning p. 755), contain similar requirements³³⁴⁴ and makes PCAs solely liable for damages.³³⁴⁵

TIGTA is required to report to Congress semiannually regarding any administrative or civil actions regarding violations of the Fair Tax Collection Practices.³³⁴⁶

F. Damages for Unauthorized Collection Action (§ 7433).

Section 7433 gives taxpayers a damage action for unauthorized collection action. I discuss this remedy beginning p. 886.

G. Release of Filed Tax Liens.

I discussed above that the filing of a tax lien is notice to the public of an unpaid tax debt. That public notice can, not only impede a taxpayer's ability to sell or otherwise deal with his or her property, but its existence in the public records can affect a taxpayer's credit rating. The problem addressed here is the taxpayer's remedy when the filed tax lien relates to a tax liability that is not legally collectible. The taxpayer may have paid the liability in full, in which case there is no liability behind the filed tax lien. Alternatively, the statute of limitations on collection of the underlying tax (the 10 year collection statute of limitations) may have expired. Still alternatively, the assessment underlying the lien may be invalid (e.g., for the IRS's failure to follow the required notice of deficiency procedures discussed above).

The filed tax lien is “self-releasing” on the date indicated in the original filing (the end of the statute of limitations on collection, usually 10 years after the tax is assessed).³³⁴⁷ In other cases where the taxpayer is entitled to release of the lien (e.g., upon payment or abatement of the tax, penalties or interest), the IRS will issue a certificate of release of tax lien upon the taxpayer’s

³³³⁹ § 6304(a)(1) & (3).

³³⁴⁰ § 6304(b).

³³⁴¹ § 6304(a)(2).

³³⁴² Fiscal Year 2022 Statutory Review of Potential Fair Tax Collection Practices Violations (TIGTA # 2022-30-056 9/13/22).

³³⁴³ § 6304(c).

³³⁴⁴ § 6306(b)(2) and § 6306(g).

³³⁴⁵ § 7433(b)(1), (4) and § 6306(f).

³³⁴⁶ § 1102(d)(1)(G) of the 1998 Restructuring Reform Act. The most recent report is Fiscal Year 2021 Statutory Review of Potential Fair Tax Collection Practices Violations (TIGTA Ref. 2021-30-068 9/22/21).

³³⁴⁷ IRM 5.12.3.3.2 (07-15-2015), Liability is Unenforceable - IRC § 6325(a)(1); and IRM 5.12.3.4.1.1 (07-15-2015). Self-Releasing Lien (noting, inter alia, that (i) the self-releasing statement provides notice that, after the date, the lien is no longer enforceable, (ii) and meets the 30-day requirement to release a lien and (iii) that, in any event, even with the self-release, the IRS “should” issue a certificate of release if requested).

request. § 6325(a).³³⁴⁸ The certificate of release is conclusive that the lien is extinguished;³³⁴⁹ however, even though the lien is extinguished, the underlying tax liability is not extinguished if it is not paid, discharged or becomes uncollectible due to the expiration of the statute of limitations.³³⁵⁰ If the IRS fails to issue the certificate of release after proper notice or request, § 7432 gives the taxpayer the right bring a suit for actual damages suffered as a result of failure to release the lien³³⁵¹ and costs of the proceeding.³³⁵² Procedural predicates apply for this suit: (i) exhaustion of administrative remedies;³³⁵³ and (ii) a two-year statute of limitations commencing on the “date the right of action accrues.”³³⁵⁴ The damages recoverable are reduced by the amount of damages which could have been mitigated.³³⁵⁵

In addition, to a certificate of release, the taxpayer can request that the filed lien be withdrawn in certain cases.³³⁵⁶ This withdrawal seems to give a positive effect on credit scoring beyond that achieved by the release of the tax lien;³³⁵⁷ the Form for requesting withdrawal states that, if granted, the IRS will notify interested parties, including “credit reporting agencies, financial institutions, and/or creditors that you want notified.” Withdrawal is permitted if (i) the lien was improperly filed, (ii) the taxpayer has entered into an installment agreement permitting withdrawal, (iii) the IRS determines that withdrawal “will facilitate” collection, or (iv) with the consent of the taxpayer or the National Taxpayer Advocate, withdrawal is in “in the best interests of the taxpayer

³³⁴⁸ The certificate of release may be revoked and the lien reinstated if it was “erroneously or improvidently” granted or the taxpayer has not met the conditions of the release, provided that the period of limitations on collection has not expired. § 6325(f)(2). The revocation is perfected by mailing notice to the taxpayer and filing the notice of revocation in the office where the original NFTL was filed. *Id.*

³³⁴⁹ § 6325(f).

³³⁵⁰ Reg. § 301.6325-1(a)(1); *Boyer v. Commissioner*, T.C. Memo. 2003-322. Hence, the erroneous improvident release of the lien does affect the taxpayer’s obligation to pay the tax. And, for such erroneous or improvident release of the lien, the release may be revoked and the certificate reinstated. § 6325(f)(2).

³³⁵¹ Section 7432 does not cover a failure to release a lien because the underlying tax is less than the assessment on which the lien is based or the assessment was procedurally invalid. Rather, it applies only where the IRS determines that the liability has been satisfied or has become legally enforceable; if the IRS stands by the assessment without making that determination, § 7432 does not apply. *Franklin v. United States*, 2021 U.S. Dist. LEXIS 186270 (N.D. Tex. Sep. 29, 2021) (Slip Op. p. 6, citing “*McIver v. United States*, 650 F. Supp. 2d 587, 592 (N.D. Tex. 2009) (citing *Gandy Nursery, Inc. v. United States*, 318 F.3d 631, 636 (5th Cir. 2003)); see also *Pollinger v. I.R.S. Oversight Bd.*, 362 F. App’x 5, 12 (11th Cir. 2010) (holding that section 7432 does not ‘allow for actions regarding assessment of tax liability’).” The Court in *Franklin* refused to consider a claim that an assessed tax penalty which allegedly violated § 6751(b) supervisor written approval requirement was invalid because the IRS had not found the assessment unenforceable.

³³⁵² Costs are the normal costs of litigation. Reg. § 301.7432-1(d). This does not include attorneys’ fees and other litigation costs but they may be recovered under § 7430, discussed elsewhere in the test. Reg. § 301.7432-1(j).

³³⁵³ § 7432(d)(1). For the interpretation of this requirements, see the discussion of similar language in § 7433 beginning p. 886. The exhaustion of administrative remedies occurs on the later of the decision date on the claim or 30 days after the claim is filed, but the taxpayer may sue immediately after filing a claim during the last 30 days of the 2-year limitations period See Reg. § 301.7432-1(e).

³³⁵⁴ § 7432(d)(3). For the interpretation of this requirements, see the discussion of similar language in § 7433 beginning p. 886. Reg. § 301.7432-1(i)(2) provides that the “cause of action accrues when the taxpayer has had a reasonable opportunity to discover all essential elements of a possible cause of action.”

³³⁵⁵ § 7432(d)(2).

³³⁵⁶ § 6323(j)(1). The Form for this request is Form 12277, Application for Withdrawal of Filed Form 668(Y), Notice of Federal Tax Lien.

³³⁵⁷ I don’t know exactly how this positive affect is achieved unless the scoring companies wipe the existence of the original filed tax lien from their scoring.

(as determined by the National Taxpayer Advocate).”³³⁵⁸ Strictly read, the mere full payment of the tax and additions (interest, etc.) that wipes away the underlying federal tax lien is not a stated basis for withdrawing the original filed tax lien. The safety valve here is the last category that, upon full payment, the lien can be withdrawn “in the best interests of the taxpayer.”

The IRS has authority also to release or, in some cases, modify the effect of liens in other situations, such as when the taxpayer provides adequate substitute collateral or bond or to subordinate the tax lien in certain cases.³³⁵⁹ This opportunity may be particularly helpful where, for example, a financially distressed property owner (including a homeowner) is attempting to refinance a loan on property to reduce money or lower the risk of forfeiture. In such cases, the IRS must “believe[] that the subordination of the tax lien to another interest will ultimately result in an increase in the amount realized by the United States from the property subject to the lien and will aid in the collection of the tax liability.”³³⁶⁰ The IRS recognizes that the decision to subordinate entails risk that the IRS will ultimately receive less than it would have otherwise, but still the authority should be exercised based on “good judgment” of the type exercised by an “ordinary prudent business person.”³³⁶¹

Finally, the IRS has authority to provide a certificate that a filed tax lien does not apply to a person who may be confused (by confusion of names or otherwise) with the taxpayer against whom a lien was filed.³³⁶²

H. Taxpayer Advocate Assistance.

It is not uncommon in collection matters for a taxpayer to feel aggrieved by a collection officer pressing for payment or taking actions to effect payment. Many times, that taxpayer just does not want to pay or pay timely and has no legitimate complaint that the collection officer is using the tools Congress granted to collect. Still, sometimes an overly aggressive collection officer will employ those tools beyond the boundaries of fair and good judgment in manners that Congress probably would not have intended under the particular taxpayer’s facts. The taxpayer can request a Taxpayer Assistance Order (“TAO”) if the taxpayer is suffering or about to suffer a “significant hardship” from tax law administration, in particular levies and liens.³³⁶³ The taxpayer seeks assistance by filing an Application for Taxpayer Assistance Order, Form 911. A TAO may require the IRS to release property of the taxpayer that has been levied upon, or to cease any action, take any action as permitted by law, or refrain from taking any action with respect to the taxpayer.³³⁶⁴ The TAO suspends the statute of limitations on collection.³³⁶⁵

XVI. Outsourcing the Collection Function (Private Debt Collection).

³³⁵⁸ § 6323(j)(1).

³³⁵⁹ § 6325(b) and (d).

³³⁶⁰ IRM 5.17.2.8.6(1)(b.) (03-19-2018), Subordination of the Tax Lien.

³³⁶¹ Id.

³³⁶² § 6325(e).

³³⁶³ § 7811. See Keith Fogg, [What is a Taxpayer Assistance Order?](#) (Procedurally Taxing Blog 3/17/17) (accessed 3/17/17).

³³⁶⁴ § 7811(b).

³³⁶⁵ § 7811(d), which suspends the statute for actions identified in § 7811(b), which generally involve collections procedures.

Historically, the IRS has administered collection with its own personnel.

In 1995, Congress authorized private debt collection which the IRS abandoned after a short trial period in 1996 because of significant net losses from the program.³³⁶⁶

Then, in 2004, Congress was back with the idea, requiring that the IRS outsource some of the collection efforts to third party contractors.³³⁶⁷ The program was referred to as Private Debt Collection, with the ubiquitous initialism, “PDC.” The reasons for the PDC initiative are typical political show biz and muddled thinking. “Big government” detractors have the knee jerk reaction that private efforts are always more efficient than Government efforts, particularly IRS efforts. (Big government detractors tend to dislike the IRS immensely.) The truth is the opposite; the IRS could more cost effectively handle the collection efforts than private contractors, but Congress refused to provide the IRS the funds to handle collection and required that some of it be outsourced so that the citizens could pay more for less service. So, between big government detractors and lobbyists for the firms that stood to gain from the PDC, we had some level of private debt collection. But strong critics of PDC came forward, including the National Taxpayer Advocate.³³⁶⁸ One called the PDC a “resounding failure.”³³⁶⁹ Cooler heads then prevailed; in 2009, the IRS abandoned the PDC program after concluding that the IRS could do a more cost effective job in working similar cases.³³⁷⁰

But, yet again proving that Congress can’t keep a bad idea down, in 2015, Congress revived PDC for some seriously delinquent debts by revising § 6306 and adding § 6307.³³⁷¹ One author summarized: “[t]he basic concept places private debt collectors on those cases where the efforts of

³³⁶⁶ GAO Report titled Tax Collection Contracts: IRS Analysis Could Help Improve Program Results and Better Protect Taxpayers 5 (GAO-19-193 3/19).

³³⁶⁷ This one in legislation titled The American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 881(a), 118 Stat. 1418 (2004). See TIGTA Report titled Private Debt Collection Was Implemented Despite Resource Challenges; However, Internal Support and Taxpayer Protections Are Limited (Ref. No. 2018-30-052 9/5/18). There are all sorts of issues involved with outsourcing—how to manage the privacy issues imbedded in § 6103 being only one. See Announcement 2006-63; 2006-37 I.R.B. 1.

³³⁶⁸ See Taxpayer Advocate Service, 2013 Annual Report to Congress, vol. 2, The IRS Private Debt Collection Program — A Comparison of Private Sector and IRS Collections While Working Private Collection Agency Inventory.

³³⁶⁹ Keith Fogg, Continued Developments in Private Debt Collection (Procedurally Taxing Blog 2/23/17).

³³⁷⁰ For a history of this early iteration of the PDC program, see Taxpayer Advocate 2016 Annual Report to Congress, MSP #12, titled Private Debt Collection: The IRS Is Implementing a PDC Program in a Manner That Is Arguably Inconsistent With the Law and That Unnecessarily Burdens Taxpayers, Especially Those Experiencing Economic Hardship. This report will hereafter be referred to as NTA 2016 Annual Report, PDC Discussion. See also GAO Report titled Tax Collection Contracts: IRS Analysis Could Help Improve Program Results and Better Protect Taxpayers 5 (GAO-19-193 3/19).

³³⁷¹ TIGTA Report titled Private Debt Collection Was Implemented Despite Resource Challenges; However, Internal Support and Taxpayer Protections Are Limited (Ref. No. 2018-30-052 9/5/18). The National Taxpayer Advocate and many others objected to the new enactment, but Congress authorized it anyway. NTA 2016 Annual Report, PDC Discussion.

the IRS have failed or the Service lacks resources to pursue the debt.”³³⁷² The key features of the new iteration of this PDC are:

- the contracts will only apply to “outstanding inactive tax receivables”;³³⁷³ basically the older inventory receivables that the IRS likely would not allocate collection resources to anyway.³³⁷⁴ The following tax receivables may not be assigned for collection to the Private Collection Agency (“PCA”): (i) assessments subject to a pending OIC, (ii) assessments in an innocent spouse case, (iii) assessments for a deceased taxpayer, (iv) assessments for a taxpayer under 18, (v) assessments for a taxpayer in a designated combat zone, (vi) assessments for a victim of tax-related identify theft, (vii) assessments for a taxpayer under examination, litigation, criminal investigation or levy,(viii) assessments currently under appeal within the IRS, (ix) assessments for a taxpayer “substantially all” of whose income is from Social Security; and (xi) assessments for a taxpayer with adjusted gross income for the most recent year did not exceed 200 percent of the applicable poverty level (as determined by the Secretary of the Treasury).³³⁷⁵
- the contractor, referred to as a Private Collection Agency (“PCA”), may contact the taxpayer to request full payment or an installment contract up to 7 years.³³⁷⁶ Incident to doing so, the PCA may obtain the taxpayer’s “financial information specified by the Secretary.”³³⁷⁷ But all tax payments must be to the IRS.³³⁷⁸ The PCA may not file notices of tax lien or make levies for payment.
- The IRS may pay the private contractor up to 25% of the amount collected and apply up to 25% of the amount collected to a special compliance fund to hire and train collection officers.³³⁷⁹
- The collections will be fully credited as paid by the taxpayer,³³⁸⁰ so that there are no additional costs for the amounts paid and applied under § 6306.
- The contract must prohibit the PCA from committing acts or omissions that employees of the IRS could not do and makes the PCA subject to the Fair Debt

³³⁷² Keith Fogg, Private Debt Collection (Procedurally Taxing Blog 2/26/16). Of course, Congress over recent years has denied the IRS resources resulting in decreased performance by the IRS. Whether, balancing all the factors involved, the IRS should be the one collecting the debts and funded to do so was never the issue so long as Republicans in Congress could punish their perceived enemy, the IRS, and perhaps reward private enterprise by shifting functions to it. This reminds me of the federal private prison program which certainly rewards private enterprise without overall cost/benefit advantage. See Jim Tankersley and Anni Karni, Biden Moves to End Justice Contracts with Private Prisons (NYT 1/26/21).

³³⁷³ § 6306(c).

³³⁷⁴ § 6306(c), as amended by Taxpayer First Act of 2019, § 1205(b), P.L. 116-25, 133 Stat 981 (July 1, 2019). The inactive receivables are defined as an outstanding assessment that meets the following characteristics: in potentially collectible inventory, not in the current IRS active inventory because of lack of resources, more 2 years has passed since assessment, and, in the case of receivables assigned for collection, there has been no interaction with the taxpayer for 365 days.

³³⁷⁵ § 6306(d), as amended by Taxpayer First Act of 2019, § 1205(a) P.L. 116-25, 133 Stat 981 (July 1, 2019).

³³⁷⁶ § 6306(b)(1)(B), as amended by Taxpayer First Act of 2019, § 1205(c), P.L. 116-25, 133 Stat 981 (July 1, 2019).

³³⁷⁷ § 6306(b)(1).

³³⁷⁸ § 6306(b).

³³⁷⁹ § 6306(e).

³³⁸⁰ § 6306(e).

Collection Act.³³⁸¹ The United States is exempt from liability for any act or omission of the PCA.³³⁸²

- For violations by the PCA, the taxpayer may sue the PCA (but not the IRS) for “actual, direct economic damages” up to \$1,000,000 (\$100,000, in the case of negligence).³³⁸³ In addition, the taxpayer should have the FDCPA civil remedies.³³⁸⁴

This PDC iteration began in April 2017.³³⁸⁵ The results to date are inconclusive, with the National Taxpayer Advocate expressing concern.³³⁸⁶ Maybe the third time will be a charm, but it is still too early to know whether, on balance, PDC is better than an adequately funded IRS.

XVII. Innocent Spouse Relief -- §§ 6015 & 66.

A. Introduction.

I covered(beginning p. 167) the inequities that may arise from the operation of the community property laws and from the joint return provisions of the Code. Please review that discussion now. Two Code sections provide some relief from the inequities.

First, § 6015 eliminates or at least mitigates some of the more egregious hardships of the joint income tax liability that results from filing joint returns.³³⁸⁷ Second, § 66 provides analogous

³³⁸¹ § 6306(b)(2) & § 6306(g). See Chi Chi Wu, FDCPA’s Application to IRS’ New Private Debt Collectors (Procedurally Taxing Blog 5/9/17).

³³⁸² § 6306(f).

³³⁸³ § 7433A(a) incorporating § 7433.

³³⁸⁴ Chi Chi Wu, FDCPA’s Application to IRS’ New Private Debt Collectors (Procedurally Taxing Blog 5/9/17).

³³⁸⁵ IR-2017-74 (4/4/17), which identifies the authorized contractors, referred to as Private Collection Agencies, and explains the program.

³³⁸⁶ Former NTA Nina Olsen, IRS Violates Taxpayer Bill of Rights by Unilaterally Terminating Installment Agreements Entered into with Private Collection Agencies (Procedurally Taxing Blog 10/18/21):

At any rate, since its inception the current PCA initiative has apparently collected about \$969 million, or 3%, of the total \$32 billion in inventory transferred to the PCAs. Now, the IRS estimates that the gross underpayment tax gap for 2008 to 2010 was \$39 billion. A raw calculation shows PCAs are now holding 82% of the underpayment tax gap. If we adjust for inflation, the \$39 billion in gross underpayment tax gap from 2010 would be about \$48.81 billion today, which means the PCAs are now holding about 65% of the underpayment tax gap inventory. And they are only collecting 2% of that inventory. All we have done, with the PCA program, is shift the IRS collection queue to the PCAs. We have not reduced the collection queue in any meaningful way.

Ms. Olsen was responding to some statistics and commentary in NTA Blog: The IRS and Private Collection Agencies: Four Contracts Lapsed and Three New Ones Are in Place: What Does That Mean for Taxpayers? (10/14/21).

³³⁸⁷ For good brief discussion of the relief intended and the various statutory changes to effect the relief, see *Commissioner v. Neal*, 557 F.3d 1262, 1264-5 (11th Cir. 2009); and *Wilson v. Commissioner*, 705 F.3d 980 (9th Cir. 2013). Section 6015 applies only to joint income tax liability and not to other types of tax liability. See *Chavis v. Commissioner*, 158 T.C. ___, ___ No. 8, (slip op. *8-*9) (2022) (§ 6015 does not apply to the trust fund recovery penalty (“TFRP”) under § 6672 because it is not an income tax liability).

A bit of history not essential for understanding the innocent spouse provisions. The innocent spouse provisions were enacted in the early 1971. Before that enactment, I was working at DOJ Tax Appellate Section and handled one of the more egregious cases in the context, involving separate property liability (*Ramos v. Commissioner*, T.C. Memo. 1969-157 (held spouse held liable, although “harsh”), rev’d 429 F.2d 487 (5th Cir. 1970)) and was aware of other cases (continued...)

income tax relief in the less common situation where a spouse files a separate return in a community property state. For perspective, even in community property states, most spouses file joint returns, so as a practitioner you will more commonly be dealing with § 6015.

Both sections are generally referred to as the “innocent spouse” provisions although neither section uses the word “innocent.” The relief provided is referred to as “innocent spouse relief.” The person qualifying for relief is referred to as the “innocent spouse.” The term innocent may be a bit of a misnomer because a spouse may qualify for relief even where not so innocent under a layman’s concept of innocence. Nevertheless, practitioners often refer to that person as the innocent spouse to indicate that he or she has or claims relief under the innocent spouse provisions; for some purposes, a better short-hand is to call the person the “requesting spouse” which is the term use in the regulations³³⁸⁸ and I will generally use here. The other spouse is sometimes referred to as the culpable spouse; I may use that term, but generally I will refer to the other spouse as the “nonrequesting spouse” which is also used in the regulations.³³⁸⁹

In this discussion, I sometimes refer to the requesting spouse using a feminine pronoun. Given where we have been and still are in society, it is a fact that the woman in the marriage needs, seeks and qualifies for this relief more often than does the man.³³⁹⁰ However, men may qualify and do qualify.³³⁹¹ You can substitute the male gender where appropriate. And, of course, there are further issues with same sex marriage. I will try to avoid by these gender issues by using the terms requesting spouse and nonrequesting spouse, but sometimes I may refer to the requesting spouse with a feminine pronoun.

Estates of a deceased spouse can qualify for the relief provided that the decedent otherwise qualified.³³⁹²

³³⁸⁷(...continued)

in the office involving joint return liability in harsh contexts (e.g., *Scudder v. Commissioner*, 48 T.C. 36 (1967) (held spouse liable under joint liability provision), rev’d on other grounds, 405 F.2d 222 (6th Cir. 1968)). From that work, I drafted proposed legislation that, if enacted, would grant innocent spouse relief. The Assistant Attorney General for the Tax Division sent the proposal to the IRS with a recommendation that the IRS work on it and make a formal proposal to Congress. The IRS resisted. The AAG finally advised the IRS that, if the IRS would not make a proposal to Congress, DOJ Tax would. At the point, the IRS worked on and made the proposal resulting in the initial innocent spouse provisions (§§ 6013(e) and 66). The IRS proposal and resulting statute were more limited than my proposal sent to the IRS by the AAG, but as the AAG said half a loaf is better than no loaf. And, later, in 1998, the innocent spouse provisions were substantially liberalized.

³³⁸⁸ Reg. § 1.6015-1(h)(1) (definition)

³³⁸⁹ Reg. § 1.6015-1(h)(1) (definition).

³³⁹⁰ I have done no independent empirical study to support this statement. The anecdotal evidence I have are the cases I read as they come out which I have been watching at some level since working on the original innocent spouse legislation in the early 1970s. In this nonscientific sampling, the requesting spouse is generally the wife. It is reported that 90% of taxpayers litigating innocent spouse relief are women. Stephanie McMahon, What Innocent Spouse Relief Says About Wives and the Rest of Us, 37 Harv. J.L. & Gender 141, 149 (2014).

³³⁹¹ Indeed, given the elements of the statute, it is possible in a single case for both husband and wife to qualify for relief. This is because of the focus of the statute on the components of tax liability (income and deductions). Thus, for example, the husband may qualify for relief as to tax on some or all of the wife’s income and the wife may qualify for relief from tax on some or all of the husband’s income. See e.g., *Weiler v. Commissioner*, T.C. Memo. 2003-255.

³³⁹² Rev. Rul. 2003-36, 2003-18 I.R.B. 849.

Finally, innocent spouse relief will not insulate a spouse from liability under the operation of other laws.³³⁹³ Perhaps the most common example of such other liability is the transferee liability provisions in § 6901 where the nonrequesting spouse's liability can be imposed upon a requesting spouse otherwise entitled to innocent spouse relief.³³⁹⁴

B. Joint Liability Relief (§ 6015).

Joint liability arises from filing a joint return.³³⁹⁵ Section 6015 provides relief from the joint liability.

At the threshold for joint liability relief is that there be a valid joint return.³³⁹⁶ Without a valid joint return, there is no joint liability and hence no need for relief from tax joint liability with respect to the other spouse's tax items.³³⁹⁷

There is a separate relief for spouses called injured spouse relief that should not be confused with innocent spouse relief. I discuss injured spouse relief elsewhere (beginning p. 219); briefly, injured spouse relief gives a spouse relief from having the injured spouse's share of a joint return refund credited against a debt for which the other spouse is solely liable. The injured spouse is simply claiming the injured spouse's right to property—the share of the refund—used to pay the other spouse's debt.³³⁹⁸

For the following discussion, I assume that a valid joint return was filed and that one of the spouses is seeking relief from the joint and several liability.

1. Basic Relief - § 6015(b).

The basic relief is found in § 6015(b).³³⁹⁹ I break down the elements for this relief, all of which must be met:

a. a joint return and tax understatement;

A joint return must have been filed. And the tax (and component items of income, deduction and credit) for which the requesting spouse seeks relief must not have been reported on the return. (For this reason, § 6015 provides no relief from liability in those situations where the spouses file a joint return and fail to pay the tax shown due on the return.)

³³⁹³ Reg. § 1.6015-1(j)(1) (“The relief provisions of section 6015 do not negate liability that arises under the operation of other laws.”).

³³⁹⁴ Id.

³³⁹⁵ § 6013(d)(3).

³³⁹⁶ To state the obvious, § 6015 provides no relief if the taxpayer did not file a joint return. *Raymond v. Commissioner*, 119 T.C. 191, 197 (2002).

³³⁹⁷ Reg. § 1.6013-4(d).

³³⁹⁸ In this sense, it is like a wrongful levy claim.

³³⁹⁹ Prior to enactment of § 6015, this basic relief was found in former § 6013(e) which provided the only innocent spouse relief for joint filers. Section 6015(b) is basically the same as this prior provision, with one added element. Therefore, the interpretation of § 6013(e) is helpful in the interpretation of § 6015(b).

These elements are not usually an issue. Either the requesting spouse filed a joint return or did not. Further, if there is no tax understatement, a requesting spouse will need no relief.

b. understatement due to nonrequesting spouse's items;

The requesting spouse cannot claim relief with respect to the requesting spouse's own items of income, deductions or credits. A spouse may only obtain relief with respect to the understatement in tax arising from the nonrequesting spouse's items.

c. requesting spouse did not know or have reason to know;

A requesting spouse must establish that the requesting spouse had neither knowledge nor "reason to know" that there was an "understatement" in tax. There are some nuances on this straightforward statutory element to the defense.

The regulations provide:

A requesting spouse has knowledge or reason to know of an understatement if he or she actually knew of the understatement, or if a reasonable person in similar circumstances would have known of the understatement. * * * All of the facts and circumstances are considered in determining whether a requesting spouse had reason to know of an understatement. The facts and circumstances that are considered include, but are not limited to, the nature of the erroneous item and the amount of the erroneous item relative to other items; the couple's financial situation; the requesting spouse's educational background and business experience; the extent of the requesting spouse's participation in the activity that resulted in the erroneous item; whether the requesting spouse failed to inquire, at or before the time the return was signed, about items on the return or omitted from the return that a reasonable person would question; and whether the erroneous item represented a departure from a recurring pattern reflected in prior years' returns (e.g., omitted income from an investment regularly reported on prior years' returns).³⁴⁰⁰

Some brief comments:

First, applying a plain meaning analysis, the requirement that the requesting spouse have known or had reason to know of the "understatement" would mean that the requesting spouse meets this element of relief unless she knew the relevant details of the transaction and the law giving rise to the understatement. Under this interpretation, a requesting spouse may meet the element by claiming ignorance—or at least reasonable ignorance—of the facts or law or combination thereof. Courts, however, have not read the statute that literally and have adopted a "knowledge of the transaction" test "because it avoids 'acceptance of an ignorance of the law defense.'"³⁴⁰¹ Thus, if the

³⁴⁰⁰ Reg. § 1.6015-2(c).

³⁴⁰¹ *Cheshire v. Commissioner*, 282 F.3d 326, 333 n. 17 (5th Cir. 2002), citing *Sanders v. United States*, 509 F.2d 162, 169 n.14 (5th Cir. 1975); see also *Price v. Commissioner*, 887 F.2d 959, 963 n.9 (9th Cir. 1989).
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requesting spouse either knows or has reason to know of the transaction or item, the requesting spouse will fail this requirement.³⁴⁰²

Second, in cases where one or more erroneous deductions led to the understatement, the knowledge of the transaction test would lead to the nonsensical result that the relief would never be available because, as a matter of policy, each signatory of the return is charged with the responsibility to read the return. The deduction appears on the return and thus each spouse signing the return is charged with a knowledge of the deduction. Accordingly, the Ninth Circuit adopted an interpretation that relief is unavailable under this element when “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.”³⁴⁰³ Some courts accepting this spin reason: “if the spouse knows enough about the underlying transaction that her innocent spouse defense rests entirely upon a mistake of law, she has ‘reason to know’ of the tax understatement as a matter of law.”³⁴⁰⁴ If, however, the spouse cannot be determined to have reason to know under the foregoing test, the court inquires factually “whether a reasonably prudent taxpayer in the spouse's position at the time she signed the return could be expected to know that the stated liability was erroneous or that further investigation was warranted.”³⁴⁰⁵ The Tax Court summarized this test:

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. Factors to consider in analyzing whether the alleged innocent spouse had “reason to know” of the substantial understatement include: (1) the spouse's level of education; (2) the spouse's involvement in the family's business and financial affairs; (3) the presence of expenditures that appear lavish or unusual when compared to the family's past levels of income, standard of living, and spending patterns; and (4) the culpable spouse's evasiveness and deceit concerning the couple's finances.³⁴⁰⁶

The Fifth Circuit’s decision in *Cheshire*³⁴⁰⁷ illustrates the application of the foregoing spins on this element of relief. The husband received lump-sum distributions from qualified plans. He rolled a minor portion of it into another tax-deferred arrangement but used much of the distribution to pay down his mortgage and purchase an automobile. The tax rules are that the distribution is taxable except for amounts rolled over into qualified deferred arrangements. In reporting the

³⁴⁰² See Summary of the Contents and Explanation of Revisions accompanying the final regulations, par. 2.A. Although the new § 6015 Regulations track the statutory language, the Summary indicates an intent to apply the same test as applicable to the same statutory language in prior § 6013(e). This means the knowledge of the transaction test or, as it is alternatively worded, knowledge of the item test.

³⁴⁰³ *Price v. Commissioner*, 887 F.2d 959, 965 (9th Cir. 1989).

³⁴⁰⁴ E.g., *Cheshire v. Commissioner*, 282 F.3d 326, 334 (5th Cir. 2002), citing and applying upon *Park v. Commissioner*, 25 F.3d 1289, 129-4 (5th Cir. 1994) (noting that ignorance of the law cannot establish an innocent spouse defense to tax liability).

³⁴⁰⁵ *Cheshire v. Commissioner*, *supra*, citing and applying *Reser v. Commissioner*, 112 F.3d 1258, 1267 (5th Cir. 1997).

³⁴⁰⁶ *Jonson v. Commissioner*, 118 T.C. 106 (2002). As the Tax Court noted in *Jonson*, the Tax Court may apply a slightly more stringent spin on this test that does the Ninth Circuit (citing *Bokum v. Commissioner*, 94 T.C. 126, 146 (1990), *affd.* 992 F.2d 1132 (11th Cir. 1993)), although in most cases the difference will not be material to the outcome.

³⁴⁰⁷ *Cheshire v. Commissioner*, 282 F.3d 326 (5th Cir. 2002).

distributions, however, the taxpayer properly noted on the return that the distributions had been received but improperly claimed the amounts used for purchase of the home and automobile as amounts qualifying for further deferral. Upon reviewing the return, the wife saw the amount thus deferred and questioned her husband as to whether it was proper. Her husband explained that he had been advised by a CPA that amounts used for those purposes could be deferred in that manner. As it turned out, the husband actually misled the wife because he had not been so advised by a CPA, and, in any event, that was not the law. Accepting the husband's explanation, however, the wife signed the return. The wife thus knew about the income item and the offset which might be analogized to a deduction, and claimed relief based essentially upon her claimed ignorance of the law. The Tax Court in a reviewed decision and the Fifth Circuit denied her relief. The Fifth Circuit reasoned that it need not determine whether the case was an omitted income or an improper deduction case, because the wife failed in either event. The Court held:

This court has not previously determined if such facts present a case of omitted income or of erroneous deduction, and we need not do so here because the outcome under either standard is the same: Appellant knew or had reason to know of the tax understatement. Under the knowledge-of-the-transaction test applied in omitted income cases, Appellant fails to satisfy 6015(b)(1)(C) because she had actual knowledge of the retirement distributions and of the corresponding earned interest at the time she signed the return. In erroneous deduction cases, this court asks whether Appellant "knew or had reason to know" that the deduction in question would give rise to a tax understatement at the time she signed the return. The parties agree that Appellant did not have actual knowledge that the deduction was improper. However, because Appellant knew all the facts surrounding the transaction that gave rise to the understatement, including the amount of the retirement proceeds, the account where the proceeds were deposited and drawn upon, the amount of interest earned on the proceeds, and the manner in which the proceeds were spent, Appellant had "reason to know" of the improper deduction as a matter of law. Appellant's defense consists only of her mistaken belief that money spent to pay off a mortgage is properly deductible from retirement distributions. Ignorance of the law cannot establish an innocent spouse defense to tax liability.³⁴⁰⁸

d. imposing tax would be inequitable; and

This is an equitable test depending upon all the facts and circumstance.³⁴⁰⁹ The most frequent factual issue addressed in determining whether joint liability would be inequitable is whether the requesting spouse benefitted from the understatement in issue.³⁴¹⁰ The issue can be illustrated by considering two extremes of the spectrum of equity. First, if the item were the husband's and he used the tax savings from the understatement to support a hidden lifestyle with a mistress in violation of

³⁴⁰⁸ 292 F.3d, pp. 334-335.

³⁴⁰⁹ Reg. § 1.6015-2(d).

³⁴¹⁰ See Reg. § 1.6015-2(d) ("One relevant factor for this purpose is whether the requesting spouse significantly benefitted, directly or indirectly, from the understatement."). The regulations refer for additional equitable considerations to Rev. Proc. 2000-15 (2000-1 C.B. 447), which has been superseded by Rev. Proc. 2013-34, 2013-43 I.R.B. 397.

See also *Reser v. Commissioner*, *supra*, at 1270 (quoting *Buchine v. Commissioner*, 20 F.3d 173, 181 (5th Cir. 1994)); and *Jonson v. Commissioner*, 118 T.C. 106 (2002).

the marriage vows, a court would easily find joint liability inequitable. Second, by contrast, if the understatement were used to buy the spouse a mink coat or even pay their children's college education, a court would be hard pressed to find joint liability inequitable.³⁴¹¹

Courts also often will consider “whether the failure to report the correct tax liability on the joint return results from concealment, overreaching, or any other wrongdoing on the part of the other spouse.”³⁴¹²

Prevailing on this issue requires that the practitioner marshal the facts and present them in the way that makes the requesting spouse a sympathetic person who has been wronged by his or her spouse.

e. Election for relief by 2 years from first collection activity.

The requesting spouse must elect relief within two years from the date of the first collection activity.³⁴¹³ A collection activity includes the computer-generated § 6330 notice of intent to levy and right to CDP hearing.³⁴¹⁴ Because this two year time window begins to run on that notice, the taxpayer and practitioner must pay attention to that notice or lose the right to claim relief.³⁴¹⁵

Even if the requesting spouse may have had an earlier opportunity to claim this relief, the spouse may still do so within this statutory window. For example, if the husband and wife had earlier pursued a Tax Court proceeding in which innocent spouse relief was not in issue (although it could have been), a spouse's right to innocent spouse relief can be pursued later within this statutory time window provided that he or she did not meaningfully participate in the Tax Court proceeding.³⁴¹⁶ As is often the fact pattern in these cases, the improper item giving rise to the understatement is the item of a domineering spouse who manages the Tax Court proceeding without concern for the other spouse's potential right to separate relief and therefore does assert innocent spouse relief in the Tax Court proceeding. In such a case, the non-domineering spouse can assert relief later within this statutory window. If, however, the requesting spouse was the one who managed and thus “meaningfully participated” in the Tax Court proceeding, the requesting spouse will be unable to later claim innocent spouse relief.³⁴¹⁷

³⁴¹¹ See *Jonson v. Commissioner, supra*.

³⁴¹² See *Jonson v. Commissioner, supra*.

³⁴¹³ The election is made by filing a Form 8857.

³⁴¹⁴ Reg. § 1.6015-5(b)(2)(i).

³⁴¹⁵ *Tu Pham v. Commissioner*, T.C. Memo. 2012-171.

³⁴¹⁶ § 6015(g)(2), titled “Res judicata,” bars innocent spouse relief if, in a prior proceeding for the same taxable year, the following **conjunctive** requirements are met: (i) innocent spouse was not in issue in the prior proceeding; **and** (ii) the requesting spouse did not meaningfully participate in the prior proceeding. See *Kechijian v. Commissioner*, T.C. Memo. 2022-127 (held res judicata barred the spouse after the spouse meaningfully participated in a prior Tax Court deficiency proceeding for the tax in issue; participation through an attorney in the prior deficiency proceeding is meaningful participation, although there might be circumstances where a attorney representing requesting and culpable spouse might not be meaningful participation).

³⁴¹⁷ For a case in between the examples in the text where the husband managed the litigation, but the wife, a sophisticated taxpayer, did meaningfully participate in the Tax Court case, see *Rogers v. Commissioner*, 908 F.3d 1094 (7th Cir. 2018).

What is a collection activity? Obviously, a levy or even a filing of federal tax lien is a collection activity. Even before that, however, a notice of intent to levy and right to request a CDP hearing is collection activity starting the two year period; and, so long as the notice is sent to the requesting spouse's last known address, the notice starts the two year period.³⁴¹⁸ And other less obvious actions may constitute collection activity. For example, the IRS's offset of a refund from one year to an assessment for another year is a collection activity that triggers the two year period for electing innocent spouse relief.³⁴¹⁹ But, since the offset is a "collection activity," the IRS must provide the spouse notice and its failure to do so will mean that this statute of limitations does not commence running simply because of the offset.³⁴²⁰

2. Relief for Spouses Separated, Divorced or Living Apart - § 6015(c).

A spouse can avoid joint and several liability if (i) no longer married to (including divorce or death),³⁴²¹ or (ii) legally separated from or was not a member of the same household as the other spouse for a period of 12 months ending on the date an election is filed with the IRS. § 6015(c).³⁴²² If the spouse qualifies, any deficiency assessed with respect to the return is allocated between the requesting spouse and the nonrequesting spouse with the requesting spouse liable only for the portion allocated to him or her. Tricky rules apply in determining the portion allocable to each spouse;³⁴²³ I will not expect you to know those but will expect you to know that you should review them before giving advice.

Relief may be denied in the following situations:

(i) with respect to items attributable to the nonrequesting spouse if the requesting spouse had "actual knowledge" of the improper treatment on the joint return.³⁴²⁴ The IRS must "demonstrate"—prove by a preponderance of the evidence—that the requesting spouse had actual knowledge—not just what a reasonably prudent person would be expected to know—to deny relief.³⁴²⁵ As with the basic relief discussed above, the knowledge relates to the item on the return and not that the item was treated incorrectly.³⁴²⁶ Relief is available whether or not the spouse had reason to know and whether or not it would be inequitable to impose joint and several liability; for this reason, relief under § 6015(c) is not really "innocent spouse" relief.³⁴²⁷

³⁴¹⁸ As to the notice to last known addresses starting the period regardless of receipt, the proposed regs adopt holding in *Mannella v. Commissioner*, 132 T.C. 196 (2009), rev'd on other grounds, 631 F.3d 115 (3d Cir. 2011).

³⁴¹⁹ *Campbell v. Commissioner*, 121 T.C. 290 (2003).

³⁴²⁰ *McGee v. Commissioner*, 123 T.C. 314 (2004). See CC-2005-010 (5/20/05), reproduced at 2005 TNT 99-17 administratively implementing *McGee*.

³⁴²¹ *Jonson v. Commissioner*, 118 T.C. 106, 123-124 (2002), aff'd. 353 F.3d 1181 (10th Cir. 2003).

³⁴²² This election is also made by filing Form 8857.

³⁴²³ § 6015(d). See Reg. § 1.6015-3(d); see also *Hopkins v. Commissioner*, 121 T.C. 73 (2003) and *Andrews v. Commissioner*, T.C. Memo. 2010-230.

³⁴²⁴ § 6015(c)(3)(C). Note, by comparison, that the basic relief provision in § 6015(b) applies only if the requesting spouse "did not know, and had no reason to know" of the understatement.

³⁴²⁵ *Culver v. Commissioner*, 116 T.C. 189 (2001); the standard for actual knowledge is discussed in *King v. Commissioner*, 116 T.C. 198, 203 (2001); and *Mora v. Commissioner*, 117 T.C. 279 (2001).

³⁴²⁶ *Cheshire v. Commissioner, supra*, (applying a variation of the concern that, otherwise ignorance of the law would be a defense); see also *King v. Commissioner*, 116 T.C. 198 (2001).

³⁴²⁷ Since the requesting spouse under § 6015(c) can obtain relief even if there are no general equitable (continued...)

(ii) if the IRS establishes that assets were transferred between the spouses to avoid payment of the tax.³⁴²⁸

(iii) under rules established by the IRS to the extent that the requesting spouse benefitted from the treatment of the item on the joint return.³⁴²⁹

(iv) under rules established by the IRS if the allocation is inappropriate because of the fraud of one or both individuals.³⁴³⁰

The relief is not available simply because the parties are separated by death. The Tax Court held that, in the case where the requesting spouse died, the proper test is made immediately before death and, if he or she did not then qualify, the separation by death will not be considered in applying § 6015(c).³⁴³¹

The claim for relief under this provision must be made within two years of the first collection activity.³⁴³² This is the same window for claiming relief as provided under § 6015(b) discussed above.

3. Equitable Relief - § 6015(f).

Section 6015(f)³⁴³³ authorizes the IRS to grant equitable relief if relief is not otherwise available under the provisions discussed above. This relief is available: (i) “Under procedures prescribed by the” IRS³⁴³⁴ where, “taking into account all the facts and circumstances, it is inequitable to hold the individual liable for any unpaid tax or any deficiency (or any portion of either):” and (ii) “relief is not available to such individual under subsection (b) or (c).”³⁴³⁵ The procedures are set forth in Rev. Proc. 2013-34, 2013-43 I.R.B. 397, which is required reading in

³⁴²⁷(...continued)

considerations such as with relief under § 6015(b) or § 6015(f), it is probably a misnomer to refer to relief under § 6015(c) as innocent spouse relief. Courts do so routinely. E.g., *Rubel v. Commissioner*, 856 F.3d 301 (3rd Cir. 2017). Similarly, in the various IRS publications, § 6015(c) relief is treated under the general rubric innocent spouse relief. E.g., the Form 8857 is now titled “Innocent Spouse Relief,” although apparently at one time it was titled “Request for Innocent Spouse Relief and Separation of Liability (And Separation of Liability and Equitable Relief);” and IRS Pub 971, “Innocent Spouse Relief.” Apparently, because the “innocence” of the requesting spouse in terms of the equities is not an issue, thus making the relief more freely available, Congress determined that refunds are not available for relief under § 6015(c). § 6015(g)(3). Refunds are available if the requesting spouse qualifies for relief under § 6015(b) or § 6015(f). But, if the spouse obtains relief under (c) apparently a refund is not available. Reg. § 1.6015-4(b); see also Keith Fogg, No Refund to Individual Granted Innocent Spouse Relief under IRC 6015(c) (Procedurally Taxing 8/24/20).

³⁴²⁸ § 6015(c)(3)(A)(ii) and (4).

³⁴²⁹ § 6015(d)(3)(B). Note that there is no requirement that the IRS rules be in regulations. For an application of this rule, see *Mora v. Commissioner*, 117 T.C. 279 (2001).

³⁴³⁰ § 6015(d)(3)(C). Note that there is no requirement that the IRS rules be in regulations.

³⁴³¹ *Jonson v. Commissioner*, 118 T.C. 106 (2002), aff’d 353 F.3d 1181 (10th Cir. 2003); *Butler v. Commissioner*, 114 T.C. 276, 292 (2000).

³⁴³² § 6015(c)(3)(B).

³⁴³³ As amended by Taxpayer First Act of 2019, § 1203, P.L. 116-25, 133 Stat 981 (July 1, 2019).

³⁴³⁴ Note that there is no requirement that the IRS rules be in regulations.

³⁴³⁵ § 6015(f)(1), as amended by Taxpayer First Act of 2019, § 1203, P.L. 116-25, 133 Stat 981 (July 1, 2019).

understanding how the IRS applies the relief.³⁴³⁶ Given the statutory delegation to the IRS to develop the procedures, the Rev. Proc. 2013-34 is the principal guide to the courts. I discuss the Rev. Proc. below.

Applying the law developed under equitable element under the prior version of the innocent spouse provisions (the same as § 6015(b)(1) discussed above), the Fifth Circuit has noted that the most important consideration “is whether the spouse seeking relief ‘significantly benefitted’ from the understatement [or underpayment] of tax.”³⁴³⁷ The Fifth Circuit noted that the benefit can be indirect to disqualify the requesting spouse for relief.

Rev. Proc. 2013-34 offers a more relaxed application of § 6015(f), as well as its separate return community property counterpart, § 66(c).³⁴³⁸ Key factors under the Rev. Proc. include:

- “gives greater deference to the presence of abuse” than before.³⁴³⁹
- relief may even be available if the item is the requesting spouse’s item, provided that the nonrequesting spouse’s fraud gave rise to the understatement of tax or deficiency.³⁴⁴⁰
- “the lack of a finding of economic hardship does not weigh against relief, as it did under [the prior procedure], and instead will be neutral.”³⁴⁴¹
- the requesting spouse may be held to have not known or reasonably known that the tax would not be paid if that spouse reasonably expected the nonrequesting spouse to pay.³⁴⁴²
- whether the requesting spouse significantly benefitted—a key disqualifier under prior procedures—“will not weigh against relief (will be neutral) if the nonrequesting spouse abused the requesting spouse or maintained financial control and made the decisions regarding living a more lavish lifestyle.”³⁴⁴³

³⁴³⁶ 2013-43 I.R.B. 399

³⁴³⁷ *Cheshire v. Commissioner*, 282 F.3d 326, 338 (5th Cir. 2002), (quoting *Reser v. Commissioner*, 112 F.3d 1258, 1270 (which, in turn, quoted *Buchine v. Commissioner*, 20 F.3d 173, 181 (5th Cir. 1994))).

³⁴³⁸ Rev. Proc. 2013-34, 2013-2 C.B. 397, 2013-43 I.R.B. 397. I present my analysis of the relief in the text but note that Professor Bryan Camp organizes the relief a bit differently—through three equity screens. Lesson From The Tax Court: The Role Of Equity (Tax Prof Blog 5/7/18).

³⁴³⁹ Id. § 3.01; and §4.01(7)(D), §4.02(3)(a), §4.03(2). See Bryan Camp, Lesson From The Tax Court: The Impact Of De Novo Review In Spousal Relief Cases (Tax Prof Blog 11/7/22), explaining:

If the requesting spouse convinces the IRS that the non-requesting spouse abused them such that the requesting spouse could not, as a practical matter, object or affect the treatment of any item that gave rise to a deficiency, or could not, as a practical matter, question or affect the actual payment of reported taxes, then such abuse or financial control will result in the IRS putting a huge thumb on the scale of fairness in favor of the requesting spouse. Specifically, the IRS will disregard whether requesting spouse knew or had reason to know of the items giving rise to the understatement or deficiency or knew or had reason to know that the non-requesting spouse would not pay the tax liability.

³⁴⁴⁰ Id. § 3.03.

³⁴⁴¹ Id. § 3.07.

³⁴⁴² Id. § 3.08.

³⁴⁴³ Id. § 3.10.

- “if only the nonrequesting spouse significantly benefitted from the unpaid tax or understatement, and the requesting spouse had little or no benefit, or the nonrequesting spouse enjoyed the benefit to the requesting spouse’s detriment, this factor will weigh in favor of relief.”³⁴⁴⁴
- A process for streamlined determinations of relief is provided.³⁴⁴⁵

With those background considerations, the Rev. Proc. lists the following factors that are considered in granting equitable relief under § 6015(f) or its § 66 counterpart.

- Streamlined relief if the requesting spouse can show clear grounds for relief where the spouses are no longer married, the requesting spouse would suffer economic hardship, and the requesting spouse did not know or have reason to know of the understatement or deficiency on the joint return or did not know or have reason to know of an underpayment on a reported liability.³⁴⁴⁶
- In other cases,³⁴⁴⁷ factors include (a) marital status (whether requesting spouse is married on date of the request, (b) economic hardship, (c) knowledge or reason to know of the item giving rise to the understatement or deficiency (or in a community property situation the item of income of the nonrequesting spouse) or in underpayment cases had no reason to know that the nonrequesting spouse would not pay, (d) who has the legal obligation under a divorce decree or binding legal document to pay the tax, (e) whether the requesting spouse significantly benefitted from the unpaid tax liability or understatement, (f) requesting spouse tax compliance in later years; (g) requesting spouse mental health.

There is no litmus test as to how these factors are applied or the weight each factor is given relative to the others. The IRS makes the initial determination, and the requesting spouse can seek Tax Court review of the determination.

³⁴⁴⁴ Id.; see also *Durland v. Commissionaire*, T.C. Memo. 2016-133 (citing *Pullins*). In *Cocojar v. Commissioner*, T.C. Memo. 2017-189, at *8-*9, the Tax Court said that the taxpayer may qualify for relief under all the facts and circumstances and that, in making that decision, citing *Pullins*:

we will weigh a number of factors: (1) marital status; (2) economic hardship; (3) in the case of an underpayment, knowledge or reason to know that the tax liability would or could not be paid; (4) legal obligation to pay the outstanding tax liability; (5) receipt of a significant benefit from the unpaid tax liability; (6) compliance with tax laws; and (7) mental or physical health at the time of filing. In making our determination, however, no single factor is determinative, and we may vary the weight we assign to each factor or to include other factors, depending on the specific circumstances of each case.

³⁴⁴⁵ Id., § 4.02. The three conditions for streamlined relief are “(1) the requesting spouse is not married to the nonrequesting spouse; (2) the requesting spouse will suffer economic hardship if relief is not granted; and (3) in an underpayment case, as of the date the return was filed or the date the requesting spouse reasonably believed the return was filed, the requesting spouse did not know or have reason to know that the nonrequesting spouse would not or could not pay the tax liability at that time of or within a reasonable period of time after the filing of the return.” *Cocojar v. Commissioner*, T.C. Memo. 2017-189, at *7.

³⁴⁴⁶ § 4.03.02.

³⁴⁴⁷ § 4.03.03.

The Tax Court generally considers the Rev. Proc. Guidelines, although it is not limited to or bound by the Guidelines. Precisely how the Tax Court determines whether a requesting spouse is entitled to equitable relief depends upon the facts and circumstances requiring judgment rather than just a counting of favorable and unfavorable factors.³⁴⁴⁸ Supposedly, for example, spousal abuse can be an important and even determinative factor, whereas a spouse's knowledge or reason to know of the tax understatement or underpayment is a strongly negative factor.³⁴⁴⁹

Once the Tax Court makes its decision as to § 6015(f) relief, the cases are not clear as to the scope of review of the Tax Court decision in the courts of appeals—i.e., abuse of discretion by the Tax Court (the usual standard for equitable relief determinations) or clear error (the usual standard of review for district court determinations, thought to be an easier standard for reversal than abuse of discretion).³⁴⁵⁰

Section 6015(f) is broader than the relief provided in the more specific sections discussed above because it may apply where a tax has been reported on the return signed by the requesting spouse. The statute thus permits relief for “any unpaid tax” as well as any deficiency, or shortfall, in tax paid.³⁴⁵¹ The Revenue Procedure thus notes:

Under section 6015(b) and (c), relief is available only from an understatement or a deficiency. Section 6015(b) and (c) do not authorize relief from an underpayment of income tax reported on a joint return. Section 66(c) and section 6015(f) permit equitable relief from an underpayment of income tax or from a deficiency. The legislative history of section 6015 provides that Congress intended for the Secretary to exercise discretion in granting equitable relief from an underpayment of income tax if a requesting spouse “does not know, and had no reason to know, that funds intended for the payment of tax were instead taken by the other spouse for such other spouse's benefit.” H.R. Conf. Rep. No. 105-599, at 254 (1998). Congress also intended for the Secretary to exercise the equitable relief authority under section 6015(f) in other situations if, “taking into account all the facts and circumstances, it is inequitable to hold an individual liable for all or part of any unpaid tax or deficiency arising from a joint return.” *Id.*³⁴⁵²

Obviously, the Revenue Procedure is key reading to taxpayers and practitioners attempting to convince the IRS of the application of § 6015(f). Under deference principles, the Revenue Procedure may also be entitled to some deference in ultimate litigation (probably *Skidmore* deference, if that means anything), should litigation become necessary.³⁴⁵³

³⁴⁴⁸ *Hale v. Commissioner*, T.C. Memo. 2018-93 (citing Rev. Proc. 2013-34, sec. 4.03(2)).

³⁴⁴⁹ Keith Fogg, Knowledge Leaves Another Innocent Spouse Petitioner Standing at the Altar (Procedurally Taxing Blog 10/1/21).

³⁴⁵⁰ *Jacobsen v. Commissioner*, 950 F.3d 414, 419 (7th Cir. 2020) (discussing the cases and ducking a decision on the issue based on the determination that the same result would apply under either standard).

³⁴⁵¹ § 6015(f). See *Commissioner v. Neal*, 557 F.3d 1262, 1265 n. 1 (11th Cir. 2009).

³⁴⁵² Rev. Proc. 2013-34, 2013-42 I.R.B. 1, par. 2.04.

³⁴⁵³ I suppose that an argument can be made that Congress' grant of authority to establish the “rules” rather than regulations means that Congress clearly intended for the IRS to make the rules. I would not think that this is a legislative grant of authority but could argue that it is a grant of interpretive authority that should qualify for *Chevron* (continued...)

The IRS, by regulation, imposed for § 6015(f) relief the same two-year period applicable to the other more specific forms of innocent spouse relief. The Tax Court invalidated the regulation on the ground that, since the statute did not impose the two-year period for this relief, the IRS exceeded its authority in the regulation;³⁴⁵⁴ the Seventh Circuit and Third Circuit, however, reversed the Tax Court, holding the regulation valid under the broad mandate of *Chevron* and its progeny (which we discussed in Chapter 2).³⁴⁵⁵ Notwithstanding its success in the Courts of Appeals, in the exercise of discretion, the IRS announced that it will no longer apply the two year limitations rule.³⁴⁵⁶ Further, the Code was amended in 2019 to provide that the request for § 6015(f) relief may be made for any portion of the liability before (i) the applicable collection statute of limitations under § 6502 or (2), if paid, before the expiration of the refund statute of limitations for the payment.³⁴⁵⁷

4. Disqualifiers.

There are several overarching disqualifiers to innocent spouse relief. They are:

a. Closing Agreement or Offer in Compromise.

A spouse is not entitled to relief if he or she has previously entered into (i) a closing agreement that disposes of the same liability that is the subject of the claim for relief or (ii) an offer-in-compromise for the liability.³⁴⁵⁸

b. Fraudulent Transfers.

A requesting spouse is not entitled to relief if the requesting spouse “transferred assets to the other spouse as part of a fraudulent scheme.”³⁴⁵⁹ Any scheme to defraud—whether related to taxes or to other creditors or potential claimant (including e.g., an ex-spouse)—is sufficient to deny relief.

c. Claim Preclusion and Issue Preclusion.

A requesting spouse is not entitled to relief under doctrines of claim preclusion (*res judicata*) or issue preclusion (*collateral estoppel*) if innocent spouse status was an issue and denied in a prior judicial proceeding or, if not an issue in the proceeding, the spouse meaningfully participated in that

³⁴⁵³(...continued)

deference.

³⁴⁵⁴ *Lantz v. Commissioner*, 132 T.C. 131 (2009), rev'd *Lantz v. Commissioner*, 607 F.3d 479 (7th Cir. 2010).

³⁴⁵⁵ *Lantz v. Commissioner*, 607 F.3d 479 (7th Cir. 2010); and *Mannella v. Commissioner*, 631 F.3d 115 (3d Cir. 2011).

³⁴⁵⁶ Rev Proc. 2013-34, 2013-42 I.R.B. 1. Consistent with the Notice, the IRS issued proposed regulations to amend Reg. § 1.6015-5(a) to eliminate the two-year rule for § 6015(b).

³⁴⁵⁷ § 6015(f)(2).

³⁴⁵⁸ Reg. § 1.6015-1(c). See *Dutton v. Commissioner*, 122 T.C. 133 (2004). The regulations provide a special exception for the special TEFRA partnership rules. Reg. § 1.6015-1(c)(2).

³⁴⁵⁹ Reg. § 1.6015-1(d).

proceeding.³⁴⁶⁰ The theory for the meaningful participation exception to relief is that, if the requesting spouse could have reasonably asserted her right to relief in the proceeding, the requesting spouse should have done so.³⁴⁶¹

However, if the requesting spouse could not have requested § 6015(c) relief because the requesting spouse was married to and not legally separated from the other spouse and did not claim such relief in the prior proceeding, the requesting spouse may thereafter claim the benefit of § 6015(c) even where that spouse is foreclosed from litigating under the other two relief provisions.³⁴⁶²

5. Refund Issues.

Relief under § 6015(b) or § 6015(f) can entitle the requesting spouse to an appropriate refund, but relief under subsection (c) cannot.³⁴⁶³ The Form 8857, Request for Innocent Spouse Relief, by which the requesting spouse requests relief under any of the provisions “generally will be treated as the filing of a claim for credit or refund even if the requesting spouse does not specifically request a credit or refund.”³⁴⁶⁴ Treating the Form 8857 as the request for credit or refund is important because of the statutes of limitation for requesting refunds.³⁴⁶⁵

³⁴⁶⁰ § 6015(g)(2); Reg. § 1.6015-1(e); *Deihl v. Commissioner*, 134 T.C. 156, 162 (2010); *Vetrano v. Commissioner*, 116 T.C. 272, 278 (2001). The Regulation is based on § 6015(g)(2) which is interpreted to deny relief under § 6015(f) (general equitable relief) even though the § 6015(g)(2) expressly applies only to (b) and (c). *Thurner v. Commissioner*, 121 T.C. 43, 51-52 (2003). See discussion of claim preclusion (res judicata) and issue preclusion (collateral estoppel) below beginning p. 648.

³⁴⁶¹ The Tax Court will not apply this test mechanically but will look to the nuance of all the facts to determine whether the requesting spouse meaningfully participated. See *Harbin v. Commissioner*, 137 T.C. 93 (2011) (relief grant despite the requesting spouse’s participation in the earlier case that was impaired by a conflicted counsel who represented both the husband and the wife in circumstances where the conflicted counsel had not explained the conflict and obtained waivers and the nonrequesting spouse really controlled the shape of the litigation); *Koprowski v. Commissioner*, 138 T.C. 54 (2012) (innocent spouse issue litigated in earlier proceeding is res judicata (claim preclusion) in subsequent proceeding; taxpayer meaningfully participated in earlier proceeding, thus no out under § 6015(g)(2)); and *Rogers v. Commissioner*, 908 F.3d 1094 (7th Cir. 2018).

³⁴⁶² *Diehl v. Commissioner*, 134 T.C. 156 (2010).

³⁴⁶³ § 6015(g)(1) & (3); see also § 6015(f)(2)(B), as added by Taxpayer First Act of 2019, § 1203(a), P.L. 116-25, 133 Stat 981 (July 1, 2019) (allowing refunds in Tax Court proceedings in (f) cases, provided that the request for relief was filed within the time allowed for refund claims). I have not researched the reason that refunds are denied for § 6015(c) relief, but it is reported that “The reason Congress made a refund under (c) unallowable is that it made relief under (c) so easy to obtain.” Carl Smith, [Taft v. Comm’r: Innocent Spouse Relief Generates a Refund](#) (Procedurally Taxing Blog 5/3/17). But there may be occasions where relief, even though not available under § 6015(c), might also be available under § 6015(b) or § 6015(f), in which case a refund may be allowed. *Taft v. Commissioner*, T.C. Memo. 2017-66.

³⁴⁶⁴ Prop. Reg. § 1.6015-1(k)(2), 80 FR 72649 (11/20/15) (in explanation nothing “This section also clarifies that, in general, Form 8857 will be treated as the requesting spouse's claim for credit or refund.”) It is not clear to me why this regulation was never finalized, but finalization may have been stymied by President’s Trumps more or less arbitrary attack on regulations early in his administration. I think the Proposed Regulation states a common sense rule and will be applied by the IRS.

³⁴⁶⁵ See *Palomares v. Commissioner*, 2017 U.S. App. LEXIS 9565 (9th Cir. 2017) (taxpayer filed Form 8379 rather than Form 8857 which would have been claim for refund; held, Form 8379 treated as informal claim).

6. Collection Issues.

a. Statutes of Limitations Issues.

When a taxpayer elects relief under (b), (c) or (f), the statute of limitations on collection of the requesting spouse's liability is suspended and the IRS may not pursue its collection remedies while the election is pending.³⁴⁶⁶

b. Community Property Issues.

Under community property laws some or all community assets may be available to apply against federal taxes. The issue therefore is whether a spouse otherwise qualifying for innocent spouse relief can nevertheless have his or her share of community assets subject to collection for the other spouse's liability. Obviously, this could negate innocent spouse relief. The IRS takes the position that innocent spouse relief does not negate the IRS's right under state community property law of the state to collect from the nonrequesting spouse's share of community property even though that collection will affect the requesting spouse.³⁴⁶⁷ The IRS explained this position as simply a state law creditor position that it was entitled—indeed mandated—to pursue:

One commentator suggested that the regulations adopt a rule that the IRS would not look to community property as a collection source when a requesting spouse with an interest in such community property is granted relief under section 6015. A federal tax lien arising under section 6321 attaches to all property and rights to property of the taxpayer. Whether a taxpayer has an interest in property to which the lien can attach is determined by state law. *Aquilino v. United States*, 363 U.S. 509 (1960). Once that property interest is defined, federal law alone determines the consequences resulting from the attachment of the federal lien on the property. *United States v. Drye*, 528 U.S. 49 (1999). If under the law of the community property state in which the spouses reside, the IRS can look to community property to collect a liability of one of the spouses, the determination that the other spouse is entitled to relief under section 6015 does not affect the Service's ability to collect the nonrequesting spouse's liability from the community property. See, e.g., *United States v. Stolle*, 2000-1 U.S.T.C. 50,329 (C.D. Cal. 2000); *Hegg v. IRS*, 28 P.3d 1004 (Idaho 2001). The final regulations do not adopt this recommendation because it goes beyond the scope of the statute.³⁴⁶⁸

³⁴⁶⁶ § 6015(e)(1)(B) & (2). The Form 8857 is deemed to be a request for relief under any of the applicable provisions. Prop. Reg. sec. 1.6015-1(a)(2).

³⁴⁶⁷ See Summary of the Contents and Explanation of Revisions accompanying the final regulations, par. 1.G. citing Reg. § 1.6015(h).

³⁴⁶⁸ Id.

7. Judicial Review of IRS Denial of Relief.

a. Tax Court Review - § 6015(e).

The clear path to obtain judicial review of IRS denials of innocent spouse relief is in § 6015(e). Section 6015(e) grants Tax Court review to (i) a spouse against whom a deficiency has been asserted and who elects relief under the basic relief provision (subsection (b)), the special relief provision for divorced or separated spouses (subsection (c)), or (ii) a spouse even in the absence of a deficiency seeking relief under the residual equity provision (subsection (f)).³⁴⁶⁹ A claimant for relief may petition the Tax Court either (i) within 90 days after the IRS's final determination denying the relief³⁴⁷⁰ or (ii) if there is no such denial, within 6 months after the relief is requested.³⁴⁷¹ During the pendency of the case, the IRS may not take collection measures³⁴⁷² but the statute of limitations is suspended.³⁴⁷³ In a nondeficiency case, Tax Court relief under subsections (b) and (c) is available only under the collection due process procedures in § 6330(d)(1), but relief under subsection (f) may be pursued as a stand-alone proceeding.³⁴⁷⁴

By amendment in 2019, the Tax Court review under § 6015(e) is (i) de novo rather than for an abuse of discretion,³⁴⁷⁵ and (ii) only based on the administrative record before the IRS plus “any additional newly discovered or previously unavailable evidence.”³⁴⁷⁶ The latter authorization

³⁴⁶⁹ § 6015(e)(1), as amended in 2006.

³⁴⁷⁰ § 6015(e)(1)(A)(i)(I) & (ii). There may be more than one “final determination” triggering a right to seek Tax Court review for each one. *Vera v. Commissioner*, 157 T.C. 78 (2021); see Bryan Camp, Lesson From The Tax Court: IRS Can Issue Multiple 'Final' Spousal Relief Determinations (Tax Prof Blog 9/7/21) (interpreting *Vera* as meaning that taxpayers may “keep resubmitting equitable relief claims because one never knows when the IRS might issue a second final determination, either deliberately or, as here, because of a goof-up.”). Of course, if the IRS only issues one “final determination” the taxpayer will not have this opportunity to litigate by filing subsequent requests for relief.

³⁴⁷¹ § 6015(e)(1)(A)(i)(II).

³⁴⁷² § 6015(e)(1)(B).

³⁴⁷³ § 6015(e)(2).

³⁴⁷⁴ *Kollar v. Commissioner*, 131 T.C. 191, 193 n. 2 (2008).

³⁴⁷⁵ § 6015(e)(7), as added by Taxpayer First Act of 2019, § 1203(a), P.L. 116-25, 133 Stat 981 (July 1, 2019). Prior to this change, *Commissioner v. Neal*, 557 F.3d 1262 (11th Cir. 2009) and *Wilson v. Commissioner*, 705 F.3d 980 (9th Cir. 2013), rejected the IRS argument that the review is based solely on the administrative record rather than through a de novo trial proceeding in the Tax Court. Section 6015(e)(7) thus changes the review from de novo on a record that could be supplemented at trial to de novo on the administrative record that could be supplemented at trial **only** for “newly discovered or previously unavailable evidence.” In other words, the amended statute constricts what the Tax Court may potentially consider. See *Sutherland v. Commissioner*, 155 T.C. 95 (2020). For some nuances that the *Sutherland* holding raises, see Christine Speidel, Only Tax Court Petitions Filed After July 1, 2019 Are Subject to TFA's Restricted Scope of Review (Procedurally Taxing Blog 9/28/20).

³⁴⁷⁶ *Id.* The new provision does not define the terms “newly discovered or previously unavailable;” In *Thomas v. Commissioner*, 160 T.C. ___ No. 4 (2023), the Court admitted certain of the requesting spouse's blog posts that were publicly available before the denial of innocent spouse relief but which the IRS did not discover until the petitioner contested the denial of innocent spouse relief in the Tax Court and thus were not part of the administrative record. The *Thomas* Court reasoned in part that the standard of review was de novo rather than abuse of discretion and held “Our holding here is generally consistent with the amici's view that ‘exceptions to the administrative record rule of § 6015(e)(7) [should] be applied expansively given the de novo review the court must conduct, the requesting spouse's specific circumstances, and the nature of the IRS's administrative procedures.’” Bryan Camp, Lesson From The Tax Court: The New Evidence Rule In Spousal Relief Cases (Tax Prof Blog 2/27/23).

(continued...)

enacted in 2019 to consider previously unavailable evidence has not been definitively interpreted, but may include the sworn testimony of the spouse relief at the Tax Court proceeding.³⁴⁷⁷ And knowledge taxpayers or counsel should keep the record rule in mind (although there is this limited escape hatch) in building the record at the administrative stage of innocent spouse consideration.

In the case of joint return liability, the spouse not making the claim for relief has the right to become a party to the suit.³⁴⁷⁸ This right is important because, if the person claiming innocent spouse relief prevails, the other spouse will bear the full liability.

b. Other Judicial Remedies.

Section 6015(e) provides a special judicial remedy for IRS denial of innocent spouse relief and clearly signals that Congress desired to channel most innocent spouse relief litigation into the Tax Court under that remedy. However, as noted elsewhere in this text, taxpayers have traditionally had judicial forums in which the contest tax liability. Section 6015(e)(1)(A), by stating that it is “in addition to any other remedy provided by law” suggests that it is not the exclusive judicial remedy for innocent spouse disputes. Accordingly, although the authorities are sparse and not always consistent, it appears that a spouse **may** be able assert innocent spouse relief in.³⁴⁷⁹

- A deficiency proceeding in the Tax Court³⁴⁸⁰ and, indeed, will be bound by the tax liability determined in the Tax Court proceeding if the putative innocent spouse materially participated in the deficiency proceeding.³⁴⁸¹

³⁴⁷⁶(...continued)

Before *Thomas*, and likely surviving *Thomas*, there were nonprecedential Tax Court bench opinions applying what is known as the “Fatty Rule” which says that the innocent spouse’s own testimony under oath and subject to cross examination in the Tax Court meets the requirement because it could not have been given in the administrative consideration. See e.g., Keith Fogg, Innocent Spouse Bench Opinion – Part 1 (Procedurally Taxing Blog 11/3/22) (discussing a nonprecedential bench opinion in *Bacigalupi v. Commissioner* (T.C. Case No. 20480-21) and *Fatty v. Commissioner* (T.C. Case No. 3787-20S; Professor Fogg notes that, particularly in small cases often pursued pro se, the administrative record will often be sparse, so that a rule permitted the putative innocent spouse to testify “makes sense.”). See also Bryan Camp, Lesson From The Tax Court: The Impact Of De Novo Review In Spousal Relief Cases (Tax Prof Blog 11/7/22), discussing *Bacigalupi*.

³⁴⁷⁷ See Bryan Camp, Lesson From The Tax Court: The Impact Of De Novo Review In Spousal Relief Cases (Tax Prof Blog 11/7/22), discussing *Bacigalupi v. Commissioner*, Docket No. 20480-21 (Order of Oct. 27, 2022); and Keith Fogg, Innocent Spouse Bench Opinion – Part 1 (Procedurally Taxing Blog 11/3/22), also discussing *Bacigalupi*.

³⁴⁷⁸ § 6015(e)(4). See Tax Court Rule 325, Notice and Intervention, requiring that the IRS notify the nonrequesting spouse and giving the right to intervene; and Tax Court Form 13, Notice of Intervention.

³⁴⁷⁹ Except where footnoted, this portion of my text relies on the discussion in Saltzman Treatise, ¶ 7C.01[1][d] Court Jurisdiction to Consider Claims of Relief From Joint and Several Liability.

³⁴⁸⁰ *Kollar v. Commissioner*, 131 T.C. 191, 193 n. 2 (2008) (noting that the taxpayer may assert § 6015(f) relief in a deficiency proceeding). Presumably, relief under subsections (b) or (c) can be asserted in a deficiency proceeding as well. If a spouse raises the issue in the deficiency proceeding, if the claiming spouse has not already done so, the claiming spouse will have to file Form 8857, Request for Innocent Spouse Relief, to permit the IRS to consider the claim.

³⁴⁸¹ The notice of deficiency is discussed in detail in Ch. 9. In CCA 201826011 (6/29/18), the IRS attorney reasoned that, while the Tax Court’s jurisdiction statute for notice of deficiency redetermination cases is not a perfect fit for jurisdiction to try the innocent spouse issue in redetermination cases, a reasonable reading of the provisions and “other practicalities” “lead to a conclusion that innocent spouse relief for the underpayment be considered in the

(continued...)

- A refund suit in the district court or Court of Federal Claims, the although Government has unsuccessfully argued that § 6015(f) relief cannot be litigated in a refund suit.³⁴⁸²
- A Collection Due Process (“CDP”) case.³⁴⁸³
- A collection suit instituted by the Government in district court.³⁴⁸⁴
- A bankruptcy proceeding where the tax liability is in issue.³⁴⁸⁵

8. The Nonrequesting Spouse.

The nonrequesting spouse suffers, at least theoretically, if the requesting spouse obtains relief. To the extent of the relief, the nonrequesting spouse must bear the tax liability alone. Hence, Congress provided that the nonrequesting spouse—the one who would bear the economic consequence of a finding that the other spouse qualifies for relief—can participate in the proceedings leading to such a finding. First, the IRS is required to adopt regulations, and has issued Proposed Regulations and a Revenue Procedure, providing the nonrequesting spouse the opportunity for notice and right to participate in the administrative proceedings.³⁴⁸⁶ Second, in any court proceeding instituted by the requesting spouse, the nonrequesting spouse is entitled notice and the right to intervene as a party.³⁴⁸⁷ As a party, presumably, the nonrequesting spouse has the right to appeal from any adverse decision (i.e., any decision in favor of the requesting spouse).³⁴⁸⁸

³⁴⁸¹(...continued)

deficiency case.” I think the Tax Court’s right to determine the innocent spouse claim in a deficiency case is implied in § 6532(g)(2)’s provision for res judicata as to innocent spouse relief if the claimant “participated meaningfully” in a prior proceeding for the same taxable year.

³⁴⁸² § 6015(e)(3) contemplates the possibility that innocent spouse relief can be obtained in a refund suit, by requiring that the refund suit take jurisdiction over a Tax Court proceeding. See also *Wilson v. Commissioner*, 705 F.3d 980, 985 (9th Cir. 2013) (dicta); *Matuszak v. Commissioner*, 862 F.3d 192, 198 n.5 (3rd Cir. 2017) (noting the Commissioner’s statement on brief that innocent spouse relief could be obtained in a refund suit but expressing no opinion); and *Hockin v. United States*, 400 F. Supp. 3d 1085 (D. Or. 2019) (rejecting the Government’s argument that § 6015(f) relief is only available in the Tax Court). See Keith Fogg, Jurisdiction of District Court in Innocent Spouse Case (Procedurally Taxing Blog 3/27/23).

³⁴⁸³ Form 12153, Request for a Collection Due Process or Equivalent Hearing (Rev. 12-2013) has a line permitting the taxpayer to claim that the spouse is responsible on the basis of innocent spouse relief, and notifying that the taxpayer must attach Form 8857, Request for Innocent Spouse Relief. See also *Kollar v. Commissioner*, 131 T.C. 191, 193 n. 2 (2008) (noting that the taxpayer may assert § 6015(f) relief in CDP proceeding). For comparison of the CDP opportunity to litigate innocent spouse and the special Tax Court proceeding under § 6015(e), see Carolyn Lee (Guest Blogger), Two tickets to Tax Court, by way of § 6015 and Collection Due Process (Procedurally Taxing Blog 8/28/19) (noting that the CDP Tax Court review has a shorter period to file (30 days) and an abuse of discretion, whereas the § 6015(e) review has a longer period (either six months after filing application if it is not denied or 90 days after the date of denial).

³⁴⁸⁴ This is my extrapolation for the general jurisdiction of district courts in collection suits to determine the underlying liability if it has not been previously determined.

³⁴⁸⁵ *In Re: Pendergraft*, 2017 Bankr. LEXIS 771 (Bkr SD TX 2017); and *In re Bowman*, No. 20-11512, 2021 Bankr. LEXIS 1836 (Bankr. E.D. La. July 12, 2021).

³⁴⁸⁶ § 6015(h)(2); Prop. Reg. § 1.6015-6; see also Rev. Proc. 2003-19, 2003-15 I.R.B. 371.

³⁴⁸⁷ § 6015(e)(4). See *Tipton v. Commissioner*, 127 T.C. 214, 217 (2006); see also *Kovitch v. Commissioner*, 128 T.C. 108 (2007) (holding that the automatic stay from the intervening spouse’s bankruptcy does not stay the proceeding as to the requesting spouse since the intervening nonrequesting spouse’s liability is not at issue).

³⁴⁸⁸ The problem, which you may have spotted, is that, if the requesting spouse prevails in the administrative consideration of the claim, even though the nonrequesting spouse is given notice and the opportunity to

(continued...)

Whether the nonrequesting spouse should exercise his or her rights is another issue that requires judgment beyond the scope of an introductory tax procedure book.³⁴⁸⁹

9. Miscellaneous Issues.

Although the basic relief under § 6015 carries forward the same elements from the prior innocent spouse provision which has been interpreted in many cases, the other provisions have not been rounded out through judicial interpretation. That process continues and will likely take several more years before the contours are fleshed out with reasonable certainty.

For some time, the Tax Court has been issuing precedential decisions interpreting the statute. For example, the Tax Court has ruled that, in a proceeding before it where the IRS was willing to stipulate that one of the spouses qualified for relief, the nonrequesting spouse can contest whether the spouse should get that relief.³⁴⁹⁰ Why would a nonrequesting spouse do that? Simple. The nonrequesting spouse is solely responsible for any liability the requesting spouse is relieved of. If the two are no longer “as one” -- i.e., if they are divorced or separated -- the nonrequesting spouse might well prefer that the requesting spouse stay liable (particularly if the requesting spouse has assets, perhaps from the divorce) and thus may be motivated to argue against relief for the requesting spouse. Stay tuned as the courts sort out this and other innocent spouse issues.

One issue that arises often is whether one spouse who might otherwise qualify for innocent spouse relief as to the original return that omits income or claims an improper deduction should agree with the other spouse to file an amended return correcting the problem. The amended return will pre-empt the IRS’s need to issue a deficiency, and thus the deficiency predicates for relief under subsections (b) and (c) will not exist if the spouse signs the amended return. The Tax Court has held that relief may still be available under the general equitable relief provision, subsection (f), with the requesting spouse’s relevant knowledge being measured at the time the original return was filed rather than at the time the amended return was filed.³⁴⁹¹

C. Separate Liability Relief Under Community Property Law (§ 66).

Section 66(c) provides relief paralleling the innocent spouse relief should also be provided to so-called “innocent spouses” otherwise liable for tax on the income of the other spouse in community property states. I only summarize the § 66 relief which is rarely encountered because most spouses, even in community property states, file joint returns and thus must qualify for relief only under § 6015.

Remember that the prototypical inequity that concerned Congress is where one spouse—typically the wife—is otherwise required to pay tax on income of the other spouse—typically

³⁴⁸⁸(...continued)

participate, the nonrequesting spouse will have no right to appeal to the courts from an adverse decision (i.e., one granting the relief claimed). See *Maier v. Commissioner*, 119 T.C. 267 (11/20/02).

³⁴⁸⁹ See Jonathan T. Trexler, *Contesting Innocent Spouse Relief: The Intervention Paradox*, 126 Tax Notes 499 (Jan. 25, 2010) (noting that, based on analysis of statistics, a culpable spouse may be better off not intervening).

³⁴⁹⁰ *Corson v. Commissioner*, 114 T.C. 354 (2000).

³⁴⁹¹ *Billings v. Commissioner*, T.C. Memo. 2007-234.

the husband—that the wife neither knew about nor benefitted from. Congress did not simply grant relief where those conditions were present, however. So, it is important to focus on the conditions that Congress did place upon relief.

There are four types of relief to the general rule that each spouse must include one-half the community income and deductions. They are:

First, if the spouses live apart the entire year, one or both have earned income that is community income and no portion of each spouse’s earned income is transferred to the other, for tax purposes, the community income is divided between the spouses according to who earned the income or whose property earned the income.³⁴⁹² The regulations provide that de minimis transfers of earned income, including transfers for the benefit of a child, will not disqualify a requesting spouse from relief.³⁴⁹³ Note that this provides relief only for earned income. Where, in the prototypical example, the husband abandoning his wife has income from property (e.g., dividends), the relief is not available because the income is not earned income.³⁴⁹⁴

Second, the IRS may disallow the community split with respect to any income that one of the spouses acted as if solely entitled to such income and, before the due date for filing the latter’s return, failed to notify the other spouse of the nature and amount of the income.³⁴⁹⁵

Third, under regulations, a spouse may be relieved with respect to income attributable to the other spouse if the requesting spouse establishes that (i) he or she did not know or have reason to know of the income and (ii) it would be unfair to tax that spouse.³⁴⁹⁶ The second and third requirements are the same as the third and fourth elements under § 6015(b)(1), and the interpretation of those elements should apply.³⁴⁹⁷

Fourth, there is a catch-all “equitable” relief provision under regulations. This provision parallels the similar provision in § 6015(f).³⁴⁹⁸

Section 66 relief generally extends to omitted income. There is generally no need for relief as to improper deductions because, at least in the worst cases, the requesting spouse would not have claimed any improper deductions attributable to the other spouse. Accordingly, the first, second, and third categories of relief apply only to omitted income. The last category—the catch all “equitable” relief provision—is not expressly limited to omitted income, saying instead that, in equitable cases, the IRS may simply relieve the individual from liability in equitable cases as “to any item for which

³⁴⁹² § 66(a).

³⁴⁹³ § 1.66-2(c).

³⁴⁹⁴ See definition of earned income in § 66(d)(1), referring to § 911(d)(2).

³⁴⁹⁵ § 66(b).

³⁴⁹⁶ § 66(c).

³⁴⁹⁷ See also § 1.66-4(a)(2) & (3).

³⁴⁹⁸ § 66(c) (final sentence) (added by the 1998 Restructuring Act); see Reg. 1.66-4(b). See *Beck v. Commissioner*, T.C. Memo. 2001-198 (relying upon its prior authority under § 6015(f), *Butler v. Commissioner*, 114 T.C. 276 (2000) and *Fernandez v. Commissioner*, 114 T.C. 324 (2000). Unlike § 6015(f) for which there is an independent grant of Tax Court jurisdiction, the taxpayer seeking judicial review of the IRS’s denial of this equitable relief must have some other basis for Tax Court jurisdiction. *Christensen v. Commissioner*, 523 F.3d 957 (9th Cir. 2008); see also IRS AOD CC-2002-05 released 12/9/02 and unofficially reproduced at 2002 TNT 240-12 (12/13/02).

relief is not granted under the preceding sentence.” If the deduction is improper, the IRS could not allow the requesting spouse to have the deduction. But the benefit could come in such a case by taxing the requesting spouse on only the requesting spouse’s income and deductions (thereby ignoring the community property split up and down), so that if the nonrequesting spouse had the bulk of the income and hence the incentive to generate erroneous deductions, the requesting spouse’s bottom line tax liability will be reduced by excluding the community share of both income and deductions.

To the extent one spouse is relieved of liability under these provisions, the other spouse must bear the tax liability. As with the joint liability relief provision under § 6015, the other spouse is given the opportunity to participate in proceedings related to a spouse requesting relief under § 66.³⁴⁹⁹ However, § 66(c) innocent spouse relief does not provide for “stand-alone” judicial review in the Tax Court as provided for § 6015(e) joint return relief.³⁵⁰⁰

These rules do not avoid liability under some other provision, such as transferee liability (which discussed below). They simply avoid liability by virtue of the marital status of the taxpayer in a community property state.³⁵⁰¹ Accordingly, you should note the possibility discussed above that some community property law states may make one spouse liable, directly or indirectly, for the other’s community debts—i.e., debts arising during the marriage—which could take away that which Congress conferred in § 66 as well as § 6015.

XVIII. Collection from Third Parties.

A. Property Titled to Others (Nominee and Transferee Liability).

1. The Problem.

Taxpayers often have priorities that, in their minds, rank higher than paying taxes. Often taxpayers will want to transfer their property so that, they hope, the property will be available for them or their loved ones but beyond the IRS's ability to seize in payment of taxes. They may do that either by titling the property to third parties while retaining beneficial interest or by transferring both title and benefit ownership to third parties who they like better than the IRS. Or they may make transfers between persons or individuals to avoid collection of the tax.

One of the prominent tax examples is the so-called intermediary or “Midco” transaction.³⁵⁰² A prototypical Midco transactions is:

Although Midco tax shelters took various forms, they shared several key features. These transactions were chiefly promoted to shareholders of closely held

³⁴⁹⁹ Prop. Reg. § 1.66-4(h).

³⁵⁰⁰ *Bernal v. Commissioner*, 120 T.C. 102 (2003).

³⁵⁰¹ Proposed Reg. § 1.66-1(c).

³⁵⁰² E.g., *Diebold Found., Inc. v. Commissioner*, 736 F.3d 172, 175-176 (2d Cir. 2013) (referring to this type of transaction as “Midco transactions” or “intermediary transactions”). One prominent example of the intermediary transaction is described in Notice 2001-16, 2001-1 C.B. 730 describing intermediary sales transactions of the type described in the text.

C corporations that had large built-in gains. The shareholders, while happy about the gains, were typically unhappy about the tax consequences. They faced the prospect of paying two levels of income tax on these gains: the usual corporate-level tax, followed by a shareholder-level tax when the gains were distributed to them as dividends or liquidating distributions. And this problem could not be avoided by selling the shares. Any rational buyer would insist on a discount to the purchase price equal to the built-in tax liability that he would be acquiring.

Promoters of Midco transactions offered a purported solution to this problem. An “intermediary company” affiliated with the promoter—typically a shell company, often organized offshore—would buy the shares of the target company. The target’s cash would transit through the Midco to the selling shareholders. After acquiring the target’s embedded tax liability, the Midco would engage in a sham transaction purporting to offset the target’s realized gains and eliminate the corporate-level tax. The promoter and the target’s shareholders would agree to split the dollar value of the corporate tax thus avoided. The promoter would keep as its fee a negotiated percentage of the avoided corporate tax. The target’s shareholders would keep the balance of the avoided corporate tax as a premium above the target’s true net asset value (i.e., assets net of accrued tax liability).

In due course the IRS would audit the Midco, disallow the fictional losses, and assess the corporate-level tax. But the Midco, having distributed its cash to the selling shareholders, would typically be asset-less and judgment-proof. The IRS would then be forced “to seek payment from other parties involved in the transaction in order to satisfy the tax liability the transaction was created to avoid.”³⁵⁰³

The question addressed in this section is whether there are legal mechanisms the IRS can use to collect the tax evaded? The IRS’s remedies in such transactions are usually through transferee liability (under state or federal law) discussed below.³⁵⁰⁴ For present purposes and elsewhere in the book, references to intermediary transactions will be to the genre of tax gambit illustrated by this simplified example.

Such maneuvers to separate assets from liabilities and leaving the creditor holding the bag are not unique to the tax laws. There is a large body of state law for protecting creditors in these circumstances. The most prominent is the various fraudulent conveyance statutes. The IRS can rely upon the substantive provisions of these state law remedies applicable to creditors in general. (There are some potential criminal problems when transfers are intended to avoid payment of tax, but I deal here only with the IRS's civil remedies when that happens.)

³⁵⁰³ *Slone v. Commissioner*, T.C. Memo. 2022-6, at *3. In *Alterman Trust v. Commissioner*, T.C. Memo. 2015-231, at *2:

Courts, including this court, have been plagued by Midco cases. Rarely do these cases present themselves for a determination of the underlying liabilities. Instead, these cases are postured so that the courts are asked to determine whether someone other than the taxpayer should be on the hook for the taxpayer's liability. They are transferee liability cases, and so are these cases.

³⁵⁰⁴ See IRM 5.17.14 Fraudulent Transfers and Transferee and Other Third Party Liability.

Basically, the state creditors' remedies require a transfer for less than full value when the transfer either made the taxpayer insolvent or made him more insolvent. Obviously, if the taxpayer receives full and fair consideration, the assets he receives in the exchange are available to the creditor and the creditor should not be able to force the transferee to give the assets back. (Note that this is different than the lien priority issue noted above; if the IRS has lien priority, transferee liability is irrelevant and whether the transferee paid full and fair value can be irrelevant.)

2. Nominee, Alter Ego, Agent and Related Concepts.

a. The Issue.

Under general legal concepts a debtor does not put his or her property beyond reach of creditors by artificial devices whereby title, but not beneficial ownership, is transferred to or otherwise appears in a third party. A third party thus may hold title as the nominee, alter ego, or agent of the debtor, and the property should be subject to the debts of the beneficial owner. So, too, in the tax law, such concepts may apply to subject property nominally titled to a third party to the tax liability of the taxpayer.³⁵⁰⁵

The resolution of the IRS's claims under these legal concepts generally require a two-step analysis: (i) first determine the status under state law which uses the concepts to determine parties' rights in nontax contexts; and (ii) determine how the federal tax law would apply those concepts. The *Drye* case which discussed above is a good application of the rules that govern. State law determines the characterization or attributes of the taxpayer's property interest in the property; federal law determine the application of the taxpayer's tax lien to the property.³⁵⁰⁶

Generally, if the IRS determines a third party is liable under these theories, it may file a special type of lien generally referred to by the name of the determination (e.g., nominee lien). The nominee filed lien will generally identify the third party, identify the taxpayer and identify the property involved so that the third party's unrelated property is not subject to the lien.³⁵⁰⁷

³⁵⁰⁵ *G.M. Leasing Corp. v. United States*, 429 U.S. 338, 350-51 (1977); *United States v. Scherping*, 187 F.3d 796, 801 (8th Cir. 1999); *F.P.P. Enters. v. United States*, 830 F.2d 114, 118 (8th Cir. 1987); see also IRM 5.17.2.5.7.2 (03-19-2018), Nominee.

³⁵⁰⁶ Exactly how the federal and state law interface in the ultimate determination is not certain. However, based on *Drye*, the courts have uniformly rejected the Government's attempts to have a Federal common law with a synthesized application of state law so that the common law as thus synthesized is applied uniformly in the states. See *Fourth Investments LP v. United States*, 720 F.3d 1058, 1068 (9th Cir. 2013) ("Accordingly, we adopt the interpretation of *Drye* advanced by the reasoning of our sister circuits and hold that questions of nominee status require a 'fact-specific state-law inquiry' prior to determining whether a nominee lien may lawfully be enforced as a matter of federal law"; however, although rejecting the application of Federal common law to achieve intra-state uniformity, the Ninth Circuit noted that the Government's concern for lack of uniformity "has proven to be unfounded, because state law nominee doctrine is typically so similar to its federal common law counterpart that the distinction is of little moment.") *Fourth Investments*, 1068 (internal quotation marks omitted). See also *Eriem Surgical v. United States*, 843 F.3d 1160 (7th Cir. 2016) (citing *Drye* and stating that it was best to apply state law, nothing that the taxpayer did not assert that "would fare better under federal law—if there is any on this subject.") For the IRS's position on a federal common law for the alter ego inquiry, see CCM CC-2012-002 (12/2/11), titled Whether Federal Common Law or State Law Governs Alter Ego Status; as indicated that view has not yet been accepted by the courts.

³⁵⁰⁷ This would not be true of the alter-ego liability, in which case the lien would attach to all of the alter-
(continued...)

b. Nominee and Agent.

Although the Code does not define the term nominee, the IRS and the courts define it as a person holding apparent or formal indicia of ownership, whether by title or otherwise, of property that really belongs to another, in this case the taxpayer owing the tax.³⁵⁰⁸ The definition is heavily fact dependent.³⁵⁰⁹ By way of contrast, the prototypical trust established by another for a benefit of a taxpayer owing tax is not a nominee situation, for the Trustee really does have ownership subject to the rights of the taxpayer beneficiary who does not and legally cannot exercise direct ownership rights with respect to trust property. Of course, if the trust is simply a front or the underlying state law confers a beneficiary the equivalent of direct ownership in the trust property, then the trustee might be a nominee of the beneficiary. In the sense used here, the nominee is thus like an agent for a principal, and the concepts discussed herein apply to agents as well as nominees.

The general federal tax lien attaches to the taxpayer's property interest in the property titled to or in the possession of such a nominee. Further, an IRS levy upon the nominee reaches that interest.³⁵¹⁰ Can the IRS protect itself as to such property short of a levy? The general tax lien arising against the taxpayer and even a filed tax lien against the taxpayer would not put third parties on notice that the property appearing in the name of someone other than the taxpayer is subject to the tax lien. Thus, given the other rules of priority discussed above, the IRS may not have protection solely based on the filed tax lien against the taxpayer's property.³⁵¹¹ In such cases, the IRS may file a tax lien identifying the third party title holder or possessor as acting on behalf of the taxpayer with respect to identified property (a "nominee lien").³⁵¹²

³⁵⁰⁷(...continued)
ego's property.

³⁵⁰⁸ IRM 5.17.14.2.4 (09-25-2020), Nominee Theory; and *Fourth Investments LP v. United States*, 720 F.3d 1058, 1066-1068 (9th Cir. 2013) (with an excellent discussion of the law of nominee liability). The ultimate inquiry, of course, is "whether the * * * [person] has engaged in a legal fiction by placing legal title to property in the hands of a third party while actually retaining some or all of the benefits of true ownership." *Holman v. United States*, 505 F.3d 1060, 1065 (10th Cir. 2007). For a listing of factors that courts consider in making the nominee determination, see *Dalton v. Commissioner*, T.C. Memo. 2008-165, *17-*18 (referring to these factors as "a relatively well-defined body of Federal common law," with case citations). See generally Stephanie Hoffer, Goldburn Maynard, Elizabeth Fate, Damon Kellar, Drienne Sneed, To Pay or Delay: The Nominee's Dilemma Under Collection Due Process, 82 Tul. L. Rev. 781 2008) (hereafter in this section referred to as "Hoffer, et al, Nominee's Dilemma").

³⁵⁰⁹ See *Fourth Investments LP v. United States*, 720 F.3d 1058 (9th Cir. 2013). A typical statement of the factors considered in making a determination of nominee status are:

- (1) whether inadequate or no consideration was paid by the nominee;
- (2) whether the property was placed in the nominee's name in anticipation of a lawsuit or other liability while the transferor remains in control of the property;
- (3) whether there is a close relationship between the nominee and the transferor;
- (4) whether they failed to record the conveyance;
- (5) whether the transferor retains possession; and
- (6) whether the transferor continues to enjoy the benefits of the transferred property.

Porta-John of Am., Inc. v. United States, 4 F. Supp. 2d 688, 701 (E.D. Mich. 1998).

³⁵¹⁰ *G.M. Leasing Corp. v. United States*, 429 U.S. 338 (1977); see also *Oxford Capital Corp. v. United States*, 211 F.3d 280 (5th Cir. 2001) (discussing differences between nominee and alter ego theories); *Al- Kim, Inc. v. United States*, 610 F.2d 576 (9th Cir. 1980); and *United States v. Krause*, 637 F.3d 1160, 1165-66 (10th Cir. 2011) (good summary of the differences).

³⁵¹¹ But see *Berkshire Bank v. Town of Ludlow, MA*, 708 F.3d 249 (1st Cir. 2013) (holding that the federal tax lien against the individual taxpayer primes a judgment lien against his sole member LLC that the Court found was his "nominee.")

³⁵¹² See Keith Fogg, Nominee Liens—the lis pendens of tax lien practice (Procedurally Taxing Blog (continued...))

The nominee lien is not specifically authorized by the Code but is authorized administratively and recognized by the courts.³⁵¹³ The nominee lien names the third party who the IRS has determined is acting as nominee for the taxpayer and identifies the taxpayer and the property to which the nominee lien attaches. The nominee lien is filed to preserve the IRS's interest in the property allegedly so held. In contrast to the general tax lien filed against the taxpayer, the nominee lien requires special approval within the IRS.³⁵¹⁴ The effect of the nominee lien is to put the public on notice that the IRS believes the property may be property of someone other than the nominal title owner, thereby clouding title of the third party (the putative nominee) and effectively preventing that third party from dealing with the property.³⁵¹⁵ Obviously, this could be a major problem to a third party who really owns the property and is not in fact acting as nominee.

The IRS may also proceed by foreclosure suit, in which case the taxpayer's interest in the property putatively owned by the nominee, alter ego or agent will be judicially determined.

c. Alter Ego.

The alter ego concept is slightly different.³⁵¹⁶ The alter ego is a separate person (often an entity) that is treated as the taxpayer because, in the IRS belief, the alter ego functions as an extension of the taxpayer without independent significance.³⁵¹⁷ For example, if a taxpayer is the shareholder of a corporation and fails to respect the corporate entity in dealing with the corporation, the IRS may assert that the corporation is an alter ego of the taxpayer and thus use collection tools against the corporation with respect to the individual shareholder's liability.³⁵¹⁸ Sometimes the IRS will use both nominee and alter ego concepts in the same collection action.³⁵¹⁹

The alter ego concept is found in state law. Traditional application of this concept has often (not always) looked to the state law to determine the scope of its deployment by the IRS. However, the IRS takes the position that, given the nation-wide application of the tax law and the need for uniformity in its application, the alter ego concept should be a federal common law concept rather than dependent on the vagaries and uncertainties of state law.³⁵²⁰

³⁵¹²(...continued)

4/7/14).

³⁵¹³ See *G.M. Leasing, supra*.

³⁵¹⁴ IRM 5.17.2.5.7.2(6) (03-19-2018), Nominee (Area Counsel approval required, citing both IRM 5.12.7.6.1, Nominee NFTLs, and IRM 5.12.7.6.5, Special Condition NFTL Approval Process: Request, Advisory Review, and Post-Approval).

³⁵¹⁵ See IRS Program Manager Technical Assistance on Nominee Lien, 2009 TNT 67-36 (citing Elliot, William D., *Federal Tax Collection, Liens & Levies* § 9.10).

³⁵¹⁶ See Hoffer, et al, *Nominee's Dilemma*, p. 806.

³⁵¹⁷ See IRM 5.17.14.2.5 (09-25-2020), Alter Ego Theory ("This theory is based on the premise that the taxpayer and the alter ego are so intermixed that their affairs are not readily separable.").

³⁵¹⁸ I have seen this, for example, where the IRS wanted to make a continuous levy on personal service compensation payments made to a corporation. The statute permits a continuous levy only against an individual performing services. By treating the corporation as the alter ego of the taxpayer who fails to respect the corporate entity the IRS can bootstrap itself into the validity of a continuous levy on payments otherwise due to the corporation.

³⁵¹⁹ *Oxford Capital Corp. v. United States*, 211 F.3d 280, 283-84 (5th Cir. 2000) (levy on corporation as nominee and alter ego).

³⁵²⁰ See CC-2012-002, reproduced at 2011 TNT 235-14.

Upon the assertion of alter ego or other theories such as agency, the IRS has the remedies discussed above for nominees.

d. Other Theories.

Other general and state law theories may be invoked to impose liability upon a person other than the taxpayer against whom a tax liability has been determined or assessed. There can be a transferee lien where the taxpayer transfers property to which a lien has attached at the time of transfer without adequate consideration (e.g., by gift, inheritance, etc.).³⁵²¹ Under state law, if an entity is deemed a successor to a taxpayer, the successor entity may be subject to the taxpayer's tax liability.³⁵²² In addition, if the IRS can assert a conversion under state law, it may be able to use the state law remedy.³⁵²³

e. Protections Against and Remedies for Wrongful Collection Activity.

You have already spotted the problem with these concepts—an “innocent” third party may be hit with collection action related to the liability of someone for whom that third party is not serving as nominee, alter ego or otherwise. We previously noted that the IRS's collection tools—including nonjudicial levy or just the filing of a tax lien against property—are powerful and, in the context of proceeding against such a third party could be quite oppressive. The remedies for wrongful collection action against such a third party are not wholly satisfactory.³⁵²⁴

For this reason, the IRS requires extra internal administrative steps, including IRS counsel approval, before these concepts may be used in collection action such as filing a lien against the third party nontaxpayer.³⁵²⁵ But, assuming that these internal steps are taken, the “innocent” third party has some but limited remedies.

³⁵²¹ IRM 5.12.7.6.3 (09-21-2017), Transferee NFTL.

³⁵²² IRM .14.2.3 (09-25-2020), Successor Liability Theory. See *Eriem Surgical v. United States*, 843 F3d 1160 (7th Cir. 2016). (suggesting that it was perhaps an open issue of whether some federal common law might apply, but noting that the parties did not suggest a difference between state law and any such federal common law if it even existed). In *Eriem Surgical*, the Court also suggested that there might be an argument for successor liability only to the extent of the common ownership between the old corporation and the putative successor but declined to address the issue because neither party asserted it.

³⁵²³ *United States v. Boardwalk Motor Sports, Limited*, 692 F.3d 378 (5th Cir. 2012) (with the majority rejecting the IRS's conversion claim because as it read state law, conversion required that the claimant (in the case, the IRS) have the right to immediate possession of the property which, on the facts, the IRS did not have). The dissenter disagreed, finding that the IRS by three party negotiated agreement had the right to possess the proceeds of sale of the property).

³⁵²⁴ See generally Hoffer, et al, *Nominee's Dilemma*; and Amy S. Elliott, *Increased IRS Use of Alter Ego Liens Causing Problems for Taxpayers*, 2012 TNT 154-2 (8/9/12).

³⁵²⁵ E.g., IRM 5.12.7.6 (10-18-2013), Special Condition NFTL (Nominee, Alter Ego, Transferee, Successor-in-Interest) (“A special condition NFTL may not be filed without the written approval of Area Counsel.”); and IRM 5.12.7.6.5 (04-22-2019), Special Condition NFTL Approval Process: Request, Advisory Review, and Post-Approval.

If the IRS levies under these theories, the third party may pursue the wrongful levy action authorized by § 7426.³⁵²⁶ In that proceeding, the proof allocation (sometimes referred to as burden shifting) is:³⁵²⁷

- The third party (the plaintiff in the action) must establish an interest in the property.
- The Government must prove a nexus between the property and the taxpayer.
- The third party must establish that its ownership and possessory interest was superior to the taxpayer's.

Constitutional protections are particularly implicated when the IRS seizes by administrative levy property of third parties.³⁵²⁸

If the IRS takes action short of levy (e.g., the filing of a nominee lien that impairs the third party's credit or ability to deal with the property), the third party has administrative appeal rights, principally the CAP appeal which does not offer a judicial remedy.³⁵²⁹ The third party apparently does not have access to the CDP which does offer a judicial remedy.³⁵³⁰ The third party can also bring a judicial action to quiet title.³⁵³¹

3. Transferee Liability.

a. General Federal and State Liability.

What happens if the taxpayer has made a transfer in which the taxpayer did not retain beneficial interest? If the general federal tax lien existed before the transfer and the transfer was without full consideration, the lien continues against the property in the transferee's hands.³⁵³² Further, the IRS has the rights allowed creditors by state or federal law of fraudulent conveyances. One prominent example of where such creditors' rights might apply is with respect to the intermediary transactions described earlier (see p. 778).

³⁵²⁶ See Hoffer, et al, Nominee's Dilemma, pp. 843-844.

³⁵²⁷ I have modified this slightly from the formula in *Biogenesis Church, Inc. v. United States*, 2017 U.S. Dist. LEXIS 187194 (D. Mass. 2017). See particularly *Oxford Capital Corp. v. United States*, 211 F.3d 280 (5th Cir. 2000) (noting split in cases on issue of how strong a showing the Government must make). I think the reference to burden shifting is unfortunate because it suggests that the evidentiary presentation goes in the order presented.

³⁵²⁸ See *Oxford Capital Corp. v. United States*, 211 F.3d 280, 286 ff. (5th Cir. 2000), concurring opinion of Judge Dennis discussing the cases suggesting that the IRS should have and be able to establish probable cause that the property is the taxpayer's before levying on it property.

³⁵²⁹ IRM 8.24.1.3 (09-28-2021), CAP Appeals (CAP available for "The filing of a NFTL against an alter-ego or nominee's property.").

³⁵³⁰ See A. Lavar Taylor (Guest Blogger), Are Alleged Alter Egos, Successors In Interest and/or Transferees Entitled to their Own CDP Rights? (Procedurally Taxing Blog 2/27/18) (but arguing that CDP rights should be available).

³⁵³¹ 28 U.S.C. § 2410; See Hoffer, et al, Nominee's Dilemma, pp. 840-841. The validity of the tax assessment underlying the tax lien cannot be contested in a quiet title action. *McCarty v. United States*, 929 F.2d 1085 (5th Cir. 1991).

³⁵³² § 6323(a).

Perhaps the most commonly encountered form of transferee liability remedy is the fraudulent conveyance suit under state law or under the Federal Debt Collection Practices Act (“FDCPA”).³⁵³³ IRM 5.17.14 Fraudulent Transfers and Transferee and Other Third Party Liability offers good summaries of the key facets of this remedy under state and federal law. The following are key points from those IRM summaries.

- Prior to the FDCPA, the United States relied on applicable creditor and debtor law of the various states to attack fraudulent transfers.
- The FDCPA gives the United States a uniform federal procedure for setting aside a fraudulent transfer to aid in the collection of federal debts, including tax debts. 28 USC § 3301 et seq. These sections of the FDCPA are based on the Uniform Fraudulent Transfers Act, 7A Pt. II Uniform Laws Annotated (ULA).³⁵³⁴
- The United States is not bound to use the FDCPA to collect its debts. If necessary, it can proceed under any cause of action provided by state or federal law.
- All states recognize a cause of action to set aside a fraudulent transfer. A majority of jurisdictions have adopted either the Uniform Fraudulent Conveyance Act (UFCA), 7A Pt. II ULA 246 (2 states & U.S. Virgin Islands) or its successor, the Uniform Fraudulent Transfer Act (UFTA), 7A Pt. II ULA 2 (43 states and the District of Columbia).³⁵³⁵
- The FDCPA, the UFCA and the UFTA recognize both actual fraud and constructive fraud as grounds for setting aside a transfer.³⁵³⁶
- Constructive fraud and actual fraud are the two principal kinds of fraud. At least one of them must be proven to set aside a transfer.³⁵³⁷
- Constructive fraud exists “when property is transferred for inadequate consideration (or for less than the reasonably equivalent value) and the transferor either is insolvent when the transfer occurs or is made insolvent by the transfer. FDCPA § 3304(a); UFTA §§ 4(a)(2) and 5; UFCA §§ 6 and 7. A transferor’s intent is immaterial if constructive fraud is proven.”³⁵³⁸
- Actual fraud occurs when property is transferred with the actual intent to hinder, delay, or defraud a creditor in the collection of a debt owed it. FDCPA § 3304(b); UFTA § 4(a)(1).³⁵³⁹
- The fact that a taxpayer is in debt does not preclude the taxpayer from transferring property for adequate consideration. A transfer founded on adequate consideration and made with a bona fide intent is valid against the United States.³⁵⁴⁰

³⁵³³ Title XXXVI of the Crime Control Act of 1990, Pub. L. No. 101-647, 104 Stat. 4789, 4933 (codified as amended in various sections of 28 U.S.C.).

³⁵³⁴ IRM 5.17.14.3.3.2.1 (09-25-2020), Fraudulent Transfers Under Federal and State Law

³⁵³⁵ IRM 5.17.14.3.3.2.1(2) (09-25-2020), Fraudulent Transfers Under Federal and State Law

³⁵³⁶ IRM 5.17.14.3.3.2.1 (09-25-2020), Fraudulent Transfers Under Federal and State Law; and IRM 5.17.14.3.3.2.2 (09-25-2020), Types of Fraud in a Fraudulent Transfer.

³⁵³⁷ Id.

³⁵³⁸ IRM 5.17.14.3.3.2.2 (09-25-2020), Types of Fraud in a Fraudulent Transfer.

³⁵³⁹ IRM 5.17.14.3.3.2.2 (09-25-2020), Types of Fraud in a Fraudulent Transfer.

³⁵⁴⁰ IRM 5.17.14.3.3.2.2 (09-25-2020), Types of Fraud in a Fraudulent Transfer.

In addition, the parallel state remedies may apply. The Tax Court has cited the following as a “generalization of typical State law” as to a remedy in equity for fraudulent conveyances:

(1) That the alleged transferee received property of the transferor; (2) that the transfer was made without consideration or for less than adequate consideration; (3) that the transfer was made during or after the period for which the tax liability of the transferor accrued; (4) that the transferor was insolvent prior to or because of the transfer of property or that the transfer of property was one of a series of distributions of property that resulted in the insolvency of the transferor; (5) that all reasonable efforts to collect from the transferor were made and that further collection efforts would be futile; and (6) the value of the transferred property (which determines the limit of the transferee's liability).³⁵⁴¹

The Tax Court cautioned, however, that this is just a generalized statement of typical state law and that the state may allow a creditor a remedy even when some of the elements are different or absent.³⁵⁴² Often, for example, the key fact in dispute will be the taxpayer's insolvency at the time of the transfer (where insolvency, under the particular state law is required for the remedy). Insolvency is a balance sheet test as of the date of the transfer, but the IRS may consider subsequent related transfers.³⁵⁴³ The test is whether the transfer for less than fair consideration rendered the transferor insolvent, thus constituting constructive fraud even if the IRS cannot show that he had actual intent to defraud.³⁵⁴⁴

The Tax Court also cautioned that the general statement of the equitable remedy did not apply to state “law” remedies at law (as opposed to “equity” remedies).³⁵⁴⁵ Examples of remedies at law are remedies under a corporate merger statute or bulk sales law.

In addition to fraudulent conveyance remedies against transferees, state law may also have other remedies against transferees. For example, many states have a provision making a shareholder receiving the assets of a liquidating corporation liable for the debts of the corporation, at least up to the value of the assets the shareholder received in the liquidation.³⁵⁴⁶ The IRS may take advantage of these remedies either in a separate collection suit or in the special transferee provision of § 6901, the Code's procedural transferee liability provision discussed below.³⁵⁴⁷

³⁵⁴¹ *Hagaman v. Commissioner*, 100 T.C. 180, 183 (1993), quoting *Gumm v. Commissioner*, 93 T.C. 475, 480 (1989), *affd.* without published opinion 933 F.2d 1014 (9th Cir. 1991).

³⁵⁴² Thus, in *Hagamann v. Commissioner*, the Court held that, under the applicable law (Florida and Tennessee), insolvency was not required so long as the transfer was made under circumstances indicating an intent to delay, hinder or defraud creditors (the key creditor being, in the case, the IRS). In applying the law, the Court also noted that state law in that case gave the creditor the benefit of a presumption that certain transfers are made with the required intent.

³⁵⁴³ *Botz v. Helvering*, 134 F.2d 538, 543 (8th Cir. 1943), *affg.* 45 B.T.A. 970 (1941); see also *Hagaman v. Commissioner*, *supra*; *Gumm v. Commissioner*, *supra*, p. 480 (1989).

³⁵⁴⁴ IRM 5.17.14.3.3.2.2 (09-25-2020), Types of Fraud in a Fraudulent Transfer.

³⁵⁴⁵ *Hagaman v. Commissioner*, *supra*.

³⁵⁴⁶ See the application of a Colorado provision in *United States v. Holmes*, 727 F.3d 1230 (10th Cir. 2013).

³⁵⁴⁷ The IRS is not required to pursue the § 6901 remedy permitting an assessment against the transferee (continued...)

Most state or federal remedies, particularly those involving fraudulent conveyances, are pursued by bringing a lawsuit in an appropriate court, including a federal district court. When the Government seeks such remedies to enforce federal rights, the Government is not subject to state statutes to enforce a federal tax lien or set aside a fraudulent conveyance; the state statutes of limitations and other procedural timeliness issues (such as laches) do not apply.³⁵⁴⁸

What administrative levy steps short of a suit can the IRS take? The IRS position is that it must look to the fraudulent conveyance and related laws of the state. Some states permit a creditor to levy on property without a need for suit to set aside the conveyance; in those states, the IRS may also do that. Other states do not permit such a levy, and the IRS will not levy in those states but will instead either pursue the transferee liability remedy or pursue a collection suit against the property in the hands of the transferee in which the IRS will rely upon the fraudulent conveyance and similar laws of the state.³⁵⁴⁹

Finally, in the immediately following section I discuss the transferee liability procedures under § 6901. Section 6901 is a separate remedial procedure to collect tax from a transferee. The Government need not use those procedures in lieu of the suit procedures discussed here. So, if for any reason, the Government proceeds under the general suit procedures, whether or not it could have proceeded under § 6901 is irrelevant.

b. Transferee Liability Procedure Under § 6901.

(1) General.

Section 6901 gives the IRS a special remedial procedure in which to invoke its rights as a creditor of a taxpayer with regard to a transferee³⁵⁵⁰ paying less than fair value. Section 6901 “does not create a new liability but merely provides a remedy for enforcing the existing liability of the

³⁵⁴⁷(...continued)

and may pursue a collection suit by invoking a general state or federal remedy without a § 6901 assessment. See *United States v. Holmes*, 727 F.3d 1230 (10th Cir. 2013) (so holding and further holding, over a vigorous dissent, that the general tax statute of limitations applied to the suit; the dissent also vigorously contests the holding that there is no requirement for a predicate § 6901 assessment). See Lori McMillan, Transferee Shareholders and the Long Arm of the IRS, 141 Tax Notes 223 (Oct. 14, 2013),

³⁵⁴⁸ Suits by the United States to collect tax are subject to § 6502(a)'s 10-year limitations period from assessment. See *United States v. Galletti*, 541 U.S. 114, 123 (2004) (the limitations period in § 6502(a), measured from the assessment of the tax, applies not only to actions against the taxpayer, but also to actions that seek to collect the assessed tax from “individuals or entities who are not the actual taxpayers but are, by reason of state law, liable for payment of the taxpayer’s debt”; no requirement that IRS make a separate assessment against those derivatively liable; the *Galletti* Court cited *United States v. Updike*, 281 U. S. 489 (1930), which, “held that the same limitations period applied in a suit to collect the tax from the corporation as in a suit to collect the tax from the derivatively liable transferee.”); and *United States v. Holmes*, 727 F.3d 1230, 1232 (10th Cir. 2013).

³⁵⁴⁹ See LGM GL-21 reprinted at 2000 TNT 121-35 (6/22/00). LGM is the initialism for Litigation Guideline Memorandum, an internal guidance device last used in 1999 and now discontinued, with prior LGMs obsoleted. See CCN 2017-001 (11/2/16). In discontinuing and formally obsoleting existing LGMs, the IRS said: “they can serve as useful research tools and historical records of positions previously taken by the Office of Chief Counsel on issues in litigation.”

³⁵⁵⁰ A transferee is defined broadly. § 6901(h); Reg. § 301.6901-1(b).

transferor.”³⁵⁵¹ One of the common examples of a pattern in which the IRS invokes transferee liability is for so-called intermediary transactions which I discuss and illustrate beginning p. 778. In intermediary transactions, the tax liability is separated from the assets with which to pay the liability, with the IRS left holding the bag, with the purchaser and seller sharing the assets that would have otherwise paid the liability. Can they be held liable under transferee liability state or federal law remedies and the procedure in § 6901? The answer is sometimes. Intermediary transactions have accounted for much of the recent case law in this area.

One key difference between this transferee liability procedure and parallel state procedures is that the transferee liability proceeding is not in rem involving the property but imposes personal liability in a dollar amount upon the transferee. Under § 6901, the IRS may proceed against the transferee in the similar manner to the way it proceeds for the underlying tax liability (notice of liability, which is the § 6901 counterpart to the notice of deficiency,³⁵⁵² with an assessment (which may be preceded by Tax Court litigation if the transferee petitions for redetermination).³⁵⁵³ A special limitations period is provided—one year after the statute of limitations expires on the taxpayer-transferor.³⁵⁵⁴ The statute of limitations may be extended by agreement.³⁵⁵⁵ When the IRS sends a notice of liability to the transferee, the statute of limitations is tolled in a manner similar to the underlying tax liability when the taxpayer receives a notice of deficiency.³⁵⁵⁶ Even if the IRS fails to make a transferee assessment under these procedures, the IRS can still invoke transferee liability on the basis of the transferor’s liability during the period that the statute of limitations permits collection against the transferor.³⁵⁵⁷

Under this transferee liability procedure and the judicial proceedings that ensue, the IRS invokes creditors’ remedies otherwise available “at law” (such as third party beneficiary under a contract theory or a specific statute imposing transferee liability such as upon dissolution of a corporation) or “in equity” under state or federal law.³⁵⁵⁸ This is a key point—§ 6901 does not create

³⁵⁵¹ *Commissioner v. Stern*, 357 U.S. 39, 42 (1958); and *Diebold Found. v. Commissioner*, 736 F.3d 172 (2d Cir. 2013). Prior to the creation of the predecessor of § 6901 in 1926, the IRS had the transferee remedies and procedures provided under state law, but the procedures were cumbersome; hence the enactment of § 6901 to create a new procedure. See *Starnes v. Commissioner*, 680 F.3d 417 (4th Cir. 2012).

³⁵⁵² See *United States v. Kardash*, 866 F.3d 1249 (11th Cir. 2017) (quoting from the legislative history that the transferee liability provision (then § 311 of the 1926 Act) was intended “to provide for the enforcement of such liability to the Government by the procedure provided in the act for the enforcement of tax deficiencies,” quoting S. Rep. No. 69-52, at 30 (1926) (Conf. Rep.)).

³⁵⁵³ § 6901(a). The proceeding in the Tax Court for redetermination of the transferee liability is akin to a notice of deficiency proceeding; once the petitioner files the petition, the petitioner cannot thereafter dismiss the petition to avoid entry of a decision. *Schussel v. Commissioner*, 149 T.C. 363 (2017) (citing §§ 6901(a) and 7459(d)).

³⁵⁵⁴ § 6901(c). Thus, for example, where the taxpayer’s tax liability involved fraud or the intent to evade, thus allowing an unlimited statute of limitations against the taxpayer, there will also be an unlimited statute of limitations against the transferee. See § 6501(c) (unlimited statute of limitations against taxpayer). The IRS will have the burden of proving fraud by clear and convincing evidence (§ 7454; see also Tax Court Rule 142(b)). For an application of these rules, see *Pert v. Commissioner*, 105 T.C. 370 (1995).

³⁵⁵⁵ § 6901(d).

³⁵⁵⁶ § 6901(f).

³⁵⁵⁷ *United States v. Henco Holding Corp.*, 985 F.3d 1290 (11th Cir. 2021).

³⁵⁵⁸ § 6901(a)(1).

the remedy; all it does is create the procedure whereby the IRS invokes a federal or state law remedy against a transferee.³⁵⁵⁹

One of the most common state law remedies invoked by the IRS is the state's fraudulent conveyance statute, but as noted the FDCPA parallels state fraudulent conveyance remedies so the fraudulent conveyance judicial authority may apply to the FDCPA. These state statutes (which may vary from state to state) generally give a creditor remedies when a debtor transfers property to hinder or defraud creditors. For example, assume that a taxpayer expects to receive a notice of deficiency from the IRS for a tax liability that the taxpayer knows is due. Because the notice of deficiency is not yet issued, there has been no assessment and thus there is no lien against the taxpayer's property. Can the taxpayer transfer his property to his children to avoid the IRS's collection against the property when the assessment is made? The answer is that he can make a transfer in anticipation of the IRS's subsequent assessment, but the IRS would likely find a remedy under the state fraudulent conveyance statute.³⁵⁶⁰ The IRS can pursue (i) the remedies and procedures under the state fraudulent conveyances statute (or the FDCPA if it chooses) or (ii) the same remedies in a § 6901 proceeding.

The IRS has the burden of proving the existence and extent of transferee liability.³⁵⁶¹ The IRS must prove that the taxpayer transferor had a tax liability and the amount of the liability. The IRS assessment meets the IRS's initial burden, for the IRS is not required to prove that the taxpayer was actually liable for the tax.³⁵⁶² In other words, just as the taxpayer in a court proceeding would have the burden of proof with respect to the liability asserted by the IRS, so the transferee seeking to avoid or mitigate transferee liability must prove that the taxpayer's tax liability is less than asserted by the IRS. If the taxpayer has previously contested the liability in a judicial proceeding, the taxpayer is bound by the results of the proceeding, and so is the transferee who is deemed to be in privity with the taxpayer.³⁵⁶³ Using similar reasoning, a transferee is bound by a taxpayer's closing agreement with the IRS under § 7121.³⁵⁶⁴

Does the taxpayer's liability include interest and penalties? Because of the way the cases have developed, this issue is complex. I break down analysis into three relevant periods—the period

³⁵⁵⁹ *Commissioner v. Stern*, 357 U.S. 39, 42-47 (1958); and *Hagaman v. Commissioner*, 100 T.C. 180, 183 (1993). Prior to the enactment of the predecessor of § 6901, the IRS could bring a civil suit just as creditors could under state law. See Gregory A. Byron, Transferee Liability Under Section 6324: Defining the Extent of a Transferee's Liability for Interest, 32 Idaho L. Rev. 383, 387-388 (1996). Whether the state law procedures previously available remain available as an alternative to the § 6901 procedure is not clear. *Id.*

³⁵⁶⁰ *Hagaman v. Commissioner*, 100 T.C. 180 (1993) (look to tax liability as it accrues rather than when assessed), citing inter alia *Edelson v. Commissioner*, 829 F.2d 828, 833-834 (9th Cir. 1987); and *Updike v. United States*, 8 F.2d 913 (8th Cir. 1925).

³⁵⁶¹ § 6902(a); see also *Commissioner v. Stern*, *supra* at 45; *Hagaman v. Commissioner*, *supra* at 183-184. As to Tax Court proceedings, see Tax Court Rule 142(d).

³⁵⁶² § 6902(a).

³⁵⁶³ *United States v. Davenport*, 484 F.3d 321 (5th Cir. 2007); *Baptiste v. Commissioner*, 29 F.3d 1533, 1539 (11th Cir. 1994); *Baptiste v. Commissioner*, 29 F.3d 433 (8th Cir. 1994); *First Natl. Bank v. Commissioner*, 112 F.2d 260 (7th Cir. 1940); *Krueger v. Commissioner*, 48 T.C. 824, 830 (1967) (noting that "it would be a strange rule to confer upon the transferee broader rights than the transferor by allowing the transferee to relitigate an issue when a transferor is denied that privilege.").

³⁵⁶⁴ *Pert v. Commissioner*, 105 T.C. 370 (1995).

up to the date of the transfer, the period from transfer to the date of the notice of transferee liability, and the period after the date of the notice of transferee liability.

- (1) Period up to the date of transfer. The basic transferee liability will include taxes, penalties and interest that had accrued as of the date of the transfer up to the value of the assets transferred, but not in excess of the assets transferred.³⁵⁶⁵ The amount thus determined will determine the amount to which the post transfer interest, if any, applies.
- (2) Period between the date of transfer and the date of notice of transferee liability. Interest will accrue on the basic transferee liability (determined under (1)) capped by the amount that the value of the assets on the date of transfer exceeded the basic transferee liability (determined under (1)), but if the cap applies then additional interest may be determined based on the law applying to the transferee liability (referred to in some cases as the law of prejudgment interest).³⁵⁶⁶
- (3) Period after the date of notice of transferee liability. The transferee liability ultimately determined will bear interest under the Code from the date of the notice of transferee liability.³⁵⁶⁷

Transferee liability requires two facets, referred to as “prongs.”³⁵⁶⁸ First, the person must be a transferee. The transferee issue is determined by a federal law test in order apply a uniform standard.³⁵⁶⁹ Second, the party must be subject to liability at law or in equity under state law (or federal creditor law such as the FDCPA, if applicable). DOJ Tax says that transferee status (the first prong) is determined under federal law and, if transferee status is determined, then the second prong

³⁵⁶⁵ IRM 5.17.14.3.4 (09-25-2020) Extent of Transferee Liability ; *Schussel v. Werfel*, 758 F.3d 82, 92-93 (1st Cir. 2014); *Lowy v. Commissioner*, 35 T.C. 393, 395-97 (1960); *Tricarichi v. Commissioner*, 908 F.3d 588 (9th Cir. 2018); and Gregory A. Byron, Transferee Liability Under Section 6324: Defining the Extent of a Transferee's Liability for Interest, 32 Idaho L. Rev. 383, 389-390 (1996) (regarding the parallel provision under § 6324).

³⁵⁶⁶ See *Tricarichi v. Commissioner*, T.C. Memo. 2016-132 (synthesizing the cases), affd on appeal, 908 F.3d 588 (9th Cir. 2018); IRM 5.17.14.3.4(6) (09-25-2020), Extent of Transferee Liability.

³⁵⁶⁷ IRM 5.17.14.3.4(7) (09-25-2020) Extent of Transferee Liability (citing *Patterson v. Sims*, 281 F.2d 577 (5th Cir. 1960)). In this regard, the Eleventh Circuit has reasoned that, although the § 6901 liability is an independent liability rather than a tax liability, § 6901(a) requires that the liability is “subject to the same provisions and limitations as in the case of the taxes with respect to which the liabilities were incurred, “so that once the transferee liability provision is invoked, interest can then accrue under § 6601. *Baptiste v. Commissioner*, 29 F.3d 1533, 1541-2 (11th Cir. 1994). The *Baptiste* court distinguished the normal § 6901 case from the § 6901 case involving § 6324(a) which creates the transferee’s liability for transfer tax at the time of the transfer or the time the tax is due (rather than when the IRS asserts transferee liability). In *Tricarichi v. Commissioner*, T.C. Memo. 2016-132, aff’d on appeal 908 F.3d 588 (9th Cir. 2018), the parties conceded that post-notice interest accrued under the Code (the Court going through the history of interest from the due date of the original transferor’s return to the date of the notice of transferee liability).

³⁵⁶⁸ *Diebold Found. v. Commissioner*, 736 F.3d 172 (2d Cir. 2013). The two prongs derive from *Commissioner v. Stern*, 357 U.S. 39, 44-45 (1958), so the two-pronged inquiry is sometimes referred to as the *Stern* test. *Slone v. Commissioner*, 810 F.3d 599, 604-05 (9th Cir. 2015).

³⁵⁶⁹ Id. See also Jeremiah Coder, ABA Meeting: Transferee Liability Cases Involve Federal Law and Substance Over Form, 2012 TNT 180-9 (9/17/12), which quotes a DOJ Tax official as reasoning that the courts say that the inquiry can be based on substance over form, an inquiry ubiquitous in the federal tax law (citing *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978)). I am not sure that the conclusion necessarily follows from the articulated premise but am not sure it would make must difference in most cases.

must be made considering the person as a transferee.³⁵⁷⁰ The courts that have addressed the issue, however, determine that the prongs are independent and that the state law prong is the same as applied to creditors generally under state law, unaffected by the transferee status determination under federal law.³⁵⁷¹ As the courts have reasoned pungently, since the prongs are independent, if there is no liability under the second prong, it makes no difference that the person was a transferee under the first prong.³⁵⁷² I am not sure that, except in rare cases, that nuance, whichever way it is finally determined, would be outcome determinative.³⁵⁷³

Under some fraudulent conveyance remedies, if the property is other than cash, the creditor can set aside the fraudulent conveyance, but that type of remedy must be pursued under the procedures of the remedy law (either state remedy law or the FDCPA). The liability under § 6901 is a dollar amount imposed personally upon the transferee(s) (as opposed to an in rem liability against the property). The general cap on the liability is the value of the property on the date of the transfer. Thus, if the taxpayer owing \$1,000,000 to the IRS on the date of transfer transfers \$10,000 to his son and thereafter does not pay the tax, the son's liability will be capped at \$10,000.

As with the trust fund recovery penalty ("TFRP" discussed below) which is also a mechanism to collect the underlying tax liability, transferee liability is joint and several, so that more than one person can be subject to transferee liability.³⁵⁷⁴ The IRS can pick and choose which transferees to pursue. Certainly, the IRS should have the flexibility to determine where its resources are best spent in the protection of the fisc. Selective or disproportionate collection from less than all transferees potentially liable, however, presents a fairness issue as among the transferees. For example, assume that a taxpayer owed \$100,000 in tax and transferred \$100,000 to each of his sons, A and B (total of \$200,000). The IRS chooses to go against A and actually collects from A, after A has pursued all administrative and judicial remedies available to him. Is it fair that the IRS collected only from A who is left with nothing and B is left with his entire \$100,000? There may be state law

³⁵⁷⁰ See *Feldman v. Commissioner*, 779 F.3d 448 (7th Cir. 2015) (summarizing the position and the state of the law).

³⁵⁷¹ See *Feldman v. Commissioner*, 779 F.3d 448 (7th Cir. 2015) (summarizing the position and the state of the law).

³⁵⁷² *Diebold Found. v. Commissioner*, 736 F.3d 172, 186 (2d Cir. 2013) ("if Diebold New York did not receive a conveyance from Double D for purposes of the NYUFCA, 'then whether or not it was a 'transferee' for purposes of § 6901 is irrelevant,'" citing and quoting *Frank Sawyer Trust of May 1992 v. Commissioner*, 712 F.3d 597, 605 (1st Cir. 2013) and *Starnes v. Commissioner*, 680 F.3d 417, 427 (4th Cir. 2012).

³⁵⁷³ For example, although rejecting DOJ Tax's argument that the prongs are interdependent, in *Diebold Found. v. Commissioner*, 736 F.3d 172 (2d Cir. 2013), the Second Circuit reversed the Tax Court's holding on the second prong, finding that "it is obvious that the parties knew, or at least should have known but for active avoidance, that the entire scheme was fraudulent and would have left Double D unable to pay its tax liability." The Second Circuit remanded to the Tax Court to make the determination of transferee status under the first prong, to determine whether a transferee of a transferee could be liable, and what statute of limitations applied. See also *Salus Mundi Found. v. Commissioner*, 776 F.3d 1010 (9th Cir. 2014) (same); and *Slone v. Commissioner*, 810 F.3d 599 (9th Cir. 2015), on remand, 2016-115 T.C. Memo., aff'd 896 F.3d 1083 (9th Cir. 2018), cert. den. ___ U.S. ___, 139 S. Ct. 1348 (U.S., Mar. 18, 2019).

³⁵⁷⁴ IRM 5.17.14.3.4(4) (09-25-2020), Extent of Transferee Liability (IRS is not required to apportion the joint and several liabilities); and Steve R. Johnson, Unfinished Business on the Taxpayer Rights Agenda: Achieving Fairness in Transferee Liability Cases, 19 Va. Tax Rev. 403, 411-413 (2000).

contribution remedies available, but that varies from state to state.³⁵⁷⁵ In this regard, although transferee liability functions somewhat like the TFRP with regard to employee's share of employment taxes— that is as a backstop to collecting the underlying liability once—the Code provides a limited remedy for among persons assessed the TFRP whereas there is no Code provided remedy for transferee tax liability.

In the quote from the Tax Court above as to the general requirements of state law **equitable** remedies included that the party asserting the remedy prove “that all reasonable efforts to collect from the transferor were made and that further collection efforts would be futile.” This is often called an exhaustion requirement. That is the general equitable requirement in federal equity law as well.³⁵⁷⁶ But § 6901 allows remedies **at law** as well as in equity. Accordingly, if the IRS asserts a non-equity remedy under state or federal law, there is an exhaustion requirement against the taxpayer-transferor only if it is imposed by the state or federal law.³⁵⁷⁷ Some such nonequitable remedy statutes do not impose an exhaustion requirement.³⁵⁷⁸

Transferee liability must be distinguished from the IRS's administrative remedy to levy on property. Transferee liability under § 6901 merely establishes the transferee's personal liability “so as to obtain a general floating lien on the transferee's property.”³⁵⁷⁹ It is different from levy where the IRS seizes the property itself but does not establish a general floating lien on the transferee's property.

I have talked above of the first level transferee from the taxpayer—i.e., the one to whom the taxpayer makes the transfer. The problem of transfers to avoid the tax applies equally to other levels of transferees—i.e., the initial transferee seeking to avoid transferee liability may transfer to one or more other transferees. The statute applies also to those transferees and gives the IRS additional statute of limitations relief in pursuing those transferees.³⁵⁸⁰

³⁵⁷⁵ See Steve R. Johnson, Unfinished Business on the Taxpayer Rights Agenda: Achieving Fairness in Transferee Liability Cases, 19 Va. Tax Rev. 403 (2000). Similar unfairness issues are presented in other circumstances where the tax law imposes joint and several liability. As we see below, with respect to the TFRP, a similar issue of fairness is presented and Congress provided in § 6672(d) a federal contribution remedy that is not dependent in any way upon the vagaries of state law contribution rights. Using § 6672 as a model, it has been suggested that Congress enact similar contribution remedy for transferee liability. Joint and several liability attending joint returns for married taxpayers also presents a potential for this type of unfairness, but some of the potential for unfairness is mitigated by the so-called innocent spouse provisions of the Code which may shift the burden from a spouse otherwise jointly liable to the nonrequesting spouse relative to the unpaid tax.

³⁵⁷⁶ *United States v. Kardash*, 866 F.3d 1249 (11th Cir. 2017) (Under principles of federal equity law, therefore, the Commissioner would have to exhaust all remedies against FECF before proceeding against Kardash, citing *Healy v. Commissioner*, 345 U.S. 278, 284 n.16 (1953).

³⁵⁷⁷ *United States v. Kardash*, 866 F.3d 1249 (11th Cir. 2017).

³⁵⁷⁸ E.g., *United States v. Kardash*, 866 F.3d 1249 (11th Cir. 2017), holding that (holding that Florida Uniform Fraudulent Transfer Act does not have an exhaustion requirement).

³⁵⁷⁹ IRS LGM GL-21, reprinted at 2000 TNT 121-35 (6/22/2000). LGM is the initialism for Litigation Guideline Memorandum, an internal guidance device last used in 1999 and now discontinued, with prior LGMs obsoleted. See CCN 2017-001 (11/2/16). In discontinuing and formally obsoleting existing LGMs, the IRS said: “ they can serve as useful research tools and historical records of positions previously taken by the Office of Chief Counsel on issues in litigation.”

³⁵⁸⁰ § 6901(c)(2).

(2) Fiduciary Liability Under § 6901.

I discuss (p. 826) the personal liability of certain representatives, sometimes referred to as fiduciaries, under 31 U.S.C. § 3713(b) for transferring to others assets when they know or have reason to know of federal tax claims. Section 6901 is also available to impose and collect liability under § 3713(b) upon such fiduciaries with respect to income, estate and gift taxes. § 6901(a)(1)(B).

B. Trust Fund Taxes; Trust Fund Recovery Penalty (“TFRP”).

1. Introduction.

a. Withholding Taxes a/k/a Trust Fund Taxes.

As I noted above, the Code requires certain payors of amounts to withhold for taxes dues or potentially due from payees with respect to the amounts paid. The most commonly encountered example is withholding from an employee’s wages for the employee’s federal income taxes and for the employee’s share of FICA and Medicare taxes. The background for the withholding issue is:

An employer is subject to federal taxes on wages paid to employees. An employer must pay a tax equal to 6.2% of wages for the Social-Security portion of the tax and 1.45% for the Medicare portion of the tax. Sec. 3111(a) and (b). Another tax, computed at the same rates (6.2% and 1.45%), falls on employees. Sec. 3101(a) (6.2% Social-Security tax on wages received by employees) and (b) (1.45% Medicare tax on wages received by employees). Both the tax on employers and the tax on employees are referred to as the FICA. In addition, an employer must withhold the employee share of FICA from the wages paid and must pay the withheld amount to the IRS. Sec. 3102(a) (the employee share of FICA must be collected by the employer by deducting and withholding the amount of tax from wages as paid) and (b) (every employer required to deduct the employee share of FICA is liable for payment of the employee share of FICA). Moreover, an employer is obligated to withhold from wages amounts for the income taxes owed by its employees and must pay the withheld amount to the IRS. Secs. 3402(a)(1) (“every employer making payment of wages shall deduct and withhold upon such wages a tax determined in accordance with tables or computational procedures prescribed by the Secretary [of the Treasury]”), 3403 (every employer that is required to deduct income tax is liable for payment of the deducted amount). Once net wages are paid to the employee, the IRS credits the employee with the taxes withheld, even if the employer does not pay over the withheld amount to the IRS. See *Slodov v. United States*, 436 U.S. 238, 243 (1978). The term “employment taxes” refers to all three of the employer's obligations that we have just discussed: (1) employer share of FICA, (2) employee FICA withholding, and (3) income-tax withholding. The term “trust-fund taxes” refers to the last two obligations.³⁵⁸¹

³⁵⁸¹ *Romano-Murphy v. Commissioner*, T.C. Memo. 2012-330, at *55-*56 (cleaned up), vacated and remanded on other grounds, 816 F.3d 707 (11th Cir. 2016), opinion on remand at 152 T.C. 278 (2019). As noted in *Romano-Murphy*, there is yet another tax related to the employer-employee status—the federal unemployment tax, (continued...)

The following example³⁵⁸² is illustrative:

Employee earns \$45,000 in wages; Employer withholds \$4,000 in federal income tax. The trust-fund (withheld from employee) and non-trust-fund portions of the employment tax are:

| | |
|--|-------------|
| Income Tax Withholdings | \$4,000.00 |
| Social Security (12.4% wages) | |
| Employee's Share (6.2% wages) | \$2,790.00 |
| Employer's Share (6.2% wages) | \$2,790.00 |
| Medicare (2.9% wages) | |
| Employee's Share (1.45% wages) | \$652.50 |
| Employer's Share (1.45% wages) | \$652.50 |
| Total Employment Tax | \$10,885.00 |
| Trust Fund Portion (Income Tax + Employee's Share of Medicare & Social Security) | \$7,442.50 |
| Non-Trust Fund Portion (Employer's Share of Medicare & Social Security) | \$3,442.50 |

I focus here on the portion referred to as the trust fund taxes. The theory is that the employer has in effect “paid” those amounts to the employee by “collecting” the amount to forward to the IRS for crediting to the employee’s liability. The employer is no longer entitled to the amounts and, by retaining (“collecting”) the amounts, the employer holds them in trust for the IRS until they are paid over to the IRS to be applied to the employee’s tax accounts.³⁵⁸³ Notwithstanding that the funds are designated “trust” funds, there is no requirement that, after withholding and prior to remitting to the Government, the funds actually be held in some type of segregated trust fund or account as is usually required for trust funds.³⁵⁸⁴ Prior to remission to the IRS, the employer holds the funds and can use them for any purpose it wants to, although the person or persons directing their use for purposes other than payment of the trust fund tax can be personally liable for this TFRP.³⁵⁸⁵ or even a parallel

³⁵⁸¹(...continued)

acronymed to “FUTA” or “FUTA tax.” That tax is a 6.2% excise tax imposed on the employer for remuneration paid up to \$7,000 per calendar year.

³⁵⁸² The example is from *Ross v. United States*, 949 F. Supp. 2d 272 (D D.C. 2013).

³⁵⁸³ § 7501 (“amount of tax so collected or withheld shall be held to be a special fund in trust for the United States”); see *Slodov v. United States*, 436 U.S. 238, 242-243 (1978).

³⁵⁸⁴ Interfacing with the bankruptcy laws, the Supreme Court has held that, although the withheld tax is not a “trust fund” in the normal use of the term so that, prior to the remittance to the IRS there only an amount rather than a trust fund, the trust fund nature of the amount is, in effect, perfected by the payment to the IRS. *Begier v. Internal Revenue Service*, 496 U.S. 53 (1990) (in bankruptcy lingo this means that the payment is not a preference that can be avoided in bankruptcy).

³⁵⁸⁵ The TFRP is a form of derivative liability for the employer’s trust fund liability. *Dixon v. Commissioner*, 141 T.C. 173, 192 (2013). Another court has said the TFRP is a form of piercing the corporate veil that

(continued...)

criminal penalty (§ 7202). The IRS must credit the employee with the amount withheld even if the employer does not remit the withheld amounts to the IRS.³⁵⁸⁶ The following is a good example of the courts' view of the trust fund tax and the employer's responsibility:

The withholding taxes “are part of the wages of the employee, held by the employer in trust for the government.” the employer, as a function of administrative convenience, extracts money from a worker's paycheck and briefly holds that money before forwarding it to the IRS. * * * * A delinquency in trust fund taxes thus is not simply a matter between the IRS and an employer, but rather involves employee wages. The significant responsibility * * * is summed up by then-Judge Cardozo's famous statement that “[a] trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior.”³⁵⁸⁷

Even if employer does not pay to the IRS the withheld trust fund taxes representing, in effect, payments by the employee of the employee's tax liabilities, the employee will be given credit against his income tax and credit for payments into the Social Security system.³⁵⁸⁸ In effect, therefore, the employer is the withholding agent for the IRS with any failure in payment borne by the IRS vis-a-vis the employee.

Keep in mind that the employer has the primary obligation to remit the employment taxes, including the trust fund taxes, to the IRS. The person responsible under § 6672 has only a secondary obligation for the trust fund taxes if the employer does not pay. One difference these two liabilities is with respect to interest. The employer's liability accrues on the date the withholding tax becomes due (periodically as prescribed based on the number of employees) and interest on failure to pay plus any employer penalties runs from the due date. The TFRP under § 6672 does not accrue until assessed and is in the principal amount of the trust fund taxes assessed without the employers' penalties; then, interest on that principal amount does not run until the assessment date.³⁵⁸⁹

³⁵⁸⁵(...continued)

would otherwise limit the liability of persons other than the corporation itself. *Ross v. United States*, 949 F. Supp. 2d 272 (D. D.C. 2013). However, this piercing the veil is not a good analogy because, although the TFRP is in the same amount as the employer's trust fund tax liability for the withheld tax, the TFRP is “separate and distinct from the underlying trust fund tax liability of an employer.” *Hellman v. Commissioner*, T.C. Memo. 2013-190, at *13.

³⁵⁸⁶ *Slodov v. United States*, 436 U.S. 238, 243 (1978) (the withheld taxes are credited to the employees “regardless of whether they are paid by the employer, so that the IRS has recourse only against the employer for their payment.”); and *Emshwiller v. United States*, 565 F.2d 1042, 1044 (8th Cir. 1977) (“any failure by the employer to pay withheld taxes results in a loss to the government in that amount”). The employee claims the credit based on the W-2. One practical problem for employees is claiming or proving the amount withheld if for some reason the W-2 is not issued or is lost. See Keith Fogg, [What Happens to Employees When the Employer Fails to Pay Over to the Government Withheld Taxes](#) (Procedurally Taxing Blog 5/3/22) (also noting that employees are barred from suing employers for failure to pay withheld tax, citing § 3403).

³⁵⁸⁷ *Bell v. United States*, 355 F.3d 387 (6th Cir. 2004).

³⁵⁸⁸ *Slodov v. United States*, 436 U.S. 238 (1978); *Fiataruolo v. United States*, 8 F.3d 930, 938 (2d Cir. 1993).

³⁵⁸⁹ *Ross v. United States*, 949 F. Supp. 2d 272 (D. D.C. 2013) (noting that the employer's liabilities for the trust fund taxes will thus be substantially higher than the responsible person's § 6672 liability because the employer's liability includes penalties not included in the responsible person's liability and will accrue interest for a longer period).

Besides the employee share of employment taxes, there are a number of situations where a person is required to collect tax from a third party and pay it over to the IRS. For example, §§ 1441-1446 requires withholding of income tax on certain payments to foreign individuals and entities. Those funds are trust fund taxes as well and thus responsible persons may be liable for the TFRP.

Obviously, given the amount of dollars in the system for such trust fund taxes, the IRS has a critical interest in encouraging compliance with requirements for withholding and paying over to the IRS. Accordingly, the IRS has major compliance functions to deal with potentially delinquent withholders.³⁵⁹⁰

b. Trust Fund Recovery Penalty (TFRP) - § 6672.

Section 6672 imposes civil liability—the TFRP—for the unpaid trust fund taxes upon those persons who organizationally had the responsibility and power to ensure that the withheld taxes were paid over to the Government for the trust fund taxes rather than being used for other purposes.³⁵⁹¹ The person(s) subject to the TFRP are those persons³⁵⁹² (1) who were “required to collect, truthfully account for, and pay over” and (2) who willfully failed to do so.³⁵⁹³ The statute refers to the liability as a penalty; in reality, it is just a secondary tax collection mechanism if the employer fails to remit the withheld taxes to the Government.³⁵⁹⁴

The person subject to the TFRP is often referred to as the “responsible person,” so the TFRP is often referred to as the “responsible person penalty.”³⁵⁹⁵

It is important to distinguish between the employer’s liability for trust fund taxes and the secondary TFRP liability under § 6672. The liabilities are related, but not the same. For example,

³⁵⁹⁰ See e.g., IRM 5.7 (“Trust Fund Compliance Handbook”).

³⁵⁹¹ This civil “penalty” provision and the parallel criminal provision in § 7202 were enacted with the 1954 Code and were based on earlier criminal provisions. See Gerald P. Moran, Willfulness: The Inner Sanctum or Unnecessary Element of Section 6672, 11 U. Tol. L. Rev. 709, 723-751 (1980) (discussing the legislative history of section 6672).

³⁵⁹² In the case of a corporation or partnership, person “includes an officer or employee of a corporation, or a member or employee of a partnership, who as such officer, employee, or member is under a duty to perform the act in respect of which the violation occurs.” § 6671(b).

³⁵⁹³ There are parallel criminal penalties for more egregious cases (§§ 7202 and 7215). Government initiatives starting around 2000 suggest that the Government will use these criminal penalties more aggressively to discourage those tempted to use trust funds in the business from doing so. See e.g., *United States v. Evangelista*, 122 F.3d 112, 121 (2d Cir. 1997); and *United States v. Gilbert*, 266 F.3d 1180 (9th Cir. 2001) for examples of prosecutions in really egregious cases (*Evangelista*) and far less egregious cases (*Gilbert*).

³⁵⁹⁴ See *Slodov v. United States*, 436 U.S. 238 (1978). See *Jenkins v. United States*, 101 Fed. Cl. 122 n. 17 (2011) (describing the history of the section). Interestingly, the penalty was initially described as a criminal penalty, even though the only sanction was liability for the unpaid withholding taxes. Congress thereafter moved the provision from the criminal penalties of the Code because the provision did not provide for imprisonment and included it in the Code alongside other civil penalties. Now there is a separate criminal penalty in § 7202 for egregious violations of the duty to withhold and pay over to the IRS.

³⁵⁹⁵ *Slodov v. United States*, 436 U.S. 238, 246 n. 7 (1978) (“The cases which have been decided under § 6672 generally refer to the “person required to collect, truthfully account for, and pay over any tax imposed by this title” by the shorthand phrase “responsible person.”). The use of the term responsible person in either context has been described as “an invention of the courts, having no statutory definition or discussion in the legislative history.” *Noffke v. United States*, 2016 U.S. Claims LEXIS 1887 (2016).

the employer's payment of delinquent trust fund taxes will extinguish any TFRP liability that has been assessed.³⁵⁹⁶ But the two assessments are different assessments and will be subject to separate collection procedures against both the employer and the person assessed TFRP liability until the underlying trust fund taxes are paid.³⁵⁹⁷

The phenomenon often giving rise to the penalty is that the employer becomes delinquent in turning over the trust fund taxes to the IRS and then is unable to pay them. Frequently when a business is experiencing cash flow difficulties, the principal person or persons managing the business will attempt to keep the business afloat by using the trust fund taxes to pay what he or they perceive as more demanding needs; usually the expectation is the cash flow shortfall will be resolved, so that the trust fund tax will be paid later. The withholding taxpayer (the employer in the case of employment taxes) will often view its interim use of the trust fund tax proceeds as only a temporary expedient to get past the rough spots, with every intention of ultimately paying. If the business succeeds or the withholding taxpayer otherwise pays the delinquent taxes (with interest on the delinquent payments), everything works out fine. Too often, however, the business goes under, with the IRS (as well as many other creditors) holding the bag because, as noted, the IRS must give the taxpayer-employee credit for the withheld amount just as if the IRS had received it.³⁵⁹⁸

A person who might or might not otherwise be subject to the TFRP may have direct liability for the trust fund tax (as well as other taxes of the employer). Thus, under most states' general partnership laws, a partner in a general partnership will be generally liable for the partnership's liabilities including tax liabilities generally and employment taxes specifically (including both the employer's employment tax and the trust fund taxes withheld from employees). This general partner state law liability is wholly apart from the TFRP, so assessing the TFRP might be a redundant and unnecessary act.³⁵⁹⁹ By contrast, an owner in a limited liability entity (limited partnership, corporation, LLC, etc.) will be liable only under the TFRP (or possibly under the transferee liability provisions discussed above).

The distinction between trust fund and non-trust fund taxes is important. In the employment context, the withholding from the employee for income tax and FICA tax are trust fund taxes. The employer's direct liability for the employer's portion of the FICA tax is not a trust fund tax and is thus not subject to the TFRP. Furthermore, delinquency penalties and accrued interest for unpaid

³⁵⁹⁶ This is because of the IRS policy to collect the trust fund tax only once. 1.2.1.6.3 (06-09-2003), Policy Statement 5-14 (Formerly P-5-60), Trust Fund Recovery Penalty Assessments.

³⁵⁹⁷ See *Bletsas v. Commissioner*, T.C. Memo. 2018-128 (IRS collection of an assessed TFRP is not suspended by the IRS reaching an installment agreement with the employer, although in that case the IRS only filed the notice of federal tax lien but did not levy on the responsible person while the installment agreement was being timely paid). See Bryan Camp, Lesson From The Tax Court: The Misunderstood Trust Fund Recovery Penalty (Tax Prof Blog 8/27/18).

³⁵⁹⁸ See *Slodov v. United States*, 436 U.S.238, 242-243 (1978).

³⁵⁹⁹ *United States v. Galletti*, 541 U.S. 114 (2004) (holding that separate assessments against the partners are not required for the collection statute of limitations to apply as to them); and *In re Pitts*, 515 B.R. 317, 2014 U.S. Dist. LEXIS 111765 (C.D. Cal 2014) (extending *Galletti*, held that the IRS can use administrative collection measures of lien and levy against a general partner liable for the partnership's tax). See also IRM 5.17.7.1.1.3 (08-01-2010), Partners/Members (general partners are generally liable for partnership debts, so "assessments are made in the name of the partnership and the names of the general partners." Also, under the check the box rules, an entity otherwise qualifying for limited liability but which is treated as a tax nothing (for single member entities) or partnership (for multiple member entities) could subject the owner to direct liability independent of the TFRP. See ILM 200235023 (released 8/30/02).
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trust fund taxes are not included in the liability. So, the quantum of the TFRP is the amount withheld (not including the employer's penalties or interest). However, once the TFRP is assessed, the amount assessed then bears interest.³⁶⁰⁰

More than one person can be and often is liable for the TFRP, and hence the IRS often makes multiple assessments.³⁶⁰¹ And a responsible person liable for the tax is not relieved of the obligation to the Government because there is another responsible person who is more culpable relative to the default.³⁶⁰² As will be noted, however, the IRS is not required to make the TFRP assessment against a person otherwise liable, even if that person is in some equitable sense more culpable.

2. Elements of Liability.

a. Parsing the Elements of the Statute.

Section 6672 imposes liability upon:

Any person required to collect, truthfully account for, **and** pay over any tax imposed by this title who willfully fails to collect such tax, or truthfully account for and pay over such tax . . . (Emphasis supplied)

Focusing on emphasized “and,” persons facing this liability argued that they could be liable only if their role with the employer encompassed each of the three stated elements—collect, account and pay over. If these various corporate functions are split up, they reasoned, no one could be liable for the TFRP. The Supreme Court rejected that argument, holding, effectively, that “and” really meant “or.”³⁶⁰³ Still, even with this holding, what is the gravamen of the liability? As we will see, it is any person who has practical control of the financial decisions that result in the trust fund taxes being paid.

b. Gravamen - Control of Financial Decisions.

The key to the TFRP civil liability is:

³⁶⁰⁰ Economically, this gives the person who is potentially subject to the TFRP incentive to delay assessment of the TFRP as long as possible. This usually will mean taking advantage of internal appeals rights prior to assessment and taking advantage of all extensions that are reasonably available. Purely dilatory tactics solely for the sake of delay, however, will likely be counterproductive and not worth the interest that might be saved by delay.

³⁶⁰¹ E.g., *Brown v. United States*, 511 F.2d 1136 (5th Cir. 1979); *Winter v. United States*, 196 F.3d 339, 345 (2d Cir. 1999), citing *Fiataruolo v. United States*, 8 F.3d 930, 938 (2d Cir. 1993).

³⁶⁰² *USLIFE Title Ins. Co. of Dallas v. Harbison*, 784 F.2d 1238, 1243 (5th Cir. 1986); see also *Thosteson v. United States*, 303 F.3d 1312, 1320 (11th Cir. 2002) (which also notes that the jury appeal of less culpability may be a false hope: “being less culpable does not exonerate Thosteson from his responsibility, which he knowingly disregarded. As we have observed, ‘the seeds of common sense compassion sown by the jury find scant hospitality on this rock hard legal landscape.’”); and *Erwin v. United States*, 591 F.3d 313, 324 (4th Cir. 2010), citing *Turnbull v. United States*, 929 F.2d 173, 178 (5th Cir. 1991).

³⁶⁰³ *Slodov v. United States*, 436 U.S.238, 246-250 (1978).

control of finances within the employer corporation: the power to control the decision-making process by which the employer corporation allocates funds to other creditors in preference to its withholding obligations.³⁶⁰⁴

A more elaborate statement of the TFRP liability is:

To determine who within a company is a “responsible person” under § 6672, we undertake a pragmatic, substance-over-form inquiry into whether an officer or employee so “participated in decisions concerning payment of creditors and disbursement of funds” that he effectively had the authority -- and hence a duty-- to ensure payment of the corporation's payroll taxes. Stated differently, the “crucial inquiry is whether the person had the ‘effective power’ to pay the taxes -- that is, whether he had the actual authority or ability, in view of his status within the corporation, to pay the taxes owed.”³⁶⁰⁵

In pertinent part, IRS Policy Statement P-5-14³⁶⁰⁶ says the following about the penalty:

5. Determination of Responsible Persons: Responsibility is a matter of status, duty, and authority. Those performing ministerial acts without exercising independent judgment will not be deemed responsible.

6. In general, non-owner employees of the business entity, who act solely under the dominion and control of others, and who are not in a position to make independent decisions on behalf of the business entity, will not be asserted the trust fund recovery penalty.

Who made the decisions that resulted in the nonpayment of the trust fund taxes? Or who was responsible or had the “effective power” for those decisions, even if he or she abdicated the responsibility?³⁶⁰⁷

Courts look to certain objective indicia to assist in identifying the role of the person. The following is a typical statement of the relevant indicia:

³⁶⁰⁴ E.g., *Godfrey v. United States*, 748 F.2d 1568, 1574 (Fed. Cir. 1984), quoting *Haffa v. United States*, 516 F.2d 931, 936 (7th Cir. 1975); see also *Scott v. United States*, 825 F.3d 1275, 1279 (11th Cir. 2017).

³⁶⁰⁵ *Plett v. United States*, 185 F.3d 216, 219 (4th Cir. 1999) (case citations omitted from the quote above). See also *Vinick v. United States*, 205 F.3d 1 (1st Cir. 2000) (“the crucial inquiry is whether the person had the effective power to pay the taxes --that is, whether he had the actual authority or ability, in view of his status within the corporation, to pay the taxes owed” (cleaned up, citing *Barnett v. IRS*, 988 F.2d 1449, 1455 (5th Cir. 1993)); *Raba v. United States*, 977 F.2d 941, 943 (5th Cir. 1992) (“effective power to pay taxes”); *Morgan v. United States*, 937 F.2d 281, 284 (5th Cir. 1991) (“effective power to pay taxes.”); *Hochstein v. United States*, 900 F.2d 543, 547 (2^d Cir. 1990) (“significant control over the enterprise's finances”) In *Moulton v. United States*, 429 F.3d 352 (1st Cir. 2005), the Court construed its precedent in *Vinick* (referred to there as *Vinick II*) to mean the power to control and not the actual exercise of the power.

³⁶⁰⁶ 1.2.1.6.3 (06-09-2003), Policy Statement 5-14 (Formerly P-5-60), Trust Fund Recovery Penalty Assessments.

³⁶⁰⁷ *Johnson, v. United States*, 734 F.3d 352,361 (4th Cir. 2013).

(1) is an officer or member of the board of directors, (2) owns shares or possesses an entrepreneurial stake in the company, (3) is active in the management of day-to-day affairs of the company, (4) has the ability to hire and fire employees, (5) makes decisions regarding which, when and in what order outstanding debts or taxes will be paid, (6) exercises control over daily bank accounts and disbursement records, and (7) has check-signing authority.³⁶⁰⁸

However, these indicia are simply factors to be considered in determining who had the financial decision making power.³⁶⁰⁹

This test of a responsible person is quite broad. It usually covers key officers whose job responsibilities gave them power or a material role in making financial decisions. It may cover directors and shareholders of a corporate employer even when they are not officers or employees of the corporation. It may even cover persons who are not officers, employees, directors or shareholders, although it is rare that such a person would have effective decision making authority or even an incentive to participate in such decisions. But it does not cover persons with titles that would normally suggest authority for making such decisions but who the facts indicate were denied that authority.³⁶¹⁰

One court has described liability as attaching to a person who “could have impeded the flow of business to the extent necessary to prevent the corporation from squandering the taxes.”³⁶¹¹ A person thus need not have final control of the financial decision but must be a significant substantive participant in the decision.³⁶¹²

Moreover, authority and power can change, so it is critical to focus on a person’s role during the quarters for which the TFRP is assessed.³⁶¹³ Thus, for example, a person who becomes a responsible person after the trust fund tax payment obligation has accrued has liability under § 6672 only to the extent that there were unencumbered funds available to pay the accrued trust fund tax at the time he or she assumes that status; the subsequent receipt and use of unencumbered funds for other creditors does not make the person liable under § 6672 for the trust fund tax delinquent at the time he or she assumes that status.³⁶¹⁴

Cases are all over the lot on how the standards apply in particular factual circumstances, but the foregoing is the gist of it.

³⁶⁰⁸ *Vinick v. United States*, 205 F.3d 1, 7 (1st Cir. 2000); for similar list of factors or indicia see also *Logal v. United States*, 195 F.3d 229, 232 (5th Cir. 1999); and *Plett v. United States*, 185 F.3d 216, 219 (4th Cir. 1999).

³⁶⁰⁹ See *Vinick v. United States*, *supra*, for a particular good discussion of the role—and limitations—of these factors in making the critical determination.

³⁶¹⁰ See e.g., *United States v. Bisbee*, 245 F.3d 1001 (8th Cir. 2001); the phenomenon of the title outstripping actual authority is not at all unusual as indicated in also Glater, *For Some Executives, Titles Surpass Power*, New York Times (April 11, 2001) (discussing the phenomenon in context of ego-stroking and compensation substitutes).

³⁶¹¹ *Thomas v. United States*, 41 F.3d 1109, 1113 (7th Cir. 1994).

³⁶¹² *Winter v. United States*, 196 F.3d 339, 347 (2d Cir. 1999); *Howard v. United States*, 711 F.2d 729 (5th Cir. 1983).

³⁶¹³ See e.g., *Vinick v. United States*, 205 F.3d 1 (1st Cir. 2000).

³⁶¹⁴ *Slodov v. United States*, 436 U.S. 238 (1978).

c. Willfulness.

Liability attaches to a person acted “willfully” with respect to the failure to pay the trust fund taxes. Willfully as a textual requirement of a Code provision is often encountered in the criminal sections of the Code (e.g., § 7201) where it means the intentional violation of a known legal duty.³⁶¹⁵ Even this strict requirement of specific intent is relaxed in the criminal area with the concept variously described as deliberate ignorance, willful blindness or conscious avoidance. The notion is that, even if, in the criminal case, the Government has not proved actual intent to violate the known legal duty, the willfulness requirement is met if the defendant consciously avoided learning the facts necessary for the intent when the facts were highly probable. (There are various formulas of the concept, all struggling with the problem that this should be punished as a crime even though the statute requires actual intent.)

In the civil penalty context, the willfulness concept is interpreted to include both specific intent and some notion paralleling and even expanding the concept of deliberate ignorance in a criminal context.³⁶¹⁶ If specific intent to not pay the taxes cannot be shown, the person’s actions must have been so grossly negligent or reckless that willfulness will be presumed. The following is the standard in the Court of Federal Claims (case citations omitted):

Limning the appropriate standards to be applied herein, the Federal Circuit has held that willfulness may be shown in at least two ways: (i) “a deliberate choice voluntarily, consciously and intentionally made to pay other creditors instead of paying the [g]overnment” or (ii) “reckless disregard of a known or obvious risk that the taxes may not be remitted to the government.” Under the first of these prongs, a responsible person who pays net wages to employees with the knowledge that there are insufficient funds with which to pay the employment taxes commits a willful failure to collect and pay over under section 6672. Under the second of these prongs, a responsible person is reckless if he knew or should have known of a risk that the taxes were not being paid, had a reasonable opportunity to discover and remedy the problem, and yet failed to undertake reasonable efforts to ensure payment. Under this latter prong, “if the facts and circumstances of a particular case, taken as a whole, demonstrate that a responsible individual knew or should have known that there was a risk that the taxes would not be paid, and failed to take available corrective action, with the result being that the government is not paid taxes to which it is entitled, that individual will be found to have willfully failed to pay over withholding taxes under IRC § 6672(a).”³⁶¹⁷

³⁶¹⁵ *Cheek v. United States*, 498 U.S. 192, 201 (1991). This formulation of the standard is often referred to as the *Cheek* standard, although *Cheek* drew the formulation from its prior decisions.

³⁶¹⁶ IRM 5.7.3.3.2 (08-06-2015), Establishing Willfulness. See *Global Tech Appliances, Inc. v. SEB*, 563 U.S. 754 (2011). This standard has been applied to the FBAR civil willful penalty. See p. 972.

³⁶¹⁷ *Jenkins v. United States*, 101 Fed. Cl. 122, 134 (2011), aff’d 2012 U.S. App. LEXIS 11618 (Fed. Cir. 2012). In the appellate decision, the court truncated the concepts to: “In addition to encompassing a deliberate choice to pay other creditors instead of paying the trust fund taxes to the government, ‘[w]illful conduct may also include a reckless disregard of an ‘obvious and known risk’ that taxes might not be remitted.’” See also *Logal v. United States*, 195 F.3d 229, 232 (5th Cir. 1999) (“Willfulness is normally proved by evidence that the responsible person paid other creditors with knowledge that withholding taxes were due at the time to the United States.”); and *McClendon v. United* (continued...)

Is willfulness present where the employer owing trust fund taxes has no unencumbered funds to make the payment? There are some differences in the nuances of the appropriate test as articulated among the circuits, but the courts seem to distinguish between assets received and held by an employer subject to a legal restriction akin to a trust fund and assets held by an employer subject to a contractual term that the assets be used for purposes other than trust fund taxes. A responsible person whose employer holds assets under the former (akin to a trust fund under law) is not willful in failing to use the assets to pay delinquent trust fund taxes, but a responsible person whose employer holds assets subject to a mere contractual restriction that they be used for other purposes is willful in not using the assets to pay delinquent trust fund taxes. A court thus held:

funds are encumbered [and thus not available to pay trust fund taxes] only when certain legal obligations, such as statutes, regulations, and ordinances, impede the freedom of a company to use its funds to fulfill its trust fund tax debts. Voluntary contractual obligations, such as the lock-box arrangement at issue in this case, do not encumber funds so as to prevent a willful failure to pay trust fund taxes.³⁶¹⁸

d. Reasonable Cause.

The statute provides no reasonable cause exception to TFRP liability. Some Circuits, however, recognize a reasonable cause exception, treating it as implicit in the statutory requirement of willfulness.³⁶¹⁹ Courts have noted that the concern is that, without the exception, “§ 6672(a) has become a strict-liability statute.”³⁶²⁰

³⁶¹⁷(...continued)

States, 892 F.3d 775, 783 (5th Cir. 2018) (willfulness “requires only a voluntary, conscious, and intentional act, not a bad motive or evil intent,” so that willfulness is present if the person knew the withholding tax was due and used unencumbered funds for other purposes or recklessly disregarded the unpaid tax liability and risk that it would not be paid).

³⁶¹⁸ *Bell v. United States*, 355 F.3d 387, 394-95 (6th Cir. 2004), citing and relying on *Honey v. United States*, 963 F.2d 1083, 1090 (8th Cir. 1992); see also *Nakano v. United States*, 742 F.3d 1208 (9th Cir. 2014) (citing *Honey* as the leading authority and adopting the Honey test: that willfulness as to funds paid to creditors other than the IRS is absent only if “the taxpayer is legally obligated to use the funds for a purpose other than satisfying the preexisting employment tax liability and if that legal obligation is superior to the interest of the IRS in the funds,”); and *McClendon v. United States*, 2016 U.S. Dist. LEXIS 159271 (S.D. Tex. 2016) (funds were not encumbered so as to avoid § 6672 liability where responsible person “lent” funds to the employer only to cover payroll), aff’d in part and vacated in part, 892 F.3d 775 (5th Cir. 2018). The quoted text and foregoing authorities are stated to be the majority rule, with the minority rule being that any restriction encumbering the employer’s funds will avoid willfulness. See *Davis v. United States*, 2018 U.S. Dist. LEXIS 36357 (D. Colo. 2018).

³⁶¹⁹ *Finley v. United States*, 123 F.3d 1342, 1343 & 1348 (10th Cir. 1997) (en banc) (reasonable cause exists “(1) the taxpayer has made reasonable efforts to protect the trust funds, but (2) those efforts have been frustrated by circumstances outside the taxpayer’s control.”); *Winter v. United States*, 196 F.3d 339, 344-345 (2d Cir. 1999); *Logal v. United States*, 195 F.3d 229, 233 (5th Cir. 1999); and *Byrne v. United States*, 857 F.3d 319 (6th Cir. 2017) (quoting *Winter*, “a responsible person’s failure to cause the withholding taxes to be paid is not willful if he believed that the taxes were in fact being paid, so long as that belief was, in the circumstances, a reasonable one”: and called the reasonable cause exception a “narrow exception.”).

³⁶²⁰ *Finley v. United States*, 123 F.3d 1342, 1347 (10th Cir. 1997); *Bell v. United States*, 355 F.3d 387, 398 (6th Cir. 2004); *Byrne v. United States*, 857 F.3d 319 (6th Cir. 2017) (“We share the IRS’s concern that Congress intended for § 6672 “to protect the government against losses, * * * but we must balance this goal against the unfairness of imposing too strict a rule of liability.”)

Reflecting these concerns, the Tenth Circuit said in an en banc opinion:

[W]e are troubled by the possibility the courts have transformed 26 U.S.C. § 6672 into a strict liability statute, outside the jury's realm, by (1) broadly defining the most likely fact scenarios leading to a failure to pay withholding taxes as “willful” conduct as a matter of law, and (2) closing the door on any opportunity for a responsible person to distinguish his case from those factual scenarios, or paradigms (i.e., demonstrate reasonable cause for failure to pay). As “maintenance of the jury as a fact-finding body is of such importance and occupies so firm a place in our history and jurisprudence,” it is our duty to carefully scrutinize any apparent curtailment of that function.³⁶²¹

In the same opinion, the Tenth Circuit tied defense into the statutory element of willfulness, which it viewed as the quintessential jury determination.³⁶²² The Tenth Circuit did attempt to circumscribe the defense:

We therefore conclude reasonable cause sufficient to excuse a responsible person's failure to pay withholding taxes should be limited to those circumstances where (1) the taxpayer has made reasonable efforts to protect the trust funds, but (2) those efforts have been frustrated by circumstances outside the taxpayer's control. By so limiting the elements of reasonable cause in the § 6672 context we avoid the temptation to inject notions of evil motive, bad faith or other improper factors into the determination of willfulness, and maintain the ability to zealously protect government revenue via the application of certain factual paradigms widely-recognized and accepted as “willful conduct.” Yet, consistent with the plain language of § 6672, this approach preserves a role for the jury to determine whether, based on all relevant evidence in a particular case, the responsible taxpayer's conduct reflects the requisite scienter.³⁶²³

Once § 6672 liability is recognized as the province of the jury under the element of “willfulness,” even with a limiting instruction such as suggested in the foregoing quote, the jury is more likely to be moved by the types of notions that would support a reasonable cause exception. The key, of course, from the putative responsible person’s perspective is to get to the jury and avoid summary judgment from district judges who either do not recognize the defense or are not as easily swayed by it as jurors might be.

Other courts have noted that, the defense, if it exists, is quite limited.³⁶²⁴ The Fourth Circuit summarized this defense, calling it a “putative” defense:

³⁶²¹ *Finley v. United States*, 123 F.3d 1342, 1347 (10th Cir. 1997).

³⁶²² *Id.*, pp. 1347-8.

³⁶²³ *Id.*, p. 1348. See also *Newsome v. United States*, 431 F.2d 742, 746-47 (5th Cir. 1970) (saying that the reasonable cause defense to TFRP should have “very limited application.”)

³⁶²⁴ E.g., the Fifth Circuit had recognized the possible defense but said that “no taxpayer has yet carried that pail up the hill.” *Bowen v. United States*, 836 F.2d 965, 968 (5th Cir. 1988).

Courts that have recognized this defense have limited it to situations in which circumstances outside a taxpayer's control have thwarted his reasonable efforts to protect trust funds, and have not applied it in situations where the taxpayer made a conscious decision to pay other creditors.³⁶²⁵

Other Circuits, such as the Fifth, say that the factors that might bear upon a reasonable cause inquiry are just considerations to be considered in determining whether the person acted willfully.³⁶²⁶ Even as articulated, however, the key is to get enough evidence in the record so that the defense—whether separately recognized or imported into the willfulness element—can be presented to the jury.

A variation of a reasonable cause defense, although not called that, is that, at the time that the withheld amounts were due to be turned over to the IRS, the employer did not have the funds to pay and therefore the responsible person did not act willfully in not having the employer pay. A variation of this argument was accepted by the Supreme Court in *Slodov v. United States*, 436 U.S. 238 (1978) where the putative responsible person assumed control of the employers after the payments became due. The withholding payments were past due, but subsequent to his assumption of control the employers had sufficient unfettered funds that could have been used to pay those unpaid withholding amounts. The Supreme Court held that the person did not act willfully in using those funds for other purposes because the funds were not traceable to the unpaid withholding taxes. However, where the person was a responsible person when the duty arose, *Slodov* does not apply and the person's decision to use funds for other purposes with constitute willfulness.³⁶²⁷

Another variation of the reasonable cause defense (although it blends into the issue of whether the person had the requisite control) is the “boss told me not to pay” defense. If the person is otherwise a responsible person, this defense will be unavailing.³⁶²⁸

e. Exception for Unpaid Volunteers to Charities.

Persons serving as unpaid volunteers for tax-exempt organizations are exempted from the TFRP if they meet the following conditions: (1) serve solely in an honorary capacity; (2) do not participate in the day-to-day business or financial operations of the charity; and (3) do not have

³⁶²⁵ *Erwin v. United States*, 591 F.3d 313, 326 n. 8 (4th Cir. 2010) (citing *Thosteson v. United States*, 331 F.3d 1294, 1301 (11th Cir. 2003), *Logal v. United States*, 195 F.3d 229, 233 (5th Cir. 1999), and *Greenberg v. United States*, 46 F.3d 239, 244 (3d Cir. 1994) (“It is no defense that the corporation was in financial distress and that funds were spent to keep the corporation in business with an expectation that sufficient revenue would later become available to pay the United States.”). See also *Winter v. United States*, 196 F.3d 339 (2d Cir. 1999).

³⁶²⁶ *Newsome v. United States*, 421 F.2d 215 (5th Cir. 1970); see also *Conway v. United States*, 647 F.3d 228 (5th Cir. 2011). A good summary of the circuit split on this issue is contained in *Bell v. United States*, 355 F.3d 387, 398 n. 8 (6th Cir. 2004).

³⁶²⁷ *Oppliger v. United States*, 637 F.3d 889 (8th Cir. 2011).

³⁶²⁸ *Myers v. United States*, 923 F.3d 935 (11th Cir. 2019) (rejecting the defense even if the nonpayment was directed by a government agency (there the SBA)).

actual knowledge of the trust fund tax delinquency.³⁶²⁹ This important exception does not apply, however, “if it results in no person being liable” for the TFRP.³⁶³⁰

The statute has not yet been fleshed out but consider this example. Suppose A, a prominent citizen of the community and, more importantly to the IRS, a very wealthy citizen of the community, serves on a charity’s board of directors in an honorary capacity,³⁶³¹ does not perform day-to-day or financial duties, but the facts are cloudy as to what A may have known about the charity’s delinquency in trust fund taxes. The president is clearly liable, since he was the principal participant in the decisions as to who got paid. The president asserts that he kept the board fully aware of the delinquency. A asserts that he was not aware of the delinquency. The board minutes are inconclusive. Everyone potentially liable for the tax except A has no money, so the IRS has no incentive to assert the TFRP against anyone but A. In this case, the IRS may well assert liability against A since he may fail the third test in the statute. What if A can show that he did not have actual knowledge of the trust fund tax delinquency, so that he meets all of the three numbered conditions of the statute? Is the IRS left holding the bag because the president, who is clearly liable, can’t pay but A who can pay meets the three conditions of the statute? The IRS may then try to invoke the savings clause in the flush language of the statute. How?

The IRS may choose not to assert the liability against the president. The IRS is not required to assert the TFRP against any person potentially or even actually liable. May the IRS assert the tax only against A and then rely upon the flush language of the statute to assert that § 6672(e) cannot help A because to hold otherwise no one would be liable for the TFRP? Can A invoke the protection of § 6672(e) by urging that the president was clearly liable (under these assumed facts, he was) and liability—not assertion of the liability by the IRS—is all that the statute requires? I don’t know the answer to the question, but I suspect that, given the purpose of the statute to give volunteers some relief from liability and comfort with respect thereto, a court would so hold.³⁶³²

3. Administrative Procedures.

a. Audits and Appeals.

When trust fund taxes are delinquent, the IRS’s first move is against the employer. If the IRS is unable to shake out payment from the employer in fairly short order, the IRS will conduct an investigation to determine whether the TFRP should apply. Unlike income and estate and gift tax examinations, the TFRP is investigated by a Revenue Officer who is already involved in the unsuccessful effort to collect the money from the corporation. The investigation will involve review

³⁶²⁹ § 6672(e). This statutory language is, of course, controlling, but I do note that it is restated in the IRS policy statement P-5-14 which deals with trust fund taxes. See IRM 1.2.1.6.3 (06-09-2003), Policy Statement 5-14 (Formerly P-5-60), Trust Fund Recovery Penalty Assessments.

³⁶³⁰ Id. (flush language).

³⁶³¹ Query whether members of a board, whether charitable or not, can really serve in an honorary capacity. They may serve without compensation and the position may be an honor, but a director position also carries with it considerable fiduciary obligations to the charity.

³⁶³² In this regard, in an analogous context involving the relief provision for contribution among jointly and severally liable responsible persons (§ 6672(d)), the statute imposes the contribution liability upon all persons “liable” whether or not the IRS chose to make an assessment against them. The same type of statutory language based on liability and not assessment is used in § 6672(e).

of corporate records (e.g., corporate documents such as articles of incorporation, by-laws and minutes to see who has authority and checks to see who had check signing authority) and interviews of the persons in a position to observe the acts that would give rise to liability.

A key part of the investigation will be interviews of the persons either potentially liable for the TFRP or who were in a position to observe such persons. The interviews will be conducted in the format of Form 4180, Report of Interview With Individual Relative to Trust Fund Recovery Penalty or Personal Liability for Excise Taxes, which the revenue officer will complete and ask the interviewee to sign.³⁶³³ Alternatively, the revenue officer may permit the interviewee to complete and sign the Form. If the interviewee declines to either submit to the interview or complete and sign the form, the revenue officer may summons the interviewee to appear and answer the questions subject to any privileges the person may assert. Since the information thus gathered (whether by form or interview) could be evidence potentially damaging to the person interviewed, the person will want to make sure that (i) the answers are fair and in that sense truthful, for the answers are given subject to potential criminal penalties for falsehoods,³⁶³⁴ and (ii) states his case to avoid the penalties in the best way to mitigate the possibility the IRS will assert the TFRP against the person.³⁶³⁵

Upon conclusion of the investigation, the IRS will have identified at least one person potentially liable for the TFRP. After the Group Manager has approved the proposed assessment, the IRS must issue a notice of proposed assessment to each person so identified.³⁶³⁶ The notice gives

³⁶³³ Although I would like to think that most revenue officers would not add information to the Form 4180 after the defendant signed without the interviewee initialing, it probably would be the better part of wisdom for the interviewee to immediately copy it and have the Agent to whom it is delivered initial and date his initials on the Form so that there is a control copy of the Form as submitted to the IRS. I have seen one criminal case where the defense attorney raised the possibility that information may have been added after the person signed. For a good discussion about dealing with the Form 4180, see Frank Agostino and Caren Zahn, How to Complete IRS Form 4180-Report of Interview with Individual Relative to Trust Fund, Agostino & Associates Monthly Journal of Tax Controversy (January 2017).

³⁶³⁴ The Form itself does not have a penalty of perjury jurat, saying instead: "I declare that I have examined the information given in this interview and to the best of my knowledge and belief, it is true, correct, and complete." The statement thus could still be subject to the perjury-like criminal provision for false statements, 18 U.S.C. § 1001, or framed in a criminal proceeding as some type of attempt to impair or impede the lawful functions of the IRS subject to prosecution under § 7212(a) or 18 U.S.C. 371, the defraud conspiracy. And these criminal penalties could apply even if the person does not sign the Form but provides the false information some other way.

³⁶³⁵ The revenue officer may also request the person to complete a Form 433-A, Collection Information Statement for Wage Earners and Self-Employed Individuals, which would be a tip off that the person is likely to be assessed the penalty. The Form 433-A usually comes later in the process, but some are collected earlier.

³⁶³⁶ See IRM 5.7.4.7 (06-29-2017), Notification of Proposed Assessment. The notice is required by § 6672(b)(1) and is given by Letter 1153. The notice is given by mailed notice or personal service. The proper mailing of the notice to the taxpayer's last known address meets the notice required of § 6672(b)(1), even if the taxpayer does not receive the notice. *Mason v. Commissioner*, 132 T.C. 14, 29 (2009); and *Hickey v. Commissioner*, T.C. Memo. 2009-2. The taxpayer may waive issuance of this notice which, as with a 30-day letter, allows the IRS to make the assessment immediately. The Form for waiver is Form 2751. In *United States v. Rozbruch*, 621 Fed. Appx. 77, 2015 U.S. App. LEXIS 19223 (2d Cir. 2105), a nonprecedential decision, the Second Circuit ducked the issue of whether the TFRP under § 6672 is a penalty subject to the § 6751(b)(1) written supervisor approval requirement and held, instead, that, even if subject to that requirement, the procedures required for TFRP approval "functionally satisfied" the requirement. Accord *Blackburn v. Commissioner*, 150 T.C. 218 (2018).

For internal guidance as to the notice and, in CDP cases, confirming that proper notice was given, see PMTA 2009-163 (12/18/09). Taxpayers and their practitioners considering signing a form 2751 should consider carefully *Moore v. United States*, 648 F.3d 634 (8th Cir. 2011), which holds that the signing of the Form 2751 permits the IRS in a

(continued...)

the person the opportunity to invoke an administrative appeal to the IRS Appeals Office by filing a protest.³⁶³⁷ This appeal is similar to the appeal that can be taken from 30-day letters discussed above in the context of income and estate and gift taxes.³⁶³⁸ The statute of limitations otherwise applicable does not expire before the later of 90 days after the date of the notice or, if the person files a protest to pursue an appeal, 90 days after the final determination on the appeal.³⁶³⁹

The TFRP liability may get to Appeals in other ways as well. For example, it can get to Appeals in the following ways: (i) before assessment, on an agreement for Fast Track Mediation,³⁶⁴⁰ after a jeopardy assessment,³⁶⁴¹ and (ii) after assessment, upon request for abatement or claim for refund.³⁶⁴²

The standard collection procedures are available for TFRP assessments. The IRS can use the IRS summons to locate assets, the IRS can levy on assets, the IRS can file a tax lien to protect the IRS's interests in the taxpayer's assets, the IRS can file nominee liens, etc. Also, the IRS may enter installment agreements or OICs with either the employer or the person who has been assessed the TFRP. However, if the IRS receives an OIC from the employer, in assessing the adequacy of the offer based on doubt as to collectibility, the IRS will consider its collection alternatives from persons liable for the TFRP.³⁶⁴³ Moreover, if the IRS compromises the underlying liability, it seems that the TFRP could not apply to the amount abated pursuant to the compromise.

I discuss below that, by filing a refund suit for a portion of a TFRP assessment, the IRS may be prohibited from levying for the unpaid TFRP.

³⁶³⁶(...continued)

subsequent responsible person case to admit the Form, not for its conclusive effect on the issue of whether the person is liable but, apparently (it is not a tightly reasoned opinion), to show that the person believed he was a responsible person at the time he or she signed the Form 2751. I think the Court is flat wrong on that one, but I suspect the error will be perpetuated.

Although proper sending—regardless of receipt—of the notice establishes its validity for purposes of § 6672(b), it is not considered a prior opportunity to contest liability in a subsequent CDP proceeding unless the notice was received (or receipt was refused by the person). § 6330(c)(2)(B); *Mason v. Commissioner*, 132 T.C. 14, 28-30 (2009).

³⁶³⁷ The right to file a protest is implicit in § 6672(b)(3)(B) which extends the assessment statute of limitations upon the filing of a protest to the notice through the date 30 days after the final determination with respect to the protest. See *Romano-Murphy v. Commissioner*, 816 F.3d 707 (11th Cir. 2016), on remand, *Romano-Murphy v. Commissioner*, 152 T.C. 278 (2019); see also IRM 8.25.1.7.2 (12-07-2012), Pre-assessment (TBOR2) Appeals.

³⁶³⁸ For procedures related to TFRP appeals, see Rev. Proc. 2005-34; 2005-24 I.R.B. 1.

³⁶³⁹ § 6672(b)(3)(B). For a case where the protest was not acted upon for some unexplained reason so that the IRS made the assessment 8 years later, the Court held that the statute was suspended during the period. *United States v. Wilson*, 2016 U.S. Dist. LEXIS 75137 (E.D. Mich. 2016).

³⁶⁴⁰ IRM 8.25.1.7.1 (09-11-2018), Fast Track Mediation (FTM).

³⁶⁴¹ IRM 8.25.1.7.3 (12-07-2012), Jeopardy Assessment Redetermination Proposal.

³⁶⁴² IRM 8.25.1.7.4 (12-07-2012), Post-assessment Appeals.

³⁶⁴³ IRM 5.8.4.22.1 (09-24-2020), Trust Fund Liabilities.

b. Assessments and Predicates.

The TFRP is an “assessable penalty” under § 6671(a).³⁶⁴⁴ Unlike income and estate and gift taxes, it requires no predicate notice that gives the taxpayer a pre-payment litigation forum in the Tax Court. Instead, as an assessable penalty, the only predicate to the assessment is that the IRS notify the putative responsible person of the proposed assessment by mail to the last known address or in-person delivery at least 60 days prior to the assessment.³⁶⁴⁵ As I discussed before, this assessment scheme forces litigation about the liability into forums other than the Tax Court, except for CDP proceedings. Finally, a question has arisen but not yet resolved as to whether the TFRP is a penalty subject to § 6751(b)(1)’s requirement that the proposing officer’s immediate superior approve in writing or whether, as a collection mechanism for the underlying trust fund tax, it is not a penalty (though nominated a penalty in the statute).³⁶⁴⁶

c. Statute of Limitations.

The statute of limitations on assessment of the TFRP is established by the statute of limitations on assessment of the employer’s underlying trust fund taxes.³⁶⁴⁷ The statute is thus 3 years if the employer filed a nonfraudulent return and forever if the employer did not file a return or filed a fraudulent return.³⁶⁴⁸ If, having filed a nonfraudulent return, the employer extends the statute of limitations on assessment or collection of the trust fund tax liability, the TFRP statute is not extended. In addition, if the employer obtains an installment agreement with respect to the trust fund taxes, the statute for assessing the TFRP or collecting from the person assessed is not extended.³⁶⁴⁹ Where the statute on the TFRP is in jeopardy, the IRS may request that the putative responsible person execute a consent to extend the statute of limitations on assessment of the TFRP.³⁶⁵⁰

³⁶⁴⁴ Although named a penalty in the § 6672, an issue has arisen whether it is a penalty as opposed to a secondary collection mechanism for the underlying tax. In any event, for present purposes it is “assessable” meaning that there is no predicate requirement such as a notice of deficiency for income tax.

³⁶⁴⁵ § 6672(b). Like the notice of deficiency, if the notice is by mail, the requirement is that the notice be mailed to the last known address, not that the taxpayer have received the notice. *Hickey v. Commissioner*, T.C. Memo. 2009-2.

³⁶⁴⁶ *Blackburn v. Commissioner*, 150 T.C. 218 (2018) (noting the issue but not resolving it); *United States v. Rozbruch*, 28 F. Supp. 3d 256 (S.D.N.Y. 2014) (holding not a penalty for purposes of § 6751(b) but on appeal, the Second Circuit ducked the issue, *United States v. Rozbruch*, 621 Fed. Appx. 77, 2015 U.S. App. LEXIS 19223 (2d Cir. 2105); and CCN 2018-006 (6/6/18) (IRS position is that it is not a penalty subject to § 6751(b)).

³⁶⁴⁷ The IRS earlier had taken the position that there was no statute of limitations for the TFRP, but the position had been rejected in *Lauckner v. United States*, 68 F.3d 69 (3d Cir. 1995). The IRS subsequently modified its position. A.O.D. 1996-06, 1996-2 C.B. 1. See IRM 5.19.14.2.2 (08-03-2018), Trust Fund Recovery Penalty Statute of Limitations (“The general rule is that an assessment of tax must be made within three years from the date a return is filed or the due date of the return, **whichever is later.**”).

³⁶⁴⁸ This is the IRS’s position. ILM 200532046 (6/30/05), reproduced at 2005 TNT 156-12. Accepting the logic of the position that an employer’s qualification for the normal three statute applies also to persons liable for the TFRP, it would follow that where the employer’s statute is extended or unlimited, the statute for persons liable for the TFRP would be extended or unlimited also.

³⁶⁴⁹ Indeed, an installment agreement with the employer does not prevent the IRS from collecting against the party otherwise liable for the TFRP. The IRS may voluntarily withhold collection, but that is a separate decision the IRS makes based on all the facts and circumstances.

³⁶⁵⁰ The consent form is Form 2750. Failure to execute the Form upon request may result in the prompt
(continued...)

The statute of limitations is suspended upon the mailing of the notice required before assessment from the date of the notice through the later of (i) 90 days after the date of the notice or (ii) if the taxpayer makes timely protest, 30 days after the IRS makes its final administrative determination.³⁶⁵¹ There is, of course, an exception for jeopardy.³⁶⁵²

4. IRS Policy to Collect Only Once.

The IRS's policy is to collect only once the underlying trust fund tax that should have been paid over.³⁶⁵³ In this sense, the TFRP might be viewed simply as a collection mechanism for the unpaid underlying trust fund taxes rather than a true penalty imposed to the full extent on each responsible person.³⁶⁵⁴ Literally read, § 6672 could impose the delinquent trust fund tax upon the employer and each responsible person so that the IRS could theoretically collect the trust fund tax amount more than once and indeed could pursue the TFRP even if the corporate taxpayer paid the trust fund tax delinquent.³⁶⁵⁵ Obviously, to the extent that imposition of civil punishment has a deterrent effect, the imposition of the TFRP on each responsible person would have the maximum deterrent effect. But, as interpreted, the IRS only collects the trust fund tax delinquency once and can collect from any available source – the employer or the persons subject to the TFRP. This

³⁶⁵⁰(...continued)

assessment of the TFRP with as complete an investigation and consideration of defenses as would otherwise be available. Contrary to normal income tax cases, it is generally in the person's favor to execute a consent because, until assessment, the taxpayer is only liable for the principal of the trust fund taxes and interest accrues as to him only after the TFRP is assessed. Postponing the assessment date thus works affirmatively in the person's favor.

³⁶⁵¹ § 6672(b)(3).

³⁶⁵² § 6672(b)(4).

³⁶⁵³ See Policy P-5-14.7, IRM 1.2.1.6.3 (06-09-2003), Policy Statement 5-14 (Formerly P-5-60), Trust Fund Recovery Penalty Assessments. The policy is recognized in cases, and the courts appear willing in some cases to hold the IRS to the policy where it seems to be deviating from it or has through its own inattention impaired the proper functioning of the policy. For example, in *Cheatle v. United States*, 589 F. Supp. 2d 694 (W.D. Va. 2008), one of the responsible persons settled his liability by paying a portion of the TFRP and, after time during which that person could have sued for refund of the amount he paid, the IRS erroneously refunded the TFRP he paid. The IRS sued to recover the erroneous refund, but in its collection activity never gave Cheatle, another responsible person, credit for the TFRP the other person paid and the IRS erroneously refunded. The Court discussed the collect only once policy, and stated that, except for the IRS's screw-up in refunding the amount to the other person, Cheatle would be entitled to reduce his liability under this policy. The Court therefore ordered the IRS to abate the amount of the benefit Cheatle would have received except for its screw-up. In discussing the collect only once policy, the Court read a Fourth Circuit precedent as implicitly holding that, as a matter of law, the IRS is entitled to collect only once, citing *United States v. Pomponio*, 635 F.2d 293, 296 (4th Cir. 1980).

³⁶⁵⁴ *United States v. Huckabee Auto. Co.*, 783 F.2d 1546, 1548 (11th Cir. 1986). Although courts frequently state that the liability is not a penalty, it does have certain penalty-like characteristics—e.g., it is not deductible and it is not dischargeable in bankruptcy. For very good discussions of whether the TFRP is a penalty, see *Mortenson v. National Union Fire Insurance Co.*, 249 F.3d 667 (7th Cir. 2001) (Posner J.); and *Duncan v. Commissioner*, 68 F.3d 315, 318 (9th Cir. 1995) (despite the IRS's administrative largesse of collecting the trust fund tax only once from any of its sources (the employer and through the TFRP), the TFRP itself functions as penalty).

³⁶⁵⁵ *Duncan v. Commissioner*, 68 F.3d 315, 318 (9th Cir. 1995) (the IRS policy of collecting once is a matter of administrative largesse rather than a statutory requirement which would permit overcollection of the trust fund taxes through each responsible person's several liability for the entire trust fund tax). So, as the court noted, if the IRS asserted the TFRP and then the corporate employer paid the trust fund tax, the statute would permit the IRS to collect the TFRP. Indeed, one might even stretch this further, Say, the corporate employer reports trust fund tax of \$20,000 for the 1st quarter of year 01, but failed to pay it. After investigating, the corporate employer pays the trust fund tax and related penalties and interest. The IRS, in theory, might be able to assert the TFRP against the responsible officers. The words of the statute clearly impose the penalty at the time of failure to collect and pay over.

collection of the tax only once (either from the employer or the responsible persons) means that the TFRP really functions as a collection mechanism rather than a penalty.

Hence, if the employer itself can and does pay the delinquent trust fund tax, the IRS will not proceed against those who were technically liable under § 6672 at the point that the tax became delinquent. Savvy persons potentially liable under § 6672 after using the trust fund tax for other cash flow needs will try to cause the employer to pay the trust fund taxes before finally going under. Often, however, the employer will have nothing left to pay those trust fund taxes.

Where the IRS is having difficulty collecting from the employer (which is, of course, the incentive to the IRS to assert the TFRP), a typical strategy adopted by a person against whom the IRS asserts the TFRP is to point the finger at other persons within the employer's organization so that the IRS (the pointer hopes) will collect from the pointees rather than the pointer. The pointer may even help the IRS locate assets of the pointees in the hope that the IRS will levy against them first. If this strategy is successful and the IRS succeeds in collecting the trust fund tax from one of the pointees, the pointer may successfully avoid his own liability to the IRS for the TFRP.³⁶⁵⁶ To properly assess this opportunity for a pointee, you must understand the further nuances discussed in the balance of this section.

The IRS's policy to collect only once requires that it pay careful attention to the administrative issues in the implementation of the policy, so that, if possible, it does collect at least once. For example, the IRS may work out an installment plan with the employer to pay the unpaid trust fund taxes over a period of time that extends beyond the expiration of the statute of limitations for assessment of the TFRP. The IRS's policy statement says that, "Absent statute considerations," normally it will not pursue the TFRP during the period the installment agreement is in effect with and being honored by the employer.³⁶⁵⁷ But, if the installment period extends beyond the statute of limitations, the IRS may assert the TFRP protectively to guard against the possibility that the employer may default on the installment agreement.

The statute of limitations may require that the IRS take other protective actions. Consider this example: within the normally applicable 3 year limitations period for assessment, the IRS determines that A and B are liable for the TFRP. A has resources that may easily be tapped by the IRS to pay the full trust fund tax delinquency. B has some resources, but they are not easily tapped (e.g., more than adequate equity in an expensive home). Since the IRS can, if it chooses, proceed only against one of them even though both are "liable," can or will the IRS assert the TFRP only against A and collect from A? All other things being equal, that might be a good strategy for the IRS so as to limit the unnecessary expenditure of its resources to pursue B. But think about it. A may bring a refund suit within the applicable refund period of limitations (2 years from the date of payment). If the assessment against A was made at the end of the 3 year statute of limitations and A instituted his refund remedy after the 3 year statute of limitations closed on assessment, the IRS would be at risk that A would prevail in the refund remedy and then be unable to assess against B. So, the IRS will protectively assess against B, although it may—but need not—withhold collection

³⁶⁵⁶ The pointer may be subject to the right of contribution discussed below.

³⁶⁵⁷ Policy P-5-14.7, 1.2.1.6.3 (06-09-2003), Policy Statement 5-14 (Formerly P-5-60), Trust Fund Recovery Penalty Assessments.

until A's refund statute of limitations has expired or, if A pursues a refund, A's potential for recovery has been denied with finality.

What if the IRS assesses against both A and B and thereafter collects the entire amount from A or even collects from the employer under an installment plan? Under the collection only once policy, the unpaid assessments against B or against A and B, respectively, should be abated. If the employer paid, of course, the employer will be entitled to no refund or, if it were entitled to a refund, that would mean it was not liable for the tax and the responsible persons would not be liable for the tax. So, upon payment or even partial payments by the employer, the assessments against A and B could be abated as appropriate. But, if the IRS collects only from A, it will have to postpone any abatement of B's assessment until A cannot pursue refund or has failed in the pursuit of a refund.

What happens if the IRS collects from both A and B and the amount collected exceeds the amount of the delinquent trust fund tax? Clearly, under the collection only once policy, someone is entitled to a refund. First, because of the statute of limitations problems noted above, the IRS will not make any refund until it is clear that the statute of limitations on either A or B, respectively obtaining a refund or they have litigated and lost.³⁶⁵⁸ Once it is clear that the IRS is entitled to retain the TFRP paid in the amount of the underlying trust fund tax, it is clear that any excess collected must be refunded. To whom should it be refunded? The IRS's policy is to refund the excess to the person whose payment created the excess.³⁶⁵⁹ Thus, for example, if the IRS collected in full first against A and then against B, once A may no longer claim a refund, the excess payment will be refunded to B because B's payment created the excess. Is this fair? We discuss below A's right of contribution if A disproportionately pays the trust fund tax, but it is clear that, in the administration of the tax laws, the IRS may adopt this methodology for determining to whom it pays the refund. We should note that the IRS interprets the IRM instructions to refund the excess to the person whose payment created the excess as permissive and not necessarily mandatory, so that presumably in appropriate cases, some other method of refund might be appropriate.³⁶⁶⁰

From the foregoing examples, you can see that the statute of limitations may force the IRS to proceed against a responsible person when it is possible that, with a little more time, the IRS may be able to collect against the employer or even against another putative responsible person. The person may want to attempt to negotiate with the IRS the use of an extension of the assessment limitations period against him in the hopes that the IRS's need to assess the tax against him will be mooted by payment by someone else.³⁶⁶¹

Because of the policy to collect only once, a taxpayer against whom the TFRP has been asserted may request and receive from the IRS the following information despite the general rule that taxpayer return information may not be disclosed: (1) the name of any other person against whom the TFRP has been asserted; and (2) the general nature of the IRS's collection efforts, if any,

³⁶⁵⁸ FSA 199904032, 1999 TNT 20-64 (2/1/1999).

³⁶⁵⁹ IRM 5.19.14.3.8 (08-03-2018), Resolving TFRP Overpayment Cases.

³⁶⁶⁰ See FSA 199904032.

³⁶⁶¹ The Form for extending the time to assess the TFRP is Form 2750, Waiver Extending Statutory Period for Assessment of the Trust Fund Recovery Penalty.

against such other person(s) and the amount collected.³⁶⁶² Obviously, a person who has been assessed the TFRP might find this information useful in assessing his economic exposure and taking certain strategic action. For example, let's assume that A and B have been assessed the TFRP, that both are clearly liable for the tax, and that, after making the assessments, the IRS has fully collected against A. Armed with the information that the IRS has collected from a clearly responsible person, B may be able to stave off collection attempts by the IRS, subject to any action the IRS feels it needs to take to ensure that A does not successfully pursue a refund claim. Even if the IRS were to feel that it must protectively collect against B, B might consider his ultimate exposure in light of the IRS's one collection policy which generally allows the IRS to refund to the person whose payment created the excess payment.

5. Collection Against Employer.

There is no requirement that the IRS first pursue all collection measures against the employer before asserting the TFRP. Of course, if the employer has readily available assets, the IRS will use its collections tools to collect from the employer, so that, given the collection only once policy, that will practically absolve the persons subject to the TFRP.

But the employer may have reached an installment agreement or have invoked a CDP remedy which would suspend IRS collection measures. There is no prohibition against the IRS asserting or attempting to collect the TFRP from a responsible person while the employer's installment agreement or CDP remedy is pending.³⁶⁶³ Of course, the person against whom the IRS asserts the TFRP may have his or her own CDP remedies.

6. Litigating the TFRP.

a. The Traditional Procedure - The Refund Suit.

(1) Procedural Predicates.

The TFRP is generally litigated in refund suits in either the district court or Court of Federal Claims.³⁶⁶⁴ There is no notice of deficiency assessment predicate that would give the person a "ticket to the Tax Court" for preassessment review in TFRP cases. Denial of preassessment review in the Tax Court can have a harsh effect, because traditionally it relegated the person to post-assessment review processes (the refund suit or the collection suit). The *Flora* rule requires in tax refund suits that the tax must be fully paid before the taxpayer may file a refund suit. It is not unusual for trust fund penalties to be quite large and thus prohibitive if the *Flora* rule were to apply full bore. Fortunately, the due process issues—and certainly general fairness issues—that might otherwise inhere in the full bore application of the *Flora* rule are avoided by two procedural techniques—one statutory

³⁶⁶² § 6103(e)(9); see IRM 11.3.2.4.14 (02-07-2022), Trust Fund Recovery Penalties

³⁶⁶³ *Bletsas v. Commissioner*, T.C. Memo. 2018-128; and IRM 5.1.9.3.7 (08-27-2021), Conducting the Trust Fund Recovery Penalty (TFRP) Investigation while Case in Appeals ("Since the statutory period of limitations for assessing the TFRP is not suspended while the CDP/EH hearing is pending, the TFRP investigation should continue unless the RO has a reasonable expectation of the account being fully satisfied.").

³⁶⁶⁴ As noted earlier, refund suits have a predicate claim for refund requirement. The claim for refund of the TFRP is the Form 843, Request for Refund and Request for Abatement.

and the other non-statutory—that permit the putative responsible person to litigate the liability without payment of the entire amount. (I discuss the below opportunity to litigate the TFRP in CDP cases; that opportunity is post-assessment but while at least some portion of the assessment is unpaid.)

The key to these refund techniques is the divisible tax concept discussed earlier beginning p. 586. Recall that the *Flora* rule requires full prepayment of the tax liability. The concept for the TFRP is that it is the same as the underlying tax liability for withholding (both the income tax withholding and the employee's share of FICA withholding). These tax liabilities are, in tax concept, divisible taxes³⁶⁶⁵—individual liabilities for each employee for each quarter. They are not aggregated for all employees for the quarter. Accordingly, under this concept, *Flora* only requires that the putative responsible person prepay the income tax withholding and FICA tax liability for one person for the quarter to contest whether the putative responsible person was a responsible person for that quarter.³⁶⁶⁶ In many cases, this amount will be less than \$100. Where the records are available to the putative responsible person, the actual minimum liability for the quarter can be determined precisely. However, because it is often difficult for the putative responsible person to know precisely the amount for the lowest paid employee, an estimate will suffice but, since the prepayment of at least one minimal amount is jurisdictional the estimate should err on the side of caution (i.e., ramp up the amount to be certain that at least one employee's divisible tax will be covered).³⁶⁶⁷ It is important in making the payment to designate the payment as completely as possible (e.g., trust fund FICA for one named employee, if possible—unnamed employee if not possible—for the 1st quarter of 2005).³⁶⁶⁸

As noted in discussing the divisible tax concept, this technique to use a partial payment is useful only if the IRS does not collect on the unpaid balance during the pendency of the refund suit. The first statutory technique in is in the TFRP Code section. Section 6672(c) provides, in part relevant to the fairness issue presented by the prepayment rule, that the taxpayer may pay the amount required for one person (“not less than the minimum amount required to commence a proceeding in court with respect to his liability for such penalty,” which as I noted above may be precisely calculated or is sometimes estimated), file a claim for refund (the predicate to a refund suit) and furnish a bond for the balance. Collection measures will then be suspended pending the resolution of the claim for refund and any suit for refund if the IRS does not act on the claim for refund in a way satisfactory to the putative responsible person. If a refund suit is filed, the IRS will counterclaim

³⁶⁶⁵ § 6331(i)(2).

³⁶⁶⁶ E.g., *Godfrey v. United States*, 748 F.2d 1568, 1573 (Fed. Cir. 1984).

³⁶⁶⁷ IRM 8.25.1.7.4.2 (10-14-2014), Request for Refund Claim (stating as a predicate to filing claim for refund that the “taxpayer” (i.e., the putative responsible person) pay the tax for one individual for each applicable period. The IRM further says (boldface added): “**If the amount required cannot be accurately determined, the Service may accept a representative amount.**” Historically, the presumption has been that a minimal amount such as \$100 or \$200 would do the trick, and the DOJ attorneys have usually not contested the amount. However, you should keep in mind that the DOJ attorneys will have access to the underlying records from which a precise determination can be made and might easily spot that the estimated amount paid does not cover the lowest paid employee. Anecdotal information I have received is that DOJ lawyers are becoming more diligent about ensuring the minimum prepayment. Practitioners should read *Vir v. United States*, 2016 U.S. Claims LEXIS 104 (Fed. Cl. 2014) (denying payment of \$100 per quarter in issue where the taxpayer made no apparent effort to show that \$100 was sufficient for one employee per quarter); and *Kaplan v. United States*, 2014 U.S. Claims LEXIS 24 (2014) (where the taxpayer made good faith effort to show that \$100 was sufficient for one employee per quarter).

³⁶⁶⁸ The IRS should post a voluntary payment as designated by the taxpayer. Rev. Proc. 2002-26, 2002-1 C. B. 746.

for the uncollected balance of the assessment so as to resolve in one proceeding the taxpayer's liability for all employees for all quarters involved.

The second—and more easily available—statutory technique applies for some (but not all) divisible taxes, including the TFRP. Section 6331(i) precludes a levy during any period that a proceeding contesting the liability for a divisible tax if the proceeding would be preclusive via claim preclusion (*res judicata*) or issue preclusion (collateral estoppel) for the unpaid tax liability. The precise scope of claim preclusion and issue preclusion levy relief provision may be uncertain,³⁶⁶⁹ for example, where the taxpayer pays for one employee for one quarter and the Government has made assessments for other employees or for other quarters where the facts may be materially different. Technically, until and unless the Government counterclaims, the proceeding might not be preclusive as to the other quarters, although arguments could be made that, depending upon the facts, it might be. But the Government usually does counterclaim, so the judgment in the case will be preclusive under concepts of claim preclusion or issue preclusion.³⁶⁷⁰ Injunctions are available for violation of this prohibition, despite the general rule that injunctions are not available in tax matters.³⁶⁷¹

There is still another technique, albeit non-statutory, for suspending collection activity while the case is pending, although its continuing need is probably pre-empted by § 6331(i). The putative responsible person first meets the *Flora* rule by paying for one employee for one of the quarters involved (this can be actual or a reasonable estimate). As in the statutory avenues, the Government will then counterclaim for the uncollected balance. The taxpayer through his counsel will ask (politely) the DOJ Tax attorney handling the case to request that the IRS not pursue collection measures while the putative responsible person's liability for the tax is being litigated. The IRS will honor the request so long as ultimate collection of the tax is not in jeopardy (a term of art that we encountered above which does not mean that the IRS is risk free, but that means the taxpayer is not doing something affirmatively to prevent the IRS from collecting).³⁶⁷²

I caution readers that the Government has taken the position that, a person subject to multiple quarter TFRP assessments must pay the minimum amount for each quarter rather than just one

³⁶⁶⁹ See discussion of claim preclusion (*res judicata*) and issue preclusion (collateral estoppel) beginning at p. 648.

³⁶⁷⁰ One way to invoke § 6331(i) with more certainty is to pay the minimum amount (say \$1000) for each quarter that the TFRP is asserted rather than just for one of the quarters. That way the Government will have to counterclaim rather than holding back to litigate the other quarters in some other case and perhaps some other court. See e.g., *Beard v. United States*, 99 Fed. Cl. 147 (2011).

³⁶⁷¹ § 6331(i)(4)(A) & (B) (prohibiting a levy or collection proceeding and permitting an injunction for violation of the provision but allowing the Government to counterclaim in the original proceeding). In *Beard v. United States*, 99 Fed. Cl. 147 (2011), the alleged responsible person paid \$100 for each quarter and sued for refund in the Court of Federal Claims. The U.S. counterclaimed for the balance but then sued that person and another in local district court seeking to resolve liability of both alleged responsible persons in a single proceeding which could not be done in the Court of Federal Claims. The Court of Federal Claims granted an injunction under this provision, holding that the suit by the United States in the district court was a “collection proceeding.”

³⁶⁷² IRM 1.2.1.6.4 (03-01-1984), Policy Statement 5-16, Forbearance when reasonable doubt exists that assessment is correct; see *USLife Title Insurance Co. v. United States*, 784 F.2d 1238, 1243 (5th Cir. 1986); and *Brown v. United States*, 591 F.2d 1136, 1143 (5th Cir. 1979).

quarter as discussed in the preceding paragraph.³⁶⁷³ In that case, the Court of Federal Claims declined to decide the issue because it could resolve the case on other issues. This issue is very important because, if the Government's argument is valid, it represents a radical departure from convention in TFRP refund suits where such suits could be commenced with payment for only one quarter, with the Government then counterclaiming for the balance in that one quarter and for the other quarters.³⁶⁷⁴

I further caution readers that the minimum payment must be made and the taxpayer must be prepared to prove it. In the past, practitioners have assumed that perhaps a payment of \$100 for a quarter would be deemed sufficient even if they did not have access to the records to show that it covered the trust fund liability for one employee. The Government has indicated that it may put the taxpayer to proof on this issue. So, if the taxpayer is estimating in making the payment, estimate on the high side.

(2) The Litigation.

TFRP cases are fun—at least they are fun for litigators who like litigation (some claim the skill but really don't like litigation). The law is reasonably settled. The inquiry is into a range of facts and circumstances, in which litigating skills and advocacy are more likely to influence the outcome. In the district court, either party may demand a jury to resolve the fact questions of liability (responsibility and willfulness). The litigator is, of course, locked in by facts, but how he or she presents the facts—how he or she weaves the tapestry—can influence the outcome. Of course, the client may have a lot at stake in the litigation and may not view it with as much fun as the litigator.

In TFRP litigation in the district court, the person can usually have a real live jury, a judge who has little interest in tax cases (although the judge will probably prefer the facts and circumstances issues of TFRP liability to the more arcane issues of the tax law) and a much less genteel venue than found in the Tax Court. Contrary to litigation in the Tax Court, rules of procedure and evidence really do matter (or at least matter more). And you will get instant feedback from the jury—which is not so great when you lose (although, as your parents taught you, you learn even when you lose).

(3) Counterclaims and Other Parties.

If the refund litigation is pursued in the district court, the Government will counterclaim against the plaintiff for any amounts unpaid on his or her TFRP assessment and will seek, if possible, to join all persons against whom it has assessed the TFRP to resolve the issue of those responsible in one proceeding. In some of these cases, the Government may assume the role of a stakeholder asserting that at least one of the persons in the case is liable for the TFRP and then let those persons duke it out with the traditional defense that someone other than me is liable for the TFRP. Usually, however, the Government will take a more active position in which it will seek to

³⁶⁷³ *Roseman v. United States*, 2013 U.S. Claims LEXIS 2 at fn. 4 (2013) (“Defendant argues that payment must be made for one employee for each of the periods involved. Given the facts presented, this court need not address this argument.”)

³⁶⁷⁴ Readers wanting to pursue this issue might desire to retrieve the Government's memorandum on motion to dismiss, pp. 12-13.

establish TFRP liability for all the persons it assessed (remember, the more persons that are liable, generally, the more likely the Government will collect). Depending upon the number of parties joined in the litigation, it can be somewhat of a free for all (at least as trials go), unless the judge keeps tight rein on counsel for the parties.

Further, although it is the Government who usually seeks to join other persons it alleges are subject to the penalty, the plaintiff in the refund litigation may. Whether it is the Government or the plaintiff seeking to join, however, the court involved must have personal jurisdiction over the party as to whom joinder is sought.³⁶⁷⁵

Under these procedures the putative responsible person's liability will then be resolved in the refund/counterclaim/cross claim litigation. Upon completion of the litigation, the IRS will conform the assessment to the result of the litigation, and, if any tax is due, the IRS will proceed with collection measures (which we discussed earlier in this chapter).

I have assumed in the foregoing discussion that the refund litigation is brought in the district court. A person assessed the TFRP is entitled to sue for refund in the United States Court of Federal Claims. I discuss the attributes of this alternative forum elsewhere in this book, but for now suffice it to say that this alternative is usually chosen because of some favorable precedent (usually subtle in the context of the TFRP). Many persons contesting the TFRP will want a jury which is only available in the district court.

But there is another wrinkle in litigating the TFRP in the Court of Federal Claims. In the past, if the IRS assessed the TFRP against multiple persons, one preferring to litigate in the Court of Federal Claims could do so under the less than full payment procedures noted above. The Government, preferring to litigate the matter in one proceeding but unable to join the other persons in the Court of Federal Claims proceeding, would sometimes file a proceeding in the district court seeking to reduce to judgment the outstanding assessments against all parties, including the refund plaintiff in the Court of Federal Claims proceeding and then ask the Court of Federal Claims to stay action on the refund suit while they all duked it out in the district court. Previously, in the exercise of its discretion, the Court of Federal Claims granted the motion to stay in some cases. However, Congress has changed the law to now prohibit the Government's joining of the Court of Federal Claims claimant in the district court proceeding.³⁶⁷⁶

(4) Burden of Proof.

The person determined by the IRS to be subject to be subject to the TFRP bears the burden of proving by a preponderance of the evidence that he or she is not a responsible person because either or both of the statutory elements—responsibility and willful failure to collect and payover—are

³⁶⁷⁵ See *Goldberg v. United States*, 2014 U.S. Dist. LEXIS 77945 (S.D. Fla. 2014) (jurisdiction of third party that refund plaintiff sought to join not present).

³⁶⁷⁶ § 6331(i)(4)(i). For discussion of the past practice, see Order in *Rineer v. United States*, 2007 U.S. Claims LEXIS 402 (12/21/ 2007), reproduced at 2007 TNT 250-62, a case involving tax assessments prior to the effective date of the statute, but declining to stay the Court of Federal Claims proceeding, thus permitting it to proceed and perhaps resolve the issue prior to an action on the district court proceeding.

not present.³⁶⁷⁷ And this burden applies to (i) the refund claim and any counterclaim against the plaintiff in the refund suit and (ii) any person joined on the basis of alleged joint and several liability.³⁶⁷⁸ And, if the person disputes the amount of the liability, the person bears the burden of persuasion.³⁶⁷⁹

b. The CDP Alternative Procedure.

The CDP procedure offers a judicial remedy for at least some TFRP determinations.³⁶⁸⁰ The CDP procedure is not available until the assessment and further IRS action to either file a lien or levy on assets. The CDP Procedure is then available to dispute the TFRP liability in the administrative CDP proceeding and, failing there, in the Tax Court CDP Proceeding if the putative responsible person “did not otherwise have an opportunity to dispute such tax liability.”³⁶⁸¹ The normal procedure before the TFRP is assessed is for the IRS to advise the person by Letter 1153 of the intent to assess the TFRP and the person’s right to pre-assessment appeal in Letter 1153. The proffered right to appeal is a prior opportunity to dispute the liability and, if the person receives that letter, will foreclose the opportunity to dispute in the CDP proceeding (either the administrative stage or the Tax Court stage) whether or not the person takes the appeal.³⁶⁸² Of course, the statute requires a prior opportunity, so if the person can show that he did not receive the letter offering the opportunity, then the CDP is available.³⁶⁸³

Assuming that the CDP remedy is available, the key downsides of using the CDP procedure to contest the merits will be (i) the lack of a jury or a generalist judge and (ii) the lack of robust discovery in the Tax Court. The key upside will be the Government’s inability to force the other putative responsible persons into the litigation, thus (i) holding down the costs from the presence of multiple parties, and (ii) avoiding having to deal with those missing persons’ claims that the party invoking the CDP remedy is the responsible person.³⁶⁸⁴

³⁶⁷⁷ *Brinskele v. United States*, 88 Fed. Cl. 334, 339 (2009), aff’d, 397 F. App’x 662 (Fed. Cir. 2010).

³⁶⁷⁸ Id.

³⁶⁷⁹ *Noffke v. United States*, 129 Fed. Cl. 341 (2016) (also citing cases for proposition that this is true even if the amount of the TFRP is based on estimate, so long as the method for the assessment is “reasonable and logical.” Echoing the *Helvering v. Taylor* holding for notices of deficiency, the court held the taxpayer can be relieved of the burden of showing amount if the assessment is made without foundation or any supporting evidence (citing precedent). However, I wonder whether this may be true with respect to the counterclaim but perhaps not the refund claim (the original pleading in the case); as I note in the discussion of *Helvering v. Taylor*, there still has to be a judgment on the refund claim that quantifies an amount); but that is trying to count angels dancing on the head of a pin.

³⁶⁸⁰ See *Williams v. Commissioner*, 131 T.C. 54, 58 n.4 (2008); *Callahan v. Commissioner*, 130 T.C. 44, 48 (2008); and *Woodley v. Commissioner*, T.C. Memo. 2017-242.

³⁶⁸¹ § 6330(c)(2)(B). See the general discussion of this prior opportunity to dispute limitation on CDP proceedings beginning p. 739.

³⁶⁸² *Lee v. Commissioner*, 144 T.C. 40 (2015); *Pough v. Commissioner*, 135 T.C. 344, 349 (2010); *Thompson v. Commissioner*, T.C. Memo. 2012-87; *Woodley v. Commissioner*, T.C. Memo. 2017-242; and Bryan Camp, *Lesson From The Tax Court: Cannot Use CDP To Contest Trust Fund Recovery Penalty (9/5/23)*.

³⁶⁸³ *Mason v. Commissioner*, 132 T.C. 301, 318 (2009) (“a section 6672(b)(1) notice that was not received, but not deliberately refused, by a taxpayer does not constitute an opportunity to dispute that taxpayer’s liability.”).

³⁶⁸⁴ This may be a mixed blessing because having that missing person in the same room might offer the decision maker (judge or juror) the fall back comfort that someone will be liable if the particular putative responsible person is relieved of liability.

7. Bankruptcy and the TFRP.

The TFRP arises because the employer is in financial difficulty. If the employer paid the trust fund tax, there would be no TFRP. Frequently, the employer will go into bankruptcy and propose a plan of reorganization that includes a deferred payout of the trust fund taxes. The IRS, however, is not required to exhaust its remedies against the employer before it proceeds against any responsible officer for the TFRP.³⁶⁸⁵ Accordingly, rather than accepting the deferred payout which will, of course, be dependent upon the success of the reorganization, the IRS can proceed to use the TFRP to collect the trust fund tax.³⁶⁸⁶

Also, the TFRP is not dischargeable in bankruptcy.³⁶⁸⁷

8. Planning for the TFRP.

The way to avoid the TFRP is, of course, to comply with the requirement that gross payroll be paid and the withholding amount be withheld and paid over. Don't pay net payroll which would leave the employer without cash to meet its obligation to pay over the withheld or deemed withheld trust fund taxes.

If, however, a client has failed to pay over the withholding taxes and has had the foresight to engage you as his attorney, you can give him the following advice. First, if your client expects the corporation (assuming a corporate or other limited liability employer) to survive the downturn in its business, then work with the IRS to have the corporation pay the taxes. We deal elsewhere in working with the IRS on collection matters. Keep in mind, of course, that the employer will have penalties for failing to pay over. But, if the employer can get an installment agreement, the employer may be able to work it out. Second, if the corporation has otherwise free assets, use them to pay the IRS the trust fund tax rather than paying third party creditors, being careful to designate in writing that all payments are to be applied to the principal only of the trust fund taxes.³⁶⁸⁸ The responsible person prefers this and benefits because it reduces the trust fund liability for which he or she can be held liable. Thus, if the corporation were to owe income taxes (it well may not owe current income taxes because of the current financial problems causing the failure to withhold and pay over, but perhaps it might owe past due taxes that can't be covered by NOL carrybacks), pay the trust fund taxes first. The limitation on the ability to designate payments to the trust fund portion is that the

³⁶⁸⁵ *In the Matter of: Prescription Home Health Care, Inc.*, 316 F.3d 542, 545 (5th Cir. 2002), citing *Hornsby v. Internal Revenue Service*, 588 F.2d 952, 954 (5th Cir. 1979).

³⁶⁸⁶ *In the Matter of: Prescription Home Health Care, Inc.*, *supra*.

³⁶⁸⁷ *United States v. Sotelo*, 436 U.S. 268, 274 (1978).

³⁶⁸⁸ For examples, both arising in bankruptcy of the underlying employer, (i) where the taxpayer used otherwise unencumbered funds to get right on its trust fund taxes (*Begier v. Internal Revenue Service*, 496 U.S. 53 (1990)); and (ii) where the taxpayer used otherwise encumbered funds to do so (*Zwosta v. J.P. Morgan Chase*, 395 B.R. 378 (6th Cir. Bankr Panel 2008)). I won't here develop the bankruptcy consequences of the difference, but I suspect you can quickly discern them without elaboration.

The procedure for designating payment is laid out in Rev. Rul. 79-284, 1979-2 C.B. 83. Absent a specific designation, the IRS will apply the payment to the non-trust fund liability. See *Wood v. United States*, 808 F.2d 411, 416 (5th Cir. 1987). Note, however, that if the payment is pursuant to an installment agreement, the IRS takes the position that the payment is not voluntary and that the IRS may apply the payments as it sees fit regardless of the taxpayer's designation.

payment must be “voluntary” and not pursuant to enforced collection measures (including installment agreements); the IRS may apply “involuntary payments” as it deems fit, which means that they will be designated last to the trust fund portion of the tax.³⁶⁸⁹

9. Contribution Among Responsible Persons.

Responsible persons who pay disproportionately on the TFRP relative to other responsible persons may recover from the others “an amount equal to the excess of the amount paid by such person over such person's proportionate share of the penalty.” § 6672(d).³⁶⁹⁰ The suit must be brought independently of a case in which the United States is asserting the TFRP against one or more of the parties.³⁶⁹¹ As discussed above, in the tax refund suit where the Government not only counterclaims against the person bringing the suit but also joins others that it has determined to be responsible persons, the parties cannot determine their proportionate payment liabilities in that proceeding. The liability determined in the refund/collection suit is joint and several. Responsible persons having to pay that joint and several liability in disproportionate amounts can only seek contribution in a separate proceeding involving only the persons potentially liable for the TFRP.

Statutory contribution is relatively new, so the warp and woof of the provision have not been fleshed out. A key threshold issue is what is a “proportionate share” of the penalty.³⁶⁹² Does it mean that the proportionate share is per capita among responsible persons? Does it mean that proportionate share factors in relative culpability for the unpaid tax subject to the TFRP?

³⁶⁸⁹ In *In re Frank Meador Buick, Inc.*, 1991 U.S. App. LEXIS 24802 (4th Cir. 1991), the court explained the legal distinction between voluntary and involuntary payments in this context:

It is the policy of the IRS to allow an employer who voluntarily makes tax payments to designate that such payments should be applied first to its trust fund tax liability. *United States v. Energy Resources Co.*, 495 U.S. 545, 548 (1990). Payments classified as being made involuntarily may not be designated. “An involuntary payment of Federal taxes means any payment received by agents of the United States as a result of distraint or levy or from a legal proceeding in which the Government is seeking to collect its delinquent taxes or file a claim therefor.” *Amos v. Comm'r*, 47 T.C. 65, 69 (1966). The IRS generally applies involuntary payments to the nontrust fund portion of the tax liability and seeks to recover the trust fund portion from the responsible parties. *In re Technical Knockout Graphics, Inc.*, 833 F.2d 797, 799 (9th Cir. 1987); cf. *Muntwyler v. United States*, 703 F.2d 1030, 1032 (7th Cir. 1983) (citing IRS Policy Statement P-5-60 (“[w]hen a payment is involuntary, IRS policy is to allocate the payments as it sees fit.”)).

³⁶⁹⁰ For a good general discussion, see Kenneth H. Ryesky, “In Employers We Trust”: The Federal Right of Contribution Under Internal Revenue Code Section 6672, 9 Fordham J. Corp. & Fin. l. 191 (2003) (in this section, I refer to this article simply as Ryesky, *supra*.); and Larry A. Campagna & William O. Grimsinger, Riddles Raised by Those Who Don't Read: Solving Purported Problems With Right of Contribution Under Sec. 6672(d), 5 J. Tax. Prac. & Proc. 15, 18 (2003-2004).

Prior to § 6672(d)'s enactment, courts declined to find an implied federal right of contribution and thus responsible persons were left to the vagaries of contribution rights under state law. Ryesky, *supra*, pp. 200-207. For example, some states viewing the conduct penalized (failure to withhold and pay over trust fund taxes) as torts or tort-equivalents might apply a doctrine that joint tort-feasors cannot seek contribution. See e.g., *Luce v. Luce*, 119 F. Supp. 779, 784 n. 4 (E.D. Ohio 2000). This possibility of a state remedy now that the federal remedy is available raises the possibility that the remedies may provide different quantum of recovery and how that issue might be resolved if the taxpayer sues in federal court alleging both remedies. In that regard, since the federal claim may be brought in state courts (Ryesky, pp. 211-212), the same issue would be presented there.

³⁶⁹¹ *Weber v. Commissioner*, 138 T.C. 348, 358 n.8 (2012); and *Thompson v. Commissioner*, 2012 T.C. Memo. 2012-87.

³⁶⁹² Ryesky, *supra*, 209-10.

Another interesting aspect of the provision is that it does not on its face require that the IRS have asserted the TFRP against the person(s) from whom contribution is sought. Assume that A is president and B is CFO of a corporate employer that is delinquent in trust fund taxes in the amount of \$100,000. The IRS asserts a TFRP of \$100,000 against A, the President of the company, but does not assert the TFRP against B for some reason (such as it thinks B may not be liable, it thinks B is only marginally liable and knows that A was clearly liable and has the funds to pay the full amount, or thinks that B cannot pay and the IRS's resources are better focused elsewhere, etc.). A pays the minimal amount (\$100), files claim for refund and, upon denial of the claim, A sues for refund. The Government counterclaims for the balance of the assessment - \$99,900. Since the Government has not determined liability for any other person, the Government does not join any other party and, of course, does not join B. A loses the litigation, and the Government proceeds to collect the full \$100,000 from A. A then sues B under § 6672 urging that B was also a responsible person. B urges that Congress did not intend § 6672(d) to bless open-ended litigation over liability and thus should be construed to exclude from § 6672(d) liability those persons whom the IRS has not determined to be responsible persons.

A court held that § 6672(d) has no predicate requirement that the IRS have determined § 6672 liability and, thus, in this example, B can be sued for contribution.³⁶⁹³ The Court reasoned that, in determining who to assess and pursue collection for the TFRP, the IRS should be able to proceed in the most efficient manner for collection of the trust fund tax and not be sidetracked pursuing persons from whom collection may be more difficult. So, the Court reasoned, Congress enacted the contribution provision to permit the parties in an independent private action to seek contribution and felt that, given the fact that the statute does not require an IRS assessment, it would not be appropriate to limit such actions to persons upon whom the IRS assessed.

The statute quantifies the amount that may be recovered as “the excess of the amount paid by such person over such person's proportionate share of the TFRP.”³⁶⁹⁴ It is not yet clear how the proportionate determination is made. Is it based upon some assessment of the relative contributions of the responsible persons to the failure to withhold and pay over? How is that assessment made?

The statute of limitations to pursue the § 6672(d) suit is 4 years from the date of accrual of the claim.³⁶⁹⁵ A person subject to the TFRP may request information about other persons subject to the TFRP under FOIA.³⁶⁹⁶

³⁶⁹³ See Memorandum and Order dated 12/5/01 in *Bromley v. Frey*, et al. (S. D. Tex. - H-01-0182).

³⁶⁹⁴ Does this suggest that the person seeking contribution need not pay the full penalty but need only pay the amount over his proportionate share which has not yet been determined by the Court? Or must the person pay the penalty in full before invoking the contribution remedy? In *Happy v. McNeil*, 2015 U.S. Dist. LEXIS 13931 (W.D. Tex. Feb. 5, 2015), the court held “A responsible person who is liable for the penalty cannot seek contribution until he has paid his proportionate share of the penalty.”

³⁶⁹⁵ 28 U.S.C. § 1658; see Ryesky, *supra*, pp. 212-214. Attention must be paid to the date the claim accrues. Does the claim accrue when the person claiming contribution has paid more than that person's share (as opposed to fully paid the penalty) or does the claim only accrue when the person pays the penalty in full? Or does it occur when the person knew or should have known of the claim. And is the statute of limitations jurisdictional or not (if not, can equitable factors toll the running of the statute of limitations).

³⁶⁹⁶ Section 6103(e)(9) authorizes the disclosure of the TFRP penalties imposed on other persons.

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C. Section 3505 Liability.

A companion provision imposes liability upon lenders, sureties, and others who make credit for a troubled company without providing for the withholding and payment to the IRS of the trust fund taxes. § 3505. This can occur where the third party makes net payments directly to the employees (i.e., net of the trust fund taxes)³⁶⁹⁷ or where, with notice or reason to believe that the employer will not pay the withheld amounts to the IRS, the lender supplies net funds to the employer who then pays the employees and does not pay over to the IRS.³⁶⁹⁸ The Government has the burden of proof (persuasion) with respect to the elements of § 3505 liability.

Sections 3505 and 6672 may overlap where the lender or an officer of the lender exercises practical control over which creditors will be paid and thus participates in the decision that the IRS will not be paid the trust fund taxes.

The IRS does not assess a § 3505 claim as it does in other cases (most prominently, as it does in § 6672 cases), but rather brings a suit against the lender. The suit must be brought within ten years after the assessment against the employer.³⁶⁹⁹ There is a conflict as to whether the employer's extension or suspension of the period of limitations for the underlying liability also extends the lender's period under § 3505.³⁷⁰⁰

Although the Government must give the notice and demand required by § 6303(a) before it may pursue administrative remedies against the taxpayer, that notice and demand is not a prerequisite to bringing a judicial action for collection. Hence, the Government can make the § 3505 for assessed taxes whether or not it has made notice and demand on the taxpayer.³⁷⁰¹

D. Special Collection Mechanisms for Tax Liabilities of Estates and Donees.

1. The Problem.

The problem is the same as the basis for transferee liability discussed earlier. Transfers may be made to third parties (other creditors, estate beneficiaries or donees) which render the party principally liable for the tax—the taxpayer or, if he is deceased, his estate—unable to pay.

2. Beneficiary and Donee Liability for Estate or Gift Tax Under § 6324.

a. Lien on Property Transferred.

³⁶⁹⁷ § 3505(a).

³⁶⁹⁸ § 3505(b).

³⁶⁹⁹ Reg. § 31.3505-1(d)(3).

³⁷⁰⁰ See *United States v. GE HFS Holdings, Inc.*, 2011 U.S. Dist. LEXIS 131307 (M.D. Fla. 2011) (holding no extension or suspension and discussing *United States v. Harvis Construction Co.*, 857 F.2d 1360 (9th Cir. 1988) (no extension or suspension) and *United States v. Associates Commercial Corp.*, 721 F.2d 1094 (7th Cir. 1983) (extension and suspension).

³⁷⁰¹ See *Jersey Shore State Bank v. United States*, 479 U.S. 442 (1987).

Section 6324(a) creates an automatic lien, as of the date of death, for the estate tax on all of the deceased's property includible in the gross estate (whether or not passing through the probate estate) as of the date of death,³⁷⁰² and § 6324(b) creates a lien on property given subject to the gift tax as of the date of the gift.³⁷⁰³ The effect of the respective liens is a bit complex, but I will try to navigate the rules as I understand them. Both of the liens are silent liens and are effective without recording,³⁷⁰⁴ except as I note.

The effect of the estate tax lien depends upon whether the property is probate property includable under § 2033 ("Probate Property") or non-probate property includable under §§ 2034-2042 ("Non-probate Property). Probate property is subject to the lien in the beneficiary's hands and in the hands of transferees of the beneficiary; there is no innocent purchaser or purchaser for value exception.³⁷⁰⁵ Non-probate Property is subject to the lien in the beneficiary's hands; upon transfer by the beneficiary, the property is "divested" of the lien and a "like lien" then attaches to the beneficiary's other property that can be divested only by transfer by the beneficiary to a purchaser or holder of a security interest.³⁷⁰⁶

As to the gift tax lien, the donated property in the donee's hands is subject to the lien but is divested of the lien if the donee transfers it to a purchaser or holder of a security interest. If the donee transfers the property, all of the donee's property is subject to the gift tax lien except that the donee's property may be transferred free of the lien to a purchaser or holder of a security interest.³⁷⁰⁷

In addition to the lien, personal liability (not just lien-type liability) is imposed on the transferee for the tax "to the extent of the value" of the property at the time of the transfer.³⁷⁰⁸ I discuss this personal liability in the section immediately following discussion of the lien.

The lien applies to all transfers subject to the estate or gift tax if tax is not paid (i.e., transfers subject to the estate tax and transfers subject to the gift tax for the period involved).³⁷⁰⁹ This lien and liability attach even if the particular transferees' gift or bequest did not actually contribute to the tax

³⁷⁰² § 6324(a)(1); and Reg. § 301.6324-1(a)(1). There is no predicate act of assessment required as for the lien provided by § 6321. Upon assessment of the estate tax and nonpayment, the regular § 6321 lien will also apply, although its scope probably only reaches the property of the probate estate. For a general discussion the lien, see IRM Part 5, Chapter 5, Section 8. Estate Tax Liens.

³⁷⁰³ This means that the lien is created even before the amount of tax it secures is ascertained (which would be at the time the return is filed). *Detroit Bank v. United States*, 317 U.S. 329 (1943). § 6324(b) seems to create this lien only if a "return was filed." If the donor did not file a gift tax return, does the lien arise? This possible limitation does not exist for the estate tax return and the regulations expressly state that it applies for deficiencies. Reg. § 301-6324-1(a)(1).

³⁷⁰⁴ *United States v. Vohland*, 675 F.2d 1071, 1074-1076 (9th Cir. 1982); *Beaty v. United States*, 937 F.2d 288, 290 (6th Cir. 1991).

³⁷⁰⁵ *Beaty v. United States*, 937 F.2d 288, 290 (6th Cir. 1991) ("Under 26 U.S.C. § 6323(a), the general tax lien is not good against bona fide purchasers or other interest-holders unless the government perfects its interest by filing in the manner prescribed by 26 U.S.C. § 6323(f). The estate tax lien, by contrast, attaches to the property by operation of law and does not require filing to be good against innocent third parties.").

³⁷⁰⁶ § 6324(a)(2); see Rev. Rul. 69-23, 1961-1 C.B. 302 (1969).

³⁷⁰⁷ § 6324(b).

³⁷⁰⁸ §§ 6324(a)(2) and 6324(b). See *Baptiste v. Commissioner*, 29 F.3d 1533, 1541 (11th Cir. 1994) (as to personal liability).

³⁷⁰⁹ § 6324(c)

liability in question. For example, assume these facts: (1) individual A makes a gift of \$1,000,000 cash to individual B which A reports on a timely gift tax return and fully pays the gift tax; (2) A makes a simultaneous gift of property worth \$1,000,000 to individual C, which A does not report on the gift tax return; and (3) the IRS timely assesses the gift tax on the gift to C. Both B and C are subject to the transferee lien and personal liability provisions; B is thus liable even though his gift does not contribute to the tax liability in question.³⁷¹⁰ A similar example in the case of an estate tax return would show that both B and C would be subject to the lien and potential liability.

The IRS may levy with respect to property subject to this lien.³⁷¹¹

The lien applies for 10 years and generally cannot be extended.³⁷¹² The IRS must actually complete levy or foreclose within that period.³⁷¹³ Note, however, that the rules requiring a suspension of the statute of limitations (e.g., for a Tax Court proceeding or an offer in compromise) could apply.

The existence of the lien can create problems because the transferee takes the property subject to the lien unless the IRS discharges or releases the lien, thus permitting a transferee to take the property free of the lien. The IRS may issue a certificate of discharge for property subject to § 6324's estate or gift tax lien, but the procedures for doing so may not fit the estate's or donor's needs.³⁷¹⁴

b. Personal Liability.

Section 6324 imposes personal liability upon the beneficiary (defined broadly)³⁷¹⁵ as to estate tax or the donee as to gift tax. As to the estate tax, the beneficiary's personal liability applies to Non-probate Property the beneficiary receives "to the extent of the value, at the time of the decedent's death, of such property."³⁷¹⁶ Importantly, Probate Property included in the gross estate under § 2033 received by a beneficiary is not subject to this special liability provision, although the beneficiary may be held liable as a transferee under § 6901 and the property received will be subject to the special lien noted immediately above. As to the gift tax, the donee's personal liability is "to the

³⁷¹⁰ Id., at 1276.

³⁷¹¹ Reg. 301.6331-1(a)(1).

³⁷¹² *Beatty v. United States*, 937 F.2d 288, 290 (6th Cir. 1991). For this reason, if the estate elects the special deferred payout provision of § 6166 there will be a period of time that the estate tax is outstanding and not protected by this lien. See Notice 2007-90, 2007-46, I.R.B. 1003 ("During the final four years and nine months, the government's interest is no longer secured by the general estate tax lien. In most cases, approximately one-half of the total deferred estate tax still remains to be paid during that final, unsecured portion of the deferral period."). However, § 6324A permits a lien to be created by agreement with respect to the assets expected to survive the deferral period.

³⁷¹³ *United States v. Cleavenger*, 517 F.2d 230 (7th Cir. 1975).

³⁷¹⁴ § 6325(c); Reg. § 301.6325-1(c). IRM 5.5.8.5.6 (03-01-2006), Processing Requests for Release, Discharge of Property From, or Subordination of IRC § 6324A Form 668-J; and IRM 5.5.8.12.1 (07-24-2018), Requests for Discharge of the Unrecorded IRC § 6324(a) Lien. See Stephen Olsen, New Estate Tax Lien Discharge Procedures — Give the IRS All the Monies (Procedurally Taxing Blog 5/8/17).

³⁷¹⁵ Just for flavor as to its breadth, the classes by the personal liability for estate tax include "the spouse, transferee, trustee * * * surviving tenant, person in possession of the property by reason of the exercise, nonexercise, or release of a power of appointment, or beneficiary, who receives, or has on the date of the decedent's death, property included in the gross estate under sections 2034 to 2042, inclusive." § 6324(a)(2).

³⁷¹⁶ § 6324(a)(2).

extent of the value of such gift.”³⁷¹⁷ This liability arises immediately upon death or gift, respectively; the lien does not require any assessment or filing or any other action by the IRS and may be pursued independently.³⁷¹⁸

This transferee liability can be a problem. Suppose a young father working with a high tech company during the high tech bubble has stock in the company worth \$30,000,000. That is his only asset other than his home which is worth \$500,000. He has only \$400,000 of debt, all of which is a purchase money mortgage on his home. On December 31 of Year 1, father gives his son \$20,000,000 of the stock. By April 1 of Year 2, the stock had declined 90% in value, leaving father with stock worth \$1,000,000 and son with stock worth \$2,000,000. Father is required to file a gift tax return by April 15 of Year 2. The gift tax—after credits for the lifetime exemption for he and his wife—would exceed \$4,000,000. What is father to do? By selling all of the stock, father and son can pay \$3,000,000, leaving a \$1,000,000+ shortfall. Father and son are both liable for the \$1,000,000 shortfall.³⁷¹⁹ Bummer!³⁷²⁰

Moreover, from the above example, you can see that, because the son has been required to pay the tax that was the primary obligation of the father (the donor), the son has not really received a \$20,000,000 gift. The law is clear, for example, that if the father had given son the gift (worth \$20,000,000) with the contractual obligation between father and son that son pay the gift tax related to the gift (\$4,000,000 if the amount of the gift were \$20,000,000), then the amount of the gift would be substantially less than \$20,000,000 because of the donee’s contractual obligation to pay the tax.³⁷²¹ This is a so-called “net-gift.” However, given the fact that the father, as donor, did not contractually pass the obligation to the son and the father thus remained liable, vis-a-vis both the IRS and the son, the “net gift” rule would not apply to reduce the amount of the gift and resulting gift tax even though in fact the son has to pay some or even all of the gift tax.³⁷²²

Another interesting facet of this liability is that it is joint and several. The IRS can proceed against any beneficiary or donee without being limited to the proportion of the tax in issue that is attributable to the proportion of the property he or she received. There is no federal right of contribution in that case, but state law may supply one.

³⁷¹⁷ § 6324(b).

³⁷¹⁸ The IRS can pursue an action under § 7402 or transferee liability under § 6901 (which is not a predicate to the personal liability. See *United States v. MacIntyre*, 2012 U.S. Dist. LEXIS 79193,*18-20 (S.D. Tex. 2012); see also *United States v. Geniviva*, 16 F.3d 522, 525 (3d Cir. 1994) (“we hold that an individual assessment under 26 U.S.C. § 6901 is not a prerequisite to an action to impose transferee liability under 26 U.S.C. § 6324(a)(2)”). The IRS, of course, may proceed under § 6901, and where it does so, the substantive liability under § 6324(a)(2) will make irrelevant reference to state law (usually required under § 6901). *Magill v. Commissioner*, T.C. Memo. 1982-148 (T.C. 1982).

³⁷¹⁹ Gifts can have certain features of a classic estate freeze which is designed to assure that future appreciation goes into the donee’s estate rather than the donor’s, thus generally skipping a generation for the transfer tax. This dramatic example shows what can happen when the property drops in value rather than increases. That which was intended to lower the transfer tax as compared to the ultimate transfer tax if the donor retained the property actually increases the transfer tax as compared to the ultimate transfer tax if the donor retained the property.

³⁷²⁰ For a similar phenomenon potentially wiping out the entire inheritance in the estate area, see *Geniviva v. United States*, 16 F.3d 522 (3d Cir. 1994).

³⁷²¹ *Diedrich v. Commissioner*, 457 U.S. 191 (1982); the actual calculation requires a complex calculation. See Rev. Rul. 75-72, 1975-1 C.B. 310. See also *Armstrong v. United States*, 277 F.3d 490 (4th Cir. 2002).

³⁷²² *Armstrong v. United States*, 277 F.3d 490 (4th Cir. 2002).

One interesting question is whether, given the scope of the personal liability, the IRS could proceed while the IRS issues a notice of deficiency against the taxpayer (the estate or donor) or while the taxpayer (estate or donor) is pursuing a Tax Court proceeding. You will recall from our discussion above that the IRS is generally prohibited against proceeding against the taxpayer before issuing a notice of deficiency or while a Tax Court case is pending, but the liability under § 6324 does not require a notice of deficiency. May the IRS proceed against a beneficiary or donee directly under § 6324? The IRS takes the position that it can but urges restraint in doing so particularly while the taxpayer is pursuing a Tax Court case on the matter.

Still another question is whether and to what extent the liability is subject to interest. Using the same example, the father must file a gift tax return on April 15 of Year 2 reporting \$4,000,000 of liability but paying only \$3,000,000. As previously discussed, the father's deficiency of \$1,000,000 will be subject to interest from the due date of the return. No problem there. But what about the son—will he be liable for the interest on the father's deficiency or will the son be liable to pay interest on his separate liability to the Government? Good question.³⁷²³

As a personal liability, the IRS may pursue personal liability independently of the liens. Although the authority is sparse, the limitations period for this personal liability appears to be the same as the limitations period against the original transferor.³⁷²⁴ This invokes the general limitations periods for (1) assessment against the original transferor and (2) if assessment is timely made, then the 10 year collection period.³⁷²⁵

Finally, § 2204 provides that, upon written application by an executor or a fiduciary otherwise potentially personally liable for an estate or other tax may request that the IRS determine the amount of tax and upon payment (or bonding) of that amount receive a discharge of liability.³⁷²⁶

c. Relationship to 6901.

The IRS may invoke the transferee liability provisions of § 6901 with respect to the beneficiary or donee liability under § 6324 but is not required to do so.³⁷²⁷

³⁷²³ See Gregory A. Byron, Transferee Liability Under Section 6324: Defining the Extent of a Transferee's Liability for Interest, 32 Idaho L. Rev. 383 (1996), discussing inter alia, *Baptiste v. Commissioner*, 29 F.3d 1533 (11th Cir. 1994), and *Baptiste v. Commissioner*, 29 F.3d 433 (8th Cir. 1994). The author makes the interesting observation that, if the IRS proceeds against a transferee under § 6901, it might get such interest but might not if it proceeds directly under its rights under § 6324. See also Wendy C. Gerzog, Saigh It Ain't So, 2005 TNT 64-38; see *United States v. Marshall*, 798 F.3d 296 (5th Cir. 2015) (holding that the donee is responsible for tax and interest only up to the value of the gift, and thus revising its earlier holding in *United States v. Marshall*, 771 F.3d 854 (5th Cir. 2014).

³⁷²⁴ *United States v. Botefuhr*, 309 F.3d 1263, 1277 (10th Cir. 2002); *United States v. Degroft*, 539 F. Supp. 42, 44 (D. Md. 1981); *United States v. Mangiardi*, 2013 U.S. Dist. LEXIS 102012 (S.D. Fla 2013).

³⁷²⁵ *Id.*

³⁷²⁶ § 2204(a) applies to executors, and § 2204(b) applies to fiduciaries. The provisions are slightly different, so attention to those differences is required.

³⁷²⁷ See Reg. § 301.6901-1(b); see *Geniviva v. United States*, 16 F.3d 522 (3d Cir. 1994).

3. Representatives of Taxpayer under 31 U.S.C. § 3713.

Section 3173,³⁷²⁸ sometimes referred to as either the Federal Priority Statute or the Federal Insolvency Statute, imposes two types of liability.

First, § 3713(a), referred to as the Federal Priority Statute, requires that a “claim” of the U.S. “shall be paid first” if the person owing a debt to the Government [claim] makes a voluntary assignment of property, has property attached or commits an act of bankruptcy.³⁷²⁹ Although the statute seems to create an absolute priority permitting of no exceptions,³⁷³⁰ there are some acknowledged exceptions for some things like family allowances and administrative expenses (such as “expenses incurred for the general welfare of creditors,” “expenses incurred to collect and preserve assets,” court costs, and funeral expenses).³⁷³¹ Further, the estate representative “must have had actual or constructive knowledge of the Government’s claim when the estate had sufficient assets to pay it, or notice of such facts as would put a reasonably prudent person on inquiry as to the existence of the Government’s unpaid claim.”³⁷³²

This priority statute applies to the tax debtor (who, of course, is otherwise liable for the tax debt anyway) and to the estate of the tax debtor (which otherwise has the same liability as the deceased debtor for the tax debt). This provision does not apply to a tax lien if a transfer to a person who had an interest in property that would prevail over the federal tax lien under IRC § 6323.³⁷³³ Section 3713(a) does not itself impose liability upon a fiduciary (such as an executor or trustee); with respect to an estate, the liability from the provision applies only to the estate and not to the fiduciary of the estate.

Second, subsection (b) imposes personal liability upon “a representative of a person or an estate” pays “any part of a debt of the person or estate before paying a claim of the Government.”³⁷³⁴ This personal liability supports the general priority in § 3713(a) by making those in control of a

³⁷²⁸ § 3713 was enacted in 1982, based on earlier priority statutes, 31 U.S.C. §§ 191 and 192 and even earlier Rev. Stat. §§ 3466 and 3467. See 31 U.S.C. § 3713(a), Notes. (The Notes are the codifier’s notes.) See Richard H.W. Maloy, The "Priority Statute" - The United States' "Ace-in-the-Hole", 39 J. Marshall L. Rev. 1205, 1210-1213 (2006),

³⁷²⁹ IRM 5.17.13.2 (07-09-2012), Priority of Government Claims Under 31 USC § 3713(a), the Federal Priority Statute.

³⁷³⁰ See *United States v. Vermont*, 377 U.S. 351, 357 (1964) (the statute “on its face permits no exception whatsoever.”).

³⁷³¹ *United States v. McNicol*, 829 F.3d 77 (1st Cir. 2016), cert. den. 137 S. Ct. 673 (2017) (citing IRM 34.4.1.7 (08-11-2004), The Insolvency Statute, 31 U.S.C. § 3713(a)); *Estate of Jenner v. Commissioner*, 577 F.2d 1100, 1106 (7th Cir. 1978); *Schwartz v. Commissioner*, 560 F.2d 311, 314 n.7 (8th Cir. 1977); and *Abrams v. United States*, 274 F.2d 8, 12 (8th Cir. 1960)).

³⁷³² *Estate of Lee v. Commissioner*, T.C. Memo. 2021-92, at *11 (citing *Leigh v. Commissioner*, 72 T.C. 1105, 1109 (1979) (involving the USC section re-codified to 31 U.S.C. § 3713).

³⁷³³ IRM 5.17.13.3 (07-09-2012), Exception for Certain Interests That Would Have Priority Under the Federal Tax Lien Act; *United States v. Estate of Romani*. See *United States v. Estate of Romani*, 523 U.S. 517 (1998).

³⁷³⁴ See also IRM 5.17.13.7 (07-09-2012), Personal Liability of the Fiduciary Under 31 USC § 3713(b). The statute defines claim as “any amount of funds or property that has been determined by an appropriate official of the Federal Government to be owed to the United States by a person, organization, or entity other than another Federal agency.” § 3701(b)(1). For purposes of the discussion in the text, I think debt or claim is the same for tax claims. Cf. § 3701(a)(8).

debtor's estate liable if the priority is not honored. Payment of a "debt" for this purpose includes a payment that wrongfully depletes the estate.³⁷³⁵ This provision often is invoked in the context of estate representatives (executors or administrators) but can apply to trustees and other persons who function in similar capacities acting as representatives for persons owing the Government money.³⁷³⁶ Although not textual requirements for personal liability, courts have "routinely read" into the liability that the estate be insolvent and that the representative know or have reason to know of the Government claim.³⁷³⁷ Neither provision applies in a bankruptcy proceeding under Title 11 where the bankruptcy provisions will determine liabilities and priorities.³⁷³⁸ When the elements of debt to the Government, insolvency at the time of the transfer and notice to the estate representative are present, personal liability is established."³⁷³⁹

What about unassessed federal tax liabilities? The IRS may be conducting an audit of the decedent's pre-death income tax liabilities but have not yet made an assessment. Alternatively, the executor may know of potential liability for pre-death income taxes but the IRS does not. Still alternatively, the decedent may have pre-death unassessed income tax liabilities that are unknown to the executor or the IRS. There are obviously many variations among these points in the spectrum. The statute says that the "claim" must be determined by the agency,³⁷⁴⁰ so I presume an assessment is usually involved for liability, but courts have held that a notice such as a notice of deficiency suffices.³⁷⁴¹

³⁷³⁵ *United States v. Coppola*, 85 F.3d 1015, 1020 (2d Cir. 1996) (citing *Want v. Commissioner*, 280 F.2d 777, 783 (2d Cir. 1960)).

³⁷³⁶ For example, in *Renda v. United States*, 709 F.3d 472 (5th Cir. 2013), the Court applied the statute to a representative of a contractor owing the Government. Renda has a good discussion of the history of the provision. (See pp. 479-481.) See also *Singer v. Commissioner*, T.C. Memo. 2016-48, at *10 ("The term "fiduciary" includes an executor or any other person acting in a fiduciary capacity. Sec. 7701(a)(6).")

³⁷³⁷ IRM 5.17.13.7(6) (07-09-2012), Personal Liability of the Fiduciary Under 31 USC § 3713(b); and IRM 5.17.14.2.2 (09-25-2020), Fiduciary Liability Theory. See also *United States v. McNicol*, 829 F.3d 77, 81(1st Cir. 2016), cert. den. 137 S. Ct. 673 (2017) (insolvency and knowledge "routinely read" into the statutes, citing *United States v. Renda*, 709 F.3d 472, 480 nn. 9 & 10 (5th Cir. 2013). As to the notice requirement, see e.g., *United States v. Coppola*, 85 F.3d 1015 (2d Cir. 1996) (also cited in *McNicol*); *Want v. Commissioner*, 280 F.2d 777 (2d Cir. 1960); and *Leigh v. Commissioner*, 72 T.C. 1105 (1979) (the representative need only have "notice of such facts as would put a reasonably prudent person on inquiry as to the existence of the unpaid claim.").

³⁷³⁸ § 3713(a)(2) and (b) (parenthetical in (b)).

³⁷³⁹ *United States v. McNicol*, 829 F.3d 77 (1st Cir. 2016), cert. den. 137 S. Ct. 673 (1/19/17) ("No more is exigible for a finding of section 3713(b) liability." The word "exigible" was not in my everyday use, so I had to repair to the dictionary. The Merriam-Webster online dictionary offers the following: "liable to be exacted" with synonyms of requirable and demandable. I think the sense of it is as I have stated it in the text. As an aside (not uncommon in my footnotes), the opinion was written by Judge Selya who often uses "uncommon words in contexts that make the words' meanings clear." See Wikipedia, Bruce M. Selya (visited on July 27, 2016).

³⁷⁴⁰ See p. 826, fn. 3734.

³⁷⁴¹ E.g., as to notice of deficiency as determination. *Viles v. Commissioner*, 233 F.2d 376, 380 (6th Cir. 1956) ("notice of the claim of delinquent taxes given to the fiduciary before distribution of the assets was sufficient to make the statute applicable.") Given § 3701(b)'s requirement that the agency have determined the claim, this statute would not apply where the representative knows there is a tax due and owing (phraseology in the tax evasion crime) but the IRS does not yet know of the tax due and owing and thus has made no determination by assessment or otherwise. (For the tax evasion crime, see *Cheek v. United States*, 498 U.S. 192, 200 (1991), requiring for the tax evasion crime in § 7201 that the taxpayer have specific intent to violate the known legal duty regarding the tax due and owing.) If the representative distributes before the IRS knows, would the representative not be liable under this statute? I am not so sure, but some of the language in *Viles* might be interpreted to mean that the accrual of the debt without even a formal

(continued...)

Of course, beneficiaries receiving distributions from the estate in these circumstances will be subject to the potential collection mechanisms of transferee liability under § 6901 and the special estate tax lien. The Government bears the burden of proving liability under § 3713.³⁷⁴²

E. Transfers by Disclaimer or Renunciation.

We discussed above the *Drye* case where the Supreme Court held that property which a beneficiary disclaims is property to which a tax lien upon the disclaiming beneficiary applies. Upon disclaimer, however, has the disclaiming beneficiary made a transfer subject to the gift tax thus giving rise to the foregoing lien? No.

F. IRS Use of State Law.

The IRS may use state law concepts and remedies to impose liability. For example, as you know, the general rule in most states is the partners in a general partnership are joint and severally liable for the partnership's debts. Assume a partnership has employees and thus incurs both trust fund taxes (the employee's income tax and share of FICA withholding) and the employer's share of FICA. Under state partnership law, a general partner is jointly and severally liable for these taxes.³⁷⁴³ You should note that this state law liability goes beyond the trust fund liability which is all the IRS can reach under § 6672. You should compare this result for general partnerships with the result for LLC and other limited liability entities that are treated as partnerships for federal tax purposes; in such cases, the state law limited liability will protect the owners (limited partners for tax purposes) from general liability but will not protect them from the trust fund tax liability.³⁷⁴⁴ State law, of course, totally controls the issue of liability and scope of liability.

We discussed above the IRS's use of state law transferee liability, with certain federal tax code special procedures to implement the state law liability. Where liability is imposed under state law and there are no special tax Code procedures, the IRS must take the state law and its limitations as it finds them.

XIX. Government Collection Suits and Related Suits.

The Government can invoke judicial remedies in cases where a judicial remedy can aid in the collection of a tax liability or assessment. In most cases, the IRS's substantial collection enforcement tools (most prominently assessment lien and levy (seizure)) will effect collection if collection is possible. However, as discussed in this section, the Government may pursue judicial remedies to supplement its administrative collection tools.

³⁷⁴¹(...continued)

notice would be sufficient. See *Estate of Lee v. Commissioner*, T.C. Memo. 2021-92, at 11 (citing *Estate of Frost v. Commissioner*, T.C. Memo. 1993-94, at *15 (executor's receipt of a letter from the estate's law firm indicating that the estate might owe additional taxes combined with the Commissioner's commencement of an examination of the estate's tax liabilities put the executor on inquiry for purposes of the FPS before making a distribution of the estate's assets)).

³⁷⁴² *Singer v. Commissioner*, T.C. Memo. 2016-48, at *15-*16.

³⁷⁴³ E.g., *Remington v. United States*, 210 F.3d 281 (5th Cir. 2000).

³⁷⁴⁴ CCA 200235023. The CCA notes that, in contrast, the IRS may look to the single member owner of such a state law entity despite the limited liability under state law.

Historically, the most prominent such remedy was the collection suit in district court. The collection suit is generally brought to reduce tax assessments to judgment toward the end of the statute of limitations for collecting the assessment.³⁷⁴⁵ Before the expiration of the statute of limitations on collection on the assessment, the IRS collection enforcement tools discussed above are generally as effective as a judgment is, so a judgment is not needed until the assessment enforcement tools can no longer be used.

Functionally equivalent collection suits may be in different procedural formats—most likely where the Government is a defendant in a suit such as a refund suit where a partial payment has been made by the plaintiff and the Government counterclaims for the unpaid balance of an assessment to conclude liability in a single judicial proceeding. Additionally, in such a suit, even third parties can be joined (just as responsible persons subject to joint and several liability for the TFRP).

Basically, the collection suit is any action in a case where the Government seeks to obtain judgment for an unpaid tax assessment. Also, the Government can bring a collection suit to obtain judgment for even unassessed taxes that have not been paid.

In collection suits, the taxpayer is permitted to contest liability if the taxpayer (or someone in privity with the taxpayer) has not judicially contested it before.³⁷⁴⁶

Other district court suits that serve as collection tools for taxes are:

- Suit to foreclose on a tax lien where not only the party assessed the liability but any other party claiming a potential interest may be joined.³⁷⁴⁷
- Suit to set aside fraudulent conveyances or establish transferee liability.³⁷⁴⁸ Note that, in discussing transferee liability discussed above, the Government may issue a notice of transferee liability that will permit the putative transferee to litigate liability in the Tax Court. But the Government is permitted to bring the transferee liability suit directly in the district court to either set aside a transfer or impose transferee liability.
- Suit to enforce a levy.³⁷⁴⁹
- Suit to obtain a judicial remedy by levy on a principal residence.³⁷⁵⁰
- Suit to Recover Erroneous Refunds.³⁷⁵¹
- Suit to establish 31 U.S.C. § 3713 fiduciary liability.³⁷⁵²

³⁷⁴⁵ IRM 34.6.2.1 (06-12-2012), Reducing the Tax Claim to Judgment (“The principal purpose for instituting a suit to reduce tax claims to judgment is to extend the statute of limitations for collection.”)

³⁷⁴⁶ I discuss (beginning p. 634) the burden of proof in a collection suit.

³⁷⁴⁷ IRM 34.6.2.2 (06-12-2012), Foreclosure of the Tax Lien.

³⁷⁴⁸ IRM 34.6.2.3 (08-11-2004), Setting Aside Fraudulent Conveyance and Establishing Transferee Liability.

³⁷⁴⁹ IRM 34.6.2.4 (01-18-2017), Enforcing the Levy.

³⁷⁵⁰ § 6334(a)(13)(B)(i), and § 6334(e)(1)(A); IRM 34.6.2.5 (08-11-2004), Judicial Approval of Principal Residence Seizures.

³⁷⁵¹ IRM 34.6.2.7 (06-12-2012), Erroneous Refunds.

³⁷⁵² IRM 34.6.2.8 (08-11-2004), Establishing Fiduciary Liability under 31 U.S.C. § 3713.

- Suit to Quiet Title.³⁷⁵³
- Suit to Order Forfeiture.³⁷⁵⁴
- Suit to establish § 3505 liability.³⁷⁵⁵
- And a potpourri of other suits for specific types of collection related matters.³⁷⁵⁶

In addition, the Government may intervene in litigation where it is not otherwise a party to protect its interests.³⁷⁵⁷

XX. Special Collection Initiatives-Abusive Transactions (“ATAT”).

The IRS has a special program designed to focus collection efforts on transactions identified in its Abusive Tax Avoidance Transaction (ATAT) Program (discussed beginning p. 865).³⁷⁵⁸ The collection groups involved in this program are described:

To combat the problem of glossing over difficult cases, the IRS developed a specialty collection group designed to handle the tough cases and not to worry about number of hours on a case. These groups had a compliance mission somewhat like that of criminal investigation rather than a strictly revenue gathering focus. If the taxpayer’s collection case resided in part in the ATAT group, it means that the IRS had significant concerns that the taxpayer was taking steps to keep assets away from the IRS.³⁷⁵⁹

XXI. International Aspect of Collection of U.S. Tax from NonResidents.

The U.S. tax system taxes its citizens and certain classes of citizens (such as green card holders) wherever they reside. Nonresidence in the U.S. means that traditional IRS collection tools such as interaction with U.S. resident taxpayers and liens and levies are not effective. For example, that the IRS general silent lien may apply to foreign assets is meaningless if the IRS has no mechanism to enforce the lien against the foreign assets by levy or by court action or to provide effective incentive to the taxpayer to voluntarily deliver the foreign assets to the IRS. This means that a tax avoidance mechanism is available for such nonresidents by avoiding having assets within the U.S. and staying out of the U.S., thus avoiding any effective enforcement of criminal or contempt sanctions for not delivering the foreign assets to the IRS.³⁷⁶⁰

³⁷⁵³ IRM 34.6.2.10.3 (08-11-2004), Action by United States to Quiet Title.

³⁷⁵⁴ IRM 34.6.2.10.5 (06-12-2012), Forfeiture Cases.

³⁷⁵⁵ IRM 34.6.2.9 (06-12-2012), Section 3505 Third Party Liability.

³⁷⁵⁶ See e.g., IRM 34.6.2.10.1 (06-12-2012), Action on Bonds; IRM 34.6.2.10.2 (06-12-2012), Action to Open Safe Deposit Box; IRM 34.6.2.10.4 (08-11-2004), Liability of Banks on Checks.

³⁷⁵⁷ IRM 34.6.2.6 (06-12-2012), Intervention (“The usual purpose of intervention is to make the United States a participant in pending litigation that affects the taxpayer’s property, and in which a decision may adversely affect the interests of the United States.”).

³⁷⁵⁸ See IRM 5.20.1 Abusive Tax Avoidance Transaction Program. For further discussion see p. 865.

³⁷⁵⁹ Keith Fogg, IRS Properly Returned Offer in Compromise (Procedurally Taxing 12/17/19) (also discussing the return of an OIC when the collection ATAT group had the collection case).

³⁷⁶⁰ See *FTC v. Affordablemedia, LLC*, 179 F.2d 1228 (9th Cir. 1999) (a nontax case holding the U.S. person in contempt for failing to honor an order to have assets in a Cook Island Trust delivered to the court).

The IRS may have an effective domestic mechanism to get to foreign assets if it has some compulsory power over the taxpayer or custodian of the assets. If the taxpayer absents himself from the U.S., the U.S. may have no effective power either through criminal or contempt proceedings. If the custodian of the foreign assets is subject to U.S. jurisdiction, the IRS can bring compulsory process against that custodian. Thus, if the taxpayer has a Tax Haven bank account, the IRS can levy the account by levying on the custodian within the U.S. jurisdiction to bring the assets to the United States. Of course, no smart Tax Haven Bank will have a U.S. custodian, and the smart U.S. tax evader will simply put his assets in an institution (bank, brokerage, etc.) that has no sufficient U.S. presence to be subject to compulsory process in the U.S.³⁷⁶¹

A small number of U.S. tax treaties have collection mutual assistance provisions. Since, when in a treaty, this is a two-way obligation—U.S. obligated to assist the foreign country in collection and foreign country obligated or permitted to assist the U.S. in tax collection—I discuss this treaty collection provision in the next section (dealing with U.S. assistance in collecting foreign country tax).³⁷⁶²

Another tool that seems to be useful to the IRS in collecting from such taxpayers is the “Customs Hold” in the Treasury Enforcement Communications System (TECS).³⁷⁶³ The TECS is a Customs database used by law enforcement, including the IRS. The IRS notifies the Department of Homeland Security (DHS) of the names of some nonresident taxpayers with outstanding tax liabilities for input into the TECS database. Taxpayers are notified of this action via Letter 4106, Letter Advising Taxpayer of Department of Homeland Security Notification. DHS then can detain such taxpayers seeking to enter the U.S. to collect their contact information at the places they will stay in the U.S. Although IRS managers believe this is an effective collection tool, there are no empirical studies to support that belief.

XXII. International Aspects of Collection in U.S. of Foreign Country Tax.

A. The Revenue Rule.

Historically, the “Revenue Rule,” has been a barrier to one country seeking to collect taxes in another country. The Revenue Rule “at its core * * * prohibited the collection of tax obligations of foreign nations.”³⁷⁶⁴ Although described as a common law rule (suggesting some affiliation with

³⁷⁶¹ In the Swiss bank initiative, at least one Swiss bank (Wegelin Bank) made the mistake of having assets with the U.S. correspondent bank which was within the enforcement power of the U.S., but as I recall the mechanism to permit seizure related to criminal law other than tax collection.

³⁷⁶² See Keith Fogg, International Collection Efforts by the IRS – Expanding the Number of Treaties in which We Have Collection Language (Procedurally Taxing Blog 11/19/14).

³⁷⁶³ TIGTA Report No. 2014-30-054 (9/12/14), titled The Internal Revenue Service Needs to Enhance Its International Collection Efforts.

³⁷⁶⁴ See *Pasquantino v. United States*, 544 U.S. 349, 361 (2005); see also, *Attorney General of Canada v. R.J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d 103, 106 (2d Cir. 2001), cert. denied 123 S.Ct. 513 (2002) (“a long-standing common law doctrine providing that courts of one sovereign will not enforce final tax judgments or unadjudicated tax claims of other sovereigns.”). See generally Brenda Mallinak, The Revenue Rule: A Common Law Doctrine for the Twenty-First Century, 16 Duke J. Comp. & Int’l L. 79, 94 (2006); and Jeremy Temkin and Jasmine Juteau, The Revenue Rule and International Tax Collection, New York L.J (11/17/21) (offering a very good summary (continued...))

Anglo-American jurisprudence), the Revenue Rule in one form or another is the general rule among countries.

This means that taxpayers desiring to avoid U.S. tax can put their assets in a foreign jurisdiction which applies the Revenue Rule or some variation and thereby avoid the U.S. being able to collect U.S. tax from those assets. Similarly, persons subject to foreign country tax (including U.S. persons whose activities are subject to tax in a foreign country) can put or keep their money in the U.S. and avoid the foreign country enforcing those tax liabilities in the U.S.³⁷⁶⁵

B. Cracks in the Revenue Rule.

1. Treaties.

As noted above, U.S. double tax treaties now have exchange of information requirements which obligate one treaty party, upon a proper request from the other, to use their internal processes to obtain information and share it with the other party.³⁷⁶⁶ The standard double tax treaty provision requires such assistance in collecting only amounts necessary to protect on the Limitations of Benefits clause.³⁷⁶⁷

Some U.S. double tax treaties go beyond merely the exchange of information and Limitation of Benefits assistance and provide for use of each other's legal systems for tax collections. E.g., the Third Protocol (1995) of the U.S.-Canada Treaty of 1980 adds Article 26A, titled "Assistance in Collection," which provides for mutual assistance in collection revenue claims one of the treaty partners against a citizen of that treaty partner resident in the other treaty partner.³⁷⁶⁸ The requests

³⁷⁶⁴(...continued)

on the state of the Revenue Rule in U.S. through 2021). In *Pasquantino*, the Supreme Court said that the rule is an extension of the general rule that one sovereign will not enforce the penal laws of another sovereign. 544 U.S., at pp. 360-361 (citing *Wisconsin v. Pelican Ins. Co.*, 127 U.S. 265, 290 (1888), and Leflar, Extrastate Enforcement of Penal and Governmental Claims, 46 Harv. L. Rev. 193, 219 (1932)). I guess we now have authority that taxes are penal in nature!

³⁷⁶⁵ *Attorney General of Canada v. R.J. Reynolds Tobacco Holdings, Inc.* presents a dramatic instance of the application of the Revenue Rule. There, American Tobacco companies allegedly participated in a scheme to avoid Canada's high tobacco tax. Apparently because those companies had no assets in Canada from which Canada could collect the taxes in issue, Canada sued in the U.S. Since the Revenue Rule would prevent Canada from bringing a direct collection suit in the U.S., Canada brought the suit as a civil RICO action wherein the measure of damages was in principal part the lost tax revenue. The underlying acts by the tobacco companies occurred in the U.S. and thus provided a jurisdictional nexus for the civil RICO claim. The majority held, in effect, that the Revenue Rule prevented Canada from using civil RICO to achieve indirectly that which it could not achieve directly through a straight collection suit in the U.S. for the Canadian taxes. The case has an extensive discussion of the Revenue Rule and the policies behind the rule. There is a vigorous dissent in the case contesting the majority's analysis.

³⁷⁶⁶ See e.g., *United States v. Stuart*, 489 U.S. 353 (1989), involving use of the IRS summons at the request of Canadian tax authority under the U.S. Canadian double tax treaty.

³⁷⁶⁷ See e.g., U.S. Treasury 1996 Model Convention Technical Explanation, discussing Article 26; and IRM 5.21.7.4(1) (06-03-2020), Mutual Collection Assistance Requests (MCAR) ("Note: Many U.S. tax treaties contain separate collection assistance provisions intended to prevent improper use of the treaties. These limited collection assistance provisions focus on exemptions or reduced rates of tax granted under the treaty.").

³⁷⁶⁸ See *Retfalvi v. Commissioner*, 216 F. Supp. 3d 648 (E.D. N.C. 2016) holding that Canada's request to the IRS for collection of its tax is a "tax under the laws of the U.S." and thus subject to the laws prohibiting injunctions (continued...)

for such assistance are called “Mutual Collection Assistance Requests (MCAR).” There are now six countries where the double tax treaties create a mutual obligation for each contracting country to use its domestic collection procedures to collect certain taxes of a treaty partner upon request.”³⁷⁶⁹ These double tax treaty mutual obligations have some key exceptions to the general obligations to assist in collecting tax.³⁷⁷⁰

The OECD has a Convention on Mutual Administrative Assistance in Tax Matters that permit collection assistance. See the discussion of this Convention beginning on p. 457.

Of course, the reason Tax Haven jurisdictions have no such treaty provisions (they wouldn’t be Tax Haven jurisdictions if they did) is to avoid such treaty information sharing provisions and tax debt collection provisions. Tax Havens typically do not have such double tax treaties with the U.S. But Tax Havens are under heavy attack to change their ways. Thus, in response to economic incentives, some of these traditional Tax Haven countries have entered into Tax Information Exchange Agreement (also referred to as a “TIEA”). How effectively they work is another issue. But the point here is that a taxpayer may get caught in this ever-expanding net as the developed countries continue their assault on Tax Havens and offer them sufficient incentives to move closer to the global mainstream. At some point, this could mean not only tax information sharing agreements, but also reciprocal tax debt collection as in the U.S.-Canada Treaty.

2. *Pasquantino* and Extensions.

In *Pasquantino v. United States*, 544 U.S. 349 (2005), the Supreme Court held that the U.S. wire fraud statute (and mail fraud statute) could apply to use of U.S. media to effect evasion of a foreign country’s taxes. In doing so, the Supreme Court resolved a conflict among the circuits as to whether the common law revenue rule and similar prudential considerations (including presumption against extraterritoriality and the rule of lenity) required the wire fraud statute to be interpreted so

³⁷⁶⁸(...continued)

in § 7421(a) and declaratory judgments in 28 U.S.C. § 2201(a); and *Retfalvi v. United States*, 335 F. Supp. 3d 791 (E.D. N.C. 2018), aff’d 930 F.3d 600 (4th Cir. 2019) (holding that the IRS’s collections pursuant to Article 26A do not violate the Constitution’s Origination Clause, Taxing Clause, or Due Process or Equal Protection guarantees).

The Fourth Circuit opinion in *Retfalvi* explains the process under the Canada treaty: (i) the requesting state (Canada in *Retfalvi*) submits a claim to the requested state (the U.S. in *Retfalvi*), certifying that the tax has been finally determined under the requesting state’s laws; (ii) the requested state determines whether to accept the request; (iii) if the requested state accepts the claim, it must then use its internal laws as if the claim were an assessed tax; (iv) any monies collected are transferred to the requesting state; and (v) the taxpayer retains all rights of review otherwise available in the requesting state. The taxpayer involved cannot seek administrative or judicial review of the revenue claim in the requesting country (U.S. in *Retfalvi*).

³⁷⁶⁹ IRM 5.21.7.4(2) (06-03-2020), Mutual Collection Assistance Requests (MCAR), The countries are:

- Canada – All taxes including both individual and business
- Denmark – Income taxes and other specified taxes
- France – Income taxes and other specified taxes
- Japan - Income taxes and other specified taxes
- The Netherlands – Income taxes and other specified taxes
- Sweden – Income taxes and other specified taxes

³⁷⁷⁰ See IRM 5.21.7.4.1(11)d. (06-03-2020), Inbound Mutual Collection Assistance Request (says that some of the treaties provide that the MCAR cannot be used to requires U.S. assistance to collect the non-U.S. treaty partner’s tax if the taxpayer is a U.S. citizen.

exclude foreign tax violations as an object of the offense. The conduct being penalized (use of the U.S. media) occurs within the U.S. and the U.S. has a sufficient interest in regulating that conduct that it can penalize it. There was nothing in the statute or its interpretation that would suggest that Congress intended or would have intended it not to apply when the object of the conduct was a foreign fraud as opposed to a U.S. fraud.

In deciding *Pasquantino*, the majority noted:

We express no view on the related question whether a foreign government, based on wire or mail fraud predicate offenses, may bring a civil action under the Racketeer Influenced and Corrupt Organizations Act for a scheme to defraud it of taxes. See *Attorney General of Canada v. R. J. Reynolds Tobacco Holdings, Inc.*, 268 F.3d 103, 106 (CA2 2001) (holding that the Government of Canada cannot bring a civil RICO suit to recover for a scheme to defraud it of taxes); *Republic of Honduras v. Philip Morris Cos.*, 341 F.3d 1253, 1255 (CA11 2003) (same with respect to other foreign governments).³⁷⁷¹

Ch. 13. Overpayments.

I. Introduction.

The bulk of this book has been concerned with underpayments of tax and the processes and procedures that apply to underpayments. We now focus on overpayments and begin with a review of earlier materials which you might want to review at this point.

II. Overpayment Issues Previously Addressed.

A. Role of the Claim for Refund.

I discussed above (p. 223) the nature of the claim for refund, the statute of limitations and the doctrine of variance.

B. Interest.

I discussed above (p. 285) the concept that overpayments are monies due to the taxpayer which bear interest.

C. Statutes of Limitation.

I discussed above (p. 224) the statute of limitations for filing the claim for refund and, if it is denied wholly or partially, the statute of limitations on filing suit for refund.

D. Who May Seek Return of the Overpayment?

The IRS may refund a tax payment to the taxpayer involved. Most tax professionals would say, perhaps instinctively, that the taxpayer is the only one to whom a tax may be refunded.³⁷⁷² This would mean, of course, that only the taxpayer may file the claim for refund and the suit for refund.

However, the Supreme Court recognized in *United States v. Williams*, 514 U.S. 527 (1995) (which we read earlier) that there may be situations where a nontaxpayer can sue. How broad is the relief provided in *Williams*? As earlier discussed, the IRS takes the position that amendments to the Code that specifically give relief to a person in Mrs. Williams' situation effectively eviscerate any continuing precedential value of *Williams* for a refund suit by a nontaxpayer.³⁷⁷³ But is the IRS reading *Williams* too narrowly? Consider the following: In advising that the victim of an embezzlement could not file a claim for refund and receive a refund of the embezzler's overpaid tax funded with embezzled funds, the IRS reasoned:

³⁷⁷² *Pershing Div. of Donaldson, Lufkin & Jenrette v. United States*, 22 F.3d 741 (7th Cir. 1994), citing citations included its own precedent in *Busse v. United States*, 542 F.2d 421, 425 (7th Cir. 1976) and *Snodgrass v. United States*, 834 F.2d 537, 540 (5th Cir. 1987).

³⁷⁷³ Rev Rul 2005-50, 2005-30 I.R.B. 124, citing §§ 6325(b)(4) and 7426(a)(4), enacted as part of the 1998 Restructuring Act.

In our view, *Williams* should be read narrowly, limited to the facts presented in that case. The present case does not involve a payment made under protest to remove a federal tax lien and, therefore, *Williams* is distinguishable. Additionally, the employer did not make a payment to the Service in this case, and so would not qualify as a taxpayer even under a broad reading of *Williams*. Moreover, even if a court were to disagree with our reading of *Williams* and decide that *Pershing* [a case prior to *Williams* that denied refunding to an embezzlement victim] has no life after *Williams*, such a decision would not give the victim in the subject case standing to obtain a refund. Unlike *Pershing*, where the sham entity that pays the tax has no tax liability to be assessed and the victim can be deemed to be the person who paid the tax, in the subject case where the embezzler directs the funds into his own tax account, the money at issue was actually paid by the person with a tax liability to be assessed and that person has the standing to obtain a refund of any money overpaid.

We recognize that these are sympathetic facts because the embezzled funds can be traced to the wrongdoer's tax account; however, the Service has no authority to put the government in a worse position than other creditors of the wrongdoer who have no knowledge or notice of an embezzlement. That is, if the wrongdoer paid a third party for services or goods with embezzled funds, the victim could not obtain the funds from the third party; instead, the victim's cause of action is against the wrongdoer. Accordingly, to the extent that Employee would have been entitled to a refund, Employer may be entitled to obtain that amount from Estate. We do not recommend paying any such refund to Employer as state law controls the disbursement of Estate's assets to Employee's creditors.³⁷⁷⁴

Do you think the IRS's position is correct? Consider the position from the perspective of a tax administrator. Does that change your view? Consider the position from the perspective of a court.³⁷⁷⁵ Does that change your view?

III. Tentative Refunds on Carrybacks and Claim of Right.

Section 6411 permits taxpayers who have certain carrybacks from one tax year to an earlier tax year to apply for quick, tentative refunds of the earlier years' tax(es).³⁷⁷⁶ For example, a corporate taxpayer may generate a net operating loss in Year 3 and carryback that net operating loss to Year 01 to generate a Year 01 refund. In this example, the taxpayer's entitlement to the refund depends upon whether it has a Year 03 net operating loss. When the taxpayer files its tax return and application to carry the loss back, the IRS will not have had an opportunity to audit the Year 03 net operating loss claim. Section 6411 requires the IRS to perform a "limited examination," subject to later detailed review if the IRS chooses, and to make a refund within 90 days from the date the application for tentative refund was filed or from the date the return for the loss year was due (Year

³⁷⁷⁴ ILM 200519081, unofficially reproduced at 2005 TNT 93-51.

³⁷⁷⁵ Cf. *Begner v. United States*, 428 F.3d 998 (11th Cir. 2005).

³⁷⁷⁶ The application is filed on Form 1043, Application for Tentative Refund.

03 in the example), whichever is later.³⁷⁷⁷ Congress' policy for the quick refund after only limited examination was:

the Commissioner, confronted by millions of returns and an economy which repeatedly must be nourished by quick refunds, must first pay and then look.³⁷⁷⁸

The limited review consists of checking for material omissions and computational errors. If the application for tentative refund passes that limited review, the IRS will make the refund. Thereafter, the IRS may audit the Year 03 return to determine the proper amount of the net operating loss, if any, that can be carried to Year 1 and make adjustments accordingly. If, upon the more thorough audit, the IRS determines that the tentative refund was excessive because the NOL claimed is too great, the IRS may immediately assess the resulting amount due from the taxpayer to the IRS without first issuing a notice of deficiency.³⁷⁷⁹

Except for the calculation of interest, the application for tentative refund is not considered a claim for refund.³⁷⁸⁰ Thus, there is no way to litigate the issue of whether the IRS properly failed to grant the application for tentative refund.³⁷⁸¹ Rather, if the taxpayer desires to contest the denial of the application, the taxpayer must invoke the regular refund procedures by filing a claim for year 01 and sue after the claim is denied or the or the six-month period expires.³⁷⁸²

³⁷⁷⁷ § 6411(b). The limited review is designed to create a presumption in favor of refund provided the request is facially regular even if there is a risk that a subsequent deficiency upon closer review may not be collectible. See FSA 200149014, reproduced at 2001 TNT 237-25.

³⁷⁷⁸ *Warner v. Commissioner*, 526 F.2d 1, 2 (9th Cir. 1975); see also H.R. Rep. No. 79-849, at 2 (1945), reprinted in 1945 C.B. 566, 566-67. Because of the exigent need to which this quick refund procedure applies, there is no requirement for Joint Committee on Taxation ("JCT") Staff review (discussed in the next section of the text above) prior to issuing the tentative refund, but the IRS must later submit a report when and if it finally determines the refund is appropriate. § 6405(b). The civil statute of limitations should remain open for any corrective action depending upon the comments of the JCT Staff, and the IRS may not enter a closing agreement pending JCT Staff review that would foreclose making the adjustment.

³⁷⁷⁹ § 6213(b)(3) (treating the "the amount of the excess as a deficiency as if it were due to a mathematical or clerical error appearing on the return"). You will recall that § 6213(b)(1) permits the immediate assessment of mathematical or clerical errors. One issue presented by this summary assessment procedure is whether an intervening Tax Court decision for the year to which the loss was taken (Year 01 in the example above) would be subject to claim preclusion (*res judicata*) or issue preclusion (*collateral estoppel*) preventing the IRS from taking the summary assessment remedy provided by § 6213(b)(1). The Eighth Circuit answered that question in *Jefferson Smurfit Corp. v. United States*, 439 F.3d 448 (8th Cir. 2006), where it held that, by virtue of the express treatment in the statute, claim preclusion did not apply. See also *Ron Lykins, Inc. v. Commissioner*, 133 T.C. 87 (2009) (holding consistently with *Jefferson Smurfit* that principles of *res judicata* (claim preclusion) did not apply, but basing its holding on narrower grounds than *Jefferson Smurfit*: "we decide this case on the narrower basis of the statutory scheme in sections 6411, 6212(c)(1), 6213(b)(3), and 6511(d)(2)(B) that is applicable only to tentative refunds and that excepts the operation of *res judicata* [claim preclusion] in that specific circumstance.")

³⁷⁸⁰ § 6411(a) (flush language providing that an application for tentative review "shall not constitute a claim for credit or refund"); Regs § 1.6411-1(b)(2) ("An application for a tentative carryback adjustment does not constitute a claim for credit or refund."),

³⁷⁸¹ Reg. § 1.6411-1(b)(1) & (2). The cases consistently hold that the Form 1045, Application for Tentative Refund, cannot not constitute an "informal" claim for refund. E.g., *Silipigno v. United States*, 2017 U.S. Dist. LEXIS 107608 (N.D. N.Y. 2017) (citing the case authority), *aff'd* 2019 U.S. App. LEXIS 3191 (2d Cir. 2019).

³⁷⁸² Reg. § 1.6411-3(c); *Coca Cola Co. v. United States*, 2009 U.S. Claims LEXIS 199 (Ct. Fed. Cl. 2009). The application for tentative refund, Form 1139 or its equivalent, Form 1045, "shall not constitute a claim for credit or

(continued...)

This tentative refund procedure also applies to refunds under the claim of right provisions in § 1341.³⁷⁸³

IV. Joint Committee on Taxation (“JCT”) Review of Large Refunds.³⁷⁸⁴

Section 6405(a) prohibits refund of income or estate and gift taxes and most other refunds in excess of \$2,000,000 (\$5,000,000 in case of a C corporation) until 30 days after the IRS has submitted a report to the JCT,³⁷⁸⁵ where it is reviewed by the staff of the JCT.³⁷⁸⁶ The \$2,000,000 threshold is determined based on net over-assessments for the audit cycle in a multi-year review. The IRS report details the IRS's findings and conclusions with respect to the refund it proposes to make. This gives the JCT Staff an opportunity to review the proposed refund and comment thereon.³⁷⁸⁷

³⁷⁸²(...continued)

refund. “ § 6411(a) (flush language); Reg. 1.6411-1(b)(2). Taxpayers’ attempts to somehow convert the application, Form 1139, or communications with the IRS about the application into an informal claim for refund have generally been unsuccessful. See e.g., *Kirsh v. United States*, 131 F. Supp. 2d 389, 391 (S.D.N.Y. 2000), *aff’d*, 258 F.3d 131 (2d Cir. 2001).

³⁷⁸³ § 6411(d).

³⁷⁸⁴ For more discussion of this JCT review process than offered here, see the IRM section on Examination dealing with Identification of Joint Committee Cases, IRM 4.36.2.1.1 (06-18-2021), Background (referring to IRM 4.36.1.1.1 (06-18-2021), Background; see also the following IRM sections; and for Appeals handling of Joint Committee cases, 8.7.9.1.1 (12-27-2017), Background and following sections. For a discussion of details and procedures, see Tax Refund Claims: An Overview of the Joint Committee on Taxation’s Review Process (JCT Paper dated 1/9/19), <https://www.jct.gov/publications.html?func=startdown&id=5156>.

³⁷⁸⁵ The complete list from § 6405(a) is: “any income, war profits, excess profits, estate, or gift tax, or any tax imposed with respect to public charities, private foundations, operators' trust funds, pension plans, or real estate investment trusts under chapter 41, 42, 43, or 44.” According to a TIGTA report (Large Dollar Refunds Are Not Always Examined and Sent to the Joint Committee on Taxation (TIGTA Ref. No. 2020-30-023 6/3/20)), the following are excluded:

1. A refund or credit of estimated or withheld income tax made without examination.
2. A refund or credit of an unassessed advance payment or deposit made prior to determination of a taxpayer’s tax liability, or a refund or credit of an amount paid on an early filed return that exceeds the amount of the tax liability reported by the taxpayer on the last return filed on or before the due date of that return.
3. Abatement of an unpaid tax liability in excess of the jurisdictional amount. For example, an abatement of an unpaid portion of an assessment under I.R.C. § 6404, regardless of the amount, is not a refund or credit under I.R.C. § 6405.
4. An overpayment determined by the U.S. Tax Court or any other court of competent jurisdiction as a result of the trial of a case (rather than by a stipulation of settlement). Non-reportable overpayments determined by the U.S. Tax Court or other courts are limited to overpayments from only those years in the court decision. Refund from any years outside of the specific court decision may be reportable if they meet the jurisdictional amount.

³⁷⁸⁶ The history of the JCT review of refunds is recounted in George K. Yin, James Couzens, Andrew Mellon, the "Greatest Tax Suit in the History of the World," and the Creation of the Joint Committee on Taxation and its Staff, 66 Tax L. Rev. 787, 866-873 (2013). A lighter but very informative summary of the current refund review is in Eric Kroh, JCT Will Review a Refund if It's Big Enough, 143 Tax Notes 160 (Apr. 14, 2014).

³⁷⁸⁷ The process is reviewed in IRM 4.36.1, Joint Committee Process Overview. Note that, as the statute is written, it gives the JTC staff 30 days to make its comments on the IRS report and the statute does not give JTC veto authority over the proposed refund. As a practical matter, JTC staff review often takes more than 30 days. Can the IRS issue refund at the end of the 30-day period if JCT staff has not provided its comments? If the JTC staff comments negatively on the refund, can the IRS refund anyway? From a strict legal perspective, the answer to both questions is yes. From a practical perspective, the answer is no (Congress is, after all, the hand that feeds the IRS). In agreeing to

(continued...)

Section 6405(a) does not give the JCT a veto power over the refund.³⁷⁸⁸ Moreover, the statute does not prohibit the refund if the JCT Staff fails to do anything in the 30 day period nor, even, does it prohibit the refund if the JCT staff disapproves.³⁷⁸⁹ Practically speaking, however, the IRS and the DOJ will almost invariably condition settlements requiring a refund over the threshold upon favorable review by the JCT Staff.³⁷⁹⁰

In a case pending in a court, the report must be made with respect to any full or partial settlement or concession which would result in refunds or credits exceeding \$2,000,000.³⁷⁹¹ For cases handled by the DOJ, DOJ will prepare and submit the report.³⁷⁹²

A return to the taxpayer of an amount held as a cash bond rather than as a payment of tax is not a refund and need not be reported to the JCT.³⁷⁹³

³⁷⁸⁷(...continued)

such a refund, the IRS usually advises that the refund is contingent upon favorable JCT staff review (whenever it comes, even outside the 30 day period).

³⁷⁸⁸ See CC-2003-023 (7/3/03), unofficially reported at 2003 TNT 134-54 (7/14/03), which contains a good summary of the JCT review requirement. The JCT web page titled “Joint Committee Statutory Refund Review” (viewed 7/22/18) says:

The statute does not require that the IRS comply with Joint Committee staff requests for reconsideration of adjustments. Both the Joint Committee staff and the IRS view the review process as a way of improving tax administration. As a matter of agency policy, the IRS will not pay any part of a refund until the Joint Committee staff and the IRS conclude their review of the case. The conclusion of a case can be that the IRS initial position was correct; that the IRS concurs with the Joint Committee recommendation; or that no change will be made because the IRS does not agree with the Joint Committee recommendation.

³⁷⁸⁹ In an interview, George K. Yin, the former tax counsel to the Senate Finance Committee, said that JCT has no authority beyond the review function. “That is to say, the Joint Committee must have an opportunity to review such proposed refunds, but has no ability, for example, to stop any refund with which it may disagree.” Interview with George K. Yin, 25 ABA Tax Section News Quarterly 14, 17(Winter 2006).

As to the time to process refunds, it is reported that “[a]bout 75 percent of reports are processed in 30 days, while 90 percent are processed within 45 days.” Eric Kroh, JCT Will Review a Refund if It's Big Enough, 143 Tax Notes 160 (Apr. 14, 2014). The same article quotes a practitioner as saying that the review typically is finished in 30 days and has never known one to take in excess of 50 days.

³⁷⁹⁰ Eric Kroh, JCT Will Review a Refund if It's Big Enough, 143 Tax Notes 160 (Apr. 14, 2014) (“Although the IRS is not statutorily required to wait more than 30 days for the JCT to finish reviewing a case before releasing a refund, in practice the agency will not issue one until the committee has weighed in.”). See also e.g., DOJ Settlement Reference Manual, ¶ I.C. At the May Meeting 2002 of the ABA Tax Section, the long-time chief of DOJ’s Review Section orally reported that DOJ had once settled without JCT approval, but that it was “a terrible mistake.” Minutes of the Meeting.

See *United States v. United States District Court for the Northern Mariana Islands*, 694 F.3d 1051, 1055 n4 (9th Cir. 2012), discussing the interplay of this provision with the DOJ delegations of authority to settle cases).

³⁷⁹¹ IRM 35.4, Settlement of Joint Committee Cases.

³⁷⁹² Id.

³⁷⁹³ IRM 35.5.4.3(5) (08-11-2004), Method of Computation.

Section 6405 also provides exceptions to JCT prior review for refunds without predicate JCT review for (i) tentative refunds under § 6411 relating to tentative carryback adjustments,³⁷⁹⁴ and (ii) refund claims attributable to certain disaster losses.³⁷⁹⁵

Consider the following about the process:

First, why does Congress require such a review if there is a refund of \$2,000,000 but does not require the review if the IRS foregoes a proposed deficiency of \$2,000,000? Isn't the effect on the fisc the same in either event?³⁷⁹⁶ Although the statute does not contain an analogous requirement in a deficiency context, IRS Appeals does periodically submit reports to JCT on the largest deficiency cases. On the same theme, what if the IRS spots a large tax issue on audit and does not pursue the adjustment. Isn't the effect on the fisc the same? Yet there is not JCT review in either of these cases.³⁷⁹⁷

Second, if you are representing a large taxpayer in an audit where the IRS is noising about a deficiency exceeding \$2,000,000 and you think the taxpayer may have a good defense in litigation, how would the potential for JCT review affect your decision as to whether to prepay or deposit (both to stop the running of interest which would include the hot interest penalty for large underpayments)?

Third, what is the correlation between the required JCT review and the tentative refund procedure discussed (see p. 836)? A tentative refund for a large taxpayer may well exceed the \$2,000,000 amount. If the IRS must act on the application for refund before it has performed an audit, it will not be in a position to provide a meaningful report to the JCT. In that event, the refund is made within the 90 day period required by § 6411(b), and a report is made to JCT after the IRS has performed such audit as it chooses to make.³⁷⁹⁸

³⁷⁹⁴ § 6405(b). After the tentative refund, after survey action or examination, refunds that exceed the specified amounts are reported to the JCT (after consideration of any deficiency due). IRM 4.36.2.2.2 (09-22-2015), Tentative Refunds IRC 6405(b).

³⁷⁹⁵ § 6405(c). The report must be made after determination of the correct tax. IRM 4.36.2.2.3 (05-04-2010), Disaster Loss Refunds IRC 6405(c).

³⁷⁹⁶ See George K. Yin, Let's Get the Facts of the Couzens Investigation Right!, 2013 TNT 165-12 (8/26/13) (a former tax counsel to the JCT who recounts the history of this provision as being based on congressional concerns about favoritism for large taxpayers, but pointing out that the favoritism can be effected by simply not requiring the payment of the tax in the first place; Professor Yin concludes: "Thus, if Congress was seriously concerned with possible, corrupt favoritism by the agency (rather than mere posturing to gain political advantage), it badly missed the mark.").

³⁷⁹⁷ For more on this seeming anomaly, see George K. Yin, James Couzens, Andrew Mellon, the "Greatest Tax Suit in the History of the World," and the Creation of the Joint Committee on Taxation and its Staff, 66 Tax L. Rev. 787, 866-873 (2013). Professor Yin, uniquely situated by experience to write this history, calls the omission "an important oversight" because it ignores an important possibility for corruption in the IRS, which was the reason for JCT review of refunds. Moreover, since the JCT is involved in other systemic aspects of the tax system, the absence of review of these other ways of achieving an equivalent effect to a large refund deprives the JCT and its staff of unique perspective within its area of responsibility.

³⁷⁹⁸ § 6405(b).

Ch. 14. Miscellaneous.

I. Purpose of Chapter.

In this chapter, I cover some specific subjects that did not easily fit in the earlier chapters dealing with tax procedure but that I think should be considered in a base level course on tax procedure.

II. Nonstatutory Doctrines that May Affect Tax Procedure.

Tax administration (including interpretation of statutory text) has developed various doctrines that may apply to affect outcomes without direct statutory authority, sort of like tax common law. Perhaps the most famous is the doctrine (or principle) that substance should generally control tax consequences rather than form (that is, except when form controls over substance). A related doctrine is the step transaction doctrine. These doctrines relate to interpretation and application of the substantive tax law rather than operating on tax procedure. I deal here with those doctrines that may affect tax procedure. Here I can just introduce the concepts deployed so that readers can be aware of the contexts of when those concepts may be deployed to affect procedural steps or outcomes.

A. Equitable Estoppel.

The doctrine of equitable estoppel basically holds that one should not be permitted to take advantage of his own wrong.³⁷⁹⁹ While it is often said that equity plays a limited role in tax cases,³⁸⁰⁰ still within the limited role it can play is to import equitable principles of procedural fairness.

The concept is illustrated in a recent case where, in a complex transaction involving an abusive tax shelter, the taxpayer sought to disavow a tax reporting position based on misrepresentations to achieve the effect of a tax refund that would not have been available based on the structure reported and could have been otherwise corrected except for the tax reporting and misrepresentations. The Tax Court declined to allow the taxpayer's disavowal of its return reporting position based on equitable estoppel. The Court noted the elements necessary for equitable estoppel to apply against a taxpayer as follows:

- (1) the taxpayer made a false representation or engaged in a wrongful misleading silence,
- (2) the error originated in a statement of fact and was not a mistake of law,
- (3) the Commissioner did not know the correct facts, and
- (4) the Commissioner is adversely affected by the taxpayer's acts or statements.³⁸⁰¹

I cannot develop all of the possibilities or even a fair range of them for the application of the doctrine of equitable estoppel in a tax procedure context. I just caution readers that, in particularly "cute" constructions of tax procedure positions to achieve an inequitable benefit, the doctrine may

³⁷⁹⁹ *R.H. Stearns Co. of Bos., Mass. v. United States*, 291 U.S. 54, 61-62 (1934).

³⁸⁰⁰ E.g., *Callaway v. Commissioner*, 231 F.3d 106, 134 (2d Cir. 2000).

³⁸⁰¹ *New Capital Fire, Inc. v. Commissioner*, T.C. Memo. 2021-67, at pp. 27-28.

be deployed in some cases. Predicting when it may apply requires careful understanding of the tax procedure universe and analysis of the specific transaction and context where the application of the usual rules seems to produce an inconsistent benefit that the taxpayer's own conduct would otherwise produce. The doctrine of equitable estoppel may apply against the taxpayer or the IRS.

The doctrine of equitable estoppel to override rules that would otherwise apply is like an affirmative defense of the party invoking the doctrine and thus, logically, the party invoking the doctrine bears the burden of proof.³⁸⁰²

B. Duty of Consistency.

A variation of the doctrine of equitable estoppel is the duty of consistency, which is sometimes referred to as "quasi-estoppel." I discussed in some detail above the application of this concept with regard to statutes of limitations. (See discussion beginning p. 258) I also discussed in summary the application to the IRS. (See discussion beginning p. 93) Refer to those sections for an understanding of the concept, but it may come up in other contexts.

C. Equitable Tolling.

Various IRC provisions have time deadlines. As discussed earlier (beginning p. 181), such deadlines can be rigid (often with jurisdictional signaling a rigid deadline) or, for lack of a better word, non-rigid (meaning that, in appropriate equitable circumstances, the deadline period may be tolled or suspended or may not even apply³⁸⁰³).

III. Nonfiler Initiatives.

Systemically, one of the biggest problems facing the IRS is how to encourage taxpayers to file tax returns. IRS data indicate that there are 55 million potential nonfilers. It is difficult to project the amount of the revenue loss with respect to nonfilers. The IRS believes that most of these nonfilers (well over 85%) would owe little or no tax; many might be entitled to refunds that, for some reason, they choose not to claim by filing a return. But some nonfilers are high income nonfilers with billions in potential tax liabilities involved.³⁸⁰⁴

Nonfilers undermine the voluntary compliance system which is premised upon the notion that if I report and pay tax, if any, that I owe, others will and should do so also. Of course, there cannot be a perfect system in which all taxpayers will have the encouragement to file. The IRS's mission requires that it take initiatives to encourage the system to work as perfectly as possible.

³⁸⁰² *New Capital Fire, Inc. v. Commissioner*, T.C. Memo. 2021-67, at p. 27.

³⁸⁰³ For example, § 7481 provides the date that the Tax Court decision becomes final. Some courts treat finality as prescribed by § 7481 as jurisdictional thus precluding change after that date; others invoke exceptions in narrow circumstances based upon equitable or related concepts. See e.g., Keith Fogg, [Finality of a Tax Court Decision](#) (Procedurally Taxing Blog 6/15/21), discussing *Kirik v. Commissioner*, 2021 U.S. App. LEXIS 16815 (2d Cir. 2021) (Summary Order).

³⁸⁰⁴ TIGTA Report, High-Income Nonfilers Owing Billions of Dollars Are Not Being Worked by the Internal Revenue Service (Ref. No. 2020-30-015 May 29, 2020).

Many taxpayers that might otherwise be nonfilers are forced or encouraged by built-in systems to file. The system of employee withholding and information returns both for employees (Form W-2) and for other payees (the series of Forms 1099, for payments to independent contractors, payments of interest and dividends, etc.) all force or encourage a taxpayer to file returns. But there is a vast part of our economy where these pressures do not exist or taxpayers choose not to respond to them.

The IRS has certain policies, programs and initiatives that may be described as nonfiler initiatives. These include:

(1) The Voluntary Disclosure Policy. Perhaps the most prominent such policy is the Voluntary Disclosure policy noted above (beginning on p. 317).

(2) Computer Matching Program. The IRS has a computer matching program based upon the various information returns it receives. If, for example, it receives a computer file database of Forms 1099-Int from a bank identifying the taxpayers to whom it paid interest, including taxpayer X, the IRS computers will do a computer search to match the payment to the return. It will quickly pick up if no return was filed for the social security number of Taxpayer X. Principally using this information, the IRS then has a Taxpayer Delinquency Initiative and Substitute for Return Initiative. Under these initiatives, the IRS will gather information from available sources (principally information returns) and write the taxpayer to encourage the filing of a return. If the taxpayer cannot be located or fails to file the returns, the IRS will then use the authority under § 6020(b) SFR to prepare a return and assess the tax. The IRS can then employ the collection measures noted above.

(3) Stop Filer Program. The IRS has a “stop filer” program that attempts to identify taxpayers who previously filed but who stopped filing.³⁸⁰⁵ This can be substantially supported by computers. There are legitimate reasons that a person does not file after filing for previous years -- the person dies, for example. But barring some indication of a reason to stop filing, the IRS may attempt at least by correspondence to confirm whether the taxpayer should be filing and then take such additional measures as appropriate.

Of course, the IRS must make a cost/benefit determination in its nonfiler efforts. By looking at the profile of a particular taxpayer or class of taxpayers that appears to be a nonfiler(s), the IRS may determine that it is not cost effective to pursue obtaining returns from the taxpayer(s).³⁸⁰⁶ In the past, this policy might permit the IRS to ignore the taxpayer(s) where the known indications are the he or she (they) would not owe a material tax or even might be entitled to a refund. But there is a factor to consider other than the immediate tax liability or refund -- that is getting the taxpayer back into the system for future years when there might be significant net tax revenue at stake (at least in the aggregate) and keeping faith with compliant taxpayers.

³⁸⁰⁵ IRM 5.19.2.3 (02-15-2022), IMF Return Delinquency Case Creation; see also GAO Report GAO-09-238, titled “Tax Gap” (1/28/2009), noting some deficiencies in the scope of the stop filer program.

³⁸⁰⁶ See IRS Policy Statement P-5-133.

Finally, as of 2020, the IRS has developed and is testing a “new nonfiler strategy * * * approach nonfiling in a more strategic manner.”³⁸⁰⁷ The goal is to more effectively use the limited IRS resources to target nonfilers, particularly high income nonfilers who are said to account for a very large revenue loss to the Government.³⁸⁰⁸

IV. Global High Wealth Program.

The IRS has found that there is sufficient noncompliance among high wealth individuals to justify special audit compliance initiatives. The offshore bank initiative is perhaps a subset, although a lot of low wealth individuals were caught up in that special initiative. In 2009, the IRS “launched the Global High Wealth program³⁸⁰⁹ (often acronymed to GHW) to centralize and focus IRS compliance expertise involving high wealth individuals and their related entities.”³⁸¹⁰ According to the IRM:

GHW was formed to take a holistic approach in addressing the high wealth taxpayer population; to look at the complete financial picture of high wealth individuals and the enterprises they control. A GHW enterprise case consists of a key case, generally an individual income tax return, and related income tax returns where the individual has a controlling interest and significant compliance risk is deemed to exist. Controlling interest can include significant ownership of or significant influence over an entity or multiple entities within the enterprise. The enterprise case may include, but is not limited to, interests in partnerships, trusts, subchapter S corporations, C corporations, gift tax or estate returns. GHW personnel work with personnel from other business operating divisions within the IRS to address noncompliance across the entire enterprise. GHW consists of three functions: Workload Services (WLS), practice network, and the field examination groups.³⁸¹¹

This group is within LB&I but draws on the experience and expertise of both LB&I and SB/SE.³⁸¹² The group is colloquially called the “IRS Wealth Squad.”

GHW audits focus on all aspects of a taxpayer or group of related taxpayers’ tax returns with review of sprawling relationships between taxpayers, including ownership interests in separate controlled entities (such as corporations and shareholders). For example, a high net worth individual may start the focus of the audit, but then family members and related controlled entities (such as

³⁸⁰⁷ TIGTA Report, High-Income Nonfilers Owing Billions of Dollars Are Not Being Worked by the Internal Revenue Service 4 (Ref. No. 2020-30-015 May 29, 2020) (in the report, TIGTA reviews IRS initiatives regarding high income nonfilers and reports on the new nonfiler initiative).

³⁸⁰⁸ Id.

³⁸⁰⁹ Initially called the Global High Wealth Industry Group.

³⁸¹⁰ IR-2010-13 (1/26/10) Prepared Remarks of IRS Commissioner Doug Shulman to New York State Bar Association Taxation Section Annual Meeting in New York City; see also IRM 4.52.1 Global High Wealth Industry Processes and Procedures. A good recent discussion of the GHW is Alan Winston Granwell & Andrea Darling de Cortes, The IRS global high wealth industry group: how the IRS targets high net worth individuals (International Bar Association 10/7/20).

³⁸¹¹ IRM 4.52.1.1.1 (04-27-2022), Background.

³⁸¹² For a negative view of the success of the program because of budget constraints, see Jesse Eisinger and Paul Kiel, Gutting the IRS: The IRS Tried to Take on the Ultrawealthy. It Didn’t Go Well. (ProPublica, 4/5/19).
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corporations and partnerships) will then be reviewed the determine whether material tax noncompliance appears. The audit activity is much more significant as the IRS uses numerous IDRs and even summonses to develop the overall view required by the program; one leading firm practicing in the area characterizes GHW audits as “thorough, invasive, and cumbersome.”³⁸¹³ My experience is that these audits are looking for the big hits, so that some of the “small stuff” that may have grabbed an agent’s attention in the historic IRS process may fall by the wayside.

The GWH focus includes not only audits of filed returns, but audits of high wealth individuals who have not filed returns.³⁸¹⁴ As of 2021, the IRS is seeking substantial additional resources, a significant portion of which will be used for this program. The Commissioner explained:

- Global High Wealth and Examinations of High Income/High Wealth Taxpayers. As noted in a recent Closer Look article¹⁰, high income/high wealth taxpayers, including high-income non-filers (HINF), continue to be a high priority for the IRS. As reported in the IRS’s most recently published Data Book (2019), the exam coverage rate (closed and in-process) for Tax Year 2015 of taxpayers with incomes of \$10 [*11] million or more is about 8.16% (down from almost 23% in 2010). The rate for taxpayers with incomes between \$5-10 million was 4.39%; for those with income between \$1-5 million was about 2.39%; for those with income between \$500,000- \$1 million was about 1.13%; and for those with income between \$200,000-\$500,000 was about 0.55%. The IRS receives more third-party information (Forms W-2’s, Forms 1099, etc.) for taxpayers with income between \$200,000-\$1 million than for those above \$1 million. Audit rates for the highest income taxpayers are higher than for any other category of individual filers, and we expect to see that trend generally continue as the timeframe expires within which we can conduct and close examinations for tax years following 2015.³⁸¹⁵

V. Audit Initiatives Regarding Fraud.

IRS Criminal Investigation (“CI”) has several streams of sources for identifying targets for criminal fraud investigations. A principal source is IRS audit and collection activity. Within the audit and collection functions is a category of personnel called Fraud Enforcement Advisor (“FEA”), formerly called Fraud Technical Advisor), whose function is to assist agents and collection officers identify potential fraud and help assess whether cases should be referred to CI or a civil fraud penalty should apply. The FEAs are managed through the Office of Fraud Enforcement (“OFE”) to

³⁸¹³ See Caplin & Drysdale web page titled “The IRS Resumes its Global High-Wealth Examination Program and Targets High Income Non-Filers,” dated 7/22/20 and viewed 2/24/21.

³⁸¹⁴ See discussion of IRS Nonfiler Initiatives below beginning on p. 842.

³⁸¹⁵ Chuck Rettig, [A Closer Look: Impacting the Tax Gap](https://www.irs.gov/pub/foia/ig/cl/A%20Closer%20Look%20-%20Impacting%20the%20Tax%20Gap%20By%20Commissioner%20Chuck%20Rettig.pdf), <https://www.irs.gov/pub/foia/ig/cl/A%20Closer%20Look%20-%20Impacting%20the%20Tax%20Gap%20By%20Commissioner%20Chuck%20Rettig.pdf> (viewed 4/28/21).

provide fraud guidance for compliance employees.³⁸¹⁶ The OFE was to better coordinate compliance efforts.³⁸¹⁷

VI. Tax Protester and Tax Defier Initiatives.

I have mentioned the term “tax protester” at several points in the text. The term tax protester has become a mainstream term—often used by the courts—although its precise meaning may not be clear. Two alternative spellings—protester and protestor—are used,³⁸¹⁸ although protester appears more often and is used in this text except where I am quoting and the quote uses protestor. Tax protesters run the gamut from those with some type of sincerely held legal objections (including constitutional objections) at one extreme to those who simply masquerade their attempt to evade tax in the guise of such objections at the other extreme.³⁸¹⁹ The term tax protesters could apply to taxpayers over the entire spectrum.

Over time, the term tax protester was often used to describe persons who questioned the legitimacy of the tax system and even deliberately gamed the system through the fog of tax protest legal and constitutional claims. The term was less used for the more benign type who had sincere legal and constitutional concerns about the application of the tax laws.³⁸²⁰ In 1998, Congress forbade the IRS from labeling a taxpayer as an “illegal tax protester” or any similar designation.³⁸²¹ The Department of Justice is not included in the prohibition but chooses now to call the illegal tax protesters tax defiers and devotes a section of the CTM to “Tax Defiers (also known as illegal tax protesters).”³⁸²² Courts, however, continue to use the term “tax protester” as the short reference to persons the CTM calls “tax defiers.”³⁸²³ I use the term tax protester in this book and generally use

³⁸¹⁶ IRM 25.1.2.1.3 (04-23-2021), Roles and Responsibilities.

³⁸¹⁷ For more on the office and the compliance fraud initiatives, see IRM 25.1.2 Recognizing and Developing Fraud.

³⁸¹⁸ E.g., *United States v. Miller*, 2016 U.S. App. LEXIS 17341 (7th Cir. 2016) (“tax protester”); and *United States v. Sloan*, 939 F.2d 499, 499-501 (7th Cir. 1991) (“tax protestor”). Indeed, sometimes both spellings are used: e.g., TIGTA Report, Fiscal Year 2020 Statutory Audit of Compliance With Legal Guidelines Prohibiting the Use of Illegal Tax Protester and Similar Designations (Ref. No. 2020-30-057 9/8/20); DOJ’s CTM 40.00 TAX DEFIERS (also known as illegal tax protesters) and *United States v. Benson*, 561 F.3d 718, 722 (7th Cir. 2009).

³⁸¹⁹ Nathan J. Hochman, Stopping “Frivolous Squared” Before It Spreads, 20 Stan. L. & Pol’y Rev. 69 (2009).

³⁸²⁰ Hochman, *supra*.

³⁸²¹ The IRS Restructuring Act of 1998, § 3707, Pub. L. No. 105-206, 112 Stat. 685. I have not researched precisely what evil Congress perceived in this particular prohibition. Section § 7803(d)(1)(A)(v) requires TIGTA to review and report annually on IRS compliance with the prohibition. The most recent report is TIGTA Report, Fiscal Year 2022 Statutory Audit of Compliance With Legal Guidelines Restricting the Use of Records of Tax Enforcement Results (Ref. No. 2022-30-067 9/27/22).

³⁸²² CTM 40.00. See also Jen E. Ihlo & Erin B. Pulice, Prosecuting Tax Defier and Sovereign Citizen Cases—Frequently Asked Questions, U.S. Attorneys’ Bull., Mar. 2013, at 49-52. (using tax defier and illegal tax protester as interchangeable; and discussing various of the schemes, including what is called the “sovereign citizen” scheme that can present itself in various contexts).

³⁸²³ Courts use of the terms occurs in hundreds of cases. Examples, more or less random, of recent cases include: *Orth v. Commissioner*, 2018 U.S. App. LEXIS 16630 (7th Cir. 2018) (unpublished) (although insisting that he was not a “tax protester,” Orth “filed an appeal rife with tax-protester arguments that this court and others have repeatedly deemed frivolous”; *United States v. Gilmartin*, 2017 U.S. App. LEXIS 5239 (2d Cir. 2017) (unpublished) (referring to “Tax Protestor Arguments”); *Crummey v. Commissioner*, 2017 U.S. App. LEXIS 5996 (5th Cir. 2017) (continued...)

it in a context to refer to the defier subset of tax protesters—those who make illegal tax protester claims.

Since the constitutionality and legality of the income tax (and federal taxes generally) have long since been recognized by the courts, there is little room for the “tax protester” to maneuver in avoiding tax obligations on constitutional grounds, but there will undoubtedly be taxpayers who, for one reason or another, will maintain a sincerely held belief that they cannot legally or constitutionally be taxed.³⁸²⁴ That belief, if sincerely held, will not exempt them from their tax obligations, but it can be a defense to tax crimes which generally require willfulness—defined in a series of Supreme Court cases culminating in Cheek v. United States, 498 U.S. 192, 201 (1991), as deliberate intent to violate a known legal duty. The standard for tax crimes means that the defendant must know the law and intend that his conduct violate the law; it thus created an exception to the general rule that ignorance of the law is no excuse.³⁸²⁵ *Cheek* created the potential for a defense that the taxpayer sincerely believed that his conduct did not violate the law and thus did not intend to violate a known legal duty. *Cheek*, however, denied that defense if the claim was a constitutional claim that the tax law did not apply, because that claim subsumes knowledge of the law and intent to violate that known law. Tax protesters usually claim to have that sincere belief that they are not violating the law. DOJ Tax charges a number of tax protesters and, if the evidence convinces the jury that they knew the law and intended to violate it (as it usually does because DOJ Tax brings only the strongest cases), they are convicted.

Most taxpayers engaging in tax defiance conduct do not have a sincerely held belief, but merely seek to mask their tax evasion in the guise of legitimate protest. There are a great number of these taxpayers and this obviously creates a major compliance problem for the IRS. This requires that the IRS employ major enforcement resources against tax defiers and even tax protesters because even sincerely held but wrong beliefs can undermine the tax system.³⁸²⁶ DOJ Tax prosecutes a small subset of the protesters making this type of claim, with the hope that by prosecuting a few and publicizing the prosecutions and convictions, many taxpayers will be discouraged from the conduct at the inception. Notwithstanding that, there has always been a vigorous and relentless tax protester community.

VII. Offshore Initiatives.

I discuss special initiatives for offshore accounts and entities in Ch.17, beginning p. 983.

³⁸²³(...continued)

(unpublished) (referring to taxpayer’s “tax protester” arguments); *United States v. Myr*, 2016 U.S. App. LEXIS 18963 (6th Cir. Unpublished) (describing the convicted defendant as “a self-employed auto mechanic with a professed interest in tax-protester theories”); *Reynoso v. Commissioner*, T.C. Memo. 2016-185 (referring to tax protester literature).

³⁸²⁴ Some examples: The Sixteenth Amendment was not properly ratified; wages are not income subject to tax; tax is a form involuntary servitude prohibited by the Thirteenth Amendment; Fifth Amendment, etc. See CTM 40.00; and Jen E. Ihlo & Erin B. Pulice, Prosecuting Tax Defier and Sovereign Citizen Cases—Frequently Asked Questions, U.S. Attorneys' Bull., Mar. 2013, at 49-52.

³⁸²⁵ See *Bryan v. United States*, 524 U.S. 184, 194-195 (1998), discussing *Cheek*.

³⁸²⁶ Hochman, *supra*, pp. 82-83.

VIII. Tax Shelters.

A. Introduction - The Compliance Problem.

Marketed tax shelters have been a compliance problem for many years. During the late 1970s and early 1980s, many individuals subject to then very high maximum individual income tax rates (going up to 70%) invested in tax shelters to reduce their tax liabilities. In response, Congress enacted various changes to the Code (the at risk rules, basis limitations, increased penalties, etc.) and significant individual income tax rate reductions designed to take away the incentive to play the tax shelter game (at least, so it was thought until the excess of the late 1990s). Corporations were, however, not burdened by these disincentives because tax sheltering at the corporate level was not then perceived as a major compliance problem.

In the 1990s, corporate tax sheltering began to proliferate or at least become more visible to the IRS and the public. With significantly increasing individual income (at least in the upper reaches of the income spectrum) and resulting high individual taxes for those lucky individuals (even with the reduced rates), creative and aggressive tax and financial professionals began again to design complex tax shelters for individuals. This is simply a tax iteration of the adage that where there is demand, supply will surface. As a result, individual tax sheltering again became a problem by the mid-1990s.

The line between shelters that simply achieve benefits intended by Congress and those that are abusive is often very hard to draw. But the perception is that some shelters crossed the line (as amorphous as the line was or at least was imagined) and created two systemic problems: (1) abusive tax shelters artificially reduce federal revenue at a time when deficits are a major problem; and (2) by permitting some taxpayers to pay less than they owe, they create a major unfairness issue -- taxpayers who don't play the game are subsidizing the cost of Government for those who do.

The visible players in the game in the 1990s and continuing into the 2000s were (i) large corporations and very wealthy taxpayers who artificially reduced their tax liabilities and (ii) their professional "enablers" (major accounting and law firms and major financial firms whose moral compass was thrown off balance by the substantial fees they could "earn").

[G]iven how few tax returns our cash-strapped IRS now audits, the reward-to-risk ratio for playing the audit lottery with extremely shady tax shelter schemes is very high. In fact, an illustration of Gresham's Law seems to have occurred in the tax field. Just as bad money drives out good in an unregulated market, bad tax advisors can drive out good ones. Accounting firms that don't market tax shelters fear they'll lose customers to their competitors. Tax lawyers who honorably refuse to write letters blessing dubious shelters -- an essential insurance policy for tax avoiders against being criminally charged if a scheme is detected and rejected by the IRS -- find their clients shifting to less principled attorneys.

In fact, all of the major accounting firms, including Ernst & Young, Deloitte Touche, PricewaterhouseCoopers and KPMG, have been involved in marketing

clearly abusive tax shelters. So have many supposedly-respectable law firms. Numerous large banks and investment firms, such as Citigroup, Bank of America, Wachovia and Merrill Lynch, have also been implicated in tax evasion and/or aggressive sheltering activities.

The more dubious the scheme, the more the lawyers and accountants charge their clients: “My own recommendation is that we should be paid a lot of money here for our opinion since the transaction is clearly one that the IRS would view as falling squarely within the tax shelter orbit,” a KPMG tax advisor told the firm in May of 1999 (as a Senate investigation revealed this February).

Far too many investors and business owners are tempted to understate their gross business receipts and/or overstate their expenses, move their investments offshore, fail to report their capital gains accurately, and so forth. Not all succumb, of course. Even for those who do, the actual alchemy of making income disappear for tax purposes is probably often a mystery. That doesn't in any way absolve the tax cheats and aggressive avoiders from blame: they're the demand side of the equation. But without the supply side, the lawyers, accountants and banks that set up the shelters, the demand would go unrequited.

The ethically-challenged tax advisers who are willing to help would-be tax evaders are well aware that the chances of their clients being audited by the IRS are extremely low, so long as a tax return doesn't raise obvious red flags. Their chief weapons to win this “audit lottery” are complexity and subterfuge.³⁸²⁷

Tax shelters are very difficult to define in a way that does not throw out at least some babies with the bath water or, on the other hand, is so narrow that too many loopholes remain. Even for abusive shelters, the ethical taxpayer or practitioner may have to rely upon the gut instinct that it is too good to be true (or, like pornography, they know it when they see it even when they are definition-challenged). We have already encountered the Code's attempt to define tax shelters in terms of the accuracy related penalty. The accuracy related penalty has a definition in § 6662(d)(2)(C)(iii) that includes any arrangement “if a significant purpose of such partnership, entity, plan, or arrangement is the avoidance or evasion of Federal income tax.” This is a very broad and sweeping definition. Virtually anything where the significant motivation to enter the transaction is tax advantage and very little business purpose is a tax shelter.

A good example of a classic tax shelter is *Compaq Computer Corp. v. Commissioner*, 113 T.C. 214 (1999), rev'd 277 F.3d 778 (5th Cir. 2002). Please read both the Tax Court and the Appellate opinions now. In net, a classic abusive tax feature present in the case is that, except for the benefit of the foreign tax credit for foreign taxes paid that Compaq did not bear the economic burden, the deal was a money-loser. The Tax Court viewed the transaction as abusive and imposed penalties; the Fifth Circuit blessed the transaction. It was a tax shelter; it was an abusive tax shelter; but it was a legal tax shelter in the view of the Fifth Circuit. Both the Tax Court and the Fifth Circuit are good courts, with good judges having radically different views of what is an abusive tax shelter

³⁸²⁷ Robert S. McIntyre, *Tax Cheats and Their Enablers*, 2005 TNT 70-20.

and where to draw the line. (Note the Fifth Circuit’s opinion, however, has not worn well with time.³⁸²⁸)

Another example of a highly structured transaction is presented in *Long Term Capital Holdings, L.P. v. United States*, 330 F. Supp. 2d 122 (D. Conn. 2004), aff’d in unreported decision at 150 F. App’x 40 (2d Cir. 2005), a case that achieved considerable notoriety because of the tax amounts and personalities involved (including prominent tax lawyers as advisors and testifiers—a mock Bushism for witnesses—and a Nobel Prize winner as a principal business decision maker). The facts are dizzyingly complex, perhaps requiring the genius of a Nobel Prize winner even to understand. And that ultimately was the downfall of the shelter, for the district court plainly recognized that all parties involved (including the lawyers) were smart enough to know that they had a tax shelter house of cards that would ultimately fail or was at high risk of failing and were hiding the defects in the complexity and hidden reporting. Basically, they were playing the audit lottery and lost.³⁸²⁹

Abusive tax shelters are many and varied. Some are outright fraudulent, usually wrapped in a shroud of paperwork, including legal opinions, and cascade of words designed to mask the shelter as a real deal. The more sophisticated are often without substance but do have some at least attenuated, if superficial, claim to **legality**. Some of the characteristics that I have observed for tax shelters that the Government might perceive as abusive are that (i) the transaction is outside the mainstream activity of the taxpayer, (ii) the transaction is incredibly complex in its structure and steps so that not many (including IRS auditors, if they stumble across the transaction(s)) will have the ability, tenacity, time and resources to trace it out to its illogical conclusion (this feature is often included to increase the taxpayer’s odds of winning the audit lottery); (iii) false legal or other types of professional opinions will appear to opine, often in a torrent of words and pages with more heat than light, as to the favorable tax consequences of the transaction;³⁸³⁰ (iv) the transaction costs of the arrangement and risks involved, even where large relative to the deal, offer a favorable cost benefit/ratio only because of the tax benefits to be offered by the audit lottery, (v) the promoters (and other enablers) of the adventure make a lot more than even an hourly rate even at the high end for professionals (the so-called value added fee, which is often insurance type compensation to mediate potential penalty risks by shifting them to the tax professional or the netherworld between the taxpayer and the tax professional)³⁸³¹ and (vi) the objective indications as to the taxpayer’s purpose

³⁸²⁸ E.g., *Bank of N.Y. Mellon Corp. v. Commissioner*, 801 F.3d 104, 124 (2d Cir. 2015), cert. den. 577 U.S. 1193 (2016) (“In so holding, we agree with the Federal Circuit in *Salem* and disagree with decisions of the Fifth and Eighth Circuits (*Compaq* and *IES*, respectively)”) cert. den., 136 S. Ct. 1377 (2016); see also cert. den. in *Am. Int’l Grp., Inc. v. United States*, 577 U.S. 1193 (2016). Lee A. Sheppard, [The Fun Goes Out of Foreign Tax Credit Planning](#), 148 Tax Notes 1283 (Sept. 21, 2015) (hyperbolically, as is her wont, “The Second Circuit essentially reversed the *Compaq* and *IES* decisions.”)

³⁸²⁹ See also *Santa Monica Pictures LLC v. Commissioner*, T.C. Memo. 2005-104.

³⁸³⁰ E.g., *Fidelity Intern. Currency Advisor A Fund, v. United States*, 747 F.Supp.2d 49, 69 (D. Mass. 2010), aff’d, 661 F.3d 667 (1st Cir. 2011) “opinions were “stagecraft” and “fraudulent,” known by all to be “false” and “not possibly correct”; “opinions had but one purpose: to serve as a form of insurance against the imposition of penalties if the transactions were ever to come to light.”) See Mortimer M. Caplin, [The Tax Lawyer’s Role in the Way the American Tax System Works](#) (13th Annual Erwin N. Griswold Lecture Before The American College of Tax Counsel 1/22/05) (““At the heart of every abusive tax shelter is a tax lawyer or accountant.””)

³⁸³¹ *Fidelity Intern. Currency Advisor A Fund, v. United States*, 747 F.Supp.2d 49, 69 (D. Mass. 2010), aff’d, 661 F.3d 667 (1st Cir. 2011) “opinions were “stagecraft” and “fraudulent,” known by all to be “false” and “not

(continued...)

for entering the transaction or how the transaction was structured are a tax savings motive rather than any type of purposive business or investment motive.³⁸³²

More succinctly, Michael Graetz, a Yale Law Professor, has described an abusive tax shelter as “[a] deal done by very smart people that, absent tax considerations, would be very stupid.”³⁸³³ Other thoughtful observers vary the theme, e.g., a tax shelter “is a deal done by very smart people who are pretending to be rather stupid themselves for financial gain.”³⁸³⁴ Others have described the abusive tax shelters as “too good to be true.”³⁸³⁵

For example, an economically motivated taxpayer would be willing to invest \$100 in an exotic arrangement X if the taxpayer has no further economic benefit, risk or costs and can achieve a tax benefit of \$1,000. In this example (a highly simplified one), the taxpayer would have a net \$100 economic loss on the transaction -- i.e., his \$100 cost with no economic return. Yet the tax savings alone would give him a \$900 profit (\$1,000 in-pocket tax savings less \$100 of economic cost). The question in tax shelters is whether Congress intended tax benefits for such nonpurposive activity. The trial level opinion in *Compaq* answers the question in the negative; the appellate decision answers the question in the positive, so long as the technical tax structure adheres to the Code. The *Compaq* appellate decision was music to tax shelter promoters’ ears, appearing to justify very aggressive exploitation of tax loopholes.

To be contrasted are the areas where Congress has chosen to give tax incentives even if there is no realistic expectation of economic profit apart from the tax benefits. Congress has thus provided

³⁸³¹(...continued)

possibly correct”; “opinions had but one purpose: to serve as a form of insurance against the imposition of penalties if the transactions were ever to come to light.”)

³⁸³² For a similar multi-factor definition, see Joseph Bankman, *The Tax Shelter Problem*, 57 Nat'l Tax J. 925, 925 (2004) (“(1) tax motivated; (2) transaction unrelated to a taxpayer's normal business operations; that (3) under a literal reading of some relevant legal authority; (4) produces a loss for tax purposes in excess of any economic loss; (5) in a manner inconsistent with legislative intent or purpose.”).

³⁸³³ Quoted in Erik M. Jensen, *Legislative and Regulatory Responses to Tax Avoidance: Explicating and Evaluating the Alternatives*, 56 St. Louis L.J. 1,3 (2012). Professor Jensen offers his own succinct version: “a transaction with claimed tax benefits that are questionable in light of congressional intentions and basic good sense, but that have sufficient authority so that fraud is not involved.”

³⁸³⁴ Id., quoting David Hariton. The definitions will necessarily vary from observer to observer. Consider for example (Kyle D. Logue, *The Problem of Tax Law Uncertainty and the Role of Tax Insurance*, Va. Tax Rev. 339, 346 n. 6 (Fall 2005)):

The term “tax shelter” is notoriously difficult to define. Unless otherwise specified, I use the term loosely to mean transactions that are primarily tax-motivated and that rely for their tax advantages on a reading of the tax laws that is (a) technically legal (that is, not obviously illegal) but (b) more likely than not be rejected by a court if examined on the merits. Many other definitions of tax shelters have been offered, some broader and some narrower than the one just stated. Some of these other definitions are mentioned below.

³⁸³⁵ This description is usually deployed in cases involving civil penalties for abusive tax shelters. Section 6662 provides an accuracy related penalty for negligence. Reg. § 1.6662-3(a), (b)(1)(ii) says that negligence includes failure to “make a reasonable attempt to ascertain the correctness of a deduction, credit or exclusion on a return which would seem to a reasonable and prudent person to be ‘too good to be true’ under the circumstances.” Similarly, although § 6664 offers a reasonable cause exception to § 6662 accuracy related penalties, reasonable cause likely will not be found for deals that are “too good to be true.” E.g., *Stobie Creek Invs. LLC v. United States*, 608 F.3d 1366, 1382 (Fed. Cir. 2010).

tax incentives to low-income housing that might not otherwise offer the appropriate economic incentive. In these areas, the benefits were intended by Congress and thus are not abusive even apart from realistic expectations of economic profit.

One of the “vexing” problems for aggressive tax transactions is discerning the taxpayer’s “intent” in entering the transactions. Generally, the professionals rendering aggressive opinions in tax advantaged arrangements require that the taxpayer represent that they are motivated by some nontax intent or nontax profit motive. This created (the players hoped) a risk free zone where neither the taxpayer nor the professional would suffer any penalty downside from the aggressive transaction. The thought, such as it was, was: (i) the taxpayer would urge that, if there is a problem, it is with the professional’s opinion upon which the taxpayer “relied”; and (ii) the professional would urge that, if there is a problem, it is with the taxpayer’s false representation of intent or motive upon which the professional “relied.” That gambit did not work except in those cases where the IRS did not discover the aggressive tax reporting or, if it did, the statute of limitations prevented asserting tax and appropriate penalties. But the search for the taxpayer’s intent is particularly frustrating. As one court observed with regard to tax intent in avoidance transactions:

The frustrating anarchy in the decisions is no doubt due, in part at least, to the element of subjectivity which seems inevitably to attend upon the search for a taxpayer’s intention or motivation. There has resulted a rather remarkable accumulation of conveniently vague maxims, such as the substance, not the form, of a transaction must control tax incidence, that an unreal or sham transaction must be disregarded, that what was actually done rather than what was said is the important criterion, that a taxpayer is privileged to reduce his taxes by means which the law permits, etc. General propositions do not decide concrete cases, however, and in the end the particular facts of this case must bear the responsibility for decision.³⁸³⁶

I now turn to the various Government initiatives to combat the abusive tax shelter problem. As of the date of writing this edition, the IRS has a web site titled “Abusive Tax Shelters and Transactions” (Page Last Reviewed or Updated: 12/20/19 and viewed 7/27/20) listing a number of the abusive tax shelter initiatives. I cover some of them in more detail here. The initiatives often involve increased and more focused use of tools the IRS already has (such as regular and John Doe summonses) and the development of new legislative, administrative and judicial initiatives to address the problem more effectively.

B. Congressional Initiatives.

1. Introduction.

Congress has addressed tax shelters in other ways. First, Congress from time to time will enact targeted legislation to deal with the perceived abuse in the substantive provision exploited by the industry.³⁸³⁷ For example, in response to a contingent liability tax shelter that the Court’s

³⁸³⁶ *Alinco Life Insurance Company v. United States*, 373 F. 2d 336, 341 (Ct. Cl. 1967) (cleaned up and footnotes omitted)

³⁸³⁷ Erik M. Jensen, Legislative and Regulatory Responses to Tax Avoidance: Explicating and Evaluating (continued...)

ultimately rejected on substance over form and related grounds, Congress enacted § 358(h) to require that basis be reduced for contingent liabilities transferred in tax-free reorganizations.

Congress, however, rarely has the appetite to play whack-a-mole with creative and aggressive tax planners and taxpayers. This legislative substantive solution is often episodic and an incomplete solution. Further, from time-to-time, Congress will enact more general substantive legislation such as the passive activity loss and at rules, basis rules and such similar rules designed to take the incentive out of abusive tax sheltering.³⁸³⁸ The most recent of these congressional initiatives is the codification of the economic substance doctrine,³⁸³⁹ along with an automatic penalty.³⁸⁴⁰ These too are episodic, but in classic whack-a-mole style do generally tend to address the abuses for which they are crafted.

In addition to such substantive legislation, Congress enacted legislation that falls more easily in the procedure category designed to make abusive tax shelters more visible to the IRS and to punish abusive tax shelter behavior. In the balance of this section, I focus on that legislation which many practitioners believe is more effective at rooting out tax shelter abuse.³⁸⁴¹ I do include a discussion of the codification of the economic substance doctrine because of the penalty imposed for violating the codification.

2. Increasing the Promoter Penalty—Upping the Ante.

Congress' early attempt to stem the tax shelter abuse tide was to penalize the promoter.

Section 6700(a)(1) imposes a penalty upon a person who meets the following **conjunctive** requirements:

- (1) **either**
 - (A) organizes (or assists in the organization of) a partnership or other entity, investment plan or arrangement, or “any other plan or arrangement; **or**
 - (B) participates (directly or indirectly) in the sale of any interest in the entity or plan or arrangement.

and

³⁸³⁷(...continued)

the Alternatives, 56 St. Louis L.J. 1, 12-17 (2012) (discussing also the limits of targeted substantive legislation).

³⁸³⁸ See Jensen, *supra*, pp. 17-21.

³⁸³⁹ § 7701(o). See Jensen, *supra*, pp. 21-43.

³⁸⁴⁰ The § 6662(a) 20% accuracy related penalty is imposed for understatements attributable to "any disallowance of claimed tax benefits by reason of a transaction lacking economic substance (within the meaning of section 7701(o)) or failing to meet the requirements of any similar rule of law". § 6662(b)(6). The 20% penalty is increased to 40% for any "non-disclosed non-economic substance transactions" - i.e., "transactions described in subsection (b)(6) with respect to which the relevant facts affecting the tax treatment are not adequately disclosed in the return nor in a statement attached to the return").

³⁸⁴¹ E.g., Jensen, *supra*, p. 45, quotes a noted practitioner, Peter Canellos, “The key to deterrence for all classes of tax shelters is reporting and penalties. To fight what amounts to audit lottery and to nip schemes in the bud, airtight, focused, prompt, and efficient disclosure rules are required.” This is just to say that abusive tax shelters are all about the audit lottery, so that effective deterrence is targeted at ensuring detection and punishing behavior that hides the ball.

- (2) makes or furnishes or causes another person to make or furnish (in connection with such organization or sale) that is either:
- (A) a material false or fraudulent statement as to any tax benefit; **or**
 - (B) a gross valuation overstatement as to material matter (200% over the correct valuation).³⁸⁴²

The § 6700 penalty is (i) \$1,000 or (ii) if the person establishes that it is lesser, 100% of the gross income “derived or to be derived” from the activity.³⁸⁴³ However, for false or fraudulent misstatements, the penalty is 50% of the gross income derived or to be derived from the penalized conduct without the \$1,000 ceiling.³⁸⁴⁴ Two types of statements are subject to the increased penalty: statements directly addressing the availability of tax benefits and statements concerning factual matters relevant to the availability of the tax benefit.³⁸⁴⁵ The statements can be written or oral.³⁸⁴⁶

The gross income includes not only the income from the initial conduct (such as setting up the entity or arrangement) but also ongoing income from the conduct. For example, in a microcaptive insurance arrangement, significant income is derived on the setup, but also may be derived from ongoing maintenance of the arrangement over the years it is in existence; the penalty applies to the ongoing income as well.³⁸⁴⁷ The activity is each sale or promotion and may apply separately to each person involved in the sale or promotion.³⁸⁴⁸

The statute has broad concepts—e.g., “organizes” and “plan”—that are not narrowly confined, but instead intended to sweep in all sorts of conduct consistent with the congressional intent to punish organized tax misbehavior. By illustration from a case,³⁸⁴⁹ a promoter wrote a book titled the Law That Never Was claiming that the Sixteenth Amendment was unconstitutional and also promoted a Package that would assist taxpayers in avoiding payment of tax. The promoter further claimed that taxpayer’s could exploit the so-called *Cheek* defense by claiming that they did not know the tax was lawful and thus could not be convicted of a tax crime because they did not act willfully. The promoter’s claims have been consistently rejected by the courts in cases involving other persons. Amazingly, the promoter had been criminally prosecuted and convicted of tax crimes and still promoted his arrangement. The court easily found the “plan” element:

³⁸⁴² § 6700(b)(1).

³⁸⁴³ § 6700(a)(2).

³⁸⁴⁴ See § 6700(a)(2) (last sentence as added by the American Jobs Creation Act of 2004).

³⁸⁴⁵ *United States v. Campbell*, 897 F.2d 1317, 1320 (5th Cir. 1990).

³⁸⁴⁶ *United States v. Music Masters, Ltd.*, 621 F.Supp 1046, 1058 (W.D. N.C. 1985).

³⁸⁴⁷ CCM 202125008 (3/12/21, released 6/25/21); and CCM 202125009 (3/12/21, released 6/25/21).

³⁸⁴⁸ Thus the penalty may apply to a promoter **and** persons associated with the promoter (such as members, officers, employees, agents, etc., depending upon their respective participation in the conduct and scienter (discussed below) that the statements are false or fraudulent. Thus, “the greater the person’s involvement in the transaction, the more likely it is that the person knew or had reason to know that the statements he made, or caused others to make, were false or fraudulent.” CCM 202125009 (3/12/21, released 6/25/21, citing H.R. Rep. 101-247 at 1397 (1989)).

Whether a partnership is a person separate from its partners has been decided differently in two separate cases. Compare *In re Tax Refund Litigation v. United States*, 766 F. Supp. 1248, 1257 (E.D.N.Y. 1991), aff’d in part and rev’d in part, 989 F.2d 1290 (2d Cir. 1993) (not separate persons hence, once penalty applied to partnership, cannot apply to partners) with *Bailey Vaught Robertson & Co. v United States*, 828 F. Supp 442 (N.D. Tex. 1993) (partners separate from partnership and can be separately assessed the penalty, thus rejecting *In re Tax Refund Litigation*).

³⁸⁴⁹ *Id.*

First, the definition of a plan for purposes of § 6700 is broad. Courts have not been hesitant in finding tax protesters' activities to qualify as plans. Benson's plan was simpler than some prior tax protester schemes, but its purpose was the same -- to evade tax liability. Instead of filing false tax returns, Benson's plan encouraged customers not to file a tax return at all. Such a don't-do-it-yourself kit does not require forms or filings. Here, the devil is not in the details. Like every other tax protester, Benson was selling an illegal method by which to avoid paying taxes; the details of that method are immaterial.³⁸⁵⁰

The Court also handily found the other elements of § 6700 present.

The penalty requires some level of conscious participation or scienter. In determining scienter, the courts consider such factors as (i) the person's reasonable reliance on knowledgeable professionals; (ii) the person's level of sophistication and education; and (iii) the person's familiarity with tax matters.³⁸⁵¹ But the penalty may be based on “imputation of knowledge” where “commensurate with the level of comprehension required by the [person's] role in the transaction.”³⁸⁵² Thus, the greater the person's involvement in the transaction and level of education and experience, the more likely it is that the person knew or had reason to know that the statements he made, or caused others to make, were false or fraudulent.³⁸⁵³

The Government bears the burden of proof in a court proceeding on the merits of the penalty.³⁸⁵⁴ The false or fraudulent standard, of course, requires the same level of proof as fraud elsewhere in the Code, and since this is a civil context the Government bears the burden by clear and convincing evidence.³⁸⁵⁵

The IRS may assess this penalty without any predicate action such as the income tax notice of deficiency that confers a prepayment remedy by filing a Tax Court petition. This means that the taxpayer is relegated to a refund remedy. The refund remedy, you will recall, is subject to *Flora's* full payment rule, which could be daunting given the size of some § 6700 penalty assessments. The full payment rule is, however, mitigated by the divisible nature of the § 6700 penalty assessments (i.e., per sale) and is further mitigated by a special refund proceeding with only 15% payment.³⁸⁵⁶ The latter mitigation rule requires that (i) within 30 days of the assessment's notice and demand, the person assessed the penalty pay 15% of the penalty and file a claim for refund and (ii) then file the refund suit in district court by the earlier of (a) 30 days from the denial of the claim or (b) 6 months

³⁸⁵⁰ P. 722 (cleaned up).

³⁸⁵¹ E.g., *United States v. Estate Preservation Services*, 202 F.3d 1093, 1103 (9th Cir. 2000).

³⁸⁵² *United States v. Campbell*, 897 F.2d 1317, 1321-22 (5th Cir. 1990).

³⁸⁵³ H.R. Rep. 101-247 at 1397 (1989).

³⁸⁵⁴ § 6703(a).

³⁸⁵⁵ Cf. § 7454(a) (applying in Tax Court cases, burden on IRS where issue is whether the petitioner guilty of fraud with intent to evade tax; that burden requires proof by clear and convincing evidence). As noted earlier, in most contexts in which § 6703(a) applies, the preponderance of the evidence standard would apply (see p. 381 n. 1613.), however in the § 6700 context where the liability hinges on a false or fraudulent statement, the clear and convincing standard would likely apply.

³⁸⁵⁶ For both mitigation rules, see *Humphrey v. United States*, 2011 U.S. Dist. LEXIS 33441 (N.D. Ga 2011). The 15% payment opportunity is in § 6703(c).

and 30 days from the date the refund claim was filed.³⁸⁵⁷ If the taxpayer pursues this special district remedy, collection procedures on the balance will be suspended and the statute of limitations on collection will also be suspended.³⁸⁵⁸ In addition, to the special procedure for partial payment and suit for refund, penalties subject to this rule (i.e., §§ 6700, 6701 and 6702) may be litigated in CDP procedures.³⁸⁵⁹

There is no statute of limitations on assessing this penalty.³⁸⁶⁰

3. Tightening Registration and Reporting Requirements.

a. “Reportable Transactions,” “Listed Transactions” and “Transactions of Interest.”

Many of the tax shelters—certainly most or all abusive ones—rely upon the audit lottery. They may be abusive, they may be complex, they may stink, but ultimately, if the IRS does not discover them or can’t understand them, they work! (What I mean is that the taxpayer gets the tax benefits as if they legally worked.) Congress addressed the issue of the IRS’s ability to discover abusive tax shelters by creating the concept of “reportable transaction” which taxpayers and material advisors must report.³⁸⁶¹ A reportable transaction is a transaction “of a type which the Secretary determines as having a potential for tax avoidance or evasion.”³⁸⁶² The determination is made under the § 6011 regulations.³⁸⁶³ Currently, reportable transactions include:³⁸⁶⁴ (i) “Listed transactions” (or substantially similar transactions) described in IRS Notices, regulations or other guidance;³⁸⁶⁵ (ii) “confidential transactions;³⁸⁶⁶ (iii) transactions with “contractual protection” requiring return of a fee if the tax benefit is not obtained;³⁸⁶⁷ (iv) “loss transactions” in which a taxpayer claims a tax

³⁸⁵⁷ § 6703(c).

³⁸⁵⁸ § 6703(c).

³⁸⁵⁹ *Gardner v. Commissioner*, 145 T.C. 161 (2015), citing *Williams v. Commissioner*, 131 T.C. 54, 58 n.4 (2008); *Harry v. Commissioner*, T.C. Memo. 2009-206; *Callahan v. Commissioner*, 130 T.C. 44 (2008).

³⁸⁶⁰ *Lamb v. United States*, 977 F.2d 1296 (8th Cir. 1992) (rejecting the general fallback statute of limitations in 28 U.S.C. § 2462); *Capozzi v. United States*, 980 F.2d 872 (2d Cir. 1992) (rejecting both the application of the § 6501 statute and the general statute in 28 U.S.C. § 2462); *Sage v. United States*, 908 F.2d 18 (5th Cir. 1990); *Emanuel v. United States*, 705 F. Supp. 434, 436 (N.D. Ill. 1989); *Agbanc, Ltd. v. United States*, 707 F. Supp. 423, 426-27 (D. Ariz. 1988); *Groves v. United States*, 2017 U.S. Dist. LEXIS 68847 (N.D. Ill. 2017) (as in *Capozzi*, rejected § 6501 statute and the general statute in 28 U.S.C. § 2462); and *Crim v. Commissioner*, T.C. Memo. 2021-117, at *16 - *18 (same rejecting § 6501 statute and 28 U.S.C. § 2462), aff’d 66 F. 4th 999 (D.C. Cir. 2023).

³⁸⁶¹ The Form for reporting is Form 8886, Reportable Transaction Disclosure Statement. The related form for material advisors to report is Form 8918, Material Advisor Disclosure Statement.

³⁸⁶² § 6707A(c)(1).

³⁸⁶³ *Id.*

³⁸⁶⁴ See Form 8886 for the categories. The Form 8886 says that the reportable transactions include prohibited tax shelter transactions in the first three categories in the list in the text. The reference is to § 4965 and Reg. § 53.4965-3.

³⁸⁶⁵ § 6707A(c)(2); Reg. § 1.6011-(b)(2). The notices of listed transactions are catalogued on an IRS web page titled “Recognized Abusive and Listed Transactions” (Last Reviewed or Updated on 5/5/17 and viewed on 7/24/17).

³⁸⁶⁶ Reg. § 1.6011-4(b)(3).

³⁸⁶⁷ Reg. § 1.6011-4(b)(4).

benefit exceeding a certain amount (\$10,000,000 for corporations);³⁸⁶⁸ and (v) “transactions of interest” which the IRS has identified by notice, regulation or other guidance.³⁸⁶⁹

Listed transactions are a special category of reportable transactions because of the consequences of failure to report by participants or material advisors. The consequences of failure to report listed transactions are:

Participants required to disclose these transactions under § 1.6011-4 who fail to do so will be subject to penalties under § 6707A. Participants required to disclose these transactions under § 1.6011-4 who fail to do so may also be subject to an extended period of limitations under § 6501(c)(10). Material advisors required to disclose these transactions under § 6111 who fail to do so may be subject to the penalty under § 6707. Material advisors required to maintain lists of investors under § 6112 who fail to do so (or who fail to provide such lists when requested by the IRS) may be subject to the penalty under § 6708(a). In addition, the IRS may impose other penalties on persons involved in these transactions or substantially similar transactions, including the accuracy-related penalty under § 6662 or § 6662A, the § 6694 penalty for understatements of a taxpayer’s liability by a tax return preparer, and the § 6695A penalty for certain valuation misstatements attributable to incorrect appraisals.³⁸⁷⁰

Courts will treat the transaction as substantially similar is a “person of ordinary intelligence” could determine that transaction is substantially similar.³⁸⁷¹

“Transactions of interest” are an interim step for transactions the IRS has identified and notified the public that the transactions have tax avoidance potential but the IRS lacks information to determine whether it is a tax avoidance transaction. When further information is developed, the transactions may be identified as listed transactions. The IRS notifies the public of transactions of interest via Notices which are collected on its web site which advises:³⁸⁷²

The following transactions have been identified and classified by the Internal Revenue Service as “Transactions of Interest”. Transactions that are the same as, or substantially similar to, these transactions are subject to the disclosure requirements of § 6011 (§ 1.6011-4), the material advisor disclosure statement requirements of § 6111 (§§ 301.6111-1, 301.6111-2, 301.6111-3), and the list maintenance requirements of § 6112 (§ 301.6112-1).

³⁸⁶⁸ Reg. § 1.6011-4(b)(5).

³⁸⁶⁹ Reg. § 1.6011-4(b)(6). The notices of transactions of interest are listed on an IRS web page titled “Transactions of Interest” (Last Reviewed or Updated 4/17/17 and viewed on 7/24/17).

³⁸⁷⁰ This is quoted from Notice 2017-10, Listing Notice–Syndicated Conservation Easements, Section 3. Listed Transactions. This is a good statement of the consequences of failure to report listed transactions.

³⁸⁷¹ *Interior Glass Sys. v. United States*, 927 F.3d 1081 (9th Cir. 2019) (also holding that the “substantially similar” standard is not unconstitutionally vague).

³⁸⁷² The IRS web site collecting the Notices is titled “Transactions of Interest” (last reviewed or updated 11/20/21 and viewed 7/27/22). As with many abusive tax shelters, the identified transactions are often complex, cobbling together a legal superstructure that appears to produce results too good to be true.

Persons required to file material advisor disclosure statements under § 6111 who have failed to do so may be subject to the penalty under § 6707(a). Persons required to maintain lists of investors under § 6112 who have failed to do so (or who fail to provide such lists when requested by the IRS) may be subject to the penalty under § 6708(a). In addition, the IRS may impose penalties on parties involved in these or substantially similar transactions, including the accuracy-related penalty under § 6662.

I have discussed these various penalties for failure to report the reportable transactions in various sections of this book. The penalties can be onerous indeed, particularly on the material advisor (often called a promoter) under § 6707.³⁸⁷³ The goal, of course, is to encourage reporting of the transactions rather than assess and possibly collect penalties for failure to do so.³⁸⁷⁴

Finally, there have been recent cases where courts have held that identifying transactions as listed or reportable in IRS Notices is not proper because, by identifying the transactions, the IRS is adopting a legislative rule, requiring that the transactions be identified by notice and comment regulations.³⁸⁷⁵ One context involves IRS use of subregulatory guidance in the form of Notices to designate listed transactions subject to statutory reporting and penalty regimes for so-called Micro-Captive Insurance arrangements. Courts rejected the IRS's use of Notices rather than notice and comment regulations.³⁸⁷⁶ In 2023, the IRS proposed regulations to list those arrangements, but stated that it continues to believe and will argue in audits and litigation outside the Sixth Circuit that Notices are a proper tool to identify those transactions.³⁸⁷⁷

³⁸⁷³ See e.g., *Larson v. United States*, 2016 U.S. Dist. LEXIS 179314 (S.D. N.Y. 2016), aff'd 888 F.3d 578 (2d Cir. 2018) involving a § 6707 penalty aggregating \$160,232,026 for two widely promoted tax shelters. The liability was imposed jointly and severally on more than one co-promoter, with \$96,820,667 having been paid in the aggregate. Larson, a co-promoter jointly and severally liable for the balance, tried and failed to avoid *Flora's* full payment rule to pursue a refund suit, which would require that he pay the unpaid balance of over \$60 million. See also *Diversified Group Inc. v. United States*, 841 F.3d 975, 981 (Fed. Cir. 2016). The Second Circuit in *Larson* said (p.587, cleaned up):

We close with a final thought. The notion that a taxpayer can be assessed a penalty of \$61 million or more without any judicial review unless he first pays the penalty in full seems troubling, particularly where, as Larson alleges here, the taxpayer is unable to do so. But, while the *Flora* rule may result in economic hardship in some cases, it is Congress' responsibility to amend the law.

³⁸⁷⁴ Two commenters on the reportable transaction regime stated its overall objective to “detect and deter abusive tax shelter activity.” Joshua D. Blank & Ari Glogower, *The Trouble With Targeting Tax Shelters*, 74 Admin. L. Rev. 69 (2022). They noted the following specifics (pp, 76-77):

- Providing agents an “audit roadmap” to detect abuse;
- Providing the IRS an opportunity to “to communicate to taxpayers that they view specific transactions as abusive and to describe their reasoning for the designations”;
- With the high penalties, deterring taxpayers from engaging in abusive transactions.

³⁸⁷⁵ E.g., *Green Valley Investors, LLC v. Commissioner*, 159 T.C. ___, No. 5 (2022); and *Mann Construction, Inc. v. United States*, 27 F.4th 1138 (6th Cir. 2022).

³⁸⁷⁶ E.g., *Mann Construction, Inc. v. United States*, 27 F.4th 1138 (6th Cir. 2022).

³⁸⁷⁷ See Proposed Reg. § 1.6011-10, 88 FR 21547,21553-4 (4/11/23); and IR-2023-74, April 10, 2023.

b. Registration.

Each material advisor for a reportable transaction is required to register and disclose the principal tax benefits of the transaction.³⁸⁷⁸ Failure to register or filing false or incomplete information is subject to a \$50,000 penalty, except that, for failure to register listed transactions, the penalty is the greater of \$200,000 or 50% of the gross income derived by the person with respect to the transaction.³⁸⁷⁹ The 50% amount is increased to 75% if the failure to register is intentional. The IRS takes the position that the § 6707 penalty has no statute of limitations, relying on cases holding that other penalties not linked to a return filing requirement³⁸⁸⁰ have no statute of limitations.³⁸⁸¹

c. Taxpayer Reporting.

Taxpayers must report on their income tax returns reportable transactions.³⁸⁸² All transactions that are “substantially similar”—a broad concept to prevent avoidance—must be reported. A taxpayer participating in a reportable transaction is required to disclose on its tax return the key tax shelter features—including the (i) “expected tax treatment and all potential tax benefits,” (ii) “any tax result protection” and (iii) “sufficient detail for the [IRS] to be able to understand the tax structure of the reportable transaction and the identity of all parties involved.”³⁸⁸³

d. Penalties.

(i) Failure to Disclose Reportable Transaction. Section 6707A imposes a penalty for failing to disclose information with respect to a reportable transaction.³⁸⁸⁴ The penalty, as amended in 2010, is “75 percent of the decrease in tax shown on the return (or which would have resulted from such transaction if such transaction were respected for Federal tax purposes)” as a result of the reportable transaction.³⁸⁸⁵ The penalty thus derived is subject to a minimum penalty and a maximum penalty. The minimum penalty for both listed and non-listed reportable transactions is \$5,000 for

³⁸⁷⁸ § 6111(a). See § 6111(b) for definition of material advisor.

³⁸⁷⁹ § 6707(b)(2).

³⁸⁸⁰ E.g., §§ 6700 and 6701.

³⁸⁸¹ See ILM 200112003 (11/28/2000), reprinted in 2001 TNT 58-74 (3/26/01), citing *Mullikin v. U.S.*, 952 F.2d 920 (6th Cir. 1991); *Lamb v. U.S.*, 977 F.2d 1296 (8th Cir. 1992); *Capozzi v. U.S.*, 980 F.2d 872 (2d Cir. 1992); and *Sage v. U.S.*, 908 F.2d 18 (5th Cir. 1990). For an example where the IRS asserted the penalty some 13+ years after the failure to register, see *Diversified Group Inc. v. United States*, 841 F.3d 975 (Fed. Cir. 2016). See also *Pfaff v. United States*, 2016 U.S. Dist. LEXIS 30844 (D. Colo. 2016).

³⁸⁸² Reg. § 1.6011-4.

³⁸⁸³ Reg. § 1.6011-4(d). I have seen no statistics for the audit coverage that results from reportable transactions disclosures, but I know anecdotally historically that return disclosures often do not substantially increase the likelihood of audit. I suppose that the latter is a bit of an overstatement, but taxpayers often believe that disclosures guarantee audits. And I do suspect the audit coverage for reportable transactions is far greater than for return disclosures generally, although not as great as perhaps most taxpayers fear. E.g., Jensen, *supra*, p. 47 (“if taxpayers have to disclose questionable return positions, they are less likely to participate in reportable transactions at all. Disclosure is not an admission that a taxpayer's reporting of a transaction is wrong, but it is like tattooing ‘audit me’ on one's forehead or corporate logo (or so a participant might fear).”).

³⁸⁸⁴ § 6707A(a).

³⁸⁸⁵ The penalty is not affected by any ultimate settlement by the taxpayer of the liability or any reporting by the taxpayer on an amended return. Reg. § 301.6707A-1.

a natural person and \$10,000 for all other taxpayers. The maximum penalty is (i) “in the case of a listed transaction, \$200,000 (\$100,000 in the case of a natural person)” and (ii) “in the case of any other reportable transaction, \$50,000 (\$10,000 in the case of a natural person).” The minimum and maximum penalties apply even if there ultimately is no understatement with respect to the transaction required to be reported, because the conduct penalized is the failure to disclose the reportable transaction rather than the tax savings.³⁸⁸⁶

The IRS has sole, unreviewable discretion to “rescind” the penalty if (i) a listed transaction is not involved and (ii) waiver would promote tax administration; otherwise, the penalty applies without relief.³⁸⁸⁷ Although the IRS’s rejection of rescission is unreviewable, the taxpayer can contest the predicate liability for the penalty.³⁸⁸⁸ There is no reasonable cause exception to the penalty, but reasonable cause and good faith can be considered as a factor in deciding whether to rescind.³⁸⁸⁹

The statute of limitations for the IRS to assert the penalty is the same as the return statute of limitations if disclosure is required on a return, except that, in the case of listed transactions, the statute is one year after the taxpayer provides the information required under § 6011 or a material advisor provides the information required under § 6112.³⁸⁹⁰ If the disclosure is not required on a return, there is no statute of limitations.³⁸⁹¹

The penalty is an assessable penalty, meaning that there is no predicate requirement of notice of deficiency with resulting prepayment opportunity to litigate;³⁸⁹² the IRS may assess and begin using its nonjudicial collection remedies (such as lien and levy). Although the taxpayer has the

³⁸⁸⁶ *Yari v. Commissioner*, 143 T.C. 157 (2014), aff’d 2016 U.S. App. LEXIS 18468 (9th Cir. 2016).

³⁸⁸⁷ § 6707A(d)(2); *Smith v. Commissioner*, 133 T.C. 424, 428 (T.C. 2009) (“A determination by the [IRS] Commissioner regarding the rescission of a penalty may not be reviewed in any judicial proceeding.”); *Barzillai v. United States*, 2018 U.S. Claims LEXIS 418 (2018). The statute uses the word rescind which I think means the same as the word “waive” commonly used in a penalty context. Reg. § 301.6707A-1(d) provides the factors the IRS considers in exercising its authority to rescind the penalty. See also IRM 4.32.4.10 (06-05-2012), Factors Weighing in Favor of Rescission (noting that, to the extent the IRM list is inconsistent with the Regulations, the Regulations control). Rev Proc 2007-21, 2007-9 I.R.B. 613 provides the procedures to request rescission. IRM 4.32.4.9 (02-11-2016), IRC 6707A Penalty Rescission Consideration provides the processes for rescission. Rescission is only appropriate if the penalty applies in the first case; a rescission request is not to be used to contest the threshold liability. One issue that has arisen is who, within the IRS, has the authority to rescind. In *Keller v. Commissioner*, 848 F.3d 1251 (10th Cir. 2017), in a revised opinion, the Court of Appeals eliminated the indication in the earlier unrevised opinion that the Appeals Office had the authority to rescind under this provision. In the same case, the taxpayer had urged in the Tax Court that the statute’s prohibition on review of the IRS’s decision denying rescission was a deprivation of due process but the Tax Court did not address the argument and it was not raised on appeal to the Ninth Circuit. *Id.*, p. 1264, n. 5.

³⁸⁸⁸ *Smith v. Commissioner*, 133 T.C. 424, 428 (T.C. 2009) (citing the legislative history).

³⁸⁸⁹ Reg. § 301.6707A-1(e).

³⁸⁹⁰ IRM 4.32.4.1.4.1 (12-12-2013), Statute of Limitations—General Information. IRM 4.32.4.1.4.1 (12-12-2013), Statute of Limitations When Disclosure Is Required With Return; IRM 4.32.4.1.4.2 (12-12-2013), Statute of Limitations When Disclosure Is Required Without a Return.

³⁸⁹¹ § 6501(c)(10); IRM 4.32.4.1.4.1.4 (12-12-2013), Statute of Limitations When Disclosure Is Required With Return.

³⁸⁹² *Keller Tank Services II, Inc. v. Commissioner*, 848 F.3d 1251 (10th Cir. 2017); *Smith v. Commissioner*, 133 T.C. 424, 428-430 (2009).

opportunity to take an appeal within the IRS,³⁸⁹³ the taxpayer may litigate the liability by refund suit, which requires full payment under Flora,³⁸⁹⁴ by CDP proceeding in the Tax Court (provided that it had no prior opportunity to contest),³⁸⁹⁵ or by awaiting a collection suit by the Government which is brought after the IRS has used its nonjudicial collection tools for almost 10 years and the 10-year statute of limitations on collection is about to expire.³⁸⁹⁶

Corporations required to file SEC reports must report the payment of this and related penalties on their SEC reports.³⁸⁹⁷

(ii) Accuracy Related Penalty for Understatements Attributable to Reportable Transactions. Section 6662A imposes a 20% penalty, increased to 30% if no adequate disclosure is made, to understatements attributable to a listed transaction or a reportable transaction with a significant purpose of tax avoidance.³⁸⁹⁸ A reportable transaction is one that the IRS determines is required to be disclosed because it is determined to have a potential for tax avoidance or evasion.³⁸⁹⁹ A listed transaction is a reportable transaction which is the same as, or substantially similar to, a transaction specifically identified by the IRS as a tax avoidance transaction for purposes of the reporting disclosure requirements.³⁹⁰⁰ The penalty is coordinated with other civil penalties, so that, portion of the understatement subject to § 6662A is not subject to other civil penalties (such as the 75% civil fraud penalty in § 6663 or the accuracy related penalty in § 6662).³⁹⁰¹

e. Extended Statute of Limitations.

If the taxpayer fails to include on the return the information required to be included with respect to a listed transaction, the time for assessment does not expire before 1 year after the earlier of (A) the date on which the Secretary is furnished the information required under § 6011, or (B)

³⁸⁹³ For a good review of the § 6707A assessment procedures and the opportunity for appeal, see *Keller Tank Services II, Inc v. Commissioner*, 848 F.3d 1251, 1260-1262 (10th Cir. 2017).

³⁸⁹⁴ *Diversified Group, Inc. v. United States*, 841 F.3d 975 (Fed. Cir. 2016).

³⁸⁹⁵ *Bitter v. Commissioner*, T.C. Memo. 2017-46 (noting that prior opportunity to contest can mean an Appeals Office opportunity even if there was no path to a judicial remedy)

³⁸⁹⁶ Liability for some taxes and penalties can be litigated in a CDP that do not require a notice of deficiency if the taxpayer “did not otherwise have an opportunity to dispute such tax liability.” § 6330(c)(2)(B). This phrasing is generally referred to as “prior” opportunity to dispute. The IRS regulations, sustained by the courts, provides that the right to have an internal appeal with the IRS Appeals Office—whether that right is taken or not—is a prior opportunity to dispute precluding CDP merits review even though that internal appeal offered no opportunity for prepayment litigation. Reg. § § 301.6320-1(e)(3), QE-2. See *Keller Tank Services II, Inc. Commissioner*, 848 F.3d 1251, 1268-1274 (10th Cir. 2017) and *Our Country Home Enterprises, Inc. v. Commissioner*, 855 F.3d 773 (7th Cir. 2017).

³⁸⁹⁷ § 6707A(e).

³⁸⁹⁸ § 6662A(a) and, as to the increase to 30%, § 6662A(c) and § 6664(d)(3)(A). See Notice 2005-12, 2005-7 C.B. 494 regarding the required disclosure. The penalty does not violate the Eighth Amendment’s Excessive Fines Clause. *Thompson v. Commissioner*, 148 T.C. 59 (2017).

³⁸⁹⁹ § 6707A(c)(1).

³⁹⁰⁰ § 6707A(c)(2).

³⁹⁰¹ § 6662A(e).

the date that a material advisor meets the requirements of § 6112 with respect to a request by the Secretary under § 6112 relating to the undisclosed listed transaction.³⁹⁰²

f. List Maintenance Requirement.

Each material advisor (defined broadly) is required to maintain a list of investors with related information as required by the Regulations and make the list available for inspection by the IRS.³⁹⁰³ If the person otherwise subject to this requirement fails to make the list available within 20 days of a request from the IRS, the penalty is \$10,000 per day after the 20th day.³⁹⁰⁴

g. Injunctions.

Section 7408 authorizes the IRS to seek and courts to grant injunctive relief for promotion or sale of abusive tax shelters.³⁹⁰⁵

h. FATP Privilege Denied.

The federally authorized tax practitioner privilege is not available for communications regarding tax shelters.³⁹⁰⁶ Note that the attorney-client privilege may still apply where it is otherwise applicable.

4. Denying Interest Deductions.

No deduction for interest is allowed for interest paid or accrued on any underpayment of tax which is attributable to the portion of any reportable transaction understatement with respect to which the relevant facts were not adequately disclosed.³⁹⁰⁷

5. Codifying Economic Substance with A Strict Liability Penalty.

The 2010 health care legislation included the codification of the economic substance doctrine.³⁹⁰⁸ The economic substance doctrine is a judicial doctrine (sometimes referred to as a common law doctrine), initially conceived as a tool of statutory construction to limit certain tax benefits to Congress' intent for enacting them.³⁹⁰⁹ The general concept sounds OK, but the doctrine proved to be troubling in its application to many of the abusive tax shelters that proliferated in the

³⁹⁰² § 6501(c)(10), as added by § 814 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004).

³⁹⁰³ § 6112, as amended by the American Jobs Creation Act of 2004.

³⁹⁰⁴ § 6708, as amended by the American Jobs Creation Act of 2004.

³⁹⁰⁵ See *U.S. v. Ernst & Whinney*, 735 F.2d 1296 (11th Cir. 1984), cert. denied, 470 U.S. 1050 (1985).

³⁹⁰⁶ § 7525(b) (as amended by the American Jobs Creation Act of 2004).

³⁹⁰⁷ § 162(m).

³⁹⁰⁸ Section 7701(o), as added by the Health Care and Education Reconciliation Act of 2010 (H.R. 4872).

For an excellent discussion, see Erik M. Jensen, Legislative and Regulatory Responses to Tax Avoidance: Explicating and Evaluating the Alternatives, 56 St. Louis L.J. 1, 21-43 (2012).

³⁹⁰⁹ See *Santander Holdings United States v. United States*, 844 F.3d 15, 21(1st Cir. 2016) (“The economic substance doctrine, like other common law tax doctrines, can thus perhaps best be thought of as a tool of statutory interpretation * * * *”)

late 1990s and early 2000s. At least a significant part of the trouble arose from the Supreme Court's mishandling of *Frank Lyon Co. v. United States*, 435 U.S. 561 (1978).³⁹¹⁰ Over time in the 2000s, the courts seemed to be reaching some consensus over the application of the doctrine, still there were substantial differences that resulted in conflicts—at least perceived conflicts—among the circuits. Given the Supreme Court's screw-up *Frank Lyon*, it appeared unlikely that the Supreme Court would want to wade into that muck again to clarify and resolve any conflicts, and, of course, the Supreme Court could easily mess it up again.³⁹¹¹ Congress determined that codification of the doctrine with Congress' particular desired spin on the doctrine was appropriate. Section 7701(o), titled Clarification of Economic Substance Doctrine, now provides that a transaction

shall be treated as having economic substance only if—

(A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and

(B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction.

The clarification also makes certain clarifications in how the tests are applied.

The warp and the woof of the economic substance doctrine and its codification are beyond the scope of this book, but suffice it to say that, although it avoided a direct slap on the hands to the Supreme Court for the confusion, Congress did clarify some of the inconsistent treatments in the lower courts that were generated by *Frank Lyon*.

With the codification, Congress enacted strict a strict liability 20% penalty for nondisclosed transactions without economic substance or “failing to meet any similar rule of law.”³⁹¹² (It is not clear what the latter language means, so that the IRS will have considerable leeway under *Chevron* and its progeny to define the scope of the language.)³⁹¹³ The penalty is 20% but increases to 40% if the transaction is not disclosed on the return or an amended return filed before an audit starts.³⁹¹⁴ The reasonable cause exception applicable to other penalties is denied for this penalty.³⁹¹⁵ This means that “no opinion of counsel, regular church attendance or anything else is going to protect a

³⁹¹⁰ *Frank Lyon* is the poster child for the saying that tax cases are too important to turn loose on the Supreme Court. See Bernard Wolfman, *The Supreme Court in the Lyon's Den: A Failure of Judicial Process*, 66 Cornell L. Rev. 1075, 1098 (1981). It has thus been noted by a thoughtful observer that that “few [tax] shelters are shoddier than those approved by the Court in *Lyon* and *Brown*.” Charles I. Kingson, *How Tax Thinks*, 27 Suffolk U. L. Rev. 1031, 1034-35 (2004). *Brown* is the earlier decision in *Commissioner v. Clay B. Brown*, 380 U.S. 563 (1965).

³⁹¹¹ See, for a more recent, Supreme Court opinion oblivious to the imperatives of the tax law, *Gitlitz v. Commissioner*, 531 U.S. 206 (2001), a case that, fortunately, has not created near the mischief that *Frank Lyon* has because, I think, courts may more easily distinguish and thus ignore it. Lawrence Zelenak, *The Court and the Code: A Response to the Warp and Woof of Statutory Interpretation*, 58 Duke L.J. 1783, 1788-1789 (2009) (noting graphically that “the Gitlitz dog has never barked again in the Supreme Court.”).

³⁹¹² § 6662(b)(6).

³⁹¹³ However, the codification does resolve a disagreement among the courts by requiring that the transaction must both (conjunctive) “‘meaningfully’ change a taxpayer's economic position (an objective test), and the taxpayer must have a ‘substantial’ non-tax purpose for the transaction (a subjective test).” § 7701(o)(1).

³⁹¹⁴ § 6662(i).

³⁹¹⁵ § 6664(c)(2) and (d)(2).

taxpayer against the penalty if the transaction is deemed to lack objective economic substance.”³⁹¹⁶ A qualified amended return or a timely filed Form 8886, Reportable Transaction Disclosure Statement, with a complete disclosure will likely avoid the penalty.³⁹¹⁷ But an amended return filed after the taxpayer is contacted for audit cannot meet the disclosure requirements to avoid this penalty.³⁹¹⁸

6. Congressional Investigations.

Congress periodically becomes more active in investigating the scope of the problem with a view toward further legislative solutions. In November 2003, Senate Permanent Subcommittee on Investigations Committee on Homeland Security and Governmental Affairs conducted a hearing on the role of tax professionals in the U.S. tax shelter industry and issued a scathing majority and minority reports criticizing certain major firm players in the tax shelter industry.³⁹¹⁹ The Committee focused its fire on prominent law firms, accounting firms and financial institutions who enabled the supposed transactions underlying the tax superstructure.

A spin off from the financial crises of false and misleading financial statements that has rocked the financial markets and substantially eroded the financial base of much of Congress’ constituency was more legislation on the tax shelter problem.³⁹²⁰ Philosophically, the aggressiveness in the corporate tax shelters may be a reflection of the same aggressiveness that gave rise to financial statement manipulation. If it is OK to manipulate results reported to shareholders, why is it not OK also to manipulate tax results? Many firms reporting increasingly growing profits (whether or not they really earned the profits) were not content with paying the taxes that normally accompany large profits and took aggressive tax positions, often in the form of promoted tax shelters, to avoid having to pay tax.³⁹²¹ It is reported that Enron used abusive tax shelters to report higher financial earnings than it should have. For other reasons, Enron did not owe significant current taxes for the years but was able to anticipate for financial statement purposes alleged future tax benefits from the shelters. Enron was assisted in this effort by some of the most prestigious financial, accounting and law firms who were willing to stretch the tax rules for the client. A similar phenomenon of assistance has since been observed in the individual tax shelter arena. Congress will almost certainly have more to say on the tax shelter issue.³⁹²²

³⁹¹⁶ Jensen, *supra*, p. 29-30.

³⁹¹⁷ CCA. 202244010 (Oct. 3, 2022).

³⁹¹⁸ § 6662(i)(3).

³⁹¹⁹ Permanent Subcommittee on Investigations of the Committee on Homeland Security and Governmental Affairs, The Role of Professional Firms in the U.S. Tax Shelter Industry (2/8/05). The Committee report followed and is generally in line with an earlier Minority Staff Report of the same committee titled U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals: Four KPMG Case Studies: FLIP, OPIS, BLIPS, and SC2.

³⁹²⁰ See e.g., the Staff of the Joint Committee on Taxation, Report of Investigation of Enron Corporation and Related Entities Regarding Federal Tax and Compensation Issues, and Policy Recommendations, JCS-3-03 (February 2003).

³⁹²¹ I had a professor in law school who was fond of saying that he liked to pay tax, for that meant he was making money. In the environment of the late 1990s and early 2000s, an attitude arose that you should not have to pay tax even when you were making (or at least reporting to investors) large profits.

³⁹²² For example, the report of the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs into the U.S. Tax Shelter Industry: the Role of Accountants, Lawyers, and Financial Professionals is expected soon and is expected to be a legislative “indictment” of the assisters of abusive tax shelters, along with
(continued...)

In 2019, the Senate Finance Committee began an investigation into abusive conservation easement appraisals.³⁹²³ I suspect that, as with the Senate Permanent Committee investigations discussed above, significant IRS initiatives and criminal prosecutions will come in the wake of this investigation.

C. Administrative Initiatives.

1. Strategic Study Initiatives.

a. Office of Tax Shelter Analysis.

The IRS is also undertaking certain administrative initiatives to identify and address tax shelters as early as possible. In February 2000, the IRS established the Office of Tax Shelter Analysis (“OTSA”) which is under the LB&I Division. The OTSA reviews the tax shelter disclosures filed under the foregoing rules to identify abusive shelters and taxpayers who have invested in them. The OTSA also coordinates with field examination personnel who have sighted potentially abusive shelters. The OTSA works with Chief Counsel and Treasury’s Office of Tax Policy.³⁹²⁴

b. Abusive Transactions Initiative.

The office of Abusive Transaction and Technical Issues (ATTI), which includes the program formerly known as the Abusive Tax Avoidance Transaction (“ATAT”) program.³⁹²⁵ Some IRS functions continue to use the ATAT acronym to describe the program.³⁹²⁶ The program defines its target as:

An abusive tax avoidance transaction includes the organization or sale of any plan or arrangement promoting false or fraudulent tax statements or gross valuation misstatements, aiding or assisting in the preparation or presentation of a return or other document to obtain tax benefits not allowed by law, and actions to impede the proper administration of Internal Revenue laws. This general definition includes both tax shelters as defined in various sections of the IRC and other types of abusive tax

³⁹²²(...continued)

recommendations for legislative remedies. In addition, Congress has just begun a round of hearings dealing with tax issues for tax exempt entities. The identified problems for tax-exempt entities include allegations that they have facilitated abusive tax shelter transactions.

³⁹²³ See SFC Press Release titled “Grassley, Wyden Launch Probe of Conservation Tax Benefit Abuse” (3/27/019); and SFC Press Release titled “Grassley, Wyden Press Subjects in Easement Investigation” (6/10/19); and Peter J. Reilly, Grassley Wyden Take On Sketchy Conservation Tax Shelters (Forbes 3/28/19).

³⁹²⁴ For a good discussion of OTSA, see Sheryl Stratton, News Analysis -- Inside OTSA: A Bird's-eye View of Shelter Central at the IRS, 100 Tax Notes 1246 (Sept. 8, 2003).

³⁹²⁵ IRM 5.20.1.1 (01-12-2016), Overview of Abusive Tax Avoidance Transaction (ATAT) Program (“In FY 2010, SB/SE Examination created the office of Abusive Transaction and Technical Issues (ATTI) which includes the program formerly known as ATAT.”).

³⁹²⁶ Id.

promotions. These strategies may be organized and marketed, often through the internet.³⁹²⁷

The IRS focuses its compliance efforts, including investigations and collections, to deal with such abusive transactions.³⁹²⁸

2. Abusive Shelters and the States.

The IRS has entered “Abusive Tax Avoidance Transaction Memorandums of Understanding” with a number of state tax agencies to share information about abusive tax shelters.³⁹²⁹

States have become very aggressive to recapture tax dollars lost to abusive tax sheltering. California has been most aggressive, enacting retroactive legislation, increasing and creating new penalties, increasing the statute of limitations for assessment, enacting the economic substance doctrine, etc. California adopted a voluntary compliance initiative encouraging taxpayers to get right and offering some incentives to do so.

3. Audits and Summonses.

The IRS has stepped up its audit activity with respect to the shelters and is devoting substantial resources to the audits.³⁹³⁰ The audits are both of the taxpayers (which requires that they first be identified, sometimes a difficult task as will be noted) and the promoters with respect to the responsibilities and penalties imposed upon them by the Code.

Although the IRS can request (by IDR) and then summons the taxpayer or its CPAs for audit workpapers or tax accrual workpapers (probably a mother lode of information for risky taxpayer behavior), the IRM says that it will do so only in unusual situations usually involving tax shelters, particularly listed transactions. IRM 4.10.20 Requesting Audit, Tax Accrual or Tax Reconciliation Workpapers.³⁹³¹ The details of the circumstances when the IRS will request and summons audit workpapers or tax accrual workpapers are very important for large case audits, particularly with aggressive taxpayers. I won’t get into those details here (although I discuss some aspects in the Chapter 15 on privileges beginning p. 926), but just alert readers that they can be quite important in practice and quite lucrative for lawyers defending those aggressive taxpayers.

Also, as we discussed above, the IRS’s principal investigative tool is the IRS summons. The summons is being used with great effect in the quest to identify the taxpayers involved and in

³⁹²⁷ IRM 5.20.1.1(2) (01-12-2016), Overview of Abusive Tax Avoidance Transaction (ATAT) Program

³⁹²⁸ See GAO Report “Abusive Tax Transactions: IRS Needs Better Data to Inform Decisions about Transactions” (GAO-11-493 May 2011).

³⁹²⁹ See IR-2004-19 (2/10/04), reproduced at 2004 TNT 28-7 (2/10/04). An example of the Memorandum is reproduced at 2003 TNT 180-27.

³⁹³⁰ For example, the IRS released a comprehensive Audit Technique Guide for tax shelters informing agents of various techniques to consider. The Guide is reproduced at 2005 TNT 102-14. The IRS earlier had issued a comprehensive Audit Technique Guide for penalties applying to abusive tax shelters. This Guide is reproduced at 2005 TNT 64-21.

³⁹³¹ See particularly IRM 4.10.20.3 (12-08-2020), Service Policy for Requesting Audit or Tax Accrual Workpapers; and IRM 4.10.20.3.1 (07-12-2004), Unusual Circumstances Standard.

investigating the promoters themselves. To identify the taxpayers, the IRS has two summons approaches. First, using the *Tiffany Fine Arts* approach, the IRS can summons promoters with respect to their Code responsibilities—specifically the lists required in the list maintenance requirements.³⁹³² Second, the IRS can use the John Doe summons procedure, the procedure specifically designed to obtain the identities of unknown taxpayers.

With great fanfare, the IRS has summoned the records of major accounting firms and other shelter promoters and then, upon noncompliance, brought either summons enforcement proceedings in the case of the regular summons or contempt proceedings in the case of the John Doe summons to obtain information about the shelters and the taxpayers who bought into them. The promoters often resist those summonses because they want to avoid identifying the investors. The IRS has been uniformly successful, at least ultimately in the judicial proceedings involving compliance, in obtaining the names of the investors.³⁹³³

4. Designation for Litigation.

The IRS has a designation for litigation procedure whereby it picks one or more issues in a specific case that it desires to litigate to develop the law.³⁹³⁴ The issues designated for litigation will not be settled—meaning that the taxpayer must either litigate or concede in full.³⁹³⁵ The designation for litigation procedure has received much press in the tax shelter arena but is not limited to tax shelters. For example, it has been applied in transfer pricing cases.³⁹³⁶ It can apply in any area where the IRS believes it is more important that the law be developed than a particular case settled. Obviously, the IRS will pick the cases that it believes offer the best chance of prevailing on its view of the law. The process of designating for litigation takes time and consideration at several levels within the IRS. The taxpayer will be notified and have an opportunity to present arguments as to why the particular case is not an appropriate vehicle for designation for litigation. The taxpayer will certainly want to take that opportunity because designation for litigation will limit the option of settling the case and will almost certainly significantly increase the costs of litigation.

³⁹³² You will recall that, under *Tiffany Fine Arts*, the IRS can issue a regular summons to a shelter promoter to obtain information regarding the shelter promoter's Code responsibilities and, if the information or documents obtained in that inquiry identify the taxpayer, so be it. The IRS is empowered to investigate the shelter promoter's list maintenance and disclosure compliance.

³⁹³³ The judicial proceedings—summons enforcement proceedings and the John Doe summons proceedings—are discussed below and in the previous text discussing privileges.

³⁹³⁴ See Notice 2004-017; and IRM 33.3.6, Designating a Case for Litigation. For a good discussion of the process for designating cases for litigation, see B. John Williams, [IRS Chief Counsel Explains Designation Procedure for Case Litigation](#), 2003 TNT 82-27 (4/29/03); Matthew R. Madara, [IRS Sheds Light on Process for Designating Issues for Litigation](#), 2015 TNT 201-6 (10/19/15); Marie Sapirie, [The Increase in Cases Designated for Litigation](#), 2016 TNT 49-3 (3/12/16). In summary, the goal of the program is to provide more efficient tax administration by litigating important recurring issues to obtain precedential resolution that will then affect future cases.

³⁹³⁵ If an issue in an audit is designated for litigation, the IRS will not issue a 30-day letter but will issue a notice of deficiency. IRM 33.3.6.1 (08-11-2004), Purpose and Effect of Designating a Case for Litigation. The other issues may then be settled after the case is docketed in the Tax Court if the taxpayer files a petition. Of course, if the taxpayer litigates in another forum (e.g., refund forum) where DOJ Tax handles the case, DOJ Tax is not bound by the designation for litigation and may settle, subject to seeking advice from the IRS.

³⁹³⁶ Marie Sapirie, [The Increase in Cases Designated for Litigation](#), 2016 TNT 49-3 (3/12/16).

5. Disclosure Initiatives.

The IRS sometimes has special disclosure initiatives for widely used tax abuses, such as the offshore voluntary disclosure program for offshore and related bank account income tax and FBAR noncompliance. It has, in the past, used such programs for tax shelters.³⁹³⁷

6. Promoter Initiatives.

A major focus of IRS concern about abusive tax shelters is the role of the promoters that hawk the abusive shelters. The IRS created an Office of Promoter Investigations (“OPI”) to focus compliance efforts and, when appropriate, criminal enforcement.³⁹³⁸

7. Penalties.

The IRS will aggressively pursue penalties in tax shelters.³⁹³⁹ These penalties are civil and criminal penalties.

a. Civil Penalties.

The IRS is pursuing penalty investigations against the promoters. As we discussed above, there are promoter penalties potentially applicable for shelters that are false or have valuation misstatements and for failure to register tax shelters. Indeed, the potential application of these penalties are the linchpin for regular summonses to the promoters when the IRS is trying to identify the taxpayers investing in the summonses.

The IRS will also pursue penalties against the investors. The penalties will be the accuracy related penalties (see the settlement initiatives below) and may include civil penalties.

b. Criminal Penalties.

The IRS and its companion in tax law enforcement, DOJ, may pursue criminal investigations and prosecutions. Indeed, DOJ and the IRS are currently conducting prominent criminal investigations and prosecutions of tax shelter abusers—both taxpayers and their enablers (tax professionals rendering opinions or otherwise assisting and other enablers) necessary to effect the abusive schemes. I discuss this in more detail below.

8. Circular 230 and OPR Initiatives.

Tax practitioners are often enablers in the abusive tax shelter game. Not surprisingly, the IRS is rattling its sabers to threaten the risk of disbarment of practitioners who play the tax shelter game

³⁹³⁷ Announcement 2002-2, 2002-2 I.R.B. 304.

³⁹³⁸ See Chuck Rettig (IRS Commissioner), A Closer Look: Impacting the Tax Gap (<https://www.irs.gov/pub/foia/ig/cl/A%20Closer%20Look%20-%20Impacting%20the%20Tax%20Gap%20By%20Commissioner%20Chuck%20Rettig.pdf>) (viewed 4/28/21).

³⁹³⁹ See the Audit Technique Guide for penalties applying to abusive tax shelters. This Guide is reproduced at 2005 TNT 64-21.

too aggressively. As we noted above, the Office of Professional Responsibility (“OPR”) has the right to disbar practitioners from practice before the IRS.

Circular 230 addresses issues related to abusive tax shelters, giving OPR more enforcement hammers to discourage abuse in the tax shelter opinion context. Suffice it to say that they are aimed at those who enable abusive tax shelters, although the bar is concerned that they approach the target with a shotgun rather than a rifle.

One of the principal areas of interest in OPR was to issue standards for opinions issued by practitioners in abusive tax shelters.³⁹⁴⁰ The sad history of tax shelters illustrates that practitioners were all too willing to lend their positions and prestige to the promotion of abusive tax shelters. The tax opinion letter was a key marketing component of hokey tax shelters where taxpayers believed, rightly or wrongly, that their claimed reliance on the tax shelter opinion would give them risk-free access to the audit lottery for a transaction that they really knew did not work. Often the practitioners issued such opinions out of sheer greed (the fees were outsized for the kind and quality of work underlying the opinions), but sometimes they did it out of sheer incompetence. Either way, they violated ethical rules for lawyers and CPAs not to violate the law and to bring a level of competence to their practices. In response, the IRS issued new Circular 230 regulations for tax opinions. The general scope of the regulations is: (i) to create “best practices” which are aspirational to give practitioners a good ethical goal and (ii) create mandatory, and thus punishable, standards for “covered opinions” and “other written advice.” Particularly in the area of tax shelter opinions, the regulations require the practitioner to exercise a greater duty of inquiry without relying upon unverified information.³⁹⁴¹

D. Judicial Initiatives.

1. Judicial Enforcement of Summonses.

As noted, the IRS has used both the regular summons and the John Doe summons to obtain the identities of taxpayers (as well as documents related thereto). The judicial proceedings related to this initiative are (i) the summons enforcement proceeding for the regular summons and (ii) the ex parte judicial procedure provided for the John Doe summons. The Government regularly achieves a successful result in these cases, although the resistance is often fierce resulting in delays.

³⁹⁴⁰ See Erik M. Jensen, Legislative and Regulatory Responses to Tax Avoidance: Explicating and Evaluating the Alternatives, 56 St. Louis L.J. 1, 51-57 (2012).

³⁹⁴¹ See 31 C.F.R. 10.35. One of the most prevalent results of these OPR rules regarding covered opinions and other written advice is the ubiquitous disclaimer on emails that claims that the substantive portion of the email is not intended to be tax advice. The disclaimer is usually required by law firms and, usually, it appears in emails having subject matter that no one could reasonably believe contained tax advice (e.g., jokes being forwarded, etc.). The IRS has issued proposed Regulations that will substantially modify these requirements. See REG-138367-00, 77 FR 57055 (9/17/12).

2. Statute of Limitations Issues.

a. Introduction - the 3-Year and 6-Year Statutes.

An abusive tax shelter “works”—at least for the taxpayers and promoters—to the extent that the statute of limitations on assessment runs out. Accordingly, taxpayers and promoters pursued delay tactics to the Government’s summonses seeking taxpayer identities, hoping that by doing so, the statute of limitations would run at least for one more year. Most of the abusive shelters as designed avoid the 6 year statute of limitations either by not involving an omission of gross income or by adequately (perhaps) disclosing.³⁹⁴² Hence, all the taxpayers need to do is outrun the 3 year statute of limitations or, if applicable the 6-year statute of limitations. But, depending upon how long it takes the Government to initiate summons procedures, delay may achieve a taxpayer benefit under the 6-year statute also.

b. Unlimited Statute for Fraudulent Tax Shelters.

It is commonplace with practitioners that there is an unlimited statute of limitations for fraud. § 6501(c)(1) (“false or fraudulent return with the intent to evade tax”). Many of the abusive tax shelters go beyond exploiting real uncertainties in the tax law and are fraudulent. It is accepted, for example, that promoters of these fraudulent abusive tax shelters can be convicted of tax evasion with respect to a taxpayer’s return. Therefore, the returns are fraudulent, thus certainly mandating an unlimited statute of limitations if the taxpayer committed the fraud reported on the return. An issue not yet finally resolved is whether the fraud of someone other than the taxpayer (such as a fraudulent preparer or a promoter of a fraudulent tax shelter reported on the return) invokes this unlimited statute of limitations. See *Allen v. Commissioner*, 128 T.C. 37 (2007) (preparer’s fraud alone is sufficient for unlimited statute); *BASR Partnership v. United States*, 795 F.3d 1338 (Fed. Cir. 2015)³⁹⁴³ (tax shelter promoter’s fraud alone not sufficient; actual taxpayer’s fraud required); see discussion p. 187). Not only that, if the language of § 6501(c)(1) includes fraud on the return without the taxpayer’s fraud, it would appear that such fraud would avoid preclusion under principles of claim preclusion (*res judicata*) or issue preclusion (*collateral estoppel*) and the preclusive language of settlements with the IRS would not prevent the IRS from opening up the years involved and imposing the tax and penalties (except perhaps the civil fraud penalty unless the taxpayer’s fraud is involved).³⁹⁴⁴

c. Statute Extension for Summons Noncompliance.

The Code provides that, if compliance with a third party summons (both a regular summons for which the taxpayer is entitled to notice and a John Doe summons) is not resolved within six months after the issuance of the summons, the taxpayer’s statute of limitations is suspended from

³⁹⁴² See § 6501(e)(1)(A). Note that for variations of a so-called basis enhancing strategy that created phony basis as the fulcrum for sheltering capital gain, the Supreme Court held that the 6-year statute does not apply. *United States v. Home Concrete*, 566 U.S. 478 (2012). That issue is covered in the Chapter on the statute of limitations.

³⁹⁴³ Incomplete cite because decided on print date of the text.

³⁹⁴⁴ See § 6212(c)(1) (further deficiency notice allowed after Tax Court decision is final “in the case of fraud,” and closing agreements under § 7122 or by Form 870-AD, exceptions for “fraud or malfeasance, or misrepresentation of a material fact.”)

six months after the summons is issued through the final resolution of the response.³⁹⁴⁵ This suspension does not apply to a regular summons issued to the taxpayer to investigate its own liability under the *Tiffany Fine Arts* gambit, thereby permitting the coincidental discovery of the shelter investors' identities.³⁹⁴⁶

Hence, when the IRS proceeds by regular summons under *Tiffany Fine Arts* against the promoter or other participant in the sales process, the IRS would often be stonewalled with assertions of the identity privilege often on the basis that assertion of the privilege was required by their contractual and ethical responsibilities to the unnamed taxpayers. To test the assertion of the identity privilege, the IRS brought summons enforcement proceedings. The summons enforcement proceeding is a fairly summary proceeding and thus, alone, probably would not achieve substantial delays except where the documents involved are voluminous and some are subject to perhaps colorable claims of privilege, which will slow down a court that has to weed through the claims and separate the wheat from the chaff. One court having to do that at the expenditure of great judicial resources and time dealing with marginal or frivolous claims of privilege, created its own suspension of the statute of limitations by holding (probably a dicta holding) that, if the statute of limitations on assessment for the underlying taxpayers would expire within 60 days of the entry of the order, that period was extended for 60 days after the entry of the order.³⁹⁴⁷

Most of the potentially affected taxpayers in regular summonses to the promoters under *Tiffany Fine Arts* thus just let the promoter fight the delay battle. Others, however, pursued a separate strategy by bringing a regular civil injunction suit—again in the name of John Doe to protect the privilege—against the person to whom the regular summons was issued to enjoin that person from giving the information and/or documents to the Government. Such a separate proceeding could gum up the works, at least by introducing sufficient uncertainty that delays would be involved. There is no provision for suspension of the statute of limitations in such a civil suit between private parties.³⁹⁴⁸

Where the IRS pursued the John Doe summons procedure and was met with delays, the statute provides for an extension beginning 6 months after the service of the summons and ending with resolution of the summons.³⁹⁴⁹ However, for taxpayers whose statute of limitations expired in the threshold 6 month period, they won by the summonsee's noncompliance! (Assuming, of course, that a court does not find some basis for an equitable suspension, e.g., if the taxpayer were found to be complicit in the promoter's delay in responding to the John Doe summons.)

³⁹⁴⁵ § 7609(e)(2); see Reg. § 301.7609-5(1). A John Doe summonsee is required to notify the ultimate taxpayer(s)—the “John Doe(s)” —of the statute suspension. § 7609(i)(4). Note that the taxpayers are not entitled to intervene of right in a regular summons to a promoter with respect to the promoter's responsibilities (as opposed to a regular third party summons under § 7609). See § 7609(b). They might have been able to intervene under the Federal Rules of Civil Procedure, but if they had done so, presumably, the suspension of the statute under § 7609(e)(1) would not apply because the intervention would not be under § 7609.

³⁹⁴⁶ The provision is contained in § 7609 which deals with procedures for third party summonses. The only third party summons related to unknown taxpayers is the John Doe summons. Hence, a summons issued to investigate compliance with the taxpayer's Code responsibilities (list maintenance) is not a third party summons subject to this statute suspension.

³⁹⁴⁷ *United States v. KPMG LLP*, 316 F. Supp.2d 30 (D. D.C. 2004).

³⁹⁴⁸ *John Doe I v. United States*, 398 F.3d 686 (5th Cir. 2005).

³⁹⁴⁹ § 7609(e)(2).

3. Grand Jury Investigations.

An even more dramatic development is the increased use of grand jury investigations targeting allegedly abusive tax shelter promotions. Grand jury investigations are far superior to the IRS criminal investigation for complex shelter investigations.³⁹⁵⁰ The Government thus used the grand jury to investigate tax shelter promotion activities by at least two large accounting firms (KPMG and Ernst & Young) and one large law firm (Jenkins & Gilchrist) that failed as a result of its tax shelter activity. These investigations produced a flurry of indictments against KPMG related defendants, Ernst & Young defendants, and Jenkins & Gilchrist defendants. Several guilty pleas and convictions have been obtained.

The Government encountered difficulty in its KPMG defendant prosecution, which was the first and most prominent case in its current criminal initiative against allegedly abusive tax shelters. In that case, involving 19 original defendants, the trial judge dismissed 13 defendants because of unconstitutional pressure by the grand jury prosecutors during the grand jury investigation that caused KPMG to withdraw attorneys' fees for those persons fingered by the prosecutors, and the court of appeals affirmed the dismissal.³⁹⁵¹ While this was a major setback for the Government's tactics, the subsequent guilty pleas and convictions have put some of the wind back in the sail of the Government's criminal enforcement initiatives against tax shelters.

The core of the Government's criminal case in complex shelter cases is to present dastardly deeds that the jury can understand. Juries rarely understand tax and accounting arcana, so in criminal cases, such arcana are merely the setting, they are not the smoking gun for conviction. Rather, in order for the Government to convict, the Government has to show the lie or equivalent—that the defendant(s) lied, cheated or stole. Thus, for example, in the Enron prosecution where accounting arcana (fully the equal of tax arcana) was the setting, the prosecution's theme was: "This is a simple case. It is not about accounting. It is about lies and choices."³⁹⁵² Many of the complex shelters and certainly all of them that created too good to believe magic had embedded in them several and often a plethora of lies that are fertile ground for prosecution and conviction.³⁹⁵³

³⁹⁵⁰ See Paul S. Diamond, Federal Grand Jury Practice and Procedure 1 (4th ed. 2001) ("the federal grand jury investigation is certainly the greatest legal engine ever invented for the discovery of evidence."). Perhaps the major tool of the grand jury is the grand jury subpoena. Ronald G. White and Michael Gerard, Grand Jury Subpoenas and the Fifth Amendment Privilege, A-1 (ABA White Collar Criminal Conference 3/5/2008).

³⁹⁵¹ *United States v. Stein*, 495 F. Supp. 2d 390 (S.D.N.Y. 2007), aff'd *United States v. Stein*, 541 F.3d 130 (2d Cir. 2008); see also earlier district court opinion at *United States v. Stein*, 435 F. Supp. 2d 330 (S.D. N.Y. 2006).

³⁹⁵² John C. Hueston, Behind the Scenes of the Enron Trial: Creating Decisive Moments, 44 AM. CRIM. L. REV. 197, 207 (2007).

³⁹⁵³ See my discussion of this genre of claim in John A. Townsend, Tax Obstruction Crimes: Is Making the IRS's Job Harder Enough?, 9 Hous. Bus. & Tax L.J. 260 (2009). See also Professor Green's article at the same symposium, Stuart P. Green, What Is Wrong with Tax Evasion? 9 Hous. Bus. & Tax L.J. 221 (2009); and Professor Green's seminal work in white collar crime, Stuart P. Green, Lying, Cheating and Stealing: a Moral Theory of White Collar Crime (2007).

4. Conclusion.

These various judicial, administrative and legislative initiatives (and more to come) are a veritable juggernaut to stem the tide of losses arising from tax shelters. It remains to be seen whether they will have a major effect, but I suspect that they will have such an effect, although, given the nature of the Code, there will always be players who will try to skirt any new lines that may be drawn.

IX. Transfer Pricing.

Transfer pricing is the tax issue involving overwhelmingly the most tax dollars in audits and litigation. By manipulating prices in related party transactions, taxpayers can put profits in the related party that is best tax advantaged. As to the U.S. fisc, transfer pricing manipulations generally have maximum revenue impact in cross-border transactions in which profits that would otherwise be taxed in the U.S. are moved offshore to a related party. If the organization is a foreign multinational enterprise shifting profits from a U.S. subsidiary to one of its foreign affiliates, the profit will escape U.S. tax altogether. If the organization is a U.S. multinational enterprise, shifting profits from a U.S. entity to one of its foreign subsidiaries will achieve deferral of U.S. tax until the profits are repatriated to the U.S., which can be indefinitely postponed in many cases thus achieving the economic effect of exemption from current taxation.

Example 1: US Parent Company (USP) sells widgets to its foreign subsidiary (FSub) which is incorporated and does business in foreign country (“F”) that imposes 5% effective tax rate on FSub's profits. USP's cost of manufacturing is \$50 per unit, and FSub, a sales company, sells the product to unrelated F country purchasers for \$100 per unit. FSub incurs \$5 cost per unit to make the sales. The total economic profit is thus \$45 (\$100 sales price less manufacturing costs of \$50 and sales costs of \$5). Assume that, if FSub were not related to USP, USP would sell the product to FSub for \$75 which would mean that the \$25 profit would be taxed by the U.S. and \$20 profit would be taxed by F Country. USP, however, has an incentive to lower the sale's price to FSub, a related party, to push profits into FSub whose profits are subject to a lower F Country tax rate. Let's say then that USP sells to FSub for \$55, with the result that, upon FSub's sale to unrelated parties for \$100 per unit, thus leaving USP with \$5 profit and shifting \$20 profit to FSub. The U.S. tax base has been eroded by \$20 per unit. Section 482 permits the IRS to adjust the price to \$75 per unit -- the “arm's length price” -- and apply the U.S. tax results accordingly. That adjustment -- referred to as a primary adjustment -- can have a collateral consequence to account for the fact that F Sub then has \$20 more cash than it should have, and additional U.S. tax consequences -- referred to as correlative adjustments -- can result from the primary adjustment.

Example 2: Let's reverse Example 1. Foreign Parent Company (“FP”) sells widgets to its U.S. subsidiary (“USSub”). In this example, FP will be motivated to shift profits out of the U.S. by increasing the sales price of its widgets. Thus, let's assume that FP sells the widgets for USSub for \$90 per unit, thus leaving the USSub with a \$5 profit (i.e., \$100 sales price per unit, less \$90 cost of goods sold per unit and \$5 cost of sales per unit). However, if FP sold for the “arm's length price,” USSub would purchase for \$75 per unit and would thereby report to the U.S. profit and taxable income per unit of \$20 (\$100 sales price less \$75 cost of goods sold and \$5 sales costs). The U.S.

tax base would be eroded \$15 by FP selling for \$90 rather than \$75, the arm's length price. Section 482 permits the IRS to adjust the sales price to \$75 per unit -- the "arm's length price" -- and apply the U.S. tax results accordingly. Collateral adjustments can attend that primary adjustment also.

Transfer pricing manipulations are very difficult for the IRS to detect or address, so long as the taxpayer is not a real hog (remember the old adage regarding the bull, the bear and the hog; you make money being a bull or a bear but not a hog). And then when the IRS does spot or think it has spotted abuse, the IRS has a great deal of difficulty in sustaining its position as to pricing. For example, you will remember our old friend the *Compaq* case in which the Tax Court rejected an exotic corporate tax shelter but the Fifth Circuit sustained the shelter. In an earlier opinion involving *Compaq*, the Tax Court resoundingly rejected the IRS transfer pricing adjustments which involved far more tax dollars. Accordingly, the tax shelter of preference for many corporate taxpayers is transfer pricing.

The Code contains several procedural provisions addressed at giving the taxpayer the incentive to avoid being a hog on its transfer pricing adjustments and give the IRS better tools to identify potential transfer pricing adjustments. They are:

(1) The Substantial Net § 482 Transfer Price Adjustment Penalty. Section 6662(e)(3) provides a substantial accuracy related penalty for substantial net § 482 transfer pricing adjustments. I have addressed this penalty problem above. Excluded from the penalty base are adjustments that meet certain requirements including record keeping requirements.³⁹⁵⁴

(2) Record Keeping Requirements. The Code has special reporting rules designed to identify related party transactions, particularly cross-border transactions, with penalties designed to encourage compliance with the reporting rules.³⁹⁵⁵

One consequence of transfer pricing adjustments that have the effect of increasing the U.S. tax base in an international transaction is that the tax base in the foreign leg (or legs) of the related parties transaction will, if made consistent, be eroded. Go back to the examples I posited. The taxpayers in each example will have reported the transaction according to the transfer price it initially set. That is, in example 1, the U.S. taxpayer ("USP") would have reported and paid tax on \$5 profit per unit to the U.S. and the foreign taxpayer would have reported and paid tax on \$40 profit per unit to F Country. In example 2, the U.S. taxpayer ("USSub") would also have reported and paid tax on \$5 profit to the U.S., and the foreign taxpayer would have reported and paid tax on \$40 profit per unit to F Country. When the U.S. subsequently adjusts the intercompany sales price to \$75, the U.S. fisc will have been made whole, but consistency would require that the foreign tax be reduced and taxes refund to the foreign related party (FSub and FP, respectively in the examples). If the adjustments are not made consistent between the U.S. and the foreign country, there will in effect be double taxation of the same quantum of income.

Consistency will require the cooperation of the foreign government to adjust the foreign corporation's profits downward and issue a refund accordingly. Normally, neither a taxpayer nor the

³⁹⁵⁴ § 6662(e)(3)(B).

³⁹⁵⁵ See §§ 6038 - 6038C.

U.S. can require such cooperation unless the foreign government has surrendered that part of its sovereignty (never). The mechanism whereby foreign governments are encouraged to make consistent adjustments is referred to as the competent authority mechanism or, referring to its general name under the treaty, the mutual agreement procedure which obligates the competent authorities of each treaty state to attempt to reach agreement upon the request of one of the treaty states. The U.S. has tax treaties with a number of foreign governments, including almost all of the developed countries in which U.S. taxpayers may be doing business either directly through branches or through related entities. Those tax treaties are designed to avoid double taxation, among other things. The tax treaties are administered in each country through an official referred to as “the competent authority.” The competent authority in the U.S. has been the Assistant Commissioner (International), who delegates the day to day functioning to the Tax Treaty Division within the IRS. Under U.S. treaties, when the U.S. proposes to make a primary § 482 adjustment which would mean that, on a consistent basis, foreign tax will have been overpaid, the U.S. taxpayer can request competent authority assistance for the U.S. competent authority to negotiate with the foreign government to make a consistent adjustment. The treaties do not require the competent authorities of the two countries (the U.S. and the foreign country) to reach a consistent agreement. The treaties do, however, require the competent authorities to negotiate in good faith to try to reach a consistent agreement to avoid double taxation. Competent authority assistance usually works because most countries do negotiate in good faith.

The problem is that “arm's length pricing” is not a fixed, finite number, but is a range. Each country in the negotiating process may, in good faith, take a position in that range (which can be quite a large range depending upon how one views the economics) that best advantages the country. In the above example, I have assumed an arm's length price of \$75, but the range of potential arm's length prices might be from \$70 to \$80. In the first example, where a U.S. taxpayer (USP) is selling to a foreign taxpayer, the U.S. might want the \$80 point in that range, whereas F Country dealing in good faith might quickly agree that the original price \$55 was too low but would want to adjust only to \$70. Both points would be in a range that each country could reasonably take a position in good faith. But, if the countries stuck there, the U.S. would or could impose tax based on an arm's length price of \$80 and F Country could impose a tax based on an arm's length price of \$70, with a smaller refund issued, or perhaps even stick the F Country taxpayer with its reported \$55 price, with no refund issued. There would be \$10 double taxation in the first alternative and \$25 double taxation in the second.

Usually, the competent authorities are able to resolve their differences to reach a mutually acceptable point within the range so that the parties are not subject to double taxation. In this example, the competent authorities would agree to some point in the range -- say \$75 -- and impose tax results in each jurisdiction accordingly. However, the competent authorities are not always able to reach agreement even when they are dealing in good faith. And, sometimes, one or even both of the competent authorities may be merely going through the motions and not really dealing in good faith. The loser, in such standoffs, is the taxpayer whose costs of doing business across national borders is increased by double taxation. In a broader economic sense, that cost is really borne by the two countries because trade will be impeded by economic double taxation or the risk of such double taxation. Accordingly, to encourage trade, both countries' competent authorities will have a significant incentive not to take petty and unreasonable positions in the competent authority process

and to strive to reach a consistent agreement. That does not always happen, but it happens enough that on balance in most of our trading partner countries economic double taxation can usually be avoided.³⁹⁵⁶

One initiative in this area is the Advanced Pricing Agreements discussed above whereby, if successful, the IRS and the taxpayer agrees upon a pricing methodology for up to five years.

X. Industry Issue Resolution (“IIR”) Program.

The IRS has initiated a so-called Industry Issue Resolution (“IIR”) Program.³⁹⁵⁷ The goal “to establish a procedure to address through pre-filing guidance rather than post-filing examination frequently disputed tax issues that are common to a significant number of large or mid-size business taxpayers.”³⁹⁵⁸

The IRS believes that the issues most appropriate for the program will have two or more of the following characteristics:

- (1) The proper tax treatment of a common factual situation is uncertain;
- (2) The uncertainty results in frequent, and often repetitive, examinations of the same issue;
- (3) Frequent, and often repetitive, examinations require significant resources from both the IRS and impacted entities;
- (4) The issue is significant and impacts a large number of entities;
- (5) The issue requires extensive factual development; and
- (6) Collaboration would facilitate proper resolution of the tax issues by promoting an understanding of entities’ views and business practices.³⁹⁵⁹

The IRS believes that the following are not appropriate for consideration under the IIR program:

- (1) Issues unique to one or a small number of entities;
- (2) Issues not under the jurisdiction of the LB&I, SB/SE, or TE/GE Operating Divisions;
- (3) Issues involving transactions that lack a bona fide business purpose, or transactions with a significant purpose of improperly reducing or avoiding federal taxes; and

³⁹⁵⁶ In the example, when the competent authority negotiations work there will be no double taxation. But, if the non-U.S. treaty partner is unreasonable and insist on the price originally reported to it (a larger share of the economic base than it is entitled), the U.S. competent authority has considerable latitude to give the U.S. taxpayer relief from the resulting double taxation by adopting a position that is not consistent with U.S. law. See Lee A. Sheppard, Don't Pay that Tax, Danilack Warns 2011 TNT 67-3 (4/7/11) (paraphrasing and quoting the U.S. competent authority : “The competent authority is not constrained by U.S. law in the positions it can take, so it can reduce or eliminate U.S. tax. Danilack warned his audience not to get ideas. ‘We don't rewrite the tax code,’ he said, adding that the lack of a domestic-law constraint means that the competent authority has ‘flexibility to negotiate on a principled basis.’

³⁹⁵⁷ Rev. Proc. 2016–19, 2016-13 I.R.B.

³⁹⁵⁸ Id., § 2.01.

³⁹⁵⁹ Id., § 3.01.

(4) Issues involving transfer pricing or international tax treaties.³⁹⁶⁰

When the IRS determines the industry-wide resolution it believes is appropriate in consultation with industry groups, it will issue guidance in the form of a regulation, a revenue ruling, a revenue procedure or a notice, as appropriate.

XI. Alternative Dispute Resolution and Other Resolution Techniques.

A. Traditional ADR.

One of the hot topics in IRS practice has been the use of ADR to resolve disputes with the IRS. I mentioned above that mediation is now being used in Appeals and test programs for binding arbitration are now required. ADR has been very successful in civil non-tax litigation, and the notion is that it can be used in appropriate cases to resolve disputes between the practitioner and the IRS.

The IRS has tried ADR in transfer pricing cases. In a landmark case, Apple Computer submitted transfer pricing to arbitration under the baseball arbitration procedure (i.e., the arbitrators must accept the most reasonable position of the parties rather than coming in between the parties' positions). I won't get into the details, but the perception—perhaps not the reality—is that the IRS won the arbitration,³⁹⁶¹ so taxpayers have apparently been less willing to use ADR for such big ticket matters. Nevertheless, there does appear to be significant mediation and arbitration activity both in Appeals and in litigation in the Tax Court, for which there is rarely public notice of the details.³⁹⁶²

Not only is ADR available for disputes with the IRS, but it is also available where the disputes involve other countries. This usually arises in transfer pricing disputes where the issue is whether the U.S. company has properly priced the goods and services it provides a related entity in a foreign country. As noted earlier in text, that pricing, if respected, can determine where income is taxed and can thus erode the fisc of countries where the income is really earned. The U.S. income tax treaties usually contain a Mutual Agreement Procedure requiring the competent authorities of the respective countries to resolve disputes to avoid double taxation; in a transfer pricing dispute, this would mean determining appropriate transfer prices for goods and services and calculating taxes accordingly. This exercise has traditionally been done through country to country negotiations by their respective “competent authorities,” which are the offices related to their tax administrations that implement the treaties. The process entails attempting in good faith to reach agreement; the competent authorities usually reach agreement, but not always. ADR can be used to break deadlock

³⁹⁶⁰ Id. §. 3.03.

³⁹⁶¹ The perception may not be the reality because, although the arbitrators accepted the IRS position, the IRS had backed off substantially from the position in the notice of deficiency before finalizing its position with the arbitrators. If the taxpayer was taking an extremely aggressive position to counterbalance the IRS's initial position in the notice of deficiency but did not thereafter moderate the position as aggressively as the IRS did, the taxpayer would lose. But the IRS may have had to give up a large part of the dollars originally at issue to prevail, so that the taxpayer really did prevail as to the dollars originally at issue.

³⁹⁶² One Tax Court case that does provide a caution to practitioners considering ADR, particularly arbitration. In *Duncan v. Commissioner*, 121 T.C. 293 (2003), the Tax Court held that arbitration is a contractual arrangement and the parties will be held to their contract.

between the competent authorities. Some treaties thus now provide for arbitration, but any type of ADR—including arbitration—can be used by the competent authorities if they agree to do so. It is reported that arbitration is being used with a number of competent authorities to resolve transfer pricing disputes.³⁹⁶³ For example, the U.S. and Canada have used baseball arbitration in transfer pricing disputes subject to the Mutual Agreement Procedure in our tax treaties.³⁹⁶⁴

I believe we will see more use of ADR in the disputes between taxpayers and the IRS. I do not have prescience enough to be able to predict the precise shape of the ADR initiatives that will finally come into the regular bag of tricks the practitioner can invoke to meet his or her client's needs. But I do know that this will increasingly be an opportunity that is and will be available.

B. Other Quasi-ADR.

I would like to mention in this context certain other IRS initiatives that, while not ADR, do represent nontraditional techniques for resolving disputes as early as possible.

1. Advance Pricing Agreements (“APAs”).

Perhaps the most prominent nontraditional dispute resolution technique is the Advance Pricing Agreement. Section 482 of the Code permits the IRS to allocate income, deductions, etc. between taxpayers under common control where the pricing on transactions between the taxpayers is not at arm's length. The pricing on the transactions is referred to as transfer pricing. The U.S. fisc generally has no overall interest on transfer pricing between U.S. related parties in the same tax bracket but does have a major interest on such pricing on transactions between a U.S. taxpayer and a related foreign taxpayer.³⁹⁶⁵ By manipulating the transfer pricing, the commonly controlled taxpayers can effectively push taxable income from the U.S. taxpayer to the related foreign taxpayer, thus causing a revenue loss to the U.S. fisc. For some time now, the IRS's largest audit adjustments and the largest and most contentious tax litigation has been over transfer pricing. The cases are fact intensive, expensive to litigate and fraught with uncertainty in final resolution.

Recognizing that litigation was time consuming, expensive and distracting for the IRS and for the taxpayer, the IRS developed its APA program, currently called the Advance Pricing and Mutual Agreement Program (“APMA Program”),³⁹⁶⁶ to permit the IRS and the taxpayer to agree

³⁹⁶³ Patrick Temple-West, International arbitration for tax disputes, "baseball" style (Reuters 11/15/12).

³⁹⁶⁴ Id. The article reports are that the IRS has succeeded in early rounds of baseball arbitration with Canada. As with the Apple arbitration noted above, the perception of success in baseball arbitration simply as a result of the arbitrator picking one side's number can be deceiving if that side gave up too much in presenting its number.

³⁹⁶⁵ The IRS would also have an interest in transfer pricing between solely U.S. related parties to the extent that one of the parties may be subject to a materially lower effective tax rate, because the incentive would be to use transfer pricing to push profit to the party subject to the lower effective rate. Despite this, most of the observable action in this area is where a U.S. taxpayer deals with a foreign related party subject to a lower effective tax rate where the incentive would be to push profits offshore, thereby escaping the U.S. tax net (either altogether or via a deferral which can, if extended, be the equivalent of exemption).

³⁹⁶⁶ The expansion of the name to include “Mutual Agreement” is in recognition that many, if not most, APAs will be obtained under tax treaty mutual agreement procedures whereby the U.S. and the treaty partner mutually
(continued...)

upon transfer pricing methodologies in advance (up to a 5 year advance period). The APMA procedures are set forth in Revenue Procedures which the IRS updates and republishes periodically to reflect changes in the program.³⁹⁶⁷

Those pricing methodologies are based upon taxpayer representations (including economic studies) and certain critical economic assumptions that must continue to exist during the period. Taxpayers must report annually to the IRS on the critical factual assumptions. The net result of an APA is that the IRS and taxpayer do not have to worry about major transfer pricing controversy over the period of the agreement. APAs are major—usually time consuming and expensive—agreements to negotiate, but many taxpayers feel it is in their advantage to do so. In addition, in many cases, the IRS will use the APA as a basis for settling past years. Thus, for example, in one case I was handling involving major transfer pricing adjustments, we considered going for an APA that could settle five future years and would likely also be used to settle seven open years for which adjustments had been proposed by the IRS. In short, if a satisfactory agreement could be reached, the taxpayer would have certainty for twelve years. We decided for other reasons not to do that, but nevertheless the opportunity was quite tempting.

Not surprisingly, the IRS reserves the right to cancel APAs if the taxpayer does not comply with the terms and conditions of the APA.³⁹⁶⁸

The user fees for APAs are significant. For APAs after 12/31/18, the fees are \$113,500 for new APAs and lesser amounts for renewals, small case and amendments to prior APAs:³⁹⁶⁹ The user fee is only the tip of the iceberg in terms of cost to the taxpayer. An expert report will be required, and competent expert reports in this area are expensive. Also, there will likely be

³⁹⁶⁶(...continued)

agree upon the transfer pricing methodology. For background of the APMA Program, see IRS web page titled “Advance Pricing and Mutual Agreement Program” (Updated 10/28/22 and viewed 7/13/22).

³⁹⁶⁷ The current Revenue Procedures are: Rev. Proc. 2015-41, 2015-35 I.R.B. 263, providing guidance and instructions on filing APA requests as well as guidance and information on the administration of APAs; and Rev. Proc. 2015-40, 2015-35 I.R.B. 236 providing procedures and guidance on requesting assistance from the U.S. Competent Authority where the taxpayer believes that the actions of the United States or a treaty country result or will result in the taxpayer being subject to taxation not in accordance with the applicable U.S. tax treaty.

³⁹⁶⁸ See Rev. Proc. 2015-41, Section 7.06. The APA “contract” is made subject to the then applicable Rev. Proc. which gives the IRS the right to cancel. In *Eaton v. Commissioner*, 140 T.C. 410 (2013), the taxpayer sought to enforce the APA as a contract with the Commissioner having the right to cancel only if the Commissioner established noncompliance. The IRS urged that, since its right to cancel was subject to the terms of the Rev. Proc., the IRS’s cancellation was subject to an abuse of discretion standard. The Court held for the IRS. On the right to terminate, the Sixth Circuit held in *Eaton Corporation v. United States* (6th Cir. 2022) that: (i) the APA is a contract that is review under normal contract principles rather than for abuse of the IRS’s discretion; (ii) the IRS has the burden to prove breach of contract; (iii) the IRS has not shown a material breach of the contract, (iv) the taxpayer’s own self-corrections by amended return of its original reporting were § 482 adjustments (which might give rise to an accuracy related penalty under § 6662(h)) but the IRS had timely raised the § 482 penalty issue only on the additional tax sought beyond the self-corrected tax reported on the amended returns and asserted the penalty on the self-corrections on the amended returns after trial when it was too late; and (v) as § 842 adjustments, the taxpayer could seek double tax relief. See *Eaton Wins Big on Appeal in Long-Running Contentious Litigation Over APAs* (Federal Tax Procedure Blog 8/27/22).

³⁹⁶⁹ See PWC report titled *US 2017 APA report reflects uptick in executed APAs and APA requests amid longer processing time* (4/4/18) (after December 31, 2018, new APAs \$113,500; renewal APAs \$62,000; small case APAs \$54,000; and amendments to APAs \$23,000).

significant outside lawyer fees required, **although** sophisticated corporate tax and legal departments could probably handle it themselves at, of course, significant internal costs. Whether the legal work is done out-house or in-house, there will be a significant internal cost for the input from the business and accounting functions in preparing the expert report and in dealing with the IRS's requests for information.

The IRS annually publishes information on APAs for each year. The publication for calendar year 2021³⁹⁷⁰ (most recent as of August 1, 2023) indicates that, in 2020, the IRS entered 124 APAs, of which 25 were unilateral, 98 were bilateral, and 1 multilateral.³⁹⁷¹ The publication offers further insightful more granular detail for those practicing in this area – industries involved, types of property involved, general methodologies involved, sources for comparable data etc. The publication also offers model or template Advance Pricing Agreements with Appendices.

2. Pre-Filing Agreements.

IRS's LB&I Division adopted a Pre-filing Agreement ("PFA") process on a permanent basis.³⁹⁷² The goal of the PFA is to provide the qualifying LB&I Division taxpayers a process to request examination and resolution of specific issues relating to completed transactions or events³⁹⁷³ to be reported on tax returns not yet filed, thereby potentially achieving reductions in allocations of resources in post-filing examinations.³⁹⁷⁴ The PFA is a closing agreement under § 7121 and is thus binding on the parties.

The PFA may involve up to 4 years beyond the current year. The PFA covers only unfiled returns for the period indicated. As with the APA (also a forward looking agreement), the question arises whether the basis of the agreement can be rolled back to earlier years where the return is already filed and the issue may have been raised in audit. There is no set answer, but the IRS in the management of its audits is likely to apply the basis of the agreement if the circumstances have not changed in a material way to make the agreement irrelevant to the earlier year(s).

The user fee for PFAs is \$50,000.³⁹⁷⁵

³⁹⁷⁰ Announcement and Report Concerning Advance Pricing Agreements (3/22/21, viewed (8/15/23).

³⁹⁷¹ See Announcement and Report Concerning Advance Pricing Agreements dated March 22, 2022, available <https://www.irs.gov/pub/irs-drop/a-22-07.pdf>.

³⁹⁷² IRM 4.30.1 Pre-Filing Agreement Program; and Rev. Proc. 2001-22, 2001-9 I.R.B. 745.

³⁹⁷³ Future transactions are not considered but may be addressed under the letter ruling procedure discussed elsewhere in the text.

³⁹⁷⁴ IRM 4.30.1.1.1 (03-28-2018), Background.

³⁹⁷⁵ Rev. Proc. 2009-14, 2009-3 I.R.B. 324.

3. Compliance Assurance Process (“CAP”).

The IRS has a Compliance Assurance Process (“CAP”) for large case taxpayers.³⁹⁷⁶ The program seeks through active collaboration between the IRS and the taxpayer to resolve issues as to completed transactions **before** the return is filed. The following is a description of the CAP program:

Purpose. The Compliance Assurance Process (CAP) is a method of identifying and resolving tax issues through open, cooperative and transparent interaction between the IRS and LB&I taxpayers prior to the filing of a return. Through the CAP (or "the Program"), the taxpayer should achieve tax certainty sooner and with less administrative burden than conventional examinations. The Program seeks to identify, develop and resolve the material issues before the return is filed. It relies on the transparent and cooperative interaction of the parties and the contemporaneous exchange of information. The Program does not provide taxpayers with guidance on, or resolution of, prospective or incomplete transactions outside of existing procedures.³⁹⁷⁷

CAP requires the following phases:³⁹⁷⁸

(i) CAP Phase. The taxpayer makes “open, comprehensive and contemporaneous disclosures of its material issues in writing.” If the IRS agrees that all material issues have been disclosed and resolved, the IRS gives the taxpayer a Full Acceptance Letter assuring that IRS will accept return as filed. Matters not resolved through this process “may be resolved through the post-filing examination process.”

(ii) Compliance Maintenance Phase. Taxpayers with limited number of material issues, continues to satisfy CAP eligibility requirement for one complete CAP phase may progress to the Compliance Maintenance Phase. In this phase, the taxpayer continues to make “open, comprehensive and contemporaneous disclosures of its material issues,” subject to unreported items being considered in post-filing examination.

(iii) Bridge Phase. Taxpayers with few, if any material issues, continuing CAP eligibility and at least one Compliance Maintenance Phase, may progress, if approved, to the Bridge Phase. The IRS will not accept disclosures or provide any assurances for bridged returns, but the taxpayer may request a pre-filing agreement for specific issues.

This is just a broad overview of CAP. Taxpayers considering CAP should be aware that there is periodic fine-tuning of the process and check for updates accordingly.³⁹⁷⁹

³⁹⁷⁶ The program was originally announced as a pilot program in 2005 in Ann. 2005-87, 2005-50 I.R.B. 1144. The program was made permanent in 2011. IR 2011-32 (March 31, 2011).

³⁹⁷⁷ IRM 4.51.8.1(1) (04-16-2020), Program Scope. See also IRS web page “Compliance Assurance Process” (last reviewed or updated 7/26/22 and viewed 7/27/22).

³⁹⁷⁸ IRM 4.51.8.2 (04-16-2020), The Three Phases of the Program.

³⁹⁷⁹ The IRS announced changes in CAP dictated by decline in LB&I workforce. IR 2018-174 (8/27/18).

XII. Mirror Code.

The United States has a “mirror code” system with certain of its territories -- including U.S. Virgin Islands, Guam and the Commonwealth of the Northern Mariana Islands (CNMI). The mirror code concept treats the U.S. tax code as the tax law of each jurisdiction -- U.S., on the one hand, and the other jurisdiction, on the other.³⁹⁸⁰ In effect, the two jurisdictions are treated as separate countries each having the U.S. Code as its tax code.

Where two separate countries have their own internal revenue laws and a taxpayer of one jurisdiction is subject to tax in the other jurisdiction, that taxpayer can potentially be subject to tax in both jurisdictions. For example, a U.S. taxpayer conducting business in another country could be subject to U.S. tax on the income from the other country in both countries. The way this potential problem is mitigated or eliminated where two unrelated countries are involved is by the foreign tax credit and/or the U.S. system of double tax treaties. Under that system, return or tax paying requirements are still applicable in each jurisdiction. The U.S. taxpayer pays tax to the other country on his income in the other country and then reports the income and claims a foreign tax credit in his U.S. return.

In certain mirror code jurisdictions, the potential for double tax is avoided or mitigated by having a single filing requirement.³⁹⁸¹ The U.S. person avoids double taxation by including all income on the single filed return and paying the tax accordingly. The jurisdiction in which the single filing is made is determined by residence or, under some statutes, bona fide residence in the noncitizenship jurisdiction.³⁹⁸² For example, if the U.S. citizen is a bona fide resident of the U.S. Virgin Islands (“USVI”), the U.S. citizen files his or her single tax return with the tax authority in USVI and does not file a U.S. tax return with the IRS; any tax paid to the U.S. will be sent (“covered into”) USVI.³⁹⁸³ If the U.S. taxpayer is not a bona fide resident of USVI, he files his single tax return with the IRS, reporting all income (including USVI income) and paying tax to the U.S. The agency receiving the single return (USVI in this example) will determine the tax attributable to that jurisdiction and “cover”–remit–the balance attributable to the citizenship jurisdiction (U.S. in this example). As noted, the U.S. taxpayer theoretically would still pay the same amount of tax to the mirror code filing jurisdiction (USVI here) under the mirror code system. That system works.

But there is a wrinkle. Some mirror code jurisdictions (USVI in this example) have certain tax credits or rebates that would apply to the portion of the tax attributable (under sourcing concepts) to that mirror code jurisdiction.

The problem came when U.S. citizens attempt to claim residence or bona fide residence in the mirror code jurisdiction and source their income into the mirror code jurisdiction so that it can

³⁹⁸⁰ See, e.g., *Vento v. Commissioner*, 147 T.C. 198 (2016).

³⁹⁸¹ See § 931-933.

³⁹⁸² E.g., *Vento v. Commissioner*, 147 T.C. 198 (2016) (Virgin Islands based on bona fide residence).

³⁹⁸³ See § 7654(a). See *Hulett v. Commissioner*, 150 T.C. 60 (2018) (showing how USVI obtains the “cover into” by sending to the IRS a portion of the return filed with USVI).

qualify for the tax credit or rebate. For example, from a case I handled, assume the mirror code system has a single filing requirement and requires that the mirror code jurisdiction cover back to the U.S. only the tax on the income that is not sourced in the mirror code jurisdiction and the U.S. citizen claiming residence or bona fide residence in the mirror code jurisdiction arranges to have all or the bulk of his income sourced in the mirror code jurisdiction. That would mean that, although the U.S. taxpayer must report and pay the same tax to the mirror code jurisdiction, the mirror code jurisdiction only covers to the U.S. the tax attributable to income not sourced in the mirror code jurisdiction. The mirror code jurisdiction keeps the lion's share of the tax because the taxpayer has forced sourcing on the lion's share of his income into that mirror code jurisdiction. Then, suppose that the mirror code jurisdiction offers a rebate or tax credit for some significant portion of the tax it keeps under the system. If that happens, the U.S. person filing the single tax return with the mirror code jurisdiction will avoid substantial tax that he would have paid and not obtained a rebate or credit had he filed with the U.S.³⁹⁸⁴

I cannot explore here all the games that can be played turning upon residence or bona fide residence.³⁹⁸⁵ Suffice it to say that it is a problem.

XIII. Remedies for IRS Employee Misconduct.

A. Introduction.

The IRS is a large organization with many employees. It is inevitable that there will be some rotten apples in the barrel who will misbehave. The issue addressed here is what are the consequences of their misbehavior and specifically whether a taxpayer has remedies for misbehavior.

The so-called *Caceres* doctrine (p. 80), which holds that, generally, a taxpayer has no remedy for damage imposed by an IRS employee's violation of the IRM. What about violation of the Code or of constitutional rights?

There are certain implicit remedies in the Code rules we have discussed above. If the IRS makes an assessment outside the statute of limitations (even knowingly so), the taxpayer's remedy is to have the assessment abated, judicially if necessary. Some of the Code's rules do not necessarily

³⁹⁸⁴ See The Mirror Code Concept; Some Thoughts and Ruminations (Federal Tax Procedure Blog 5/27/13).

³⁹⁸⁵ See e.g. *Coffey v. Commissioner*, 982 F.3d 1127 (8th Cir. 2020) and, on resubmission, 987 F.3d 808 (8th Cir. 2021) (taxpayer was not a bona fide resident of USVI and thus attempted filing of single return with USVI did not start statute of limitations for U.S. tax liability); *Tice v. Commissioner*, 160 T.C. ___, No. 8 (2023) (U.S. citizen not a bona fide resident of Virgin Islands must file return both with Virgin Islands and U.S. in order to start U.S. statute of limitations on assessment); and *Commissioner v. Sanders*, 834 F.3d 1269 (11th Cir. 2016) (holding that the test for the single return required by a U.S. citizen who actually filed in USVI is not determined by the U.S. citizen's good faith choice in filing in USVI but rather by whether the U.S. person is a bona fide resident; hence the U.S. citizen who, regardless of good faith, was not a bona fide resident of USVI and thus should have filed his single return with the IRS had an open-ended statute of limitations under § 6501(c)(3)).

prescribe a remedy, in which case it is up to the courts to determine what remedy, if any, may be appropriate for the violation. For example, we discussed above the requirement that the notice of deficiency advise the taxpayer of the final date for filing a petition for redetermination in the Tax Court. If the notice does not state that date, is it invalid and therefore cannot support a subsequent assessment? The statute does not say, and the few cases to date seem to state that the notice of deficiency is not thereby invalidated so long as it is otherwise regular on its face.

What about tort and tort-like remedies for an IRS employee's negligent or intentional actions that result in damage to taxpayers that are not remedied simply by correcting the improper action (e.g., reversing the improper assessment or returning property wrongfully levied upon)? Under general tort law, there are two potential targets for tort-like action—the employer and the employed (i.e., the IRS employee committing the malfeasance). Generally, in torts, it is best to nail the employer—here the Government—because the employer generally has deeper pockets than the employee.

This presents the first problem here. The general rule is that the Government is the employer and the general rule of Anglo-American jurisprudence is that the sovereign cannot be sued unless it has expressly consented to be sued. We shall first look at the areas in which the Government has consented to be sued for actions of IRS employees.

We then consider actions directly against the IRS employee.

This is a complex area of the law and the following will only introduce you to the subject.³⁹⁸⁶

B. Remedies Against the United States.

1. Federal Tort Claims Act (“FTCA”).³⁹⁸⁷

The FTCA, 28 U.S.C. §§ 2671-2680, waives the general rule of sovereign immunity prohibiting suit against the United States, for certain “claims against the United States . . . under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred,”³⁹⁸⁸

Where applicable, the FTCA is the exclusive civil remedy against Government employees acting within the scope of their employment.³⁹⁸⁹ The remedy is for negligence, but is severely limited by exceptions in § 2680,³⁹⁹⁰ including an exception for most intentional torts (other than malicious

³⁹⁸⁶ A good article is Michael G. Tanner, IRS Misconduct in an Audit: Is There A Civil Remedy?, 55 Tax Law. 107 (2001). I have relied significantly on this article in preparing this summary.

³⁹⁸⁷ 28 U.S.C. §§ 2671-2680.

³⁹⁸⁸ 28 U.S.C. § 1346(b)(1).

³⁹⁸⁹ 28 U.S.C. § 2568(b)(1).

³⁹⁹⁰ *Morris v. United States*, 521 F.2d 872, 874 (9th Cir. 1975).

prosecution).³⁹⁹¹ Liability is determined by the law of the state in which the act or omission occurred; the United States is liable to the same extent as a private citizen would be, but not for prejudgment interest or punitive damages.³⁹⁹² The FTCA, however, requires the exhaustion of certain administrative remedies available whereby the claims must first be presented to the Government agency and denied.³⁹⁹³

The FTCA remedy is not available “in respect of the assessment or collection of any tax.”³⁹⁹⁴ The exception thus virtually eliminates FTCA remedies in tax matters.³⁹⁹⁵ The courts interpret the exception liberally to avoid FTCA liability in criminal and civil investigations but will draw a line in particularly egregious cases when the agent’s conduct is sufficiently remote from his IRS responsibilities.³⁹⁹⁶

Assuming a citizen aggrieved by putative IRS employee misconduct can clear that not insubstantial hurdle, there is still one other potential limitation under FTCA. The FTCA does not apply if the employee’s putative misconduct was “based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty.”³⁹⁹⁷ This discretionary function limitation to FTCA is an affirmative defense that must be raised and proved by the Government. The exception applies only to acts that are discretionary in nature.

Where the FTCA applies, it is the only remedy available (meaning that there is no separate remedy against the Government employee).

2. Wrongful Return Information Disclosure Remedies.

I discussed above the general statutory prohibition against the IRS disclosing taxpayer return information. In that discussion, I also included the statutory remedy under § 7431 (p. 1058). I do not repeat that discussion here.

³⁹⁹¹ 28 U.S.C. § 2680(h) exempts “assault, battery, false imprisonment, false arrest, malicious prosecution, abuse of process, libel, slander, misrepresentation, deceit or interference with contract rights,” but excludes from the exemption suits against investigative or law enforcement officers for claims “arising * * * out of assault, battery, false imprisonment, false arrest, abuse of process, or malicious prosecution.” Courts will not permit artful pleading to avoid these exceptions and will look instead to the substance of the claim. *Dorking Genetics v. United States*, 76 F.3d 1261, 1265 (2d Cir. 1996); and *Lambertson v. United States*, 528 F.2d 441, 443 (2d Cir. 1976).

³⁹⁹² 28 U.S.C. § 2674.

³⁹⁹³ The time periods on presenting the claim and pursuing judicial action are somewhat reminiscent of the claim for refund procedure—i.e., the claim must be presented within two years of the date it accrues and then the suit must await denial of the claim or lapse of six months from the date the claim was presented. Unlike the suit for refund, however, the FTCA claim must be filed within six months from the date of denial. § 2401(b); 2665(a).

³⁹⁹⁴ § 2680(c).

³⁹⁹⁵ The exclusion from liability is construed very broadly to exempt virtually any action by the IRS in furtherance of its functions. *Snyder & Associates Acquisitions, LLC v. United States*, 859 F.3d 1152 (9th Cir. 2017) (noting the “expansive reach” of § 2680(c), but also holding that it does not grant the IRS “absolute immunity.”).

³⁹⁹⁶ Cf. *Snyder & Associates Acquisitions, LLC v. United States*, 859 F.3d 1152 (9th Cir. 2017).

³⁹⁹⁷ § 2680(a).

3. Unauthorized Collection Actions (§ 7433).

Section 7433(a) of the Code allows taxpayers to sue and recover:

[i]f, in connection with any collection of Federal tax with respect to a taxpayer, any officer or employee of the Internal Revenue Service recklessly or intentionally, or by reason of negligence disregards any provision of this title, or any regulation promulgated under this title * * * *

The provision permits a remedy for many of the activities excluded by the tax exception to the FTCA.

The key features of § 7433 are:

- The remedy is only for collection actions; it does not permit recovery for other actions, such as assessment actions³⁹⁹⁸ or denials of OICs.³⁹⁹⁹
- In the collection activity, the IRS or agent must have disregarded a provision of the Code or a tax regulation. Violations of internal operating procedures, including the IRM, are not covered.
- Only the taxpayer subject to the collection activity may recover; others who are not the taxpayer who may have been harmed in the collection activity may not recover.⁴⁰⁰⁰
- A taxpayer may only recover “actual direct economic damages,” which means pecuniary out of pocket damages (plus costs), up to \$1 million (if reckless or

³⁹⁹⁸ *Goldberg v. United States*, 881 F.3d 529, 534 (7th Cir. 2018) (collecting cases in other circuits). This is true even though assessment is a predicate to collection activity; only the collection activity is subject to § 7433. The *Goldberg* Court also reasoned that:

If § 7433 applied to tax code violations committed in the assessment process, the remedy would at best duplicate the refund process and at worst create an unnecessary loophole that might allow taxpayers to skirt the administrative refund process entirely by claiming the IRS negligently violated the tax code

³⁹⁹⁹ *Morales v. United States*, 2019 U.S. Dist. LEXIS 57 (D. N.J. 2019) (citing *United States v. Ullman*, No. 01-0272, 2002 U.S. Dist. LEXIS 8542, 2002 WL 987998, at *6 (E.D. Pa. May 8, 2002), *aff'd*, 55 F. App'x 105 (3d Cir. 2003)) (OIC is not a collection activity and, moreover, an OIC is purely discretionary rather than a requirement that the IRS could disregard.).

⁴⁰⁰⁰ *Gessert v. United States*, 703 F.3d 1028, 1033 (7th Cir. 2013) (“the plain language limits relief to such taxpayers that were subjected to the wrongful activity; the Code does not permit recovery by third parties harmed by the activity.”). Does this limitation preclude the type of argument in *United States v. Williams*, 514 U.S. 527, 533 (1995) that someone other than the person traditionally described as the taxpayer could be considered the taxpayer? *Southland Farming, Inc. v. United States*, 1997 U.S. Dist. LEXIS 21286 (S.D. Fla. 1997) held that “the term taxpayer [in §7433] includes . . . a party [other than the traditional taxpayer] from whom the IRS seeks to collect deficient tax liabilities.” But this holding in *Southland Farming* does not seem to have gained traction and has been criticized other cases. E.g., *Parker v. United States*, 2010 U.S. Dist. LEXIS 103957 (S.D. CA 2010) (discussing the cases).

intentional) or \$100,000 (if negligent).⁴⁰⁰¹ Recovery will be reduced by damages that could have been mitigated.⁴⁰⁰²

- A taxpayer may recover only for collection activities. Are assessment activities—which perforce must precede collection activities—within the ambit of the term “collection activities?” The answer appears to be no.⁴⁰⁰³ For example, if the IRS made an improper assessment because the taxpayer did not owe the liability, but the IRS’s collection activity pursuant to the assessment is otherwise proper, § 7433 offers no remedy.⁴⁰⁰⁴
- As with other claims against the Government, the taxpayer must first seek and exhaust administrative remedies before filing the suit.⁴⁰⁰⁵
- The suit must be brought “only within 2 years after the date the right of action accrues.”⁴⁰⁰⁶
- The suit must be brought in the district court⁴⁰⁰⁷ and is triable to the judge rather than to a jury.⁴⁰⁰⁸
- Except as provided in § 7432 for failure to release a lien, § 7433 is the exclusive civil remedy for actions within the scope of the provision.⁴⁰⁰⁹

⁴⁰⁰¹ § 7433(b)(1).

⁴⁰⁰² § 7433(d)(2).

⁴⁰⁰³ *Miller v. United States*, 66 F.3d 220, 222–223 (9th Cir. 1995), cert. denied, 517 US 1103 (1996) (no recovery for a claimed erroneous or illegal assessment); *Shaw v. United States*, 20 F.3d 182, 184 (5th Cir. 1994) (no recovery for improper assessment); the holding of which was re-affirmed in *Gandy Nursery, Inc. v. United States*, 412 F.3d 602 (5th Cir. 2005); see generally, Michael G. Tanner, *IRS Misconduct in an Audit: Is There a Civil Remedy*, 55 Tax Law. 107, 116-117 (2001).

⁴⁰⁰⁴ *Shaw v. United States*, 20 F.3d 182, 184 (5th Cir. 1994),

⁴⁰⁰⁵ § 7433(d)(1); see Reg. § 301.7433-1(a), (d) & (e). The exhaustion requirement is action on the administrative request or passage of the sixth month, except that, if the administrative claim is filed during the last six months of the two year period to file the suit, the taxpayer may file the suit at any time after the administrative claim is filed. Reg. § 301.7433(d); see *Portsmouth Ambulance, Inc. v. United States*, 756 F.3d 494 (6th Cir. 2014), noting that this special regulation treating a filing in the last six months as exhaustion was:

promulgated to provide an alternative exhaustion mechanism for individuals who could not wait for an administrative decision or for six months from the filing of an administrative claim before the expiration of the statutory limitations period. Regardless of when during the two-year period established in 26 U.S.C. § 7433(d)(3) a taxpayer files an administrative claim, such an entity still must file its federal-court complaint within two years after the date on which the cause of action accrued.

This exhaustion requirement is not jurisdictional and thus can be waived by the Government. *Gray v. United States*, 723 F.3d 795, 798 (7th Cir. 2013), cert. denied 572 U.S. 1137 (2014) *Gray* rejected the argument that the exhaustion requirement could be done after filing suit and before judgment was rendered, applying *Chevron* analysis to support the Regulations interpretation of exhaustion prior to filing suite. See also *Hassen v. Gov’t of the Virgin Islands*, 861 F.3d 108, 114 (3d Cir. 2017) (interpreting the exhaustion requirement under § 7433 of the Virgin Islands “Mirror Code” which is the same as the U.S. version, and discussing cases on the U.S. version; “we join our sister circuits and hold that § 7433(d)’s exhaustion requirement is not jurisdictional and hence need not be satisfied for the district court to entertain a claim under § 7433(a).”)

⁴⁰⁰⁶ § 7433(d)(3). Note the exhaustion nuance permitting suit without action if the administrative claim is filed during the last six-months of the two year period. Reg. § 301.7433(d)(2).

⁴⁰⁰⁷ § 7433(a)

⁴⁰⁰⁸ *Law Offices of Gary Rossi, PLLC v. United States*, 2012 U.S. Dist. LEXIS 157237 (E.D. Mich. 2012).

⁴⁰⁰⁹ § 7433(a).

- Costs recoverable under the statute are the normal costs of litigation.⁴⁰¹⁰ This does not include attorneys’ fees and other litigation costs but they may be recovered under § 7430, discussed elsewhere in the text.⁴⁰¹¹
- The § 7433 remedy, like the § 7432 remedy, may not survive the death of the taxpayer.⁴⁰¹²

Section 7433 is sometimes referred to as TBOR or TBOR I. (See p. 102, discussing § 7803(a)(3) which is sometimes called TBOR III or, usually, just TBOR. Usually, when the term TBOR is used, the reference is to § 7803(a)(3), TBOR III.

4. Recovery of Attorneys’ fees.

I covered above Section 7430 allowing recovery of fees and costs (including attorneys’ fees) against the Government in administrative and judicial proceedings. See discussion of attorneys’ fees and costs recovery beginning p. 601 Suffice it to say that, for the types of litigation discussed in this section, the taxpayer may recover such fees and costs under § 7430.⁴⁰¹³

C. Remedies for Tort or Intentional Injury (“FTCA”).

As noted above, the FTCA is the exclusive remedy for suits against the Government for tortious damages within the scope of a Government employee’s responsibility and the suit is against the United States except for violation of the Constitution or a statute permitting the Government employee to be sued.⁴⁰¹⁴

If the Government employee’s actions are not within the scope employment (including violating the Constitution), the person allegedly harmed may sue the employee (but not the United States) under otherwise applicable state remedies. This turns upon the state law of remedies which may or may not permit a remedy against the Government employee. There is, however, one key federal common law remedy against Government employees acting under color of federal authority resulting in violations of constitutional protections.⁴⁰¹⁵ This is the *Bivens* remedy, named for a Supreme Court case allowing suit for searches and searches violating the Fourth Amendment.⁴⁰¹⁶

⁴⁰¹⁰ § 7433(b)(2); and Reg. § 301.7433-1(c).

⁴⁰¹¹ Reg. § 301.7433-1(h).

⁴⁰¹² *Pansier v. United States*, 2020 U.S. Dist. LEXIS 156362 (E.D. Wis. 2020). For discussion of *Pansier*, see Leslie Book, Death of Taxpayer Extinguishes Claims for Wrongful Collection and Failure to Release Lien (Procedurally Taxing 9/14/20) (commenting that “While the government may pursue the estate for any tax liability, and even for possible civil penalties, this case shows that the government enjoys special status and is free from any consequences from alleged misconduct in collecting those taxes when the taxpayer was alive.”).

⁴⁰¹³ See e.g., Reg. § 301.7432-1(f); and § 301.7433-1(h).

⁴⁰¹⁴ 28 U.S.C. § 2679(b)(1).

⁴⁰¹⁵ 28 U.S.C. 2679(b)(2)(A) (creating exception allowing suit against the individual employee claiming “violation of the Constitution of the United States.”).

⁴⁰¹⁶ *Bivens* refers to the case of *Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics*, 403 U.S. 388 (1971). The remedy is “a judicially-created remedy stemming directly from the Constitution itself.” *Arar v.* (continued...)

Unconstitutional searches and seizures are outside the scope of employment and thus outside the FTCA. If the conduct rises to the level of a constitutional violation, *Bivens* allows a federal common law tort remedy for money damages against the Government employee personally despite the absence of any statute conferring the remedy. Unlike the FTCA, the *Bivens* remedy permits a jury trial and punitive damages.⁴⁰¹⁷

The *Bivens* remedy has parameters, some of which severely constrict the remedy in tax administration contexts. The Supreme Court has signaled that the *Bivens* remedy, although well-settled in its context, is limited to its past applications, with expansions from past applications “now a ‘disfavored’ judicial activity.”⁴⁰¹⁸ **New applications foreclosing *Bivens* are those which are “different in a meaningful way from previous *Bivens* cases decided by this [the Supreme] Court.”** Specifically, expansion is not permitted in new contexts where “special factors” counsel hesitation.⁴⁰¹⁹

There is no definitive list of the scope of the *Bivens* remedy as of this publication but my conclusions are: First, the conduct complained of must rise to the level of a clear constitutional violation. Second, the remedy clearly applies only in the narrow set of circumstances the Supreme Court previously approved the remedy.⁴⁰²⁰ Third, the remedy is not available in areas in which Congress has provided remedies for misconduct even if the remedies are incomplete.⁴⁰²¹ In the context of investigating, determining, assessing and collecting taxes, Congress has provided remedies which generally preclude the *Bivens* remedy.⁴⁰²² (Note in this regard that the FTCA does not pre-empt the *Bivens* remedy.⁴⁰²³) Fourth, other special factors (outside the scope of tax matters, such as conduct implicating authorities assigned to the executive such as foreign relations) will often

⁴⁰¹⁶(...continued)

Ashcroft, 585 F.3d 559, 571 (2d Cir. 2009) (en banc). The *Bivens* common law remedy has been equated to the statutory remedy under 42 U.S.C. § 1983 for purposes of the qualified immunity defense. *Wilson v. Layne*, 526 U.S. 603, 609 (1999).

⁴⁰¹⁷ *Carlson v. Green*, 446 U.S. 14, 22 (1980).

⁴⁰¹⁸ *Hernandez v. Mesa*, 589 U.S. ___, 140 S. Ct. 735 (2020); and *Ziglar v. Abbasi*, 582 U.S. 120, 135 (2017) (citing *Ashcroft v. Iqbal*, 556 U.S. 662, 675 (2009)).

⁴⁰¹⁹ *Id.*

⁴⁰²⁰ *Hernandez v. Mesa*, 589 U.S. ___, 140 S. Ct. 735 (2020); and *Ziglar v. Abbasi*, 582 U.S. 120, 137 S. Ct. 1843, 1857 (2017) (citing *Ashcroft v. Iqbal*, 556 U.S. 662 (2009)).

⁴⁰²¹ *Hernandez v. Mesa*, 589 U.S. ___, 140 S. Ct. 735 (2020); and *Carlson v. Green*, 446 U.S. 14, 18 (1980).

⁴⁰²² E.g., *Hudson Valley Black Press v. Internal Revenue Service*, 409 F.3d 106, 113 (2d Cir. 2005) (“Because of the complex remedial scheme that Congress has created, and the plain indication that the failure of Congress to provide a remedy for injuries arising from tax assessment was not inadvertent, every circuit that has considered the appropriateness of a *Bivens* remedy in the taxation context has uniformly declined to permit one.”). The holding applies to other normal IRS activities, such as collections. In *Adams v. Johnson*, 355 F.3d 1179, 1184-1185 (9th Cir. 2004), quoted in *Hudson Valley Black Press*, the Ninth Circuit included collection activities as being outside the *Bivens* remedy. The courts note that, although the statutory remedies Congress provided may be less than complete, at least in some cases, such as § 7433, Congress considered broader remedies and rejected them, a factor which mitigates against a *Bivens* remedy. See also *Canada v. United States*, 950 F.3d 299, 311-312 (5th Cir. 2020).

⁴⁰²³ *Carlson v. Green*, 446 U.S. 14, 22 (1980).

preclude the remedy. Fifth, the Government employee must not have absolute or qualified immunity for the conduct in question (discussed below).

Absolute immunities are generally not offered Government employees. But some cases are exceptions. First, there is absolute immunity for prosecutors and their agents with respect to action in initiating and presenting the Government's case.⁴⁰²⁴ Second, where the *Bivens* claim is for false testimony by a Government employee in a judicial proceeding (including a grand jury proceeding), the Government employee will have absolute immunity.⁴⁰²⁵

Even in the face of a *Bivens* or other private right claim, the Government employee may have qualified immunity that precludes civil monetary damages against the Government employee. The Supreme Court explained qualified immunity in this context as:

The doctrine of qualified immunity shields officials from civil liability so long as their conduct does not violate clearly established statutory or constitutional rights of which a reasonable person would have known. A clearly established right is one that is sufficiently clear that every reasonable official would have understood that what he is doing violates that right. We do not require a case directly on point, but existing precedent must have placed the statutory or constitutional question beyond debate. Put simply, qualified immunity protects all but the plainly incompetent or those who knowingly violate the law.⁴⁰²⁶

The *Bivens* remedy, if available, is governed by the statute of limitations of the state in which the injury occurred.⁴⁰²⁷

⁴⁰²⁴ *Imbler v. Pachtman*, 424 U.S. 409 (1976); *Joseph v. Shepherd*, 211 F. App'x 692, 697 (10th Cir. Dec. 15, 2006) (absolute immunity for investigator for prosecutor); and *Nogueros-Cartagena v. United States Department of Justice*, 75 F. App'x 795, 798 (1st Cir. Sept. 26, 2003) (affirming dismissal of *Bivens* action against FBI agent).

⁴⁰²⁵ See *Rehberg v. Paulk*, 132 S. Ct. 1497, 1505 (2012) (citing *Briscoe v. LaHue*, 460 U.S. 325 (1983)); and *Lyle v. Sparks*, 79 F.3d 372, 378 (4th Cir. 1996) (citing *Briscoe* and holding absolute immunity for testimony in grand jury proceeding).

⁴⁰²⁶ *Mullenix v. Luna*, 575 U.S. 1, 11-12 (2015) (cleaned up). The key case cited is *Harlow v. Fitzgerald*, 457 U.S. 800, 818 (1982).

⁴⁰²⁷ Because Congress provided no statute of limitations for the common law *Bivens* remedy, the *Bivens* action is subject to the statute of limitations for the state action analog under 42 U.S.C. § 1983 which is based on the statute of limitations of the state where the constitutional violation occurred. *Roberts v. Barreras*, 484 F.3d 1236, 1238 (10th Cir. 2007).

Ch. 15. Evidentiary Privileges in Tax Controversy Practice.

I. Privileges to Withhold Information in Tax Related Investigations.

A. Introduction.

Privileges are an evidentiary concept. The general rule in Anglo-American jurisprudence is that each person—both individuals and artificial entities—may be compelled to tell what the witness knows to administrative agencies and courts to assist those agencies and courts administer the laws and dispense justice. Pithily, the Supreme Court proclaims that “the public has the right to everyman’s evidence.”⁴⁰²⁸ Privileges, where applicable, permit persons to withhold evidence and thereby hamper the truth finding process so critical to good government. Privileges are thus justified only where there is some overriding public benefit—a “public good transcending the normally predominant principle of utilizing all rational means for ascertaining truth.”⁴⁰²⁹ Privileges must be justified, and the party asserting the privilege must establish that the privilege applies.⁴⁰³⁰

In the federal system, the recognized privileges are those that existed at common law subject to such adjustments as Congress or, sometimes, the courts have made “in light of reason and experience.”⁴⁰³¹

⁴⁰²⁸ *Trammel v. United States*, 445 U.S. 40, 50 (1980) (internal quotes and words omitted for clarity), quoting *United States v. Bryan*, 339 U.S. 323, 331 (1950).

⁴⁰²⁹ *Trammel v. United States*, 445 U.S. 40, 50 (1980) (internal quotes omitted, but quoting *Elkins v. United States*, 364 U.S. 206, 234 (1960) (Frankfurter, J., dissenting)).

⁴⁰³⁰ *United States v. BDO Seidman*, 337 F.3d 802, 811 (7th Cir. 2003). See also FRCP 26(b)(5) (requiring that a party asserting privilege in discovery must expressly assert the claim and provide sufficient detail to support the privilege without disclosing the underlying privileged information). As to documents for which a privilege is claimed in whole or in part (through redaction), this is usually done via a “privilege log,” containing as much detail as possible (e.g., date of the document, author, etc., supported by an accompanying affidavit describing the confidential nature of the documents. Maura I. Strassberg, Privilege Can Be Abused: Exploring the Ethical Obligation to Avoid Frivolous Claims of Attorney-Client Privilege, 37 Seton Hall L. Rev. 413, 461-462 (2007) (noting that the precise requirements of the privilege log may vary from district to district, but all require minimal information to support the privilege).

⁴⁰³¹ Rule 501 of the Federal Rules of Evidence states:

Except as otherwise required by the Constitution of the United States or provided by Act of Congress or in rules prescribed by the Supreme Court pursuant to statutory authority, the privilege of a witness, person, government, State, or political subdivision thereof shall be governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience.

The “in light of reason and experience” mandate is a quote from *Wolfe v. United States*, 291 U.S. 7, 12 (1934). Under this Rule, courts may develop the law—the common law—on a case by case basis. See *United States v. Cintolo*, 818 F.3d 980, 1002 (1st Cir. 1987), citing *United States v. Gillock*, 445 U.S. 360, 367 (1980); *Trammel v. United States*, 445 U.S. 40 (1980). Courts do not view this as a license to create new privileges, but certainly they can embellish the privileges that are there. See *Trammel* (embellishing the common law privilege), and *United States v. Arthur Young & Co.*, 465 U.S. 816 (1984) (refusing to create a new privilege).

B. Privileges in the Federal Universe Generally.

A witness' obligations for an IRS summons (and other compulsory processes such as subpoenas) are subject to the traditional privileges and limitations of any other compulsory process.⁴⁰³² The traditional privileges most commonly encountered in tax practice:

- (1) The attorney/client privilege;
- (2) A variant of the attorney/client applicable only in certain (but not all) tax contexts - the federally authorized tax practitioner privilege ("FATP");
- (3) Work product privilege;
- (4) Fifth Amendment privilege against self-incrimination; and
- (5) Spousal Privileges.

There are other privileges that may apply in a tax setting and practitioners and students should be aware of them. For example, there is a doctor / patient privilege and clergy-penitent privilege. These other privileges are not commonly encountered in tax practice, so I do not discuss them here.

Privileges apply both in administrative proceedings—such as, most prominently here, IRS audits and collection activities—and in judicial proceedings. They apply in basically the same way. The party having the privilege can assert the privilege to prevent a compelled disclosure of the information subject to the privilege.⁴⁰³³ The privileges can usually be waived either by not asserting them to a compulsory disclosure requirement or by some affirmative act inconsistent with maintaining the privilege. For example, clients can waive the privilege for otherwise privileged attorney-client communications by disclosing the communications to persons other than those authorized to receive the privileged communications.⁴⁰³⁴

II. Attorney-client Privilege.

A. General.

FRE 501 recognizes the attorney-client privilege “governed by the principles of the common law as [it] may be interpreted by the courts of the United States in the light of reason and experience.” The purpose of the privilege is “to encourage clients to make full disclosure to their attorneys”⁴⁰³⁵ The privilege is normally an absolute bar to compulsory disclosure of a qualifying

⁴⁰³² *Upjohn Co. v. United States*, 449 U.S. 383, 398 (1981) (quoting *United States v. Euge*, 444 U.S. 707, 714 (1980)); see also FRE Rule 501 (except as otherwise specifically provided, privileges are “governed by the principles of the common law as they may be interpreted by the courts of the United States in the light of reason and experience”).

⁴⁰³³ See e.g., FRCP Rule 26(b) providing for discovery of nonprivileged matter.

⁴⁰³⁴ FRE 502 protect against unintended waivers incident to litigation discovery or even waivers as to so-called sneak-peeks designed to narrow down real discovery disputes as to potentially privileged matters. FRE 502 should be read along with FRCP 26(b)(5)(B).

⁴⁰³⁵ *Fisher v. United States*, 425 U.S. 391, 403 (1976).

attorney-client communication.⁴⁰³⁶ That privilege may be asserted at the examination stage, even in response to an IRS summons, just as it could in a litigated case. However, as always with privileges, the party asserting the privilege must prove entitlement to the privilege or, stated otherwise bears the risk that party has not established the applicability of the privilege.

Perhaps the classic statement of the attorney-client privilege, oft quoted by the courts, is from Wigmore:

where legal advice of any kind is sought, from a professional legal adviser in his capacity as such, the communications relating to that purpose, made in confidence, by the client, are at his instance permanently protected, from disclosure by himself or by the legal adviser, except the protection be waived.⁴⁰³⁷

Federal Courts apply a more generalized federal common law attorney-client privilege.⁴⁰³⁸ There is no definitive statement of this federal common law privilege, so Wigmore's definition is often used as a starting point. In addition, Proposed FRE 503(b), 56 F.R.D. 183, 326 (1972), although not adopted, is recognized as "a source of general guidance regarding federal common law principles."⁴⁰³⁹ That proposed rule is:

A client has a privilege to refuse to disclose and to prevent any other person from disclosing confidential communications made for the purpose of facilitating the rendition of professional legal services to the client, (1) between himself or his representative and his lawyer or his lawyer's representative, or (2) between his lawyer and the lawyer's representative, or (3) by him or his lawyer to a lawyer representing another in a matter of common interest, or (4) between representatives of the client or between the client and a representative of the client, or (5) between lawyers representing the client.

The following communication is clearly a confidential attorney-client communication: client, for purpose of seeking legal advice and in the privacy of the lawyer's office, advises his attorney that he filed a fraudulent tax return. However, if the client sees the attorney with a group of friends at church and, in a repentive and confessional mood, advises the attorney (as well as the

⁴⁰³⁶ There may be one significant exception for congressional investigations. Although some committees will not press the issue, some committees have made strident noises that the privilege will not apply to congressional investigations. However, the courts have not yet resolved the propriety of that claim. See Kalah Auchincloss, Note: Congressional Investigations and the Role of Privilege, 43 Am. Crim. L. Rev. 165, 179-185 (Winter 2006); Jonathan P. Rich, Note: The Attorney-Client Privilege in Congressional Investigations, 88 Colum. L. Rev. 145 (1988) (arguing that the attorney-client privilege is applicable to congressional investigations).

⁴⁰³⁷ 8 Wigmore, Evidence § 2292, at 554 (McNaughton Rev. Ed. 1961). Courts routinely and sometimes even rotely cite this definition as the starting point for analysis of attorney-client privilege claims. E.g., *In re Grand Jury Subpoena*, 662 F.3d 65, 71 (1st Cir., 2011) (citing Wigmore and *Cavallaro v. United States*, 284 F.3d 236, 245 (1st Cir.2002)); and *United States v. Evans*, 113 F.3d 1457, 1461 (7th Cir. 1997).

⁴⁰³⁸ Rule 501, Federal Rules of Evidence; see *Johnston v. Commissioner*, 119 T.C. 27 (2002).

⁴⁰³⁹ *In re Grand Jury Investigation*, 399 F.3d 527, 532 (2d Cir. 2005); see also *United States v. BDO Seidman, LLP*, 492 F.3d 806, 815 (2007) (quoting *In re Grand Jury Investigation*).

others within easy hearing distance) that he filed a fraudulent tax return, that is not a confidential attorney-client communication. There are two reasons that the privilege would be denied under the classic definition: (1) the communication was not intended to be confidential; and (2) under the facts, the client may have just been making a statement and not seeking legal advice.

Real world cases may not be so easily resolved. The tension has been described as follows in a case where the court denied the attorney-client privilege for communications between a corporate counsel with a unrelated tax strategy promoter (also a lawyer) about the tax strategy:

The privilege protects communications between a client and an attorney, not communications that prove important to an attorney's legal advice to a client. Thus, a communication between an attorney and client may be privileged even if it turns out to be unimportant to the legal services provided. Conversely, a communication between an attorney and a third party does not become shielded by the attorney-client privilege solely because the communication proves important to the attorney's ability to represent the client. Accordingly, we reject the magistrate judge's explanation for extending Paramount's privilege to conversations between its counsel and an independent investment banker, notwithstanding our assumption that those conversations significantly assisted the attorney in giving his client legal advice about its tax situation.⁴⁰⁴⁰

In discussing the attorney-client privilege, I will also refer to cases decided under the federally authorized tax practitioner privilege (“FATP”) of § 7525. I discuss the FATP after this discussion, but for present purposes what the FATP privilege does is to create a privilege like the attorney-client privilege for communications from a client to a federally authorized tax practitioner who is not an attorney. Cases resolving the FATP privilege thus use attorney-client privilege analysis; in reverse, those cases may offer insight into the attorney-client privilege.

Please note that the following is a limited discussion of the attorney-client privilege. A more complete discussion would expand this Tax Procedure book beyond the needs of the target audience for the book. Hence, I deal only with certain facets of the privilege that appear to be most relevant to a tax practice as of the date of publication of this text.

B. Client Communications for Legal Advice.

The privilege only protects confidential communications made by the client to the attorney to obtain legal advice for the client. The purpose for the client communication is thus critical. The question of the purpose of the communication often comes up where the attorney participates at some level in the business decision making process. For example, an attorney (either outside or in-house) may attend a business meeting of corporate employees where they discuss and make business decisions that may or may not be related to the need for legal advice and may even seek the business judgment of the lawyer. Since the party asserting the privilege must prove that the communication

⁴⁰⁴⁰ *United States v. Ackert*, 169 F.3d 136, 139 (2d Cir. 1999) (cleaned up).

was made for the purpose of seeking legal advice, difficulty can be encountered by such mixed-purpose meetings.⁴⁰⁴¹ A significant issue that has arisen in such cases involving dual purposes, one of which is seeking legal advice, is whether the standard to recognize the privilege requires that the seeking legal advice is the principal purpose of the client communications or merely a significant purpose of the client communications.⁴⁰⁴²

The privilege only protects the client communication. It does not protect the attorney's communication to the client. However, if the attorney's communication directly or indirectly discloses the client's communication to the lawyer for obtaining legal advice, the attorney's communication to the client is protected, not because it is an attorney's communication but because it reveals the client's communication.⁴⁰⁴³ Furthermore, the attorney's communication of his or her legal advice is protected apparently without regard to whether the legal advice directly or indirectly discloses the client communication.⁴⁰⁴⁴

C. Reasonable Confidentiality Expectation.

As in the example, the communication must be given in circumstances where the client expected that it be a confidential communication. This reasonable expectation requirement for the privilege is seen in several tax areas.

Perhaps the principal area is where the tax practitioner is both a tax return preparer and an attorney (or person qualifying for FATP privilege). Are communications to that person expected to be confidential when they are reflected on the return that is filed with the IRS? A facet of this issue is whether the tax practitioner is serving as an attorney at all or just a tax preparer, a compiler and reporter of data, as to the communication? I address that subject below.

The issue of reasonable expectation of privacy surfaced in abusive tax shelter litigation. As noted elsewhere, persons involved in the promotion of tax shelters are required to maintain lists of the persons purchasing the shelters and turn the lists over to the IRS upon request. Some of these persons include attorneys rendering opinions to the taxpayers and FATPs who may otherwise qualify to assert the attorney-client or FATP privilege. These persons may assert an "identity privilege,"

⁴⁰⁴¹ *United States v. BDO Seidman*, 337 F.3d 802 (7th Cir. 2003), cert. denied sub nom., *Roes v. United States*, 134 S. Ct. 1410 (2004); *United States v. KPMG LLP*, 237 F. Supp.2d 35 (D. D.C. 2002).

⁴⁰⁴² See *In re Grand Jury*, 23 F.4th 1088 (9th Cir. 2022) (principal purpose), cert. granted on issue of whether principal purpose is proper standard), but then "dismissed as improvidently granted," 598 U. S. ____ (2023). As typically the "DIG" does not explain the reason for the dismissal. For a discussion of the (i) oral argument, see [On Supreme Court Oral Argument in In Re Grand Jury On Issue of Principal or Significant Purpose for Attorney-Client Privilege](#) (Federal Tax Crimes Blog 1/10/23; 1/11/23) and the DIG see [Supreme Court Dismisses Attorney-Client Privilege Case as Improvidently Granted](#) (Federal Tax Crimes Blog 1/23/2023; 1/25/23).

⁴⁰⁴³ *United States v. Defazio*, 899 F.2d 626, 635 (7th Cir. 1990).

⁴⁰⁴⁴ See *United States v. Defazio*, 899 F.2d 626, 635 (7th Cir. 1990) ("Communications from attorney to client are privileged only if they constitute legal advice or tend directly or indirectly to reveal the substance of a client confidence." (Emphasis supplied). Still, although this is slicing it a bit thin, if the attorney's communication were totally unsolicited to any direct or indirect communication from the client, it might arguably not be covered by the attorney-client privilege. I doubt that that thin a line would ever be tested.

which is a branch of the attorney-client privilege (discussed below). The courts hold that, because of the Code's list maintenance and disclosure requirements, the clients could have no reasonable expectation of confidentiality as to their names and thus that the privilege does not apply.⁴⁰⁴⁵

D. Client Identity Privilege.

Is the identity of the client privileged under the attorney-client privilege?⁴⁰⁴⁶ A frequent context in which this question is presented is the reporting requirements for cash payments via the Form 8300, Report of Cash Payments Over \$10,000 Received in a Trade or Business. (Recall that the Form 8300 is a double agency form—for the IRS and for FinCEN.) This reporting requirement applies to cash received by attorneys. Often clients engaged in criminal activity pay their attorneys in cash. Can the attorney receiving cash omit the client's name from the report? The mere receipt of the cash might disclose, at least implicitly, something confidential that is important to the purposes behind the attorney-client privilege; thus a requirement that the attorney disclose the receipt of the cash from the identified client might be inconsistent with the attorney-client privilege. Another context in which the issue comes up is when the IRS issues a John Doe Summons (“JDS”) to a law firm (or other enabler) related to abusive tax shelter transactions to discover the names of clients engaging the firm with respect to the shelter. That those clients engaged the firm with respect to the shelter does imply something about the clients' communications with the firm, at a minimum the clients' desire and tax need for some form of tax mitigation. The conventional holding in this context is that the identity of the client and fee arrangements are not attorney-client communications invoking the attorney-client confidential communications privilege.⁴⁰⁴⁷

Some courts of appeals recognize that there may be a “narrow exception * * * when revealing the identity of the client and fee arrangements would itself reveal a confidential communication.”⁴⁰⁴⁸ For purposes of convenience I refer to this narrow exception as the “identity privilege” which is a common term for it, but you should remember that it is not a separate privilege

⁴⁰⁴⁵ *United States v. BDO Seidman, supra*; and *United States v. KPMG* (D. D.C. 5/4/04).

⁴⁰⁴⁶ See generally Richard Lavoie, Making a List and Checking it Twice: Must Tax Attorneys Divulge Who's Naughty and Nice, 38 U.C. Davis L. Rev. 141 (2004) (arguing that the identity privilege should not apply in most tax contexts).

⁴⁰⁴⁷ E.g., *Taylor Lohmeyer Law Firm P.L.L.C. v. United States*, 957 F.3d 505 (5th Cir. 2020) (citing *In re Grand Jury Subpoena for Attorney Representing Criminal Defendant Reyes-Requena*, 926 F.2d 1423, 1431 (5th Cir. 1991)). The Fifth Circuit denied petition for rehearing en banc in, 982 F.3d 409 (2020), and the Supreme Court denied certiorari ___ U.S. ___, ___, 142 S. Ct. 87 (2021).

⁴⁰⁴⁸ *In re Grand Jury Subpoena for Attorney Representing Criminal Defendant Reyes-Requena*, 926 F.2d 1423, 1431 (5th Cir. 1991).

In his article, Professor Lavoie identifies an identity privilege exception based on overlapping approaches: “(1) the legal advice exception; (2) the last link exception; and (3) the confidential communication exception.” Richard Lavoie, Making a List and Checking it Twice: Must Tax Attorneys Divulge Who's Naughty and Nice, 38 U.C. Davis L. Rev. 141, 150-151 (2004). In the text here, I focus on the confidential communication exception because client confidential communication is the key focus of the attorney-client privilege discussed in this section. Also, Professor Lavoie discusses (pp. 160-162) a famous identity privilege case, *Baird v. Koerner*, 279 F.2d 623 (9th Cir. 1960) holding privileged a client identity where the attorney was engaged to make payments to the IRS for anonymous taxpayers who felt they had underpaid tax. Professor Lavoie says that the logic of the confidential communication exception supports the result, but I am not sure that other factors did not compel the result. I need not go down that rabbit trail now.

but rather a particular subset of one or more other privileges or policies that might be involved (here the attorney-client privilege). The district court in *Gertner* relied upon the identity privilege but the Court of Appeals did not address the issue because it denied enforcement of the summons in any event because the Government had not used the proper John Doe summons procedure.

I attempt here just a summary of the law in the area in tax cases:

- In the overwhelming number of the cases, courts hold that the attorney-client privilege does not protect the client identity in the context of compulsory disclosure (such as on the Form 8300 or by summons (including JDS) or subpoena).⁴⁰⁴⁹
- The frequently-cited example of a case applying the “narrow exception” is *United States v. Liebman*.⁴⁰⁵⁰ In *Liebman*, a law firm was engaged in rendering advice regarding tax shelter real estate partnerships. The law firm advised that the fees the taxpayers paid would be deductible. The IRS took the position that the fees were nondeductible brokerage fees required to be capitalized with the investment. The IRS issued a John Doe summons (“JDS”) to the law firm seeking the identity of the clients paying the fees. The Third Circuit held that, although the identity of a lawyer’s client is normally not a privileged communication, here the nexus between the information the IRS sought and the taxpayer was a specific type of privileged communication (i.e., as to the deductibility of the fees) and therefore the disclosure of the identities would necessarily disclose the privileged communication made to them.
- *Liebman* is usually distinguished on the facts, so that the identity privilege does not apply.⁴⁰⁵¹ A good example is a case decided by the Fifth Circuit in 2020 involving a law firm (“Firm”). *Taylor Lohmeyer Law Firm P.L.L.C. v. United States*, 957 F.3d 505 (5th Cir. 2020).⁴⁰⁵² In an audit of an individual client of the Firm, the IRS discovered the Firm had created offshore accounts and entities through which the client had substantially underreported tax liability.⁴⁰⁵³ Believing that the Firm might have used the strategies for other clients, the IRS served a JDS on the Firm for documents for unknown clients, John Does (U.S. taxpayers), who, in the stated time period, “used the services of [the Firm] . . . to acquire, establish, maintain, operate, or control (1) any foreign financial account or other asset; (2) any foreign corporation, company, trust, foundation or other legal entity; or (3) any foreign or domestic financial account or other asset in the name of such foreign entity.” The

⁴⁰⁴⁹ E.g., *Gerald B. Lefcourt, P.C. v. United States*, 125 F.3d 79 (2d Cir. 1997).

⁴⁰⁵⁰ 742 F.2d 807 (3rd Cir. 1984).

⁴⁰⁵¹ E.g., *United States v. Sidley Austin Brown & Wood LLP*, 2004 U.S. Dist. LEXIS 6452, *21-23 (N.D. Ill. 2004), reconsideration den. 2004 U.S. Dist. LEXIS 7355 (N.D. Ill. 2004), *Deng v. United States*, 2015 U.S. Dist. LEXIS 78804 (D. Del. 2015) (“A bare list of clients who paid fees does not fall within the privilege unless such a list would “automatically identify” unknown clients with a known communication.”)

⁴⁰⁵² Rehearing en banc was denied on 12/4/20. *Taylor Lohmeyer Law Firm P.L.L.C. v. United States*, 982 F.3d 409(5th Cir. 2020). The denial had a lengthy dissent. The Supreme Court denied a petition for certiorari, ___ U.S. ___, 142 S. Ct. 87 (10/4/21).

⁴⁰⁵³ Presumably the audited client had also failed to file FBARs.

Firm moved to quash the summons, and the Government moved to enforce the summons. The Firm asserted that the documents summonses would disclose the client's identities which were confidential client communications, subject to the attorney-client privilege. The district court enforced the summons. The Court of Appeals affirmed, rejecting the assertion of the identity privilege. The Court of Appeals distinguished *Liebman* because, in *Liebman*, the request was linked to advice given to deduct certain fees. By contrast, in *Taylor Lohmeyer*, the request was not connected to "identified specific, substantive legal advice the IRS considered improper:" rather, the request asked for documents of clients for whom the Firm established, maintained, operated or controlled certain foreign accounts, assets or entities, without limitation to any specific advice the Firm rendered, so that it was "less than clear . . . as to what motive, or other communication of [legal] advice, can be inferred from that information alone."⁴⁰⁵⁴ On 12/4/20, the Fifth Circuit denied a petition for rehearing en banc in *Taylor Lohmeyer* by vote of 9 to 8, with 6 of the judges voting for rehearing issuing a dissent saying that, upon remand, the district court should be guided by the following: "[i]f the disclosure of the client's identity will also reveal the confidential purpose for which he consulted an attorney, we protect both the confidential communication and the client's identity as privileged." This statement of dissenting judges seems to be an attempt to keep the client identity privilege live in the particular case and in the Fifth Circuit by suggesting how the majority panel decision, the law of the Circuit, should be interpreted.

Two key caveats: First, this is just a summary with certain anecdotal cases illustrating the general rule and the exception, designed primarily to alert students (and practitioners) as to the issues involved. Second, since FATP privilege in § 7525 incorporates the key concepts of the attorney-client privilege, presumably these concepts apply to nonlawyer practitioners subject to that Section.⁴⁰⁵⁵

E. Attorney Communications to Client.

The privilege is for confidential communications from the client to the attorney. It is not for communications from the attorney to the client, except as the attorney's communications disclose the client's communications to the attorney. Of course, most critical communications from the attorney to the client will disclose at least indirectly confidential client communications to the attorney (e.g., what the nature of the client's problems are based upon the client's communications to the attorney).

Consider in this regard, whether the attorney's billing and payment information is confidential. Generally, billing and payment information is not treated as within the privilege. The amount the client pays an attorney does not disclose any privileged communication to or from the

⁴⁰⁵⁴ 957 F.3d, at 512.

⁴⁰⁵⁵ See the Court's discussion in *Taylor Lohmeyer* regarding § 7525 and *United States v. BDO Seidman*, 337 F.3d 802 (7th Cir. 2003).

attorney. Similarly, the amount of time the attorney spends on a client matter does not per se disclose any privilege communication. However, many lawyers prepare detailed billing statements that describe the services rendered. Such detailed statements often contain information as to the nature of the client communication and the attorney's advice. The few cases that have addressed the issue have parroted the general rule that fee information is not privileged but have permitted redaction from the fee statements of any information that may implicate client communications to the attorney.

Practice Pointer: One of the dangers of detailed fee statements is that clients sometimes do not keep them confidential. For example, if you provide services to a large corporation, there is no question that, within a need-to-know control group, communications between the client and the members of the group are confidential. However, fee statements may be sent through processes that are broader than that group and, if they contain confidential information, may constitute a waiver of the privilege. In such representations, I prepare both a cover summary billing statement containing the bottom-line number and an underlying detailed statement. Both statements are sent initially to a person within the corporation who is within the group with need-to-know and has authority to approve the fee statement because he or she is knowledgeable as to the kind and quality of services rendered. I direct that person to separate the summary cover statement from the detailed statement and to forward only the summary cover statement to the appropriate support offices (usually accounts payable).

This issue of what attorney communications to the client are subject to the privilege surfaced in the contentious abusive tax shelter arena. Many abusive tax shelter opinions are written in conjunction with a prototype tax shelter plan developed by a promoter (perhaps with the active involvement of the tax professional rendering the opinions). The opinion (including the facts it assumes and the representations from the client) are standard and, in fact, do not actually represent communications from a real client. Often, when the promoter gets a taxpayer to buy the shelter, the attorney simply requires the taxpayer to sign a pre-packaged set of factual representations (such as profit motive) and churns out the form opinion (often referred to pejoratively as a “cookie cutter” opinion). The only other interaction between the attorney and the taxpayer is to obtain the fee (which often precedes the delivery of the opinion). Is there any attorney-client communication in this context? Some courts have held or strongly suggested that the privilege may not apply.⁴⁰⁵⁶

F. Relationship to Legal Representation.

The communication must be incident to legal representation. One issue that is often encountered in the tax practice where an attorney is both a lawyer and a tax return preparer is whether communications to and from the client are privileged. This issue is set up and thoughtfully (maybe even correctly) discussed in *United States v. Frederick*, 182 F.3d 496 (1999),⁴⁰⁵⁷ which you

⁴⁰⁵⁶ *John Doe #1 v. Wachovia Corp.*, 268 F. Supp. 2d 627 (W.D. N.C. 2003); E.g., *United States v. KPMG*, 316 F. Supp.2d 30 (D. D.C. 2004).

⁴⁰⁵⁷ 182 F.3d 496 (1999). This case is in the materials. Judge Posner’s analysis, while a good one, is not the only good one. See e.g., *Colton v. United States*, 306 F.2d 633, 637 (2nd Cir. 1962) (“[t]here can, of course, be no question that the giving of tax advice and the preparation of tax returns -- which unquestionably constitute a very (continued...)”).

should read now and be prepared to discuss in class. I assign this case because it is an important and recurring issue as to which the dividing line is quite fuzzy, and because it is a Judge Posner opinion (I like to have at least one per class).

We will encounter another iteration of this issue below in discussing how the attorney can field a team consisting of various non-lawyer disciplines to provide more effective legal representation and assure that client communications to non-lawyers on the team are protected (see discussion beginning p. 930.). In addition to fielding the team having the necessary expertise to give effective legal advice, the client and the lawyer may have communications with and among other persons who have common legal interests. For example, lawyers representing co-defendants in a criminal case may enter a joint defense agreement and thus preserve the attorney-client privilege (as well as the work product privilege) for information shared pursuant to the joint defense agreement. The joint defense agreement in this setting is just a specific iteration of a larger doctrine that information shared pursuant to common legal interests should permit the attorney-client privilege to be preserved.⁴⁰⁵⁸ Specifically, there is a “small circle of others with whom information may be shared without loss of the privilege.”⁴⁰⁵⁹ Included within that circle are persons and entities who have a common interest in legal advice from another's lawyer; accountants and other non-legal experts useful to a lawyers' delivery of legal advice; and a parent present when a child consults a lawyer.⁴⁰⁶⁰ But the person asserting such privilege must be prepared to prove its existence and suffer the consequences if unable to do so.⁴⁰⁶¹

⁴⁰⁵⁷(...continued)

substantial part of the legal services rendered[--] [are] sufficiently within the professional competence of an attorney to make them prima facie subject to the attorney-client privilege.”)

⁴⁰⁵⁸ See *United States v. M.I.T.*, 129 F.3d 681 (1st Cir. 1997).

⁴⁰⁵⁹ Id at 684. The so-called common interest doctrine is “an exception to the rule that no privilege attaches to communications between a client and an attorney in the presence of a third person,” in effect extending the attorney-client privilege to otherwise non-confidential communications in limited circumstances. *United States v. BDO Seidman*, 492 F.3d 806, 815-816 (2007); *Cavallero v. United States*, 284 F.3d 236, 250 (1st Cir. 2002).

⁴⁰⁶⁰ Id. See also *In re Grand Jury Proceedings Jean Auclair*, 961 F.2d 65, 69 (5th Cir. 1992) (“The [attorney- client] privilege is not, however, waived if a privileged communication is shared with a third person who has a common legal interest with respect to the subject matter of the communication” (quoting Hodges, *Grant & Kaufman v. United States Government*, 768 F.2d 719, 721 (5th Cir. 1985)).

⁴⁰⁶¹ See *Cavallaro v. United States*, 284 F.3d 236 (1st Cir. 2002) (where less than careful practitioners failed to preserve the privileges).

G. Privilege and Entity Counsel.

Two significant related issues arise from communications by entity employees with attorneys representing the entity. The first is which employees are within the scope of “client” when the entity (corporate or other) is the client. This issue relates to the entity assertion of the attorney client privilege or waiver of the privilege. The second issue relates to whether an employee may assert the privilege where the entity is the client and the employee is not the client but may have reasonably believed that the communication with the lawyer was to seek personal legal advice for the employee.

In *Upjohn v. United States*, 449 U.S. 383 (1981), the Supreme Court held that the privilege was not necessarily limited to communications from the corporation’s control group. In *Upjohn*, the corporation’s in-house counsel conducted an internal investigation requiring that that counsel receive communications from persons outside the control group. The Court sustained the corporation’s assertion of the attorney-client privilege, based upon a fact-specific inquiry. In *Upjohn*, the corporation engaging the attorney to conduct the investigation asserted the privilege. Could the person outside the control group that is interviewed assert the privilege to prevent the corporation from waiving the privilege without his consent? Probably not, under the Wigmore definition, because the lawyer was the corporation’s lawyer, not the individual’s lawyer and his communication to the lawyer was not for the purposes of obtaining personal legal advice.

Two significant areas of potential controversy are implicated by this analysis.

First, we noted above a setting where the privilege for corporate counsel might be compromised by having a meeting where general business is discussed rather than focusing on communications for obtaining legal advice. For this and related reasons, the following precautions should be implemented in a corporate setting when the privilege for communications is desired:

- Generally, communicate, if possible, with the highest level management officer for decision making with respect to the matter involved.
- Avoid, if possible, questions seeking business advice, and avoid offering it sua sponte. This may not be possible where the corporation desires the business advice or participation of the attorney, but the attorney must be especially diligent in making sure that there is a clear record that the communication in question was for the purpose of seeking legal advice rather than business advice.
- Depending upon the setting for the communications, use the formality of indicating the intention for the communication to qualify for the privilege and the need for confidentiality. Thus, if in written form, it should contain a prominent notation that it is attorney-client privileged information and is confidential.
- Do not overdo the claims for confidentiality. Overdoing confidentiality claims will water down the claims as to the real good stuff and thus may jeopardize a court’s view of the claims.⁴⁰⁶²

⁴⁰⁶² This actually occurred in *United States v. KPMG LLP*, 316 F. Supp.2d 30 (D. D.C. 2004).

- Make sure all writings (including handwritten notes) contain a date and some indication of the purpose of the writing.
- Protect the intended confidentiality of the communication. Do not discuss such communications in areas where persons outside the permitted circle can hear the communications. Maintain systems that prevent persons outside the circle to have access to written communications.⁴⁰⁶³

Second, is the corporation's potential waiver for employee interviews in internal investigations to ferret out the existence of wrongdoing within the corporation. Often, the corporation will desire to disclose to prosecutors internal wrongdoing to curry favor with the prosecutors or, if not unmitigated favor, at least a decision not to prosecute the corporation by throwing some of the employees under the bus. In the internal investigations, the attorney-client privilege and, in this context, the related work product privilege, are the corporation's privileges with respect to an employee's communications to a corporation's lawyer. It is not the employee's privilege, even if the employee is a member of a control group (e.g., officer or director).⁴⁰⁶⁴ In such a circumstance, where the corporate attorney is not representing the individual being interviewed, the corporation would not have an attorney-client privilege with respect to the employee's statements but would have a work product privilege. But the danger is that the officer may confuse the corporation's privilege with his own privilege, on some notion that the attorney is somehow also the attorney for the officer or director. So long as the officer is in the control group, he or she may have some assurance that the corporation will assert the privilege, thus protecting the officer's communications to the attorney, but if the officer is not within the group or leaves the group (e.g., by leaving the corporation, willingly or not so willingly), the then former officer may find that the new control group is not so interested in asserting a privilege to help the former officer.⁴⁰⁶⁵

Corporations appear increasingly willing to trade their privileges for more favorable treatment by prosecutors investigating or prosecuting the corporation's misdeeds through its officers, usually former officers. DOJ has prosecution policies for corporations and other entities.⁴⁰⁶⁶ Even where the Government may be reluctant to indict an entity (such as a major accounting firm which would fail upon the indictment or innocent shareholders or employees may be hurt), the Government may require or "encourage" those entities, to avoid indictment, to waive the privileges (attorney-client, as well as the work product privilege) that might otherwise apply with respect to the

⁴⁰⁶³ These bullet points are inspired in part by Bufkin Alyse King, Preserving the Attorney-Client Privilege in the Corporate Environment, 53 Ala. L. Rev. 621 (2002). I have, however, refined and modified them to reflect my experience.

⁴⁰⁶⁴ *Commodity Futures Trading Corporation v. Weintraub*, 471 U.S. 478 (1986); *In re Grand Jury Subpoenas*, 144 F.3d 653, 658 (10th Cir. 1998). Notwithstanding this general demarcation, the facts may permit at least an argument that, in communicating with the attorney, the corporate employee thought that the attorney was also acting for him or her personally. In such cases, some courts have developed a strict test that is often impossible to meet. See *In the Matter of Bevill, Bresler & Schulman Asset Management Co.*, 805 F.2d 120,123 (3d Cir. 1986); *U.S. v. International Brotherhood of Teamsters*, 199 F.3d 210, 215 (2d Cir. 1997); *In re Grand Jury Proceedings*, 156 F.3d 1038, 1040 (10th Cir. 1998); and *In re Grand Jury Subpoena*, 274 F.3d 563, 572 (1st Cir. 2001).

⁴⁰⁶⁵ See e.g., *Commodity Futures Trading Corporation v. Weintraub*, *supra*.

⁴⁰⁶⁶ See U.S. Justice Manual (successor to USAM) 9-28.000 - Principles Of Federal Prosecution Of Business Organizations.

underlying conduct.⁴⁰⁶⁷ Furthermore, in the event the corporation is charged, its sentencing will be reduced when it discloses all pertinent information.⁴⁰⁶⁸ In short, officers of corporations take substantial risk in undertaking risky behavior that the corporation will not act to protect them.

One of the side effects of the corporation's waiver of the attorney-client privilege to curry favor with the prosecutors is, to state the obvious, the scope of the waiver. Thus, for example, corporations have made disclosures of attorney-client privileged information to the Government subject to a reservation of the privilege; courts have rejected the reservation of the privilege, saying that if that nuance is to be recognized, Congress rather than the courts must do it.⁴⁰⁶⁹ Of course, as in other areas where the attorney-client privilege fails, the proponent may still be able to assert work product privilege which is not subject to the unconditional waiver rule.⁴⁰⁷⁰

Returning to the situation of the hapless employee in an internal investigation. Particularly delicate attorney-client issues can arise in any setting where a person—the employee here—may be confused as to whether the lawyer is representing him or her as well as the entity. This can be particularly important in internal investigations into actions that may have criminal aspects. As in *Upjohn*, the corporation may have an outside legal team conduct the investigation pursuant to an appropriate attorney-client privilege with the corporation. As noted above, under *Upjohn*, the corporation's privilege may extend to communications to the lawyer by certain high-level officers. But, within its normal contours, it would not apply to many of the persons within the entity that would be interviewed within the scope of the internal investigation. (Those communications would not be attorney-client communications but would be work-product as to the corporate client.) Indeed, even employees in the control group cannot claim their own personal privilege for interviews by the corporation's lawyer in such investigations unless employee establishes that, in making the communication, the employee reasonably believed that attorney was representing him and was made to obtain personal legal advice.⁴⁰⁷¹

⁴⁰⁶⁷ It is important in this regard to differentiate between such privileges that arose contemporaneously while the underlying fraud was being committed and those that arise because of representation in the investigation or prosecution of the underlying fraud. The prosecutor may request and receive a waiver of both the work product and attorney-client privileges arising contemporaneously with the conduct being investigated or prosecuted but would usually only ask waiver of the work product privilege with respect to privileges arising during the investigative or prosecutive stage.

⁴⁰⁶⁸ Sentencing Guidelines § 8C2.5.

⁴⁰⁶⁹ *United States v. Thompson*, 562 F.3d 387 (D.C. Cir. 2009) (discovery in a criminal case of the results of internal investigations produced to the Government under a selective waiver; discovery required subject to the traditional limited criminal discovery rules such as Brady, Jencks Act, etc.); see also *In re Qwest Communications Int'l, Inc.* 450 F.3d 1179 (10th Cir. 2006) (civil litigants' access to privileged material produced to government under a selective waiver).

⁴⁰⁷⁰ *Id.* at p. 394 (noting, however, that such selective disclosure of work product might still be a waiver if the circumstances of the disclosure are inconsistent with the maintenance of the privilege).

⁴⁰⁷¹ In *United States v. Int'l Bhd. of Teamsters*, 119 F.3d 210, 215-215 (2d Cir. 1997), the Court listing the elements the employee must establish as (i) the employee sought legal advice, (ii) the employee sought legal advice in personal capacity; (iii) counsel communicated with the employee in the personal capacity, (iv) the communications were confidential; and (v) the substance of the communication did not concern the matters or affairs of the entity. Basically, the inquiry is whether the employee establishes that the employee reasonably believed he was seeking personal
(continued...)

To avoid confusion in the employee's mind (thus potentially affecting his or her valuable right to remain silent), the better part of wisdom is for the lawyer conducting the internal investigation to warn the employee at the outset that the attorney represents the entity and not that individual being interviewed. This warning is commonly referred to as an *Upjohn* warning, for reasons that should be obvious. Indeed, the *Upjohn* warning, properly given, can be quite elaborate with several components, which in the aggregate is often referred to in the plural as *Upjohn* warnings, so I use the plural here.⁴⁰⁷²

The *Upjohn* warnings are particularly important for three reasons. First, most obviously, is to put the interviewee on clear notice that the interviewing attorney is not the interviewee's attorney and therefore the interviewee cannot rely upon the attorney to render personal legal advice, to protect his or her personal interests, or to keep the statements confidential. Second, and related, the lawyer ethically is bound to make sure the interviewee understands that the lawyer is not representing him or her. Third, although the statements would be at least attorney work product and, in context, even confidential attorney-client communications as to the corporation, the corporation can make the choice to waive any protections afforded by the attorney-client or work product privileges. Indeed, as noted above, in many criminal investigations where the corporation is a potential target, there may be great pressure on the corporation to waive these privileges and even where the prosecutor may not be formally exerting the pressure, the entity could believe that waiving the privileges would be in its best interests. The employee's statements could then be delivered up to the prosecutors on a silver platter and be used against the employee. But a prosecutor's ability to use the statements may be compromised if the employee had not been properly warned that the interviewing lawyer was not representing him or her⁴⁰⁷³ and, where there is murkiness about whether the employee could have reasonably believed that the attorney might be representing him or her and the corporation cannot prove that the warnings were given. The result is that the corporation's bargaining power with the prosecutor has been compromised, and that may be a very bad result for the corporation.

⁴⁰⁷¹(...continued)

legal advice, the attorney recognized that the communication was for that purpose and undertook to act in that capacity. This would mean, for example, that the communication to the attorney also representing the entity could not be disclosed to the entity without violating the employee's privilege. As will be discussed in the text, most attorneys simply will not enter a personal attorney engagement with an employee, particularly when the context suggests a potential for a conflict of interest and will, particularly in an investigative capacity for the entity, so warn employees that they represent the entity and not the employee.

⁴⁰⁷² See particularly [Upjohn Warnings: Recommended Best Practices When Corporate Counsel Interact with Corporate Employees \(7/17/09\)](#) (published by ABA WCCC Working Group), which may be found here.

⁴⁰⁷³ For a dramatic instance where an employee, a CEO of the company, suffered this fate, see *United States v. Ruehl*, 583 F.3d 600 (9th Cir. 2009). In that case, the trial court found that the investigating attorneys had not properly warned the CEO that it was not representing him with respect to the interviews and even referred the attorneys to the state bar for ethical violations. The court of appeals pulled the fat out of the fire to permit the Government's use of the statements in prosecution because, under the circumstances, it found that the CEO had not made the statements with an understanding of confidentiality.

H. Waiver.

The privilege can be waived. Waiver is usually encountered where the communication originally intended to be confidential is shared beyond the attorney-client relationship. Of course, if (as often encountered in tax return preparation situations), the information when originally disclosed was intended to be shared beyond that relationship, it would not have qualified for the attorney-client privilege at all, because a necessary requirement is that the communication be intended to be confidential. There are some contexts in which potential waiver is commonly encountered in a tax practice.

Waiver will occur when a taxpayer asserts reliance on counsel as a defense to a criminal or civil penalty.⁴⁰⁷⁴ Even, without specifically asserting reliance on counsel as a defense, an assertion of good faith as a defense can put the client's intent in issue, thus potentially waiving the attorney client privilege as to attorney client communications that bear on that defense.⁴⁰⁷⁵

It is not unusual in the tax shelter context (or other types of aggressive tax planning) for taxpayers to obtain an opinion from counsel or from a practitioner with the § 7525 privilege that will serve principally or in major part to be asserted as a defense to a penalty if the shelter is discovered and successfully challenged on the merits. If that was the purpose of the opinion, then the opinion arguably did not qualify for the attorney-client privilege at all (since not obtained with expectation of confidentiality), although I think that the mere possibility but not certainty that it will be so used means that it is privileged until so used.

The Federal Rules of Evidence contain special rules to avoid “foot fault” waivers for unintentional and inadvertent waivers in federal proceedings, including agency proceedings and limits subject matter waivers beyond the document being disclosed.⁴⁰⁷⁶

⁴⁰⁷⁴ *In re G-I Holdings, Inc.*, 218 F.R.D. 428 (D. N.J. 2003) (taxpayer asserted “reasonable basis” and “reasonable cause” based upon consultation with “outside legal counsel and others” as a defense to the accuracy related penalties; held this defense waived the privilege).

⁴⁰⁷⁵ *AD Investment 2000 Fund LLC et al. v. Commissioner*, 142 T.C. 248, 254-258 (2014), citing inter alia *In re County of Erie*, 546 F.3d 222, 229 (2d Cir. 2008). For an application of this aspect of AD Investment in a hotly contested case, see *Eaton Corp. v. Commissioner* (Tax Court dkt. 5576-12, discovery order dated 4/6/15).

⁴⁰⁷⁶ FRE 502, added in 2008. The text states a general summary of the rule. I caution that it should be reviewed carefully by those making the types of disclosures that could invoke the Rule.

III. Federally Authorized Tax Practitioner Privilege (“FATP”).

Section 7525 extends the attorney-client privilege to federally authorized tax practitioners⁴⁰⁷⁷ who are not lawyers as to tax advice. In this sense, it is often said that the FATP is essentially coterminous with the attorney-client privilege.⁴⁰⁷⁸ Thus, the communication must meet all of the requirements for an attorney-client protected communication except that the tax advisor is not an attorney but is rather a federally authorized tax practitioner (e.g., accountant or enrolled agent).

Unlike the attorney-client privilege, however, this privilege is not absolute.

- The privilege may only be asserted in any noncriminal administrative tax matter with the IRS or in judicial proceedings involving taxes brought by or against the U.S. § 7525(a)(2).
- The privilege is not available in a criminal investigation. § 7525(a)(2)(A).⁴⁰⁷⁹ When a taxpayer really, really needs the privilege most, it is just not there.
- The privilege is also not available for written advice “in connection with the promotion of the direct or indirect participation of the person in any tax shelter.” § 7525(b).⁴⁰⁸⁰
- But the privilege would be available for otherwise covered client communications in an audit, even if the underlying transaction were a tax shelter.⁴⁰⁸¹

⁴⁰⁷⁷ There may be a problem for return preparers to qualify for § 7525. In *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014), the Court held that the IRS had no authority to regulate return preparers who were not CPAs, attorneys or enrolled agents by imposing continuing education and testing requirements. The reasoning was that return preparers did not practice before the IRS. That holding may mean that such return preparers are not “federally authorized practitioners to whom the FATP applies. § 7525(a)(3)(A) (defines “federally authorized practitioner” as one authorized to practice before the IRS “if such practice is subject to regulation under section 330 of title 31, United States Code.”); see also See Dennis B. Drapkin, *Loving and Ridgely: Implications for Practitioners*, 2015 TNT 140-8 (7/22/15); and Nathan J. Richman, *Expanding Ridgely Would Contract Tax Return Preparer Privilege*, 2015 TNT 227-4 (11/24/15).

⁴⁰⁷⁸ *Evergreen Trading, LLC ex rel. Nussdorf v. United States*, 80 Fed. Cl. 122, 135 (Fed. Cl. 2007); *United States v. BDO Seidman*, 337 F.3d 802, 810 (7th Cir. 2003).

⁴⁰⁷⁹ Sorry for the redundancy, but this is important.

⁴⁰⁸⁰ As amended by the American Jobs Creation Act of 2004. Prior to this amendment the exception to confidentiality applied only for corporate tax shelter promotion. The Government and taxpayers have sparred over who has the burden of proof with respect to the existence of this element which takes away the privilege. In *United States v. BDO Seidman, LLP*, 492 F.3d 806 (7th Cir. 2007) held that, being an exception to the privilege, the Government must “prove preliminary facts that would support a finding that the claimed privilege falls within an exception.” See also *Countryside Ltd. P’ship. v. Commissioner*, 132 T.C. 347 (2009). This burden may not be very great because of the broad meaning of tax shelter. See e.g., *Valero Energy Corp. v. United States*, 569 F.3d 626 (7th Cir. 2009). But the Tax Court in *Countryside* said that it would interpret the elements of the exception practically (i.e., the written communication requirement does not include an FATP’s handwritten notes of oral communications and the requirement of a nexus to “promotion” is not met where the taxpayer’s established accountant was advising at the regular hourly rate with respect to a one-off deal unrelated to a broad promotion of a strategy at premium rates).

⁴⁰⁸¹ There seems to be agreement on this point (e.g., Robert H. Aland and B. John Williams, *Parsing the Practitioner Privilege*, 2005 TNT 79-47), but the privilege in the context of the audit may be unexceptional and really superfluous because the communications (as well as the accountants’ other work) would probably be covered by the work product privilege. See Kip Dellinger, *The Dubious Value of the Practitioner Privilege*, 2005 TNT 84-46. The in-

(continued...)

Once the taxpayer shows that the communication is to an FATP, the IRS then has to establish its right to the exception to the general rule of confidentiality.⁴⁰⁸²

Now review what Judge Posner had to say about the new privilege in Frederick (noting limits on the privilege under § 7525 and noting that it does not apply at all to work product).

In an important decision,⁴⁰⁸³ the Seventh Circuit considered the limits of § 7525 and the identity privilege previously discussed. The IRS summoned information from an accounting firm relevant to the enforcement of the statutory requirement that promoters of potentially abusive “tax shelters” register tax shelters they promote and maintain lists of persons purchasing the shelter (requirement discussed beginning p. 848). The summonses were the regular IRS summonses using the *Tiffany Fine Arts* gambit to obtain the identities of the persons to whom the tax shelters were sold (that being, of course, Congress’ express purpose for the requirement that lists of the names of investors be maintained by promoters).⁴⁰⁸⁴ Two sets of investors moved to intervene using pseudonyms to protect their identity (“John Doe and Jane Doe”). They asserted the standard defenses (e.g., no legitimate purpose under *Powell* for the summons), but the significant issue considered on appeal was their assertion of the identity privilege under § 7525. Quoting its holding in Frederick, the Seventh Circuit said: “Thus the section 7525 privilege is no broader than that of the attorney-client privilege, and ‘[n]othing in [section 7525] suggests that. . . nonlawyer practitioners are entitled to privilege when they are doing other than lawyers' work.’” The Court then considered the applicability of the attorney-client privilege, apparently assuming that the accounting firm was performing legal services in relation to the clients.⁴⁰⁸⁵ The Court said that a requirement of the attorney-client privilege and thus the § 7525 privilege is that the communication be made in confidence and this requirement is not present where the information is intended for disclosure to others. The Court noted the general rule that client identity is not a confidential communication and then moved to consideration of the limited exception referred to as the client identity exception. The Court distilled the holdings in the Seventh Circuit as applying only where the client’s identity would disclose the client’s motive for seeking legal advice (the motive being

⁴⁰⁸¹(...continued)

between question is whether communications with respect to the return preparation—an event that occurs after the promotion—included in the exception?

⁴⁰⁸² In *United States v. BDO Seidman, LLP*, 492 F.3d 806 (7th Cir. 2007); *Countryside L.P. v. Commissioner*, 132 T.C. 347 (2009). Both cases deal with the promotion of a tax shelter exception.

⁴⁰⁸³ *United States v. BDO Seidman*, 337 F.3d 802 (7th Cir. 2003), cert. denied sub nom., *Roes v. United States*, 134 S. Ct. 1410 (2004).

⁴⁰⁸⁴ You will recall from our discussion of the John Doe summons that the regular IRS summons should not be used unless the IRS is seeking information relevant to the liability of the summonsee. *Tiffany Fine Arts* blessed the use of a regular summons even when it would have the incidental effect of identifying investors in tax shelters promoted by the summonsee. *Gertner* held that the investigation of the liability of the summonsee must not be pretextual to avoid the John Doe summons requirement. Here, of course, the IRS easily cleared that hurdle and the Seventh Circuit did not even consider that an issue in the case.

⁴⁰⁸⁵ The Court does, however, fuzz this issue by stating that the party asserting the privilege must “show that the attorney-client communication was made for the purpose of obtaining legal advice, or, more precisely in the case of the section 7525 privilege, tax advice.” This may suggest that the court viewed “tax advice” under § 7525 as not necessarily being coterminous with the attorney-client privilege.

at least an implicit client communication to the attorney). The issue thus was whether the client's identity would disclose the client's motive for seeking tax advice from the accounting firm. The Court questioned whether the intervenors had made or could make this showing. However, "more fundamentally," the Court held that, because Congress had required that the promoter register and maintain lists of investors, the clients could not have had any expectation of privacy with respect to their names. Hence, the case before the Court was "easily distinguishable" from the few cases recognizing a limited client identity privilege.

IV. Work Product Doctrine/Privilege.

The work product doctrine protects the work product and thought processes in preparing for litigation. The work product doctrine was originally blessed as to attorney work product in *Hickman v. Taylor*, 329 U.S. 495 (1947). The doctrine announced in *Hickman* is often called the attorney work product doctrine because *Hickman* approved its application for attorney work product. Rule 26(b)(3) of the Federal Rules of Civil Procedure setting the rules for discovery in civil cases in the district courts adopted the concept but in a slightly broader form.⁴⁰⁸⁶ The *Hickman* attorney work product doctrine, at least facially, only applied to attorney work product.⁴⁰⁸⁷ Rule 26(b)(3) applies to work product prepared by or for a person who would be a party in the litigation, whether or not that product is prepared by an attorney.⁴⁰⁸⁸ Furthermore, the *Hickman* attorney work product doctrine applies generally to any compelled production (including e.g., IRS summonses,⁴⁰⁸⁹ grand jury subpoenas and civil and criminal trial subpoenas),⁴⁰⁹⁰ whereas Rule 26(b)(3) applies to discovery in civil cases in the Federal District Courts (including summons enforcement or quash proceedings).⁴⁰⁹¹ Caveat: the work product doctrine is not a privilege in the traditional meaning of the term. Nevertheless, it is commonly referred to as a privilege; I will do so sometimes because in a colloquial sense it functions like a privilege permitting the party asserting it to refuse to comply with compulsory production unless, of course, an exception applies.

⁴⁰⁸⁶ This rule, applicable to district courts, is mirrored in the other fora (that is, courts) in which tax cases are litigated—the Tax Court (Rule 70(c)(3)) and the Court of Federal Claims.

⁴⁰⁸⁷A In the 1970 Amendments to Rule 26, the drafters noted that the difficulties in existing interpretations of *Hickman* as to work product: "The courts are divided as to whether the work-product doctrine extends to the preparatory work only of lawyers." In this regard, it is obvious that the work product of direct *Kovel* agents employed specifically for the litigation would be covered by *Hickman* since they are direct agents of the attorneys, operating in their stead. But work product of more indirect persons, even if in some sense agents, such as FBI agents, claims agents, etc., not directly under the control and direction of the attorney is more problematic.

⁴⁰⁸⁸ In the 1970 Amendments to Rule 26, the drafters said: "Subdivision (b)(3) reflects the trend of the cases by requiring a special showing, not merely as to materials prepared by an attorney, but also as to materials prepared in anticipation of litigation or preparation for trial by or for a party or any representative acting on his behalf. The subdivision then goes on to protect against disclosure the mental impressions, conclusions, opinions, or legal theories concerning the litigation of an attorney or other representative of a party." For a prominent tax case involving nonattorney work product, see *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998).

⁴⁰⁸⁹ Although not technically applicable to IRS summonses, since they are applicable in any judicial proceedings to enforce or quash the summons, I am confident that assertion on the broader Rule 26(b)(3) privilege in the summons interview or production prior to judicial enforcement is proper.

⁴⁰⁹⁰ E.g., In criminal cases, FRCrP Rule 16(b)(2)(A) denies discovery of "'reports, memoranda, or other documents made by . . . the defendant's attorney or agent, during the case's investigation or defense."

⁴⁰⁹¹ *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998) (applied in summons enforcement case).

Work product requires some nexus to litigation. Litigation need not be in progress at the time the work product is created but litigation must be more than a remote prospect.⁴⁰⁹² Within those broad parameters, the work product must be “prepared in anticipation of litigation”; “[i]t is difficult to pinpoint the moment when a hypothetical possibility of litigation in the future becomes “anticipation of litigation” for purposes of the work product doctrine.⁴⁰⁹³ Courts apply one of two principal tests to determine whether documents are prepared in anticipation of litigation. Most circuits apply the “because of” test asking whether the document was created “because of” anticipated litigation and was the subjective anticipation of litigation objectively reasonable.⁴⁰⁹⁴ The other, more restrictive, test is the “primary purpose” test asking if the “primary motivating purpose behind the creation of the document was to aid in possible future litigation.”⁴⁰⁹⁵

Under Rule 26(b)(3), work product subject to the privilege falls into two broad categories—(i) “opinion work product” such as the mental impressions, conclusions, etc. of the attorney or other representative in the litigation⁴⁰⁹⁶ and (ii) other work product that relates to facts. All work product is subject to the required of showing substantial need and undue hardship, but opinion work product is discoverable only by (i) waiver by disclosure to the adverse party, (ii) if disclosed in a manner likely to become known to the adverse party, and (iii) by making an extraordinary showing of substantial need and undue hardship which, as to opinion work product would be almost impossible.⁴⁰⁹⁷ The D.C. Circuit has said that opinion work product “is virtually undiscoverable.”⁴⁰⁹⁸

The work product privilege is often asserted along with the attorney-client privilege. Since the attorney-client privilege is absolute, it will be better to avoid disclosure on that grounds.

⁴⁰⁹² E.g., *Diversified Indus., Inc. v. Meredith*, 572 F.2d 596, 604 (8th Cir. 1977), modified on other grounds on reh'g, 572 F.2d 606 (8th Cir. 1978) (en banc).

⁴⁰⁹³ See e.g., *Wells Fargo & Company v. United States*, 2013 U.S. Dist. LEXIS 79814 (D. Minn. 2013).

⁴⁰⁹⁴ E.g., *United States v. Roxworthy*, 457 F.3d 590 (6th Cir. 2006); *United States v. Adlman*, 134 F.3d 1194, 1205 (2d Cir. 1998).

⁴⁰⁹⁵ *United States v. El Paso Co.*, 682 F.2d 530, 542 (5th Cir. 1982), cert. denied, 466 U.S. 944 (1984).

⁴⁰⁹⁶ The opinion work product concept incorporated in Rule 26(b)(3)(B) was approved in *Upjohn Co. v. United States*, 449 U.S. 383, 400-402 (1981).

⁴⁰⁹⁷ As to the difficulty of overcoming the opinion work product privilege, see *In re Grand Jury Subpoena*, 870 F.3d 312, 316 (4th Cir. 2017); *In re Cendant Corp. Sec. Litig.*, 343 F.3d 658, 663 (3d Cir. 2003); and *In re Murphy*, 560 F.2d 326, 336 (8th Cir. 1977); and for the more extreme version, see *Duplan Corp. v. Moulinage et Retorderie de Chavanoz*, 509 F.2d 730, 734 (4th Cir. 1974) (opinion work product never discoverable). However, if mental impressions of an attorney are in issue in the case (e.g., in a malpractice case or perhaps in a civil penalty or criminal case involving the attorney’s conduct), the opinion work product could be discoverable but only if the work product were communicated to the client.

⁴⁰⁹⁸ *Dir., Office of Thrift Supervision v. Vinson & Elkins, LLP*, 124 F.3d 1304, 1307 (D.C. Cir. 1997). In similar vein, it is sometimes said that opinion work product is not within the scope of Rule 26(b)(3). *In re EchoStar Communications Corp.*, 448 F.3d 1294, 1302 (Fed. Cir. 2006) (“This rule, however, only allows discovery of ‘factual’ or ‘non-opinion’ work product and requires a court to ‘protect against the disclosure of the mental impressions, conclusions, opinions, or legal theories of an attorney or other representative.’”). In *United States v. Sanmina Corp.*, 968 F.3d 1107 (9th Cir. 2020), the Court held that, while the taxpayer had waived the work product privilege, it had done so only as to factual work product and not to opinion work product, consistent with its prior holding in *Holmgren v. State Farm Mut. Auto. Ins. Co.*, 976 F.2d 573, 577 (9th Cir. 1992) that opinion work product is discoverable only “when mental impressions are at issue in a case and the need for the material is compelling.”

Nevertheless where, for some reason, the attorney-client privilege is not available, the work product privilege is a good fall back.⁴⁰⁹⁹

The work product privilege can be waived. The courts are not consistent as to the circumstances that will waive the privilege. A court held that the privilege is waived if the work product is disclosed intentionally to an opposing party but not if the disclosure is under circumstances that there was no intention to disclose to the opposing party.⁴¹⁰⁰ And some courts hold that waiver of work product protection generally extends only to non-opinion work product, except in certain settings such as malpractice or reliance on counsel.⁴¹⁰¹

It is important to distinguish between the work product privilege recognized in the federal universe and the accountant client or accountant work product privilege which is not recognized.⁴¹⁰² An accountant's work product can qualify for the work product privilege if it meets the requirements of the attorney work product privilege in *Hickman* (e.g., via a *Kovel* arrangement) or the FRCP 26(b)(3) work product privilege. Both of course must have a principal nexus to litigation or anticipated litigation. But, where the work product is prepared for other non-litigation reasons (such as financial statements prepared for public company disclosures), they will not qualify for any work product privilege.

Finally, in an attorney-client context, “the work product privilege belongs to both the client and the attorney, either of whom may assert it. Thus, a waiver by the client of the work product privilege will not deprive the attorney of his own work product privilege, and vice versa.”⁴¹⁰³

V. Fifth Amendment Privilege.

A. Compulsory Testimonial Communications.

The Fifth Amendment precludes compelling a witness to give testimony that is incriminating. Certainly, we all recognize that a taxpayer cannot be forced to testify as to incriminating matters.

⁴⁰⁹⁹ For a good application of this fall back, see *United States v. Adlman*, 134 F.3d 1194 (2d Cir. 1998).
⁴¹⁰⁰ *Wells Fargo & Company v. United States*, 2013 U.S. Dist. LEXIS 79814 (D. Minn. 2013) (disclosure to auditor is not a waiver); see also *United States v. Deloitte LLP*, 610 F.3d 129 (D.C. Cir. 2010) (same; not enough risk of adversarial relationship between financial auditor and client); *In re Sealed Case*, 676 F.2d 793 (D.C. Cir. 1982) (waiver to professional on same side); and *United States v. MIT*, 129 F.3d 681, 687 (1st Cir. 1997) (“work product protection is provided against ‘adversaries,’ so only disclosing material in a way inconsistent with keeping it from an adversary waives work product protection”).

⁴¹⁰¹ *In re Martin Marietta Corp.*, 856 F. 2d 619, 625 (4th Cir. 1988) (testimonial use of work product of non-opinion work product does not waive opinion work product privilege). Indeed, it has been said that, even where a party waives the privileges in a malpractice suit against the attorney or by raising the advice of counsel defense (e.g., to avoid accuracy related penalties), the privilege is waived only as to opinion work product actually communicated to the party waiving the privilege.

⁴¹⁰² See *United States v. Arthur Young*, 677 F.2d 211 (2nd Cir. 1982).

⁴¹⁰³ *In re Grand Jury Subpoenas*, 561 F.3d 408, 411 (5th Cir. 2009) (quoting *In re: Grand Jury Proceedings*, 43 F.3d 966, 972 (5th Cir.1994)). I am not sure if this concept can be extended so that work product prepared by a third party for a client is treated similarly.

Thus, in a summons proceeding and in an ensuing summons enforcement proceeding, a taxpayer having a substantial fear of incrimination from answering the questions posed can assert the Fifth Amendment.

In any compulsory process proceeding (e.g., an agency administrative summons, grand jury subpoena, or trial subpoena), a witness can be compelled to testify if given immunity coextensive with his Fifth Amendment rights.⁴¹⁰⁴ This means that any testimony the witness is compelled to give cannot be used directly or indirectly against the witness in a criminal proceeding. Hence, the type of immunity given to compel testimony coterminous with the Fifth Amendment is called use and derivative use immunity (often just called derivative use immunity).⁴¹⁰⁵ If the Government then charges the witness criminally, the Government cannot use the compelled testimony either (i) directly by introducing it or (ii) introducing evidence that is derived from the compelled testimony. The potential use and derivative use of compelled testimony is tested in the criminal case in a *Kastigar* proceeding⁴¹⁰⁶ where the Government must prove that its evidence does not include the compelled testimony directly or derivatively.⁴¹⁰⁷

⁴¹⁰⁴ *Kastigar v. United States*, 406 U.S. 441, 449 (1972).

⁴¹⁰⁵ The formal procedure for granting use and derivative use immunity is in 18 U.S.C. §§ 6002 and 6003. In criminal jargon, there is a form of immunity called use immunity, which is conferred by agreement with the prosecutor rather than by statute. Use immunity prohibits the direct use of compelled testimony but does not preclude its derivative use to discover other evidence that is used in a criminal proceeding against the witness compelled to testify. Use immunity is not coextensive with the Fifth Amendment and a defendant cannot be compelled to testify upon simply being given use immunity. Use immunity is typically conferred in proffer sessions with a federal prosecutor where the inducement the witness perceives is that, by cooperating and testifying or proffering, the witness may avoid prosecution. The other type of immunity commonly spoken about in criminal practice is transactional immunity—essentially immunizing the witness from prosecution with the scope of the immunity. That type of immunity goes beyond the Fifth Amendment protections which simply require for compelled testimony that the witness be given use and derivative use immunity but permits prosecution based on other evidence independently derived. Transaction immunity is almost never given in federal criminal practice except unintentionally in some cases from which a witness may have reasonably believed that was the immunity being offered and then acted to his detriment by testifying.

⁴¹⁰⁶ The proceeding is so-called after the leading case, *Kastigar v. United States*, 406 U.S. 441 (1972).

⁴¹⁰⁷ There is some nuance behind the summary given in the text. I just introduce a high level summary of the nuance without the nuance. If the testimony is compelled in the federal system, the foregoing summary applies. The witness can assert the Fifth Amendment to decline to testify unless given use and derivative use immunity. In most circumstances, the witness will assert the privilege. But there may be circumstances where the witness is compelled without being given use and derivative use immunity and without having asserted his privilege. For example, the testimony may have been extracted via torture. That testimony cannot be used for other constitutional reasons. But there may be circumstances where a witness is compelled to testify and the question is whether that testimony can be used directly or derivatively. I think the answer is no. For example, the testimony of a witness compelled to testify in a state proceeding after being given use and derivative use immunity from state prosecution cannot then be used directly or derivatively in a federal prosecution. *Murphy v. Waterfront Comm'n*, 378 U.S. 52 (1964). Similarly, if in another judicial or investigative system (state or foreign) the witness were compelled to testify without any immunity or with only use immunity (not coterminous with the Fifth Amendment), that compelled testimony cannot be used for criminal prosecution. See *United States v. Allen*, 864 F.3d 63 (2d Cir. 2017) (derivative evidence from testimony compelled in Great Britain subject only to use immunity for prosecution in Great Britain cannot be used in the U.S. prosecution, relying on *In re Terrorist Bombings of U.S. Embassies in E. Africa*, 552 F.3d 177, 200 & 208 (2d Cir. 2008) (forced or involuntary statements by foreign authorities cannot be used in U.S. prosecution)). One of the tests of voluntariness of statements to U.S. authorities is the giving of *Miranda* warnings where the witness is in custody; since *Miranda* warnings (continued...)

Imposing a burden of proof on a person in a civil proceeding the person brings against the Government is not compulsion for purposes of the Fifth Amendment even though, if the person invokes the Fifth Amendment to avoid testimony or discovery the court may impose an adverse inference or find a failure of proof.⁴¹⁰⁸

Finally, the person otherwise compelled can waive the privilege in a particular proceeding. The easiest case is when in a criminal proceeding, a defendant voluntarily testifies in his defense, thereby waiving the Fifth Amendment privilege. In other types of proceedings (e.g., a civil tax proceeding), a person making some testimonial statement as to matters for which the person might have otherwise claimed the Fifth Amendment privilege may be deemed to have waived the privilege in that proceeding (although not for purposes unrelated to the proceeding). For example, assume a Tax Court deficiency case where the IRS asserted the civil fraud penalty, the taxpayer contesting the penalty can be called to testify and still assert the privilege (if he can show fear of incrimination), but may have adverse consequences in the case (such as default judgment, adverse inference, failure to meet some proof burden imposed upon the person). Those adverse consequences in a civil case are not inconsistent with the Fifth Amendment privilege, for the person can always assert the privilege and just suffer those consequences.⁴¹⁰⁹

B. Documents.

1. No Fifth Amendment Privilege for Contents of Documents.

In a tax investigation, all competent practitioners and most taxpayers will know that no person can be compelled to testify as to matters that may be incriminating. IRS agents will also know that. So, they tend to focus on documents which often tell a story more powerful than a confession or at least well enough to convict if a confession cannot be obtained. Does a taxpayer or other witness subject to summons (or subpoena in the case of a grand jury investigation) have a Fifth

⁴¹⁰⁷(...continued)

just go to the issue of coercion, testing coercion is a foreign setting requires inquiry into whether the witness' statement is "the product an essentially free and unconstrained choice by its maker." *United States v. Abu Ali*, 528 F.3d 210, 232 (4th Cir. 2008). These principles apply to testimony compelled by foreign authorities in a foreign country who, perforce are not subject to the Fifth Amendment in the interrogation and the witness has no Fifth Amendment right that can stop the interrogation. The Fifth Amendment applies in such a situation when a U.S. prosecution is brought and the potential use of the foreign compelled testimony is implicated in the prosecution. The Fifth Amendment guards against the use of the testimony that was compelled by the foreign authority.

⁴¹⁰⁸ *Markell Co., Inc. v. Commissioner*, T.C. Memo. 2014-86, at *24-25, 27 (adverse inference may be asserted against parties and against nonparties (depending upon relationship with parties).

⁴¹⁰⁹ *United States v. Rylander*, 460 U.S. 752, 758 (1983) (Fifth Amendment is a valid basis to avoid testimony but does not serve to meet a burden imposed on the party in a civil proceeding); *Feinberg v. Commissioner*, 916 F.3d 1330, 1336-1337 (10th Cir. 2019) (Fifth Amendment is not a basis for relieving a party in a civil case of a burden of proof otherwise imposed); *Baxter v. Palmigiano*, 425 U.S. 308, 318 (1976) (quoting 8 J. Wigmore, *Evidence* 439 (McNaughton rev. 1961): "the Amendment 'does not preclude the inference where the privilege is claimed by a party to a civil cause.'"); *LiButti v. United States*, 107 F.3d 110, 124 (2d Cir. 1997); *United States v. Ianniello*, 824 F.2d 203, 208 (2d Cir. 1987) (applying the *Baxter* rule even if the government is the beneficiary of the adverse inference). This only speaks to a civil tax case. Of course, government law enforcement agents might draw an adverse inference for purposes of actions that they are authorized to take.

Amendment privilege against being required to produce documents that may incriminate? The answers to this question are not without some degree of uncertainty.

One thing that is certain is that there is no Fifth Amendment privilege that attaches to the contents of pre-existing documents that were voluntarily prepared or possessed.⁴¹¹⁰ At one time, this pre-existing document exclusion from the Fifth Amendment privilege was thought to apply only to juridical entities such as corporations, so that personal papers of an individual (a diary being a classic example) were subject to the privilege.⁴¹¹¹ However, over time, the Supreme Court accepted the concept that, since the documents themselves were not originally prepared under act of compulsion, the contents of the documents are not subject to a Fifth Amendment privilege by anyone.

a. Act of Production.

Under current jurisprudence, while the person compelled to produce the documents may not assert a Fifth Amendment privilege as to the contents of the documents, the person may have and assert a Fifth Amendment privilege as to any testimonial characteristics inherent in the compulsory act of producing the documents. This is called the Act of Production Doctrine. For example, as discussed above, a person is not compelled to keep a diary wherein she records her innermost thoughts. If the IRS or other governmental agency summonses or subpoenas the person to produce the diary, the Fifth Amendment privilege against compulsory self-incrimination is implicated only by the testimonial characteristics of the compulsory act—i.e., producing the diary. If in response to the summons or subpoena, the witness produces the diary, the witness is implicitly testifying that (i) I understand the summons or subpoena to require production of my diary and (ii) this book I deliver is my diary. Then, if the diary contains incriminating information, the Government can introduce the diary at trial and link it to the witness by showing that the witness produced it pursuant to the summons or subpoena. This latter “link” is referred to as the testimonial aspects of the “act of production.” That link is testimonial as to which the Fifth Amendment privilege may be asserted.

b. Hubbell and Act of Production.

This Act of Production Doctrine was addressed in *United States v. Hubbell*, 530 U.S. 27 (2000), a case of some notoriety because it involved Webster Hubbell, former Deputy Attorney General and, until then, a long-time friend of President Bill Clinton. In Hubbell, the special prosecutor investigating virtually anything criminal President Clinton or his cronies might be associated with (including, as we know, sex lives which itself was not criminal), fixed on Webster Hubbell. As a tool to get to the president, the special prosecutor investigated Hubbell's potential nontax crimes. The hapless Hubbell pled guilty to those nontax crimes. In doing so, he promised to provide the special prosecutor information against the President. Subsequently, the special

⁴¹¹⁰ *Fisher v. United States*, 425 U.S. 391, 410 (1976); *United States v. Doe*, 465 U.S. 605, 612 n.10 (1984) (“If the party asserting the Fifth Amendment privilege has voluntarily compiled the document, no compulsion is present and the contents of the document are not privileged.”)

⁴¹¹¹ *Boyd v. United States*, 116 U.S. 616 (1886)

prosecutor instituted a grand jury investigation of whether Hubbell had complied with his promise. The special prosecutor had the grand jury issue to Hubbell broadly worded grand jury subpoenas for a number of categories of financial records. Hubbell appeared before the grand jury and invoked his Fifth Amendment privilege. The prosecutor thereupon delivered to Hubbell an order from the district court commanding that he comply and granting immunity “to the extent allowed by law.” The immunity is referred to as derivative use immunity, meaning that, if the Government subsequently prosecutes the witness (Hubbell here), the Government must show that the prosecution is based on information other than the testimonial information it obtained only by the grant of immunity. Hubbell then produced over 13,000 pages of documents. From the documents thus produced, the special prosecutor obtained an indictment of Hubbell for tax crimes and mail and wire fraud. The Government admitted that it could not prove those crimes independently of the documents produced under compulsion, so the parties agreed that the charges would be dropped altogether if the “Act of Production” doctrine would be a significant bar to prosecution. In that posture, the Supreme Court granted certiorari at the request of the special prosecutor “to determine the precise scope of a grant of immunity with respect to the production of documents in response to a subpoena.”

The following are the key points of the Hubbell case (mostly quotes, slightly modified for readability, from the opinion):

- [Under the act of production doctrine] The “compelled testimony” that is relevant in this case is not to be found in the contents of the documents produced in response to the subpoena. It is, rather, the testimony inherent in the act of producing those documents.”
- The testimonial aspect of a response to a subpoena duces tecum does nothing more than establish the existence, authenticity, and custody of items that are produced.
- The question is not whether the response to the subpoena may be introduced into evidence at his criminal trial. That would surely be a prohibited “use” of the immunized act of production. But the fact that the Government intends no such use of the act of production leaves open the separate question whether it has already made “derivative use” of the testimonial aspect of that act in obtaining the indictment against respondent and in preparing its case for trial. It clearly has. It is apparent from the text of the subpoena itself that the prosecutor needed respondent’s assistance both to identify potential sources of information and to produce those sources. Given the breadth of the description of the 11 categories of documents called for by the subpoena, the collection and production of the materials demanded was tantamount to answering a series of interrogatories asking a witness to disclose the existence and location of particular documents fitting certain broad descriptions. The assembly of literally hundreds of pages of material in response to a request for “any and all documents reflecting, referring, or relating to any direct or indirect sources of money or other things of value received by or provided to” an individual or members of his family during a 3-year period, Appendix, *infra*, at 19, is the functional equivalent of the preparation of an answer to either a detailed written

interrogatory or a series of oral questions at a discovery deposition. Entirely apart from the contents of the 13,120 pages of materials that respondent produced in this case, it is undeniable that providing a catalog of existing documents fitting within any of the 11 broadly worded subpoena categories could provide a prosecutor with a “lead to incriminating evidence,” or “a link in the chain of evidence needed to prosecute.”

- We cannot accept the Government’s submission that respondent’s immunity did not preclude its derivative use of the produced documents because its “possession of the documents [was] the fruit only of a simple physical act—the act of producing the documents.” It was unquestionably necessary for respondent to make extensive use of “the contents of his own mind” in identifying the hundreds of documents responsive to the requests in the subpoena. The assembly of those documents was like telling an inquisitor the combination to a wall safe, not like being forced to surrender the key to a strongbox. The Government’s anemic view of respondent’s act of production as a mere physical act that is principally non-testimonial in character and can be entirely divorced from its “implicit” testimonial aspect so as to constitute a “legitimate, wholly independent source” (as required by *Kastigar*) for the documents produced simply fails to account for these realities.
- In sum, we have no doubt that the constitutional privilege against self-incrimination protects the target of a grand jury investigation from being compelled to answer questions designed to elicit information about the existence of sources of potentially incriminating evidence. That constitutional privilege has the same application to the testimonial aspect of a response to a subpoena seeking discovery of those sources.

The Court distinguished an earlier case where it had rejected the Fifth Amendment because there the Government already knew of the existence of the specific documents in question. Where, as in *Hubbell*, the government is just out on a fishing expedition, the Act of Production applies if the Government lands the big one. In this respect, the Court specifically rejected the notion that a mere assumption as to the existence of the type of records will cure the defect. This offers a lot of opportunity for the potential application of the Act of Production Doctrine.

What level of knowledge of existence of the documents is required to support compulsory production by subpoena or its administrative counterpart, the IRS summons? In 2005 case,⁴¹¹² the IRS had instituted a much heralded initiative to discover foreign bank accounts by issuing John Doe summonses to credit card processing agencies within the United States who would have records of processed charges for foreign bank accounts. From those records, the IRS obtained evidence of a particular taxpayer, the taxpayer-defendant in this summons enforcement proceeding, The IRS issued the summons for the taxpayer’s bank and credit card records and related documents. The taxpayer appeared pursuant to the summons and asserted privileges. The Government then brought the summons enforcement proceeding and requested that the Court also issue an order requiring compliance with a consent directive directing the offshore bank to disclose information to the IRS. In the affidavit in support of the summons (recall that such an affidavit is used to meet the *Powell*

⁴¹¹² *United States v. Norwood*, 420 F.3d 888 (8th Cir. 2005).

requirements in the summary summons enforcement proceeding), the IRS Agent recounted the evidence that: (i) the taxpayer had a foreign bank account with two associated credit cards; (ii) the bank account number for that account; and (iii) the taxpayer had answered no to the foreign bank account question on Schedule B of his 1040.

One of the taxpayer's defenses to compliance was the Hubbell defense. The district court and the court of appeals rejected the defense on the basis that the information the IRS already had made the existence of the foreign bank account virtually a "foregone conclusion," sufficient to meet Hubbell's requirements. The court of appeals reasoned:

The existence of the requested records relating to Norwood's [foreign bank credit] cards and [related foreign bank] account is a foregone conclusion. The summons seeks records such as account applications, periodic account statements, and charge receipts, all of which are possessed by the owners of financial accounts as a matter of course. Norwood does not contend that he does not possess any of these documents, and the government knows far more about the documents associated with Norwood's [foreign bank] cards and account than it did about the defendant's business records in *Hubbell*. 530 U.S. at 44. In *Hubbell*, the government could not show "any prior *knowledge* of either the existence or whereabouts" of the documents sought. *Id.* (emphasis added). Here, by contrast, the government knows the name and location of the bank that created the records sought, Norwood's payment card numbers, and even the details of a number of discrete transactions involving the cards and his [foreign bank] account. Accordingly, the district court's conclusion that "Norwood's production of the records has no testimonial significance," is not clearly erroneous.

In 2016, the Second Circuit applied *Norwood's* analysis in an offshore bank account record case but, on the facts, concluded "that the Government has failed to establish that it is a foregone conclusion that the requisite exercise, control, and authenticity of the documents existed as of time of the issuance of the summons."⁴¹¹³ So, practitioners faced with the issue should explore the parameters of the current law on the predicate foregone conclusion that the Government must establish.

The D.C. Circuit Court of Appeals addressed some of these issues left open by Hubbell in holding that the Fifth Amendment was implicated in a compelled document production.⁴¹¹⁴ Focusing on the spectrum usually encountered between the frames of the two cases—Fisher where the documents were reasonably known to exist (no Fifth Amendment privilege) and Hubbell where the Government was just fishing (Fifth Amendment privilege)—the court said:

Although the Supreme Court did not adopt the "reasonable particularity" standard in affirming our decision, it emphasized that the applicability of the Fifth

⁴¹¹³ *United States v. Greenfield*, 831 F.3d 106 (2d Cir. 2016).

⁴¹¹⁴ *United States v. Ponds*, 454 F.3d 313 (D.C. Cir. 2006).

Amendment turns on the level of the government's prior knowledge of the existence and location of the produced documents. See *Hubbell*, 530 U.S. at 44-45. Post-*Hubbell*, another circuit has applied the reasonable particularity standard to determine whether an act of production is sufficiently testimonial to implicate the Fifth Amendment. See *In re Grand Jury Subpoena Dated April 18, 2003*, 383 F.3d 905, 910 (9th Cir. 2004). Because that standard conceptualizes the Supreme Court's focus in a useful way, so do we.⁴¹¹⁵

The Court of Appeals found that, under the facts, the prosecutors did not have the required particularity of knowledge as to some of the documents and, accordingly, that the subpoenaed party had a Fifth Amendment right to not produce the documents.

Reasonable particularity as to what? Is it the level of reasonable particularity to support a search warrant? I am not sure that the imperatives of the Fifth Amendment guarantee against self-incrimination are coterminous with the imperatives of the Fourth Amendment guarantee of unwarranted searches and seizures. Go back to *Hubbell* where the Court asked a more particular type of particularity than required for a search warrant. The Ninth Circuit had previously decided a case on a reasonable particularity analysis,⁴¹¹⁶ but in a later case focused back on the "foregone conclusion" requirement without mentioning the "reasonable particularity" standard and said:

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, 40-41 (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 910.⁴¹¹⁷

At least arguably, as articulated, this might be a tighter standard of particularity that in the search warrant context. Still, I have to ask the question of whether a tighter standard would just force the Government to obtain a search warrant. Certainly, in at least some of these cases, the Government had enough evidence to obtain a search warrant. It seems to me to be somewhat counterproductive to permit the Government to obtain by search warrant that which it cannot obtain by subpoena, but again the imperatives of the Fifth Amendment and the Fourth Amendment are not coterminous.

I do want to make clear the whole point of this analysis—that the contents of documents, although not privileged per se by current Fifth Amendment analysis, can get the benefits of privilege via the act of production doctrine. In other words, the safety net given by the act of production doctrine also protects the contents of the documents simply because the Government cannot get to

⁴¹¹⁵ 454 F.3d., at 320-321.

⁴¹¹⁶ *In re Grand Jury Subpoena, Dated Apr. 18, 2003*, 383 F.3d 905 (9th Cir. 2004). See generally Mark A. Cowen, The Act-of-Production Privilege Post-*Hubbell*: *United States v. Ponds* and the Relevance of the "Reasonable Particularity" and "Foregone Conclusion" Doctrines, 17 *Geo. Mason L. Rev.* 863 (2010).

⁴¹¹⁷ *United States v. Bright*, 596 F.3d 683, 692 (9th Cir. 2010).

the contents except through an act of production which implicates the Fifth Amendment or, if the Government does get to the contents by compulsion, will not be able to use the contents directly or indirectly against the witness. Hubbell thus held that, having obtained the documents by immunity after the party properly asserted the Fifth Amendment privilege under the act of production doctrine, the prosecutors could not use the contents of the documents despite the fact that the contents of the documents were per se not subject to the Fifth Amendment privilege.

Practitioners should be aware of the “required records” exception that, when applicable, will trump the Fifth Amendment Act of Production doctrine. The required records doctrine is variously formulated, perhaps because of its tenuous logic in view of contemporary Fifth Amendment jurisprudence. Here is a good statement of the rule and its predicates in a tax setting:

However, there is an important exception to the “communicative aspects” doctrine when the documents in question are “required records.” To constitute “required records,” documents must satisfy a three-part test: (1) The requirement that they be kept must be essentially regulatory, (2) the records must be of a kind which the regulated party has customarily kept, and (3) the records themselves must have assumed ‘public aspects’ which render them analogous to public documents. Courts in the Second Circuit have held that “required documents” include W-2 forms, 1099 statements, tax returns, and employee earnings statements. Those are among the documents the IRS seeks from Mr. Whitehouse.⁴¹¹⁸

I offer this for what it may be worth. The required records exception is often criticized because its stated underpinnings are inconsistent with the Fifth Amendment: If the subpoenaed or summoned party has a Fifth Amendment privilege under the act of production concept, why should it matter that the documents may be required records for some administrative scheme?⁴¹¹⁹

You will recall that there is a general Code and Regulations requirement that the taxpayer keep records sufficient to calculate and report his or her tax obligations.⁴¹²⁰ Does this mean that all of the taxpayer’s records relevant to tax liabilities are required records?⁴¹²¹ Fortunately, the Government has not pressed that argument and has disavowed intent to do so,⁴¹²² so the cases have

⁴¹¹⁸ *United States v. Whitehouse*, 2010 U.S. Dist. LEXIS 122979 (D. Conn. 2010) (cleaned up).

⁴¹¹⁹ See e.g., Akhil Reed Amar and Renee B. Lettow, Fifth Amendment First Principles: The Self-Incrimination Clause, 93 Mich. L. Rev. 857, 869-873(1995) (noting the logical inconsistency and the ad hoc and inconsistent holdings in the cases); but see Michael J. Zydney Mannheimer, Toward a Unified Theory of Testimonial Evidence Under the Fifth and Sixth Amendments, 80 Temp. L. Rev. 1135, 1181 (2007) (“The best reading of these cases is that the Court utilizes this consideration to determine whether, at the time of compulsion, it was the government’s objective purpose to create evidence for a potential criminal proceeding.”).

⁴¹²⁰ § 6000 and underlying regulations.

⁴¹²¹ See *Shapiro v. United States*, 335 U.S. 1, 51 (1948) (Frankfurter, J., dissenting) (“If records merely because required to be kept by law ipso facto become public records, we are indeed living in glass houses.”)

⁴¹²² DOJ Tax has disclaimed that it will seek such expanded application. Shamik Trivedi, No Intention to Expand Required Records Doctrine, Keneally Says, 2013 TNT 44-3 (3/6/13), discussed in my Federal Tax Crimes blog entry, DOJ Tax Disavows Intent to Expand Required Records Exception to Act of Production Fifth Amendment (continued...)

not had to deal with it except episodically for certain types of documents—e.g., Forms W-2 and 1099 as mentioned in the quote. I can't predict where this might go if the Government were to get more aggressive. Maybe the courts would embrace the idea, but also maybe they would rethink the required records exception altogether.

A tax crimes related context for the Government assertion of the required records exception to the Fifth Amendment is for the records required to be maintained with respect to the FBAR reporting obligations. The regulations underlying the statute require the maintenance of records.⁴¹²³ The Courts of Appeals consistently hold that, given the regulatory nature of the FBAR requirement, the required records doctrine applies to overcome the claim of the Fifth Amendment Act of Production Doctrine.⁴¹²⁴ 7

2. Entity Records and Act of Production.

A common context for the potential application of the Act of Production doctrine applies when entity records are summoned or subpoenaed. The entity itself has no Fifth Amendment privilege, but the custodian of the records may have a Fifth Amendment privilege under the Act of Production Doctrine. As noted in *Hubbell*, the act of compiling records complying with a compulsory process and producing them may have certain testimonial features. The Supreme Court addressed this issue in *Braswell v. United States*, 487 U.S. 99 (1988), reasoning:⁴¹²⁵

- Entities can only act through humans. Entities are not humans and have no Fifth Amendment privilege; permitting them to hide through humans would be detrimental to “white collar crime” enforcement.
- Even granting the custodian of the records testimonial immunity for the testimony inherent in the act of production is not the solution, for the Government would have difficulty prosecuting after granting that immunity. The Court cited *Kastigar v. United States*, 406 U.S. 441 (1972) for the heavy burden the Government has after giving immunity to show that the case is not based on the immunized testimony.
- Acting as custodian of corporate records, the custodian would produce the records in his capacity as corporate representative and not his individual capacity. Therefore, the Government may make no use of the testimony implicit from production against the individual.
- “For example, in a criminal prosecution against the custodian, the Government may not introduce into evidence before the jury the fact that the subpoena was served upon and the corporation's documents were delivered by one particular individual, the custodian. The Government has the right, however, to use the corporation's act

⁴¹²²(...continued)

Privilege (3/8/13). But a court faced with the issue may be hard-pressed to articulate a rationale that would exclude application of the required records exception to some required records tax schemes.

⁴¹²³ 31 C.F.R. § 103.32 and .24.

⁴¹²⁴ *United States v. Chen*, 815 F.3d 72 (1st Cir. 2016), the most recent in the unanimous decisions in the Courts of Appeals, citing all of those decisions.

⁴¹²⁵ Footnotes, some internal quotes and case citations omitted for readability.

of production against the custodian. The Government may offer testimony—for example, from the process server who delivered the subpoena and from the individual who received the records—establishing that the corporation produced the records subpoenaed. The jury may draw from the corporation's act of production the conclusion that the records in question are authentic corporate records, which the corporation possessed, and which it produced in response to the subpoena. And if the defendant held a prominent position within the corporation that produced the records, the jury may, just as it would had someone else produced the documents, reasonably infer that he had possession of the documents or knowledge of their contents. Because the jury is not told that the defendant produced the records, any nexus between the defendant and the documents results solely from the corporation's act of production and other evidence in the case.”

Is this satisfactory to reconcile the Fifth Amendment strands brought to bear or is it just a practical solution in spite of some theoretical inconsistencies?

3. Other Issues.

There are still other Fifth Amendment issues potentially at play in the IRS information gathering process.

a. Handwriting Exemplars.

Handwriting exemplars are often compelled, particularly in criminal tax investigations. Handwriting exemplars are simply samples of the witness's handwriting. Building on the Supreme Court's holdings that compulsory police line ups and even compulsory blood samplings are not Fifth Amendment violations, the Supreme Court has held that handwriting exemplars are also not Fifth Amendment violations.⁴¹²⁶ The typical drill is for the IRS to issue a summons for or the grand jury to subpoena the handwriting exemplars. The witness will then be required to appear at the time and place designated and produce by writing in the presence of witnesses his or her signature⁴¹²⁷ and other words from documents relevant to the case. There will usually be multiple iterations of each to guard against the possibility that, if only one were acquired, the witness might have changed his handwriting.

⁴¹²⁶ *United States v. Euge*, 444 U.S. 707, 714-717 (1980).

⁴¹²⁷ Section 6064 treats a signature on a return as “prima facie evidence for all purposes that the return, statement, or other document was actually signed by him.” A taxpayer can overcome that evidence but may have a heightened burden to do so. However, where the IRS has the burden of proof (e.g. in a criminal case or a civil case involving fraud), at least arguably § 6064 may have limited benefit for the IRS (but see *United States v. Kim*, 884 F.2d 189 (5th Cir. 1989)), and the IRS may well want to obtain signature exemplars where there is any doubt as to the authenticity of the signature.

b. Consent Directives to Foreign Banks.

We have noted elsewhere that people often use foreign bank accounts in so-called Tax Haven jurisdictions to hide their income and protect their assets from reach of creditors. In a U.S. tax setting, these people are U.S. taxpayers (or, more accurately, nontaxpayers) who seek to hide their income and thus not report or pay tax on that income, on the notion that the secrecy laws of the Tax Haven jurisdiction will prevent the IRS from discovering the income. Alternatively, if the IRS has claims (i.e., tax assessments or potential tax assessments) against these U.S. taxpayers, they may desire to put their assets beyond the IRS's reach. Of course, the IRS can summons any person within the U.S. jurisdiction to answer questions and among those questions may be questions about hidden income or secreted assets. The taxpayer thus summoned can assert the Fifth Amendment privilege if it is otherwise available, and in the case of omitted income it almost certainly would be available. The privilege probably could be asserted both as to testimony pursuant to summons or grand jury subpoena and also as to documents under the Act of Production doctrine.

The IRS's retort to that Fifth Amendment assertion is to request a court to order the taxpayer to sign a consent directive (sometimes called a disclosure directive) which is a document authorizing foreign parties (such as a Tax Haven bank) to divulge information about accounts which the taxpayer owns or has signatory authority over.⁴¹²⁸ The consent directive on its face does not contain an admission that the taxpayer actually has a foreign bank account; it simply says that, if he does, the bank is authorized to disclose information about the account. A court either in a summons enforcement proceeding or pursuant to a grand jury subpoena may recognize the taxpayer's assertion of the Fifth Amendment for compelled production of the documents but order the taxpayer to sign the consent directive or be held in contempt. *Doe v. United States*, 487 U.S. 201 (1988) (involving a grand jury subpoena and holding that the court may order the taxpayer to sign such a consent directive over a Fifth Amendment privilege assertion because but the target is not doing anything of testimonial significance and the only testimonial act will be the bank's implicit statement by its production that the records are the target's records).

In light of *Doe*, a taxpayer subjects himself or herself to almost certain contempt sanctions, including incarceration, for refusing to sign a consent directive. As is often the case in Supreme Court jurisprudence, however, shifts occur in constitutional analysis. *Doe* is the law now, at least for the lower courts who will impose contempt sanctions. But the Supreme Court can always shift the analysis and arguably reach another result based on subsequent refinements in its analysis of the Fifth Amendment and other constitutional protections, such as the right of privacy, that were not addressed in *Doe*.

Of course, merely the possibility of derailing the prosecution at the certain cost of suffering contempt charges may not be the most appetizing alternative for a taxpayer. So, the taxpayer is

⁴¹²⁸ See IRM 5.21.2.4 (04-06-2018), Consent Directives; see also IRM 34.6.3.7 (02-01-2011), Issuance of Summons for Books and Records Abroad.

between a rock and a hard place.⁴¹²⁹ And most taxpayers are not going to be willing to suffer contempt to see if they can chase the issue of the continuing viability through the courts when there is significant chance that the Supreme Court would not agree to re-consider and, even if it did, might reach the same bottom-line decision to order the taxpayer to sign over the various objections that might be mounted.

The IRS's ultimate ability to get to the underlying records is wholly dependent upon the foreign person complying with the consent directive. Here too, the foreign person may take the position that it is prohibited from complying with such a compelled consent directive⁴¹³⁰ or simply refuse to do so because it is not good business for a tax haven bank. And, if a person to whom the consent directive is addressed is beyond the U.S. summons or subpoena power, no further effective steps can be taken. Certainly, the taxpayer cannot be jailed because the foreign person refuses to comply.

I discuss elsewhere (beginning p. 438) certain treaty and related procedures permitting the IRS to obtain foreign information and documents without the taxpayer's cooperation and without consent directives which may, as a practical matter, be ineffective anyway.

4. Judicially Contesting Use of Compelled Testimony.

The most common judicial remedy for improper use of compelled testimony in violation of immunity is a hearing after indictment. The key case is *Kastigar v. United States*, 406 U.S. 441 (1972). In that case, the Court held that, to avoid exclusion of the evidence, the Government must establish that the intended use does not violate the terms of the immunity given the witness. Proceedings to which *Kastigar* applies are called *Kastigar* hearings. The burden to show that none of the Government's intended case is based on testimony immunized or compelled over Fifth Amendment objections is quite substantial. Fear of the burdens imposed in *Kastigar* hearings make the Government very stingy in its granting of derivative use immunity. Good prosecutors will only grant such immunity where the witness is in a very strong bargaining position in the give and take of the testimony involved.

VI. Spousal Privileges.

A. General Reason for Spousal Privilege.

The societal value supported by the spousal privileges is the integrity of the marriage unit. The justification for the particular subset of marital privileges is usually more fine-tuned than that, focusing on the nature of the testimony, its potential adverse effect on the marriage unit or marriage

⁴¹²⁹ See Timothy P. O'Toole, Dawn E. Murphy-Johnson, and George M. Clarke III, Can a Prosecutor Make you Cough Up Your Offshore Account?, 130 Tax Notes 1313 (Mar. 14, 2011).

⁴¹³⁰ See *Id.* fn. 16; See also *In re Grand Jury Proceedings (Marsoner)*, 40 F.3d 959, 966 (9th Cir. 1994), cert. denied, 515 U.S. 1132 (1995). See the unofficially reported decisions in *United States v. Gippetti*, 248 Fed. Appx. 382 (3d Cir. N.J. 2007), and its predecessor case *United States v. Gippetti*, 153 Fed. App. 2005, 2005 U.S. App. LEXIS 24054 (3d Cir. 2005), where the foreign bank did not respond.

in general, and harm to society that justifies the privileges. For present purposes, readers should just recall that it is the marriage unit and the societal value of fostering the marital unit that justifies these privileges.

B. Spousal Communications Privilege.

The spousal or marital confidential communications privilege covers “information privately disclosed between husband and wife in the confidence of the marital relationship.” *Trammel v. United States*, 445 U.S. 40, 51 (1980).⁴¹³¹ The societal benefit is to ensure that spouses communicate confidentially without fear of exposure in court.⁴¹³² Either spouse “may invoke the privilege to avoid testifying or to prevent the other from testifying about the privileged communication.”⁴¹³³

What are protected communications? We all know that people—including spouses specifically—communicate by words and actions. So, is everything one spouse learns about the other through words or actions communications? The answer is that general verbal communications are what is protected rather than actions. Consider the following:

[T]he protected subject matter includes only what one spouse communicates to the other, not what one spouse learns about the other in other ways, such as by observing the other's actions. In Mr. Brock's trial, the marital communications privilege could have applied to Mrs. Brock's testimony that he told her to take two guns from their home and put them in a car. It would not have applied to her testimony about Mr. Brock handling the guns or shooting possums.⁴¹³⁴

Not all communications between spouses, even if intended to be confidential are covered; there is an exception for communications in furtherance of joint participation in a crime.⁴¹³⁵

The privilege is waivable only by the spouse making the communication, and like the attorney-client privilege, the presence of some person other than the married parties who is capable of understanding the communications will waive the privilege.⁴¹³⁶ It is commonly stated that the waiver must be knowing and voluntary, but this means only that

⁴¹³¹ See also *Blau v. United States*, 340 U.S. 332, 333 (1951).

⁴¹³² *United States v. Lofton*, 957 F.2d 476, 477 (7th Cir. 1992).

⁴¹³³ *United States v. Lea*, 249 F.3d 632, 641 (7th Cir. 2001).

⁴¹³⁴ *United States v. Brock*, 724 F.3d 817, 821 (7th Cir. 2013) (case citation omitted). Note that this inquiry has overtones of the concerns involved in the Fifth Amendment Act of Production Doctrine.

⁴¹³⁵ *United States v. Ramirez*, 145 F.3d 345, 355 (5th Cir. 1998); *United States v. Chagra*, 754 F.2d 1181, 1182 (5th Cir. 1985).

⁴¹³⁶ *Trammel v. United States*, 445 U.S. 40 (1980). Thus, for example, the presence of a child of the marriage might waive the privilege if the child were of an age to be able to understand it. In *Trammel*, the communication was in writing which had been transcribed by a stenographer. Held, not a confidential marital communication. See also *United States v. Brock*, 724 F.3d 817 (7th Cir. 2013) (waiver at earlier stage of judicial proceeding is effective for later stage).

the holder must realize that the once-confidential communication is being revealed. But if the holder intends to disclose the privileged material, even without realizing the impact of the disclosure on the privilege, then there is a waiver.⁴¹³⁷

The privilege survives the marriage.⁴¹³⁸

C. Spousal Testimonial Privilege.

The spousal testimonial (sometimes called the spousal immunity privilege, adverse testimony privilege, or spousal immunity) protects a witness spouse from giving compelled adverse testimony against the other spouse in a criminal proceeding. The predicates for the privilege are: (1) at the time of communication there must have been a marriage recognized as valid by state law; (2) the privilege applies only to utterances or expressions intended by one spouse to convey a message to the other, and (3) the communication must be made in confidence.⁴¹³⁹ The privilege must be asserted by the witness spouse; the defendant spouse is not permitted to assert it as a bar to the witness spouse's testimony if the witness spouse is willing to testify.⁴¹⁴⁰ The notion is that, if the witness spouse is willing to testify against the defendant or target spouse, the marriage is already in disarray and no societal benefit is furthered by permitting the defendant or target spouse to prevent the testimony of the witness spouse. Further, since the purpose of the privilege to protect marital harmony, the privilege is not available after divorce. The defendant spouse may, of course, assert the marital communications privilege to prevent the witness spouse from testifying about confidential communications during the marriage.

One important context in which the assertion of spousal testimonial privilege created landmark constitutional law is in *Crawford v. United States*, 541 U.S. 36 (2003). In that case, the wife gave a taped statement to the police shortly after an assault on a third party. In the interview in which she made the statement, both the husband the wife had been given standard *Miranda* warnings but neither asserted privileges of any sort, much less that spousal testimonial privilege. At the husband's criminal trial, the husband invoked the spousal testimonial privilege to prevent the wife from being compelled to testify. (Note that, under Washington state law, the husband could prevent the testimony, contrary to the rule in federal courts noted above that only the witness spouse may invoke this privilege.) The state then successfully moved, over the husband's objection, to enter the statement in evidence. The Washington Supreme Court sustained the use of the statement based on a hearsay analysis that then was materially coterminous with the right of confrontation—i.e., the statement had indicia, referred to as guarantees of trustworthiness, of reliability so as to clear a hearsay / Confrontation Clause hurdle. The issue upon which the Supreme Court digressed was whether the use of the statement violated the husband's Sixth Amendment right to be "confronted with the witnesses against him." Specifically, the Court reimaged and rewrote Confrontation Clause analysis. The right to confrontation where successfully asserted to prevent an out of court

⁴¹³⁷ *United States v. Brock*, 724 F.3d 817 (7th Cir. 2013) (internal quotes and citations omitted).

⁴¹³⁸ *United States v. Entekin*, 624 F.2d 597, 598 (5th Cir. 1980).

⁴¹³⁹ *United States v. Porter*, 986 F.2d 1014, 1018 (6th Cir. 1993).

⁴¹⁴⁰ *Trammel v. United States*, *supra*.

statement from coming in operates like a privilege—i.e., it results in denying the factfinder the right to otherwise available evidence in the truth finding process. The Confrontation Clause is nevertheless not normally perceived as a privilege, so I won't further digress here on the Confrontation Clause as a privilege. (Bottom line, the Court held that the use of the statement violated the Confrontation Clause.)

1. Examples.

To use a stark nontax example, assume the unlikely case that (i) a wife observes her husband shoot and kill a person with a gun and (ii) later, after all the immediate events of the shooting are in the past, the husband tells her that he intended to kill the person when he shot him. If the wife were called to testify against her husband in a criminal proceeding, the wife could assert the spousal testimonial privilege to avoid her compelled testimony but the husband could not assert the spousal testimonial privilege if she were otherwise willing to testify. However, even if she were otherwise willing to testify, the husband could invoke the spousal communications privilege to prevent her testimony about the subsequent communications between them.

To use a closer to home but analogous tax example, assume that (i) after signing a joint return, the wife gave the return to her husband, and the wife observed the husband writing his signature on the return, depositing the signed return in an envelope and dropping the envelope with the return in a mailbox; and (ii) the husband later admitted to the wife that he had fraudulently omitted some income from the return. In a later criminal trial, the Government wants to have the wife testify to these matters. The wife could assert the spousal testimony privilege to avoid her compelled testimony but could testify if she chose to. The husband could invoke the spousal communications privilege to prevent her from testifying as to the confidential communications about his fraudulent intent in omitting income from the return.

I have used the combination of these privileges in a criminal investigation where I represented the husband who was the sole target of the investigation and also represented the wife who the IRS CI agent summoned to appear solely as a witness in the investigation of her husband. As my opening salvo monologue to the CI agents, I pronounced that (i) the husband and the wife each asserted the spousal communications privilege as to their respective communications to each other and (ii) the wife asserted the spousal testimonial privilege to being forced to testify in a proceeding against her husband's criminal interests. I even instructed the witness not to answer any questions. Indeed, I did not even let her testify as to her name or other such nonincriminating information because the spousal immunity privilege is a blanket privilege. I "testified" to the fact that the person in the room with me and the CI Agents was the wife who had been summoned to appear, but I did not let her verbally testify to that effect. The CI agents present were not pleased but could do nothing about it.

To put this anecdotal experience in perspective, in my experience, it is rare indeed that a spouse will be called in a criminal investigation of the other spouse where the parties are still married. In a tax setting, it may not at all be clear that the purported witness is or could not be at

criminal jeopardy and thus have the additional privilege of the Fifth Amendment that would likely be asserted. But, even where it may be clear that a spouse might not have a Fifth Amendment privilege, the IRS in investigation usually does not call an existing spouse.

VII. The Limits of Privileges - Tax Accrual Workpapers.

The Courts have resisted expanding the common-law privileges that are available even when strong policy arguments are made that privileges should be available. Courts thus routinely reject the existence of an accountant/client privilege even though one may exist under state law. *Couch v. United States*, 409 U.S. 322 (1973). In *United States v. Arthur Young & Co.*, 465 U.S. 805 (1984), the IRS issued a summons to the taxpayer's independent certified public accountants to obtain the information and documents behind the tax reserve reported on the taxpayer's certified financial statements.

At this point, I should introduce the background that helps explain the law and IRS policy and practice in this area.⁴¹⁴¹ Publicly held companies prepare and file public financial statements that report the financial results of their operations for a period. The financial statements include a profit and loss statement for a period (a year period for the major filings), as well as an ending balance sheet, and extensive notes to assist in making the statements comprehensible. In reporting a result for the period, a company must accrue as expenses liabilities that arose during the period and, on the ending balance sheet, must show any accrued but unpaid liabilities. Specifically, with respect to transactions with favorable tax aspects that might otherwise be reflected as a benefit on the financial statements, reserves must be accrued to reflect the probability that the benefits may not be ultimately sustained. In making a decision whether and how much to reserve for such unpaid potential liabilities, a company internally will prepare workpapers that back up its decisions. Similarly, when the independent auditor then attests the financial statements, the auditor prepares audit workpapers that back up the attestation. The company's and the auditor's workpapers underlying that type of liability or reserve are called "tax accrual workpapers" or some variation of that term (including audit workpapers).⁴¹⁴² The tax accrual and audit workpapers should be

⁴¹⁴¹ See *Wells Fargo & Company v. United States*, 2013 U.S. Dist. LEXIS 79814 (D. Minn. 2013) for a detailed discussion of the jargon and application in a particular large and aggressive taxpayer setting.

⁴¹⁴² IRM 4.10.20.1.1 (07-12-2004), Definitions, offers the following:

The term "tax accrual workpapers" refers to those audit workpapers, whether prepared by the taxpayer, the taxpayer's accountant, or the independent auditor, that relate to the tax reserve for current, deferred and potential or contingent tax liabilities, however classified or reported on audited financial statements, and to footnotes disclosing those tax reserves on audited financial statements. These workpapers reflect an estimate of a company's tax liabilities and may also be referred to as the tax pool analysis, tax liability contingency analysis, tax cushion analysis, or tax contingency reserve analysis. The name given the workpapers by the taxpayer, the taxpayer's accountant, or the independent auditor is not determinative.

And

These are workpapers created by or for the independent auditor. They are retained by the independent auditor and may be shared with the taxpayer. These workpapers include information about the procedures followed, the tests performed, the information obtained, and the conclusions reached pertinent to the independent auditor's review of a taxpayer's financial statements. Audit workpapers

(continued...)

distinguished from the “tax reconciliation workpapers” which reconcile the financial reporting to the tax return.⁴¹⁴³ The tax reconciliation workpapers are not tax accrual or audit workpapers, because they are not prepared by the company in making the financial statements or by the independent accountants in attesting them. “Tax reconciliation workpapers should be requested as a routine matter at the beginning of an examination. Ordinarily, tax reconciliation workpapers are prepared and provided by the taxpayer.”⁴¹⁴⁴

The tax accrual workpapers should provide the detail behind the tax reserve on the audited financial statements and thus identify the taxpayer's material risky tax positions. Particularly since the combination of the Enron/Worldcom scandals and the abusive corporate tax shelters, companies preparing and independent accountants attesting company financial statements are paying greater attention to tax accrual work papers. Those workpapers could be the “mother lode” for IRS auditors, providing a much easier roadmap for audit.⁴¹⁴⁵ Although not presaging these developments, the accountants in *Arthur Young* argued that they should have a privilege from disclosing such information and documents because of the importance of certified financial statements to the market economy. Denying a privilege, they urged, would result in important information being withheld from the auditors and the quality of and public confidence in financial statements would suffer, with potential dramatic impact on public markets. In other words, the accountants urged, there were countervailing public policy arguments for allowing a privilege in this limited situation even if there were federally recognized accountant/client privilege generally. The Supreme Court rejected the argument, simply because the courts could not create a new privilege not allowed at common law or allowed by Congress.

Although *Arthur Young* was a taxpayer defeat in the Supreme Court, I commend the case to you for two reasons. First, it illustrates the lawyers' creativity in urging a new privilege with some degree of success before the Supreme Court. The Supreme Court does not take many tax cases, so success prior to that stage is usually the end of the matter. Second, it illustrates that despite a seeming loss in Court, the policy arguments made can still have an impact in administrative practice. An IRS agent concerned about efficiency could simply take *Arthur Young* at face and routinely request or summons the tax accrual workpapers as the first order of business in an audit. The audit plan and resulting audit would be far more efficient. On the other hand, as the taxpayers' lawyers

⁴¹⁴²(...continued)

may include work programs, analyses, memoranda, letters of confirmation and representation, abstracts of company documents, and schedules or commentaries prepared or obtained by the auditor. These workpapers provide important support for the independent auditor's opinion as to the fairness of the presentation of the financial statements, in conformity with generally accepted auditing standards and generally accepted accounting principles.

⁴¹⁴³ Tax reconciliation workpapers are defined by IRM 4.10.20.1.1 (07-12-2004), Definitions, as workpapers that are used in assembling and compiling financial data preparatory to placement on a tax return. These papers typically include final trial balances for each entity, a schedule of consolidating and adjusting entries, and information used to trace financial information to the tax return. Any tax return preparation documents that reconcile net income per books or financial statements to taxable income are also tax reconciliation workpapers.

⁴¹⁴⁴ IRM 4.10.20.2(2) (05-04-2017), Service Policy for Requesting Tax Reconciliation Workpapers (but permitting some redactions) . See also Bret Wells, Voluntary Compliance, This Return Might Be Correct, But Probably Isn't, 29 Va. Tax Rev. 645, 675 (2010).

⁴¹⁴⁵ See *Wells Fargo & Company v. United States*, 2013 U.S. Dist. LEXIS 79814 (D. Minn. 2013) (citing *Arthur Young* for the proposition that they can be helpful to the IRS).

urged in *Arthur Young*, that easy access would discourage corporate taxpayers from making adequate disclosures to their public auditors and the public market system would be negatively impacted because the quality of financial statements would suffer. The IRS realized that, should it exploit its victory in *Arthur Young* by routine request for tax accrual workpapers, Congress might well act to take away its victory if it felt the public markets would be negatively impacted. Accordingly, the IRS has adopted policies exhibiting considerable restraint with respect to tax accrual workpapers. (See discussion beginning p. 866.)

Since the high profile financial accounting disasters leading to the Sarbanes-Oxley Act⁴¹⁴⁶ and not unrelated corporate tax shelter disasters, the IRS has relaxed its policy of restraint. Sarbanes-Oxley (sometimes referred to as SOX) requires increased independent accountant due diligence for attested financial statements, which means more detailed audit workpapers (including tax accrual workpapers). For example, focusing on the adequacy of corporation's tax reserves, auditors have begun demanding to see legal advice rendered to the corporation regarding their liabilities. I discussed above the interpretation known as Fin 48 that governs financial reporting of uncertain tax positions. Obviously, this quantification process required to underlying make the Fin 48 disclosures is part of the tax accrual workpapers and can be the mother lode to the IRS.

Although the Supreme Court in *Arthur Young* declined to create a new privilege, it left the existing privileges intact. A large taxpayer, Textron, resisted an IRS summons of its accrual workpapers. In the ensuing summons enforcement proceeding, the district court held that (1) the corporation had waived any attorney-client privilege for its tax accrual workpapers prepared by or under the direction of the corporation's lawyers because it had shown the workpapers to its auditors, but (2)(a) the work papers qualified for the work product doctrine / privilege and (b) Textron had not waived the work product "privilege" by showing its tax accrual workpapers to the auditors because that showing did not defeat the purpose of the work product doctrine / privilege.⁴¹⁴⁷ On the Government's appeal, the First Circuit panel (three judges) originally hearing the case held that the work product doctrine could prevent compelled disclosure since the workpapers were prepared "in anticipation of litigation," adopting a more taxpayer friendly approach to the work product doctrine than the Fifth Circuit.⁴¹⁴⁸ The First Circuit panel further held that the company's disclosure of the tax accrual workpapers to its auditor did not per se constitute a waiver of the work product privilege, because the auditor itself was not a potential adversary; the panel, however, would have remanded for the district court to make further findings as to whether disclosure to the auditor would make the auditor a conduit to a potential adversary which might defeat the work product doctrine. The panel finally held that, since per *Arthur Young* the auditor's tax accrual workpapers were not subject to any privilege or the work product doctrine, the district court on remand should determine whether the company had the right to obtain the auditor's tax accrual workpapers so that a summons to the

⁴¹⁴⁶ Sarbanes-Oxley Act of 2002, P.L. No. 107-204, 116 Stat. 745.

⁴¹⁴⁷ *United States v. Textron Inc.*, 507 F. Supp. 2d 138, 142-143 (D. R.I. 2007), which was subsequently reversed in *United States v. Textron*, 577 F.3d 21 (1st Cir. 2009)(en banc), cert. denied 176 L. Ed. 2d 1219 (5/24/10); see also *Regions Financial Corp., et al. v. United States*, 2008 U.S. Dist. LEXIS 41940 (S.D. Ala. 2008), which the Government appealed but the taxpayer settled before the court of appeals decided the case.

⁴¹⁴⁸ *United States v. Textron*, 553 F.3d 87 (1st Cir. 2009), reversed 577 F.3d 21 (1st Cir. 2009)(en banc), cert. denied 176 L. Ed. 2d 1219 (5/24/10). In the panel opinion, the panel rejected the Fifth Circuit's stricter test—the "because of" test—in *United States v. El Paso Co.*, 682 F.2d 530 (5th Cir. 1982).

company for tax accrual workpapers included compulsion to obtain and produce the auditor's workpapers.

This *Textron* panel decision was viewed as a major defeat for the IRS because it appeared to offer taxpayers in the Circuits with the more lenient work product test a roadmap to insulate their workpapers from the IRS. This defeat for the Government's policies on obtaining work papers appeared to offer an end-run around the Government victory in *Arthur Young*. For that reason, the Government petitioned for rehearing en banc and the petition was granted.⁴¹⁴⁹ On rehearing en banc, the First Circuit reversed, holding that the workpapers did not qualify for the work product privilege because they were prepared not for the litigation but for the audit certification.⁴¹⁵⁰ The decision, rendered en banc in a 3 - 2 split by the full court, reverses the prior panel's decision (a 2 -1 split). I eschew a technical analysis here, but note the quote from the majority en banc decision pretty much sums it up:

Textron apparently thinks it is "unfair" for the government to have access to its spreadsheets, but tax collection is not a game. Underpaying taxes threatens the essential public interest in revenue collection. If a blueprint to Textron's possible improper deductions can be found in Textron's files, it is properly available to the government unless privileged.⁴¹⁵¹

Bottom-line in terms of technical analysis, the *Textron* en banc decision determined that the tax accrual workpapers were not work-product—"the *Textron* workpapers were independently required by statutory and audit requirements and [therefore] that the work product privilege does not apply."⁴¹⁵²

Then, in *United States v. Deloitte*, 610 F.3d 129 (D.C. Cir. 2010), the Court of Appeals took a more taxpayer-friendly approach to the work product privilege in the context of tax accrual workpapers. The court concluded that the work product privilege could apply even if the memorandum in question was prepared by the outside auditor rather than the client and "was generated as part of the routine audit process, not in anticipation of litigation." The memorandum in question was an auditor memo of a meeting among the client, the client's outside attorneys and the auditor to discuss litigation which, of course, must be reserved and attested on the financial statements. Applying the "because of" standard, the Court said that the memorandum did include the thoughts and analyses of outside counsel which existed because of the litigation and that would likely qualify for the work product privilege, but the memorandum also might include information that would not qualify for the privilege. The Court further held that the disclosures of documents to the auditors that would, except for the disclosure, constitute work product with respect to the client's dispute with the IRS were not the type of disclosures to an adversary that would waive the work product privilege. In pungent language, the Court said that "we conclude that [the auditor] is

⁴¹⁴⁹ 560 F.3d 513 (1st Cir. 2009).

⁴¹⁵⁰ *United States v. Textron*, 577 F.3d 21 (1st Cir. 2009)(en banc), cert. denied 176 L. Ed. 2d 1219 (5/24/10).

⁴¹⁵¹ *Id.*, at p. 31.

⁴¹⁵² *Id.* at p. 26

not a conduit to [the client's] adversaries.”⁴¹⁵³ Accordingly, the privilege had not been waived by the disclosures to the auditor, but the Court remanded the case for the district court to determine whether any portion of the memorandum contained information that did not qualify for the work product privilege.

VIII. Protecting Information Developed in the Audit (Kovel).

In delivering legal services, an attorney will often need the assistance of non-lawyers who will become privy to confidential information. At its most basic level, non-attorney personnel in the lawyer's firm—paralegals and other assistants, secretaries, etc.—will learn the information, either from the client with whom they interface, from the lawyer or from just handling the documents related to the engagement. Disclosures of such information to these personnel will not constitute a waiver of any privileges that may otherwise apply.

Often, however, the attorney will find it helpful to engage personnel outside the firm. For example, where the client is not an English speaker or is not a native English speaker, effective communications between the client and the lawyer may require an interpreter who thereby becomes privy to confidential client communications.⁴¹⁵⁴ Another example: often in a tax engagement, an attorney will hire an outside accountant to assist the lawyer in delivering legal services to the client which will require that the accountant receive client communications, either directly from the client or from the lawyer. The traditional method by which such client communications disclosed to the outside expert without waiving the attorney-client privilege is with an arrangement whereby the lawyer engages the outside personnel to become part of the team delivering legal services to the client.

This procedure was approved in *United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961). *Kovel* is now shorthand for the concept. The engagement for such legal related services is now commonly called a *Kovel* engagement, and the service provider is called a *Kovel* accountant or whatever is appropriate for the nature of the services. Here, as in many areas of the law, it is imperative to do it right.⁴¹⁵⁵

The *Kovel* arrangement is just a logical subset of the attorney-client privilege. So, its parameters are set by the attorney-client privilege discussed above.⁴¹⁵⁶ However, the following key points to keep in mind in using the arrangement.

⁴¹⁵³ *United States v. Deloitte LLP*, at p. 141.

⁴¹⁵⁴ Martin Schainbaum, *The Scope and Limitations of the Kovel Accountant*, 40 *Champion* 26 (2016).

⁴¹⁵⁵ See generally Martin Schainbaum, *The Scope and Limitations of the Kovel Accountant*, 40 *Champion* 26 (2016); and John A. Townsend, *The Accountant's Role—and Risks—in Kovel*, 2 *Tax Practice & Procedure* No. 4 p. 20 (Aug-Sept. 2000); for an example of doing it wrong in a case where the parties could have well afforded to do it right, see *Cavallaro v. United States*, 284 F.3d 236 (1st Cir. 2002); see also *United States v. Adlman*, 468 F.2d 1495 (2d Cir. 1995) which is discussed below in this section.

⁴¹⁵⁶ See e.g., *Cavallero v. United States*, 284 F.3d 236, 245 (1st Cir. 2002) (quoting Wigmore's classic definition of the attorney-client privilege). The need for the Kovel expert for effective communications with the client must be more than just useful and convenient. *Id.*, p. 249.

First, substantively, the outside expert must be necessary or highly useful to the process of effective client communication for the delivery of legal services.⁴¹⁵⁷ The confidential attorney-client information imparted to the outside expert will be privileged if necessary for effective representation.⁴¹⁵⁸ Note, in this regard, that the work of the outside expert may be cloaked with the work product privilege whether his work qualifies for the attorney-client privilege, and often for the accountant's work, work product is the more appropriate privilege because the work may be unrelated to client communications and effective representation with respect to client communications.

Second, it is better form for the attorney to engage the *Kovel* expert rather than having the client do so. Some cases will honor the *Kovel* claim for client-engaged experts,⁴¹⁵⁹ but establishing the required nexus between the *Kovel* expert and the attorney can be dicier where the attorney is not involved in the engagement. The better part of wisdom is to avoid this issue by doing it right in the first place. Good lawyers will engage the expert, often in a three-way agreement among the lawyer, the expert and the taxpayer. A nuance of this consideration is how the *Kovel* expert's billing is handled. Some attorneys have the *Kovel* expert to bill the law firm, with the law firm then passing the cost to the client.⁴¹⁶⁰ Others have the *Kovel* expert bill the client for direct payment by the client, but only after the lawyer reviews and approves the bill first. Either way should work. However, under a lawyer's state bar ethical rules, the lawyer usually has responsibility to ensure that the expert's fees—which are fees for legal services under the construct—are appropriate. So, I always require that the expert present the proposed fees to me for review and approval before they are billed.

Third, a valid *Kovel* expert can involve any type of expert needed for legal representation and communication with the client—not just the accountant. For example, media experts used by the attorneys in providing representation can qualify for the privilege under a *Kovel* agreement.⁴¹⁶¹ I have engaged experts for translation and even effective communication purposes where the client had another primary language.⁴¹⁶²

Fourth, as in *Kovel*, the attorney need not be present when the *Kovel* expert and the client are meeting in furtherance of the expert providing the assistance to the lawyer.⁴¹⁶³

Fifth, potential problems are encountered in the *Kovel* engagement of an accountant that has been a long-term accountant for the taxpayer or provides ongoing non-legal services for the

⁴¹⁵⁷ *Cavallero v. United States*, 284 F.3d 236, 247-248 (1st Cir. 2002) (citing *Kovel*).

⁴¹⁵⁸ *United States v. Schwimmer*, 892 F.2d 237, 243 (2d Cir. 1989).

⁴¹⁵⁹ E.g., *United States v. Judson*, 322 F.2d 460 (9th Cir. 1963).

⁴¹⁶⁰ Martin Schainbaum, *The Scope and Limitations of the Kovel Accountant*, 40 *Champion* 26, 28 (2016). Schainbaum states that “in almost all cases,” the law firm should pay the accountant. I am not convinced that this is required.

⁴¹⁶¹ *In re: Grand Jury Subpoenas Dated March 24, 2003*, 265 F. Supp. 2d 321 (S.D. N.Y. 2003).

⁴¹⁶² In one case, I engaged a family member who was an effective communicator both in English and Spanish, where the client was the mother whose native language was Spanish, could not speak English well, and straight or literal translation would have been less effective. The son's services assured me that the client was communicating with me as effectively as possible and that I was communicating with her as effectively as possible.

⁴¹⁶³ *In re: Grand Jury Subpoenas Dated March 24, 2003*, 265 F. Supp. 2d 321, 331 (S.D. N.Y. 2003).

taxpayer. The threshold problem is that it might be difficult to distinguish between what the accountant knows outside the *Kovel* engagement and what he or she knows only within the *Kovel* engagement. Using the historical accountant requires that extra steps be taken to assure that the information related to the *Kovel* engagement is clearly separate from the information learned in the accountant's other engagements. Consider a prominent case from the 1990s⁴¹⁶⁴ involving a large corporation that engaged a large accounting firm to render advice on a sensitive reorganization issue. The officer in the corporation who engaged the accountants was a lawyer who, of course, rendered legal services to the corporation. By having clear understandings and clear responsibilities, the lawyer could have "Kovelized" the accountants. He did not do that, however, and the engagement was treated as just a continuation of the accountant's historical accounting services for which there is no privilege. When the IRS audited, the IRS wanted to look at the planning memoranda. Bottom-line, the Second Circuit held that the taxpayer had not satisfied its burden to establish that the accountants had been engaged in the rendering of legal services through an attorney for the taxpayer. Like I say, with a little attention to detail, for that type of planning transaction, the accountant could have easily been Kovelized. The attention to detail would have been to prepare a *Kovel* agreement clearly delineating that the services would be rendered to the corporate attorney for legal advice to the corporation, to require the accountants to treat the engagement separately (e.g., separate billing and maintenance of separate privileged files within the accounting firm), and to have the corporate attorney as the conduit through which all advice flowed.

Sixth, one of the most nettlesome issues in dealing with the attorney-client privilege in a tax practice, exemplified by Judge Posner's visceral reaction in *Frederick*, is to distinguish between providing legal services that qualify for the privilege and providing other types of services which do not qualify for the privilege. It is always the client's obligation to establish the privilege. This means that where an attorney or an expert serves in more than the capacity of just serving as lawyer or as an expert rendering advice to assist in the legal representation, respectively, the client may not be able to establish the privilege. This issue often arises in a situation of the filing of an amended return.

If an accountant is engaged by the attorney to prepare the amended return that, after review by the attorney, may be filed by the client, does the filing of the amended return waive the privilege for all communications to the accountant or alternatively, at least as to information that flowed from the client to the accountant /return preparer that is incorporated, directly or indirectly, on the return, was there ever an expectation of confidentiality, a basic requirement for the privilege? This is just to say that, just as the lawyer who appears in a dual role a la *Frederick* and *Bornstein* must be careful what he does, so too must the lawyer pay close attention to the *Kovel* expert's services. The lawyer may not want everything the accountant learns to be an open book to the IRS if it inquires. This particularly should be considered where the lawyer engages an accountant under a *Kovel* arrangement to prepare amended or delinquent returns in order, for example, to qualify for the voluntary disclosure policy. The filing of the returns will mean that the *Kovel* expert's kimono is opened a bit, at least as to the items on the return, under the traditional attorney-client analysis. The question is whether the IRS can then force the full Monty. (OK, I recognize I am mixing my

⁴¹⁶⁴ *United States v. Adlman*, 68 F.3d 1495 (2d Cir. 1995); subsequent opinion *United States v. Adlman*, 114 F.3d 1194 (2d Cir. 1998).

allusions, but you get the point.) A court willing to slice and dice the relationship a la *Bornstein* may save the day for the client, but an unwilling court (or apparently unwilling court) such as Frederick may not. Careful practitioners with clients with large budgets may solve the problem by engaging two separate accountants—one to serve as a pure *Kovel* accountant to gather the information and analyze it and then, in consultation with the attorney, to deliver to the second accountant, not a *Kovel* accountant, only the information for inclusion on the return. The second accountant then prepares the return with knowledge only of that information. So, the theory goes, if the IRS presses, it will only learn from that second accountant only what he knows which is already presented on the return. Whether or not this will work remains to be seen, but in appropriate cases (high risk and sufficient resources) it should be considered.

The IRS has noised about taking a more aggressive stance toward accountants in IRS criminal investigations.⁴¹⁶⁵ It is too early in the cacophony—to date it is just noise—to figure out precisely what the IRS’ attack may be. Obviously, however, the IRS will want to interview accountants who are not wearing a *Kovel* assistant sign on their foreheads, just because they often have information relevant to a tax investigation and, at least in their status as accountant or return preparer, they have no privilege that can be asserted in a criminal investigation. (Remember the FATP does not apply in criminal investigations.) Indeed, that is precisely why one of the first CI summonses or grand jury subpoenas that are issued are to the accountants. But, once that accountant is summoned or subpoenaed, the lawyer engaging the accountant (or the accountant) may spring the attorney-client privilege in its *Kovel* iteration. The Government will not be pleased because the very nature of any privilege—particularly an absolute one like the attorney client privilege—is to bar the Government from getting the information. From the reported cases, the Government does not seem to have aggressively tested the validity of the assertion of the privilege in the *Kovel* context. I think the warnings now issuing forth are that the Government will pick out some very extreme cases to test the limits of the *Kovel* privilege.⁴¹⁶⁶

⁴¹⁶⁵ See Sam Young, Government Will Subpoena Accountants in Criminal Tax Prosecutions, Official Warns, 2010 TNT 91-4.

⁴¹⁶⁶ One context of the *Kovel* privilege has bothered some practitioners. The context is to hire a *Kovel* accountant (either the historical one or a new one) to handle an “egg-shell” civil tax audit—one having the potential to turn criminal if the agent asks the right questions or stumbles on the right documents. Managing the audit so as to mitigate that risk—provided that no inappropriate action (such as deception) is undertaken in the process—is what skilled attorneys do. But the attorney might believe that he or she can best mitigate the risk by not becoming visible to the IRS agent, but instead deputizing an accountant via *Kovel* to be the representative of the client in the investigation. Many attorneys will enter a *Kovel* agreement with the accountant and then have the accountant file a Form 2848, power of attorney, to represent the client in the audit, without disclosing that the accountant is really acting as the deputy—or agent—of the attorney. The concern some practitioners have over this behavior is that it may be deceptive conduct. Be sure and think this through before doing it. Indeed, if you do think it through, you just might not do it.

Ch. 16. Partnerships and S Corporations.

I. Introduction.

A. TEFRA (For Partnership Tax Years Beginning Before 2017).

The preceding materials deal principally with a taxpayer who owes a tax liability and how the system interfaces with that taxpayer in reporting tax liability, determining additional tax liability through audits, appeals and litigation, and assessing and collecting any additional liability or refunding any overpayment. In other words, we have dealt with liabilities between a **tax payer** and the IRS.

The Code requires certain tax-related reporting by persons and entities that, with respect to the reporting, are not **tax payers**. We covered above certain information reports such as the various Forms 1099 with respect to which the reporters are not tax payers. Historically, within this category of reporting but not tax paying are certain entities that report the results of their operations (income, deduction and credits) and allocate those results to and among other persons who then report their shares so allocated and pay any tax due. The principal such entities were partnerships (including limited liability companies that are treated as partnerships) and S Corporations. The entities in the past were called “flow-through” entities because their component income, deductions, and credits flowed through and were taxed to the partners or shareholders, respectively. In today's world, particularly in the international context, they are referred to as “transparent entities.”

The Tax Equity and Fiscal Responsibility Act of 1982 (“TEFRA”)⁴¹⁶⁷ amended the Code to provide unified audit and litigation procedures for such entities. (I give you the name of the statute because tax practitioners use the acronym TEFRA to identify partnerships and procedures originally enacted by this statute; the Code sections thus added were in Chapter 63, Subchapter C, titled Tax Treatment of Partnership Items, §§ 6221-6234.) The core TEFRA concept was that, with respect to the results of the operations of the partnership, the partnership itself was the audit and litigating unit as to entity level items. When those issues are resolved at the entity level, the results are then allocated out to the owners (partners or shareholders) in their proper shares for those owners to report and pay tax without further ado. (That’s the core concept, but there is a lot of complexity in the application of the core concept.)

To fully understand these provisions, you need a brief introduction to the system pre-TEFRA.⁴¹⁶⁸ Prior to TEFRA, for example, a partnership with 1,000 or more partners might still be audited as an entity since the partnership did file a partnership return that hit the IRS's radar screen. However, while the partnership level audit was proceeding and at its conclusion, the IRS would have to coordinate the results with the 1,000 partners, who might be scattered throughout the country or overseas. Even relatively simple procedural steps—such as assuring that all partners’ statutes of limitations were extended if that became necessary—could be an administrative nightmare,

⁴¹⁶⁷ 96 Stat. 648, Title IV, which has the short name “Tax Treatment of Partnership Items Act of 1982.”

⁴¹⁶⁸ Good introductions and background are found in *United States v. Woods*, 571 U.S. 31, 38 (2013); *Callaway v. Commissioner*, 231 F.3d 106 (2d Cir. 2000) and *Duffie v. United States*, 600 F.3d 362, 365 (5th Cir. 2010) (“Before 1982, examining a partnership for federal tax purposes was a tedious process.”).

since each of the partners needed to be contacted and could make independent decisions as to whether to extend the statute.

The system became stressed, particularly during the partnership tax shelter heyday in the late 1970s and early 1980s where any number of promoters wanting money and taxpayers wanting to avoid taxes were quite willing to exploit the administrative problems. Moreover, each partner could separately litigate his or her liability arising from the partnership's activities leading to the possibility of inconsistent results.

I give an example of this administrative complexity from a case involving a tax shelter partnership in a pre-TEFRA year. In that case, a group of 20 partnerships were involved in the so-called "Elektra-Hemisphere" tax shelter. The IRS audited the partnerships and determined that the partnerships had claimed erroneous tax benefits which it had allocated to and among the partners. The IRS sent notices of deficiency to the partners accordingly. The general partners hired a law firm to represent those partners who desired it to do so. Over 4,000 of the limited partners elected to let the law firm represent them, and the law firm (and its successor) then filed over 17,000 petitions in the Tax Court on behalf of those partners (the larger number being because multiple years were involved and thus multiple notices of deficiency were sent). In all of these multiple proceedings the principal issue was the proper tax results for the partnerships' operations.

The law firm would receive correspondence from the partner including the notice of deficiency and would then file a form petition, changing only the variable information (the name(s) of the petitioner(s), the IRS office issuing the notice of deficiency, the amount of deficiency and penalties asserted against the partner(s), and any other adjustments not arising from the partnerships). The Tax Court then set trials for test cases, and deferred decision on the other cases. Many partners in the deferred cases agreed to be bound by the test case; others did not. The taxpayers lost in the test cases. That resolved the nontest cases wherein the taxpayers had agreed to be bound. The Court then held show cause hearings for the nontest cases wherein the taxpayers had not agreed to be bound, directing them to show cause why the result in their cases would be different than the results of the test cases. These procedures made the best of a bad situation and did bring some degree of order to chaos. But there were inevitable cracks in the process.

Thus, in the case, the taxpayer's accountant without the authority of the taxpayer had routinely sent the notice of deficiency to the law firm which had then routinely filed a petition in the Tax Court on the assumption that it had authority to do so. In fact, the taxpayer had not authorized the filing of a petition. Some 10 years later it surfaced that the taxpayer had never authorized the filing of the petition. The Tax Court held that the petition was invalid. What does that mean? You will recall that, under § 6213(a), the IRS may not assess a tax liability until the Tax Court proceeding has concluded and under § 6503(a)(1) the statute of limitations on assessment is suspended "if a proceeding in respect of the deficiency is placed on the docket of the Tax Court, until the decision of the Tax Court becomes final." During this entire period, the IRS operated on the assumption that a Tax Court proceeding had suspended that partner's statute of limitations. The taxpayer asked the Tax Court to hold, contemporaneously with its holding that a valid petition had not been filed, that the statute of limitations on assessment had not been suspended and thus

prevented any assessment for that pre-TEFRA year. The Tax Court declined to so hold, saying that the issue was not before it.⁴¹⁶⁹ I hope this discussion gives you some idea of the complexities of the system prior to the TEFRA partnership changes.

TEFRA dealt with these administrative problems by enacting unified audit and litigation procedures for partnerships. TEFRA's core principle was that the IRS will audit or otherwise deal with the partnership entity through an authorized representative of the partnership in unified proceedings (audits and litigation) that will determine for all partners the tax results of partnership operations. The tax results so determined will then be administratively allocated to and among the partners in their respective partnership distributive shares for those partners to pay any tax resulting from the allocated items. Significant administrative issues were addressed such as who represents the partnership, whether other partners can participate in the proceedings, how to keep the partners' statutes of limitations from expiring while the entity level unified proceedings are in process, etc. The provisions were quite complex in how they resolved the host of issues involved, but for present purposes I want you to keep the focus on the overarching principle to resolve partnership audits and litigation in unified proceedings at the entity level. With that focus you will understand the basis for Congress's choices of procedures to implement the system.

I deal only with the key administrative TEFRA themes.⁴¹⁷⁰ Because of the complexity and resulting problems in the TEFRA regime, Congress replaced the TEFRA regime with a new regime, called the Centralized Partnership Audit Regime ("CPAR"), applicable to partnership tax years beginning after 2017. Because we are still in the period before the new procedures apply and the TEFRA procedures will in any event continue to play out for audits and litigation well after 2017, I first discuss the TEFRA regime before discussing the new regime.

B. Centralized Partnership Audit Regime ("CPAR") (After 2017).

In 2015, Congress enacted a new audit and litigation regime for partnerships—called the Centralized Partnership Audit Regime ("CPAR")—effective generally for tax years beginning after 2017.⁴¹⁷¹ The TEFRA regime and the related large partnership rules (discussed in detail in the next section) are repealed and replaced with a regime that, where applicable, makes audit adjustments and imposes the resulting tax at the partnership level.

Students using this book might want to just go directly to Section III discussing the CPAR. CPAR is the future (at least until changed) and will have the most impact on students when they enter practice. The discussion of CPAR in Section III begins on p. 954. However, Students and practitioners should be aware that litigation over the TEFRA regime will continue for many years.

⁴¹⁶⁹ I hope you will see that the IRS will argue that the language of the statute authorizes the suspension solely based upon the docketing of the case regardless of lawyer's actual authority to file. See *Eversole v. Commissioner*, 46 T.C. 56 (1966); and *Martin v. Commissioner*, T. C. Memo. 2003-288.

⁴¹⁷⁰ The IRS has identified the general TEFRA procedures and a number of issues in CC-2009-027, published in 2009 TNT 164-5 (8/21/09). This is a worthwhile read.

⁴¹⁷¹ § 1101, The Bipartisan Budget Act of 2015 (H.R. 1315), enacting new Code sections 6221 through 6241.

C. CAVEAT on Code and Regulations Section Under TEFRA and CPAR.

Congress enacted the new CPAR for years beginning after 2017 by (i) removing the TEFRA Code sections (in subchapter C of chapter 63 of the Code) and (ii) adopting in their place new Code sections some of which have the same numbers as the removed TEFRA Code sections.⁴¹⁷² Readers therefore need to be careful in considering partnership audit Code and Regulations citations.⁴¹⁷³

When I discuss the TEFRA provisions (applicable prior to 2017) in Section II of this chapter, I cite to the Code and Regulations sections applicable under TEFRA; when I discuss the new CPAR in Section III I cite to the Code and Regulations sections applicable to CPAR.

II. The TEFRA Regime (Applicable to years PRIOR to 2018).

A. Caveat Regarding Code and Regulations Citations.

Reminder: All Code and regulations citations in this section II are to the TEFRA regime in the Internal Revenue Code prior to adoption of CPAR discussed in Section III.

B. Partnerships Generally.

1. Entities Subject to Procedures.

Partnerships, other than qualifying “small partnerships,” required to file a partnership return are subject to the TEFRA partnership procedures.⁴¹⁷⁴ Partnerships are defined to include “a syndicate, group, pool, joint venture, or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a corporation or a trust or estate.”⁴¹⁷⁵

⁴¹⁷² There are various possible ways in which to make clear whether the Code Section of TEFRA or post-TEFRA. For example, I could include the word TEFRA before each Code section under the TEFRA regime (e.g., TEFRA § 6221 and not include the TEFRA predicate for Code Section in the CPAR regime succeeding TEFRA. I will do that if I have time before the next editions. Some use other techniques to make the difference. E.g., *SNJ Limited v. Commissioner*, 28 F. 4th 936, 940 n 2 (9th Cir. 3/10/22) (“To avoid confusion, this Opinion cites Title 26 of the United States Code prior to TEFRA’s repeal as ‘I.R.C.’ and Title 26 after the repeal as ‘26 U.S.C.’”)

⁴¹⁷³ Section 1101(a) of Bipartisan Budget Act of 2015, Public Law 114-74 (BBA), as amended by the Protecting Americans from Tax Hikes Act of 2015, Public Law 114-113, div Q (PATH Act), and §§ 201 through 207 of the Tax Technical Corrections Act of 2018, contained in Title II of Division U of the Consolidated Appropriations Act of 2018, Public Law 115-141 (TTCA).

⁴¹⁷⁴ § 6231(a)(1)(A). A partnership that is required to file a return but does not is subject to the TEFRA procedures. By contrast, if a partnership return is filed but it is later determined that there was no partnership entity, the TEFRA rules will nevertheless apply. § 6233(a) and Reg. § 301.6233-1(b). Also, some associations—such as joint operating agreements—that might otherwise be treated as partnerships are excluded from the requirement of filing partnership returns and thus are not subject to the TEFRA procedures. See e.g., § 761(a) and Reg. § 1.761-2(a) & (b).

⁴¹⁷⁵ § 761(a); see also § 7701(a)(1) and also Reg. § 1.761-1(a) (cross-referencing Reg. § 301.7701-1, 2 and 3 which includes the definition of partnership under the check-the-box procedures which permit some corporate entities to qualify as partnerships for tax purposes). The statutory definition is not a litmus test of what types of common activity constitute a partnership. In *Commissioner v. Tower*, 327 U.S. 280, 286 (1946), the Court held that a partnership for tax

(continued...)

Small partnerships are exempted from the TEFRA procedures and thus continue to be treated under the prior individual partner audit and litigation rules described in the introduction. A small partnership qualifying for this treatment is a partnership with “10 or fewer partners each of whom is an individual (other than a nonresident alien), a C Corporation, or an estate of a deceased partner.”⁴¹⁷⁶ Husbands and wives (and their estates) are treated as one partner for this purpose.⁴¹⁷⁷ Otherwise qualifying small partnerships may elect to be subject to the TEFRA procedures.⁴¹⁷⁸

Section 6231(g) provides that (i) if the IRS reasonably determines that the TEFRA procedures apply to the partnership, the TEFRA procedures will apply even if that determination is wrong; and (ii) if the IRS reasonably determines that the TEFRA procedures do not apply to the partnership, the TEFRA procedures will not apply if the determination is wrong.⁴¹⁷⁹

2. Partners Subject to the Procedures.

Persons subject to the TEFRA procedures include any partner **in** a partnership and any other person whose income tax liability is determined “in whole or in part, by taking [partnership items] into account directly or indirectly.”⁴¹⁸⁰ Thus, so-called pass-through partners are bound by the unified audit and litigation results. To illustrate, if A, an individual, is a partner in partnership X and partnership X is a partner in partnership Y, A will be affected by determinations made as to partnership Y. In the terminology of the Code, partnership X is a pass-through partner, and A is an indirect partner of partnership Y.⁴¹⁸¹

⁴¹⁷⁵(...continued)

purposes exists when persons “join together their money, goods, labor, or skill for the purpose of carrying on a trade, profession, or business and when there is community of interest in the profits and losses.” The test is factual and an issue of intent (not intent as to the label but intent as to the common activities that together add up to partnership). See *Commissioner v. Culbertson*, 337 U.S. 733 (1949).

⁴¹⁷⁶ § 6231(a)(1)(B). The small partnership exception does not apply if any partner is a “pass-through” partner (such as another partnership, an LLC, etc.) Reg. § 301.6231(a)(1)-1(a)(2). Pass through partner is defined as “partnership, estate, trust, S corporation, nominee, or other similar person through whom other persons hold an interest in the partnership.” The question has arisen whether a single-member pass-through entity which elects to be disregarded under Reg. § 301.7701-3 is also disregarded for this limitation on pass-through partners, so the pass-through entity itself will not be disqualified from the TEFRA procedures. The IRS held that use of the pass-through entity, whether disregarded or not, is disqualifying for the exception, so that the partnership is subject to the TEFRA procedures. Rev. Rul. 2004-88, 2004-2 C.B. 165. The courts sustained that interpretation. *Seaview Trading LLC v. Commissioner*, 858 F.3d 1281 (9th Cir. 2017); and *Mellow Partners v. Commissioner*, 890 F.3d 1070 (D.C. Cir. 2018).

⁴¹⁷⁷ Id.

⁴¹⁷⁸ § 6231(a)(1)(B)(ii).

⁴¹⁷⁹ This provision was added by the Taxpayer Relief Act of 1997, Pub. L. No. 105-34, sec. 1232(a), 111 Stat. at 1023 to provide relief to the IRS for erroneous but reasonable determinations as to status.

⁴¹⁸⁰ § 6231(a)(2).

⁴¹⁸¹ § 6231(a)(9) & (10).

3. Rule of Consistency in Partner Return Reporting.

A partner is required to treat the “flow-through” item on the partner's return consistent with its treatment on the partnership return.⁴¹⁸² The Partnership notifies each Partner of his or her share of partnership items via a Schedule K-1, titled “Partner’s Share of Income, Deductions and Credits,” that the partnership must send annually to each partner. The partner is required to report the items consistently with the Schedule K-1.

If a partner disagrees with the partnership's treatment reflected on the Schedule K-1 and desires to report differently, the partner may either notify the IRS of his or her election to treat a partnership item inconsistently with its treatment on the partnership return,⁴¹⁸³ or file an administrative adjustment request (“AAR”).⁴¹⁸⁴ In either event, the notification or request is filed on the Form 8082, titled “Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR).” Otherwise, if a partner treats items inconsistently with the partnership's treatment of those items, the IRS may assess a deficiency against the partner without any notice, as a “computational adjustment” without issuance of a notice of deficiency and may impose penalties, including the fraud penalty.⁴¹⁸⁵ If the partner so notifies the IRS, the IRS may not adjust the notifying partner’s return reporting the inconsistent treatment unless the IRS conducts a partnership level audit or notifies the partner that that partner’s partnership items will be treated as nonpartnership items subject to audit with respect to that partner’s return alone.⁴¹⁸⁶

4. Unified Partnership Level Proceedings for Partnership Items.

The key administrative concept is the unified proceeding with respect to partnership items. Section 6221 thus states broadly:

Except as otherwise provided in this subchapter, the tax treatment of any partnership item (and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item) shall be determined at the partnership level.

Similarly, Section 6226(f) provides:

⁴¹⁸² § 6222(a).

⁴¹⁸³ § 6222(b). Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR), is used to report the inconsistency. The Form is also used for an Administrative Adjustment Request (“AAR”).

⁴¹⁸⁴ § 6227(a). Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR), is used to request the adjustment. For a rejection of partners changing by amended return with limited disclosure and without filing the Form 8082, see *United States v. Stewart*, 2016 U.S. App. LEXIS 18446 (5th Cir. 2016) (unpublished). The IRS then has the authority to conduct a partnership proceeding or treat the items for which an AAR is filed as nonpartnership items and calculate the tax liability of the partner requesting the AAR accordingly. See § 6227(a). As noted by the Tax Court, the IRS generally opts to conduct a partnership proceeding. *Samueli v. Commissioner*, 132 T.C. 37 (2009) (citing 2 Audit, Internal Revenue Manual (IRM) (CCH), pt. 4.31.4.2.3.1(4), at 10,864 (Sept. 1, 2006)).

⁴¹⁸⁵ §§ 6222(c) &(d) & 6230(a)(1). See *Samueli v. Commissioner*, 132 T.C. 37 (2009).

⁴¹⁸⁶ Reg. § 301.6222(b)-2(a).

A court with which a petition is filed in accordance with this section shall have jurisdiction to determine all partnership items of the partnership for the partnership taxable year to which the notice of final partnership administrative adjustment relates, the proper allocation of such items among the partners, and the applicability of any penalty, addition to tax, or additional amount which relates to an adjustment to a partnership item.

A “partnership item” is a tax item that is “more appropriately determined at the partnership level than at the partner level.”⁴¹⁸⁷ Obviously, the partnership’s income, deductions, and credits are partnership items. Also, partnership level statutes of limitations are partnership items.⁴¹⁸⁸ Partnership level penalty defenses such as partnership level reasonable cause and good faith defenses to a penalty and other penalty defenses (such as IRS failure to meet § 6751(b)’s written supervisor approval defense) are partnership items and must be asserted at the partnership level.⁴¹⁸⁹ For example, whether a general partner acting for the partnership did the necessary diligence and reliance for reasonable cause and good faith with respect to a partnership reporting position is a partnership item determined at the partnership level.⁴¹⁹⁰ (By contrast, as discussed below, individual partner level defenses are not partnership items and are asserted at the partner level.) Whether a partnership is in a trade or business or whether the “partnership lacks economic substance is an adjustment to a partnership item.”⁴¹⁹¹ And some components of partnership outside basis—i.e., the partners’ basis in the partnership interest—can be partnership items if they are more appropriately determined at the partnership level.⁴¹⁹² A partnership’s liability for withholding tax is a partnership item.⁴¹⁹³ A partnership item is determined at the partnership level.

A “nonpartnership item” is one that is “not a partnership item.”⁴¹⁹⁴ Nonpartnership items are determined at the individual partner level and raised by notice of deficiency to the partner. Sometimes this dividing line between items that are to be determined at the partnership level and items that are to be determined at the individual partner level is not so clear and, in such cases, the IRS may protectively proceed both at the partner level via the TEFRA procedures and at the individual level via the notice of deficiency.⁴¹⁹⁵

⁴¹⁸⁷ § 6231(a)(3).

⁴¹⁸⁸ *Bedrosian v. Commissioner*, 940 F.3d 467, 471-472 (9th Cir. 2019) (listing cases).

⁴¹⁸⁹ E.g., as to § 6751(b), see *Ginsburg v. United States*, 17 F.4th 78 (11th Cir. 10/26/21).

⁴¹⁹⁰ *Superior Trading LLC v. Commissioner*, 137 T.C. 70 (2011), aff’d 728 F.3d 676 (7th Cir. 2013).

⁴¹⁹¹ *United States v. Woods*, 571 U.S. 31, 39 (2013). See also FAA 20162901F (3/21/16), concluding that “the determination of whether a partnership is a sham, lacks economic substance, or otherwise should be disregarded for tax purposes is a partnership item,” citing Reg. § 301.6233-1T(a); and *Petaluma FX Partners, LLC*, 131 T.C. 90, 131 (2008), aff’d in part 591 F.3d 649 (2010).

⁴¹⁹² For example, the partner’s basis in the partnership interest is affected by partnership taxable income, nontaxable income, losses and deductions, and share of partnership liabilities. Those items are clearly more appropriately determined at the partnership level. § 705; Reg. § 301.6231(a)(3)-1; *Nussdorf v. Commissioner*, 129 T.C. 30, 42-44 (2007).

⁴¹⁹³ *YA Global Investment v. Commissioner*, 151 T.C.11 (2018).

⁴¹⁹⁴ § 6231(a)(4).

⁴¹⁹⁵ See *Bausch & Lomb Inc. v. Commissioner*, T.C. Memo. 2009-112 (where the IRS took the protective dual positions and, in the Tax Court proceeding regarding the taxpayer’s petition to have the notice of deficiency redetermined, successfully urged that the notice of deficiency was invalid because the matter in dispute between the taxpayer and the IRS was properly to be determined at the partnership level via the TEFRA procedures).

The regulations contain a laundry list of the types of items that are “partnership items” subject to these procedures.⁴¹⁹⁶ Most of these you will easily recognize simply by keeping in mind Congress’ purpose to have a unified proceeding at the partnership level as to items related to the partnership that can reasonably be determined at the partnership level in a single proceeding. Common sense⁴¹⁹⁷ and focus on the purpose of the TEFRA unified proceedings will generate the right result as to what is a partnership item more appropriately determined at the partnership level. Nevertheless, the IRS and the courts continue to struggle with the concept of what is a partnership item.

There is a third category of items—“affected items.” Affected items are a subcategory of nonpartnership items. Affected items are determined at the partner level but may be automatic adjustments as a result of the treatment of partnership items. The unified partnership level proceeding will not determine the affected items for each partner specifically, but the determinations of the partnership items will necessarily also determine the resolution of affected items on the partners’ returns unless they require individualized partnership facts. Thus, there are two types of affected items: (i) those that do not require individualized partnership determinations (sometimes called computational affected items) and (ii) those that do require such determinations (sometimes called noncomputational affected items or factual affected items).⁴¹⁹⁸ Examples of affected items that would not require further partner level determinations are the automatic adjustments that flow from changes in income resulting from the partnership item adjustments (such as allowable medical deductions, etc.). The adjustments for affected items, as well as for the partnership items themselves, are subject to the special statute of limitations for the TEFRA procedures.⁴¹⁹⁹

There is a key exception to the requirement for a notice of deficiency as to penalties where the partner may have partner level defenses. Penalties such as the accuracy related penalties (§ 6662) and the fraud penalty (§ 6663) arising from TEFRA audit adjustments to partnership items were originally nonpartnership items requiring a notice of deficiency to the individual partner after the

⁴¹⁹⁶ Reg. § 1.301.6231(a)(3)-1.

⁴¹⁹⁷ Common sense is an attribute that gets sorely tested in the tax shelter partnerships where even the most outrageous arguments are made to avoid an adjustment.

⁴¹⁹⁸ See *Duffie v. United States*, 600 F.3d 362, 366 (5th Cir. 2010) (adopting opinion of district court attached as an appendix). See CC-2009-11 (3/11/09), published at 2009 TNT 54-19. In *Estate of Keeter v. Commissioner*, T.C. Memo. 2018-191, at *10, the Court said: “There are two types of affected items: one that does not require a partner-level determination and one that does.”

⁴¹⁹⁹ The affected item concept does create some uncertainty as to whether the IRS must make the adjustment under the TEFRA statute of limitations or the partner’s individual statute of limitations. As noted elsewhere, the statute of limitations for partnership related adjustments is the greater of the TEFRA partnership statute of limitations or the partner’s individual statute of limitations. But, if an adjustment is an affected item, it in some circumstances may not be subject to the TEFRA provisions and the partner’s statute of limitations controls even if shorter than the TEFRA statute of limitations. Because of this nuance, the IRS has procedures that require a protective partner level statutory notice of deficiency under the following circumstances (CC-2009-11, reproduced at 2009 TNT 54-19):

If a partner has reported a loss (or reduced gain) on the partner's individual return as a result of having sold the TEFRA partnership interest or an asset distributed by the TEFRA partnership, the IRS should make certain protective assessments to ensure that the assessments are made before the period of limitations on assessment expires. Given the different types of affected items -- those that can be directly assessed and those requiring determinations at the partner level -- the IRS may not know with certainty how a court will classify the affected item.

partnership level proceedings were concluded.⁴²⁰⁰ This allowed each partner to contest the penalties separately from the unified partnership proceeding. This has some logic to it. For example, you will recall that there is a reasonable cause exception (§ 6664(c)) that relates to the partner's individual level attributes. Some partners may qualify under this exception, while others may not. Another example is the substantial understatement penalty that requires certain threshold dollar amounts that may be applied only at the partner level and, as to tax shelters, only applies if the partner did not reasonably believe that he or she would not prevail.

In 1997, however, Congress amended the TEFRA procedures to provide that penalties related to partnership item adjustments are determined in the unified partnership level proceeding and that, therefore, no notice of deficiency need be issued to the partner.⁴²⁰¹ The individual partner is not permitted to raise his or her individual partner-level defenses to the penalty in the partnership proceeding but may then contest the penalty after assessment either in a refund proceeding⁴²⁰² or in a CDP proceeding.⁴²⁰³ The Regulations assert that, although the accuracy related penalty itself is determined at the partnership level, a partner's individual reasonable cause and good faith exception must be asserted at the partner level in a post-TEFRA proceeding refund suit based on factors unique to the partner.⁴²⁰⁴ (In Code-speak, this means that liability under § 6662 is determined at the

⁴²⁰⁰ *United States v. Woods*, 571 U.S. 31, 39 (2013). Some components of penalties were, however, partnership items that were and continue to be determined at the partnership level. For example, the issue of whether there substantial or gross valuation misstatement for purposes of the accuracy related penalty for substantial or gross valuation misstatement in § 6662(b)(5), (g) and (h) is properly determined at the partnership level. *RERI Holdings I, LLC v. Commissioner*, 149 T.C. 1 (2017), aff'd sub nom. *Blau v. Commissioner*, 924 F.3d 1261 (D.C. Cir. 2019) (citing Reg. § 1.6662-5(h)(1), and 1.6662-4(f)(5)). This would still allow the partner to assert partner level defenses, such as the dollar limitation and partner-level reasonable cause, subject to the requirement in § 6664 with respect to charitable contributions requiring a qualified appraisal and individual taxpayer investigation of the value of the property.

⁴²⁰¹ §§ 6221 and 6230(a)(2)(A)(i); see also § 6226(f). This procedure is explained and applied in *United States v. Woods*, 571 U.S. 31 (2013); and *Highpoint Tower Technology, Inc. v. Commissioner*, 931 F.3d 1050 (11th Cir. 2019); see also *Fears v. Commissioner*, 129 T.C. 8, 10 (2007), *Domulewicz v. Commissioner*, 129 T.C. 11, 23, and *Bedrosian v. Commissioner*, T.C. Memo. 2007-376.

Perhaps obvious from the statement of the rule—that it applies to TEFRA audit adjustments of partnership items, it necessarily follows that where there is no TEFRA audit adjustment to partnership items, the rule does not apply. Thus, where a partner initially failed to report consistently with the partnership return or file a notice of inconsistent treatment, the IRS must assert the penalty at the partner level via notice of deficiency and not at the partnership level. *Malone v. Commissioner*, 148 T.C. 372 (2017).

The IRS's guidance on the application of § 6751(b)'s supervisor written approval requirement for penalties states that evidence of compliance should be introduced in TEFRA cases at the partnership level proceeding even if the penalties are not contested. CCN 2018-006 (6/6/18),

⁴²⁰² § 6230(c)(1)(C), (c)(3) & (c)(4); *Fears v. Commissioner*, 129 T.C. 8 (2007); Reg. § 301.6221-1(c) & (d); This procedure is explained and applied in *United States v. Woods*, 571 U.S. 31 (2013); and *Highpoint Tower Technology, Inc. v. Commissioner*, 931 F.3d 1050 (11th Cir. 2019) (relying on *Woods*). See also *Klamath Strategic Inv. Fund v. United States*, 568 F.3d 537, 547 (5th Cir. 2009); and *Santa Monica Pictures, LLC v. Commissioner*, T.C. Memo. 2005-104, at *280 n. 195, determining at the partnership level whether there was substantial authority and a reasonable belief that the tax shelter item would more likely than not prevail for purposes of the substantial understatement penalty but noting that matters uniquely determined at the partner level (e.g., whether the understatement is substantial) can be presented in a subsequent refund suit.

⁴²⁰³ *McNeil v. Commissioner*, 148 T.C. 481 (2017); and *Highpoint Tower Technology, Inc. v. Commissioner*, 931 F.3d 1050, 1060 n8 (11th Cir. 2019).

⁴²⁰⁴ Reg. § 301.6221-1(c) and § 301.6221-1(d) (both say that contesting the penalties at the partner level may be done in a refund suit; neither mention the CDP alternative which may be available). For example, the determination of whether the substantial or gross valuation misstatement applies is made at the partnership level. *RERI* (continued...)

partnership level,⁴²⁰⁵ but any partner having a partner-level § 6664 good faith and reasonable cause defense may assert them at the partner level in a refund suit⁴²⁰⁶ or, as noted, possibly in a CDP proceeding.) If there is a reasonable cause and good faith defense “based on facts and circumstances common to all partners, such as the reliance of a partnership's managing partner on the advice of counsel,” that is a partnership level defense rather than a partner level defense.⁴²⁰⁷

Any other item that requires determinations to be made at the partner level, however, requires a notice of deficiency to the partner.⁴²⁰⁸ In addition, a spouse claiming innocent spouse treatment as to the item may invoke administrative and Tax Court consideration of the claim.⁴²⁰⁹

In certain circumstances a partnership item or items may be converted into a nonpartnership item or items.⁴²¹⁰ The conversion excepts the items from the unified audit proceedings and subjects it instead to partner level audit, including the notice of deficiency procedures covered above.⁴²¹¹ Such a conversion can occur, for example, as to a partner subject to a criminal tax investigation, in which case the conversion occurs on the date the partner is first notified that he or she is subject to the criminal tax investigation.⁴²¹² Similarly, a termination or jeopardy assessment against the partner or a bankruptcy proceeding involving the partner would make a partnership level proceeding inappropriate.⁴²¹³

⁴²⁰⁴(...continued)

Holdings I, LLC v. Commissioner, 149 T.C. 1 (2017), aff'd sub nom. *Blau v. Commissioner*, 924 F.3d 1261 (D.C. Cir. 2019)(noting that the special requirements for asserting the reasonable cause defense for such misstatements–qualified appraisal and good faith investigation (§ 6664(c)(2))–are partnership level determinations, citing *Whitehouse Hotel Ltd. P'ship v. Commissioner*, 131 T.C. 112, 173 (2008) vacated on other grounds 615 F.3d 321 (5th Cir. 2010); and *Whitehouse Hotel Ltd. P'ship v. Commissioner*, 139 T.C. 304, 351 (2012), aff'd in part, vacated in part, 755 F.3d 236 (5th Cir. 2014)); and see also *Highpoint Tower Technology, Inc. v. Commissioner*, 931 F.3d 1050, 1060 n8, 2019 U.S. App. LEXIS 22086 (11th Cir. 2019).

⁴²⁰⁵ This includes negligence, substantial understatement, and the various mis-valuation penalties. *United States v. Woods*, 571 U.S. 31 (2013),

⁴²⁰⁶ One procedural issue to the partner pursuing partner level penalty defenses at the partnership level is whether § 6751(b) applies in the partner level refund suit to require the IRS to meet a production burden under § 7491(c). In *Nix v. United States*, 339 F. Supp. 3d 580 (E.D. Tex. 2018), the court said that, in effect, the § 6751(b) defense must be litigated at the partnership level and that, if the penalty is sustained at the partnership level, it is no longer in issue when the IRS imposes the penalty at the partner level and the partner litigates liability for the penalty in a refund suit.

⁴²⁰⁷ *RERI Holdings I, LLC v. Commissioner*, 149 T.C. 1 (2017), aff'd sub nom. *Blau v. Commissioner*, 924 F.3d 1261 (D.C. Cir. 2019) (citing inter alia *Stobie Creek Invs., LLC v. United States*, 608 F.3d 1366, 1380-1381 (Fed. Cir. 2010), *Am. Boat Co. v. United States*, 583 F. 3d 471, 479-480 (7th Cir. 2009); see also *Klamath Strategic Investment Fund v. United States*, 568 F.3d 537, 548 (5th Cir. 2009) (citing *Santa Monica Pictures v. Commissioner*, 2005-104; and *Stobie Creek Investments, LLC v. United States*, 82 Fed. Cl. 636, 703-04, 717-21 (2008)). For a good concise summary of the problem, see Miller & Chevalier's Tax Appellate Blog titled “Schizophrenic Application of Tax Penalties (Part II)” (8/12/10).

⁴²⁰⁸ § 6230(a)(2).

⁴²⁰⁹ § 6230(a)(3).

⁴²¹⁰ See § 6231(a)(4) and 6231(b)(1).

⁴²¹¹ See § 6230(a)(2)(A)(ii).

⁴²¹² Reg. § 301.6231(c)-5.

⁴²¹³ § 6231(c)(1)(A); Reg. § 6231(c)(7).

5. Statutes of Limitation.

TEFRA provides a special minimum statute of limitations rule for assessing tax to the partners for partnership items and affected items.⁴²¹⁴ The partner's assessment periods of limitations are determined under § 6501, and TEFRA does not change that rule. TEFRA does, however, provide a rule that may extend the partner's statute of limitations for partnership and affected items beyond the statute of limitations provided in § 6501. TEFRA provides that each partner's § 6501 assessment period for tax "attributable to any partnership item (or affected item)" will not expire before the date that is three years after the later of: (i) the date on which the partnership return for the taxable year was filed or (ii) the last day for filing the return for that year (determined without regard to extensions).⁴²¹⁵ The net effect of this rule is that the partner's statute of limitations as to the partnership and affected items may be extended under TEFRA but will not be shortened. This has practical effect in those cases where the special TEFRA extension period has expired but the partner's statute of limitations is still open.⁴²¹⁶ The partners' statute may be still open in several ways, including by partner-level consent,⁴²¹⁷ (ii) by the partner-level 6 year statute for 25% omission, or (iii) at the partner level, for fraud that keeps the partner's statute open forever under § 6501(c)(1).⁴²¹⁸

This minimum—"not later than"—period may be extended as to all partners by agreement with the person acting for the partnership (see Tax Matters Partner below).⁴²¹⁹ Similarly, there are special

⁴²¹⁴ § 6229(a).

⁴²¹⁵ § 6229(a). Thus, early filed returns have the statute determined from the due date for the return. This rule is comparable to a similar rule for income tax returns. § 6501(b)(1) and § 6513(a). For discussion of the "attributable to" concept in this context, adopting its ordinary meaning, see *Russian Recovery Fund Ltd. v. United States*, 851 F.3d 1253 (Fed. Cir. 2017).

One nuance of this rule is that, as to any partner (including an indirect partner) who is not disclosed on the partnership return, the statute of limitations is open until 1 year after the date the previously undisclosed partner is identified to the IRS. § 6229(e). This exception is often called the unidentified partner exception. For an application of this rule as to an indirect partner, see *Gaughf Properties v. Commissioner*, 738 F.3d 415 (D.C. Cir. 2013).

⁴²¹⁶ As a result, for TEFRA audit purposes, the agents consider § 6229, but if the TEFRA audit agent believes one or more partners' statutes are open under § 6501, the agent is directed to consult associate area counsel. IRM 8.21.6.1(5) (10-31-2013), General Rules For IRC 6229.

⁴²¹⁷ The partner's (or in some cases an ultimate taxpayer's) statute may be open in several ways (such as the exceptions in § 6501(c) or (e) to the normal 3-year statute in § 6501(a).

One of those exceptions is an ultimate partner level consent via Forms 872 or 872-A. For periods prior to October 2009, the IRS used Form 872-I, Consent to Extend the Time to Assess Tax As Well As Tax Attributable to Items of a Partnership. The Form 872-I consent was quite sweeping. *WHO515 Investment Partners v. Commissioner*, T.C. Memo. 2012-316, aff'd 2019 U.S. App. LEXIS 32233 (D.C. Cir. 2019).

⁴²¹⁸ *Curr-Spec Partners, LP v. Commissioner*, 579 F.3d 391, 399 (5th Cir. 2009) (holding that § 6501 is the applicable partner-level statute of limitations with § 6229 establishing a minimum partner-level statute of limitations); *Andantech L.L.C. v. Commissioner*, 331 F.3d 972 (D.C. Cir. 2003); *GD Global Fund LLC v. United States*, 481 F.3d 1351 (Fed. Cir. 2007); *Rhone-Poulenc Surfactants & Specialties, L.P. v. Commissioner*, 114 T.C. 533 (2000) (reviewed, rev'd on other grounds 249 F.3d 175 (3d Cir. 2001)). At the time of *Curr-Spec*, this holding was controversial, although it appears a fairly straightforward interpretation of the statute. Since then, it has been uniformly followed.

⁴²¹⁹ § 6229(a) & (b). The consent to extend the statute of limitations is on Form 872-P (you will recall that the consents in nonpartnership cases are Forms 872 and 872-A). The consent, as with the parallel consent for income tax under § 6501(c)(4), requires an "agreement" executed by the partner or partnership and the IRS. Interestingly, though, read literally, § 6229(b) does not require an agreement in writing, as does § 6501(c)(4). The regulation does not address the issue. Of course, the implication is that the agreement will be in writing, and the Form 872-P requires signatures of

(continued...)

rules paralleling the general § 6501 rules for longer statutes in case of: (i) false or fraudulent partnership returns (6 years except “in the case of partners so signing or participating in the preparation of the return, any tax imposed by subtitle A which is attributable to any partnership item (or affected item) for the partnership taxable year to which the return relates may be assessed at any time),”⁴²²⁰ (ii) substantial omissions (6 years for 25% gross income),⁴²²¹ (iii) no return,⁴²²² and (iv) Service prepared returns.⁴²²³ Finally, the period may be extended by failure to file the necessary information about listed transactions.⁴²²⁴

If the IRS issues an FPAA to the partnership, the statute for partnership items and affected items at the partner level is suspended during the period that the partnership or any partner may file a judicial proceeding contesting the FPAA, during the period any resulting judicial proceeding is pending, and for one year thereafter.⁴²²⁵ Within that one year period, the IRS may assess with respect to the partnership items and the affected items even if the partner’s statute of limitations had otherwise closed.

Notwithstanding the foregoing, there are some affected items that may not be subject to the TEFRA statute of limitations provisions, in which case the IRS must make the assessment within the partner’s statute of limitations or lose the ability to do so. For this reason, in those cases, the IRS has procedures to issue protective notices of deficiency, with resulting protective assessments, if the agents are unsure as to the possibility of the statute running at the partner level.⁴²²⁶

⁴²¹⁹(...continued)

both sides.

⁴²²⁰ § 6229(c)(1) (paralleling § 6501(c)(1) and (2)’s unlimited statute, except that, as to an innocent partner, the statute is 6 years rather than an unlimited statute of limitations).

⁴²²¹ § 6229(c)(2) (incorporating § 6501(e)(1)(A), the 25% omission rule). Note that § 6501(e) contains provisions not included by incorporation in § 6229(c)(2) (such as the gross revenue spin on gross income in § 6501(e)(1)(A)(i) and the adequate disclosure provision in § 6501(e)(1)(A)(ii)). See *CC&F Western Operations Ltd. Partnership v. Commissioner*, 273 F.3d 402, 407 (1st Cir. 2001).

Section 6229(c)(2) should be interpreted consistently with § 6501(e) as to the incorporated provisions. Cf. *United States v. Home Concrete*, 566 U.S. 478 (2012) (applying the interpretation of § 6501(e)(1)(A) in *Colony, Inc. v. Commissioner*, 357 U.S. 28, 37 (1958) that an overstatement of basis resulting in an understatement of gross income is not an omission of gross income for this purpose).

⁴²²² § 6229(c)(3).

⁴²²³ § 6229(c)(4).

⁴²²⁴ § 6501(c)(10). See *Blak Investments v. Commissioner*, 133 T.C. 431 (2009), Blak was a partnership level proceeding, but the partners’ statute of limitations was still open at the effective date for the obligation to make the disclosure and hence the partners’ failure to provide the notice extended their statutes of limitation. As noted above, this has the effect that the partnership level proceeding is still within the statute as to them.

⁴²²⁵ § 6229(d). This rule parallels the extension upon issuance of a notice of deficiency in § 6503(a)(1). Even a defective TMP petition contesting the FPAA will toll the statute under this section. *O’Neill v. United States*, 44 F.3d 803 (9th Cir. 1995). This parallels the same rule for notices of deficiency and Tax Court proceedings under § 6501(a)(1). See *Shockley v. Commissioner*, 686 F.3d 1228 (11th Cir. 2012); see also Robert W. Wood and Dashiell C. Shapiro, For Whom the Statute Tolls, 140 Tax Notes 1035 (Sept. 2, 2013) (noting that “[T]he key fact in O’Neill was the Service’s lack of knowledge of the TMP’s bankruptcy” and suggesting that the IRS’s knowledge of the defect by the time of issuing the FPAA may defeat application of this rule).

⁴²²⁶ See CC-2009-11 (3/11/09), reproduced at 2009 TNT 54-19) requiring partner level protective notices and assessments in the following circumstances:

If a partner has reported a loss (or reduced gain) on the partner’s individual return as a result of having sold the TEFRA partnership interest or an asset distributed by the TEFRA partnership, the IRS should

(continued...)

If a partnership or affected item is converted into a nonpartnership item so that determinations are made at the partner level, the statute of limitations is the partner's statute of limitations, but not less than 1 year after the conversion event.⁴²²⁷

6. Tax Matters Partner.

The partnership is represented in the unified proceedings by the partnership's "Tax Matters Partner," often acronymed to "TMP."⁴²²⁸ The TMP can sign a consent to extend the statute of limitations for the partnership and otherwise enter agreements with the IRS respecting the proceedings or litigation.⁴²²⁹ The TMP is required to keep the partners informed during the proceedings.⁴²³⁰ This is in addition to a requirement that the IRS notify the partners of the commencement of the audit and the conclusion of the audit.⁴²³¹ The TMP is usually designated in the partnership agreement, but fall back rules are provided for determining the TMP in the event the partnership agreement does not designate or the partner designated does not serve.⁴²³²

There has been some controversy as to whether a person who is designated as the TMP may continue to serve as TMP after a conflict of interest develops. In *Transpac Drilling Venture 1982-12 v. Commissioner*,⁴²³³ the Second Circuit held that the IRS could not continue to deal with a TMP to obtain a valid consent to extend the statute of limitations where the TMP was under criminal investigation, and thus had an incentive to ingratiate himself with the IRS at the expense of the partners to whom the TMP owed a fiduciary duty, and the limited partners had declined to extend the statute of limitations. Subsequently, the Second Circuit clarified that its decision in *Transpac Drilling* was based upon a clear and actual conflict.⁴²³⁴ *Transpac* appears to be a limited holding.⁴²³⁵

⁴²²⁶(...continued)

make certain protective assessments to ensure that the assessments are made before the period of limitations on assessment expires. Given the different types of affected items -- those that can be directly assessed and those requiring determinations at the partner level -- the IRS may not know with certainty how a court will classify the affected item.

⁴²²⁷ § 6229(f)(1); see *Gingerich v. United States*, 77 Fed. Cl. 231 (2007) (determining event that starts the 1 year period).

⁴²²⁸ § 6231(a)(7).

⁴²²⁹ § 6229(b).

⁴²³⁰ § 6223(g).

⁴²³¹ § 6223(a).

⁴²³² See Reg. § 1.6231(a)(7)-1 for the rules for designating the TMP.

⁴²³³ 147 F.3d 221 (2d Cir. 1998).

⁴²³⁴ *Madison Recycling Assocs. v. Commissioner*, 295 F.3d 280, 288 (2d Cir. 2002).

⁴²³⁵ See *Phillips v. Commissioner*, 272 F.3d 1172 (9th Cir. 2001); *United States v. Martinez*, 564 F.3d 719 (5th Cir. 2009) (distinguishing *Transpac Drilling* on basis that (i), unlike the facts in *Transpac Drilling*, the IRS had not sought consents from the partners and been denied the consents, (ii) the IRS did not have a pending criminal investigation against the tax matters partner, (iii) the tax matters partner's request for a quid pro quo via relief from the preparer penalties was not disabling because the IRS had already determined not to seek the penalty, and (iv), although the IRS believed the tax matters partner was dishonest, that alone did not create a per se conflict between his interests and the limited partners' interests sufficient to put the IRS' reliance unreasonable under the circumstances.). But the Second Circuit is determined to continue its holding in the same fact pattern. See *Leatherstocking 1983 Partnership v. Commissioner* (2d Cir. 10/20/2008), unpublished opinion, summarily reversing the Tax Court on the basis of *Transpac*; and *Fab Holdings, LLC v. Commissioner, T.C. Memo. 2021-135* (holding that an advisor in a transaction not widely promoted did not have a prohibited conflict of interest voiding consents; the Court said: "The mere fact that an adviser

(continued...)

7. Notice to Partners.

The partners are notified by the IRS or by the TMP as to the key events in the proceedings.⁴²³⁶ The TMP and “notice partners” are notified of the beginning of the administrative proceeding by a Notice of Administrative Proceeding (“NAP”).⁴²³⁷ Notice partners are partners whose names and addresses are furnished to the IRS.⁴²³⁸ In larger partnerships, the partner must be at least a 1% partner to be entitled to notice.⁴²³⁹ However, the TMP is required to notify all partners of significant developments in the audit.

8. Partner Participation in Proceedings.

Partners other than the TMP may participate in the audit and litigation.⁴²⁴⁰ It is still, however, just one proceeding at the audit and litigation stages.

9. Settlements.

An elaborate system for reaching settlements during the audit is provided.⁴²⁴¹ Generally, the IRS may settle with one or more partners.⁴²⁴² If the IRS enters such an agreement with less than all the partners, the other partners have the right to the same treatment.⁴²⁴³ The TMP may enter such an agreement for a nonnotice partner (i.e., one whose interest is so small that the IRS is not required to give notice under these procedures).⁴²⁴⁴

⁴²³⁵(...continued)

is being paid to help with a transaction does not transform the adviser into a promoter” and did not put IRS on notice of a conflict (Slip Op. 20-22.)).

⁴²³⁶ §§ 6223(a) (notice IRS must give) and 6223(g) (TMP's obligation to keep partners informed).

⁴²³⁷ § 6223(a)(1). See also § 6223(d)(1), requiring that NBAP be mailed to notice partners be notified 120 days before the date of the FPAA.

⁴²³⁸ § 6223(a). Notice partners means at least those partners listed on the partnership return and those indirect partners whose names and addresses are furnished to the IRS. *Block Developers LLC v. Commissioner*, T.C. Memo. 2017-142 (holding that the IRS is not required indirect partners whose names and addresses are known to the IRS but are not furnished to the IRS by the partnership or the indirect partners; the procedure for notifying the IRS of the indirect partners, thus requiring NBAPs for those indirect partners, are set forth in Reg. § 301.6223(b).).

⁴²³⁹ § 6223(b)(1) (applying to partnerships with more than 100 partners when the partner has less than 1% interest).

⁴²⁴⁰ §§ 6224 & 6226(d).

⁴²⁴¹ § 6224(c).

⁴²⁴² § 6224(c)(1).

⁴²⁴³ § 6224(c)(2). A covered settlement must be a settlement of only the partnership item and not a combined settlement of partnership and nonpartnership items. Reg. § 301.6224(c)-3(b)(1); See *Cinema '84, et al. v. Commissioner*, 294 F.3d 432 (2d Cir. 2002) (approving the requirement as a Temporary Regulation, but perhaps leaving open the question of whether the rule would apply if the settlement of the partnership item and the nonpartnership item were independent of each other, which may be a very difficult showing in most cases). Thus, for example, a settlement that covers the abatement of interest on the partner level tax under § 6404 does not trigger this consistency rule. *Jaffe v. Commissioner*, TCM 2004-122 (citing *Cinema '84*).

⁴²⁴⁴ § 6224(c)(3).

10. Conclusion of Audit - 60-Day Letter & Appeal.

At the conclusion of the audit, if sufficient time remains on the statute of limitations (the IRM requires one-year), the IRS will issue a “60-day letter” which permits the partnership or any partner to appeal to the IRS Appeals Office.⁴²⁴⁵ The “60-day letter” is the TEFRA analog to the 30-day letter discussed for Examinations of non-TEFRA taxpayers.⁴²⁴⁶ As in the general context, the appeal is taken by filing a protest. The appeal then takes place essentially as it does in the general context discussed earlier in the text.

11. Conclusion of Audit (or Appeal, If Taken) - FPAA.

At the conclusion of the partnership audit and the appeal, if taken, the IRS issues a Final Partnership Administrative Adjustment, commonly acronymed to “FPAA.” The FPAA is analogous to a notice of deficiency.⁴²⁴⁷ You will recall that the notice of deficiency advises the taxpayer that the IRS has determined net additional tax liability and offers the opportunity to litigate in the Tax Court.⁴²⁴⁸ The FPAA does not notify the partnership of additional tax due because the partnership is not a tax *payer*. Rather the FPAA notifies the partnership and the partners of the adjustments the IRS has determined at the partnership level.⁴²⁴⁹ The tax effect when and if those determinations are “flowed-through” to the partners is not calculated at this time. Like the notice of deficiency, the FPAA is the key item that concludes the administrative proceedings and offers the opportunity to litigate. Thus, as I will note, just as the notice of deficiency is the “ticket to the Tax Court,” so the FPAA is the “ticket to the Tax Court.”

The issuance of the FPAA suspends the special TEFRA statutes of limitations during the period the partnership may file a judicial proceeding and for one year thereafter.⁴²⁵⁰

If the FPAA is issued within 120 days of the notice starting the administrative proceeding (“NBAP”), a partner not receiving timely notice may elect out of the partnership level proceeding.⁴²⁵¹

⁴²⁴⁵ The Code does not provide for this appeals process. It is discussed in the in the Pass-Through Entity Handbook in the IRM. See 8.19.1.6.8.4 (10-01-2013), Examination Process.

⁴²⁴⁶ See IRM 8.19.1.6.8.4.3. (10-01-2013), Examination Process.

⁴²⁴⁷ *Curr-Spec Partners, L.P. v. Commissioner*, 579 F.3d 391, 394 (5th Cir. 2009). For this reason, interpretations of the notice of deficiency provisions are useful in interpreting the FPAA provisions. See e.g., *Green Gas Delaware Statutory Trust et al. v. Commissioner*; T.C. Memo. 2015-168 (applying the interpretation of the determination requirement for notices of deficiency in *Scar v. Commissioner*, 814 F.2d 1363 (9th Cir. 1987) to the FPAA determination requirement.)

⁴²⁴⁸ For a good discussion of the determination and notice purposes of both the notice of deficiency and FPAA, see *Natalie Holdings Inc., et al. v. United States*, 2003 U.S. Dist. LEXIS 1978 (W.D. Tex. 2003).

⁴²⁴⁹ The IRS may send the FPAA to persons it believes to be partners even if they subsequently are determined not to be partners, without violating § 6103. *Abelein v. United States*, 323 F.3d 1210 (9th Cir. 2003).

⁴²⁵⁰ § 6229(d).

⁴²⁵¹ § 6223(e). The election out requires formalities that if not observed will vitiate any claimed election out. See *Bedrosian v. Commissioner*, 940 F.3d 467, 472-473 (9th Cir. 2019) (rejecting argument for substantial compliance).

12. Judicial Remedies.

You will recall that a key feature of the general nonpartnership system discussed earlier is that taxpayers have a right to a prepayment remedy via the notice of deficiency. The partnership audit provisions similarly allow a prepayment remedy. During the partnership audit, the IRS may not assess the partners for the partnership items.⁴²⁵² Upon completion of the partnership level audit (including appeals if taken), the IRS issues the FPAA. The TMP then has 90 days to petition for readjustment in the Tax Court, the Court of Federal Claims or an appropriate district court.⁴²⁵³ If the TMP does not file a petition within this period, then any notice partner may file a petition for readjustment within the next 60 days.⁴²⁵⁴ Regardless of who institutes the proceeding, all partners are treated as parties to the suit and may participate therein. Because it is possible that one partner might file in the Tax Court and another in the district court, the Tax Court case will take priority as the single unified litigation of the partnership items.⁴²⁵⁵ If more than one case is filed in the Tax Court, the first in time takes precedence and the others are dismissed.⁴²⁵⁶ If there is no Tax Court case filed but multiple cases filed in the other forums, the first to be filed is the one that proceeds to finality and all partners may participate in that litigation.⁴²⁵⁷ If a case proceeds in a district court, the case will be tried to a judge rather than a jury because this proceeding does not fit within the narrow classes of cases where juries are permitted in suits against the United States.⁴²⁵⁸

In the partnership level judicial proceeding, “each person was a partner in [the] the partnership shall be treated as a party to the action” and each has the right to participate.⁴²⁵⁹ Perhaps this is obvious, but the partnership is also a party, having brought the proceeding.⁴²⁶⁰

⁴²⁵² § 6225(a); this is the partnership analogue to the restriction on assessment in § 6213(a).

⁴²⁵³ § 6226. If the proceeding is in the district court or the Court of Federal Claims, the partner filing the case must deposit the amount of the tax that would result from the adjustment. § 6226(a). Although it is described as a deposit and functions in some respect like a deposit (e.g., it will be returned upon request if the case is dismissed because the Tax Court case has priority), it will draw interest as if it were a payment. § 6226(a) & (b).

⁴²⁵⁴ See § 6226(b)(1).

⁴²⁵⁵ § 6226(b)(2).

⁴²⁵⁶ *PCMG Trading Partners v. Commissioner*, 131 T.C. 206 (2008).

⁴²⁵⁷ § 6226(b)(3) & (4).

⁴²⁵⁸ See *Eastwood Mall v. United States*, 1994 U.S. App. LEXIS 33713 (6th Cir. Ohio 1994) (citing *Thomas v. United States*, 695 F. Supp. 1021, 1022 (E.D. Mo. 1988)); and *RCL Properties, Inc. v. United States*, 2009 U.S. Dist. LEXIS 37816 (D. Colo. 2009). In *Eastwood Mall*, the court noted that FRCP 39(c) permits an advisory jury in which case the jury’s decision is advisory and, even if the judge acts on it, must still enter findings and conclusions are required by FRCP 52.

⁴²⁵⁹ § 6226(c). Tax Court Rule 245(b) permits partners to file, within 90 days of the date the clerk serves the petition on the IRS, notice of election to participate in the proceeding. Late election may be allowed on showing of sufficient cause. See also *Peking Inv. Fund, LLC v. Commissioner*, T.C. Memo. 2013-288, at *13-*16.

⁴²⁶⁰ *BASR Partnership v. United States*, 915 F.3d 771 (Fed. Cir. 2019) (*BASR* involved the recovery of fees under § 7430, which, in the case, required the court to determine whether § 6226(c) making partners parties was an exclusive list limiting party status to partners or whether the partnership itself was a party in addition to the partners; held the partnership is a party; the *BASR* Court rejected a contrary indication in *Foothill Ranch Co. P’ship v. Commissioner*, 110 T.C. 94, 99 (1998)).

The filing of the case suspends the statute of limitations.⁴²⁶¹ Indeed, even if the tax matters partner filing the proceeding is serving his or her own interests rather than the interests of the partners, the filing of the case will suspend the statute of limitations.⁴²⁶²

For any partner level litigation, the matters that were or should have been litigated at the partnership level cannot be litigated. As noted elsewhere, those matters are resolved summarily without a notice of deficiency as a computational adjustment. Hence, the taxpayer will not receive a notice of deficiency ticket to the Tax Court. And the taxpayer cannot bring a refund suit attributable to partnership items.⁴²⁶³

13. Conclusion of Unified Proceedings.

a. Partnership Items.

At the conclusion of the unified proceedings, the IRS distributes the determinations of partnership items finally made (either the determinations in the FPAA if there is no unified litigation or the determinations in the litigation) to the partners in their distributive shares as computational adjustments which do not require a notice of deficiency be issued to the partners.⁴²⁶⁴ The opportunity for judicial review has already been provided at the partnership level, so there is no further need for partner judicial review, which is the sole purpose of the notice of deficiency.⁴²⁶⁵

b. Affected Items.

Adjustment at the partner level may also be made for items that are not “partnership items” but are instead “affected items.” Affected items are items that are affected by the partnership items. For any affected item which is a computational or automatic adjustment requiring no further determinations at the partner level, the IRS may assess immediately as a computational adjustment.⁴²⁶⁶ An example of an affected item that could be made by computational adjustment is a medical deduction which is automatically affected by percentages of adjusted gross income, so that if all that is at issue is the partnership item adjustment and the automatic affected item adjustment (here the medical deduction), the IRS could assess immediately without a notice of deficiency. For

⁴²⁶¹ §§ 6229(d) & 6226.

⁴²⁶² *United States v. Martinez*, 564 F.3d 719, 727-8 (5th Cir. 2009), citing *O’Neill v. United States*, 44 F.3d 803, 805-806 (9th Cir. 1995).

⁴²⁶³ § 7422(h).

⁴²⁶⁴ § 6230. The Court of Federal Claims held that notices of computational adjustments are not subject to the holding of *Scar v. Commissioner*, 814 F.2d 1363 (9th Cir. 1987) that a notice of deficiency stating a facially invalid basis for the deficiency is invalid. *Bush v. United States*, 2012 U.S. Claims LEXIS 1083 (2012). Even as to notices of deficiency, *Scar* is subject to limited application. But, according to the Court of Federal Claims it does not apply at all to notices of computational adjustment. *Bush* did not really involve a facially invalid computational adjustment—just a notice that the adjustment had been based on the best information available rather than the very old year return (1983) which had been misplaced. Perhaps if the notice of computational adjustment had misidentified the tax shelter involved, the Court of Federal Claims might have been more receptive to a *Scar* type argument.

⁴²⁶⁵ *Callaway v. Commissioner*, *supra*, p. 109.

⁴²⁶⁶ § 6230(a)(1).

affected items that may require further partner level determinations, a partner level notice of deficiency may be required.⁴²⁶⁷

c. Computational Adjustments.

As noted, summary computational adjustments may be made for partnership items and affected items that arise from partnership level determinations. Computational adjustments are any “change in the tax liability of a partner which properly reflects the treatment under * * * [TEFRA] of a partnership item.”⁴²⁶⁸ These include numerical or mathematical computations from the partner’s share of partnership items or partnership affected item and can include any other type of adjustment not requiring partner level determination.

Although the partner, not having received a notice of deficiency, cannot petition the Tax Court to review the computational adjustment, the partner may in a CDP proceeding obtain Tax Court review of the merits of the computational adjustment because the partner has not had a prior opportunity to contest (on prior opportunity to dispute see p. 739, above).⁴²⁶⁹

d. Penalties.

As noted above (p. 942), certain penalties related to adjustment of partnership items are now partnership items even if there are partner level defenses that must be asserted only at the partner level. This means that they can be summarily assessed without a notice of deficiency and the partner can only contest by refund suit.

14. The Oversheltered Partner Return.

The individual partner with material partnership losses may have also made aggressive claims on his return as to nonpartnership items. For example, assume that a partner has the following items of income and loss on a return (assume no other items in the calculation of taxable income):

| | |
|------------------|-------------|
| Partnership Loss | (\$100,000) |
| Other Income | \$ -0- |
| Taxable Income | \$ -0- |

This illustrates a phenomenon called an “oversheltered return” (which is defined as a return showing a partnership loss and no taxable income).⁴²⁷⁰ The IRS audits and determines that, instead of \$0 other income, the taxpayer had \$50,000 other income. The taxpayer still has no taxable income and no deficiency because of the partnership loss, so the IRS can’t issue a notice of deficiency. The partnership has not yet been audited with respect to that loss. The IRS may issue a “notice of adjustment” which, assumes solely for purposes of the notice, that the partnership loss is correctly

⁴²⁶⁷ § 6230(a)(2)(A). *Petaluma FX Partners v. Commissioner*, 591 F.3d 649 (D.C. Cir. 2010). for a good crisp discussion of affected items requiring partner level determinations required by notice of deficiency.

⁴²⁶⁸ § 6231(a)(6).

⁴²⁶⁹ *Gluck Irrevocable Trust v. Commissioner*, 154 T.C.250, 267 (2020).

⁴²⁷⁰ § 6234(b). For a discussion of the oversheltered partner return discussed in this section, see *Stevens v. Commissioner*, T.C. Memo. 2020-118, at *26-*29.

reported.⁴²⁷¹ The notice of adjustment is a substitute for a notice of deficiency; a deficiency does not exist, of course, because of the partnership loss that may or may not be proper. The taxpayer may then file a petition in the Tax Court to contest the proposed adjustment, and failure to file the petition will mean that the adjustments are deemed correct (specifically, if the partnership loss is disallowed in whole or in part, the IRS may make the partner level adjustment and send a notice of deficiency based upon the adjustments in the notice of adjustment). In some cases where the partnership loss is disallowed under the TEFRA procedures, which would then turn the effect of the adjustments into a deficiency, the notice of adjustment will be treated as a notice of deficiency and any petition filed will be a petition for redetermination of the deficiency.⁴²⁷²

Without this special procedure, a subsequent disallowance of the partnership loss under the TEFRA procedures could result in the statute of limitations being closed with respect to the adjustments from the nonpartnership item(s).

15. A Reprise.

The partnership unified audit and litigation rules attempt to apply a fairly simple concept in a context where there is generally a good fit, but sometimes there are serious glitches where the rules simply do not offer the answer. See, e.g., *Callaway v. Commissioner*, 231 F.3d 106 (2d Cir. 2000) (for a good court summary of the overview of the partnership tax rules).

C. Large Partnerships.

In 1997, Congress enacted special provisions for large partnerships dealing with certain potential glitches inherent in the normal TEFRA partnership rules. The goal was to simplify the flow-through regime by reducing the number of items reported to partners, thus permitting simpler reporting by partners and easier matching by the IRS, and to create a simplified audit regime.⁴²⁷³ As with TEFRA, Congress removed the Large Partnership provisions discussed here and treat partnerships general under CPAR.⁴²⁷⁴

In summary, these rules are subject to the TEFRA regime except with respect to the following key features.⁴²⁷⁵

- As with TEFRA, unified audit and litigation procedures apply.

⁴²⁷¹ § 6234.

⁴²⁷² § 6324(g)(3).

⁴²⁷³ Staff of the Joint Committee on Taxation, General Explanation of the Tax Legislation Enacted in 1997 (JCA-23-97) (1997 Blue Book), pp. 354 & 363.

⁴²⁷⁴ Section 1101(b) of Bipartisan Budget Act of 2015, Public Law 114-74 (BBA), as amended by the Protecting Americans from Tax Hikes Act of 2015, Public Law 114-113, div Q (PATH Act), and §§ 201 through 207 of the Tax Technical Corrections Act of 2018, contained in Title II of Division U of the Consolidated Appropriations Act of 2018, Public Law 115-141 (TTCA).

⁴²⁷⁵ The principal source for the bullet points in the text is the 1997 Blue Book, officially titled the Joint Committee on Taxation, General Explanation of the Tax Legislation Enacted in 1997 (JCA-23-97), pp. 361 ff. I will not separate cite the Blue Book for the bullet points, but may cite in the footnotes other authorities, principally Code sections. The procedures provisions are found at §§ 771 ff., with the audit procedures in §§ 6240 ff.

- Partnerships with more than 100 partners may elect into the regime; except that large service partnerships are excluded.⁴²⁷⁶ A partnership making the election is called an “electing large partnerships” (“ELP”)⁴²⁷⁷ If the partnership does not make the election, the TEFRA rules apply. The ELP must designate a person to represent and bind the ELP.
- Partners are not notified of the commencement of the TEFRA audit procedures or a final adjustment, with the partnership representative having the power to bind the ELP and all of its partners.⁴²⁷⁸
- Partnership adjustments generally flow through to the partners for the year of the adjustment rather than for the tax year involved.
- In lieu of flowing the adjustment through to the partners, the partnership may elect to pay a tax and any resulting penalties and interest on an imputed underpayment. The partner cannot claim a credit or refund for the tax the partnership pays.
- The partners must report consistently with the partnership reporting.
- The statute of limitations for ELP adjustments is generally 3 years after the later of the filing of the partnership return or the due date for the partnership return. Special rules apply to false or fraudulent returns, a substantial omission of income or the failure to file a return. For adjustments flowed through to the partner in the year of adjustment, the IRS assesses and collects with respect to the partnership item based on the partner’s statute.

D. S Corporations.

Prior to 1996, S Corporations were subject to TEFRA tax treatment paralleling partnerships in that, generally, the tax attributes flow through to be taxed at the shareholder level rather than the entity level. Like partnerships, S Corporations file an entity level return which is generally just an information return (like partnerships), although there is a potential for entity level tax for C Corporations that have converted to S Corporations (the so-called built-in gains tax⁴²⁷⁹). Because of the similarity of the two types of entities, S Corporations were formerly subject to TEFRA unified audit procedures that apply to partnerships (see above). For years after 1996, however, the entity level audit procedures for S Corporations were repealed.⁴²⁸⁰

The shareholders are still required to report consistently with the treatment on the corporate return or notify the IRS of any inconsistent treatment.⁴²⁸¹ Any shareholder failing to notify the IRS

⁴²⁷⁶ See § 755 (b)(2), incorporated by § 6255(a)(1).

⁴²⁷⁷ § 6255(a).

⁴²⁷⁸ See H. R. Rep. No. 105-148, at 218-28, 1997-4 C.B. 319, 540-550.

⁴²⁷⁹ § 1374.

⁴²⁸⁰ Small Business Job Protection Act of 1996, Pub L No 104-737, 104th Cong, 2d Sess, § 1307(c)(1) (Aug 20, 1996).

⁴²⁸¹ § 6037(c). IRS Form 8082, Notice of Inconsistent Treatment or Administrative Adjustment Request (AAR), notifies the IRS of the inconsistent treatment and should be filed with the original or amended return. Although generally, the Form should be filed with the return, some other presentation on the shareholder’s return that provides substantial compliance with the information requirements might suffice. E.g., *Blonien v. Commissioner*, 118 T.C. 541, 556 (2002) (failure to file Form 8082 precludes inconsistent treatment) *Samuelli v. Commissioner*, 132 T.C. 336 (2009) (suggesting that substantial compliance might suffice, although holding that the taxpayer’s amended return did not

(continued...)

of inconsistent treatment is subject to audit adjustment consistent with the return as filed without the benefit of the notice of deficiency.⁴²⁸²

As with partnerships, S Corporation audits are made at the entity level. Since the TEFRA rules do not apply after 1996 that would hold open the partner statute of limitations for partnership items and affected items determined in the entity level audit, the IRM requires the agent examining an S Corporation return to protect the statute of limitations for the shareholders.⁴²⁸³

III. The Centralized Partnership Audit Regime (“CPAR”) After 2017.

A. Caveat Regarding Code and Regulations Citations.

Reminder: All Code section citations in this section III are to the CPAR in the Internal Revenue Code applicable for years after 2017. The CPAR replaced the TEFRA Code sections, some of which have the same numbers. Students and practitioners should be careful to ensure that they refer to the CPAR Code sections and, where applicable, the Regulations under the CPAR Code sections. All references to the Regulations in this section are to the regulations promulgated under the CPAR Code sections.

Students and practitioners should assure that the statutes and regulations they refer to incorporate all changes to these provisions (a good practice always, but particularly with major new regimes such as CPAR that require corrections and refinements). The latest statute changes I incorporate in this discussion occurred in 2018 in Tax Technical Corrections Act of 2018, contained in Title II of Division U of the Consolidated Appropriations Act of 2018, Public Law 115-141 (“TTCA”). For this purpose, I have used the Code sections offered by LII on the web. The latest regulations I have incorporated in the discussion were by T. D. 9844, published in December 2018.

⁴²⁸¹(...continued)

substantially comply); and *Rubin v. United States*, 904 F.3d 1081 (9th Cir. 2018) (taxpayer provided the information that would have been included on Form 8082 and could have been used by the IRS to meet the needs of that Form).

⁴²⁸² § 6037(c)(3). See Small Business Job Protection Act of 1996, Pub. L. 104-188, sec. 1307(c)(1), 110 Stat. 1781 (repealing unified audit procedures for S corporations).

⁴²⁸³ The former IRM provision was IRM 4.31.5.7.1 (06-07-2013), S Corporation Statute Considerations. I think provision was moved and I have not yet tracked it down. The current provision is IRM 4.31.5.8.1 (05-17-2022), S Corporations (“Generally, when auditing an S corporation it is the examiner’s responsibility to protect the entity statute and all shareholders’ statutes.”).

B. Introduction to the CPAR.

1. General - Audit Adjustments Assessed and Collected at Partnership Level.

Effective for tax years beginning after 2017, the Code provides a new regime for partnership audits and litigation.⁴²⁸⁴ This regime is called the **Centralized Partnership Audit Regime (“CPAR”)** and contained in §§ 6221-6241 of the Code. In the literature, the **CPAR** and partnerships subject to CPAR are often referred to as the **BBA regime** and **BBA partnerships**, with the initialism **BBA** referring to the legislation enacting the CPAR.⁴²⁸⁵ Sometimes the two descriptions are joined, such as on the IRS central one-stop web site for guidance documents titled **BBA Centralized Partnership Audit Regime**.⁴²⁸⁶ In this section, I generally refer to the regime as the **CPAR** (rather than the **BBA regime**), and to partnerships subject to the CPAR simply as **partnerships** (the term often used is **BBA partnerships**).⁴²⁸⁷

A partnership is generally required to file a partnership return (Forms 1065) each year reporting entity level results of partnership activity and report on Schedules K-1 to partners and to the IRS each partner's allocable share of partnership items and related items so that the partners report the appropriate tax consequences at the partner level. This long-time requirement was retained under TEFRA and is retained under CPAR. As with TEFRA, CPAR applies to audit and related activities after the partnership year (the reviewed year). In general, the CPAR carries forward the prior practice of making audit adjustments for partnership-related items in the reviewed year at the partnership level **but** imposes the tax consequences of the adjustments upon the partnership (rather than the partners) in the year the adjustments are made (the adjustment year).

There are many complexities in implementing the CPAR and there are some situations in which this general regime for partnership level payment will not apply so that the tax consequences, including assessment and payment, apply at the partner level. But, in broad strokes, the default rule is that CPAR allows one assessment of the tax, penalties and interest at the partnership level and one “taxpayer”—the partnership— from whom to collect the amounts assessed.

⁴²⁸⁴ Section 1101 of the Bipartisan Budget Act of 2015, Public Law 114-74 (“BBA”), as amended by the Protecting Americans from Tax Hikes Act of 2015, Public Law 114-113, div Q (PATH Act), and sections 201 through 207 of the Tax Technical Corrections Act of 2018, contained in Title II of Division U of the Consolidated Appropriations Act of 2018, Public Law 115-141 (“TTCA”). The BBA permitted the IRS to provide that partnerships with taxable years after 11/20/15 and before 1/1/18 to elect into the CPAR procedures. The IRS has done so in Reg. § 301.9100-22.

⁴²⁸⁵ For example, references often are to the “BBA centralized partnership audit regime” and to the “BBA regime.” E.g., IRM 4.31.2.1.1 (05-10-2019), Background; see also Form 1065 instructions for 2019 (referring to the partnerships subject to the CPAR as **BBA partnerships**). The term **BBA partnerships** seems to be used more frequently than **CPAR partnerships**.

⁴²⁸⁶ This web page was created on 9/1/20 to serve as a “one-stop location for anything BBA-related, including regulations and other guidance and instructions related to the Partnership Representative (PR), electing out of the centralized audit regime, Administrative Adjustment Requests (AARs) and what to expect during a BBA administrative proceeding.” IR-2020-199 (9/1/20).

⁴²⁸⁷ E.g., Saltzman Treatise, ¶ 8A.01 Overview of the Partnership Audit Procedures Under the Bipartisan Budget Act.

In the text in this section, I provide only a relatively high-level summary addressed to the student of tax procedure. I provide some detail in the footnotes, but not enough that practitioners should rely either upon the text summary or the footnotes for the detail necessary to actually practice in this CPAR area.

2. CPAR Code and Regulations Sections and Citations in Text.

In the text, I generally cite only the major Code section when introducing a topic. I will not cite subsections in the text but will provide subsections in the footnotes (along with other explanatory material). I do offer the following list of the Code sections for CPAR and their titles:

- § 6221 - Determination at partnership level
- § 6222 - Partner's return must be consistent with partnership return
- § 6223 - Partners bound by actions of partnership
- § 6225 - Partnership adjustment by Secretary
- § 6226 - Alternative to payment of imputed underpayment by partnership
- § 6227 - Administrative adjustment request by partnership
- § 6231 - Notice of proceedings and adjustment
- § 6232 - Assessment, collection, and payment
- § 6233 - Interest and penalties
- § 6234 - Judicial review of partnership adjustment
- § 6235 - Period of limitations on making adjustments
- § 6241 - Definitions and special rules

The Regulations (all of which have not yet been finalized) will not be cited in the text but will be cited in the footnotes. The regulations format is the format for procedural regulations. The following is an example of the first CPAR regulation: Reg. § 301.6221-1, titled "Tax treatment determined at partnership level."

C. Tax and Related Adjustments, Assessments, and Payments at the Entity Level.

Although the partnership continues to be a non tax-paying entity with respect to its **initial** partnership return returns (with the tax characteristics for partnership items flowing through to the partners with tax paid at the partner level):

- CPAR adjustments to **partnership-related items** (any item relevant to tax liability or a partner's distributive share)⁴²⁸⁸ for a **reviewed year** (the partnership audit year)

⁴²⁸⁸ The TCJA amended §§ 6221(a) and 6241(2) to make § 6221 apply to partnership-related items and amended § 6241(2) to define partnership-related items broadly to include any item or amount with respect to the partnership which is relevant to determining the liability of any person under chapter 1 of the Code and any partners distributive share. Partnership-related items include determinations with respect to partnership transactions with the partner and thus include:

- transactions between the partnership and a partner other than in a capacity as a partner (e.g., guaranteed payments under § 707);
- items or amounts relating to a partner's basis or adjusted basis in the partnership or the partnership's basis in partnership property.

(continued...)

are made at the partnership level in a single proceeding (both audit and, if litigated, judicial proceeding) (§§ 6221 & 6225); and

- A tax, called an “**imputed underpayment**” and penalties, if any, attributable to the reviewed year imputed underpayment is (i) assessed as a tax⁴²⁸⁹ at the partnership level for the **adjustment year** (the year the audit is final) and (ii) paid by the partnership (§ 6225).

The regulations deal in great length with the key defined items: **partnership-related items** and **imputed underpayment**. I will develop these defined terms as appropriate to this summary discussion.

The net effect (**as compared to the past procedure of imposing the tax consequences on reviewed year partners for the reviewed year**) is that the economic cost of the tax imposed for the reviewed year adjustments at the partnership level is borne by the partnership and thus the partners in the adjustment year, and that there will be no partner-level penalty defense in the calculation of the imputed underpayment and penalties. The net converse effects are that: (i) partners whose allocable shares in the adjustment year are greater than in the reviewed year will bear more of the economic cost of the adjustments and (ii) partners whose allocable shares in the adjustment year are less than in the reviewed year will bear less of the economic cost of the adjustments.⁴²⁹⁰

D. Computation of the Imputed Underpayment.

“Imputed underpayment” is determined by netting all audit adjustments of the same tax-relevant character (e.g., ordinary income and capital gain) and applying the highest reviewed year tax rate under section 1 or 11. § 6225.⁴²⁹¹ The netting occurs in the reviewed year only; there is no netting of more than one reviewed year. After the netting, the IRS applies the tax rate to the groups and aggregates the resulting amounts to reach the imputed underpayment. The imputed underpayment amount may be modified as indicated below. The partnership must pay the tax thus calculated.⁴²⁹²

⁴²⁸⁸(...continued)

- items or amounts relating to the determination of partnership liabilities or to the effect on a partner of a decrease or increase in a partner’s share of partnership liabilities is a partnership-related item.

⁴²⁸⁹ Section 6221(a) says that the “tax” attributable to the adjustments is assessed and collected at the partnership level. Section 6225(a) says that the partnership shall pay the “imputed underpayment.” Section 6232 says that the imputed underpayment is assessed and collected “as if it were a tax imposed for the adjustment year by subtitle A.” Thus, if the imputed underpayment is technically not the same as a tax, it is practically the same. So, in this section, I will usually use the term imputed underpayment but may use the term tax to mean the same. Also, the definitions of reviewed year and adjustment year are in § 6225(d) and in Reg. § 301.6241-1.

⁴²⁹⁰ I have not worked out whether there might be some contractual mechanism, such as in the partnership agreement, to require partners whose allocable shares in the adjustment year or less to make some contribution that might have the effect of compensating the partners in the adjustment year whose allocable shares have increased.

⁴²⁹¹ § 6225(b)(1); Regs § 301.6225-1(b). The Regulations provide in great detail how the calculations are made. The following is the general process: The partnership-related items are assigned to four groups: the reallocation grouping, the credit grouping, the creditable expenditure grouping, or the residual grouping. There may be subgrouped as appropriate. The items in each group are then netted to produce the partnership adjustment. Reg. § 301.6225-1(b)(2), Reg. § 301.6225-1(d) and Reg. § 301.6225-1(e).

⁴²⁹² § 6225(a). No deduction is allowed for the partnership’s payment of the tax. § 6241(4).

The IRS is required to establish procedures for modifications to the computation of the partnership's imputed underpayment in the notice of proposed partnership adjustment ("NOPPA"), with modifications approved by the IRS.⁴²⁹³ Examples of such modifications are: (i) imputed underpayment will not include amounts attributable to partners who file returns taking account of the partnership level adjustments **and** pay the resulting tax;⁴²⁹⁴ (ii) imputed underpayment will not include the portion of the underpayment that the partnership establishes is attributable to tax exempt partners;⁴²⁹⁵ and (iii) imputed underpayment may take into account lower tax rates.⁴²⁹⁶ If the partnership adjustments reallocates any partner's distributive share from one partner to another, paragraph (i) applies only if consistent returns are filed by all partners affected by the adjustment.⁴²⁹⁷ The IRS is also authorized to establish "by regulations or guidance" for other adjustments to the imputed underpayments "on the basis of such other factors as the Secretary determines are necessary or appropriate to carry out the purposes of this subsection,"⁴²⁹⁸ Pursuant to this authority, the IRS has promulgated complex Regulations to effect such modifications.⁴²⁹⁹ The details of the procedures are not important for the scope of this text.

E. Penalties and Interest.

Penalties (including additions to tax and additional amounts) and interest are determined at the partnership level.⁴³⁰⁰ (For the balance of this discussion of CPAR, when I refer to penalties, I refer to the financial costs, commonly called penalties, Subtitle F, Chapter 68, Subchapter A - Additions to Tax and Additional Amounts, which includes Code §§ 6651-6665.) Interest and those penalties which are time-based are calculated from the due date of the reviewed year return. § 6233.⁴³⁰¹ Interest and penalties may be imposed for the partnership's failure to pay the imputed underpayment in the adjustment year.⁴³⁰²

Only partnership level defenses to penalties may be asserted by the partnership.⁴³⁰³

F. Partnerships Subject to CPAR.

1. All Partnerships.

The general rule is that all partnerships are subject to the regime. § 6221.

⁴²⁹³ § 6225(c); Reg. § 301.6225-2.
⁴²⁹⁴ § 6225(c)(2). A special rule is provided in case of reallocations among the partners; this rule will apply only if amended returns are filed by all partners affected by the reallocation. § 6225(c)(2)(B).
⁴²⁹⁵ § 6225(c)(3).
⁴²⁹⁶ § 6225 (c)(4).
⁴²⁹⁷ § 6225(c)(2)(B).
⁴²⁹⁸ § 6225(c)(6).
⁴²⁹⁹ Reg. § 301.6225-2.
⁴³⁰⁰ § 6233(a)(2) & § 6233(a)(3); Reg. § 301.6233(a)-1.
⁴³⁰¹ Id.
⁴³⁰² § 6233(b); Reg. § 301.6233(a)-1(b)
⁴³⁰³ § 6233(a)(3); Reg. § 301.6233(a)-1(c)(noting exception for modifications under Reg. § 301.6225-2).

2. Exception - Partnerships With 100 or Fewer Partners Based on Annual Election Out.

Partnerships may elect out of CPAR if the partnership has 100 or fewer Schedules K-1 for partners who are individuals, C corporations (including foreign entities which would be treated as C Corporations if domestic), S Corporations (but only if the partnership provides identity information for each person to whom each S corporation partner is required to file Schedules K-1) or estate of deceased partner.⁴³⁰⁴ Partnerships are not eligible partners.

The election is made annually on a timely filed partnership return and must include the name and taxpayer identification number of each partner and the partnership must notify each partner of the election.⁴³⁰⁵ The result of the opt out election is that, although the partnership may be audited to determine the partnership's results that flow through to the partners, separate audits and judicial proceedings are required at the partner level rather than at the partnership level. Penalties are determined at the partnership level and imposed on the partner without partner level defenses.

G. Partner Must Report Consistent with Partnership Return.

The partner must report on the partner's return the partnership-related items consistent with the partnership's treatment on the partnership return.; § 6222.⁴³⁰⁶ The following do not meet this requirement: (i) reporting consistently with a schedule (such as a Schedule K-1) provided by the partnership, unless upon notification by the IRS of the inconsistency the partner files an election;⁴³⁰⁷ and (ii) any partner level reporting where the partnership does not file a return.⁴³⁰⁸ If the partner fails to so report, the IRS may make immediate assessments to the partner consistent with the partnership return as if it were a mathematical or clerical error under § 6213(b) unless the partner has filed a notice of inconsistent treatment.⁴³⁰⁹

A partner is excepted from the consistent reporting requirement if the partner files a notice of inconsistent position with the return on which the partnership items are treated inconsistently or with an amended return filed before the IRS mails notice of administrative proceeding.⁴³¹⁰ A partner who filed the partner's return consistent with the treatment the partnership furnished the partner will be deemed to meet this notice requirement if the partner makes an election within 60 days after the IRS notifies the partner of the inconsistent treatment.⁴³¹¹ However, if the IRS disagrees with the

⁴³⁰⁴ § 6221(b); see Reg. § 301.6221(b)-1.

⁴³⁰⁵ § 6221(b)(1)(D) & (E); Reg. § 301.6221(b)-1(c)(1).

⁴³⁰⁶ § 6222(a); § 301.6222-1, Partner's return must be consistent with partnership return.

⁴³⁰⁷ § 6222(c)(1)(A).

⁴³⁰⁸ § 6222(c)(1)(A); Reg. § 301.6222-1(a)(3).

⁴³⁰⁹ § 6222(b) & (c); Reg. § 301.6222-1(b). The procedures under § 6213(b)(2) for requesting abatement of the mathematical or clerical error assessments, however, do not apply. Reg. § 301.6222-1(b)(2).

⁴³¹⁰ § 6222(c); Reg. § 301.6222-1(c).

⁴³¹¹ § 6222(c)(2); Reg. § 301.6222-1(d). The partner makes the election in a writing clearly identified as a 6222(c)(2)(B) Election, signed by the partner, accompanied by a copy of the partnership statement or other document the partner relied upon in making the original filing that was inconsistent with the partnership treatment. Reg. § 301.6222-1(d)(2).

claim of inconsistent position or the IRS determines the correct treatment in a partnership level proceeding, the IRS may adjust the item on the partner's return.⁴³¹²

H. Partnership Administrative Adjustment Request.

Although a partnership generally may not amend the partnership return,⁴³¹³ the partnership may make an Administrative Adjustment Request ("AAR"), which is taken into account in the year the administrative adjustment request is made. § 6227.⁴³¹⁴ In filing the AAR, the partnership must compute the imputed underpayment.⁴³¹⁵ If the AAR results in an imputed underpayment, the partnership must pay the imputed underpayment on the date of the AAR or appropriate penalties and interest on the nonpayment.⁴³¹⁶ The partnership may elect, however, to have the tax consequences of the adjustments associated with the imputed underpayment imposed on the reviewed year partners in the reporting year.⁴³¹⁷ If any adjustments are not associated with an imputed underpayment at the partnership level, the partnership must furnish appropriate statements to the reviewed year partners and those partners must report the adjustments in the reporting year.

The partnership must file the AAR within three years after the later of the date the return was filed or the due date of the return without extensions.⁴³¹⁸ but may not make an AAR for a partnership taxable year after the IRS has mailed the partnership a notice of an administrative proceeding with respect to the taxable year.⁴³¹⁹

I. Procedures.

1. Partnership Representative and Authority to Bind.

In the partnership level proceedings, the partnership is represented by a single Partnership Representative who has sole authority to act for the partnership. § 6223.⁴³²⁰ The Partnership Representative has authority to bind the partnership and the partners in respect of any partnership administrative proceeding and any ensuing judicial review of the determinations made in the partnership administrative proceeding.⁴³²¹ Partners do not have the **right** to participate in the partnership level proceedings but the IRS **may** permit a partner to participate.⁴³²²

⁴³¹² Reg. § 301.6222-1(c)(4).

⁴³¹³ § 6031(b) precludes amending the information provided to the partners on Schedules K-1, which practically means that the partnerships may not amend the return. Section 6031(b)(4) provides that the Secretary may "otherwise provide." Invoking that authority, the IRS has provided an exception to permit amended returns to take advantage of certain retroactive relief in the Coronavirus Aid, Relief, and Economic Security Act (CARES Act), P.L. 116-136, 134 Stat. 281 (March 27, 2020). See Rev. Proc. 2020-23, 2020-18 I.R.B.

⁴³¹⁴ § 6227(a).

⁴³¹⁵ Reg. § 301.6227-1(a).

⁴³¹⁶ Reg. § 301.6227-2(b).

⁴³¹⁷ § 6227(b)(2); Reg. § 301.6227-1(c).

⁴³¹⁸ § 6227(c)

⁴³¹⁹ § 6227(c) (flush language).

⁴³²⁰ § 6223(a); Regs § 301.6223-1; Reg. § 301.6223-2(d)(1).

⁴³²¹ § 6223(b); Regs § 301.6223-2.

⁴³²² Reg. § 301.6223-2(d)(1).

The Partnership Representative is designated by the partnership in its partnership return in the manner required by regulations.⁴³²³ Different partnership years may have different Partnership Representatives. The Partnership Representative need not be a partner but must have a substantial presence in the U.S.⁴³²⁴ The Partnership Representative may be an entity, known as the entity partnership representative, if the partnership appoints an individual, known as a designated individual, as the sole individual to represent the partnership.⁴³²⁵

Once designated in the return, the partnership may not change its Partnership Representative until the IRS notifies an administrative proceeding.⁴³²⁶

If no Partnership Representative is designated or the IRS determinations that a designation is not in effect, the IRS may select the partnership representative.⁴³²⁷ Although the statute allows the IRS to designate “any person,” the regulation provides factors that the IRS considers in designating an appropriate Partnership Representative.⁴³²⁸

The regulations provide elaborate procedures to assure that, at any time, there is a Partnership Representative authorized to deal with the IRS.⁴³²⁹

2. Audit Proceedings and Notices.

The partnership is audited at the entity level. For many years, for a host of reasons, businesses conducted through a partnership were audited less frequently and less comprehensively than businesses conducted through C corporations. Under the CPAR, the audit activity for partnerships will likely increase. The IRS has announced the intention to implement a Large Partnership Compliance Program (acronymed to “LPC”), with the early stages in a “pilot” program titled the LPC Pilot Program.⁴³³⁰ This program is “modeled off of the Large Corporate Compliance (LCC) Program, which replaced the Coordinated Industry Case (CIC) Program.”⁴³³¹ The overall goal is to better identify appropriate partnerships for audit and to deploy IRS audit resources better for maximum compliance effect.⁴³³²

The IRS must mail the following notices to the partnership and the partnership representative (§ 6231).⁴³³³

⁴³²³ Reg. § 301.6223-1(a) & 1(c).
⁴³²⁴ Reg. § 301.6223-1(b)(2).
⁴³²⁵ Reg. § 301.6223-1(b)(3).
⁴³²⁶ Reg. § 301.6223-1(d)(2).
⁴³²⁷ § 6223(a); Reg. § 301.6223-1(f)(5).
⁴³²⁸ Reg. § 301.6223-1(f)(5)(ii).
⁴³²⁹ Reg. § 301.6223-1.
⁴³³⁰ See IRS LB&I Memo for all LB&I Employees dated 10/21/21 (Publication 5388 (Rev. 7-2021) Catalog Number 73720B).
⁴³³¹ Rochelle Hodes (Guest Blogger), Recent Developments in Partnership Audits (Part 2) (Procedurally Taxing Blog 11/2/21).
⁴³³² The IRS offers a helpful schematic in Pub. 5388 titled Bipartisan Budget Act (BBA) Roadmap for Taxpayers (Rev. 7-2021 Catalog Number 73720B).
⁴³³³ § 6231(a); Reg. § 301.6231-1(a).

- Notice of administrative proceeding (“NAP”) (the administrative proceeding is the audit at the partnership level “with respect to an adjustment of any item of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year, or any partner’s distributive share thereof”).⁴³³⁴
- Notice of any “proposed partnership adjustment” (“NOPPA”), which must be made within the statute of limitations for making adjustments.⁴³³⁵
- Notice of any “final partnership adjustment” (“FPA”), which must be mailed earlier than 270 days after the NOPPA (unless an extension is agreed in writing).⁴³³⁶

The IRS may withdraw the NAP or NOPPA.⁴³³⁷ The FPA may be rescinded by the IRS with consent of the partnership.⁴³³⁸ After the FPA and the partnership petitions a court for review, further notices are not permitted except upon “showing of fraud, malfeasance, or misrepresentation of a material fact.”⁴³³⁹

3. Judicial Review of FPA.

The partnership may contest the FPA in the Tax Court, the district court for the partnership’s principal place of business, or the Court of Federal Claims. § 6234.⁴³⁴⁰ In the proceeding, the Court may determine: (i) all partnership-related items for the partnership year; (ii) the proper allocation of such items among the partners, and (iii) the application of any penalty.⁴³⁴¹

Judicial review requires that (i) the partnership file a “petition for a readjustment” within 90 days after the FPA,⁴³⁴² and (ii) if filed in the district court or Court of Federal Claims, prior to or contemporaneously with the petition, make a “deposit” (treated as a payment only for purposes of

⁴³³⁴ § 6231(a)(1).

⁴³³⁵ § 6231(a)(2); Reg. § 301.6231-1(b)(1), referring to § 6235(a)(1) (including any extensions under section 6235(b) and any special rules under section 6235(c)).”

⁴³³⁶ § 6231(c)(3) (including flush language); Reg. § 301.6231-1(b)(2).

⁴³³⁷ Reg. § 301.6231-1(f).

⁴³³⁸ Reg. § 301.6231-1(g).

⁴³³⁹ § 6231(b). As to the interpretation of this provision, the authority under the similarly worded § 6223(f) TEFRA rule replaced by this statute should apply. **Caveat as to misrepresentation:** The IRC contains provisions, variously worded, that provide exceptions to a prescribed result when certain conditions, including misrepresentation, are present. The ones relevant to this course are: §§ 6231(b) (if FPAA issued and petition filed, no more FPAAs permitted “in the absence of a showing of fraud, malfeasance, or misrepresentation of a material fact”); 6532(b) (statute of limitations on erroneous refund suit is 2 years except extended to 5 years if “any part of the refund was induced by fraud or misrepresentation of a material fact”); and 7121(b) (closing agreement final except for “fraud or malfeasance, or misrepresentation of a material fact”) (Note, § 6231(b) is the successor to repealed TEFRA § 6223(f) similarly worded.) Depending upon context, the word “misrepresentation” may mean either an innocent misrepresentation of fact or requires some level of culpability (at least negligence, but usual intent to deceive). E.g., *Halpern v. Commissioner*, T.C. Memo. 2000-151, at *9 (“For purposes of section 7121, a misrepresentation is not synonymous with a mistake: It denotes something more deliberate or more conscious than mere error or mistake.” (Internal quotations omitted)); and *NPR Invs., L.L.C. v. United States*, 740 F.3d 998 (5th Cir. Tex. 2014) (§ 6223(f), barring a second FPAA notice except for “fraud, malfeasance, or misrepresentation of a material fact,” does not require intent to deceive for misrepresentation and even innocent misrepresentations can apply).

⁴³⁴⁰ § 6234(a); Reg. § 301.6234-1.

⁴³⁴¹ § 6234(c).

⁴³⁴² § 6234(a).

interest computations) of the amount of the imputed underpayment and any penalties.⁴³⁴³ The partnership is entitled to return of the amount of the deposit in excess of the amount of tax imposed upon the partnership.⁴³⁴⁴

The Tax Court has adopted Rules for judicial review in the Tax Court.⁴³⁴⁵

4. Assessment and Collection.

Any imputed underpayment tax at the partnership level is assessed and collected in the same manner as if it were a tax. § 6232.⁴³⁴⁶ Unless the adjustment is correction a mathematical or clerical error appearing on the return or for an inconsistency in reporting related to a partnership in which the partnership is a partner, the assessment may not be made until the FPA is issued nor until the expiration of 90 days (during which period the partnership may file a judicial proceeding to contest) or, if such proceeding is filed, during the period before the decision of the court is final.⁴³⁴⁷ The partnership adjustment will be subject to interest (at 2% over the regular underpayment interest rate) and penalties based upon the reviewed year.⁴³⁴⁸

If the imputed underpayment or related amount for interest or penalties has not been paid within 10 days after the date the IRS makes notice and demand for payment (commensurate with assessment), the IRS may assess each partner, determined at the close of the adjustment year, the partner's proportionate share of the unpaid amount.⁴³⁴⁹

5. Statute of Limitations.

The statute of limitations for adjustments is generally 3 years after the latest of the date the partnership return was filed, the due date of the partnership return, or the date of filing an AAR. § 6235.⁴³⁵⁰ Exceptions are: (i) the period may be extended by agreement;⁴³⁵¹ (ii) an unlimited statute for a false or fraudulent partnership return with intent to evade tax;⁴³⁵² (iii) a substantial omission of gross income under the rules of § 6501(e)(1)(A);⁴³⁵³ (iv) an unlimited statute if no return was

⁴³⁴³ § 6234(b)(1); Reg. § 301.6234-1(b). The

⁴³⁴⁴ Reg. § 301.6234-1(e). This invokes the payment/deposit distinction discussed earlier (beginning p. 281), but given the carve out for interest, the deposit will be treated as payment for interest.

⁴³⁴⁵ See Tax Court Rules Title XXIV.A. Partnership Actions Under BBA Section 1101 (Rules 255.1 through 255.7), effective December 19, 2018.

⁴³⁴⁶ § 6232(a).

⁴³⁴⁷ § 6232(b) and § 6232(d)(1). The exception for mathematical or clerical errors adopts "rules similar to the rules of paragraphs (1) and (2) of section 6213(b)." See Reg. §301.6232-1(d)(1). The partnership may waive these restrictions on assessment. § 6231(d).

⁴³⁴⁸ § 6233 and 6232(f).

⁴³⁴⁹ § 6232(f)(1)(B).

⁴³⁵⁰ § 6235(a)(1).

⁴³⁵¹ § 6235(b).

⁴³⁵² § 6235(c)(1).

⁴³⁵³ § 6235(c)(2).

filed;⁴³⁵⁴ (v) an unlimited statute if the IRS files a § 6020(b) partnership return;⁴³⁵⁵ (vi) extension for failure to report information described in § 6501(c)(8) as provided therein;⁴³⁵⁶ and (vii) extension for failure to report listed transactions.⁴³⁵⁷ The statute is suspended during the period after mailing the FPA and, if litigated, until the decision of the court is final plus 1 year thereafter.⁴³⁵⁸

J. Partnership Election for Partner Level Assessment and Payment After FPA.

The partnership may elect within 45 days of the FPA to have the partnership adjustments (that underlie the computation of the imputed underpayment) apply to the reviewed year partners in their respective shares. § 6226.⁴³⁵⁹ This election is sometimes called the “Push Out Election.” This election imposes the tax, penalties and interest on the reviewed year partners (as opposed to the partners in the adjustment year).⁴³⁶⁰ The reviewed year adjustments at the partner level applies to the reviewed year partner’s returns in the year the partnership furnishes the reviewed year partners a statement of the reviewed year partners’ respective shares.⁴³⁶¹ The partner must then report the adjustment in his return including the statement year consistent with the statement furnished by the partnership.⁴³⁶² The resulting reporting at the partner level may require additional tax, penalties and interest at the partner level or may result in a refund at the partner level.

The push out election allows adjustments to be pushed out through tiers of partnerships.⁴³⁶³

The partnership may still file for judicial review of the FPA to contest the partnership adjustments.⁴³⁶⁴ A filing in the district court or the Court of Federal Claims requires that the partnership meet the jurisdictional deposit requirement discussed above.

Penalties and interest are imposed on the resulting partner-level adjustments in the adjustment year from the due date of the partner’s return for the reviewed year.⁴³⁶⁵ The interest rate on the tax thus “pushed out” to the partners is increased by 2 points over the normal underpayment interest rate.⁴³⁶⁶ Penalties for partnership-related items are initially determined at the partnership level and allocated to the partners; any partner with a partner level defense may litigate by paying the penalty and claiming a refund.⁴³⁶⁷

K. Partnership Ceases to Exist; Bankruptcy.

| | |
|------|---|
| 4354 | § 6235(c)(3). |
| 4355 | § 6235(c)(4). |
| 4356 | § 6235(c)(5). |
| 4357 | § 6235(c)(6). |
| 4358 | § 6235(d). |
| 4359 | § 6226(a) & (b); Reg. § 301.6226-1. See § 6225(d)(1) for the definition of the reviewed year. |
| 4360 | Reg. § 301.6226-1(a). |
| 4361 | § 6226(a)(1) & § 6226(b)(1). |
| 4362 | Reg. § 301.6226-1(e). |
| 4363 | § 6226(b)(4). |
| 4364 | § 6226(d) (referring to § 6234 for timing of a petition for readjustment); Reg. § 301.6226-1(f). |
| 4365 | § 6226(c). |
| 4366 | § 6226(c)(2)(C), which increases the underpayment rate, normally the federal short-term rate plus 3%, to the federal short-term rate plus 5%. |
| 4367 | § 6226(c)(1); Reg. § 301.6226-3(d)(1) and (3). |

1. Bankruptcy.

If the Partnership is under Title 11 (Bankruptcy), the statute of limitations is suspended: (i) for assessment and collection of the imputed underpayment during the period that the IRS is prohibited from making the adjustment, assessment or collection; and (ii) for filing the petition for readjustment under § 6234. § 6241(6).⁴³⁶⁸

2. Partnership Ceases to Exist.

If the partnership ceases to exist before a partnership adjustment is made, the unpaid partnership adjustments related to unpaid imputed understatements is taken into account, as prescribed in regulations, by the former partners. § 6241(7).⁴³⁶⁹ The regulations are complex, but basically impose the adjustments related to unpaid imputed understatements on the partners in the last year of the partnership.⁴³⁷⁰

3. Entity Never Existed but Filed Partnership Return.

If the entity or putative entity was not a partnership but filed a partnership return, the CPAR applies. § 6241(8).⁴³⁷¹

L. Special Enforcement Matters.

The IRS is authorized to provide that CPAR does not apply or that special rules do apply for “Special Enforcement Matters” defined as (§ 6241(11)):

- (i) failure to comply with the requirements of section 6226(b)(4)(A)(ii),
- (ii) assessments under section 6851 (relating to termination assessments of income tax) or section 6861 (relating to jeopardy assessments of income, estate, gift, and certain excise taxes),
- (iii) criminal investigations,
- (iv) indirect methods of proof of income,
- (v) foreign partners or partnerships, and
- (vi) other matters that the Secretary determines by regulation present special enforcement considerations.

The IRS issued proposed regulations under this section.⁴³⁷²

M. Partnership Payments Nondeductible.

⁴³⁶⁸ Reg. § 301.6241-2.

⁴³⁶⁹ Reg. § 301.6241-3; Reg. § 301.6241-3(c)(2).

⁴³⁷⁰ Reg. § 301.6241-3(d), (e) & (f).

⁴³⁷¹ Reg. § 301.6241-5.

⁴³⁷² Prop. Reg. § 301.6241-7. Section 7(f) of the Proposed Regulations, for example, permits adjustment of partnership-related items in certain controlled partnerships at the partner level even if the period for adjustment at the partnership level has expired if the period of limitations at the partner level is still open or they agree in writing.

Partnership payments under the CPAR provisions (including payments of imputed underpayment, penalties and interest) are not deductible. § 6241(4).⁴³⁷³

N. Addressing CPAR Issues in Partnership Agreements.

Partnerships and partners should consider CPAR in drafting or amending partnership agreements. As noted above, the economic costs of reviewed year adjustments are generally imposed upon the partners in the adjustment year rather than the partners in the reviewed year. There are elections that can change this result, such as the election out when the partnership less than 100 or fewer partners or the “push out” election. Partnership agreements should address these elections and impose partnership obligations (both to the partnership and among the partners) so that partnerships can make and manage the elections effectively. In addition, the partnership agreement should address the annual selection of the Partnership Representative, because that individual has full authority to bind the partnership and its partners. These are the more significant issues to address, but the partners should address in the partnership agreement all aspects of CPAR that may be relevant to the operation of the partnership and the partners sharing in the economic and tax results from those operations.

IV. Publicly Traded Partnerships (Treated as Corporations).

Section 7704(a) provides that “a publicly traded partnership shall be treated as a corporation.” A publicly traded partnership (“PTP”) is defined as a partnership (i) with partnership interests “traded on an established securities market” or (ii) with partnership interests “readily tradable on a secondary market (or substantial equivalent thereof).”⁴³⁷⁴ Most publicly traded partnerships are tax as corporations. If, however, the partnership’s passive income (called “qualifying income”) is 90 % or more of its gross income for the year in question and years after 1987, the partnership is excepted from corporate treatment.⁴³⁷⁵

I will not deal further here with PTPs but caution that there are considerable complexities for PTPs treated as corporations and for PTPs treated as partnerships because of the passive income exception.⁴³⁷⁶

⁴³⁷³ Reg. § 301.6241-4.

⁴³⁷⁴ § 7704(b).

⁴³⁷⁵ § 7704(c).

⁴³⁷⁶ See e.g., Dawn Drnevich and Thomas Sternberg, Publicly Traded Partnerships: Tax Treatment of Investors (The Tax Adviser 4/1/2019), here.

Ch. 17. Foreign Bank Account Issues (FBARs And Related).

I. Introduction.

Bad actors desiring to avoid detection by U.S. law enforcement (including the IRS as to tax enforcement) often use foreign bank accounts. Accordingly, in the Currency and Foreign Transaction Act,⁴³⁷⁷ often referred to as the Bank Secrecy Act (“BSA”), Congress enacted a regulatory scheme that authorized Treasury, by regulation, to require (i) U.S. persons to file reports related to foreign financial accounts and maintain recordkeeping requirements for foreign financial accounts and imposing significant criminal and monetary penalties and (ii) imposed significant penalties for failure to do so.⁴³⁷⁸ While the principal focus of such requirements is for other more general law enforcement (such as money laundering and drugs), tax enforcement is a goal of the requirements because significant erosion of the U.S. tax base is caused by nonreporting of income deposited into and earned in such foreign accounts. I spend some time here on aspects of the BSA because, since 2009, it has become such a prominent piece of the IRS’s enforcement efforts, including criminal enforcement efforts through DOJ Tax.

I focus in this chapter on the Report of Foreign Bank and Financial Accounts (“FBAR”) because that is the context most taxpayers and practitioners will encounter the BSA reporting requirements for offshore accounts.⁴³⁷⁹

II. The FBAR Report - FinCEN Form 114.

The BSA and underlying regulations require a Report of Foreign Bank and Financial Accounts, FinCEN Form 114 (often referred to as “FBAR,” the popular term for this form)⁴³⁸⁰ that must be filed by United States persons having a financial or signatory interest in a foreign financial account.⁴³⁸¹ You may recall that Form 1040, Schedule B has for years asked whether the taxpayer has foreign accounts and alerted the taxpayer as to a potential FBAR filing requirement. The most current iteration on the **2023** Form 1040 Schedule B asks

(i) “ At any time during 2023, did you have a financial interest in or signature authority over a financial account (such as a bank account, securities account, or brokerage account) located in a foreign country?” and

⁴³⁷⁷ Titles I and II of Pub. L. No. 91-508, as amended, codified at 12 USC § 1829b, 12 USC § 1951–1959, and 31 USC § 5311–5330.

⁴³⁷⁸ 31 U.S.C. § 3511, requiring “certain reports or records where they have a high degree of usefulness in criminal, tax, or regulatory investigations or proceedings, or in the conduct of intelligence or counterintelligence activities, including analysis, to protect against international terrorism.”

⁴³⁷⁹ Title 31 has other requirements, with applicable penalties for noncompliance, in the international context that are extremely important in cross-border transactions, particularly involving the financial system. For example, §§ 5314 and 5315 authorize the Treasury to require reports for foreign financial agency transactions and foreign currency transactions, and Treasury has done so. Failure to meet the requirements is penalized. I do not deal with those in this chapter.

⁴³⁸⁰ This report was formerly called Treasury TD 90.22.1.

⁴³⁸¹ 31 U.S.C. § 5314; 31 C.F.R. § 103.24.

(ii) if yes, “are you required to file FinCEN Form 114, Report of Foreign Bank and Financial Accounts (FBAR), to report that financial interest or signature authority.”⁴³⁸²

Not only does a wrong answer on the question on the income tax return (Form 1040, Schedule B) raise the specter of a tax perjury charge or even tax evasion if income is omitted and tax underreported, but failure to file the FBAR is an independent felony criminal act subject to the potentially harsher civil penalties (which I discuss below). The requirement to file an FBAR is independent of the requirement to answer the Schedule B questions on the tax return and to pay tax on income related to the foreign financial account. The two are related, for a taxpayer having a reportable interest in a foreign bank account who answers the question no is unlikely to report the income or file the FBAR; similarly a taxpayer who fails to answer the question at all is unlikely to report the income or file the FBAR.⁴³⁸³

III. Requirements for Filing the FBAR.

A United States person⁴³⁸⁴ is required to file an FBAR if all of the following are present: (i) at any time during the calendar year, (ii) the person has a “financial interest” in, or “signature authority” or “other authority” over (iii) one or more “financial accounts” in a “foreign country” (iv) with an aggregate value exceeding \$10,000.⁴³⁸⁵ Financial interest and signature or other authority are defined quite broadly to minimize technical avoidance of the duty to file.⁴³⁸⁶ In its current iteration, the FBAR requires the owner or person with signatory authority over the account to identify himself, herself or the entity filing the FBAR, identify the account (bank, location and account number), state the highest amount in the account during the year for which the report is filed, and identify the account owner. A close reading of the FBAR instructions and common sense are required to understand the quoted terminology.⁴³⁸⁷

⁴³⁸² There is also a question about dealing with foreign trusts and gifts and the obligation to file Form 3520, Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts.

⁴³⁸³ The Schedule B instructions generally do not require the Schedule B if taxable interest or ordinary dividends do not exceed \$1,500, but the Schedule B is required in all events if “You had an interest in, or signature authority over, a financial account in a foreign country.”

⁴³⁸⁴ A U.S. person is defined by reference to the definitions in Title 26. 31 C.F.R.1010.350(b). For example, the following are U.S. persons with potential FBAR filing requirements: (i) a U.S. citizen (§7701(a)(30)(A); 31 C.F.R.1010.350(b)(1); and (ii) Lawful permanent residents residing in the U.S. (31 C.F.R.1010.350(b)(2), incorporating § 7701(b) (but see § 7701(b)(6)(flush language) whereby an LPRM may cease to be an LPRM if commences residence in foreign country)).

⁴³⁸⁵ These requirements are drawn from the FBAR filing instructions on the FinCEN website. (See BSA Electronic Filing Requirements For Report of Foreign Bank and Financial Accounts (FinCEN Form 114) (release date 1/2017 v1.4). The underlying regulations requiring the filing are 31 C.F.R. § 1010.350 - Reports of foreign financial accounts.

⁴³⁸⁶ See the FBAR form instructions. See also *United States v. Clines*, 958 F.2d 578, 583 (4th Cir. 1992), cert. denied, 505 U.S. 1205 (1992) (involving an earlier version of the FBAR form).

⁴³⁸⁷ For example, a financial account includes the usual suspects (bank and brokerage accounts), but also includes “other financial account[s]. Id. Courts are likely to read this expansively to include accounts that can function like such accounts. In *United States v. Clines*, 958 F.2d 578 (4th Cir. 1992), cert. den. 505 U.S. 1205 (1992), the court held that a profit share capital account maintained on a ledger of a foreign corporation that permitted the defendant to withdraw funds met the definition.

The FBAR was historically required to be filed on June 30 for the prior year. In 2015, Congress changed the filing date to April 15 (contemporaneously with the individual income tax return due date for calendar year taxpayers, which can be the next succeeding business day if April 15 falls on a weekend or holiday) with the ability to obtain a 6-month extension to October 15 (also contemporaneous with the extended due date for individual income tax returns and also extended to the next succeeding business day if October 15 falls on a weekend or holiday).⁴³⁸⁸ Under the current instructions, FinCEN grants an automatic extension from April 15 to October 15; the automatic extension applies without any action on the filer's part other than not filing by the original due date.⁴³⁸⁹

IV. Informational Form Only; Use of Information.

The FBAR is just an information report requiring no payment. The FBAR is filed electronically with the IRS Detroit Computing Center (“DCC”). Upon the filing, the information from the FBAR is incorporated into the BSA financial database, which is jointly administered by DCC and FinCEN. The information is then available to FinCEN analysts, law enforcement (including the IRS), and appropriate regulatory authorities for use, among other things, in tracking flows of money. The FBAR is not subject to § 6103's privacy requirements and thus may be freely shared with law enforcement agencies. The IRS has principal responsibility to investigate FBAR compliance for civil and criminal penalty purposes and to assess and collect FBAR civil penalties.⁴³⁹⁰ The IRS may refer violations of the FBAR reporting requirements to the DOJ with a recommendation for criminal prosecution or civil suits to assert the FBAR civil penalties. Since the FBAR requirements are not part of the Internal Revenue Code, the procedural safeguards applicable in civil tax contexts may not apply, but the IRS may voluntarily apply some of them (such as the internal Appeals Office review process).⁴³⁹¹

⁴³⁸⁸ § 2006(b)(11), the Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (P.L. 114-41). The effective date of this FBAR filing provision is the filing year 2016 (i.e., the 2016 FBAR is due April 15, 2017 (actually, on the next succeeding business day), subject to the automatic extension to October 15, 2017 noted in the text).

⁴³⁸⁹ See IR-2021-83 (April 9, 2021) (noting due date of April 15 but noting that “filers missing the April 15 deadline will receive an automatic extension until October 15, 2021, to file the FBAR. They don’t need to request the extension.”)

⁴³⁹⁰ The IRS has been delegated authority to investigate, assess and collect FBAR civil penalties. 4.26.16.1.2 (06-24-2021), Authority (citing 31 CFR 1010.810); IRM 4.26.16.5(1) (06-24-2021), FBAR Penalties’ and IRM 4.26.16.5.1(8) (11-06-2015), FBAR Penalty Authority (citing 31 CFR 1010.810(g)). The IRS has been delegated criminal investigation authority for violations of the BSA, including FBAR reporting requirements. IRM Id., at (3) (citing 31 CFR 1010.810(c)(2)).

⁴³⁹¹ But, for example, the IRS will not apply the Code requirement of § 7491(c) that the IRS bear a burden of production with respect to penalties. That may not be an important matter because, as I note later, the IRS probably has an affirmative burden of persuasion at least with respect to the most draconian FBAR penalty, that will necessarily carry a burden of production. I suspect that, for the lesser FBAR penalties (the nonwillful penalties), the IRS may have the standard civil proof burden—more likely than not which would also carry with it a burden of production. It is not clear that the nonwillful FBAR penalty is subject to the presumption of correctness or any other similar consideration that some courts purport to use to force the burden of persuasion on the taxpayer to rebut the IRS’s determinations in IRC cases.

V. Criminal Penalty for FBAR Noncompliance.

The criminal penalty for willful failure to file is 5 years incarceration or \$250,000 fine or both.⁴³⁹² If the proscribed conduct occurs “while violating another law of the United States or as part of a pattern of any illegal activity involving more than \$100,000 in a 12-month period,” the criminal penalty increases to 10 years or \$500,000 fine, or both.⁴³⁹³ Although the language of this penalty “double-up” is not as crisp as I would like it, anecdotal evidence, which I cite in the footnote, suggests that these disjunctives do not include prototypical tax crimes—e.g., (i) multi-year failure to include on the return and pay tax on the interest income on the foreign account or (ii) the multi-year failure to report the foreign account(s) on FBARs.⁴³⁹⁴ Willful for criminal prosecution is, presumably, *Cheek*⁴³⁹⁵ willfulness - the intentional violation of a known legal duty, but the latter concept seems to include the criminal concept described as conscious avoidance, deliberate ignorance or similar labels.⁴³⁹⁶

The criminal statute of limitations is 5 years.⁴³⁹⁷

The foregoing discusses the criminal penalty for failure to file the FBAR. It is not clear that the FBAR criminal statute covers filing a false FBAR. As a result, it is reported that false FBARs may be charged under some other statute, such as 18 U.S.C. 1001, false statements.⁴³⁹⁸

⁴³⁹² 31 U.S.C. § 5322(a). By contrast, the criminal penalty is 5 years for false statements (18 U.S.C. §1001) and 3 years for tax perjury (§ 7206(1)). In the criminal prosecutions arising during the 2009-2011 major IRS initiatives for offshore financial accounts, the plea deal offered to most defendants was one count of FBAR violation (5 years) or one count of tax perjury (3 years) related to omitting the income and/or failing to answer the foreign account question properly, with the defendant given his choice. The Guidelines sentencing range would be the same in any event and thus the count of plea and conviction would be irrelevant for sentencing but could have some collateral consequences.

⁴³⁹³ 31 U.S.C. § 5322(b).

⁴³⁹⁴ Although a case might be made that the disjunctives in the double-up statutory text might catch the prototypical tax crime or the failure to file FBARs involving foreign accounts exceeding \$100,000, anecdotal evidence implies that the Government and courts do not apply the statute to cover such conduct. In the criminal convictions to the date of this article arising from the Government’s offshore financial account initiative commencing with the UBS onslaught in 2009, several defendants have pled to FBAR violations. In those cases which have been sentenced to date, all parties involved in the process—the Government, the defendant, the Probation Office and the court—seem to have acted on the assumption that the five year criminal penalty applied. Of course, in those cases, it seems clear that the courts were not going to actually impose penalties beyond the undoubled penalties, so these anecdotal instances may not be true indicators of whether the doubled penalties could apply to an extreme, but prototypical, tax crime. Finally, a word of caution. Similar language on the double up is contained in S.G. 3S1 which is the Sentencing Guideline applying to FBAR criminal violations.

⁴³⁹⁵ *Cheek v. United States*, 498 U.S. 192 (1991).

⁴³⁹⁶ This concept is too large to develop in this text. I do note that the Supreme Court blessed this concept in a civil context and, in doing so, seemed in dicta to bless it in a criminal context. *Global Tech Appliances, Inc. v. SEB*, 563 U.S. 754 (2011). I don’t think that the application of this concept in the criminal area is yet settled.

⁴³⁹⁷ 18 U.S.C. §3282.

⁴³⁹⁸ An IRS attorney reported at a seminar that it is not certain that the FBAR criminal penalty in 31 U.S.C. § 5314 can be applied to a false FBAR. In subsequent email correspondence about this issue, he explained: My Area [geographical area of the IRS] typically recommends 1001 [18 U.S.C., false statement] be used for false FBARs since Fin Cen Form 114 (formerly TD F 90-22.1) does not contain a jurat. I think there is uncertainty whether an FBAR violation can be charged under * * * 5314 since there is no jurat and 5314 does not say that an accurate statement must be filed—just that one must be filed.

(continued...)

VI. Civil Penalties for FBAR Noncompliance.

The civil penalties for failure to file the FBAR, which apply even if the criminal penalties apply,⁴³⁹⁹ are graduated according to the gravity of the offense. In part relevant to most taxpayers,⁴⁴⁰⁰ they are divided into willful violations and nonwillful violations:

(i) if **nonwillful**, not exceeding \$10,000 [inflation adjusted to \$13,481 for amounts assessed after 2/19/20]⁴⁴⁰¹ per violation but with an exception if both reasonable cause (“reasonable cause requirement”) and proper reporting of the account(s) (“reporting requirement,” which is developed in the **footnote**).⁴⁴⁰² The statute says that the nonwillful penalty “shall not exceed \$10,000,” implying that the IRS can assess a nonwillful penalty of less than \$10,000.⁴⁴⁰³ In the exercise of that authority, the IRS has certain mitigation guidelines that may apply to assess a lesser nonwillful penalty.⁴⁴⁰⁴ **In *Bittner v. United States*, 598 U.S. 85 (2023) the Court held that the “violation” for the nonwillful penalty is the FBAR Form, so that the penalty maximum for a year is \$10,000 (adjusted for inflation) regardless of the number of accounts that were not reported.**

⁴³⁹⁸(...continued)

This might be too cautious but since the instructions to Form 114 (and 90-22.1) explicitly state that false Forms may be prosecuted under 1001, I prefer to recommend that charge.

⁴³⁹⁹ 31 U.S.C. § 5321(d).

⁴⁴⁰⁰ There are some penalties applicable for violations by financial institutions and nonfinancial trades of businesses. 31 U.S.C. § 5321(a)(6)(a) (dealing with negligent and pattern of negligence. I do not discuss these here because the current enforcement focus is on the individual FBAR violations which I do discuss in the text.

⁴⁴⁰¹ 31 CFR Part 1010, § 1010.821 Penalty adjustment and table (published 2/19/20 and effective 2/19/20).

⁴⁴⁰² 31 U.S.C. § 5321(a)(5)(B)(ii). The exception to the non-willful penalty has two conjunctive requirements: (i) a reasonable cause requirement and (ii) a reporting requirement.

Reasonable cause is a frequently encountered concept avoiding tax penalties and is used for the nonwillful FBAR penalty defense. E.g., *United States v. Bittner*, 19 F.4th 734 (5th Cir. 2021) (analyzing issue and citing cases), **rev'd on other issue, *Bittner v. United States*, 598 U.S. 85 (2023)**; and *United States v. Ott*, 2019 U.S. Dist. LEXIS 132013 (E.D. Mich. 2019) (citing cases).

The reporting requirement is unusual. In the case of a failure to report timely (either no FBAR filed or an FBAR filed with accounts omitted), the failure to report or report timely is the act that causes the filer/non-filer to be at risk for the penalty in the first place. Surely, if the statutory conjunctive reporting requirement means proper and timely FBAR reporting in the first instance, the issue of the non-willful penalty never arises and a supposed reasonable cause escape is meaningless. Assuming the reasonable cause exception means something, some interpretation of the conjunctive requirement is required to give it meaning. The IRM currently says that this conjunctive reporting requirement is that “Accurate delinquent or amended FBAR(s) are filed, **rectifying** prior violation(s).” IRM 4.26.16.5.4 (06-24-2021), Penalty for Non-willful FBAR Violations (emphasis supplied by JAT). This seems consistent with the prior IRM provisions which said: (1) “This means that the examiner must receive the delinquent FBARs from the non-filer to avoid application of the non-willfulness penalty.” IRM 4.26, ¶ 16.4.4.2, Non-Willfulness Penalty (July 1, 2008); and (2) “The person files any delinquent FBARs and properly reports the **previously** unreported account.” IRM ¶ 4.26.16.6.4, Penalty for Nonwillful FBAR Violations (Nov. 6, 2015) (emphasis supplied).

⁴⁴⁰³ The IRM says that the penalty is “up to” \$10,000 implying authority for a lesser nonwillful penalty. IRM 4.26.16.5.4(4) (06-24-2021), Penalty for Non-willful FBAR Violations.

⁴⁴⁰⁴ IRM 4.26.16.5.4.1(1) & (2) (06-24-2021), Penalty for Non-willful Violations - Calculation (referencing mitigation guidelines).

(ii) if **willful**, not exceeding the greater of \$100,000 [inflation adjusted to \$134,806 for amounts assessed after 2/19/20]⁴⁴⁰⁵ or 50% of the balance in the account(s) at the time of the violation.⁴⁴⁰⁶ As with the nonwillful penalty, the willful penalty amounts are maximum amounts, which means that the IRS, in its discretion, may assert willful penalties in lesser amounts.⁴⁴⁰⁷ In the exercise of that authority, the IRS has certain mitigation guidelines that may apply to assess a lesser nonwillful penalty.⁴⁴⁰⁸ The violation to which the willful penalty applies is per account rather than per Form.⁴⁴⁰⁹ Although the maximum willful penalty may apply to each willful year to which the statute of limitations is open, the IRM provides that, absent unusual circumstances, a single willful penalty amount will be 50% of the aggregate high amount in the account(s) during the willful years, which is then allocated to the willful years relative to their high amounts but not in excess of 50% of the high balance on the year's reporting date (which is the statutory maximum amount). In multiple year willful penalty cases, this method of allocation will always produce in each year a maximum willful penalty equal to or less than the statutory high amount based on reporting date balances. This method of allocation has been subject to litigation and, in some cases, held to be arbitrary and capricious because it does not use the reporting date balances (except as a cap).⁴⁴¹⁰

These penalties apply to false FBARs, but false FBARs are more likely to draw the willful penalty because the filing of the FBAR establishes the filer's knowledge of the FBAR requirement and an inference of willfulness in leaving one or more accounts is easier to draw.

Willful for this penalty includes the *Cheek* criminal willfulness standard--intentional violation of a known legal duty--and a more relaxed civil willful standard including (1) recklessly

⁴⁴⁰⁵ See FinCEN publication in of final rule in Federal Register, 85 FR 9370 (2/19/20), revising Table 1 of § 1010.821—Penalty Adjustment and Table.

⁴⁴⁰⁶ 31 U.S.C. §5321(a)(5)(C). The not exceeding language is actually in the nonwillful penalty, with the willful penalty substituting the willful penalty maximum amounts for the nonwillful penalty maximum amounts.

The courts have held that the 2004 statutory amendment to increase the willful penalty above its prior statutory maximum of \$100,000 applies after the effective date of the 2004 statutory amendment even regulation 31 CFR § 1010.820(g) stating the prior maximum remained. E.g. *Norman v. United States*, 942 F.3d 1111, 1117-1118 (Fed. Cir. 2019); and *United States v. Kahn*, 5 F.4th 167, 173-177 (2d Cir. 2021). That regulation was finally amended effective December 23, 2021 to delete subsection (g), thus eliminating the seeming inconsistency with the willful penalty maximum as provided in the 2004 statutory amendment.

⁴⁴⁰⁷ *Bedrosian v. United States*, 42 F.4th 174, 179 & 181-182(3rd Cir. 2022).

⁴⁴⁰⁸ IRM 4.26.16.5.5.3(1) & (2) (06-24-2021), Penalty for Willful FBAR Violations - Calculation

⁴⁴⁰⁹ See IRM Exhibit 4.26.16-2, FBAR Penalty Mitigation Guidelines for Violations Occurring After October 22, 2004 (Willful Penalty Mitigation Level IV, which is the maximum penalty without mitigation, applying “For each account for which there was a violation, the greater of 50% of the account balance on the violation date (defined in IRM 4.26.16.5.2) or the statutory maximum penalty for willful violations.”).

⁴⁴¹⁰ E.g., the ongoing saga in *United States v. Schwarzbaum*, 125 AFTR2d 2020-1323 (SD Fla. 2020), aff'd 24 F4th 1355 (11th Cir. 2022). The *Schwarzbaum* penalty amount was remanded of the IRS for redetermination and, after remand, the IRS determined the same aggregate amounts. That redetermination was approved by the district court. Schwarzbaum appealed the decision on 11/2/22. I expect Schwarzbaum will include on appeal that the statute of limitations was closed because, having found the initial assessment arbitrary and capricious, the initial assessment was void requiring the IRS's redetermination to be subject to a new assessment barred by the 6-year statute of limitations.

violating a legal duty and (2) acting “willful blindness” as to the legal duty.⁴⁴¹¹ The Government must prove the willful conduct by a preponderance of the evidence.⁴⁴¹² For the nonwillful penalties, it is not clear exactly how the burden of proof works since there is virtually no learning on that subject. Presumably, since this is not a tax penalty where factors inherent in the tax system may require some burdens to be borne by the taxpayer, the IRS will have to prove its entitlement to the penalty by the standard civil more likely than not burden and the taxpayer will have to prove entitlement to the reasonable cause exception.

⁴⁴¹¹ IRM 4.26.16.5.5.1 (06-24-2021), Willful FBAR Violations - Defining Willfulness. At one time, the IRM provided that the FBAR willful penalty standard was the *Cheek* definition without the more relaxed standards. The more relaxed standards have been sustained by consensus holdings in the courts. *Bedrosian v. United States*, 912 F.3d 144 (3rd Cir. 2018) (willfulness includes acting knowingly or recklessly); *United States v. Garrity*, 304 F. Supp. 3d 267 (D. Conn. 2018); *United States v. Bohanec*, 263 F. Supp. 3d 881 (C.D. Cal. 2016) (reckless conduct is willful); *Kimble v. United States*, 2018 U.S. Claims LEXIS 1761(CFC 2018) (same); and *United States v. Horowitz*, 361 F. Supp. 3d 511 (D. Md. 2019) (willful blindness). The Supreme Court blessed this concept as a basis for willfulness in a civil nontax context in *Global Tech Appliances, Inc. v. SEB*, 563 U.S. 754 (2011). See in the context of FBAR willfulness penalty, *United States v. Williams*, 2012 U.S. App. LEXIS 15017 (4th Cir. 2012); and *United States v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012).

In an earlier version of the IRM, the IRS said what FBAR civil willfulness was the same as *Cheek* willfulness for the criminal tax provisions. IRM 4.26.16.6.5.1 (11-06-2015), Willful FBAR Violations - Defining Willfulness, defines willfulness as “a voluntary, intentional violation of a known legal duty,” which is the same as the *Cheek / Pomponio* definition of willfulness for purposes of the criminal tax provisions. As indicated the courts have not so constrained the FBAR civil willful penalty, so the current IRM provision reflects these case holdings.

⁴⁴¹² *United States v. Williams*, 2012 U.S. App. LEXIS 15017 (4th Cir. 2012) (unpublished); *United States v. McBride*, 908 F. Supp. 2d 1186 (D. Utah 2012); *Bedrosian v. United States*, 2017 U.S. Dist. LEXIS 154625 (E.D. Pa. 2017), aff’d 912 F.3d 144 (3rd Cir. 2018); *United States v. Garrity*, 2018 U.S. Dist. LEXIS 56888 (D. Conn. 2018). The lower court in *Williams* said that the preponderance of the evidence standard applied, although that holding was dicta. *United States v. Williams*, 2010 U.S. Dist. LEXIS 90794 (E.D. Va. 2010), reversed on other grounds without reaching the standard of proof issue, 2012 U.S. App. LEXIS 15017 (4th Cir. 2012). The district court in *United States v. Zwerner* (S.D. Fla. - No. 13-22082), without opinion, submitted to the jury on a preponderance standard; would likely have been raised on appeal, but case settled after jury verdict). Although the clear trend is for preponderance of the evidence, I suggest persons litigating the FBAR penalty consider asserting the clear and convincing standard. See generally, *Addington v. Texas*, 441 U.S. 418, 424 (1979) (discussing the basis for the clear and convincing standard in cases where the allegations involve “fraud or some other quasi-criminal wrongdoing by the defendant” and other cases where particularly important societal interests are at issue); and *Grogan v. Garner*, 498 U.S. 279 (1991) (applying, however, preponderance of evidence for fraud exception to bankruptcy discharge because of the nature and context of that exception to discharge). For example, if the IRS asserts the civil fraud penalty under § 6663, the Code only says that the burden of proof is on the IRS (§ 7454(a)) but the Code is silent as to whether the burden is preponderance of the evidence or clear and convincing. The law is clear that, for Title 26 fraud penalties, the IRS must prove fraud by clear and convincing evidence. See T.C. Rule 142(b); John Gamino, Tax Controversy Overburdened: A Critique of Heightened Standards of Proof, 59 Tax Law. 497, 506 n. 38 (2006) (“Tax Court Rule 142(b) echoes the statutory language but specifies the clear and convincing standard by which the government must carry its burden. While not technically controlling in other courts, Rule 142(b) is representative of the broadly prevailing rule.”). The clear and convincing burden is conceptualized as heavier than preponderance (the normal civil burden) and lighter than beyond a reasonable doubt (the criminal burden). The term “willfulness” in the FBAR statute has the same meaning as willfulness in the criminal tax statutes and the civil fraud penalty. For that reason, the IRS itself earlier recognized that it would expect courts to apply a “clear and convincing” standard. See ILM 200603026 (1/20/06) (“Because the FBAR penalty is not a tax or a tax penalty, the presumption of correctness with respect to tax assessments would not apply to an FBAR penalty assessment for a willful violation—another reason we believe that the Service will need to meet the higher standard of clear and convincing evidence.”) The IRS has abandoned that conclusion and the Courts have applied the preponderance standard.

Some have argued that the IRS's assertion of multiple year willful penalties at the full 50% amount may be so punitive as to implicate the Eighth Amendment's prohibition of Excessive Fines.⁴⁴¹³ The Courts have not accepted the Eighth Amendment argument.⁴⁴¹⁴

The FBAR civil penalty statute of limitations is six years for the assessment.⁴⁴¹⁵

The FBAR civil penalty is likely not dischargeable in bankruptcy because it is a nontax "penalty . . . for the benefit of a government unit, and is not compensation for actual pecuniary loss."⁴⁴¹⁶

One question is whether the civil willful penalty survived the death of the person penalized. The limited authority indicates that it does survive.⁴⁴¹⁷

VII. IRS Investigation and Initiatives to Identify FBAR Noncompliance.

The IRS has many tools and sources to identify taxpayers who may not be in compliance with FBAR and related tax obligations. Some tools that include:

⁴⁴¹³ For good recent discussions, see *Landa v. United States* 153 Fed. Cl. 585, 599, 2021 U.S. Claims LEXIS 635 (Fed. Cl. 4/19/21) (FBAR penalty remedial in nature and not subject to Eighth Amendment excessive fine attack; covering cases); and *United States v. Toth*, 33 F.4th 1, 29-37 (1st Cir. 4/29./22) (concluding that the FBAR penalty is not punishment or a fine).

In *United States v. Bussell*, 2017 U.S. App. LEXIS 21189 (9th Cir. 2017), an unpublished opinion, the Court held:

Bussell bears the burden to prove that the fine against her violates the Constitution. See *United States v. \$132,245.00 in U.S. Currency*, 764 F.3d 1055, 1058 (9th Cir. 2014) (explaining that the claimant has the burden of establishing that the forfeiture is grossly disproportional to the offense). Generally, "a punitive forfeiture violates the Excessive Fines Clause if it is grossly disproportional to the gravity of a defendant's offense." *United States v. Bajakajian*, 524 U.S. 321, 334, 118 S. Ct. 2028, 141 L. Ed. 2d 314 (1998).

I am not sure what this assignment of the burden of proof means in FBAR collection suits or refund suits. The Government bears the burden of proving that the person acted willfully to sustain the FBAR willful penalty. It is hard to imagine a suit where the Government met that burden and all of the facts relevant to the Eighth Amendment excessive fines issue were not flushed out at trial. If that is the case, the only issue left is the legal issue of whether the FBAR willful penalty is excessive under the Eighth Amendment. I suppose that burden of proof could be teed up if the person asserting the Eighth Amendment admitted willfulness so that the Government did not have to prove willfulness to sustain the penalty. That posture would leave the factual record bare except for such factual proof as the parties entered in the case as they sparred about the Eighth Amendment issue; in that case, the person might have a risk of nonpersuasion (burden of persuasion) as to any fact that would support application of the Eighth Amendment.

⁴⁴¹⁴ See e.g.,

⁴⁴¹⁵ 31 U.S.C. § 5321(b)(1).

⁴⁴¹⁶ 11 U.S.C. § 523(a)(7); IRM 8.11.6.2(14) (09-27-2018), FBAR Overview ("Title 11 Bankruptcy does not provide relief for FBAR penalty debt."); and see *United States v. Simonelli*, 614 F. Supp. 2d 241 (D. Conn. 2008). See also IRM 4.26.17.5.4 (12-11-2019), Bankruptcy Procedures in FBAR Cases. I do note in this regard that the offshore penalties imposed under the offshore bank voluntary disclosure programs may be dischargeable because, while they may be in whole or in part, in lieu of FBAR penalties, they are assessed as miscellaneous penalties under the Internal Revenue Code.

⁴⁴¹⁷ *United States v. Green*, 125 AFTR2d 2020-1894 (SD Fla. 2020); *United States v. Schoenfeld* (M.D. Fla. 3:16-cv-1248-J-34PDB), by order dated 9/25/18; and *United States v. Gill*, 2021 U.S. Dist. LEXIS 122038(S.D. Tex. 2021) (denying motion to dismiss). See also Will the FBAR Willful Penalty Survive Death (Federal Tax Crimes Blog 6/6/14).

- John Doe Summonses to foreign banks or related entities or facilitators within the summons power.⁴⁴¹⁸
- Information obtained in the U.S. DOJ Swiss Bank Program which required participating banks to provide information about potentially noncompliant U.S. taxpayers.
- FATCA and other inter-governmental cooperation agreements which, on an ongoing basis, provides mechanisms for foreign banks to provide the U.S. information about U.S. taxpayers with deposits in those banks and impose reciprocal obligations on U.S. banks for participating countries.⁴⁴¹⁹
- Whistleblowers who report on banks and their enablers who assisted in U.S. tax and FBAR noncompliance⁴⁴²⁰ and even against individual U.S. taxpayers who are not in compliance. FBAR penalty collections are part of the penalty base.⁴⁴²¹
- IRS Data Mining through sophisticated computer and statistics techniques⁴⁴²² of disparate pieces of information that is available in IRS's various databases and other sources available to the IRS.

Once the IRS has information about noncompliance that it deems sufficient to warrant an audit, the IRS will investigate FBAR violations in much the same way it handles audits and appeals to the Appeals Office.⁴⁴²³ The IRS agents may handle FBAR and tax related investigations together or in sequence if there is what is called a related statute determination to address and resolve § 6103 concerns as to access, use and disclosure of return information.⁴⁴²⁴ In an independent FBAR

⁴⁴¹⁸ For example, a John Doe Summons to a U.S. affiliate of UBS A.G., a major Swiss bank, started the U.S. Swiss bank initiatives discussed later in this chapter. Also, in 2018, the IRS issued a John Doe summons firm with respect to offshore bank activity. *Taylor Lohmeyer Law Firm PLLC v. United States*, 957 F.3d 505 (5th Cir. 2020), pet. reh. en banc denied 985 F.3d 409 (5th Cir. 2020), cert. denied ___ U.S. ___, 142 S. Ct. 87 (10/4/21). For discussion of the John Doe Summons, see *supra*, beginning p. 429.

⁴⁴¹⁹ FATCA is the Foreign Account Tax Compliance Act, (P.L. 111-147, Chapter 4 (adding §§ 1471 through Code Sec. 1474).

The OECD developed a reporting standard called Common Reporting Standard (“CRS”) analogous to FATCA. See Wikipedia entry titled “Common Reporting Standard” (last edited on 1/22/22 and viewed 7/18/22). Because of FATCA, the U.S. has not yet joined that standard. A reasonable future development may be that there will be a CRS (perhaps alternatively titled) that includes the U.S.

⁴⁴²⁰ The most prominent example is Bradley Birkenfeld, a former UBS officer assisting U.S. persons evade their tax and FBAR noncompliance. Birkenfeld’s information literally was the key that opened up the Swiss bank secrecy resulting in billions in revenue collected. Birkenfeld received a \$104 million whistleblower award. See Wikipedia Page for Bradley Birkenfeld (last edited 7/6/19 and viewed 8/5/19). Another instance was a whistleblower claim with respect to Wegelin Bank. See *Whistleblower 21276-13W v. Commissioner*, 147 T.C. 121 (2016).

⁴⁴²¹ See Ch. 18 on Whistleblower Rewards, where the inclusion of FBAR penalty collections in the reward base is discussed beginning p. 1000.

⁴⁴²² For some introduction to the topic of data mining, see Wikipedia entry titled “Data Mining” (last edited 7/11/22 and viewed on 7/18/22).

⁴⁴²³ See Toscher & Stein, *supra*, p. 42. The IRS may use tax return information in the FBAR audit. See *Hom v. United States*, 2013 U.S. Dist. LEXIS 142818 (N.D. Cal. 2013) (holding that such use does not violate § 6103’s confidentiality requirements because the FBAR statute, § 5314 is a “related statute.”), *aff’d* 645 Fed. Appx. 583, 2016 U.S. App. LEXIS 5528 (9th Cir. 2016).

⁴⁴²⁴ IRM 4.26.17.2.1 (12-11-2019), Starting an FBAR Examination Resulting from Title 26 – Related Statute Memorandum (RSM) Required. Basically, BSA examinations are not tax investigations and thus § 6103 precludes use of tax return information unless a “designated official determines, via the Related Statute Memorandum (continued...)

investigation (no related statute determination to authorize the Title 26 investigation), the IRS will not have the IRS summons power, but will have parallel summons authority under the Bank Secrecy Act.⁴⁴²⁵

In Appeals, FBAR penalties are “an Appeals Coordinated Issue and require a referral to International Operations prior to holding the first conference.”⁴⁴²⁶

VIII. FBAR Civil Penalty Assessment.

Upon completion of the investigation and the appeal to the Appeals Office (if appealed), the Secretary of Treasury assesses the penalty without any statutorily required predicate act (such as a notice of deficiency).⁴⁴²⁷ The IRS makes notice and demand for payment by sending notice by certified mail.⁴⁴²⁸

The FBAR penalty draws interest if not paid within 30 days of notice of assessment⁴⁴²⁹ and a 6% delinquency penalty if unpaid 90 days after assessment.⁴⁴³⁰

If Appeals consideration is not sought pre-assessment, it may be obtained post-assessment.⁴⁴³¹

IX. FBAR Civil Penalty Enforcement After Assessment.

The FBAR penalty is not a tax or tax related penalty and may be assessed by Treasury (by delegation to the IRS) without any predicate act (such as a notice of deficiency as required for many tax assessments). Since the FBAR penalty is not a tax, the Treasury may not use the collection tools

⁴⁴²⁴(...continued)
(RSM), that a potential BSA violation was in furtherance of a potential Title 26 violation”).

⁴⁴²⁵ See IRM 4.26.8.4 (02-14-2019). FinCEN Form 113, BSA Summons. Significantly subpar (5) provides: A BSA Title 31 summons may not be issued after an IRS related criminal referral has been made to the U.S. Attorney’s office or to the Department of Justice (DOJ) Tax Division. A criminal referral in this context means an IRS initiated request, attorney for the government grand jury request, or IRS prosecution recommendation. A BSA summons may be issued after declination by DOJ or final adjudication of a related Title 31 criminal investigation.

These limitations seem to parallel the prohibition on use of the IRS summons under § 7602(d) and conditions for authorization to share information with the Department of Justice in § 6103(h)(2) & (3).

⁴⁴²⁶ IRM 8.11.6.1(16) (09-27-2018), FBAR Overview.

⁴⁴²⁷ *Williams v. Commissioner*, 131 T.C. 54 (2008).

⁴⁴²⁸ IRM 4.26.17.4.3.3 (12-11-2019), Closing the FBAR Case Unagreed.

⁴⁴²⁹ 31 USC § 3717(b)(2) & (d); IRM 4.26.17.4.4(3) & (4) (12-11-2019), Closing the FBAR Case - Payment and Collection.

⁴⁴³⁰ 31 USC § 3717(e)(1).

⁴⁴³¹ IRM 8.11.6.2(17) (09-27-2018), FBAR Overview. If Appeals is sought post-assessment and the assessment exceeds \$100,000, any compromise by Appeals must be approved by DOJ Tax. IRM 8.11.6.11 (09-27-2018), Department of Justice (DOJ) Approval of Post-Assessed FBAR Penalty Cases Where Assessment Exceeds \$100,000. See also IRM 8.11.6.12 (09-27-2018), Time Limitations on FBAR Cases with DOJ Involvement. The assessment makes the penalty a claim of the U.S. Government. 31 U.S.C. 3711(a)(2); 31 C.F.R. § 902.1.

for tax assessments (covered in Chapter 12, above).⁴⁴³² And, because it is not a tax or tax penalty, the CDP procedures do not apply.

The FBAR assessment does not create a lien until and unless a judgment is obtained.

Treasury has two enforced collection procedures. First, Treasury may sue for collection if the suit is brought by within two years of the later of the following dates: (i) the date of assessment or (ii), if (i) does not apply, the date the person was convicted of the relevant FBAR violation.⁴⁴³³ I will call this an FBAR collection suit, using the term normally applied to Government suits to reduce assessed tax to judgment. The FBAR collection suit is brought in federal district court and handled by DOJ Tax representing Treasury, the defendant may raise defenses to the FBAR assessment. The FBAR collection suit might be brought as a counterclaim in a refund suit where the person has not paid the full amounts of all FBAR penalty assessments. The defendant is entitled to a jury trial on the collection suit but may not be entitled to a jury trial on the refund claim (whether in a stand-alone refund suit or in a refund suit with collection suit counterclaim).⁴⁴³⁴ If Treasury obtains a judgment in that suit, Treasury will then have the judgment remedies applying to judgments generally.

⁴⁴³² 31 C.F.R. § 1010.810(g) says that the IRS has been delegated authority to assess and collect FBAR penalties. However, the FBAR penalties are still not Title 26 penalties and thus the IRS cannot use its normal tax collection tools and thus BFS is responsible for collecting it as a non-tax debt. IRM 5.21.6.7(2) (02-18-2016), Collection of FBAR Penalties. In this regard, FBAR penalties cannot be included or considered for a tax offer in compromise. *Id.*, at par. (1).

⁴⁴³³ 31 U.S.C. § 5321(b)(2). It is conceivable that (ii) would apply where the IRS brings a timely criminal case (say near the end of the 5-year criminal statute of limitations or later if the defendant extended the statute of limitations or it was suspended) and the IRS does not timely make the civil penalty assessment. I don't know whether there is a practice is for deferring the civil penalty assessment while a criminal investigation is in effect, which often occurs when there is a criminal investigation because it is felt that the IRS could always rely upon the fraud exception to the civil statute of limitations and making an assessment during the investigation could give the taxpayer an opportunity through civil discovery to obtain information about the investigation that he would not otherwise be entitled to until the indictment is brought and the various criminal discovery tools are invoked. There is no such safety valve for the FBAR civil penalty that provides an extended or unlimited statute for the civil FBAR penalty, so I would think that the IRS would assess the civil FBAR penalty within the 6-year statute of limitations period that is otherwise applicable, so Treasury's reliance upon (ii) for the FBAR civil penalty collection suit would be limited indeed. In my readings of cases and materials, I have never observed a case where that exception was invoked for the civil FBAR penalty collection suit.

⁴⁴³⁴ 28 U.S.C. § 1345; for venue see 28 U.S.C. § 1395. A jury trial is not available in the Court of Federal Claims. Now as to the right to jury trial even in district court, my understanding is that a jury trial is not available on the refund suit but is available on a collection suit (which is what a counterclaim for the assessed unpaid balance is) See Robert Horwitz and Steven Toscher, Litigating the FBAR Penalty—Where Do We Go From Here, *Journal of Tax Prac. & Proc.* 33, 38 (June-July 2018). This gets a bit hairy, so I won't delve into it here. I present my discussion of this issue in Outstanding Powerpoint Presentation on All Things FBAR Penalties (Procopio #1) (Federal Tax Crimes Blog 11/5/18). Of course, for many of the cases involving the FBAR penalties, the defendant in a collection suit or plaintiff in a refund suit with counterclaim may not have characteristics that would play well to a jury anyway (which might mean that the Government could demand the jury).

There is an anecdotal instance where the defendant did have a jury trial in a willful FBAR collection suit. In the *United States v. Zwerner* (S.D. Fla No. 13-22082-CIV), the defendant raised defenses and, by special interrogatory to the jury, the jury was asked to decide whether the Government established by a preponderance of the evidence that the defendant's failure to timely file the FBAR for each of four years was willful. The jury answered the question yes for three years and no for one year. I discuss the verdict and link to the jury verdict with the answers to the questions on my blog: Zwerner Jury Verdict -- FBAR Willfulness for 3 Years (Federal Tax Crimes Blog 5/29/14).

Second, the Government may invoke the enforcement procedures under the Federal Debt Collection Act (“FDCA”).⁴⁴³⁵ Most prominently,

- Government may offset against a person’s FBAR liability against payments the person is otherwise due from the federal government.⁴⁴³⁶ For example, the Government can offset refunds due the taxpayer against the FBAR liability.⁴⁴³⁷ The Government claims the right of offset has no statute of limitations, even if it has a statute of limitations for any other collection measure.⁴⁴³⁸
- Government can also garnish wages (up to 15% of disposable pay) of federal employees and nonfederal employees.⁴⁴³⁹
- Government can engage private debt collections services to attempt collection of the debt.⁴⁴⁴⁰
- The Government may notify credit bureaus.⁴⁴⁴¹

The FBAR penalty does not accrue interest until the FBAR penalty is assessed, but accrues no interest if payment is made within 30 days of the assessment.⁴⁴⁴² If not paid in that period, the assessment accrues interest from the date of the notice of assessment.⁴⁴⁴³ Further, assessments still outstanding after 90 days accrue a 6% delinquency penalty in addition to interest.⁴⁴⁴⁴ And certain significant processing and collection costs can be added as well.⁴⁴⁴⁵

⁴⁴³⁵ 51 31 USC §§3701 et seq.

⁴⁴³⁶ 31 U.S.C. § 3711(g)(9). FBAR penalties constitute debts owed to federal agency. 31 U.S.C. § 3701(b)(1)(F) (2001) (debts include “any fines or penalties assessed by an agency”); see 8.11.6.1 (02-02-2015), FBAR Overview; see also *United States v. Simonelli*, 614 F. Supp. 2d 241, 246 (D. Conn. 2008) (FBAR penalty is a civil penalty, not a tax penalty). Related to this offset authority is authority to garnish periodic payments due by the federal government, such as Social Security payments, but these may be subject to restrictions. 31 U.S.C. § 3720D. For the latest definitive treatment of this offset authority for FBAR collections that I am aware of, see Caroline D. Ciraolo, Collection of the FBAR Penalty (3/30/13). (I have posted a discussion of this issue with a link to Ms. Ciraolo’s presentation on my Federal Tax Crimes Blog in a posting titled FBAR Penalty Collection -- Beyond the Collection Suit, Administrative Offsets Loom Large and Long (4/2/13).

⁴⁴³⁷ § 3711(g)(9)(B); 31 C.F.R. § 5.4(a)(6). Tax refund offsets may be used only after an attempt to collect directly from the debtor. 31 U.S.C. § 3720A(b)(5); 31 C.F.R. § 285.2(d).

⁴⁴³⁸ 31 U.S.C. § 3716 (e)(1). (“Notwithstanding any other provision of law, regulation, or administrative limitation, no limitation on the period within which an offset may be initiated or taken pursuant to this section shall be effective.”); and 31 C.F.R. § 285.5(d)(3)(v) (“Debts may be collected irrespective of the amount of time the debt has been outstanding.”); and IRM 8.11.6.4.1.1 (09-27-2018), FBAR Penalty Statute of Limitations on Collection. I discuss the offset authority generally and for refunds in the text below, beginning p. 218.

⁴⁴³⁹ 5 U.S.C. § 5514(a) and 31 § C.F.R. § 285.11 (Federal employee salary offset); 31 U.S.C. § 3720D(b) (non-government employee wage garnishment).

⁴⁴⁴⁰ 31 U.S.C. § 3718; 31 C.F.R. § 5.15; 31 C.F.R. § 285.12(c)(2).

⁴⁴⁴¹ 31 U.S.C. 3711(e), 31 C.F.R. § 901.4, 31 C.F.R. § 285.12(c)(2) and 31 C.F.R. § 5.14

⁴⁴⁴² 31 USC § 3717(b).

⁴⁴⁴³ Id.

⁴⁴⁴⁴ Id. 31 U.S.C. § 3717(e)(2).

⁴⁴⁴⁵ 31 U.S.C. § 3717(e)(1), additional liability for costs of processing and handling a delinquent debt. Pursuant to Letter 3708 (rev. 5-2013), the letter sent to demand payment of the assessed FBAR penalty, an approximately 18% of balance due debt servicing fee upon referral to Treasury’s Financial Management Service and 18% to 28% of balance due on referral to private debt collection services.

X. Judicially Contesting the FBAR Penalty Assessment.

A. Government Suit to Reduce Assessment to Judgment.

The BSA authorizes the Secretary to bring a civil action to recover the FBAR penalty, an FBAR collection suit.⁴⁴⁴⁶ The suit (as a standalone suit) must be brought in the district court.⁴⁴⁴⁷ In that suit, the defendant may raise appropriate defenses to the FBAR assessment (e.g., as to the willful penalty that the defendant was not willful) and the defendant may obtain a jury trial on liability and defense issues.⁴⁴⁴⁸ I also note in the prior section that, as for federal tax assessments, there are nonjudicial methods for the IRS to collect the FBAR assessment. Those methods can be quite intrusive for persons assessed FBAR penalties, so the question addressed in this section is other judicial relief is available.

If the Government gets a judgment (whether in an FBAR collection suit or pursuant to a counterclaim in a taxpayer refund suit (the equivalent of a collection suit)), the judgment will create a lien in favor of the Government upon filing a certified copy of the abstract of title.⁴⁴⁴⁹ The lien is effective for 20 years and may be renewed for 20 years.⁴⁴⁵⁰ The Government can execute judgment against the judgment debtor's real and personal property and obtain a writ of garnishment.⁴⁴⁵¹

B. No Prepayment Judicial Remedy.

Is there a prepayment judicial remedy (other than the Government suit discussed above)? The answer is no. I have no citations for that answer because I am aware none; I am also aware of no authority for a such a prepayment remedy initiated by the party assessed the penalty. In this environment where a statute would be required for a prepayment remedy, I assume that there is no such remedy.

C. FBAR Refund Suit After Payment (or Partial Payment).

1. Introduction.

Can the person assessed an FBAR penalty pay some or all of the FBAR assessment and sue for return of the amount paid? The classic path for such litigation is to sue the Government for the return of the money illegally exacted. In the tax context, that is called a tax refund suit. The law is settled as to how to pursue tax refund suits. I discuss tax refund suits earlier in this text and hence only provide here a high level summary. A taxpayer may file a tax refund suit in the district court or the Court of Federal Claims. The taxpayer must first pay the assessed tax (or so much of it as required by *Flora's* full payment rule), file a claim for refund, and await denial of the claim or passage of 6 months from the date of filing the claim. In the district court, the taxpayer may obtain

⁴⁴⁴⁶ 31 U.S.C. § 5321(b)(2).

⁴⁴⁴⁷ The Government cannot bring suit in the CFC, although it might be able to raise affirmative claims by counterclaim. See CFC Rule 13.

⁴⁴⁴⁸ See p. 977, n. 4434, above.

⁴⁴⁴⁹ 28 U.S.C. § 3201(a).

⁴⁴⁵⁰ 28 U.S.C. § 3201(a) & (c).

⁴⁴⁵¹ 28 U.S.C. §§ 3201(f), 3202, 3203, 3205.

a jury trial on the issue of liability and amount. The taxpayer bears the burden of proof (production and persuasion) on the elements of his claim (the fact of liability and amount of liability to quantify any refund judgment).

Is an analogous judicial remedy available for FBAR assessments? The answer is yes as I explain. (In the discussion I will refer to this suit as an FBAR refund suit by analogy to that term in the tax context.)

2. Court of Federal Claims.

The FBAR refund suit may be brought in the Court of Federal Claims, a court of general jurisdiction to hear various types of claims, including illegal exactions, against the Government. 28 U.S.C. § 1491(a)(1) (often called the “Tucker Act” or sometimes the “Big Tucker Act”).⁴⁴⁵² The case is tried to a judge because no jury is available in the Court of Federal Claims. The Government bears the burden of persuasion as to liability for and amount of the FBAR willful penalty.⁴⁴⁵³

The Court of Federal Claims held that the FBAR penalty is not a tax subject to the *Flora* full payment requirement.⁴⁴⁵⁴ If not subject to *Flora*, a person assessed the FBAR penalty can partially pay the FBAR assessment and sue for refund in the Court of Federal Claims.

3. District Court.

The FBAR refund suit may also be brought in the district court under one of two possible jurisdictional grants and immunity waivers.

The first provision allowing FBAR refund suits in district court is in 28 U.S.C. § 1346(a)(2) (often called the “Little Tucker Act”). The Little Tucker Act is in the same section as is the refund

⁴⁴⁵² In *Norman v. United States*, 126 Fed. Cl. 277 (2016), the Court rejected the Government’s argument that Court of Federal Claims lacked jurisdiction under § 1491(a)(1) because the exclusive remedy was in the district court pursuant to 28 U.S.C. § 1355(a). I discuss § 1355(a) in the text immediately below; suffice it to say that *Norman* court held that the Court of Federal Claims did have jurisdiction to consider the FBAR penalty. I don’t know whether the Government would continue to press that argument after *Norman*, but the Government did assert in later litigation that a FBAR refund suit under § 1491 offered an adequate remedy for the FBAR penalty. See *Kentera v. United States*, 2017 U.S. Dist. LEXIS 12450 (E.D. Wisc. 2017). See also Leslie Book, [Jurisdiction in the Court of Federal Claims and FBAR Cases](#) (Procedurally Taxing Blog 8/14/18) (noting that the Government could have appealed, did not appeal and abandoned the argument in *Norman*).

⁴⁴⁵³ For discussion of the burden of proof as to the willful FBAR penalty, p. 973, n. 4412,

⁴⁴⁵⁴ *Mendu v. United States*, 2021 U.S. Claims LEXIS 537 (2021) (holding that its “illegal-exaction” refund jurisdiction for the FBAR penalty did not implicate *Flora’s* full payment rule because the FBAR penalty is not a tax; in so holding, the Court of Federal Claims found unpersuasive the dicta belief stated in *Bedrosian v. United States*, 912 F.3d 144, 149 n. 1 (3rd Cir. 2018) that the FBAR penalties were sufficiently related to internal-revenue tax to make refund suits in the district court under 28 U.S.C. § 1346(a)(1) subject to the *Flora* full payment rule). Note in this regard that the Court of Federal Claims illegal exaction jurisdiction is not the same as district court jurisdiction under 28 U.S.C. § 1346, but the Court of Federal Claims tax refund jurisdiction via illegal exaction is subject to the *Flora* rule, so the interpretation of the district court jurisdiction statute could be relevant. See also *Kentera v. United States*, 2017 U.S. Dist. LEXIS 12450 (E.D. Wis. 2017) and the Government’s briefs in *Kentera*, available at my blog posting on [Kentera: Court Denies FBAR Penalty Relief Under APA, Requiring Alternative Paths to Remedy](#) (Federal Tax Crimes Blog 2/3/17).

suit provision, 28 U.S.C. § 1346(a)(1)). The statute allows the civil action (described in a manner that also includes FBAR refund suits) “not exceeding \$10,000 in amount.”⁴⁴⁵⁵

The Third Circuit, in what is at best dicta in an appeal from a district court FBAR refund suit, questioned whether the FBAR refund suit could be based on partial payment of the FBAR penalty for the period contested.⁴⁴⁵⁶ In that case, as is often the case when full payment is not made, the IRS counterclaimed in the refund suit for the unpaid balance; the Court of Appeals found jurisdiction based on the counterclaim.

The second provision possibly allowing district court jurisdiction for FBAR refund suits is 28 U.S.C. § 1355(a). Under that provision, district court jurisdiction—and presumably immunity waiver—is provided for actions “for the recovery or enforcement of any fine, penalty, or forfeiture, pecuniary or otherwise, incurred under any Act of Congress” other than “matters within the jurisdiction of the Court of International Trade” 28 U.S.C. § 1582. That basis for district court review of an FBAR refund suit surfaced, I think, for the first time in 2016 in two cases. In the first, an FBAR refund suit in the Court of Federal Claims, the Government argued that § 1355(a) was the exclusive FBAR refund remedy.⁴⁴⁵⁷ The court rejected that argument, holding that § 1491 was an available FBAR refund remedy. Implicit in the holding and explicit in the Government’s arguments was that § 1355(a) was an available FBAR refund remedy in the district court. Then in a later case, the Government argued that FBAR refund remedy was available under all three—§§ 1491(a)(1), 1346(a)(2) and 1355(a).⁴⁴⁵⁸ The Court in that case declined to address the availability of the § 1355(a) remedy because it had been raised in the Government’s reply brief. The fact that the Government asserted the § 1355(a) remedy twice in arguments to two different courts may be comforting that it will not contest jurisdiction under § 1355(a). Of course, the Government’s not contesting cannot confer jurisdiction on a court, but still, if the waters don’t get ruffled, the issue may not be addressed.

The cases do not address the issue of whether § 1355(a) requires full payment.

In any event, if one wants to proceed in district court, probably the better part of wisdom would be to proceed under both § 1346(a)(2) and 1355(a).

⁴⁴⁵⁵ Normally, suits of the type allowed in the district court by the Little Tucker Act must be brought in the Court of Federal Claims under 28 U.S.C. § 1491(a)(1) (sometimes called the “Big Tucker Act”). But, so long as the amount does not exceed \$10,000, the suits may be brought in the district court under the Little Tucker Act.

⁴⁴⁵⁶ *Bedrosian v. United States*, 912 F.3d 144, 149 n. 1 (3rd Cir. 2018) (where the Court after analyzing the jurisdictional statute, 28 U.S.C. § 1346(a)(1), said that it was “inclined to believe” that FBAR penalties could have sufficient nexus to tax to be subject to the *Flora* full payment rule for district court jurisdiction. That is a statement of belief rather than a holding as to an issue that was not necessary for resolution of the case. If it had been presented as a holding rather than a statement of belief, it would be dicta.). Note that the district court has a different jurisdictional statute than the Court of Federal Claims, so this “belief” is not technically inconsistent with the of Federal Claims holding that the *Flora* rule does not apply.

⁴⁴⁵⁷ *Norman v. United States*, 126 Fed. Cl. 277 (2016).

⁴⁴⁵⁸ *Kentera v. United States*, 2017 U.S. Dist. LEXIS 12450 (E.D. Wis. 2017), at fn. 6 of the opinion.

A jury trial is not available in FBAR penalty refund suits⁴⁴⁵⁹ (but may be available in FBAR collection suits).⁴⁴⁶⁰ On the counterclaim in a refund suit, either party may demand a jury.⁴⁴⁶¹

XI. Record Keeping Requirements.

Persons required to file FBARs must maintain records containing considerable detail about the foreign account(s) for five years.⁴⁴⁶² There are two significant consequences of this “required records” obligation. First, the FBAR civil penalty will apply if, upon request, the taxpayer has not maintained the required records.⁴⁴⁶³ Second, under the “required records” doctrine, these records are not subject to the Fifth Amendment privilege that a person may otherwise have to oppose their compulsory production.⁴⁴⁶⁴

XII. Voluntary Disclosure for Offshore Account Noncompliance.

A. IRS Voluntary Disclosure Practice.

For FBAR noncompliance related to tax noncompliance (but not to other criminal noncompliance such as money laundering), FBAR criminal exposure and FBAR civil penalty exposure can be resolved under the current iteration of the IRS voluntary disclosure policy. I discussed that policy beginning p. 318. The current policy grants some assurance that the IRS will not recommend criminal prosecution and offers a somewhat favorable income tax resolution. Relief from income tax related FBAR criminal prosecution can be achieved through this voluntary disclosure practice, but the FBAR civil penalties will be resolved under the guidelines in the IRM. Under these guidelines, the taxpayer can still have the right to Appeals Office review of determinations made by the examining agent.

⁴⁴⁵⁹ 28 U.S.C. § 2402 (saying that except in tax refund suits under § 1346 “shall be tried by the court without a jury.”) A bench trial was held in *Bedrosian v. United States Dep’t of Treasury, Internal Revenue Serv.*, 2017 U.S. Dist. LEXIS 154625 (E.D. Pa. 2017), which rejected the willful FBAR penalty, but the holding was reversed on appeal and remanded for the district court to apply the correct willful standard and holding *Bedrosian* liable for the civil willful penalty. *Bedrosian v. United States*, 912 F.3d 144 (3d Cir. Pa. 2018), on remand 2020 U.S. Dist. LEXIS 228208 (E.D. Pa. 2020).

⁴⁴⁶⁰ Since the FBAR collection suit is not brought under 28 U.S.C. § 2402, it is not subject to that prohibition on jury trial discussed in the preceding footnote. In *United States v. Zwerner* (S.D. Fla. No. 1:13-cv-22082-CMA), an FBAR penalty collection suit, the case was decided by a jury.

⁴⁴⁶¹ Even if, theoretically, the judge could make the decision on the claim, I doubt that a judge would enter a different decision on the claim for refund than the jury determined on the counterclaim. But it may be theoretically possible to have different judgments. An analogous situation, at least arguably, was presented in *Beacon Theatres v. Westover*, 359 U.S. 500 (1959), where some claims were normally trial to the court (no jury) but others clearly could be tried to a jury, with the court suggesting that, to preserve the right to jury trial, the jury trial claims should be tried first with the preclusive effect then applying to the nonjury trial claims.

⁴⁴⁶² 31 C.F.R. § 103.32.

⁴⁴⁶³ The IRS usually will not seek to collect the penalty for the FBAR failure and the required records failure, although the statute permits the penalty for both of the proscribed conducts. Jeremiah Coder, District Court Allows Second FBAR Penalty Collection to Proceed, 2012 TNT 219-3 (11/10/12) (quoting an IRS attorney prominently involved in the IRS’s offshore accounts initiatives, who added that “FBAR failure-to-file penalty is significant enough that an additional penalty for the failure to keep records is usually unnecessary,” and noting that he is not aware of the application of both penalties).

⁴⁴⁶⁴ *United States v. Chen*, 815 F.3d 72 (1st Cir. 2016), the most recent in the unanimous decisions in the Courts of Appeals, citing all of those decisions.

There is no assurance (as there was under OVDP below) that related offshore income tax noncompliance (such as Forms 8938 and 5471) will be avoided or mitigated.

B. Special Program (“OVDP”) Discontinued September 2019.

1. OVDP Inside Penalty Structure.

From 2009 through September 2018, incident to its compliance enforcement initiative first focused on UBS and other Swiss banks assisting U.S. taxpayers evade U.S. reporting and tax on foreign accounts, the IRS adopted a special voluntary disclosure program (“OVDP”) for FBAR and income tax noncompliance related to offshore accounts.⁴⁴⁶⁵ OVDP was designed to give the taxpayers the assurance of the IRS general voluntary disclosure practice of no criminal prosecution and further offered substantial mitigation of the income tax and FBAR civil penalties that might apply. Since inception in 2009, the program was revised periodically, principally to increase the potential civil penalties in the program. Because the OVDP is now discontinued, I offer here a substantially reduced summary of the program only to offer some historical context going forward. I refer readers wanting more detail to the Chapter 16 discussion in the 2017 versions of this text cited in the footnote.⁴⁴⁶⁶

OVDP had the following key features:

1. Taxpayer must file amended income tax returns or, if no original income tax returns were filed, delinquent income tax returns for 8 years.⁴⁴⁶⁷ With the returns, the taxpayer must pay the tax, interest and appropriate civil penalty (20% accuracy related or delinquency).

2. Taxpayer must file amended or delinquent FBARs for 8 years (the information return for foreign bank accounts)⁴⁴⁶⁸ and pay an ad valorem offshore penalty (sometimes called miscellaneous offshore penalty (“MOP”)) based on the highest annual value over the period of tax noncompliant foreign bank accounts and foreign assets in the year with the highest aggregate account or asset value. The MOP was in lieu of all other applicable penalties (both FBAR and income tax penalties other than the civil penalties noted in paragraph 1). By the time of discontinuance of OVDP, the MOP percentage was 27.5%⁴⁴⁶⁹ (increased to 50% if one of the accounts is an account with a bank that the IRS or DOJ has started a publicly disclosed action against the bank (such as criminal prosecution, announcing a nonprosecution agreement or starting a summons enforcement action

⁴⁴⁶⁵ The program (including its processing features) is announced in a series of memoranda, FAQs and accompanying press releases.

⁴⁴⁶⁶ The 2017 Practitioner Edition may be downloaded at <https://ssrn.com/abstract=3011403>; The 2017 Student Edition may be downloaded at <https://ssrn.com/abstract=3011373>.

⁴⁴⁶⁷ In the initial iteration of OVDP in 2009, only six years were required. The next iteration, in 2011, moved the covered period to 8 years and that covered period remained until OVDP was terminated on September 28, 2018.

⁴⁴⁶⁸ In the initial OVDP in 2009, only six years were required.

⁴⁴⁶⁹ The original MOP was 20% when OVDP was first announced in 2009 but increased to 25% in 2011 and 27 ½% in 2012.

(typically a John Doe Summons)).⁴⁴⁷⁰ If the taxpayer thought that the OVDP civil penalties, particularly the offshore penalty, are too harsh, the taxpayer can “opt out” of the civil penalty regime and be subject to any applicable penalties upon audit.

3. The taxpayer must file the various other forms that may be required but the IRS will not assert the penalties that might apply to them. In some cases, the IRS will allow intermediate entities that served no purpose other than to hide the accounts to be “shammed” out (ignored for purposes of these various forms, such as 5471).

4. The program is available only to those who meet the voluntary disclosure policy in IRM 9.5.11.9 (12-02-2009), Voluntary Disclosure Practice. (Caveat: That IRM provision has been changed significantly, IRM 9.5.11.9 (12-02-2009), Voluntary Disclosure Practice.) The program appears to contemplate only noisy disclosures (e.g., initial screening at CI is required and a closing agreement is required).

2. Opting Out of OVDP Penalty Structure.

The OVDP penalties, including principally the offshore penalty are significant and are a one-size fits all penalty. The penalty is designed to benefit the U.S. person who was willful as to his or her income tax and FBAR filing requirements. The IRS recognized that some taxpayers entering the program may not be as culpable as that one size penalty structure suggests. The IRS thus offered those taxpayers the opportunity to “opt out” of the civil penalty structure of the program and subject themselves to a regular civil audit.⁴⁴⁷¹ Taxpayers so opting out were unable to re-join the program penalty structure if the IRS, upon audit, asserts greater penalties than the program required (as outlined above).

The new Streamlined Procedures discussed in the next section were designed to permit, at least from the date of announcement in June 2014, nonwillful taxpayers a streamlined resolution so that they did not have to join OVDP and then opt out.

3. End of OVDP 9/28/18.

The latest such OVDP initiative, called the 2014 OVDP, ceased on September 28, 2018 and was not replaced with any other special initiative specifically directed to persons the OVDP was designed to offer a path to U.S. compliance.⁴⁴⁷² Those persons are U.S. taxpayers with unreported and tax noncompliant offshore accounts and assets whose failure to report and tax noncompliance

⁴⁴⁷⁰ The foreign banks that result in the 50% penalty are collected on the IRS web page titled “Foreign Financial Institutions or Facilitators,” which is updated as new disqualifying initiatives are made public.

⁴⁴⁷¹ In OVDP, there was an analogous process actually within the program without opting out to have what is called an FAQ 35 review to ensure that the program penalties were not in excess of the penalties the IRS would otherwise assert. Technically, this was inside OVDP rather than an opt out, but the drill was essentially the almost the same as the opt out audit. Perhaps the key benefit of the FAQ 35 review was that it did not require the taxpayer to give up the benefits of the program penalties to find out what the alternative result would be. Under the opt out described in the text, the taxpayer would not know what the alternative result is until he or she has given up the penalty regime inside the program.

⁴⁴⁷² IR-2018-52 (3/13/18).

was willful, so that they were at risk of tax and FBAR criminal penalties and the more onerous tax and FBAR civil penalties. As noted in subsection A, FBAR criminal exposure related to income tax and related FBAR noncompliance can be resolved under the IRS general voluntary disclosure practice with the FBAR penalties applied as stated in the IRM. (The general OVD practice is discussed beginning p. 318.)

For U.S. taxpayers whose conduct was nonwillful, the Streamlined initiatives immediately below continue to be available.

C. Streamlined Procedures.

In June 2014, the IRS announced new Streamlined Filing Compliance Procedures⁴⁴⁷³ for taxpayers who certify that their income tax noncompliance and FBAR noncompliance was nonwillful for the covered years requiring that the taxpayer come into compliance by delinquent or amended income tax returns and FBARs.⁴⁴⁷⁴ The Streamlined Procedures are designed for taxpayers who, if their certifications of nonwillfulness are correct, have no real risk of criminal prosecution and thus did not need the key benefit of OVDP. Had these taxpayers improvidently joined OVDP, they would have been candidates for opting out of the OVDP civil penalty structure.⁴⁴⁷⁵ These Streamlined Procedures continue after the discontinuance of OVDP.

Taxpayers qualifying for the Streamlined Procedures must be individuals or estates, must not be under examination or IRS criminal investigation, and, at the time of filing under the Procedures, must have a valid U.S. TIN (which, in the case of U.S. citizens is the SSN but ITIN in other cases).

Along with the certification of nonwillfulness, the taxpayers must give a detailed narrative statement, under penalty of perjury, supporting their certification of nonwillfulness, stating the good

⁴⁴⁷³ There were earlier and narrower versions of the Streamlined Procedures.

⁴⁴⁷⁴ See IRS web page titled “Streamlined Filing Compliance Procedures” (last update 12/7/21 and viewed on 7/18/22). The certification is made for U.S. **nonresident** on Form 14653, Certification by U.S. Person Residing Outside of the United States for Streamlined Foreign Offshore Procedures, and for **U.S. resident** on Form 14654, Certification by U.S. Person Residing in the United States for Streamlined Domestic Offshore Procedures. On the most recent Forms (October 2017 and September 2017, respectively) the key certification is:

My failure to report all income, pay all tax, and submit all required information returns, including FBARs, was due to non-willful conduct. I understand that non-willful conduct is conduct that is due to negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of the law.

There is considerable nuance in that certification. John A. Townsend, The New Streamlined Processes' Requirement of Certifying Non-Willfulness (Federal Tax Crimes Blog 6/19/14; rev'd 6/21/14); and Charles P. Rettig, OVDP and Streamlined Procedures: Am I Non-Willful? (October 13, 2014). Journal of Tax Practice & Procedure, August - September 2014. Available at SSRN: <http://ssrn.com/abstract=2509439>. One issue that has arisen is whether an attorney's advice with respect only to the narrative supporting the nonwillful certification (but not with respect to the numbers placed on the Forms or the accompanying tax returns and FBARs) makes the attorney a return preparer. I am aware of no definitive or even tentative resolution of that issue.

⁴⁴⁷⁵ IRS Commissioner Koskinen said that the IRS had been too focused on willful actors and “not accommodating enough to others who don't necessarily need protection from criminal prosecution because their voluntary compliance failures have been of the non-willful variety.” Quote from speech to U.C. Council for Int'l Business-OECD Int'l Tax Conference (6/18/14).

and the bad facts.⁴⁴⁷⁶ For taxpayers who were nonresidents, the Streamlined Procedures require 3 years of delinquent or amended returns and 6 years of delinquent FBARs, plus the certification of willfulness. For those nonresidents, the only cost is the income tax liability reported on the returns plus interest on the income tax reported; there is no income tax penalty or offshore penalty. For U.S. residents, the Streamlined Procedures require 3 years of amended returns (those who filed no returns are not eligible) and 6 years of delinquent FBARs, plus the certification of nonwillfulness. For those residents, the costs are the income tax liability and interest **plus** a 5% offshore penalty on the high yearend aggregate value of the taxpayer's financial interest⁴⁴⁷⁷ during the covered period for (i) assets reportable but not reported on a timely FBAR, (ii) assets reportable but not reported on Form 8938 with the original returns, and (iii) assets reportable on either or both FBAR and Form 8938 which were properly reported but the income was not properly reported.⁴⁴⁷⁸

One recurring problem is where spouses who originally filed joint returns that require amendment under the Procedures but one spouse declines to sign the required amended returns (because divorced, separated or otherwise estranged). Procedures are available to permit the participating spouse to file amended joint returns with only one signature.⁴⁴⁷⁹ And procedures are provided for amending mistakes on earlier submissions under the Procedures.⁴⁴⁸⁰

Taxpayers filing under the Streamlined Procedures do not obtain a pre-clearance or any assurance that they will not be prosecuted. Further, the IRS reserves the right to audit any Streamlined Procedures submissions and, if the taxpayer certified nonwillfulness improvidently (i.e., he lied in the general certification or stating the narrative facts in support of the general certification), the IRS can assert any taxes, civil penalties and interest as appropriate and the Government can assert criminal penalties either with respect to the underlying conduct or the false certification. The Government has indicated that it will prosecute some cases.⁴⁴⁸¹

⁴⁴⁷⁶ The current forms (see prior footnote) explain the requirements for the detailed narrative: Provide specific reasons for your failure to report all income, pay all tax, and submit all required information returns, including FBARs. Include the whole story including favorable and unfavorable facts. Specific reasons, whether favorable or unfavorable to you, should include your personal background, financial background, and anything else you believe is relevant to your failure to report all income, pay all tax, and submit all required information returns, including FBARs. Additionally, explain the source of funds in all of your foreign financial accounts/assets. For example, explain whether you inherited the account/asset, whether you opened it while residing in a foreign country, or whether you had a business reason to open or use it. And explain your contacts with the account/asset including withdrawals, deposits, and investment/management decisions. Provide a complete story about your foreign financial account/asset. If you relied on a professional advisor, provide the name, address, and telephone number of the advisor and a summary of the advice. If married taxpayers submitting a joint certification have different reasons, provide the individual reasons for each spouse separately in the statement of facts. The field below will automatically expand to accommodate your statement of facts.

⁴⁴⁷⁷ Assets in which the taxpayer had no financial interest are not included in the penalty base. FAQ 1

⁴⁴⁷⁸ Practitioners should particularly note that having reported the income on the original tax returns will not permit the asset to be eliminated from the penalty base if the asset was not reported on the timely FBAR or Form 8938.

⁴⁴⁷⁹ SFO FAQ 7, and SDO FAQ 14.

⁴⁴⁸⁰ SFO FAQ 9, and SDO FAQ 16.

⁴⁴⁸¹ See e.g., DOJ Tax Principal DAAG Recent Review of Activities Related to Federal Tax Crimes (Federal Tax Crimes Blog11/13/16) (quoting DOJ Principle Deputy AAG from an address: "Tax Division prosecutors (continued...)

The Streamlined Procedures remain in place after the termination of OVDP on September 28, 2018, but there is no assurance as to how long they will be available or whether the terms may change.

D. Delinquent Submission Procedures.

U.S. taxpayers with who do not need the OVDP or Streamlined Procedures for failure to file FBARs or other tax international information forms (such as Form 5471) may use delinquent submission procedures. In effect, the delinquent procedures are for taxpayers who paid the tax and/or have reasonable cause but just had a foot fault in filing the forms.⁴⁴⁸² Taxpayers with foreign accounts who reported and paid tax on all income but did not file FBARs can file delinquent FBARs with a statement as to why they filed late.

E. Foreign Institutions and Other Foreign Enablers.

1. General.

Foreign financial institutions and their foreign enablers (officers, employees, agents, and others) who assist U.S. taxpayers evade tax are subject to criminal prosecution for their activity. Of course, if there is a prosecution (indictment), the U.S. must have some practical enforcement capability (such as, in the case of artificial entities, some nexus that would permit enforcement of any criminal judgment or, as in the case of individuals, some ability to produce the defendant for trial and then to enforce any criminal judgment (including incarceration, fines and restitution). But, assuming that those hurdles are cleared, the U.S. can prosecute foreign banks and their enablers of both categories (artificial entities or individuals).

2. Prosecutions and DOJ Swiss Bank Program.

DOJ Tax has brought a number of criminal tax prosecution of enablers of offshore tax evasion, principally those foreign actors with or related to foreign financial institutions.⁴⁴⁸³

⁴⁴⁸¹(...continued)

are reviewing certain streamlined filings and will investigate and prosecute taxpayers who willfully submit false statements in an effort to obstruct and impede the IRS and evade the payment of tax due.”); Report of DOJ Interest in Prosecuting Improper Streamlined Certifications (Federal Tax Crimes Blog 6/8/16).

⁴⁴⁸² As to FBARs, see IRS web site titled “Delinquent FBAR Submission Procedures” (last reviewed or updated 8/8/18 and viewed 7/22/18). As to other international forms, see “IRS web site titled Delinquent International Information Return Submission Procedures” (last reviewed or updated 11/5/20 and viewed 12/24/20).

⁴⁴⁸³ I maintain a spreadsheet and periodically post it for download on my Federal Tax Crimes Blog at a page titled “Offshore Charges / Convictions Spreadsheet.”

3. Voluntary Disclosure for Foreign Financial Institutions.

a. DOJ Swiss Bank Program.

In August 2013, the DOJ Tax announced a special voluntary disclosure program for Swiss financial institutions.⁴⁴⁸⁴ The program is generally referred to as the Swiss Bank Program. The program allows Swiss banks assisting U.S. taxpayer income tax evasion to resolve their potential criminal exposure short of criminal prosecution in the U.S. in exchange for detailed disclosures and, for some banks, the payment of monetary penalties.

The details of the program are nuanced and relevant only for the limited subset of Swiss banks (numbering about 80). For present purposes, the program had three key consequences: (1) 14 Swiss banks under criminal investigation are not included in the program (these are so-called Category 1 banks); (2) the more culpable Swiss banks (so-called Category 2 banks, being those that have a reason to believe that they have committed tax or related criminal offenses under U.S. law) obtained nonprosecution agreements in return for disclosing aggregate data about U.S. taxpayers sufficient for the IRS to formulate a treaty request for the more specific individual taxpayer information under the treaty and paying a significant penalty based on a percentage of noncompliant U.S. accounts after August 2008;⁴⁴⁸⁵ and (3) the other banks (Categories 3 and 4) who have not engaged in criminal conduct or are deemed compliant will, upon application to DOJ, receive a “nontarget letter.” The key impact for U.S. taxpayers is that the offshore penalty ad valorem rate increases from 27 ½% to 50% for all assets subject to the offshore penalty (not just the bank or banks so identified) as each Swiss Bank in Categories 1 and 2 have been identified publicly.

DOJ Tax has claimed that the Category 2 results were quite successful.⁴⁴⁸⁶

b. Other Foreign Financial Institutions/Enablers.

Other foreign financial institutions and enablers may negotiate their own voluntary disclosures and mitigated penalties even though outside the scope of the Swiss Bank Program. There is, however, no formal program to do so.

⁴⁴⁸⁴ See DOJ Web Page titled “Swiss Bank Program” (updated 7/24/19 and viewed 8/4/19). The web page contains links to the agreements and other documents establishing the program and to the individual nonprosecution agreements with participating Category 2 banks. The remainder of this paragraph summarizes those documents, unless otherwise noted.

⁴⁴⁸⁵ There is some nuance in how the penalty is calculated. I won’t develop that now, but one nuance is that the banks could exclude from the base to which the penalty applied the accounts for U.S. persons who they show either were compliant all along or who came into compliance via the IRS voluntary disclosure initiatives such as OVDP and Streamlined Procedures.

⁴⁴⁸⁶ See DOJ Tax web site titled “Swiss Bank Program” (updated 10/28/20 and viewed on 7/18/22). The DOJ Tax listing indicates 72 Swiss banks in the program. The listing combines some of the banks (e.g., at 68 for Edmond de Rothschild (Suisse) SA and Edmond de Rothschild (Lugano) SA). My count indicates 87 banks. Further, my analysis indicates that, in the aggregate, Category 2 Swiss banks paid over \$ 4 billion dollars in penalties.

XIII. Reporting Foreign Financial Assets on Form 8938.

In 2010, Congress enacted a tax return reporting requirement for foreign financial assets that parallels but is different from the FBAR.⁴⁴⁸⁷ The reporting is on Form 8938 which is attached to the income tax return. Form 8938 is required in the following circumstances with the reporting thresholds as indicated: (i) an unmarried taxpayer having specified foreign financial assets that have a value of more than \$50,000 on the last day of the year or \$75,000 at any time during the year; (ii) married taxpayers residing in the U.S. and filing a joint return having specified foreign financial assets of more than \$100,000 on the last day of the year or \$150,000 at any time during the year; (iii) married taxpayers filing separate returns and residing in the U.S. having specified foreign financial assets of \$50,000 on the last day of the tax year or more than \$75,000 at any time during the year; and (iv) taxpayers living abroad (either for the entire tax year or for 330 days during 12 consecutive months ending in the tax year) (a) not filing a joint return and having specified foreign assets of \$200,000 on the last day of the year or \$300,000 at any time during the year and (b) filing a joint return and having specified assets of \$400,000 on the last day of the year or \$600,000 at any time during the year.⁴⁴⁸⁸ There are certain limited exceptions for reporting assets that are reported elsewhere on tax forms (not the FBAR).⁴⁴⁸⁹

Reportable “specified foreign financial assets” are (1) depository or custodial accounts at foreign financial institutions and (2) to the extent not held in an account at a financial institution, (i) stocks or securities issued by foreign persons, (ii) any other financial instrument or contract held for investment that is issued by or has a counter-party that is not a U.S. person, and (ii) any interest in a foreign entity.⁴⁴⁹⁰ The IRS interprets these terms broadly, so IRS pronouncements must be consulted each time the issue arises, particularly during the early years of implementation when the IRS’s interpretations may be in a period of flux. The assets and foreign institutions and the maximum values during the year must be reported.⁴⁴⁹¹

The criminal penalties related to the form are the standard criminal penalties for tax obligations. The most likely criminal penalties are evasion (§ 7201) for underreported or underpaid taxes related to income from the assets required to be disclosed and tax perjury (§ 7206(1)) either for underreporting the related income or presenting false information on the Form. The criminal statute of limitations is six years, but various conditions (including most prominently the period a U.S. person is outside the United States) can suspend the statute of limitations.⁴⁴⁹²

The civil penalty for failure to file the form or failure to file a complete and correct form is \$10,000 with an additional incrementing penalty if the taxpayer fails to provide the information to

⁴⁴⁸⁷ § 6038D.

⁴⁴⁸⁸ IRS website titled Do I need to file Form 8938, “Statement of Specified Foreign Financial Assets”? (last revised 5/22/19 and viewed 8/4/19).

⁴⁴⁸⁹ For example, a foreign financial account does not have to be reported on Form 8938 if it is reported on: (i) Form 3520 reporting related to foreign trusts, (ii) Form 5471 reporting related to certain foreign corporations; (iii) Form 8621 reporting related to a passive foreign investment company and (iv) Form 8891 reporting related to certain Canadian Registered Retirement Plans.

⁴⁴⁹⁰ § 6038D(b).

⁴⁴⁹¹ § 6038D(c).

⁴⁴⁹² § 6531.

the IRS after the IRS notifies the individual of the failure to disclose.⁴⁴⁹³ The penalty increases by \$10,000 for each 30 day period after the notice. There is a reasonable cause exception to this failure to disclose penalty but “[t]he fact that a foreign jurisdiction would impose a civil or criminal penalty on the taxpayer (or any other person) for disclosing the required information is not reasonable cause.”⁴⁴⁹⁴ The penalty is an assessable penalty, meaning that the deficiency notice and advance litigation procedure prior to payment is not available.⁴⁴⁹⁵

In addition, a 40% new accuracy related penalty applies to any understatement attributable to undisclosed foreign financial assets.⁴⁴⁹⁶ This penalty provision not only applies to this new section but older sections requiring disclosure of foreign financial assets (such as Form 5471).⁴⁴⁹⁷ Finally, of course, the traditional 75% civil fraud penalty can apply to the related understatement.

Contemporaneously with enacting this new provision, Congress provided two special extended civil assessment statutes of limitations related to these assets and the income from them. First, if the taxpayer omits gross income exceeding \$5,000 attributable to the foreign assets (regardless of whether the assets themselves are reported), the statute of limitations is 6 years rather than the normal 3 years.⁴⁴⁹⁸ Second, the failure to report this foreign financial asset information and other types of information regarding foreign activity (i) generally subjects the entire return to an open statute of limitations that does not expire until three years from the date the taxpayer furnishes the information required to be disclosed but (ii) if the failure to provide that information was due to reasonable cause and not willful neglect, extended statutory period in (i) does not apply to any tax liability except as related to the information required to be reported.⁴⁴⁹⁹ The second extension applies whether or not the taxpayer reported the income from the foreign financial assets or other types of specified activity.

⁴⁴⁹³ § 6038D(d). This does not appear to be a separate penalty for each asset not disclosed or misstated. By contrast, as noted earlier, the IRS interprets the FBAR nonwillful penalty to apply per account per year.

⁴⁴⁹⁴ § 6038D(g). This latter negation of reasonable cause based on foreign law makes this a heightened standard for reasonable cause. Andrew Velarde ABA Meeting: Practitioners Assail Reasonable Cause Standard for Penalties, 2016 TNT 21-5 (2/2/16).

⁴⁴⁹⁵ ECC 201226028 (4/27/12), reprinted at 2012 TNT 127-61.

⁴⁴⁹⁶ § 6662(j).

⁴⁴⁹⁷ § 6662(j)(2).

⁴⁴⁹⁸ § 6501(e)(1)(A)(ii). This statute extension applies to all returns the statute for which was otherwise open on March 18, 2010, the effective date of enactment. This means that the 2006 year, with its 1040 due date of 2007, will be open because the normal 3 year statute made it open on March 18, 2010. See CCA-822152-11 (8/22/11) (discussing the effect of the change by an example with years prior to 2006 and starting in 2006). Earlier years will be affected by the rule if there were some other event that caused the statute to be open on March 18, 2010. If that other event were the 25% omission rule causing a 6 year statute, the new statute will be irrelevant, because the statute will be 6 years anyway. Hence, practically, it seems to have actual consequences for pre-2006 returns where there was a statute extension still in effect on March 18, 2010. For a good discussion of these interplays, see SBSE-25-0312-022 (3/9/13).

⁴⁴⁹⁹ § 6501(c)(8), (as amended by the HIRE Act (FATCA provisions) and then by Pub. L. 111-226 (124 Stat. 2403), § 218 (8/10/10)). In PMTA-2014-18 (10/3/14), the author determined that an executor’s failure to file the Forms 8938 with respect to the decedent’s final Form 1040 and the estate’s Form 1041 invoked this suspended statute of limitations for the income tax returns (Forms 1040 and 1041) and for the estate tax return (Form 706). Presumably, this exception to the extended statute of limitations is interpreted the same as the international penalties which do not apply in the case of reasonable cause and not willful neglect. See IRM 20.1.9.1.5 (01-29-2021), Common Terms and Acronyms.

The IRS is authorized to promulgate regulations necessary to carry out the intent of the Code provision.⁴⁵⁰⁰

Form 1040 Schedule B will continue to ask for information about foreign accounts and advising the taxpayer of the obligation to file the FBAR. The requirement to file the FBAR is independent of the obligation to file Form 8938 with the tax return. As a tax return filing, the Form 8938 is subject to § 6103's secrecy rules, and thus not generally available to other law enforcement agencies.

Finally, the IRS has announced that it will better coordinate the information it has from foreign financial institution (“FFI”) reporting on Form 8966, FATCA Report, with individual Forms 8938. On the Form 8966, the FFI reports the name, address, and Taxpayer Identification Number of each accountholder who is a specified U.S. person; the account number; the account balance or value; and the gross receipts and gross withdrawals or payments from the account.⁴⁵⁰¹

XIV. Cross-Border Financial Account Reporting.

A. Foreign Account Tax Compliance Act (“FATCA”).

In 2010, as a result of the massive noncompliance with respect to foreign accounts discussed above, Congress enacted the Foreign Account Tax Compliance Act (“FATCA”).⁴⁵⁰² One key feature of FATCA is Section 6038D which requires U.S. taxpayers to report their foreign financial assets on Form 8938 filed with their annual income tax returns if the thresholds are met. I discuss Form 8938 above.

The other principal feature of FATCA is a system of either (i) withholding and payment to the IRS or (ii) reporting to the IRS the amounts and taxpayer identify. A summary of the feature is:

FATCA also promotes third-party reporting of foreign financial assets by requiring a withholding agent to withhold 30 percent on certain payments to an FFI unless the FFI or the jurisdiction in which the FFI is located has entered into an agreement with the United States to report certain account information of their U.S. customers. Under such an agreement, participating FFIs report detailed information to IRS annually about accounts held by their U.S. customers using an IRS Form 8966, FATCA Report (Form 8966). **n13** According to IRS, FATCA improves visibility into taxable income from foreign sources, and enhances the agency’s ability to identify and pursue taxpayer noncompliance. For example, FATCA allows IRS

⁴⁵⁰⁰ § 6038D(h).

⁴⁵⁰¹ TIGTA Report titled Despite Spending Nearly \$380 Million, the Internal Revenue Service Is Still Not Prepared to Enforce Compliance With the Foreign Account Tax Compliance Act 3 (Ref. No. 2018-30-040 7/5/18). The report also notes that “information required to be reported includes the name, address, and Taxpayer Identification Number (TIN) of each accountholder who is a specified U.S. person; the account number; the account balance or value; and the gross receipts and gross withdrawals or payments from the account.” The report recommends further compliance efforts to match the Form 8966 information with the U.S. taxpayer’s Form 8938 obligations.

⁴⁵⁰² Subtitle A of Title V of the Hiring Incentives to Restore Employment Act is commonly referred to as FATCA. Pub. L. No. 111-147, §§ 501-541, 124 Stat. 71, 97-117 (2010).

to compare information reported by FFIs on Forms 8966 to information reported by U.S. persons on Forms 8938. According to IRS, this comparison can be used to ensure taxpayers and FFIs are properly reporting foreign financial assets and income from international investments. This type of comparison is a common IRS enforcement technique. For example, IRS can directly compare information it receives from financial institutions' IRS Form 1099-INT, Interest Income, against a tax return to determine if the taxpayer reported income generated from interest earned.⁴⁵⁰³

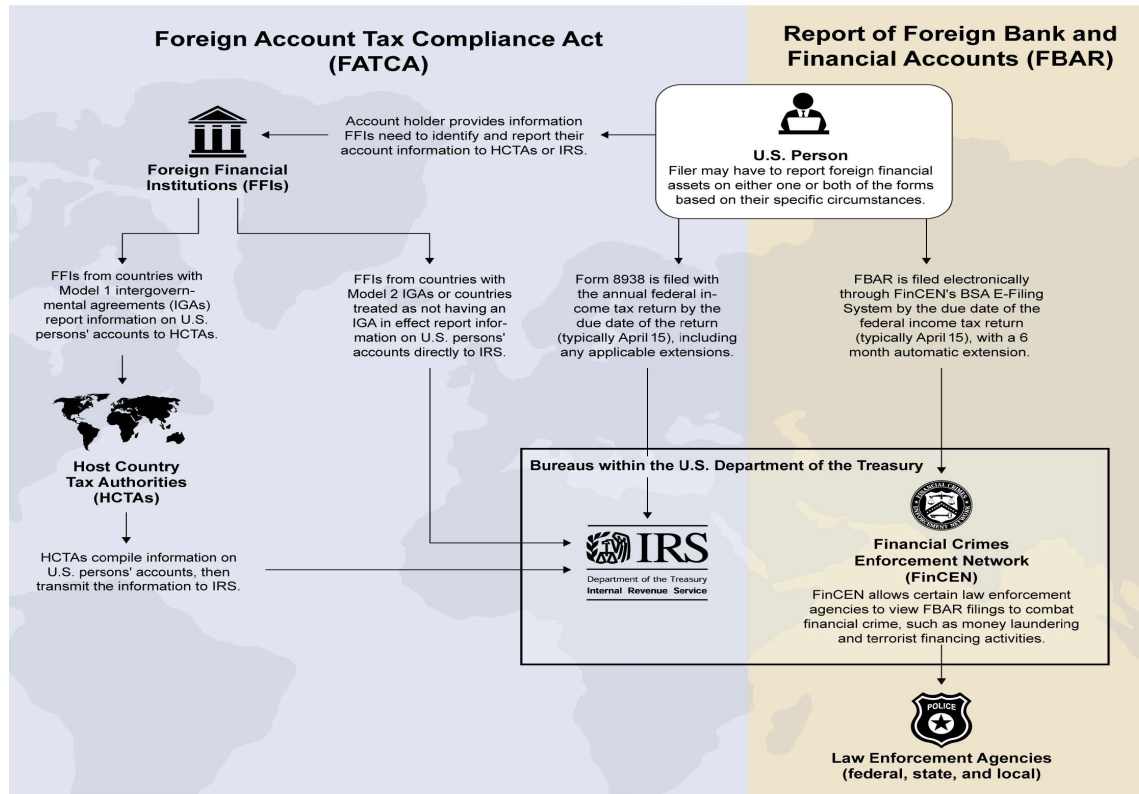
n13 In general, information participating FFIs are required to report on the Form 8966 includes the name, address, and TIN of accountholders who are specified U.S. persons; and the account number, balance or value, gross receipts, and gross withdrawals or payments from each account held by such persons.

To facilitate FATCA implementation for FFIs operating in jurisdictions with laws that would prohibit FFIs from complying with the terms of the FFI agreement, Treasury developed two alternative intergovernmental agreements (IGA)—Model 1 and Model 2—to facilitate the effective and efficient implementation of FATCA by removing partner jurisdictions' legal impediments to comply with FATCA reporting requirements, and reducing burdens on FFIs located in partner jurisdictions. FFIs from countries with Model 1 IGAs report information on U.S. persons' accounts to their respective host country tax authorities (HCTAs). The HCTAs, in turn, compile the information from FFIs and transmit it to IRS. In contrast, FFIs from countries with Model 2 IGAs, or countries treated as not having an IGA in effect, directly report information on U.S. persons' accounts to IRS.

The following is a schematic of how the system works, assuming that the U.S. taxpayer provides the taxpayer identifying information to the FFI, and reports the account.⁴⁵⁰⁴

⁴⁵⁰³ GAO Report, Foreign Asset Reporting, Actions Needed to Enhance Compliance Efforts, Eliminate Overlapping Requirements, and Mitigate Burdens on U.S. Persons Abroad 5-6 (GAO-19-180 April 2019) (one footnote omitted).

⁴⁵⁰⁴ Id., Table.



The IRS has not yet figured out how to make maximum use of the information that it is receiving under FATCA,⁴⁵⁰⁵ but it is fair to assume that the IRS will over time make better use of the information.

B. OECD Common Reporting Standard (“CRS”).

After the enactment and implementation of FATCA, the OECD developed a parallel (but different) reporting system called the Common Reporting Standard (“CRS”),⁴⁵⁰⁶ which has been widely adopted.⁴⁵⁰⁷ Like FATCA, “its purpose is to combat tax evasion” and is based on FATCA. FATCA was designed to meet U.S. needs before there was a common standard such as CRS. CRS was designed to provide a general framework for the needs of other countries.

The following describes the general features of CRS as compared with FATCA:

⁴⁵⁰⁵ TIGTA, Additional Actions Are Needed to Address Non-Filing and Non-Reporting Compliance Under the Foreign Account Tax Compliance Act (Report # 2022-30-019 4/7/22); GAO Report, Foreign Asset Reporting, Actions Needed to Enhance Compliance Efforts, Eliminate Overlapping Requirements, and Mitigate Burdens on U.S. Persons Abroad (GAO-19-180 April 2019).

⁴⁵⁰⁶ See OECD web page titled “Common Reporting Standard” (viewed 4/4/19). The OECD has a companion “CRS Implementation Handbook,” a practical guide to implementing CRS which includes a comparison of CRS and FATCA.

⁴⁵⁰⁷ See Wikipedia Page “Common Reporting Standard” (last edited on 3/15/19 and viewed 4/4/19).

CRS reporting requirements are in many ways similar to FATCA, including required reporting of the account holders' name and address, taxpayer identification number, account number, account balance, and income and sales proceeds. However, the requirements differ in significant ways. The biggest differences in requirements are driven by the nature of the U.S. tax system. The United States, like many countries, generally taxes citizens and resident aliens on their worldwide income regardless of where that income is earned. However, the United States differs from other countries because it generally subjects U.S. citizens who reside abroad to U.S. taxation in the same manner as U.S. residents. In contrast to U.S. policy, most other countries do not tax their citizens if they reside in a country other than their country of citizenship. Further, IGAs implementing FATCA require FFIs to report the foreign-held accounts of U.S. citizens and residents—including resident aliens—while CRS requires financial institutions in jurisdictions participating in CRS to report on almost all accounts held by nonresidents of the reporting country.

* * * *

These differences in tax systems drive variations in due diligence procedures between FATCA and CRS. For example, FATCA aims to identify whether an account holder at a foreign institution is a U.S. person based on citizenship and tax residency information. In contrast, CRS aims to identify the tax residency of all account holders of a financial institution, and does not consider citizenship. Due to the multilateral nature of CRS, if an account holder is determined on the basis of the due diligence procedures to have residency in two or more countries, information would be exchanged with all jurisdictions in which the account holder is determined a resident for tax purposes. Under CRS rules, information about foreign accounts held by a U.S. citizen with a tax residence abroad would not be reported to IRS, but rather to the jurisdiction in which they were a resident for tax purposes. Because the United States taxes the worldwide income of U.S. citizens, CRS rules would need to require identification of account holders' citizenship in member countries where they are residents if FATCA were to be aligned with CRS.

XV. Related LB&I Compliance Campaigns.

LB&I has a compliance initiative program called Compliance Campaigns.⁴⁵⁰⁸ I discussed Compliance Campaigns above (beginning p. 407.) These are areas of special interest to LB&I. The Compliance Campaigns related to offshore income tax noncompliance of the type discussed in this chapter are:⁴⁵⁰⁹

- Offshore Service Providers, The focus of this campaign is to address U.S. taxpayers who engaged Offshore Service Providers that facilitated the creation of foreign entities and tiered structures to conceal the beneficial ownership of foreign financial

⁴⁵⁰⁸ See discussion of LB&I Compliance Campaigns beginning p. 407, above.

⁴⁵⁰⁹ The full list of compliance campaigns are on an IRS web page titled "Full List of LB Large Business and International Campaigns" (Page last reviewed or updated 8/1/19; viewed on 8/4/19).

accounts and assets, generally, for the purpose of tax avoidance or evasion. The treatment stream for this campaign will be issue-based examinations.

- FATCA filing accuracy. The overall purpose is to detect, deter and discourage offshore tax abuses through increased transparency, enhanced reporting and strong sanctions. Foreign Financial Institutions and certain Non-Financial Foreign Entities are generally required to report the foreign assets held by their U.S. account holders and substantial U.S. owners under the FATCA. This campaign addresses those entities that have FATCA reporting obligations but do not meet all their compliance responsibilities. The Service will address noncompliance through a variety of treatment streams, including termination of the FATCA status.
- OVDP Declines-Withdrawals Campaign. The Offshore Voluntary Disclosure Program (OVDP) allows U.S. taxpayers to voluntarily resolve past non-compliance related to unreported offshore income and failure to file foreign information returns. This campaign addresses OVDP applicants who applied for pre-clearance into the program but were either denied access to OVDP or withdrew from the program of their own accord. Taxpayers, who have yet to resolve their non-compliance and who meet the eligibility criteria, are encouraged to consider entering one of the offshore programs currently available. The IRS will address continued noncompliance through a variety of treatment streams including examination and letters.⁴⁵¹⁰
- Swiss Bank Program Campaign. In 2013, the U.S. Department of Justice announced the Swiss Bank Program as a path for Swiss financial institutions to resolve potential criminal liabilities. Banks that are participating in this program provide information on the U.S. persons with beneficial ownership of foreign financial accounts. This campaign will address noncompliance, involving taxpayers who are or may be beneficial owners of these accounts, through a variety of treatment streams including, but not limited to, examinations and letters.
- Post OVDP Compliance. This campaign addresses tax noncompliance related to former Offshore Voluntary Disclosure Program (OVDP) taxpayers' failure to remain compliant with their foreign income and asset reporting requirements. The IRS will address tax noncompliance through soft letters and examinations.

⁴⁵¹⁰ These taxpayers are known to the IRS because they attempted to join OVDP and were rejected or were accepted and then failed to complete the process. In 2018, the IRS began sending these taxpayers so-called "soft letters"—Letter 5935 (8-2917)—offering these taxpayers options with respect to offshore noncompliance. The letter indicates that the IRS believes that the taxpayer has not corrected noncompliance and therefore has three options, and that, if the taxpayer does not take any option, the IRS may audit to determine compliance. The options include (i) filing under the Streamlined Procedures, if eligible, (ii) filing all required returns to correct the noncompliance and be subject to applicable penalties subject to any reasonable cause for penalties if the IRS audits, and (iii) providing a narrative statement establishing that the taxpayer is not noncompliant. This mailing is pursuant to LB&I's having designated the OVDP declines and withdrawals as a Campaign Compliance initiative.

XVI. Forfeitures and Limitations.

The BSA has various reporting requirements other than FBAR. Several provisions require reporting on the movement of money. For example, I discussed earlier the parallel IRS Form 8300 and FinCEN Form 8300.⁴⁵¹¹ The FinCEN requirement is based on the BSA. The BSA requirement and other monetary instruments reporting requirements permit civil and criminal forfeiture of the assets involved.⁴⁵¹² The IRS is a principal enforcer of these requirements and therefore of forfeiture. The IRS has drawn considerable negative publicity for enforcing forfeiture with respect to transactions in otherwise lawfully obtained money that are structured to avoid the reporting requirements. For example, an owner of a business that has substantial cash transactions may make multiple deposits just under the \$10,000 reporting threshold (e.g., for bank CTRs). The negative publicity was based on the notion that structuring legal currency should not draw harsh civil forfeiture penalties because, after all, the BSA reporting requirements are principally designed to identify illegal currency transactions.

Due to that negative publicity, in 2019, Congress amended 31 U.S.C. § 5317(c)(2) to provide that the IRS may only seize property for a “claimed violation of section 5324 if the property to be seized was derived from an illegal source or the funds were structured for the purpose of concealing the violation of a criminal law or regulation other than section 5324.”⁴⁵¹³ Further, Congress required the IRS, within 30 days, to make a good faith effort to identify the owners of the property and notify them of the seizure and their rights to a post-seizure hearing in which the court shall order return of the property

unless the court holds an adversarial hearing and finds within 30 days of such request (or such longer period as the court may provide, but only on request of an interested party) that there is probable cause to believe that there is a violation of section 5324 involving such property and probable cause to believe that the property to be seized was derived from an illegal source or the funds were structured for the purpose of concealing the violation of a criminal law or regulation other than section 5324.⁴⁵¹⁴

XVII. Delinquent International Return Submission Procedures.

In the foregoing discussion, I have focused principally upon foreign financial accounts for which there are special reporting regimes (FBARs and Forms 8938). There are, however, related foreign reporting regimes that often travel along with foreign financial account reporting. For example:

- Form 3520, titled “Annual Return To Report Transactions With Foreign Trusts and Receipt of Certain Foreign Gifts”
- Form 3520-A, Annual Information Return of Foreign Trust With a U.S. Owner.

⁴⁵¹¹ See discussion beginning p. 118.

⁴⁵¹² 31 U.S.C. § 5317(c)(1) (criminal forfeiture); and § 5317(c)(2) (civil forfeiture).

⁴⁵¹³ Taxpayer First Act of 2019, § 1201, P.L. 116-25, 133 Stat 981 (July 1, 2019).

⁴⁵¹⁴ 31 U.S.C. § 5317(c)(2).

- Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations

Noncompliance issues with respect to those returns could be resolved in the various iterations of the voluntary disclosure practice (e.g., OVDP, SFCP, etc.). Some noncompliance issues, however, may not be sufficiently problematic to require those voluntary disclosure practice procedures. For that type of noncompliance, the IRS has “Delinquent International Information Return Submission Procedures.”⁴⁵¹⁵ Those procedures involve filing appropriate delinquent returns just as any other delinquent returns would be filed (except that care must be taken to file with the particular IRS office for the type of returns involved). With those delinquent submissions, taxpayer’s may include reasonable cause statements to avoid application of delinquency penalties. Upon such filings, delinquency penalties are usually automatically applied, regardless of the reasonable cause statements, but taxpayers feeling they have reasonable cause to avoid delinquency penalties are encouraged to respond to notices of the penalties to contest the imposition of the penalties, including submission or resubmission of reasonable cause statements.

⁴⁵¹⁵ See IRS web site titled “Delinquent International Information Return Submission Procedures” (last updated 11/5/20 and viewed 7/25/20).

Ch. 18. Whistleblower Rewards.

I. Introduction.

The chapter covers the IRS program for awards to informants, called whistleblowers, providing information to the IRS that it uses to collect revenue that might have not been collected except for the information provided by the whistleblower. The IRS has always been budget constrained and is particularly so now with the IRS being a favorite whipping boy for conservatives who until recently controlled all the levers of power and still control enough of those levers to prevent more robust revenue to support the IRS mission. In this environment, the IRS's enforcement efforts necessarily leave large amounts of potential revenue untapped.

To complement the IRS's budget constrained enforcement resources, Congress mandated that the IRS give awards to whistleblowers who bring information that the IRS uses to collect revenue. In broad strokes, the award program permits (i) general discretionary payments for certain qualifying information and (ii) for a narrower subset of whistleblower information (generally involving larger amounts), a mandatory payment of 15% of proceeds collected, with an additional discretionary increase up to an additional 15% (so that 30% total is possible).⁴⁵¹⁶

Whistleblower claims discussed in this Chapter are made by filing Form 211, Application for Award for Original Information.⁴⁵¹⁷

II. The Historic Discretionary Award Authority - § 7623(a).

Section 7623(a) (including prior Code and Revenue Act predecessors) has long given the IRS **discretionary** authority to grant whistleblowers awards. The awards are payable from "proceeds" collected as a result of the whistleblower's information.⁴⁵¹⁸ Prior to 2007, this was the only IRS whistleblower award program. The awards under this provision are administered by the IRS Whistleblower Office ("WBO") and are not subject to judicial review. The actual awards pursuant to this authority were generally perceived as being spare.

This historic discretionary award program is significant but has not historically generated much attention among practitioners because it was totally discretionary, was viewed as being not generous in amounts awarded, and somewhat opaque in its workings. This program still exists, but the IRS is more open about the process because it is subject to reporting mandated with the program discussed in the next section.

⁴⁵¹⁶ § 7623. See also Publication 5251, titled The Whistleblower Claim Process.

⁴⁵¹⁷ The application simply starts the process where the IRS considers the claim and, if appropriate, makes an award. The filing of the Form 211 and processing of the claim in the Form does not create a contract to make an award. *Meidinger v. United States*, 989 F.3d 1353 (Fed. Cir. 2021).

⁴⁵¹⁸ § 7623(a) and (c), as amended by § 41108 of the Bipartisan Budget Act of 2018, P.L. 115-123.

III. The Minimum Mandatory Authority - § 7623(b).

A. The Award 15-30% of Proceeds Collected.

In 2006, Congress amended the statute to include § 7623(b) providing a more objective and more robust award system. The WBO also administers this system; WBO's determinations under this system are subject to judicial review in the Tax Court, with appeal to the Court of Appeals for the District of Columbia Circuit.⁴⁵¹⁹

A whistleblower award depends upon (1) an "administrative or judicial action" based on the whistleblower's information and (2) "proceeds collected as a result of the action."⁴⁵²⁰

There are two threshold requirements for § 7623(b) to apply – (i) the target taxpayer's gross income must exceed \$200,000 for any taxable year subject to the action and (ii) the "proceeds in dispute" must exceed \$2,000,000.⁴⁵²¹

Assuming the whistleblower information clears the thresholds, there are two critical components to the 7623(b) award – the percentage and the base to which the percentage is applied. The award percentage is a minimum of 15% and may be up to 30% with the amount above the

⁴⁵¹⁹ § 7623(b)(4). If the whistleblower files in the Tax Court, the claim will survive the death of the whistleblower. *Insinga v. Commissioner*, 157 T.C. ___, No. 8 (2021). See IRM 25.2.2.8.3 (01-12-2018), Deceased Whistleblowers, indicating that the IRS will continue processing the claim and issue determination letters.

⁴⁵²⁰ § 7623(b)(1); *Cooper v. Commissioner* ("Cooper II"), 136 T.C. 597, 601 (2011).

⁴⁵²¹ § 7623(b)(5)(B), as amended by § 41108 of the Bipartisan Budget Act of 2018, P.L. 115-123. If the threshold amount is not met, an award, if any, is made only under § 7623(a) which does not allow judicial review. The threshold amount is not jurisdictional to Tax Court review provided in § 7623(b) but is an affirmative defense to § 7623(b) judicial review that the IRS must allege in its pleadings and prove. *Lippolis v. Commissioner*, 143 T.C. 393 (2014). If the threshold were jurisdictional, the whistleblower would have to plead that the amount was met and then prove the allegation to obtain judicial review of the award under § 7623(b). The practical difficulties of meeting those burdens, if the threshold amount were jurisdictional, are that the IRS may not have disclosed enough in the denial for the whistleblower to make a good faith allegation about amounts in excess of \$2,000,000 and then, because of the IRS's reticence even to disclose in discovery, the whistleblower may not get the information to meet the burden of proof. Since the amount is not jurisdictional, the IRS should plead failure to meet the amount in its answer and, if not, the Court may consider the merits. *Rogers v. Commissioner*, 157 T.C. 20, 27 (slip op. at 13 (2021)).

The calculation of the \$2,000,000 threshold is not necessarily the same as the calculation of the "collected proceeds" base to which the 15-30% awards apply. I offer two examples of differences between collection proceeds and the threshold amount. First, collected proceeds may be more than the threshold amount. For example, collected proceeds may include collections outside Title 26 (such as Title 18 civil fines and forfeitures) but those non-Title 26 collections are not included in the threshold \$2,000,000. See *Whistleblower 21276-13W v. Commissioner*, 147 T.C. 121 (2016); and *Whistleblower 22716-13W v. Commissioner*, 146 T.C. 84 (2016). Thus, the collected proceeds from non-Title 26 collections could conceivably be very large but the threshold amount would be under \$2,000,000 so that the § 7623(a) award regime applies (discretionary but less than 15%) rather than the mandatory 15-30% award regime of § 7623(b). Second, collected proceeds may be less than the threshold amount. For example, if the whistleblower gave specific information that led to an audit where the IRS collected \$1,000,000 based on the information but collected \$9,000,000 unrelated to the whistleblower's information, the collected proceeds is \$1,000,000 but the threshold amount is \$10,000,000. *Smith v. Commissioner*, 148 T.C. 449 (2017) (readers have to study the opinion to understand the textual gymnastics that lead to this result); see also *Lissack v. Commissioner*, 157 T.C. 63 (2021) (award base may include only collections "based on" the whistleblower information and not unrelated collections based on other information in an audit generated by the whistleblower claim), *aff'd* 68 F.4th 1312 (D.C. Cir. 2023). The whistleblower thus qualifies for the 15%-30% award regime of § 7623(b).

minimum 15% depending “upon the extent to which the individual substantially contributed to such action,”⁴⁵²² The Regulations explain the parameters for determining the whistleblower’s contribution to collected proceeds for purposes of exercising the discretion authorized in the statute.

The base to which the percentage applies is the “proceeds collected as a result of” IRS action on the whistleblower’s information.⁴⁵²³ Proceeds for this purpose includes (i) “penalties, interest, additions to tax, and additional amounts provided under the internal revenue laws,” and (ii) “any proceeds arising from laws for which the Internal Revenue Service is authorized to administer, enforce, or investigate,” including specifically “(A) criminal fines and civil forfeitures, and (B) violations of reporting requirements.”⁴⁵²⁴ Accordingly, for example, proceeds include Title 18 fines and restitution related to tax conspiracies under 18 U.S.C. § 371 and FBAR penalties collected under 31 U.S.C. § 5321(a)(5) as a result of the whistleblower’s information.⁴⁵²⁵

Further features of the critical “proceeds” base to which the award percentage applies are:

- If there are no proceeds because the IRS does not undertake any action, there can be no recovery.⁴⁵²⁶
- The IRS may collect proceeds in periods other than the period in which action is taken pursuant to the whistleblower claim; the question is whether those collections in the subsequent years permit or require an award. For example, based on the whistleblower claim, the IRS may reduce a net operating loss carryforward in audit year 01 that does not result in collected proceeds in year 01 but may result in collected proceeds in a subsequent year that is not audited. Since collection in the subsequent year arises from the action in the audit year the subsequent year collection can result in an award.⁴⁵²⁷

⁴⁵²² § 7623(b)(1)

⁴⁵²³ § 7623(b)(1) and (2)(A), as amended by § 41108 of the Bipartisan Budget Act of 2018, P.L. 115-123.

⁴⁵²⁴ § 7623(c), as added by § 41108(a) of the Bipartisan Budget Act of 2018, P.L. 115-123. This addition was in response to IRS position that collected proceeds only included proceeds collected under 26 U.S.C. The Tax Court had rejected the IRS position in *Whistleblower 21276-13W v. Commissioner*, 147 T.C. 121 (2016), but that case was pending Government appeal at the time of the statutory change. Note that the effective date for the new definition of proceeds is for information provided before, on, or after the date of the enactment of this Act with respect to which a final determination for an award has not been made before such date of enactment.” § 41108(d) of the Bipartisan Budget Act of 2018, P.L. 115-123,

⁴⁵²⁵ The Tax Court had given a broad reading of the prior base, “collected proceeds,” to include non-Title 26 collections. *Whistleblower 21276-13W v. Commissioner*, 147 T.C. 121 (2016), on appeal by IRS to the District of Columbia Circuit. After the effective date of the change in definition (see prior footnote), this should no longer be an issue. For a discussion of the treatment of FBARs by the Whistleblower Office prior to the law change, see GAO Report titled “Whistleblower Program: IRS Needs to Improve Data Controls for Some Award Determinations” (GAO-18-698 published 9/28/18 and publicly released 10/29/18).

⁴⁵²⁶ The statute allows recovery only if the IRS “proceeds with an administrative or judicial action.” § 7623(b)(1). If for any reason, the IRS does not proceed with such action, there can be no recovery. *Whistleblower 23711-15W v. Commissioner*, T.C. Memo. 2018-34 (the IRS decided not to proceed with any action; the information supplied by the informant, a lawyer, was subject to the attorney client privilege and was thus deemed unusable).

⁴⁵²⁷ Reg. § 301.7623-2(d)(5)(ii). This concept in this regulation does not seem to be affected by the statutory changes to the penalty base (from the prior “collected proceeds” to “proceeds” with new provisions as to its coverage in § 41108 of the Bipartisan Budget Act of 2018, P.L. 115-123). For an example where the whistleblower’s information caused a transaction recharacterized as a gift in a target year to reduce the unified gift and estate tax credit, (continued...)

- If the whistleblower’s information results in no change the audit year but the IRS’s inquiries during the audit year based on the whistleblower’s information induces the taxpayer to come into compliance in years after the audit year, the Tax Court held that there can be no award for the subsequent voluntary compliance because there was no action upon which to treat the subsequent compliance collections as proceeds.⁴⁵²⁸
- If the whistleblower’s claim results in an audit, but the audit produces (i) no proceeds related to the claim and (ii) proceeds related to an issue discovered during the audit on the whistleblower’s claim, the whistleblower is entitled to no award; in other words, the proceeds collected must arise from the issues in the whistleblower’s claim.⁴⁵²⁹ There is no “but for” reasoning that but for the whistleblower’s claim the IRS would not have discovered the unrelated issue.
- The whistleblower generally is required to identify the taxpayers from whom the IRS collects proceeds for an award. Thus, if a whistleblower identifies a tax shelter promoter (such as a Swiss banker promoting or assisting U.S. taxpayers use offshore accounts for avoiding tax) but does not identify the underlying taxpayers but instead claims that, by identifying the promoter the IRS was able to craft a voluntary disclosure initiative, the whistleblower is not entitled to an award from collected proceeds from the identified taxpayers in the voluntary disclosure initiative.⁴⁵³⁰ I caveat that statement with the word generally. I think circumstances might be encountered that would encourage the IRS or the Tax Court to award recovery even for unknown taxpayers that, at the time, are easily knowable to the IRS.⁴⁵³¹
- If the taxpayer made multiple claims with respect to different taxpayers actions in a common scheme, the taxpayers actions in each of the schemes may on different fact patterns for each scheme, result in different award percentages.

The statute gives the IRS discretion as to the amount of the percentage award between %15 and 30%,. The IRS has identified positive and negative factors it uses in exercise of this discretion.⁴⁵³² As noted below, upon the WB’s petition of the WBO’s determination, the Tax Court reviews the IRS exercise of the discretion for abuse of discretion.

⁴⁵²⁷(...continued)

thus resulting in tax in a later year when the unreduced unified credit would have been available, see *Lewis v. Commissioner*, 154 T.C. 124 (2020) (In a revised preliminary award, “The WBO acknowledged the possibility that the IRS will collect future proceeds because the wife used part of her unified credit to offset her 2010 and 2011 gift tax and stated that petitioner is entitled to a 22% award on the future proceeds.”).

⁴⁵²⁸ *Whistleblower 16158 14W v. Commissioner*, 148 T.C. 300 (2017). This case was decided under the statute prior to the 2018 changes in § 41108 of the Bipartisan Budget Act of 2018, P.L. 115-123. Those changes do not appear to affect this issue. See *Lewis v. Commissioner*, T.C. 154 T.C. 124, 135 (2020).

⁴⁵²⁹ *Berenblatt v. Commissioner*, 160 T.C. ___, No. 14, (2023).

⁴⁵³⁰ *Shands v. Commissioner*, 160 T.C. ___, No. 5 (2023).

⁴⁵³¹ I have filed one such claim that failed for other reasons, but I think the IRS would not have rejected it for failure to name the specific taxpayers (some of whom I could name, but the IRS knew about others that they could easily identify).

⁴⁵³² Reg. § 301.7623-2(b); and Reg. § 301.7623-2(c). For a discussion of this process, see *Whistleblower 8391-18W v. Commissioner*, 161 T.C. ___ No. 5,(slip op. at 12-16) (2023).

B. Adjustments - Sequestration Reduction; No Interest.

The amount thus determined is subject sequestration reduction (5.7% for FY 2023).⁴⁵³³ The sequestration reduction is not an abuse of discretion, because the IRS had no discretion.

The amount thus determined does not draw interest.⁴⁵³⁴ In this respect in theory the IRS could obtain interest free use of the award proceeds by delaying out the process of the original determination and delaying the WB proceeding in the Tax Court. Note in this regard that processing a WB claim from initiation, acceptance, audit, tax determination, and tax payment with refund opportunities foreclosed can take many years. The interest the IRS collects on the tax determination will enter the award proceeds calculation, but from the IRS's collection of the tax proceeds until payment of the award, the IRS has interest free use of the proceeds.

C. Judicial Review of WBO Determination.

After the IRS makes a final determination as to whether the whistleblower is entitled to an award (and if so, the amount), the whistleblower may contest the determination by filing a petition in the Tax Court within 30 days of the determination.⁴⁵³⁵ The whistleblower may claim that (i) the

⁴⁵³³ The sequestration requirement and process are described in *Luu v. Commissioner*, T.C. Memo. 2022-126, * 19 n 15, a whistleblower case, as follows:

Sequestration is a measure by which Congress enforces mandatory spending cuts across most government programs and agencies during the budgetary process. Sequestration applies to all nonexempt direct spending when Congress fails to enact certain budgetary legislation for the fiscal year. Budget Control Act of 2011, Pub. L. No. 112-25, §§ 101–103, 125 Stat. 240, 241–46, as amended by American Taxpayer Relief Act of 2012, Pub. L. No. 112-240, § 901, 126 Stat. 2313, 2370 (codified as amended at 2 U.S.C. § 901(a) (2012)). The applicability of the sequestration and the sequestration percentage are determined on the basis of the government fiscal year when the award is paid. The OMB calculates the sequestration percentage for each fiscal year following the procedures set forth by statute. See 2 U.S.C. § 901(a).

A shorter version of sequestration appears in *Whistleblower 8391-18W v. Commissioner*, 161 T.C. ___ No. 5, (slip op. at 10 n. 2) (2023).

See also CBO web page titled “Sequestration” (viewed 1/4/23). The OMB calculates annually the amount of the reduction and presents it in Sequestration reports that are linked on the page. The IRS explains the current sequestration on a web page titled “FY23 Sequestration Rate for Whistleblower Awards” (viewed 8/15/23). The page explains: “every award payment made to a whistleblower under IRC § 7623 on or after October 1, 2022, will be reduced by the fiscal year 2023 sequestration rate of 5.7 percent, regardless of when the IRS received the whistleblower’s Form 211.” See *Smith v. Commissioner*, 148 T.C. 425, 428 (2017) (an example of sequestration but not deciding whether sequestration is appropriate).

⁴⁵³⁴ *Whistleblower 8391-18W v. Commissioner*, 161 T.C. ___ No. 5 (slip op. at 18-19) (2023).

⁴⁵³⁵ § 7623(b)(4); IRM 25.2.2.9 (01-12-2018), Appeal Rights under IRC § 7623(b); and *Cooper v. Commissioner*, 135 T.C. 70 (2010) (denial letter can be contested). “Section 7623(b)(4) is unusual as a jurisdiction-conferring provision because it does not prescribe any particular form of notice to the would-be petitioner.” *Whistleblower 4496-15W v. Commissioner*, 148 T.C. 425, 431 (2017) (cleaned up). Normally, the determination is made in a determination letter sent to the claimant at his or her last known address, which starts the 30-day period running. *Whistleblower 26876-15W v. Commissioner*, 147 T.C. 375 (2016) (although there is no explicit statutory requirement that the determination be sent to the last known address or, for that matter, that the whistleblower be notified at all, that requirement will be read into the statute unless the whistleblower is actually notified in some other way; stated otherwise, if the WBO notifies by mail, it must be to the last known address). See also *Myers v. Commissioner*, 148 T.C. 438 (2017), *aff'd* and *remanded* on other grounds, 124 AFTR2d 2019-5022, 928 F3d 1025 (DC Cir. 2019) (for possibility (continued...))

IRS has miscalculated the amount the whistleblower should be awarded (either because the IRS should have awarded more in the range from 15 to 30% than it did or the IRS collected proceeds base is too low)⁴⁵³⁶, (ii) that the IRS miscalculated the threshold \$2,000,000 amount, thus relegating the whistleblower to a § 7623(a) award rather than a § 7623(b) award, or (iii) that the IRS improperly failed to make any award under § 7623(b) at all. The Tax Court's Rules for such proceedings: (i) require that information that might identify the taxpayer subject to the claim must be redacted;⁴⁵³⁷ and (ii) permit a whistleblower and his attorney to proceed anonymously upon a proper showing of special circumstances (such as fear of retaliation) that outweigh the societal need for public proceedings.⁴⁵³⁸

In the Tax Court proceeding, the scope of review is (i) the general APA standard called the record rule (meaning that the review is limited to the agency record); (ii) the review of the award or lack of reward based on that record is an abuse of discretion standard, and (iii) the *Chenery* rule requiring that the Tax Court can uphold the agency (here the WBO) only on the grounds it asserted in its determination.⁴⁵³⁹ In the proceeding, the IRS will submit the administrative record setting the

⁴⁵³⁵(...continued)

of multiple determinations and taxpayer receipt in time to file a Tax Court proceeding makes the determination effective). *Myers* was reversed but not on this point. *Myers v. Commissioner*, 928 F.3d 1025 (D.C. Cir. 2019).

An issue is whether a whistleblower can file seriatim claims based on the same facts and, based on each of the serial overlapping claims and resulting determinations (however described) denying the claims, get for each a new opportunity to petition the Tax Court. This would mean that there is no preclusive effect of the first denial determination. See *Whistleblower 15488-17W v. Commissioner*, T.C. Memo. 2019-23 (holding, where the taxpayer did not contest the first denial, but continued to submit information, the IRS rejection is a determination that may be contested). A variation on that issue is whether the whistleblower can dismiss the whistleblower case without prejudice. In *Insinga v. Commissioner*, (T.C. Dkt. 16575-16W - Designated Order 8/25/18), the Tax Court (Judge Gustafson) agreed that the whistleblower could dismiss the whistleblower case, citing *Jacobson v. Commissioner*, 148 T.C. 68 (2017), but asked the parties to address the issue of whether, even if dismissed with prejudice so that it clearly bound with respect to the determination involved in that petition, dismissal with prejudice could affect a subsequent whistleblower filing with respect to a later determination.

⁴⁵³⁶ The percentage above 15% is statutorily in the IRS's discretion. If the Tax Court rejects the IRS's discretionary award amount (of percentage) because it is arbitrary or capricious, except in rare circumstances, the Tax Court must remand to the IRS WBO to exercise the discretion more appropriately. *Whistleblower 8391-18W v. Commissioner*, 161 T.C. ___ No. 5 (slip. Op. 13 (2023)) (quoting *Whistleblower 769-16W, v. Commissioner*, 152 T.C. at 178 (quoting *Fla. Power & Light Co. v. Lotion*, 470 U.S. 729, 744 (1985)).

⁴⁵³⁷ Rule 345(b).

⁴⁵³⁸ Rule 345(a); see *Whistleblower 7208-17W v. Commissioner*, T.C. Memo. 2018-118 (has good discussion of the process). The original petition must bear the whistleblower's name and be accompanied by a motion to seal. The petition is sealed upon acceptance by the clerk and stays sealed until the court denies the motion or, if granted, removes the order granting the motion. If anonymous proceedings are allowed, the case will be captioned with the word Whistleblower and the case number – e.g., *Whistleblower 12568-16W v. Commissioner*, 148 T.C. 103 (2017) (noting that the granting of the motion to proceed anonymously may be lifted later if the need for anonymous proceeding no longer applies); see also *Whistleblower 14377-16W v. Commissioner*, T.C. Memo. 2021-113 (denying request for anonymity with extensive discussion of the anonymity issue, after remand in *In re Sealed Case*, 931 F.3d 92 (D.C. Cir. 2019)). A report from the 2018 Tax Court Judicial Conference indicates that 101 whistleblower cases have requested to permit the petitioner to proceed anonymously and that the Tax Court granted the request in about ½ the cases. Keith Fogg, Don't Expect a Whistleblower Award for Giving the IRS Privileged Information and General Information from the Judicial Conference on this Issue (Procedurally Taxing Blog 4/16/18). Often, when the petitioner requests anonymity, the petitioner's attorney will do so as well from concern that identifying the attorney might identify the petitioner. The foregoing statistic does not break out how many cases attorney anonymity was allowed.

⁴⁵³⁹ *Kasper v. Commissioner*, 150 T.C. 8, 11 n. 1(2018); *Rogers v. Commissioner*, 157 T.C. 20, 32-33 (continued...)

scope of review. The Tax Court presumes that the submitted record has been properly compiled and submitted, absent the taxpayer showing cause that it is not complete.⁴⁵⁴⁰ Further, generally, matters outside the record in exceptional circumstances may be submitted and considered.⁴⁵⁴¹ And the matters that the IRS considered may include hearsay of a type inadmissible in a court proceeding and Tax Court review may consider the hearsay if reliable and trustworthy in assessing whether the IRS abused its discretion in considering the hearsay in making its determination.⁴⁵⁴²

The D.C. Circuit held that the Tax Court does not have jurisdiction to review the IRS's threshold rejection of a whistleblower claim without forwarding the claim to Examination for review and potential action.⁴⁵⁴³ The D.C. Circuit's holding seems pre-emptive as to further Tax Court review without at least the WBO's transfer and actual collection of proceeds⁴⁵⁴⁴ because appeals in whistleblower cases in Tax Court are to the D.C. Circuit.⁴⁵⁴⁵

Where the WBO transfers the information to Examination for review but determines, based on recommendation from Examination, that the information did not contribute to assertion of liability and, most importantly, collected proceeds, the Tax Court has jurisdiction to review the determination.⁴⁵⁴⁶ Even if there is jurisdiction, under the valid regulation, if the IRS actually collects no proceeds related to the whistleblowers information, there is no reward; hence, collection of actual proceeds related to the information requires a direct relationship rather than a simple "but for" analysis that asks only whether the IRS would have discovered and collected proceeds on an unrelated issue because the whistleblower information caused the audit.⁴⁵⁴⁷

In appropriate circumstances, the Tax Court may remand a whistleblower case to the IRS WBO for further consideration.⁴⁵⁴⁸

⁴⁵³⁹(...continued)

(2021); *McCrory v. Commissioner*, T.C. Memo. 2021-116, at *12 & *13 ("we generally confine ourselves to the administrative record to decide whether there has been an abuse of discretion," citing *Kasper* and *Van Bemmelen v. Commissioner*, 155 T.C. 65, 78 (2020)). The *Chenery* doctrine is based on *SEC v. Chenery Corp. (Chenery I)*, 318 U.S. 80, 93-95 (1943). The second of the two holdings—that review is limited to abuse of discretion—must be considered in context. One of the purposes of § 7623(b) was to make a minimum award of 15% nondiscretionary. If a § 7623(b) award is appropriate, then obviously an award of less than 15% would be an abuse of discretion per se. The abuse of discretion would thus focus on whether an award exceeding 15% should have been made and whether the IRS's calibration of that extra percentage abused its discretion.

⁴⁵⁴⁰ *Van Bemmelen v. Commissioner*, 155 T.C. 64, 74 (2020).

⁴⁵⁴¹ *Id.*, at 73. For a discussion of a rejected claim to consider matters outside the record submitted by the IRS, see *Whistleblower 14377-16W v. Commissioner*, T.C. Memo. 2021-113, *60-66 and *Marino v. Commissioner*, T.C. Memo. 2021-130, *14.

⁴⁵⁴² *Marino v. Commissioner*, T, C, Memo. 2021-130, *21 - 23.

⁴⁵⁴³ *Li v. Commissioner*, 22 F.4th 1014 (D.C. Cir. 2022).

⁴⁵⁴⁴ The D.C. Circuit's opinion in *Li, supra*, footnoted (p. 1017 n. 2) that Li made no claim that the IRS rejected the claim at the threshold but then "but nevertheless proceeded against a target taxpayer based on the provided information."

⁴⁵⁴⁵ Under the Tax Court's *Golsen* rule, the Tax Court must follow the precedent of the Circuit to which the case is appealable.

⁴⁵⁴⁶ *Whistleblower 97217W v. Commissioner*, 159 T.C. ___ No. 1 (7/13/22), slip op. 7-10.

⁴⁵⁴⁷ *Lissack v. Commissioner*, 68 F.4th 1312 (C.A. D.C. 2023).

⁴⁵⁴⁸ *Whistleblower 769-16W v. Commissioner*, 152 T.C. 172 (2019).

Venue for appeals from Tax Court whistleblower cases in the D.C. Circuit.⁴⁵⁴⁹

IV. Processing Claims and Granting Awards.

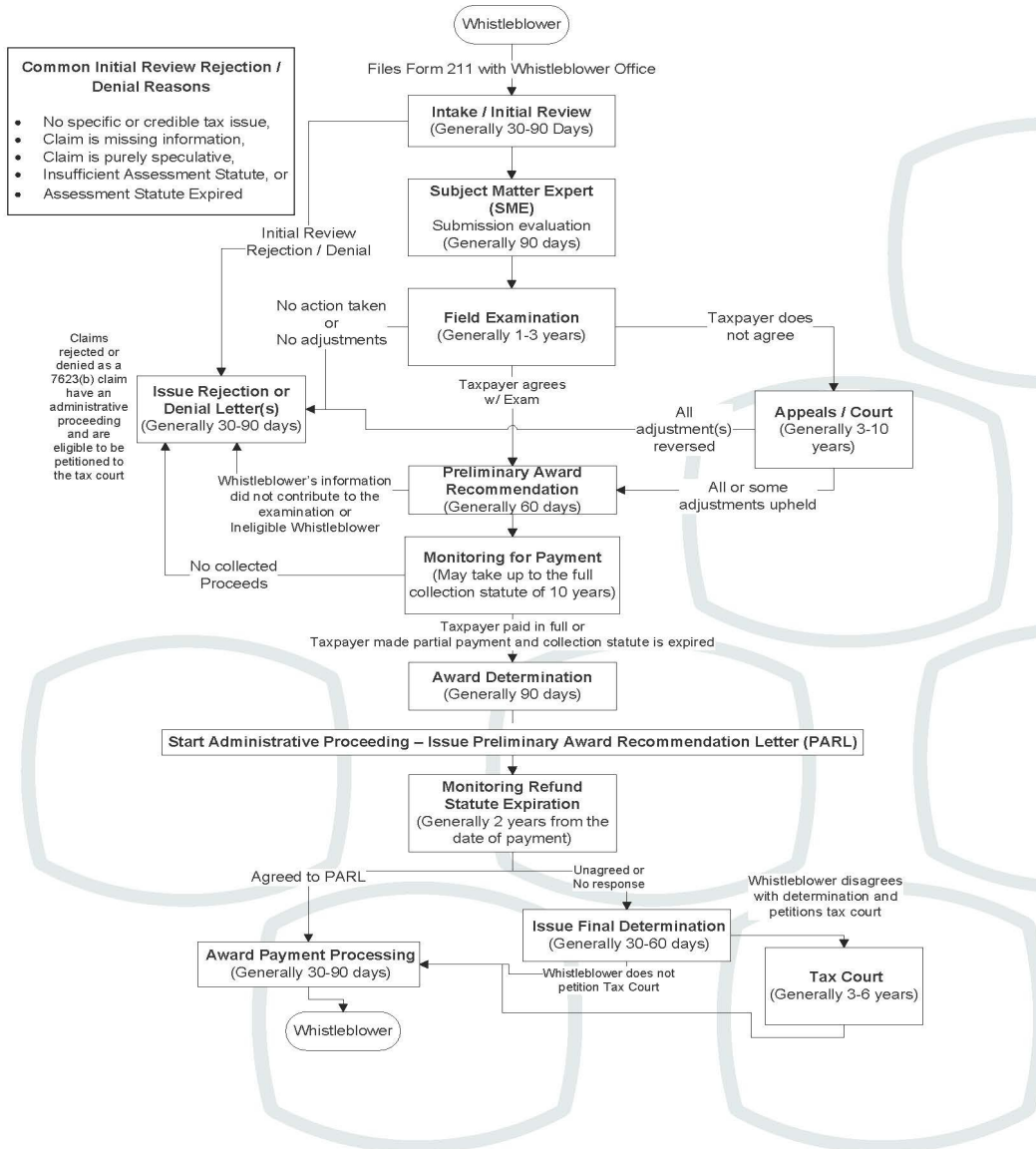
IRM 25.2.2 Whistleblower Awards provides an overview of the IRS administrative processing of whistleblower claims.⁴⁵⁵⁰ IRS Publication 5251, Whistleblower Claim Process and Timeline, provides a graphic that shows the timeline and steps in the process for processing a Whistleblower Claim.⁴⁵⁵¹ Here is the graphic for the Timeline:

⁴⁵⁴⁹ § 7482(b)(1) (flush language) makes venue for Tax Court appeals in the D.C. Circuit unless otherwise provided. There is no provision otherwise, so the appeal would be to the D.C. Circuit. See *Kasper v. Commissioner*, 150 T.C. 8, 11 n. 1(2018) (citing also *Ware v. Commissioner*, 499 F. App'x 957, 959 n.1 (11th Cir. 2012)).

⁴⁵⁵⁰ See Bryan Camp, Lesson From The Tax Court: The Slippery Slope Of Tax Court Review (Tax Prof Blog 10/12/20).

⁴⁵⁵¹ See Pub. 5251 (Rev. 9/22), The Whistleblower Claim Process, p. 5.

Whistleblower Process Timeline



V. WBO Annual Report to Congress.

The IRS Whistleblower’s Office must give an annual report to Congress on how the program is working.⁴⁵⁵² The following are key statistics from its recent reports:

| Amounts Collected and Awards under IRC § 7623, Fiscal Years 2017 to 2019 (Compiled from Annual | | | | |
|--|-----------------|---------------|---------------|---------------|
| | FY 2018 | FY 2019 | FY 2020 | FY 2021 |
| Total Claims Related to Awards | 423 | 510 | 593 | 380 |
| Total Number of Awards | 217 | 181 | 169 | 159 |
| Total IRC § 7623(b) Awards | 31 | 24 | 30 | 20 |
| Total Amounts of § 7623(b) Awards | N/R | N/R | N/R | \$27,298,747 |
| Total Amounts of Awards n2 | \$312,207,590 | \$120,305,278 | \$86,619,032 | \$36,144,926 |
| Proceeds Collected | \$1,441,255,859 | \$616,773,127 | \$472,080,014 | \$245,303,646 |
| Awards as a Percentage of Proceeds Collected | 21.70% | 19.50% | 18.30% | 14.70% |
| | | | | |
| N/R means not reported | | | | |
| 2 “Total Amount of Awards” is prior to the sequestration reduction. | | | | |

Note that the aggregate awards (both § 7623(a) & (b)) have decreased significantly over the years from 2018 to 2021. I can’t explain the decrease without some speculation (which might even be half-informed speculation), so I will not.

One particular award is worthy of separate mention because it is not just a statistic. Although whistleblowers generally desire to remain anonymous and the WBO honors that desire, the whistleblower and the WBO did publicize one very noteworthy award. Bradley Birkenfeld, a UBS officer who participated in promoting UBS deposits as a U.S. tax evasion opportunity. After enactment of the new automatic reward program in 2006, Mr. Birkenfeld saw his opportunity to turn in U.S. taxpayers for substantial rewards; since very rich U.S. taxpayers cheated on their U.S. tax through UBS and he was aware of a number of these U.S. taxpayers, the whistleblower reward opportunity appeared very lucrative. Birkenfeld also simultaneously wanted immunity from prosecution for his own crimes in assisting U.S. taxpayers to cheat on U.S. tax. Mr. Birkenfeld’s disclosures brought UBS to its knees and cracked out—at least partially—the Swiss franchise on secrecy to help tax cheats (U.S. and others).⁴⁵⁵³ For this reason, he was named 2009 Tax Analysts Person of the Year⁴⁵⁵⁴ Because of the way he allegedly handled the disclosure of information (being selective, perhaps to the point of being misleading, rather than open and fully cooperative), he was

⁴⁵⁵² IRS Whistleblower Office, Fiscal Year 2020 Annual Report to Congress. Links to the annual reports are compiled at <https://www.irs.gov/compliance/whistleblower-office-annual-reports> (accessed July 1, 2022).

⁴⁵⁵³ The reports of Mr. Birkenfeld’s key role are all over the press and the internet. A good summary is in Tax Analyst’s article naming Mr. Birkenfeld the “2009 Person of the Year.” Tax Analysts, Year in Review: The 2009 Person of the Year, 126 Tax Notes 7 (Jan. 4, 2010).

⁴⁵⁵⁴ Id.

convicted and sentenced to 40 months. But he received a whistleblower award of \$104 million in 2012 under § 7623(b).⁴⁵⁵⁵

A related development is the disclosure of what are popularly called the “Panama Papers.” The International Consortium of Investigative Journalists (“ICIJ”) had a source deliver vast quantities of data that came from a Panama law firm. That data became known as “the Panama Papers.” Panama is a well-known tax haven where, like Switzerland, non-citizens hide vast wealth and, through hiding it from law enforcement, avoid detection. Tax evasion is a significant part of the equation. In 2016, the ICIJ published reports on the data and a large portion of the data on its web site.⁴⁵⁵⁶ The publication of the data has had enormous consequences in many countries, including the U.S. It is too early to know precisely what the IRS and DOJ Tax has done with the data, other than the certainty that they are examining it with an eye to U.S. tax enforcement using all appropriate tools, civil and criminal.⁴⁵⁵⁷ I don’t know whether whistleblower claims under the provisions discussed below were made with respect to this data. I do also know, however, that claims have been made with respect to U.S. taxpayers and foreign banks assisting them.⁴⁵⁵⁸

VI. WBO Assistance from Whistleblower; § 6103 Issues.

The WBO ““in its sole discretion, may ask for additional assistance from such individual or any legal representative.”⁴⁵⁵⁹

It may be helpful or even necessary in the whistleblower consideration or in the related audit or in litigation to disclose to the whistleblower or whistleblower representative the underlying taxpayer’s return information otherwise protected under § 6103. The disclosure to the whistleblower is now specifically permitted, along with periodic disclosures of the status of the whistleblower claim.⁴⁵⁶⁰

VII. Protecting the Whistleblower from Retaliation.

⁴⁵⁵⁵ See [Birkenfeld Gets \\$104 Million Whistleblower Award](#) (Federal Tax Crimes Blog, 9/11/12). The Federal Tax Crimes Blog is my blog, and hence the citation is to myself. But I have various resources linked on the blog.

Birkenfeld’s is the largest award to date. It appears that a potentially even larger award might be in the offing. David Voraceos and Joe Deaux, [The Whistleblower Behind Caterpillar’s Massive Tax Headache Could Make \\$600 Million](#) (BloombergBusinessweek 6/1/17). If an award is forthcoming, I will discuss in a later edition.

⁴⁵⁵⁶ See ICIJ web site titled “An ICIJ Investigation The Panama Papers: Exposing the Rogue Offshore Finance Industry“ (viewed 7/22/18),

⁴⁵⁵⁷ See Arthur J. Cockfield, [Big Data and Tax Haven Secrecy](#), 18 Fla. Tax Rev. 483 (2016) (for analysis and some conclusions based on a subset of the Panama Papers data).

⁴⁵⁵⁸ *Whistleblower 21276-13W v. Commissioner*, 147 T.C. 121 (2016) (§ 7426(b) claim).

⁴⁵⁵⁹ Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, sec. 406(b)(1)(C), 120 Stat. at 2960 (emphasis supplied), discussed in *Van Bemmelen v. Commissioner*, 155 T.C. 64 (2020) (holding that this is the WBO’s sole discretion, offers no meaningful standard of review and thus is not reviewable).

⁴⁵⁶⁰ § 6103(k)(13) and § 6103(a)(3), as added or modified, respectively, by Taxpayer First Act of 2019, § 1405, P.L. 116-25, 133 Stat 981 (July 1, 2019). Prior to this specific addition, it was thought that disclosure might be allowed under § 6103(h)(4); Reg. § 301.6103(h)(4)-1 (disclosure in administrative proceedings). In *Amgen Inc. v. Commissioner* (T.C. Dkt. ## 16017-21 Case Docket Entry 38 Order dated 3/4/23), the Tax Court held that § 6103(h)(4)(B) permits disclosure in Tax Court litigation, but the documents will be subject to a protective order limiting its use or further distribution.

Section 7623(d), as added in 2019, forbids an employer (or its agents) from retaliatory action (such as discharging, demoting, suspending, threatening, etc., or in any other manner retaliating) for an employee's lawful acts to disclose or provide information or otherwise assist in an investigation in which the employee "reasonably believes constitutes a violation of the internal revenue laws or any provision of Federal law relating to tax fraud."⁴⁵⁶¹ The agencies to whom disclosures are covered are the IRS, Treasury, TIGTA, the Comptroller General of the United States, and the Department of Justice.

The employee has a private right of action for improper retaliation by unfavorable personnel action where whistleblowing was a contributing factor.⁴⁵⁶² The employee may file a complaint with the Secretary of Labor and, if the secretary does not issue a decision in 180 days, may commence an action at law or equity for de novo review in the district court in which a jury may be used.⁴⁵⁶³ The employee is entitled to "all relief necessary to make the employee whole," including reinstatement and restoration of seniority, 200% of back pay and 100% of lost benefits, and compensation of special damages, including litigation costs, expert witness fees and attorneys' fees.⁴⁵⁶⁴ The rights thus provided may not be waived as a condition of employment and any arbitration agreement denying the protection is not valid or enforceable.⁴⁵⁶⁵

⁴⁵⁶¹ This authority likely covers violations of legislative regulations. Cf. *Chrysler Corp. v. Brown*, 441 U.S. 281 (1979). I suspect that it would also cover interpretive regulations entitled to *Chevron* deference at least if the taxpayer was on notice of them.

⁴⁵⁶² The burdens of proof are those set forth in 49 U.S.C. § 42121(b), the Airline Industry Whistleblower law. § 1405(b)(2)(B)(iii). The standard "broad and forgiving," with protected activity only playing some role and even an insignificant or insubstantial role. *Palmer v. Canadian Nat'l R.R.*, ARB No. 16-035, ALJ No. 2014-FRS-154, at 53 (ARB Sept. 30, 2016).

⁴⁵⁶³ § 7623(d)(2), as added by Taxpayer First Act of 2019, § 1405(b), P.L. 116-25, 133 Stat 981 (July 1, 2019). The Department of Labor's Occupational Safety and Health Administration will handle worker retaliation complaints under this provision of the TFA. See News Release titled "U.S. Department of Labor Handles Retaliation Complaints Under New Taxpayer First Act" dated 9/11/19.

⁴⁵⁶⁴ § 7623(d)(3), as added by Taxpayer First Act of 2019, § 1405(b), P.L. 116-25, 133 Stat 981 (July 1, 2019).

⁴⁵⁶⁵ § 7623(d)(5), Taxpayer First Act of 2019, § 1405, P.L. 116-25, 133 Stat 981 (July 1, 2019).

Ch. 19. Ethics, Malpractice and Tax Procedure.

I. Introduction.

Many ethical issues confront the tax practitioner. This book is designed for the law student of tax procedure, so I deal with examples of the types of ethical issues that confront the tax attorney in a tax procedure practice. However, since tax procedure and its implications cover virtually the entire gamut of tax practice, the following discussion may be used fruitfully by all tax practitioners. I do not attempt to provide an exhaustive discussion but do provide some examples help you frame the analysis when you are confronted with variations of the issues in your practice.

Ethical issues obviously overlap with the civil and criminal penalty issues that we covered above. An attorney acts unethically if, in his or her practice, he or she commits a tax crime or assists a taxpayer or other person in the commission of a tax crime (such enabler acts also constituting a crime under, you will recall, § 7206(2) or 18 U.S.C. §§ 2 or 371). But an attorney's ethical responsibilities are not confined by the criminal statutes.

There are guides to, or standards for, ethical conduct. These include:

- State professional licensing standards for lawyers, CPA and other professionals.
- As to Tax Court Practice, Rule 201(a) requires that “Practitioners before the Court shall carry on their practice in accordance with the letter and spirit of the Model Rules of Professional Conduct of the American Bar Association.”
- Circular 230 providing certain standards of conduct for tax professionals should use as guides to conduct (see discussion of Circular 230 above beginning p. 45).

Some questions that might be asked: Does an attorney act unethically if the attorney knows or believes that the client’s position will subject the client or the practitioner himself to a civil penalty? Does an attorney act unethically if the plan relies on technical tax rules but are just too good to be true, as was the case, for example, with many of the abusive tax shelters that have come into vogue from time to time (e.g., the Son-of-Boss tax shelters in the late 1990s and early 2000s)? Does the attorney act unethically if his conduct skirts Circular 230 which might subject him to IRS practice sanctions?

This is not a course in ethics. I will not attempt to be encyclopedic in the applications of the ethical rules to the tax practice.⁴⁵⁶⁶ I will, however, illustrate through examples the types of issues that arise. I don't have easy answers and in some cases will simply pose the issue without the answers. As in all law school courses and in law practice, if you spot the issue, you can then yourself—with research, thought and discussion with colleagues, working from the known to the unknown with principled analysis—come up with as good an answer as anyone can.

⁴⁵⁶⁶ More complete treatments of the ethics of tax practice are found in many good articles. Some are: Heather M. Field, Aggressive Tax Planning and the Ethical Tax Lawyer, 36 Va. Tax Rev. 261 (2017); Dennis J. Ventry, Jr. & Bradley T. Borden, Probability, Professionalism, and Protecting Taxpayers, 68 Tax Law. 83 (2014); David Weisbach and Brian Gale, The Regulation of Tax Advice and Tax Advisors, 130 Tax Notes 1279 (2011); Rachelle Y. Holmes, The Tax Lawyer as Gatekeeper, 49 U. Louisville L. Rev. 185 (2010); and Frank J. Gould, Giving Tax Advice - Some Ethical, Professional and Legal Considerations, 97 Tax Notes 523 (2002).

II. Ethical Issues in Planning.

I think the following, from a 2017 law review article, is a good introduction to the issues often encountered in a tax planning practice (Heather M. Field, Aggressive Tax Planning and the Ethical Tax Lawyer, 36 Va. Tax Rev. 261, 263-270 (2017) (footnotes omitted)):

A core function of a tax planning lawyer is to help her client achieve non-tax economic objectives in a manner that minimizes the client's tax burden. Sometimes it is reasonably clear that a particular tax minimization opportunity complies with the law, but sometimes attempts to reduce tax involve more aggressive positions - positions that are potentially wrong, positions that the tax authority may want to challenge, and positions where the asserted tax treatment is likely not the proper analysis under the law.

Can an ethical tax lawyer provide this type of planning advice?

This inquiry contemplates a lawyer who wants to advise ethically on contestable tax positions. She does not think that tax planning is inherently wrong. She agrees with the notion that “any one may so arrange his affairs that his taxes shall be as low as possible; he is not bound to choose that pattern which will best pay the Treasury; there is not even a patriotic duty to increase one's taxes.” She respects that most of her clients do not want to take the most conservative (highest tax) approach when arranging their affairs. And she wants to pursue a career as a tax planner helping clients to arrange their affairs while reducing their taxes.

Yet she will not assist a client in committing fraud, and she is not interested in helping a client take advantage of under-enforcement of the tax law to get away with clear violations of the law. She does not want to be a “sheltering lawyer,” like Paul Dagerdas (formerly of *Jenkins & Gilchrist*) and Raymond J. (“R.J.”) Ruble (formerly of *Brown & Wood*), both of whom went to jail for their roles in tax shelters. And she does not want to be part of the next Mossack Fonseca, the law firm at the center of the Panama Papers scandal. Rather, she merely hopes to make a living as a tax planner, and she wants to do so in a way that maintains her personal integrity. Ultimately, she is concerned about staying on the right side of the ethical line, wherever that “mythical line” is.

So what does it mean to be ethical when providing tax planning advice on potentially aggressive tax positions?

It clearly requires knowledge of the rules of ethics that govern the profession, whether those are the Model Rules of Professional Conduct or the variation thereon that applies in the jurisdiction in which the tax planner is authorized to practice. The tax planner must also understand the ABA Formal Opinions relevant to the provision of tax advice and the Circular 230 regulations that set out standards of practice for those individuals who “practice before the IRS,” which includes anyone who

“renders written advice with respect to any entity, transaction, plan or arrangement, or other plan or arrangement having a potential for tax avoidance or evasion” (i.e., tax planners). The tax planner must know what actions could subject her to preparer penalties, particularly if she is likely to render advice both before and after the transaction. Further, if the tax planner advises with respect to reportable transactions, she must be familiar with the disclosure and list maintenance requirements and with the related penalties. The foregoing is not easy. Indeed, there is ample literature that discusses the meaning of both the rules of professional conduct that apply to all lawyers and the specific rules that regulate tax practice.

Understanding these rules is necessary, but it is not sufficient because these rules leave many questions unanswered. The rules and standards do set some clear boundaries - for example, an ethical tax planner must be truthful, and she cannot help a client commit tax fraud. But the authorities regulating the profession leave tax planners with a tremendous amount of discretion on questions such as the following: Which matters will the lawyer agree to take on (and why)? How aggressive is the lawyer willing to be within the boundaries of what is allowed? Should the lawyer-client relationship be one where the lawyer does what the client requests or should (and in what circumstances should) the lawyer try to persuade the client to do something else? Should the lawyer consider only the client's interests when advising the client or should the lawyer also consider interests of others?

Of course, ethical practice is not merely “a matter of individual conscience and therefore individual choice.” Within the boundaries of the rules, however, there are many choices that individual practitioners must make. These issues of discretion and judgment are important in a wide variety of practice areas. And although scholars have discussed these questions extensively, there is no consensus about the answers. Further, the literature has not effectively engaged these issues in the context of tax planning.

This gap is glaring because these issues involving exercise of discretion and judgment are particularly important and challenging in the context of tax practice. This is for several reasons. First, tax planners are subject not only to the general rules of professional responsibility that apply to all lawyers, but are also subject to an additional set of tax-specific ethical rules, making the exercise of discretion more complex and fraught with minefields in the tax context. Second, both tax planning practice and the rules articulating the standards of practice for tax lawyers place a very heavy emphasis on the lawyer's degree of confidence in the strength of a client's position, thereby elevating the importance of the tax lawyer's judgment. Third, the tax-specific ethics rules and standards explicitly allow tax advisers to help clients take positions that are likely to be wrong (i.e., that are not more likely than not to be sustained on the merits if challenged). As a result, tax planners must determine whether and to what extent they are willing to assist on such matters. Fourth, tax practitioners have played a key role in tax-sheltering activities that have generated much public scorn, meaning that tax advisers have not always exercised their

discretion in a way that comports with the public's view of right and wrong. Fifth, the IRS only audits a small percentage of taxpayers and is thus a weak enforcement body, and tax compliance generally cannot be enforced through private rights of action. As a result, much depends on taxpayer self-reporting. This, in turn, makes the tax lawyer's advice particularly significant because of its strong influence on taxpayer behavior.

So how should a tax planner, who wants to engage in “permissible tax planning” but not cross the line over into “unethical loophole lawyering,” exercise her discretion and judgment? This article argues that a lawyer seeking to pursue a career as an ethical tax planner should identify and implement her philosophy of lawyering to help her make difficult discretionary tax advising decisions in a principled way, and when implementing that approach to tax lawyering, she should work to counteract the subtle factors that can skew her professional judgment.

This article focuses on the role of the individual, and how each individual tax lawyer should make difficult discretionary decisions within the existing boundaries of what is arguably allowable. By using the example of a U.S. multinational corporation that wants to invert and engage in other cross-border tax minimization strategies that Congress and the Treasury have tried to curtail, and by drawing on both the extensive literature on lawyering and professionalism and on social science literature about factors that lead to skewed decision-making, this article helps each tax planner operationalize, on an individual basis and in a way that aligns with her values, both the general and tax-specific rules of professional conduct.

This article contributes to the literature in three key ways. First, it focuses on the questions that the existing rules leave to the discretion of each tax practitioner, rather than helping tax advisers grapple with issues that the rules address. Second, it approaches the discussion from an individual lawyering perspective, rather than from a policymaking perspective. Third, it provides actionable guidance to tax professionals about how to regulate their own behavior, rather than merely lamenting the decline in the professionalism of the tax bar and telling cautionary tales. Notably, this article does not advocate for one particular lawyering approach for individual tax planners. Rather, it presents a framework - with options, examples, and factors that would suggest different approaches - that each lawyer can use to identify and implement an approach to tax planning in potentially aggressive situations and in a way that aligns with her values.

* * * *

Ultimately, this article argues that an important part of being an ethical tax planner, particularly when dealing with contestable tax positions, includes both being deliberate about how one approaches the task of giving tax planning advice and being self-aware about the ways in which one exercises judgment. Given that the collective ethics of the tax planning profession reflect the sum of the choices made

by individual practitioners, perhaps this article's guidance about the ethics of the tax planning can empower tax advisers to make better decisions about how they approach potentially aggressive tax planning. This, in turn, can strengthen the professionalism of the tax bar and help to rehabilitate the public image of tax lawyers.

The tax planning that raises ethical issues is the planning that is aggressive with little chance of prevailing (remember the ranking of tax positions I discussed earlier in dealing with penalties). Just to remind about the most aggressive positions:⁴⁵⁶⁷

| Confidence Level | Probability of Winning | Probability of Losing |
|----------------------------------|------------------------|-----------------------|
| not frivolous | 10% | 90% |
| reasonable basis | 20% (some say 30%) | 80% (70%) |
| realistic possibility of success | 33 1/3% | 66 2/3% |
| substantial authority | 40% (some say 35%) | 60% (65%) |

Each of these confidence levels involves a likelihood that the tax planning position will likely not prevail. An initial question is whether an attorney should be involved in a transaction that is not likely to prevail? I think most would say that the attorney should not take frivolous positions for a client. But what about the other positions? Would some type of disclosure on the return solve an ethical issue? How does a lawyer reach confidence levels that the lawyer can actually quantify at say 20%, 33 1/3% or even 40%?

Does it make any difference as to the likelihood of audit? All tax positions prevail if the taxpayer is not audited or, if audited, the agent does not spot or understand the transaction underlying the position. Should the attorney consider or advise the client as to the likelihood of audit (the audit lottery)?⁴⁵⁶⁸ (For more on the audit lottery, see discussion below beginning p. 1016). Should the lawyer assist in structuring a transaction designed, in its components, to be less visible to the IRS? Specifically, should the attorney assist with respect to the audit lottery by injecting some meaningless or marginally relevant steps to mask the transaction? How much real world substance must the various steps in the planning or even the overall planning have in order for the attorney to advise and implement the planning?

This is a type of ethical concerns that is encountered in tax practice.⁴⁵⁶⁹ Much of the concern relates to mitigating the risk for aggressive planning that, if IRS may identify and then audit, challenge and prevail if litigation ensues.

⁴⁵⁶⁷ For the rankings see, p. 349.

⁴⁵⁶⁸ E.g., Michael B. Lang and Jay A. Soled, *Disclosing Audit Risk to Taxpayers*, 36 Va. Tax Rev. 423 (2017)

⁴⁵⁶⁹ For a good recent discussion, see Richard A. Shaw, *2020 Erwin N. Griswold Lecture Before the American College of Tax Counsel: Tomorrow Is Another Day—How Did We Get Here Ethically*, 73 Tax Lawyer 753 (2020).

One way that the market (yes, this is a market) facilitated aggressive tax planning was for the lawyer to render an aggressive tax opinion quantifying the probability that the position would prevail higher than the position deserved. An opinion of that nature could mitigate the risk that the taxpayer would be criminally investigated, prosecuted or convicted for entering the transaction or would suffer a civil penalty for entering the transaction. If the taxpayer's reporting of the aggressive position is caught, the taxpayer could claim reliance on the attorney's opinion as a basis to avoid those untoward consequences of the taxpayer's behavior. If the potential tax "savings" (e.g., tax avoided/evaded) are large enough, the potential benefits to the taxpayer could justify outsized fees for the attorneys and the other enablers of the transaction; a key component in "earning" the outsize fees was a favorable, but aggressive or even false, tax opinion from the attorney to the taxpayer for which the attorney was paid,⁴⁵⁷⁰ as the market euphemism went, on a "value added" basis. Basically, the value added "fees" were compensation for a type of insurance intended to mitigate the taxpayer's risk of playing the audit lottery. The market attracted exactly that type behavior. (For more on abusive legal opinions, see discussion beginning p. 1018.)

In thinking about this genre of tax shelter, I ask students to consider how exactly one determines that a tax shelter has a 51% chance of prevailing as opposed to a 49% chance of not prevailing. Indeed, in advising clients on their prospects of litigating particular cases, I usually decline, saying merely (tongue in cheek) that I have rarely seen a tax case I could not win or lose.⁴⁵⁷¹ But I certainly would not attempt to advise a client as to the dividing line between 49% and 51% chance of prevailing, except that, if the overall deal had an odor piscatorial as these shelters did, I would tilt toward advising that it was more likely than not that they would not prevail. Indeed, for this genre of shelter, I always advised them they would not prevail and refused to handle the litigation.

I offer for consideration the following materials that, although now over 15 years old, they are still useful. Richardson, Audit Avoidance via Intent Modification -- Is Fred Corneel onto Something ... or Not, 2001 TNT 131-93; and Corneel, Audit Avoidance: A Response to David Richardson, 2001 TNT 131-91. These articles are found in the materials that I make available on my Federal Tax Procedure Blog.

III. Ethical Issues in Return Preparation.

Normally, the attorney is not the return preparer. But an attorney can be a return preparer if he or she advises the client as to how the item or transaction is to be reported on the return. What are the attorney's ethical responsibilities in this case?⁴⁵⁷²

The attorney historically serves two key roles—that of advisor and that of advocate. Which role best fits for an attorney advising as to reporting positions on the return? Is the tax return like

⁴⁵⁷⁰ Heather M. Field, Tax Opinions & Probability Theory: Lessons From Donald Trump, 156 Tax Notes 61 (7/3/17).

⁴⁵⁷¹ That's hyperbole but not much; I've won cases that many (including myself) did not think I would or could win, and I've lost cases that I did not think I would or could lose. There are only a couple in each category, and there are back stories to them that I cannot get into now.

⁴⁵⁷² For a far deeper analysis of this question than I can offer here, see Dennis J. Ventry, Jr. & Bradley T. Borden, Probability, Professionalism, and Protecting Taxpayers, 68 Tax Law. 83 (2014).

a pleading in a civil case, where, at least in Federal courts, FRCP Rule 11 polices abuses and perhaps sets normative standards of attorney conduct? Is the Government an adversary of the taxpayer in the return filing process, so that the attorney representing the taxpayer is acting in his role as advocate? Does the attorney owe a responsibility to the Government that, while perhaps not trumping his or her responsibility to the client, might limit that responsibility?

The historical approach is that, vis-a-vis the responsibilities to the Government and the tax system, the attorney is acting as advocate for the client and may recommend any position that is not frivolous, just as he or she may do in litigation, at least so long as there is reasonable basis or a realistic possibility of success.⁴⁵⁷³ Of course, the attorney is required in all events to advise the client as to the risks to the client from reporting the transaction in the manner contemplated. The attorney remains the attorney for the client owing a duty of loyalty and objectivity. Thus, even if the attorney avoids ethical impropriety, the attorney must still advise the client as to the risks of the client being subject to penalties. As noted, above, the accuracy related penalties—particularly the substantial understatement penalty—may apply in certain circumstances as to positions that meet the minimum ethical threshold, however it may be formulated. Thus, as you will recall, absent a disclosure, a return position may be penalized if it does not have substantial authority, a threshold that is higher than the threshold as to the propriety of the lawyer’s advice. The lawyer must advise the client realistically about the chances of attracting penalties. Even if the attorney can ethically advise the taxpayer as to the propriety of the position, he cannot do so if the taxpayer is also not aware of the penalties the position may attract.

Let’s think now about the audit lottery discussed in the articles I asked you to read. The audit lottery is a lottery the taxpayer wins by not getting audited. The lottery so formulated has two aspects. First, being subjected to an audit is distracting and can be expensive even if the positions are sustained as reported after the audit or litigation after the audit. Rational people thus want to avoid audit even where they think correctly they owe no additional tax. Second, being subjected to an audit can be both distracting and expensive where the taxpayer does owe additional tax. In either of these two situations, the taxpayer will almost certainly have an incentive to do what is necessary to lower his or her audit exposure. But the audit lottery is perceived as most objectionable when played by taxpayers who owe additional tax. Here, the IRS’s low audit rates appear to give real incentive to taxpayers to play the lottery.

⁴⁵⁷³ See generally, Frank J. Gould, Giving Tax Advice - Some Ethical, Professional and Legal Considerations, 97 Tax Notes 523 (2002). As the author notes, the historical analysis was on the basis of the advocate role of the lawyer which has carried forward. The ABA’s initial attempt to address some perceived uncertainty was in ABA Opinion 314 which opined that the law should have a reasonable basis for the return position. While, in terms of the words used, the reasonable basis formula appeared more strict than the not frivolous formula, in practice it is not at all clear what, if any, the difference was. In the subsequently issued Opinion 85-532, the reasonable basis standard was abandoned in favor of “some realistic possibility of success.” Even so, while the change in language for the standard might suggest that the ABA intended to raise the ethical bar, there is no guidance that indicates that it really did so. In all of these reformulations, the ABA continued to adhere to the position that the attorney was acting as advocate and was simply playing with different formulations as to when the line had been crossed. The differences between the formulations just were not clear. A subsequent ABA Tax Section Task Force with unclear authority to speak authoritatively did attempt to differentiate the two standards, but in ways that also injected some uncertainty. In any event, these proposals were never adopted, so the issue remains somewhat muddled.

The taxpayer plays the audit lottery on the notion that the benefits to be derived (taxes underpaid) are greater than the risks undertaken. What are the risks? They are, roughly, (1) whether the taxpayer will be audited at all (we now have a very low audit rate), (2) whether, if audited, the agent will recognize or understand the risky transaction (often aggressive positions are shrouded in complexity), (3) whether, if the agent understands the position reported, he or she will disagree with it, (4) whether, if the taxpayer litigates with the IRS over its disagreement, the taxpayer will lose, and (5) whether, if the taxpayer loses, the taxpayer will be subject to a civil or criminal penalty. Many taxpayers choose to play the audit lottery, because they conclude that the risks presented by the answers to these questions are very low, and often they will have lawyers guiding them through the minefield.

A question that has bedeviled the tax bar for some time is whether it is appropriate to advise clients as to the audit lottery. This can play out in several ways. For example, the taxpayer may advise that he has \$100,000 income that he received in cash from a party who is thinking about not reporting it on his tax return. He seeks advice from you as to whether, in his circumstances, the IRS would find out about the income if he did not report it and pay tax on it. Can you advise him that the audit rate is very low and, in those circumstances, he is not likely to be audited? (A separate question other than generalities about the audit lottery, perhaps implicating criminal penalties, is whether the lawyer can advise the client of actions that might give him better odds in audit lottery, such as how to deploy the cash in a way that the IRS is less likely to discover it (e.g., don't deposit in bank, don't purchase traceable assets such as a Mercedes, or stash it away in a safety deposit box or cookie jar and leave it for years)?

Some attorneys take the position that the audit lottery and its various permutations should not be part of the attorney's advice, and Circular 230 takes the position for its purposes. Others take the position that an attorney may—indeed has the obligation to—discuss the possible consequences of conduct.⁴⁵⁷⁴ These attorneys say that advising as to consequences is not the same as advising the client to take inappropriate or illegal action. Thus, for example, if a client with suicidal tendencies asks his attorney what the punishment for assassinating the president is, the attorney can certainly advise him that it includes the death penalty without anyone considering the attorney to have counseled the client to do the act. Similarly, if a client were to ask his attorney, what the speed limit is in a given stretch of road and what the chances are of him being stopped if he goes just 5 miles above the speed limit, an attorney with both knowledge of the law and that particular stretch and police practices in that particular stretch might well answer that the speed limit is 65 mph and that it is unlikely that the client will be ticketed if he goes no more than 70 mph. Indeed, if the attorney knows the turf well enough, the attorney might even be able to say that he knows the cop on this beat and knows that he does not stop unless the cars are going at least 75. Yet, no one would view that as counseling the client to speed.

⁴⁵⁷⁴ Michael B. Lang and Jay A. Soled, Disclosing Audit Risk to Taxpayers, 36 Va. Tax Rev. 423 (2017) (arguing that the tax professional can advise the client of the risk of audit, but cannot under the ethical rules allow the risk of audit to influence the probability assessment of the merits of the tax position—reasonable basis, substantial authority or more likely than not); see also Caleb Smith, “But I’ve Always Done It That Way!” Practitioner Considerations on Subsequent Year Exams (Procedurally Taxing 1/11/22).

What if you suspect that the client will take the information you provide about the audit lottery and then act on it in a way that you believe is inappropriate—i.e., you would not be willing to take the return reporting position on your return? Do you owe a client a lesser duty or no duty at all simply because your client, without your encouragement, would do something you would not do? Is merely giving a client your best advice about the elements of the audit lottery based upon your vast experience encouraging your client to act inappropriately?

A related question is whether you as a professional may assist a client in taking action that is otherwise legal but which is intended to make the reporting or nonreporting of a transaction less likely to be audited.⁴⁵⁷⁵ For example, we studied the rules that provide a six-year statute of limitations in the case of an omission of 25% of gross income unless the transaction is disclosed on the return. The general thinking is that the disclosure may increase the audit risk for a return. Can you as a professional discuss with the taxpayer the audit risks if there is no disclosure as compared to the audit risks if there is a disclosure? Even more subtly, if the client wants to foreclose the six-year statute by making a disclosure, can you assist him in making a disclosure that, while meeting in your judgment the requirements for a disclosure, is still worded in such a way as also in your judgment to lower the audit profile for the return? A similar question is presented where a client wants to consider a disclosure to avoid the substantial understatement penalty. Most practitioners, I believe, feel that, so long as the disclosure is fair and accurate, the disclosure does not have to wave a red-flag begging the IRS to audit the transaction.

Can the tax professional advise or assist a client in reporting a transaction in one of two (or more) permissible manners based upon a belief that the manner chosen will be less likely to be audited than the other? Of course, if the taxpayer does really have two (or more) alternative ways to report a transaction, I am not aware of any that condition the choice upon the taxpayer's mental perceptions as to likelihood of audit, so the taxpayer's motivation in making the choice should be irrelevant. At least, that's what I think most tax professionals would say. And they would then conclude that the taxpayer can make his or her choice for any reason, including perceptions as to likelihood of audit, and the professional likewise can advise or assist for any reason.

Consider tax professionals' role in the abusive tax shelter phenomenon. One of the common elements in selling abusive tax shelters is an accompanying legal opinion that clients may perceive as a free ticket to the audit lottery—meaning that, armed with the legal opinion upon which the taxpayer claims to have relied, the taxpayer will avoid civil or criminal penalties for playing the audit lottery. For example, many of the common abusive tax shelters that proliferated in the late 1990s and early 2000s came with very expensive tax opinions analyzing the shelter at great length (usually offering more obscurity than reasoning) and solemnly pronouncing that the tax reporting of the claimed benefits of the shelter would more likely than not prevail. The notion was that, even if the shelter on any objective basis was “too good to be true” (i.e., creating tax benefits out of thin air in a fog of paper), at least the taxpayer could avoid criminal and civil penalties. And for that opportunity to play the audit lottery with some imagined penalty risk avoidance, the lawyers were

⁴⁵⁷⁵ For an exploration of the potential criminal risks in audit avoidance planning, see John A. Townsend, Tax Obstruction Crimes: Is Making the IRS's Job Harder Enough, 9 Hous. Bus. & Tax. L.J. 255 (2009) and particularly its companion Online Appendix where I provide examples of the range of audit avoidance conduct – i.e., the intent to lower the audit profile coupled with some legal - even morally neutral objective – conduct.

compensated handsomely for their tax opinions which were promoted as a form of penalty insurance.⁴⁵⁷⁶ One tax shelter promoted referred to this as “value-added” billing for the opinion which was usually a cookie-cutter form opinion sold to many taxpayers with lots of income to shelter. As it turns out, some of the tax professionals in the more egregious of these abusive shelters were themselves prosecuted,⁴⁵⁷⁷ but most who engaged in this behavior were not. (One might say that those tax professionals won the penalty lottery.) Suffice it to say that, beyond the civil and criminal exposure those professionals undertook, there was the underlying ethical issues that I hope students will at least consider as they are advising clients on return reporting positions.

IV. Ethical Issues with Amended Returns.

Example: A new client advises you that he or she significantly underreported the taxes on the return he or she filed 6 months ago. Upon questioning the client about it, you determine that the facts suggest the possibility—perhaps even the probability—that the new client could have criminal tax problems if the IRS were to discover the matter.

- A threshold question is a purely legal one -- is a taxpayer required to file an amended return to correct an error on a previously filed original return? The answer to that is no. The law does not impose that duty.
- May the attorney insist that the client file an amended return? No, the client is a free agent, and, in any event, the attorney should not insist that the client do something that the law does not command.
- May the attorney counsel the client that it might be in his or her best interest to file an amended return even though that action is not commanded by law? Yes, of course. Because, just as the audit lottery phenomenon is within a tax attorney's competence to advise, so is the practical consequences of failing to file an amended return within a tax attorney's competence to advise. I discussed above the “voluntary disclosure” policy (beginning p 318) under which a taxpayer can obtain some assurance that he or she will not be prosecuted for tax and tax-related crimes by filing an amended return. This may be a very practical incentive for the attorney to counsel filing an amended return.

So far, we have focused on ethical issues with respect to an amended return that corrects underpayment of tax on a previously filed return. What about an amended return that claims an overpayment? We noted above that such a return is a claim for refund. Certainly, a taxpayer will be self-motivated to file a claim for refund, although the taxpayer is not legally required to file one. But there are significant issues lurking here as the tax attorney rummages through his or her bag of tricks for the client. You will recall that, by careful attention to the statutes of limitations, the statute

⁴⁵⁷⁶ Dennis J. Ventry, Jr. & Bradley T. Borden, Probability, Professionalism, and Protecting Taxpayers, 68 Tax Law. 83, 130 ff. (2014).

⁴⁵⁷⁷ See Tanina Rostain and Milton C. Regan, Jr., Confidence Games: Lawyers, Accountants, and the Tax Shelter Industry (MIT Press 2014); See also Senate Permanent Subcommittee on Investigations of the Comm. on Homeland Sec. and Governmental Affairs, The Role of Professional Firms in the U.S. Tax Shelter Industry, S. Rep. No. 109-54 (2005), which preceded the prosecution of the more prominent professionals connected with shelters promoted by major accounting and law firms, with some of the firms obtaining deferred or nonprosecution agreements requiring major payments to the Government.

of limitations on additional assessments can expire while the statute of limitations on claiming a refund is still open. This will in effect create a one-way opportunity for the taxpayer.

Let me illustrate in an example. Let's say that the taxpayer is audited and the IRS sets up a single issue that results in a notice of deficiency for \$100,000. You counsel the taxpayer that, in your best judgment as a seasoned tax litigator, you can win that issue in whichever court the taxpayer chooses to litigate it. However, since you handled that audit, you also know that the auditing agent did not spot an even larger issue that, in your judgment, the taxpayer would lose in any court that the taxpayer chooses to litigate it. That issue would create a tax liability larger than the dollars that would be saved on the issue that you believe the taxpayer could win. One of the traditional gambits is to preserve the refund statute of limitations, let the assessment statute expire, and then file the claim for refund. For example, assume that the Year 01 return was filed on April 15 of Year 02, the audit deficiency was proposed on September 1 of Year 04, your client signs a Form 870 waiver of the restrictions on assessment for Year 01 on September 5 of Year 04, the IRS assesses the tax on February 1 of Year 5, the taxpayer pays on February 10 of Year 05, and the statute of limitations on further assessment expires on April 15 of Year 5. You will recall that, although the statute of limitations on further assessment has expired, the taxpayer still has 2 years from the date of the February 10 payment to claim a refund. So, on June 1 of Year 05, the taxpayer files a claim for refund for the tax (and interest) paid on February 1 of Year 05, alleging that the IRS erred on the one audit issue (the only issue the IRS knows about).⁴⁵⁷⁸ In that claim for refund, the taxpayer does not mention the issue the IRS did not audit and is not otherwise aware of, despite the fact that, in his attorney's judgment, he would lose that issue and his taxes for the year are therefore not overpaid. Can the taxpayer lawfully sign the amended return (the claim for refund) with the jurat? Can the attorney counsel or otherwise assist the taxpayer in filing the return?

On a separate issue, do you think that the nature of proper return disclosure is different on the original return than it is on an amended return?

V. Ethical Issues in the Audit.

A. Closing the Statute Gambit.

Attorneys, of course, can't mislead. An attorney cannot mislead a revenue agent auditing his client's tax returns. As we noted above, there are criminal penalties for lying to an agent (§ 7212(a) and 18 U.S.C. § 1001). Certainly, the attorney cannot commit a crime. Short of lying, where is the ethical line drawn?

Let's go back to the example noted above with respect to the claim for refund. In representing the taxpayer at the audit stage, the attorney knows that there are two potential issues -- the one raised by the agent as to which the attorney believes the taxpayer has a slam dunk winner and the one not

⁴⁵⁷⁸ In this example, facts could vary with the IRS being practically shut out of making an additional assessment. For example, if the taxpayer filed the claim for refund on, say, March 15 of year 05, the IRS would not have time to adequately consider the claim much less spot a previously unspotted issue. Astute readers of this text may recall that, upon filing a claim for refund reporting additional tax within 60 days of the end of the assessment statute, the IRS gets 60 days from filing to assess the tax thus reported. § 6501(c)(7). But the example considered here does not report additional tax liability.

spotted by the agent as to which the attorney believes the taxpayer has a slam dunk loser. Must the attorney tell the agent about the losing issue? May the attorney tell the agent about the losing issue? Must the attorney consult with the taxpayer and follow the taxpayer's instructions as to whether the attorney tells the agent? If the taxpayer refuses to allow the attorney to tell the agent about the issue, must the attorney resign, should the attorney resign, and may the attorney resign?

Most attorneys take the position that the attorney is not required to advise the agent as to the unspotted issue, so long as the attorney does not do anything affirmative to misrepresent. When the agent closes out the case, the attorney may then have to face the issue of whether he or she will assist with the claim for refund, but I have discussed that above. Let's return to the audit, however, and ask the question regarding the attorney's predicament where he knows he or she must not do anything to mislead the agent. What if the agent directly asks the attorney whether he or she is aware of any potential issues not addressed in the audit? Certainly, the attorney cannot directly answer that question no. Can or should the attorney respond by just saying that it is the agent's audit and the agent can do as he or she sees fit, but it is not the attorney's job to give the agent leads? What if the agent prepares a Notice of Changes (Form 4549) or a Waiver of the Restrictions on Assessment (Form 870) calculating the additional tax liability based on the one issue the agent addressed and asks the attorney to agree to the numbers thus calculated? May the taxpayer sign and may the attorney counsel the taxpayer to sign? Both of these Forms merely waive the restrictions on assessment (the notice of deficiency) and are not an agreement by the taxpayer or explicit or implicit representation that the amounts in the Forms are deficiencies. Indeed, the taxpayer can pay the tax assessed as a result of the waiver and sue for refund. Most attorneys do not view either of those Forms as a representation by the taxpayer or his attorney that the amount of tax due indicated is the correct amount of tax due; rather, the amount of tax is simply the agent's determination as to the amount of tax due.

Of course, one of the dangers of knowing about an unspotted issue and playing it close to the line in avoiding a misrepresentation while gently nudging the agent away from the unspotted issue is that, if the IRS learns of the issue later, it may have a reconstructionist view of the attorney's activities during the audit and bring criminal or IRS disbarment proceedings.

B. Statement 1999-1.

Let's use another example. What if there is one issue raised by the agent and there are no unspotted issues of which the attorney is aware? The attorney has determined that the IRS will surely prevail on that issue if it is litigated and has advised the taxpayer that litigation would be fruitless. The agent then sends the attorney a calculation of the tax liability resulting from that issue and presents the Form 4549 or Form 870 with the incorrect calculation on it, making a major error so that the amount of tax indicated due is just a fraction of the proper amount. The attorney quickly spots that a major calculation error has been made in the taxpayer's favor. Can the attorney or the client execute it, in the hopes that it will then sail through the IRS without correction of the error and the statute will thereafter close on additional assessments?

There is some authority on this subject in Statement of Standards of Tax Practice 1999-1 ("Statement 1999-1), issued by the ABA Tax Section which is not an authoritative body for the

issuance of ethical standards but is nevertheless a thoughtful body. In that Statement, one of the scenarios considered is an erroneous calculation by the appeals office, but the material facts are otherwise basically the same. Standard 1999-1 takes the position that the attorney's knowledge of the error is a client confidence which would normally not be disclosable without the client's consent, but further takes the position that the client has impliedly consented so as to permit and even require the attorney to disclose without discussing the matter with the client. The implied consent arises because, in authorizing the attorney to settle with the appeals officer before the number was calculated, the taxpayer already knew what bottom-line tax liability he or she was agreeing to; the authority to effectuate the settlement encompassed the correct calculation. But what if, in authorizing the settlement, the taxpayer stated to the attorney his expectation that the tax liability would be \$100,000, the IRS calculates it to be \$125,000 and the attorney then calculates it to be \$150,000? Statement 1999-1 takes the position that there is no implied authority because the client's stated expectation to the attorney is inconsistent with such implied authority, and therefore the attorney cannot disclose.

Statement 1999-1 takes a different approach for so-called "conceptual" errors that inhere in the IRS's calculations. The example given is that the attorney and the appeals officer agree that the taxpayer is entitled to a \$100,000 deduction that was originally reflected on Schedule C. The attorney, however, believes that the deduction is attributable to a passive activity requiring that the deduction be deferred. That issue was not addressed at appeals (remember the "unspotted issue"), and the IRS calculation treats the deduction as nonpassive giving the taxpayer a current tax savings to which the taxpayer is probably not entitled. Statement 1999-1 treats the error as "conceptual" rather than "calculational," thus requiring that the attorney not disclose the error without the express consent of the taxpayer.

Even if you were comfortable that there is no legal requirement that the client authorize you to advise the agent of the error, should you insist to the client that he or she authorize you to do so?

I should caution that Statement 1999-1 is by no means the last word on this subject. As noted, it was not even promulgated by anybody officially or unofficially having authority over ethical issues.

C. Conflicts of Interest in Audits.

Normally, the attorney is not faced with a conflict of interest in tax procedure practice. The attorney represents the taxpayer and the only other party in interest is the Government whom the attorney does not represent. No need for a conflict search there. But that does not mean that conflicts of interest do not abound in a tax procedure practice and in audits in particular.

We have already discussed one example above where, during the course of an audit in which the attorney represents the taxpayer, the IRS desires to interview the accountant. The accountant may then want the taxpayer's attorney to represent the accountant at the interview. Alternatively, the taxpayer's interest might be best served if the attorney were to guide the accountant through the process and the best way to accomplish that might be for the attorney to undertake the representation

of the accountant. Can the attorney undertake that representation? Should the attorney undertake the representation? (See the discussion beginning p. 441.)

Another example that is not necessarily unique to tax law is where you represent a corporation, partnership or other juridical entity. You are hired and continue being hired based on the good graces of the president, CEO or other managing individual. What do you do if the legal services the managing individual asks of you, at the corporation's cost, is in his interest but not necessarily in the corporation's interest? We saw in the Richardson/Corneel dialog a situation where the attorney would bill the corporation for the legal services really performed on behalf of the corporation's owners. In that example, the persons receiving the individual legal services were the owners of the corporation, so there is no employee/shareholder conflict. But misdescribing the services rendered or even rendering the statement without description to the corporation is wrong, because it lends itself to tax fraud by giving the corporation the tools and incentive to claim a deduction for what is really a disguised dividend.

Would it make any difference if you found that the corporation paid the lawyer's firm \$2,000,000 in legal fees for work that clearly was on the corporation's behalf and then the law firm, as a matter of good client development or retention, did his personal work for free? Would it matter in the same case if the CEO controlling the relationship were not the sole shareholder of the corporation? Would it matter if the corporation were a publicly held company?

Another common example is representing husband and wife who filed a joint return in either the audit or in the litigation of a tax issue. Because of joint and several liability, both spouses have a common interest in getting the number down as low as possible. But what about the innocent spouse relief issue? To the extent that one spouse qualifies for innocent spouse relief the burden of the tax is shifted to the other spouse. Consider the attorney's obligations in a typical situation: Husband as the family breadwinner comes to you with a notice of deficiency issued to husband and wife with respect to their joint return. Husband asks for advice on whether to litigate liability and to represent him and her if he decides to litigate. Can you represent both? Under what conditions? Does either or both of them need separate counsel as to the potential innocent spouse defense? Can they engage you only to represent them in getting the number down, but not addressing the innocent spouse issue? These questions are at the forefront of every tax litigator's practice, and the litigator must have developed some method for fully recognizing the parameters of the issue and resolving them in a way that does not result in malpractice.

VI. Ethical Issues in Litigation.

There are a host of ethical rules that apply to litigation, and tax litigation is not just a form of litigation subject to these rules. Here is one example, conceptually related to the refund example I discussed earlier.

Assume the IRS sets up only one issue in the notice of deficiency and the IRS never spotted a big issue involving omitted income. There is no real gray area in the unspotted issue; the taxpayer clearly would owe tax if the unspotted issue were fully litigated (indeed taxpayer's counsel did not think she could even make a nonfrivolous argument that the omitted income should not have been

included). After filing the petition, IRS Counsel offers to concede that one issue (the spotted issue in the NOD) and sends a draft stipulated decision document saying that the deficiency is \$0. The taxpayer's counsel knows that § 6211(a) defines a deficiency basically as the tax actually due less the tax previously assessed. Taxpayer's counsel reads the wording of the decision document as follows: "there is no deficiency in income tax due from petitioner." Because the taxpayers' counsel knows that stipulation that there is no deficiency is not true, can the taxpayers' counsel sign the stipulated decision? What does the taxpayer tell the client. (Of course, they should have thought about that issue before they filed the petition to redetermine the deficiency, but the taxpayer's counsel may have learned about the unspotted issue only pursuant to work done on the discovery in the case.)

Is this example materially different than the claim for refund example discussed on p. 1020 involving claiming a refund with respect to which the IRS audited and is wrong when, based on an issue not spotted, the taxpayer is not entitled to a refund?

Let's also return to the example posited above -- the calculation error in the client's favor. At the end of tax litigation, calculations are usually required. What if the IRS makes a calculation error in the taxpayer's favor either in the Tax Court as to the amount of the deficiency or overpayment or in a refund court (District Court or Court of Federal Claims) as to the amount of overpayment? I noted above the conclusion of Statement 1999-1 that, in IRS administrative setting, the attorney usually has implied consent to disclose the error to the IRS. Is the answer different in litigation?

Standard 1999-1 states that the answer is different. The attorney must disclose the error to the opposing Government attorney.

VII. Ethical Issues in Collections.

The same genre of issues arises in collections issues. You should have the flavor for these issues in this setting from the foregoing materials.

VIII. A Reminder on IRS Disbarment.

I remind you that, in addition to state bars and courts to which an attorney is admitted to practice, the IRS which allows practitioners to practice before it also has the ability to disbar a practitioner for unethical or criminal practices. You may want to review at this point the discussion above of the Office of Professional Responsibility (beginning p. 45).

IX. A Brief Note on Malpractice.

Needless to say, in any area of the law malpractice is a risk. From an ethical standpoint, all attorneys are required to bring a certain level of competence to the representation of their clients. If they do not, they may face disbarment and liability for malpractice and, under some states' law, deceptive trade practices or some such claim. We cannot here discuss the full ramifications of such

potential claims. I do, however, want you to read one case -- *Streber v. Hunter*⁴⁵⁷⁹ which arose from the representation of the taxpayers in *Streber v. Commissioner*, a case we read earlier (p. 354) in discussing a taxpayer's ability to avoid the substantial understatement penalty based on the existence of substantial authority. Some of the points I want you to note about the malpractice case are:

1. Tax specialists will be held to a higher standard than attorneys who do not specialize. Thus, theoretically, clients suffering the same kind and quantum of damage can recover if they engage a tax specialist but not if they engage an attorney who is not a tax specialist. This obviously raises the risk for being a specialist and that higher risk, just as the basic malpractice risk itself must be factored into the fees a lawyer must charge.

2. Other good tax lawyers will indeed testify against their peers. Mike Cook, the testifying expert for the plaintiffs is a very good lawyer. Attorneys who do testify make good money for their efforts -- they are, after all, specialists. Query: can a testifying tax specialist who botches his or her testimony be held liable for malpractice? Or, if not malpractice since they are not appearing as an attorney for the client but rather a specialist, can they be held liable for negligence?

3. Note that the Texas Deceptive Trade Practices Act has changed in a way beneficial to lawyers so as to make lawyers less likely to become guarantors for a good result.

4. This case illustrates several sound maxims--do not depend upon any particular client too much, for your judgment may become clouded;⁴⁵⁸⁰ do your homework in advance rather than after you and the client have been committed to the cause; be reasonable.

⁴⁵⁷⁹ 221 F.3d 701 (5th Cir. 2000).

⁴⁵⁸⁰ This caveat is inherent in being inside counsel for an entity. The pressures on the private attorney from a client with substantial economic leverage over the private attorney can apply to inside entity counsel. Care must be taken.

Ch. 20. Discovering What the IRS Knows—FOIA, Privacy Act, Etc.

I. Freedom of Information Act (“FOIA”).

A. The Theory of FOIA.

Information is the engine of democracy. FOIA⁴⁵⁸¹ is a congressional judgment that citizens should know the operations of Government and should have a formalized procedure to obtain that information.⁴⁵⁸² FOIA and similar statutes in state and local Governments are often referred to as “sunshine” acts to let the sunshine on the otherwise dark corners of government.⁴⁵⁸³

Much of the information that shows how the Government works is available to citizens under FOIA. In a tax setting, FOIA permits taxpayers to learn much about IRS operations through FOIA and specifically to discover through FOIA much of what the IRS knows about the taxpayer. FOIA thus operates as a form of discovery unrelated to specific litigation.⁴⁵⁸⁴

B. General Rule - Governmental Information is Available.

Consistent with the purpose of FOIA to have an informed citizenry, the general rule is that governmental information is available. FOIA has three general categories by which information is available:

- The Federal Register category requires agencies to publish in the Federal Register certain information or documents, including most importantly statements of procedures, rules of procedure and description of forms, and “substantive rules of general applicability adopted as authorized by law, and statements of general policy or interpretations of general applicability formulated and adopted by the agency.”⁴⁵⁸⁵ In the tax context, this category includes Treasury regulations.
- The “reading room” category requires agencies must make available in electronic format certain other documents without a citizen having to request the documents.⁴⁵⁸⁶ This category includes (i) opinions in adjudication of cases, (ii) statements of policy and interpretations not published in the Federal Register; (iii) administrative staff manuals and instructions to staff that affect a member of the public, and (iv) records requested in the next category (requiring a specific request) that are likely to be the

⁴⁵⁸¹ 5 U.S.C. § 552.

⁴⁵⁸² See *NLRB v. Robbins Tire & Rubber Co.*, 437 U.S. 214, 242 (1978).

⁴⁵⁸³ E.g., substantial amendments to FOIA were enacted in 1976 in The Government in the Sunshine Act (P.L. 94–409, 90 Stat. 1241, enacted September 13, 1976, 5 U.S.C. § 552b).

⁴⁵⁸⁴ FOIA was “fundamentally designed to inform the public about agency action and not to benefit private litigants.” *N.L.R.B. v. Sears, Roebuck & Co.*, 421 U.S. 132, 143 n.10 (1975). Although FOIA can be used for litigation purposes, that was not the purpose of FOIA. *Renegotiation Bd. v. Bannerkraft Clothing Co., Inc.*, 415 U.S. 1, 24 (1974).

⁴⁵⁸⁵ 5 U.S.C. § 552(a)(1).

⁴⁵⁸⁶ 5 U.S.C. § 552(a)(2). For an example of litigation as to the adequacy of an agency’s compliance with this reading room provision, see *Citizens for Responsibility & Ethics in Washington v. United States DOJ*, 922 F.3d 480 (D.C. Cir. 2019) (regarding DOJ Office of Legal Counsel documents).

subject of similar requests or have been requested 3 or more times, along with a general index of those records. In the tax context, this includes a plethora of the IRS guidance and other documents that practitioners commonly use in practice, in the following categories (on the IRS FOIA Library Web Site):⁴⁵⁸⁷

- (i) Published Tax Guidance (such as Final or Temporary Regulations and Proposed Regulations, IRS Publications and Notices (including the I.R.B. which contains Revenue Rulings and Procedures and Notices);
 - (ii) Administrative Manuals and Instructions (such as the Internal Revenue Manual and Chief Counsel Notices);
 - (iii) Program Plans and Reports (including annual reports);
 - (iv) Non-precedential Rulings and Advice (such as private letter rulings);
 - (v) Training and Reference Materials (such as Audit Technique Guides and Tax Crimes Handbook); and
 - (vi) Frequently Requested Documents.
- The specific request category requires agencies to make available records upon request that follows the procedures for requests (including fees).⁴⁵⁸⁸ Because records in the first two categories are available for public inspection without request, practitioners' conscious interface with FOIA is usually in this category.⁴⁵⁸⁹ All the citizen has to do is to ask the Government agency, reasonably describe the records requested, and follow the agency's procedures for FOIA requests.⁴⁵⁹⁰ Most litigation involving an agency's compliance with FOIA is in this category.

FOIA provides a judicial remedy if a federal agency improperly withholds agency records. *United States DOJ v. Tax Analysts*, 492 U.S. 136 (1989) is illustrative. In that case, Tax Analysts, an organization that provides subscribers summaries of tax developments and copies of documents reflecting same, obtained under FOIA from the DOJ Tax a summary record of tax decisions that were rendered by the courts in which DOJ Tax represented the IRS. DOJ Tax represents the IRS in all courts except the Tax Court. Tax Analysts initially would use the summary records to obtain copies of the decisions from all of the courts -- i.e., the district courts, the courts of appeals, the Supreme Court, the predecessor of the Court of Federal Claims, and any other courts, including state courts in which the DOJ Tax represented the IRS. I hope you can appreciate that it was inconvenient to deal with the clerks of all these various courts when DOJ Tax had the decisions in a central location. Tax Analysts made FOIA requests for DOJ Tax's copies of the decisions, which DOJ Tax

⁴⁵⁸⁷ IRS Web Page titled "FOIA Library": <https://www.irs.gov/privacy-disclosure/foia-library>.

⁴⁵⁸⁸ 5 U.S.C. § 552(a)(3).

⁴⁵⁸⁹ *Citizens for Responsibility & Ethics in Washington v. United States DOJ*, 922 F.3d 480 (D.C. Cir. 2019) (calling this category the "more commonly invoked" category).

⁴⁵⁹⁰ 5 U.S.C. § 552(a)(3)(A); see *DOJ v. Reporters Comm. for Freedom of the Press*, 489 U.S. 749, 754-55 (1989). Failure to comply with the agency's procedures is often referred to a failure to exhaust the administrative remedy and requires dismissal of a district court FOIA suit. *Oglesby v. Dep't of Army*, 920 F.2d 57, 61-62, 66-67 (D.C. Cir. 1990). For example, the regulations for IRS FOIA request state that failure to comply with these procedures risk having the FOIA request or appeal denied. Reg. § 601.702(c)(1)(i); and § 601.702(c)(4)(i). Of course, the procedures imposed must be reasonable. *Clemente v. FBI*, 867 F.3d 111, 119 (D.C. Cir. 2017). "An agency thus of course cannot impose requirements on requesters that take on the character of a shell game, imposing unwarranted burdens on requesters without apparent justification."

Division regularly receives as a party litigant. DOJ Tax resisted, urging in the final analysis that FOIA should not be used to obtain documents otherwise publicly available simply for the convenience of the requester. The Supreme Court handily found that the opinions met the requirements for disclosure -- i.e., they were agency records and DOJ Tax had improperly withheld them.

There is no requirement under FOIA that the agency create records or that it use its powers (such as summonses or of persuasion) to obtain records that it does not have. The requirement is that it produce records that it does otherwise have.

FOIA is not the same as discovery in litigation. In litigation, discovery requires relevance to the pending dispute.⁴⁵⁹¹ FOIA is based on the imperative of an informed citizenry. The requester under FOIA need not state a reason for the request. The reason is irrelevant.

Implicit in the right to request and receive records under FOIA is the requirement that the agency show “beyond material doubt that its search was reasonably calculated to uncover all relevant documents.”⁴⁵⁹² To meet this requirement in FOIA litigation, the agency submits a reasonably detailed affidavit or affidavits of agency personnel performing the search describing “the search terms and the type of search performed” and that all files likely to contain responsive material have been searched.⁴⁵⁹³ The issue is the reasonableness of the search.⁴⁵⁹⁴ The agency is not required to perform fishing expeditions beyond the scope of a reasonable search, nor “embark on a time-consuming and costly goose chase in pursuit of phantom [documents].”⁴⁵⁹⁵

C. Key Exemptions from Disclosure under FOIA.

Agency records must be made available on request except for enumerated exceptions.⁴⁵⁹⁶ The enumerated exceptions permit the agency (here the IRS) to withhold information when countervailing public interests are involved.⁴⁵⁹⁷ When the agency relies upon the exceptions, the agency must prove its entitlement to the exceptions.⁴⁵⁹⁸

⁴⁵⁹¹ FRCP Rule 26(b)(1) (“Parties may obtain discovery regarding any matter, not privileged, that is relevant to any party’s claim or defense * * * *.” (Emphasis supplied).) The other judicial forums for relevant litigation (tax litigation) have the same relevance requirement for discovery. Court of Federal Claims Rule 26(b)(1); and Tax Court Rule 70(b).

⁴⁵⁹² *Ancient Coin Collectors Guild v. U.S. Dep’t of State*, 641 F.3d 504, 514 (D.C. Cir. 2011) (quoting *Valencia-Lucena v. U.S. Coast Guard*, 180 F.3d 321, 325, 336 U.S. App. D.C. 386 (D.C. Cir. 1999)).

⁴⁵⁹³ *Oglesby v. U.S. Dep’t of Army*, 920 F.2d 57, 68 (D.C. Cir. 1990).

⁴⁵⁹⁴ *Hodge v. FBI*, 703 F.3d 575, 580 (D.C. Cir. 2015).

⁴⁵⁹⁵ *Twist v. Ashcroft*, 329 F. Supp. 2d 50, 52 (D. D.C. 2004), *aff’d*, 171 F. App’x 855 (D.C. Cir. 2005).

⁴⁵⁹⁶ *Grand Cent. P’ship, Inc. v. Cuomo*, 166 F.3d 473, 478 (2d Cir. 1999); *Elec. Privacy Info. Ctr. v. IRS*, 910 F.3d 1232, 1236-1237 (2018) (noting “nine exemptions” which I call exceptions here and describing the agency process for separating nonexempt from exempt records).

⁴⁵⁹⁷ A good review of the history of FOIA and exemptions for IRS documents interpreting the law is Richard C. Stark, Hartman E. Blanchard Jr., and Saul Mezei, Consistency, Sunshine, Privacy, Secret Law, and the APA Program, 130 Tax Notes 655 (Feb. 7, 2011).

⁴⁵⁹⁸ TIGTA periodically performs a retrospective statistical review of a sampling of IRS denials of FOIA requests to determine whether the IRS is properly applying the exemptions and, where appropriate, to recommend improvements. See e.g., Fiscal Year 2019 Statutory Review of Denials of Freedom of Information Act and Internal (continued...)

The key exemptions that you will face as a tax practitioner are (note that the exemptions have numbers based on their numbering sequence in 5 U.S.C. § 552(b) and are frequently referred to by that number):

1. Exemption 3 - Exemptions by Other Statutes.

FOIA exempts information that may or must be withheld by statute.⁴⁵⁹⁹ A key information withholding provision in the tax area is section 6103, discussed in Chapter 20, which prohibits the IRS from disclosing tax return information of a taxpayer.⁴⁶⁰⁰ Taxpayer return information may be disclosed to the taxpayer involved, but the information generally may not be disclosed to persons other than the taxpayer involved or, in some cases, persons in close nexus to the taxpayer. I cannot obtain the return information of my neighbor, business colleague or enemy. I cover in more detail the limitations of § 6103 below the next chapter (beginning p. 1039).⁴⁶⁰¹

2. Exemption 5 - Deliberative Memoranda and Documents Unavailable in Litigation.

This exemption protects pre-decision deliberative process documents that would not be available in discovery in litigation.⁴⁶⁰² The exemption's purpose is to avoid the chilling effect that threat of disclosure would bring to such pre-decisional processes. The proper functioning of Government, it is felt, is best shown by the documents and information reflecting the decision that is made. While the pre-decisional deliberative considerations might be helpful to an informed citizenry, on balance, Congress felt that the system would work better if the predecision deliberative documents were not subject to FOIA.

As interpreted, the exemption covers information that would be subject to three evidentiary privileges in litigation: the deliberative process privilege, the attorney-client privilege and the attorney work-product privilege.⁴⁶⁰³

An example of a predecision document is a memorandum of the recommendations or opinions on legal or policy matters of Government personnel involved in making a decision but who do not make the final decision.⁴⁶⁰⁴ In a prominent case,⁴⁶⁰⁵ an individual of some public notoriety (the Reverend Sun Myung Moon) was considered for criminal prosecution. The IRS recommended prosecution, so that the matter came under the jurisdiction of the DOJ Tax. Within DOJ Tax, the responsibility for approving or declining prosecution is normally with the Chief of the Criminal

⁴⁵⁹⁸(...continued)

Revenue Code Section 6103 Request (Ref. No. 2019-10-057 9/5/19).

⁴⁵⁹⁹ § 552(b)(3).

⁴⁶⁰⁰ § 6103(a); see also *Church of Scientology of Cal. v. IRS*, 484 U.S. 9, 10 (1987) (“Section 6103 . . . lays down a general rule that ‘returns’ and ‘return information’ as defined therein shall be confidential.”); and *Elec. Privacy Info. Ctr. v. IRS*, 439 U.S. App. D.C. 113, 118, 910 F.3d 1232, 1237, 1240- (2018). I discuss § 6103 in more detail in the next chapter.

⁴⁶⁰¹ For an application of Exemption 3 for taxpayer return information, see *Elec. Privacy Info. Ctr. v. IRS*, 910 F.3d 1232 (2018); and *Elec. Privacy Info. Ctr. v. IRS*, 2021 U.S. Dist. LEXIS 232291 (D.D.C. Dec. 3, 2021).

⁴⁶⁰² § 552(b)(5); *NLRB v. Sears, Roebuck & Co.*, 421 U.S. 132, 149 (1975).

⁴⁶⁰³ *Burka v. HHS*, 87 F.3d 508, 516 (D.C. Cir. 1996).

⁴⁶⁰⁴ *Vaughn v. Rosen*, 523 F.2d 1136, 1143-44 (D.C. Cir. 1975).

⁴⁶⁰⁵ *Heggstad v. United States Department of Justice* 182 F. Supp. 2d 1 (D. D.C. 2000).

Enforcement Section (“CES”). However, the Chief of CES reports to and is subject to the direction of a Deputy Assistant Attorney General for DOJ Tax, who is in turn subject to the direction of the Assistant Attorney General for DOJ Tax. It appeared that the Chief of CES had decided that Rev. Moon not be prosecuted, but that decision was overruled by the Assistant Attorney General who authorized prosecution. The Court held that the memorandum of the Chief of CES was predecisional and thus not subject to disclosure under FOIA.

I discuss the attorney-client privilege and work product privileges below in the context of privileges potentially applicable in an IRS examination (audit or criminal investigation) process. Suffice it to say here that, if the documents within the scope of the FOIA request are subject to those privileges, they may be asserted by the IRS as an exemption to FOIA disclosures.

Notwithstanding the foregoing, deliberative process exemption does not apply to records created more than 25 years before the FOIA request.⁴⁶⁰⁶

3. Exemption 7 - Records for Law Enforcement Purposes.

This exemption generally exempts agencies from disclosing a significant portion of its criminal investigation files, which category includes IRS criminal tax investigations.⁴⁶⁰⁷ Still, FOIA may require disclosure of purely fact based documents and other information in IRS criminal investigations despite this exemption. Many practitioners routinely file FOIA requests in criminal investigations in the hope that something of value will be learned. The worst that can happen is that the IRS will say no. But it might not say no or it might release documents for which it arguably could have asserted an exemption and did not.

An important category of law enforcement documents exempt from disclosure are documents that might identify a confidential informant (including whistleblowers providing information for a whistleblower award under § 7623 discussed in Ch. 18). This is called the 7(D) exemption. Because of the importance of the general rule requiring open disclosure of government operations, the Supreme Court has held that an agency does not qualify for withholding agency records simply by chanting informant's exception when it does not want to disclose. The agency must prove that the informant gave the information under circumstances where the informant was given express assurances of confidentiality or the circumstances indicate that such assurances were necessarily assumed by the agency and the informant.⁴⁶⁰⁸ The Court refused to assume that, merely because a citizen gave information to the FBI, there was an assurance, express or implied, of confidentiality.

The IRS (or any agency) may give what is a “neither confirm nor deny” (“NCND”) response (sometimes referred to as a “*Glomar*” response) to a question to which an answer could reveal the identity or even existence of a confidential informant. An NCND response is a FOIA response that “neither confirms nor denies the existence of documents responsive to the request” because it would

⁴⁶⁰⁶ § 552(b)(5).

⁴⁶⁰⁷ § 552(b)(7).

⁴⁶⁰⁸ *United States DOJ v. Landano*, 508 U.S. 165 (1993).

cause cognizable harm under a FOIA exception.⁴⁶⁰⁹ The D.C. Circuit explains that the broad (7)(d) FOIA exemption to maintain confidential whistleblower sources:

To this end, the IRS gives a Glomar Response to FOIA requests seeking documents pertaining to whistleblowers, refusing to either confirm or deny the existence of such records. This policy makes sense. If the IRS only asserts Glomar when whistleblower records exist, and gives a negative answer when no records exist, savvy requesters would both (1) recognize that a Glomar Response indicates the positive existence of whistleblower documents; and (2) may well be able to deduce the identity of a potential whistleblower himself, the very information the IRS is required to protect. This is especially true when the pool of potential whistleblowers is very small, leading a revenge-seeking requester to narrow down the informant with relative ease. Far from violating FOIA's statutory scheme, the IRS's Glomar Response to FOIA requests for whistleblower documents aligns with the purpose of Exemption 7(D) and the duties of the IRS to protect whistleblower identities.⁴⁶¹⁰

D. Procedural Aspects.

1. General.

Each agency is required to adopt regulations and procedures for handling FOIA requests.⁴⁶¹¹ The IRS has done so at Reg. § 601.702. The following are some of the key items in those regulations:

- For items of more general interest, the IRS maintains a FOIA Reading Room at the IRS National Headquarters.⁴⁶¹² This would include items that are not taxpayer specific or have had the taxpayer specific information redacted. Tax publications often routinely print this information (or some selected subset of it).
- The form of the specific request is set forth.⁴⁶¹³ This information includes the IRS office to which the request is to be directed.
- Procedures for appeal of a decision to withhold all or part of any record.

⁴⁶⁰⁹ See Bernard Bell, Shhh! Don't Say Glomar Anymore (Notice and Comment 3/14/22); see also e.g., *Ctr. for Constitutional Rights v. C.I.A.*, 765 F.3d 161, 164 (2d Cir. 2014); and *N.Y. Times v. CIA*, 965 F.3d 109, 113 n. 1 (2d Cir. 2020) (discussing the origin of the *Glomar* doctrine and its inapplicability if the Government has publicly acknowledged the documents). For a general discussion of the origin of the term *Glomar* response and its general application in and outside FOIA, see Wikipedia entry titled "*Glomar* response." (Last edited 3/29/20 and viewed 6/1/20). A *Glomar* response might indicate that there was such an informant or, at least, it does not foreclose the possibility of an informant. I suppose that it is the best the agency can do for a specific request. I suppose the agency could have a practice for *Glomar* responses to such requests which may make it more difficult to assume that there was an informant, even if not identified. See e.g., *Nosal v. IRS*, 2021 U.S. Dist. LEXIS 39446 (D. D.C. 2021) (citing *Montgomery v. Internal Revenue Serv.*, 330 F. Supp. 3d 161, 171 (D.D.C. 2018)).

⁴⁶¹⁰ In *Montgomery v. IRS*, , 40 F.4th 702 (D.C. Cir. July 19, 2022).

⁴⁶¹¹ 5 U.S.C. § 552.

⁴⁶¹² Many documents reflecting interpretations of law with specific taxpayer identifying information redacted is available on the IRS website titled "FOIA Library" (last reviewed or updated 5/29/19 and viewed 7/12/19).

⁴⁶¹³ Reg. § 601.702(c)(4).

Federal courts have jurisdiction to enjoin a federal agency from withholding agency records and to order the production of any agency records improperly withheld.⁴⁶¹⁴

2. Charges/Fees and Waivers.

Pursuant to regulations each agency must adopt, an agency may make “reasonable standard charge” for “document search, duplication, and review” but certain requests and requesters may be entitled to have the charges waived or reduced.⁴⁶¹⁵ Certain requests or requesters may be entitled to have the charges waived or reduced. Two such examples are:

- disclosures “ in the public interest because it is likely to contribute significantly to public understanding of the operations or activities of the government and is not primarily in the commercial interest of the requester.”⁴⁶¹⁶
- charges are limited to document reproduction costs (and not search and review fees) when “when records are not sought for commercial use and the request is made by an educational or noncommercial scientific institution, whose purpose is scholarly or scientific research; or a representative of the news media.”

3. The Redaction Process.

When the agency asserts exemptions from disclosure, it will often do so by “redacting” (i.e., blacking out) the portion of the document qualifying for the exemption or, where the entire document qualifies for the exemption, withholding the document altogether. If the agency handles the matter properly, it will advise the requester of which documents have been withheld and the exemption relied upon and, as to documents provided subject to redaction, which exemptions justify the specific redactions. Often, however, the agency will paint in broad strokes -- for example, saying that 40 documents have been withheld based on the informant's privilege. In those cases (and often even where the agency even provides a more particular identification of the documents (such as memo to Joe Blow from Sam Spade dated 1/1/94)), the requester will have no way of assessing whether the agency properly asserted an exemption.

Some agencies have also redacted information in documents disclosed that they deemed not responsive to the request made. In a key 2016 case, the Court of Appeals for the District of Columbia Circuit held that redactions for nonresponsiveness were not permitted.⁴⁶¹⁷ The Court held that the exemptions from disclosure were the sole authority for redactions from otherwise responsive documents.

The redaction process is the same that is used in discovery in civil litigation or pursuant to compulsory process (such as the IRS summons or a grand jury subpoena, that I cover later in this

⁴⁶¹⁴ 5 U.S.C. § 552(a)(4)(B).

⁴⁶¹⁵ 5 U.S.C. § 552(a)(4)(A)(ii)(I).

⁴⁶¹⁶ 5 U.S.C. § 552(a)(4)(A)(ii)(I) and § 552(a)(4)(A)(iii).

⁴⁶¹⁷ *American Immigration Lawyers Association v. Executive Office for Immigration Review*, 830 F.3d 667 (D.C. Cir. 2016). The issue is a more subtle, as to the difference between a record and a document. See DOJ OIP Guidance, titled Defining a “Record” Under the FOIA (updated 2/15/17), which was issued in response to this decision.

text). By redacting, the person seeking the information in the documents is given the portion that is not exempt from disclosure without disclosing the portion that is.

4. Appeals and Judicial Review.

The requester then may pursue an administrative appeal within the agency. If the requester is not satisfied with the result of the administrative appeal, the requester may pursue nonbinding mediation (optional) and seek judicial review.

When administrative appeal is denied in whole or in part under FOIA (but not under the Privacy Act), the requester may pursue mediation prior to the judicial review noted immediately below. The Office of Government Information Services (“OGIS”), an office in the National Archives and Records Administration, conducts the mediation.⁴⁶¹⁸ The mediation is not binding.

If information or documents continue to be withheld after mediation or, if the requester did not pursue mediation, the requester can pursue litigation. In that litigation, the IRS will have to establish that it made a proper search and, if it withholds any documents within the scope of the search, establish that an exception to disclosure applies.⁴⁶¹⁹ In that judicial review, the Government may provide, if it has not done so during the administrative consideration, a so-called *Vaughn* index.⁴⁶²⁰ The index is the FOIA equivalent of a privilege log in civil litigation. The index should provide as much description as possible of the withheld documents without disclosing the information claimed to be exempted from disclosure. The Government will then, usually, file a motion for summary judgment and submit declarations⁴⁶²¹ of agency personnel asserting the basis for the claimed exemptions. Some or all of the declarations and attachments may be submitted in camera, if necessary to preserve the exemption claimed pending resolution by the court. The Government may produce voluntarily or upon order of the court the underlying documents for in camera inspection for the court to rule upon the validity of the claimed exemptions. The court will then rule.

The requester or the Government may then appeal to the Court of Appeals and then to the Supreme Court via the certiorari process.

Obviously, throughout this court process, the requester is operating blindfolded. The requester does not know whether an exemption is claimed properly or whether the search was properly conducted. The requester thus must file his initial complaint and appeals without the usual due diligence required to determine whether the suit or the judicial appeal has a basis in the underlying merits. The system contemplates that the requester has a right to a trial level consideration and an appeals consideration to have the courts test whether an exemption was

⁴⁶¹⁸ 5 U.S.C. § 552(h).

⁴⁶¹⁹ E.g., *Electronic Privacy Information Center v. Internal Revenue Service*, 910 F.3d 1232 (D.C. Cir. 2018).

⁴⁶²⁰ The name is from a leading case, *Vaughn v. Rosen*, 484 F.2d 820 (D.C. Cir. 1973). For a case discussing the role served by the Vaughn index in ensuring an adequate judicial review, see *Batton v. Evers*, 598 F.3d 169 (5th Cir. 2010).

⁴⁶²¹ Declarations are an affidavit-equivalent for Government employees. See 28 U.S.C. § 1746.

properly claimed and the search properly made, even if the requester does not know whether an exemption was properly claimed or the search properly made.

E. Practical Uses of FOIA in a Tax Setting.

1. Discovery of the Audit.

Many practitioners routinely file a FOIA request during the course of or at the conclusion of an IRS audit or criminal investigation.⁴⁶²² Alternatively, by carefully watching the agent's activities and keeping in communication (including asking questions), the practitioner may already have a pretty good idea what is in the agent's files. Another alternative in a civil examination is to ask the IRS Appeals Officer for access to the files.⁴⁶²³

2. Discovery in the Criminal Investigation.

Criminal investigators keep the fruits of the investigation close to the vest. Practitioners will often have less assurance that they know what is in the agent's files. FOIA requests are often made to obtain discovery.⁴⁶²⁴ However, a key exception under FOIA is with regard to investigatory records and enforcement proceedings,⁴⁶²⁵ as well as the confidential informant exception. A FOIA request thus may not produce sensitive matters, but may give important information, nevertheless, particularly in clues that might be derived from the exceptions asserted.

Remember in this context to request the IRS's records and, if DOJ Tax was involved in the investigation (a process I discuss below), DOJ Tax's records also.

3. Other.

The foregoing are the practical uses of FOIA for the ordinary practitioner. However, FOIA and a related provision—§ 6110—have been extraordinarily useful to tax practitioners generally to obtain access to so-called “hidden law” of the IRS. For example, I discussed in Chapter 2 private letter rulings (PLRs) issued by the IRS National Office to individual taxpayers requesting them. The rulings may contain key IRS interpretations and policy decisions as to law and procedure. FOIA was used early as a fulcrum for access to these documents, and § 6110 now specifically requires that the IRS disclose determination letters (of which private letter rulings are a class), subject to redaction

⁴⁶²² See Charles P. Rettig, FOIA Requests: A Look into the IRS Examination File, 128 Tax Notes 877 (Aug. 23, 2010) (arguing that “The information received will almost always justify the limited effort required to submit a FOIA request.” and that “If not requested, the information will not be forthcoming. If requested, the responsive information may be the key to a favorable resolution.”); and Lee A. Sheppard, Textron Case Expands Work Product Privilege, 116 Tax Notes 917 (Sept. 10, 2007) (“Practitioners routinely submit FOIA requests to the IRS in the course of audits, and litigators use FOIA to get information that may not be available in discovery.”).

⁴⁶²³ § 7803(e)(7), added by Taxpayer First Act of 2019, § 1001(a), P.L. 116-25, 133 Stat 981 (July 1, 2019).

⁴⁶²⁴ Justin Gelfand, Defending a Criminal Tax Case, 40 Champion 40 (2016) (“File a FOIA request. If a defense attorney represents a taxpayer during an investigation and discovery obligations do not yet exist, she should file a FOIA request for IRS revenue agent and revenue officer activity, including all contacts with the taxpayer.”)

⁴⁶²⁵ § 552(b)(7)(A).

of taxpayer specific information. There is thus some overlap between FOIA and § 6110. I discuss § 6110 above beginning p. 83.

II. Privacy Act.

The Privacy Act⁴⁶²⁶ generally regulates an agency's disclosure of information about a U.S. Citizen and a Lawful Permanent Resident. In summary,⁴⁶²⁷ the Privacy Act:

- Permits an individual to have access to records containing personal information on him for purposes of inspection, copying, and, with certain exceptions including tax records, correction;
- Makes known to the American public the existence and characteristics of all “systems of records” of Federal agencies containing information about individuals;
- Limits availability of records containing personal information to agency employees who need to access them in the performance of their duties;
- Requires agencies to keep an accurate accounting of disclosures and make such an accounting available to the individual;
- Requires agencies to publish in the Federal Register the routine disclosures that are made of their information outside of the agency (“routine uses”) and establish procedures for access;
- Provides a civil remedy for individuals who have been denied access to their records or whose records have been used or disclosed in contravention of the Act.

In this book, I deal principally with the IRS’s interaction with taxpayers in the context of examinations (audits) or collection matters, internal appeals and judicial consideration. The records that the IRS obtains in such interactions will generally be the type of information subject to the Privacy Act. Formal requests for such information will be processed by the IRS under the Privacy Act and, as to information or documents exempt from disclosure to the taxpayer under the Privacy Act, will be processed under FOIA to see if it allows disclosure notwithstanding an exemption under the Privacy Act.⁴⁶²⁸

⁴⁶²⁶ 5 U.S.C. § 552a.

⁴⁶²⁷ This summary is verbatim from a summary in Treasury Dept. Office of Tax Policy, Report to The Congress on Scope and Use of Taxpayer Confidentiality and Disclosure Provisions (October 2000), pp. 29-30.

⁴⁶²⁸ *Blazy v. Tenet*, 979 F. Supp. 10, 16 (D.D.C. 1997) (“Even where a requester is not entitled to a document under the Privacy Act, he or she may still be entitled to it under the FOIA. . . . Document requests therefore must be analyzed under both Acts.”). Technically, if the taxpayer’s own return information (including information and documents in examinations or collections) is sought, the request is a Privacy Act request. See generally the National Archives Ombudsman Blog titled “Reconciling FOIA and the Privacy Act” (10/26/12, viewed 7/9/22); see also IRS Web Page titled “Freedom of Information Act (FOIA) Guidelines” (Last Reviewed or Updated 4/22/22 and viewed on 7/9/22) (“The IRS will automatically consider a request for personal information under both the FOIA and the Privacy Act and will rely on the statute that provides the greater access.”).

There is substantial overlap in tax matters with § 6103 of the Code, and the courts are not consistent on whether § 6103 (next chapter) pre-empts the Privacy Act.⁴⁶²⁹

III. Other Ways to Discover What the IRS Knows.

A. Requests in Exam and Appeals.

There are other, often less formal ways to learn what the IRS knows about a taxpayer. If the taxpayer is being audited or subject to collection action, upon request of the taxpayer or his representative, the examiner “must give taxpayers access to their returns or return information unless the Secretary determines that the release of the information would seriously impair tax administration.”⁴⁶³⁰

The same is true for Appeals from IRS audit, collection or other action. A “specified taxpayer in Appeals may request access to the “to the nonprivileged portions of the case file on record regarding the disputed issues.” § 7803(e)(7);⁴⁶³¹ see discussion p. 489. The available portions of the case file should be the same as under FOIA. A specified taxpayer is a natural person with adjusted gross income of \$400,000 for the taxable year in dispute or other taxpayers whose gross receipts do not exceed \$5 million for the year.⁴⁶³² This right to access the files should obviate the need for “specified taxpayers” to make a formal FOIA request.

B. Copies of Tax Returns.

Taxpayers can request copies of tax returns as far back as six years by filing an appropriate form and paying a fee (currently \$50 per return).⁴⁶³³ The requesting Form 4506, Request for Copy of Tax Return, offers an opening “Tip” at the top that taxpayers that:

You may be able to get your tax return or return information from other sources. If you had your tax return completed by a paid preparer, they should be able to provide you a copy of the return. The IRS can provide a Tax Return Transcript for many returns free of charge. The transcript provides most of the line entries from the original tax return and usually contains the information that a third party (such as a mortgage company) requires.

⁴⁶²⁹ Cases holding that § 6103 pre-empts the privacy act in the areas of overlap include *Lake v. Rubin*, 62 F.3d 113 (D.C. Cir. 1998), cert. denied, 526 U.S. 1070 (1999); *Cheek v. United States*, 703 F.2d 271 (7th Cir. 1983); and *Gardner v. United States*, 213 F.3d 735 (D.C. Cir. 2000).

⁴⁶³⁰ IRM 4.2.5.6 (03-16-2022), Requests for Open Examination File and Workpapers.

⁴⁶³¹ As added by Taxpayer First Act of 2019, § 1001(a), P.L. 116-25, 133 Stat 981 (July 1, 2019).

⁴⁶³² § 7803(e)(7)(C).

⁴⁶³³ Form 4506, Request for Copy of Tax Return. The current form 4506 (dated November 2021 and viewed on 7/18/22) on line 8 indicates “a \$43 fee for each return requested.” However the IRS web page titled “What taxpayers should know about tax return copies and transcripts” (last reviewed or updated 3/28/22; viewed 7/18/22) indicates that the fee is \$50 (albeit linking to the Form 4506 which indicated a \$43 fee).

C. IRS Transcripts.

The taxpayer or authorized representative may request “transcripts” which provide key taxpayer information (discussed in more detail below).⁴⁶³⁴ Transcripts are provided without charge. Because accessing the transcripts is so important to the tax practice, I offer the following IRS Tax Advocate summary of transcripts and related information available:⁴⁶³⁵

- **Tax Return Transcript:** This shows most items reflected on a taxpayer’s original tax return, including adjusted gross income, and accompanying forms and schedules for the current year and three prior years. This transcript will often be accepted by lending institutions for student loan or mortgage purposes. Note: the secondary spouse on a joint return must use Get Transcript Online or Form 4506-T to request this transcript type. When using Get Transcript by Mail or phone, the primary taxpayer on the return must make the request.
- **Wage and Income Transcript:** This provides data from the third-party information statements the IRS has received for a specific taxpayer, such as Forms W-2, 1099, 1098, or 5498, and can be useful if the taxpayer did not receive or retain a copy of these documents. Wage and Income Transcripts are available for up to ten years. While the Wage and Income transcript provides federal withholding amounts, it does not reflect state tax withholdings, which may limit its use when preparing state income tax returns.
- **Tax Account Transcript:** This provides basic tax return data (marital status, adjusted gross income, taxable income) along with listing the activity on a tax account, such as tax adjustments, payments, etc., for the current year and up to ten prior years using Get Transcript Online. When using Get Transcript by Mail or phone, taxpayers are limited to the current tax year and returns processed during the prior three years.
- **Record of Account Transcript:** This is the most comprehensive transcript. It combines the Tax Return Transcript and the Tax Account Transcript to provide a more complete picture of a taxpayer’s tax return and subsequent account activity for the current year and for returns processed in the three prior years.
- **Verification of Non-Filing Letter:** This provides proof that the IRS has no record of a filed Form 1040-series tax return for the year requested. However, it doesn’t indicate whether a taxpayer was required to file a return for that year. This letter is available after June 15 for the current tax year or any time for the prior three tax years using Get Transcript Online.

The transcript conveys information via certain numeric codes. The transcript will show IRS activity, including audit activity except that certain information not disclosable (as determined by the IRS) may be redacted or not included in the transcripts. In addition for transcripts that are unmasked certain identifying information (such as SSNs and telephone numbers) will be partially redacted;

⁴⁶³⁴ See IRS website titled “Transcript Types and Ways to Order Them” (last reviewed and updated 7/6/22 and viewed 7/18/22). See also IRS web page titled “Get Your Tax Record” (last reviewed or updated 5/19/22; viewed 7/17/22).

⁴⁶³⁵ These are modified from the National Tax Advocate Blog, Decoding IRS Transcripts and the New Transcript Format: Part I (10/5/21). They also are presented in slightly different wording and order on the IRS website titled Transcript Types and Ways to Order Them (last reviewed and updated 7/6/22 and viewed 7/18/22).

taxpayer or representatives can request unmasked transcripts.⁴⁶³⁶ Readers interested in a basic illustration and discussion of the transcript information (including codes) may review the NTA discussion of a “fictitious example” Record of Account Transcript,” here.⁴⁶³⁷

⁴⁶³⁶ See NTA blog title, “Decoding IRS Transcripts and the New Transcript Format: Part II” (10/6/21).

⁴⁶³⁷ See NTA blog title, “Decoding IRS Transcripts and the New Transcript Format: Part II” (10/6/21).

Ch. 21. Confidentiality and Disclosure of Return Information.

I. Introduction.

Management of our tax system requires that the IRS have a significant amount of information regarding a taxpayer. Not only will the IRS have the taxpayer's returns, but the IRS will have significant additional information, particularly information developed in an audit. Societally, we have determined that most of this information is the type of information that should be confidential. Why is that? Because Congress was concerned that the critical revenue function of Government would be jeopardized if citizens were not generally assured that the information the IRS gathers about them would not be broadcast outside the agency.⁴⁶³⁸ (The devil is in the word “generally,” because the exceptions are many; first, more on the background of the confidentiality rules.)

At one time, the IRS was perceived as a “lending library” to other government agencies, state and federal. The worst form of this problem was brought to light as a sidelight of the now infamous Watergate scandal. The congressional hearings showed that President Nixon (as well as some other Presidents before him) had used or attempted to use the IRS to serve political agendas—by obtaining return information to use against enemies (real or perceived) and causing the IRS to target enemies (real or perceived).⁴⁶³⁹ Less egregious to Congress but still troublesome was the fact that the IRS would make return information available to other government agencies -- state and federal -- for any number of purposes having nothing to do with the revenue function or with any other identified national priority. Congress determined that this floodgate of information to other agencies was harmful to the critical revenue function of the IRS and the Code. Congress believed that taxpayers would be less willing to report and pay voluntarily and would be less cooperative in audits if the information thus provided were too freely available.

Accordingly, after Watergate in the mid-70s, Congress substantially revised § 6103 to provide taxpayers more assurance that, except in specific Congressionally approved instances, the information the IRS gathers about taxpayers will not be disclosed.⁴⁶⁴⁰ **[Note to Students regarding reading § 6103: don't read it in its entirety; read only the specific subsections cited in the text below.]**

As we will see below, the enforcement mechanism for the confidentiality rules are (1) significant felony criminal penalties for a person wrongfully disclosing return information and (2) potentially significant civil damages (including punitive damages) that a taxpayer may recover from the United States for wrongful disclosures. First, I turn to the legal parameters and thereafter discuss the punishments and remedies.

⁴⁶³⁸ See S. Rep. No. 94-938, 94th Cong., 2d Sess. Pp. 317-317(1976).

⁴⁶³⁹ Joint Committee on Taxation, Study of Present-law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998, Volume. 1: Study of General Disclosure Provisions (JCS-1-00), pp. 3-4 (January 28, 2000) (hereafter referred to as “JCT Confidentiality and Disclosure Study”).

⁴⁶⁴⁰ For a good discussion of § 6103 as applicable to the IRS, see Disclosure & Privacy Law Reference Guide (IRS Publ. 4648 Catalog Number 40891P (Rev. 10-2012)).

II. Definitions.

The statute defines key terms in § 6103(b). Some are self-evident, but some are not. For example, § 6103(b) defines return as you would expect to cover the submissions a taxpayer makes on a return (or an attached schedule).⁴⁶⁴¹ Other key definitions that may not be so intuitive are:

A. Return Information.

“Return Information” is virtually everything the IRS has about the taxpayer.⁴⁶⁴² A good working statement of the scope of “return information” is:

The definition of Return Information is very broad and includes such things as a taxpayer's identity, the nature, source, or amount of his income, payments, receipts, deductions, exemptions, credits, assets, liabilities, net worth, tax liability, tax withheld, deficiencies, overassessments, or tax payments; whether the taxpayer's return is subject to collection, examination, investigation, or any other actions taken by the Secretary with respect to Federal filing requirements.⁴⁶⁴³

B. Taxpayer Return Information.

Taxpayer return information is return information under the foregoing definition which has been filed with or furnished to the IRS by the taxpayer.⁴⁶⁴⁴ For example, a taxpayer return itself is taxpayer return information, whereas an affidavit submitted by a third party during the audit of the taxpayer's return is return information but not taxpayer return information.

It is important to focus on the concept of return information and its nexus to a taxpayer. For example, if a tax shelter promoter is investigated, the information gathered may be the return information of the tax shelter promoter and the return information of a taxpayer who invested in the shelter.⁴⁶⁴⁵

C. Return Information May Not Be Disclosed Even if Specific Taxpayer Identifying Information Is Redacted.

⁴⁶⁴¹ § 6103(b)(1). I discuss elsewhere what constitutes a return. A document sent to the IRS must be tested under that definition to see if it is a return. A document that is not a valid return is not a return for purposes of § 6103(b)(1). AM-2017-004 (7/8/16). So, if a document is not a return (as with the case for documents filed to implement stolen identity refund fraud), the “it [the document] may not be afforded disclosure protection under Code Sec. 6103.” Id. But, by contrast, if the document is an income tax return filed by an undocumented person to report income tax liability despite using a false or stolen SSN, the document is a return. In the case of a stolen identity refund form filed by a person other than the taxpayer, the return information related to the false return may be the return information of “both the victim and the thief” from the moment filed with the IRS. Id.

⁴⁶⁴² § 6103(b)(2).

⁴⁶⁴³ IRM 11.3.1.1.4 (11-12-2021), Terms/Definitions/Acronyms.

⁴⁶⁴⁴ § 6103(b)(3).

⁴⁶⁴⁵ *Solargistic Corp. v. United States*, 921 F.2d 729 (7th Cir. 1991); *Millennium Mktg. Gp., LLC v. United States*, 2010 WL 1768235 (S.D. Tex. 2010).

Taxpayer return information is prohibited from disclosure even if the IRS could redact the taxpayer identifying information.⁴⁶⁴⁶ For example, the IRS could not simply redact all identifying information from a tax return and make the tax return public or otherwise disclose it without concern for § 6103. The IRS can, however, incorporate taxpayer return information in statistical data studies or compilations.⁴⁶⁴⁷

III. General Rule - Return Information is Nondisclosable.

The general rule is that return information may not be disclosed. § 6103(a).⁴⁶⁴⁸ As noted, return information is defined to include the return and virtually all information the IRS has about a taxpayer, including information developed in an audit and other information gathered by the IRS about a taxpayer. § 6103(b). The prohibition applies even to disclosures to IRS personnel who have access only on the basis of need to know for their duties (as discussed later).

IV. Exceptions—Must be Congressionally Approved.

Congress provided many exceptions to the general rule of nondisclosability. Some may think that the exceptions, which seem to go on endlessly in the Code, swamp the general rule. Basically, the exceptions represent congressional judgments that, as important as is the general rule, there are some areas in which there must be exceptions. The key exceptions that you will encounter as a tax practitioner are:

A. Taxpayer, Taxpayer Representative, Related Persons and Material Interest Disclosures.

The IRS must disclose the taxpayer's return to the taxpayer or the taxpayer's authorized representative.⁴⁶⁴⁹ The IRS generally "may" also disclose return information to the taxpayer or his or her representative or designee unless it determines that the disclosure would "seriously impair Federal tax administration."⁴⁶⁵⁰ Thus, to take an example, the IRS may disclose such return

⁴⁶⁴⁶ *Church of Scientology of Cal. V. IRS*, 484 U.S. 9 (1987).

⁴⁶⁴⁷ § 6103(b)(2)(flush language). See *Church of Scientology of Cal. V. IRS*, 484 U.S. 9 (1987).

⁴⁶⁴⁸ For a discussion of this general rule and its importance, see *Electronic Privacy Information Center v. Internal Revenue Service*, 910 F.3d 1232 (D.C. Cir. 2018) where the court denied the FOIA request by a nonprofit organization (billing itself as a public interest research center) for President Trump's tax returns, saying:

This case presents the question whether a member of the public—here, a nonprofit organization—can use a FOIA request to obtain an unrelated individual's tax records without his consent. With certain limited exceptions—all inapplicable here—the answer is no. No one can demand to inspect another's tax records.

⁴⁶⁴⁹ § 6103(e)(1)(A)(i) (disclose to the individual). Under this authority, in an audit, the examiner may disclose taxpayer return information (basically for this purpose, the audit file subject to withholding any information or documents that may impair tax administration) without a formal FOIA request. IRM 4.2.5.6 (03-16-2022), Requests for Open Examination File and Workpapers. However, unless the examiner identifies any withheld information and states a proper basis for withholding, it might be best to contemporaneously file a FOIA request.

⁴⁶⁵⁰ § 6103(c) (as to taxpayer's representative) and § 6103(e)(7) (as to taxpayer and others otherwise having access). Reg. § 601.702(c)(5)(iii)(C) ("In the case of an attorney-in-fact, or other person requesting records on behalf of or pertaining to other persons, the requester shall furnish a properly executed power of attorney, Privacy Act consent, or tax information authorization, as appropriate."). For an interesting application of this limitation where the FOIA suit

(continued...)

information developed in a criminal investigation to the taxpayer or his or her representative but is not compelled to disclose it.

The IRS may generally disclose to the taxpayer victim of stolen identity theft fraud whose name and identification information appears on a return filed fraudulently by a person involved in stolen identity fraud.⁴⁶⁵¹

The representative of the taxpayer must have written authority of the taxpayer to receive return information from the IRS. The taxpayer grants the authority by a power of attorney—Form 2848, Power of Attorney and Declaration of Representative, discussed above (which is the form for general representation of the taxpayer with respect to the tax form and periods indicated on the document) or the more limited Form 8821, Tax Information Authorization (“TIA”).⁴⁶⁵²

The IRS may also disclose return information to certain persons having some relationship to the taxpayer.⁴⁶⁵³ These relationships are based upon some need to know grounded in tax administration considerations. The IRS may also withhold in these cases also if the disclosure would “seriously impair Federal tax administration.”⁴⁶⁵⁴ Let's just catalogue a few:

(1) Direct Family Members.

(a) Spouse. Joint returns may be disclosed to either spouse.⁴⁶⁵⁵ If, with respect to a joint return, the spouses are no longer married or living together, the IRS must disclose upon request from one spouse information related to the collection activity against the other spouse.⁴⁶⁵⁶ Also, returns of one spouse may be disclosed to the other spouse as needed with respect to split gifts.⁴⁶⁵⁷

⁴⁶⁵⁰(...continued)

was dismissed because the requester seeking the returns of President Donald J. Trump did not provide President Trump's consent to the disclosure, see *Elec. Privacy Info. Ctr. v. IRS*, 261 F. Supp. 3d 1 (D. D.C. 2017).

⁴⁶⁵¹ Originally, the IRS took the position that the fraudulent return was not the taxpayer-victim's return and thus could not be disclosed under this provision. The IRS changed its position and now allows the returns to be disclosed, subject to some redactions. However, the IRS will not release a copy “for any identity theft case open and still being worked.” The information in this footnote is drawn from a TIGTA Report: Actions Can Be Taken to Improve Processes of a Newly Developed Program That Enables Victims of Identity Theft to Request Copies of Fraudulent Tax Returns (TIGTA Ref. No. 2017-40-011 11/8/16).

⁴⁶⁵² For a discussion of these authorizations and the potential for improper authorizations, See TIGTA report 2018-40-062, titled Improved Procedures Are Needed to Prevent the Fraudulent Use of Third-Party Authorization Forms to Obtain Taxpayer Information (8/27/18). The TIGTA report notes that the IRS estimates that there is at least one unauthorized form per 1.1 million taxpayers and recommends that the IRS adopt procedures to ensure that the authorizations are proper.

⁴⁶⁵³ See § 6103(e).

⁴⁶⁵⁴ § 6103(e)(7).

⁴⁶⁵⁵ § 6103(e)(1)(B).

⁴⁶⁵⁶ § 6103(e)(8).

⁴⁶⁵⁷ § 6103(e)(1)(A)(ii).

(b) Child. Returns of a parent may be disclosed to a child or child's legal representative as needed to comply with the child's obligation to use the parent's tax rate.⁴⁶⁵⁸

(2) Partnerships. Returns of a partnership or S Corporation may be disclosed to a partner or shareholder, respectively.⁴⁶⁵⁹

(3) Corporations. Returns of a corporation may be disclosed to an authorized representative of the corporation or any bona fide shareholder owning 1 percent or more of the stock.⁴⁶⁶⁰

(4) Estates. Returns of an estate may be disclosed to (a) the executor or administrator or (b) to a beneficiary, next of kin, or heir if the IRS determines the person has a legitimate interest in accessing the information.⁴⁶⁶¹ Similarly, those same categories of persons may access the return information of the decedent.⁴⁶⁶²

(5) Trusts. Returns of a trust may be disclosed (a) to a trustee or (b) to any beneficiary if the IRS determines the person has a legitimate interest in accessing the information.⁴⁶⁶³

(6) Incompetents. Returns of incompetents may be disclosed to “ to the committee, trustee, or guardian of his estate.”⁴⁶⁶⁴

(7) Trustees in Bankruptcy Cases. Returns of bankrupts in certain bankruptcy cases may be disclosed to the bankruptcy trustee.⁴⁶⁶⁵

(8) Return Information for All of the Above. Return information (that is the IRS information related to the taxpayer's return other than the return itself) may be disclosed to the foregoing persons if the IRS determines that such disclosure will not impair tax administration.⁴⁶⁶⁶

(9) Trust Fund Penalty Collections. That trust fund recovery “penalty” (“TFRP”) is an enforcement mechanism to collect the income and FICA taxes an employer withholds from an employee’s salary). Persons related to the employer who have the responsibility to collect and remit the withheld tax to the IRS are subject to the penalty. The penalty may attach to multiple responsible persons within a single employer, but the underlying tax amount may only be collected once in the aggregate from the taxpayer and all responsible persons. The IRS must disclose if requested by any person liable for the penalty (a) whether any other person has been determined to be liable and (b)

⁴⁶⁵⁸ § 6103(e)(1)(A)(iii).
⁴⁶⁵⁹ § 6103(e)(1)(C) & 6103(e)(1)(D)(v).
⁴⁶⁶⁰ § 6103(e)(1)(D).
⁴⁶⁶¹ § 6103(e)(1)(E).
⁴⁶⁶² § 6103(e)(3). See Rev. Rul. 2004-68, 2004-31 I.R.B. 118 (applying the provision for heirs at law and next of kin of an intestate decedent to inspect the decedent’s income tax return for the calendar year preceding death).
⁴⁶⁶³ § 6103(e)(1)(F).
⁴⁶⁶⁴ § 6103(e)(2).
⁴⁶⁶⁵ § 6103(e)(4) & (5).
⁴⁶⁶⁶ § 6103(e)(7).

whether there have been collection efforts against such other person or persons.⁴⁶⁶⁷ I deal in some detail with the responsible person penalty (beginning p. 793).

B. Tax Administration Disclosures.

1. Disclosures Within the IRS.

IRS personnel may inspect returns and return information when their “official duties require such inspection or disclosure for tax administration purposes.”⁴⁶⁶⁸ To police this mandate, the IRS has developed in its computer system the ability to track persons accessing return information by keeping an “audit trail.” Obviously, the system is not perfect, so there are prosecutions of IRS personnel who access return information of friends and foes.

2. Disclosures to DOJ Tax for Criminal Tax Enforcement.

The IRS investigates criminal violations of tax duties. Prior to a referral to DOJ, the IRS is the only federal agency authorized to investigate tax crimes.⁴⁶⁶⁹ The IRS, however, does not prosecute tax crimes or conduct grand jury investigations with respect to tax crimes. DOJ prosecutes tax crimes and conducts the grand jury investigations of tax crimes. Accordingly, there is an exception to § 6103 permitting the IRS to disclose tax return information regarding tax crimes to the Department of Justice through a process called a “referral.”⁴⁶⁷⁰

3. Disclosures to DOJ for Civil Tax Litigation.

Civil tax litigation is conducted in the district courts and Court of Federal Claims where DOJ Tax conducts the litigation. The IRS may disclose tax return information to DOJ Tax relevant to the tax litigation being handled by DOJ Tax.⁴⁶⁷¹

4. Disclosures as Necessary for Audits and Investigations.

Section 6103(k)(6) authorizes the IRS to prescribe by regulation when IRS officers and employees may disclose return information in an audit, collection or civil or criminal tax investigation, but only “to the extent that such disclosure is necessary in obtaining information, which is not otherwise reasonably available.”⁴⁶⁷² This is called the “investigatory disclosures

⁴⁶⁶⁷ § 6103(e)(9).

⁴⁶⁶⁸ § 6103(h)(1); see ECC 2--036036 (7/2/09) (“Need to know means reasonably necessary to do the job correctly, efficiently, economically. It does not require a “cannot function without it” level of need.”).

⁴⁶⁶⁹ See Webster Commission, Review of the Internal Revenue Service’s Criminal Investigation Division (April 1999) from William H. Webster and the Criminal Investigation Division Review Task Force (often referred to as the “Webster Report”), p. 1 (“CI is the only agency that can investigate potential criminal violations of the Internal Revenue Code.”). This mantra has been repeated frequently by the IRS.

⁴⁶⁷⁰ § 6103(h)(2) & (3).

⁴⁶⁷¹ § 6103(h)(2) & (3). For limits upon what may be disclosed, see *In Re United States*, 669 F.3d 1333 (Fed. Cir. 2012) (construing (h)(2) and (h)(4)).

⁴⁶⁷² Reg. § 301.6103(k)(6)-1, titled Disclosure of return information by certain officers and employees for investigative purposes.

(continued...)

exception.”⁴⁶⁷³ To conduct audits and criminal tax investigations, the IRS often contacts third parties for information and/or documents. The IRS officer must identify himself or herself and generally must state the purpose of the contact and requests for information and/or documents. The taxpayer under investigation will be identified.⁴⁶⁷⁴

The Fifth Circuit distilled the teaching of the cases as to when a disclosure is necessary under this exception:

* * * an IRS agent may disclose return information during an investigation in order to obtain information, provided three requirements are met: (1) the information sought is “with respect to the correct determination of tax, liability for tax, or the amount to be collected or with respect to the enforcement of any other provision of the [Internal Revenue Code],” (2) the information sought is “not otherwise reasonably available,” and (3) it is “necessary to make disclosures of return information in order to obtain the additional information sought.”⁴⁶⁷⁵

This is a significant problem in a criminal investigation. The third parties contacted by the IRS may be customers, clients or patients of the taxpayer being investigated and merely being advised that the taxpayer is under criminal investigation can have serious detrimental effects to the taxpayer. Moreover, the taxpayer may lose social standing among his friends and colleagues.

A serious controversy has raged as to whether it is necessary for the IRS to advise such third party contacts that the taxpayer is under criminal investigation. That might be obvious from the fact that the agent is a “Special Agent” -- i.e., a CI agent who only conducts criminal investigations -- or the nature of the questions. But the narrow issue is whether it is necessary to disclose specifically that the taxpayer is under criminal investigation. The courts have taken different tacks on this, so be sensitive to the issue in your practice.⁴⁶⁷⁶

An even more subtle issue is whether third party contact and the return information disclosures that attend that contact is “necessary” when the taxpayer has indicated willingness to

⁴⁶⁷²(...continued)

For example, the IRS Whistleblower Office uses this provision to “to communicate with whistleblowers where appropriate.” IRS Whistleblower Program Fiscal Year 2017 Annual Report to Congress p. 8. The Report indicates that this section is not a perfect fit and encourages Congress to enact amendments recently proposed that specifically authorize investigative disclosures to whistleblowers.

⁴⁶⁷³ See e.g., *Williams Dev. & Constr. v. United States*, 2020 U.S. Dist. LEXIS 187212 (D.C. S.D. 2020).

⁴⁶⁷⁴ For example, if a third party has information or documents related to the investigation of a taxpayer, the IRS may use a third party summons which will identify the taxpayer being investigated.

⁴⁶⁷⁵ *Payne v. United States*, 289 F.3d 377, 382 (5th Cir. 2002), citing *DiAndre v. United States*, 968 F.2d 1049, 1052 (10 Cir. 1992); and *Barrett v. United States*, 795 F.2d 446, 449 (5th Cir. 1986).

⁴⁶⁷⁶ One case is *Williams Dev. & Constr. v. United States*, 2020 U.S. Dist. LEXIS 187212 (D. S.D. 2020) where the taxpayer sought damages under § 7431 for the following disclosures in summonses issued to third parties and third party recordkeepers: the identity of the taxpayer under investigation, the CI status agent signing the summonses, and the taxpayer identification number. The Court granted summary judgment under the § 7436(k)(6) finding the disclosures as necessary or appropriate under the Reg. § 301.6103(k)(1)-1(a)(3). The court did except the disclosure of the taxpayer identification number on the summons to certain third parties who were not third party recordkeepers.

supply the information.⁴⁶⁷⁷ In the Fifth Circuit’s decision in *Payne v. United States*,⁴⁶⁷⁸ the taxpayer had indicated a willingness to cooperate to get information to the IRS’s criminal investigation agent, but the agent nevertheless contacted third persons to gather information that, at least arguably, the taxpayer was willing to produce. The Fifth Circuit rejected the United States’ argument that it is always entitled to seek information from third parties without considering the taxpayer himself as a reasonably available source of the same information. The Court said that an earlier precedent “implicitly considers the taxpayer a ‘reasonably available’ source of necessary information.” The Court specifically rejected the Government’s argument that it must be allowed to contact third parties to corroborate information from the taxpayer. The Court indicated that, in appropriate cases, it might be permissible for the IRS to contact third parties to corroborate, but the IRS should first consider the taxpayer as an available source of the information and contact third parties only when there is reasonable basis to assume that the taxpayer source is not adequate. The Court concluded by saying:

We do not hold that the taxpayer is always such a fruitful and reliable source of information that IRS agents may never approach third-parties for necessary information. We hold only that such a determination must be made in light of the “facts and circumstances of the case,” and that the taxpayer’s cooperation legitimately forms part of the inquiry.⁴⁶⁷⁹

Fearing that these interpretations of improper return information disclosures might hamper its ability to conduct legitimate investigations, the IRS promulgated regulations under § 6103(k)(6) addressing the authority to disclose in connection with official duties. In pertinent part, the disclosure is authorized if the IRS officer “reasonably believes is necessary to obtain information to perform properly the official duties” official duties.⁴⁶⁸⁰ The Regulations continue: “The term necessary in this context does not mean essential or indispensable, but rather appropriate and helpful in obtaining the information sought.”⁴⁶⁸¹ The Regulations also provide:

Information not otherwise reasonably available means information that an internal revenue or TIGTA employee reasonably believes, under the facts and circumstances, at the time of a disclosure, cannot be obtained in a sufficiently accurate or probative form, or in a timely manner, and without impairing the proper performance of the official duties described by this section, without making the disclosure. This definition does not require or create the presumption or expectation that an internal revenue or TIGTA employee must seek information from a taxpayer or authorized representative prior to contacting a third party witness in an investigation. Neither the Internal Revenue Code, IRS procedures, nor these regulations require repeated contacting of an uncooperative taxpayer. Moreover, an internal revenue or TIGTA

⁴⁶⁷⁷ Reg. § 301.6103(k)(6)-1(a)(2) allows disclosure “only if the internal revenue or TIGTA employee reasonably believes, under the facts and circumstances, at the time of a disclosure, the information is not otherwise reasonably available, or if the activity connected with the official duties cannot occur properly without the disclosure.”

⁴⁶⁷⁸ *Payne v. United States*, 289 F.3d 377, 382 (5th Cir. 2002).

⁴⁶⁷⁹ *Payne*, p. 377.

⁴⁶⁸⁰ Reg. § 301.6103(k)(6)-1(c)(1).

⁴⁶⁸¹ *Id.*

employee may make a disclosure to a third party witness to corroborate information provided by a taxpayer.⁴⁶⁸²

5. Disclosures to State Tax Authorities.

The IRS is permitted to disclose to state tax authorities tax return information relevant to state tax administration, provided certain procedures are followed.⁴⁶⁸³ The general requirement is some type of written request from the State Tax Agency. Depending upon agreements with the state and practices pursuant to the agreements, the state tax authority may be notified upon completion of a federal tax audit. Some states have piggyback taxes (i.e., taxes based on the federal taxes) or tax regimes that substantially parallel the federal tax. Hence, a federal tax adjustment upon audit can quickly be turned into a state tax adjustment. Moreover, even when the results are not shared routinely, often the state statute of limitations will remain open until the taxpayer notifies the state of a federal audit. For this reason, in handling a federal tax audit, a good practitioner will be sensitive to potential issues in the state system that may arise from the federal audit.

6. Disclosures in Judicial and Administrative Proceedings.

The IRS may disclose return or return information in a federal or state judicial or administrative proceeding if “if the taxpayer is a party to the proceeding, or the proceeding arose out of, or in connection with, determining the taxpayer’s civil or criminal liability, or the collection of such civil liability, in respect of any tax imposed under this title.”⁴⁶⁸⁴

Further, the IRS may disclose return or return information of a person other than the taxpayer involved in the proceeding if the return information is “directly related to the resolution of an issue in the proceeding.”⁴⁶⁸⁵ Suffice it to say that return information that might indicate that another taxpayer got different tax treatment for a similar item is not directly related to the issue of how the taxpayer in the proceeding should be treated and thus would not be disclosable.⁴⁶⁸⁶

The IRS may also disclose if the return or return information “directly relates to a transactional relationship between a person who is a party to the proceeding and the taxpayer which directly affects the resolution of an issue in the proceeding.”⁴⁶⁸⁷

⁴⁶⁸² Reg. § 301.6103(k)(6)-1(c)(3).

⁴⁶⁸³ § 6103(d)(1).

⁴⁶⁸⁴ § 6103(d)(4)(A). In *Whistleblower 97217W v. Commissioner*, 159 T.C. ___ No. 1 (2022), slip op. 12-26, the Court held that taxpayer information could be disclosed in a whistleblower case under § 7623, subject to appropriate redactions.

⁴⁶⁸⁵ § 6103(h)(4)(B). For example, the IRS interprets this section to include the authority to use investor return information in a penalty audit of an appraiser in an abusive shelter and to disclose that information to the Appraiser under audit. CCN 2020-008 (9/8/29).

⁴⁶⁸⁶ *In Re United States*, 669 F.3d 1333 (Fed. Cir. 2012) (issuing the extraordinary writ of mandamus to overturn an interim order of the trial court to the contrary)

⁴⁶⁸⁷ § 6103(h)(4)(C).

This permits disclosure of the return information both to the Government and to other taxpayers involved in the proceeding so long as the nexus required by the statute is met and the disclosure is relevant to the litigation.⁴⁶⁸⁸

7. Disclosures to the Public for Tax Administration Purposes.

If the JCT approves, the IRS may (but is not required) disclose return information with respect to a specific taxpayer “to the extent necessary for tax administration purposes to correct a misstatement of fact published or disclosed with respect to such taxpayer’s return or any transaction of the taxpayer with the Internal Revenue Service.” § 6103(k)(3).⁴⁶⁸⁹

C. NonTax Criminal Enforcement.

1. Ex Parte Order or High Level Request Required.

Disclosure to federal agencies involved in nontax administration may be disclosed as follows:

- Return or return information may be disclosed upon an ex parte order from a U.S. District Judge (Article III) for purposes of investigating (including grand jury investigation) or trying any nontax criminal case;
- Return information **other than taxpayer return information** may be disclosed upon a request from a head of Department (with certain narrow exceptions) to the IRS.⁴⁶⁹⁰

⁴⁶⁸⁸ In *Mescalero Apache Tribe v. Commissioner*, 148 T.C. 291 (2017), the IRS sought employment taxes (including withholding) from an employer who had erroneously treated certain service providers as independent contractors. Section 3402(d) permits the employer in that case to offset the liability by the income tax paid by the recharacterized employees. The Court held that, under this provision and its discovery rule, the employer could discover the amounts of income tax paid by the workers in the aggregate under § 6103(h)(4)(C). The Court noted a split among the circuits, with most courts (including the Tenth Circuit to which the case was appealable), holding consistently. The Fifth Circuit, however, held that, because of the caption to the subsection, third-party return information could be disclosed only to Treasury and DOJ officials. In *CCA 201723020 (5/5/17)*, an IRS attorney advised that *Mescalero* did not require disclosure of this information in an audit or in Appeals, reasoning that, in the Tax Court, the court can determine whether the requested information is disclosable and balance relevancy and burden. The CCA has generated some controversy because, in the view of some, the position forces the putative employer to go into the Tax Court to get the right result – a reduction for taxes paid by the recharacterized employees. See Keith Fogg, [Misclassification of Workers and its Aftermath](#) (Procedurally Taxing Blog 1/5/18); and Keith Fogg, [NTA’s Reaction to Today’s Post on Misclassified Workers](#) (Procedurally Taxing Blog 1/5/18).

⁴⁶⁸⁹ See *Electronic Privacy Information Center v. Internal Revenue Service*, 910 F.3d 1232 (D.C. Cir. 2018) (holding that the preconditions (JCT approval and IRS discretion, neither of which existed) did not require disclosure; the Court also noted that (i) “There is scant history of the IRS’s use of section 6103(k)(3)” and (ii) “the record before us is silent regarding whether the Joint Committee has ever given its (k)(3) approval to the IRS.”). For IRS procedures, see IRM 11.3.21.4 (06-02-2022), Disclosure of Return Information to Correct Misstatements of Fact - IRC 6103(k)(3).

⁴⁶⁹⁰ § 6103(i)(1) & 6103(i)(2). See *United States v. Ajudua*, 2013 U.S. Dist. LEXIS 73003 (D NM 2013) (in nontax prosecution for conspiracy, bank fraud and identity theft related to bank fraud).

There are some built-in procedural safeguards—such as reasonable cause to believe that a specific nontax crime has been committed and that the information not be reasonably available through other sources; suffice it to say that in some nontax criminal investigations and prosecutions return information may be available. The important point in this area, of course, is that requesting and obtaining the return information is not a matter of routine.

2. Exception for Crimes and Emergencies.

The IRS may disclose return information (other than taxpayer return information, i.e., return information supplied by the taxpayer) to advise federal agencies of possible federal crimes or terrorist activities.⁴⁶⁹¹ Further, the IRS may disclose return information in cases involving (i) imminent danger of death or bodily injury or flight from federal prosecution,⁴⁶⁹² or terrorist incident, threat or activity.⁴⁶⁹³

3. Other.

There are other exemptions of this genre but you should get the flavor that, while the IRS is not a “lending library” in nontax criminal enforcement because of the procedural safeguards, return information can be obtained for nontax federal criminal enforcement purposes. Practitioners should consult the relevant IRM provisions in IRM 11.3, titled “Disclosure of Official Information,” for more understanding of IRS practice related to these disclosures.⁴⁶⁹⁴

The disclosure provision discussed here, § 6103(i), “is the only code section where it may be necessary to distinguish between taxpayer return information and return information (other than taxpayer return information).”⁴⁶⁹⁵ Return information is the broader category that includes taxpayer return information (being the portion of return information supplied by the taxpayer).⁴⁶⁹⁶ In reviewing the discussion above, therefore, pay special attention to the difference between return information and taxpayer return information.

D. To Congress.

1. Tax Committees and JCT.

Section 6103(f)(1) provides that Treasury “shall furnish” to the Congressional tax committees (House Ways and Means Committee and Senate Finance Committee) upon written request of the chair of the Committee, but any return information that could be associated with or

⁴⁶⁹¹ § 6103(i)(3)(A).

⁴⁶⁹² § 6103(i)(3)(B).

⁴⁶⁹³ § 6103(i)(3)(C).

⁴⁶⁹⁴ IRM 11.3.28 Disclosure to Federal Agencies for Administration of Non-Tax Criminal Laws; IRM 11.3.29 Disclosure to Federal Agencies for Administration of Nontax Laws; and IRM 11.3.34 Disclosure for Non-tax Criminal Violations.

⁴⁶⁹⁵ IRM 11.3.28.1.1(3) (07-23-2018), Background.

⁴⁶⁹⁶ See IRM 11.3.28.1.4 (07-23-2018), Terms and Definitions defining taxpayer return information as “return information filed with or furnished to the IRS by or on behalf of the taxpayer to whom such information relates.”

identify the taxpayer may only be disclosed in closed executive session.⁴⁶⁹⁷ Although the statute text is unconditional, the request must serve a legitimate legislative purpose which, in respect to a co-equal branch, will be presumed except in exceptional circumstances.⁴⁶⁹⁸

Returns or return information thus submitted to the tax committee “may be submitted by the committee to the Senate or the House of Representatives, or to both.”⁴⁶⁹⁹ Although the express text of the foregoing authorization to submit to Congress, thus making the returns and return information public, appears to have no limitations, one prominent scholar has argued that such disclosure must serve a legitimate legislative purpose.⁴⁷⁰⁰

The IRS “shall furnish” return information to the Chief of Staff of the Joint Committee on Taxation (“JCT”), provided that the information can then be disclosed to the Congressional tax committees under the same conditions for disclosure directly to the tax committees.⁴⁷⁰¹ Staff or agents of the Congressional tax committees (including the JCT) may review the information.⁴⁷⁰² A “whistleblower” (such as an IRS agent) who has return information may disclose to the Congressional tax committees or agents of such committees (as defined) if he or she believes the information “may relate to possible misconduct, maladministration or taxpayer abuse,”⁴⁷⁰³ which properly interpreted probably does not mean conduct of the taxpayer but of the IRS.⁴⁷⁰⁴

⁴⁶⁹⁷ This is the provision that the House Ways and Means Committee Chair invoked in requesting President Trump’s returns and return information (including audit history and work papers) in 2019 and then again in 2021. This controversy is discussed in the succeeding footnote.

⁴⁶⁹⁸ *Committee on Ways and Means v. United States Dept of Treasury*, 45 F. 4th 324 (D.C. Cir. 8/9/22) (analogizing the § 6103(f)(1) request to a congressional subpoena in terms of the legitimacy of the investigation, discussing *Trump v. Mazars USA, LLP*, 140 S. Ct. 2019 (2020)). The case also discusses the history of the attempts by the House Democratically controlled committees to gain access to President Trump’s tax returns. The case also suggests that, in seeking a President’s tax return information, separation of powers could be implicated and must be considered, so that *Mazars* heightened standard applies whether or not the President remained in office.

⁴⁶⁹⁹ § 6103(f)(4)(A).

⁴⁷⁰⁰ George K. Yin, Preventing Congressional Violations of Taxpayer Privacy, 69 Tax Law. 103 (2015). Professor Yin, formerly Chief of Staff of the JCT, presents his research in the context of disclosures to Congress in the brouhaha arising from concerns about alleged political targeting in the processing of § 501(c)(4) organizations. Professor Yin argues that the disclosures to Congress by the House Ways and Means Committee were unnecessary. “In fact, there does not appear to have been any purpose whatsoever for the disclosures other than possibly providing a partisan political advantage to the Committee majority.” *Id.*, p. 105-106. Professor Yin asserts that, based upon the history and context, the “legitimate purpose” requirement is implicit, and thus is the proper reading and application of the text. I am not sure what the remedy would be if a tax writing committee violated this implicit limitation. See also Andy Grewal, Can Congress Get President Trump’s Tax Returns? (Yale J. Reg. Notice & Comment 2/13/17) (Congress may expose for the sake of exposure only where there is a legislative purpose.). Readers should distinguish between the power to make such returns public and the wisdom of doing so. See Daniel J. Hemel, House Democrats Can Release Trump’s Tax Returns. But Should They? (LawFare 12/2/22).

⁴⁷⁰¹ § 6103(f)(2).

⁴⁷⁰² § 6103(f)(4)(A). The Chief of Staff of the Committee on Taxation and the Chairs of the tax writing committees may designate GAO personnel as agents to receive return information from the IRS. IRM Section 23. Disclosure to the Government Accountability Office (GAO).

⁴⁷⁰³ § 6103(f)(5).

⁴⁷⁰⁴ Bryan Camp and Victor Thuronyi (Guest bloggers), Disclosing President Trump’s Tax Returns – An Unconventional Idea (Procedurally Taxing Blog 2/22/17) (“[D]espite the statute’s broad language, the history of its enactment suggests that the language may refer only to the misconduct or maladministration by the IRS or its employees.”)

2. Other Committees.

The IRS may disclose to nontax committees upon all of the following being satisfied: (a) action of the committee to request the information; (b) written request of its chair; and (c) concurrent resolution of the Houses specifying the need for the information and its unavailability from other sources. The information may be disclosed in closed executive session to the requesting committee.⁴⁷⁰⁵ Only limited staff of the committee may review the information.⁴⁷⁰⁶

In addition, the General Accounting Office (“GAO”), an investigative arm of Congress, may have access to return information under certain circumstances.⁴⁷⁰⁷

3. Individual Congress Member with Taxpayer Consent.

The taxpayer involved may authorize release of that taxpayer’s return information to a member of Congress.⁴⁷⁰⁸

4. Congressional Subpoena to Taxpayer for Return Information.

Congressional committees can subpoena a taxpayer’s return information from the taxpayer. This does not require the IRS to be involved in the disclosure, thereby not implicating § 6103.⁴⁷⁰⁹

E. To the President.

The IRS “shall furnish” return information to the President only in limited circumstances. The IRS is required to disclose if the President provides the following information: (1) the name and address of the taxpayer; (2) the kind of return or return information to be disclosed; (3) the taxable periods involved; and (4) the specific reason for the request.⁴⁷¹⁰ Certain return information may also be disclosed to the President for Presidential appointees.⁴⁷¹¹ The staff to whom this information may be disclosed cannot further disclose without express written authority from the President.⁴⁷¹² Quarterly, the President and the head of any agency requesting returns and return information must report to the JCT “setting forth the taxpayers with respect to whom such requests were made during such quarter under this subsection, the returns or return information involved, and

⁴⁷⁰⁵ § 6103(f)(3).

⁴⁷⁰⁶ § 6103(f)(4)(B).

⁴⁷⁰⁷ § 6103(i)(7).

⁴⁷⁰⁸ The procedures are in Reg. § 301.6103(c)-1(c), authorized by § 6103(c). See IRM 11.3.4.2 (05-20-2005), Disclosure to Members of Congress, and IRM 11.3.4.2.1 (06-10-2008), Inquiry Accompanied by Taxpayer’s Correspondence

⁴⁷⁰⁹ George K. Yin, Preventing Congressional Violations of Taxpayer Privacy, 69 Tax Law. 103 (2016).

⁴⁷¹⁰ § 6103(g)(1).

⁴⁷¹¹ § 6103(g)(2). The information that may be disclosed is (i) whether the person has filed income tax returns for the immediately preceding 3 years, (ii) has failed to pay any tax upon notice and demand or assessed any penalty for negligence in the same period; has been or is under criminal tax investigation (with no period limitation); and (ii) has been assessed a civil fraud penalty (with no period limitation). The IRS must notify the person that the request has been made.

⁴⁷¹² § 6103(g)(3).

the reasons for such requests”; the JCT may then determine that disclosure to Congress is necessary⁴⁷¹³

F. Tax-Exempt Organizations.

Congress determined that the public has a legitimate interest in disclosure of certain information regarding tax-exempt entities, which by virtue of their tax exemption are indirectly subsidized by the public. Certain categories of tax-exempt organization documents and information are excepted from the general prohibition of § 6103.⁴⁷¹⁴ The IRS must release the following in unredacted form: approved applications for tax-exempt status, certain related documents, and annual information returns filed by tax-exempt organizations.

G. Exchange of Information Under Treaties.

The United States has treaties that provide for mutual exchange of return information. An exception is therefore provided for disclosures under those treaties.⁴⁷¹⁵ The U.S. or treaty partner taxing authority receiving information under the treaty is required:

to treat any information received as secret in the same manner as information obtained under its domestic laws. In general, disclosure is not permitted other than to persons or authorities involved in the administration, assessment, collection or enforcement of taxes to which the treaty applies.⁴⁷¹⁶

I discuss the exchange of information under treaties and other conventions in more detail beginning p. 451).

There is a relevancy limitation for permitted disclosures under treaties. For example, the Japanese Double Tax Treaty provides for “[t]he competent authorities of the Contracting States shall exchange such information as is pertinent to carrying out the provisions of this Convention or preventing fraud or fiscal evasion in relation to the taxes which are the subject of this Convention.”⁴⁷¹⁷ If the information shared with the treaty partner competent authority is not pertinent to the treaty partner’s tax compliance duties, it is not an authorized disclosure. And, to close that loop, a court has held that the disclosure of knowingly false information to the treaty partner competent authority is not an authorized disclosure under the statutory authorization as implemented by the U.S. Japan Double Tax Treaty.⁴⁷¹⁸ The 2016 U.S. Model Income Tax Treaty has

⁴⁷¹³ § 6103(g)(5).

⁴⁷¹⁴ § 6104.

⁴⁷¹⁵ § 6103(k)(4).

⁴⁷¹⁶ JCT Confidentiality and Disclosure Study, Volume 1, pp. 59-60.

⁴⁷¹⁷ U.S. Japanese Double Tax Treaty, Art. 26, ¶ 1 (bold face added), as quoted in *Aloe Vera of America, Inc. v. United States*, 699 F.3d 1153 (9th Cir. 2012).

⁴⁷¹⁸ *Aloe Vera of America, Inc. v. United States*, 699 F.3d 1153 (9th Cir. 2012) (“information known to be false cannot be subject to protection as ‘pertinent’ information under the Tax Treaty.”); *Aloe Vera of Am., Inc. v. United States*, 2015 U.S. Dist. LEXIS 16605 (D. Ariz. 2015), aff’d in part and rev’d in part by *Aloe Vera of Am., Inc. v. United States*, 686 Fed. Appx. 451 (9th Cir. Ariz., 2017), and *Aloe Vera of Am., Inc. v. United States*, 2017 U.S. App. (continued...)

a similar limitation using the word relevant rather than pertinent.⁴⁷¹⁹ The OECD Model, used by most developed countries, has a similar limitation using the words “foreseeably relevant.”⁴⁷²⁰

H. Other Permitted Disclosures.

Section 6103 contains a plethora of other permitted disclosures. All are grounded in some perception of national priority that trumps the general need for secrecy. I do not expect you to know these other exceptions for this class. You should, however, know that, when you practice in this area, you simply have to slug through the various and many permitted disclosures to assess risks of disclosure for your client and remedies that may be available for wrongful disclosure. Your intuition based on the foregoing examples should also give you a sense of when a national priority exists for which Congress might have provided an exception. But you still must read the statute, because sometimes Congress' sense of national priorities may be different than what you think it is or should be.⁴⁷²¹

I. Accounting for Disclosures and Annual Report on Disclosures.

The IRS is required to maintain a record of disclosures under § 6103.⁴⁷²² The IRS is also required to make annual reports to the Joint Committee on Taxation (“JCT”) on disclosures under § 6103.⁴⁷²³ The JCT then reports the same results to the public.⁴⁷²⁴ I provide certain select data from the report for 2018⁴⁷²⁵ to give you an idea of the magnitude and scope of the disclosures:

⁴⁷¹⁸(...continued)

LEXIS 11145 (9th Cir. Ariz., June 22, 2017).

⁴⁷¹⁹ Art. 26, ¶ 1 (“The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or the domestic laws of the Contracting States concerning taxes * * *”).

⁴⁷²⁰ OECD Model Tax Convention, Art. 26, ¶ 1, as approved 7/12/12 (“The competent authorities of the Contracting States shall exchange such information as is foreseeably relevant for carrying out the provisions of this Convention or to the administration or enforcement of the domestic laws concerning taxes * * *”).

⁴⁷²¹ There is one disclosure authority within this general grouping that is worth a passing mention because of its topical interest. Section 6103(k)(3) permits the IRS, upon approval of the JCT, to disclose return information “with respect to any specific taxpayer to the extent necessary for tax administration purposes to correct a misstatement of fact published or disclosed with respect to such taxpayer’s return or any transaction of the taxpayer with the Internal Revenue Service.” Notice the qualifiers for this authority: (i) approval by the JCT; and (ii) necessity for tax administration. See § 6103(b)(4) (defining tax administration). Merely some national emergency does not fit this exception; rather the necessity must arise from tax administration and it is solely to correct a misstatement of fact. It is hard to imagine this authority being invoked with these limitations; so far as I am aware, it has never been invoked. See for a failed attempt to require the IRS to exercise this authority to release President Donald J. Trump’s tax returns, *Elec. Privacy Info. Ctr. v. IRS*, 261 F. Supp. 3d 1 (D. D.C. 2017) (calling this exception a “rara avis” and also stating that the Court is aware of no instance of its actual use, but (i) noting two instances where preliminary moves were made to obtain the required permission but the permission from the JCT were not granted and (ii) other citings in cases appear to have been errors). This case also held that, under the APA or otherwise, there is no requirement that the IRS seek the approval of the JCT to make the disclosures.

⁴⁷²² § 6103(p)(3)(A).

⁴⁷²³ § 6103(p)(3)(B) & (C).

⁴⁷²⁴ § 6103(p)(3)(C).

⁴⁷²⁵ Disclosure Report for Public Inspection Pursuant to Internal Revenue Code Section 6103(p)(3)(C) for Calendar Year 2021 (JCX-8-22 May 17, 2022).

| Disclosure To/For | IRC Section 6103 Subsections | Bulk Master File Data | Other Disclosures | Total Number of Disclosures |
|---|-------------------------------------|------------------------------|--------------------------|------------------------------------|
| State Tax Agencies | (d) | 11,408,006,225 | 459,104,897 | 11,867,111,122 |
| Joint Committee on Taxation | (f)(4) | 67,818,804 | 0 | 67,818,804 |
| GAO, as Agent to Congressional Committees | (f)(4) | 10,714,145,710 | 0 | 10,714,145,710 |
| President and Head of Agencies | (g) | 0 | 0 | 0 |
| Department of Justice (see note 6) | (h)(3)(B) | 0 | 0 | 0 |
| US Attorneys | (i)(1) | 0 | 50,325 | v |
| US Attorneys | (i)(2) | 0 | 42,301 | 42,301 |
| US Attorneys | (i)(7)(C) | 0 | 30 | 30 |
| Government Accountability Office | (i)(8) | 0 | 3,064,539,757 | 3,064,539,757 |
| Bureau of Census | (j)(1)(A) | 1,561,236,024 | 0 | 1,561,236,024 |
| Treasury Office of Tax Analysis | (j)(3) | 0 | 2,915,226 | 2,915,226 |
| Foreign Countries Tax Treaty Authority (Note 6) | (k)(4) | 394,957 | 200,696 | 595,653 |
| Whistleblower Office | (k)(13) | 0 | 4,741 | 4,741 |
| Child Support Enforcement Agencies | (l)(6) | 11,782,349 | 0 | 11,782,349 |
| Affordable Care Act | (l)(21) | 71,378,582 | 0 | 71,378,582 |

Reference Notes [Selected]

- (d) Disclosure of returns and return information to State tax officials having responsibility for administering State tax law.
- (f)(4) Disclosure of returns and return information to Committees of Congress or their agents (including Government Accountability Office (GAO) and the Joint Committee on Taxation (JCT)).
- (g) Disclosure of returns and return information of any taxpayer by request of the President, or for return information of taxpayers considered for appointment to the executive or judicial branches by the President or head of any Federal agency.
- (h)(3)(B) Disclosure of returns and return information to the Department of Justice in a tax administrative matter for use in, or preparing for, any proceeding or investigation before a Federal Grand Jury, Federal or State court, pursuant to a written request by the Attorney General, Deputy or Assistant Attorney General.
- (i)(1) Disclosure of return information, other than taxpayer return information, to Federal officers or employees for use in Federal nontax criminal investigations, upon request by the head of the agency or Inspector General thereof (or designated officials of the Department of Justice).
- (i)(2) Disclosure of return information, other than taxpayer return information, to Federal officers or employees for use in Federal nontax criminal investigations, upon request by the head of the agency or Inspector General thereof (or designated officials of the Department of Justice).
- (i)(7)(C) Disclosure of return or return information to a Federal law enforcement or Federal intelligence agency engaged in any investigation, response to, or analysis of information concerning a terrorist incident, threat, or activity upon grant of an Ex Parte Court Order by a Federal district court judge or magistrate.
- (i)(8) Return and return information is open to inspection by the Government Accountability Office for purposes of auditing, among others, the Internal Revenue Service.
- (j)(1)(A) Disclosure of returns, or return information reflected thereon, to the Bureau of Census in activities allowed by law.
- (j)(3) Disclosure of returns and return information to the Department of the Treasury Office of Tax Analysis for use in preparing economic or financial forecasts, projections, analyses, and statistical studies.
- (k)(4) Disclosure of returns or return information to the competent authority of a foreign government that has a tax convention or bilateral information exchange agreement with the United States
- (k)(13) Disclosure of return information to a whistleblower on the status and stage of any investigation or action related to a claim, subject to IRS procedures and conditions.
- (l)(6) Disclosure of return information to Federal, State, and local child support enforcement agencies for use in establishing and collecting child support obligations from and locating individuals owing such obligations.
- (l)(21) Disclosure of return information to the Secretary of Health and Human Services for use in determining any premium tax credit, cost-sharing reduction, eligibility for participation in a State's Medicaid program, a State's children's health insurance, or a basic health program covered by the Patient Protection and Affordable Care Act.

V. Some Issues Under § 6103.

A. Information in the Public Record.

Has the IRS made a wrongful disclosure if the information it discloses from its files is otherwise in the public record? This issue has arisen in the past where a taxpayer is convicted of a tax crime with the details in the public record and the IRS issues a press release of information from its files that just happens to be the same as information in the public record. This issue can come up in other ways. For example, the IRS may file a tax lien in a public record. Is the IRS then free to disclose the information that the taxpayer is subject to a tax lien simply because the same information is in a public record otherwise available to the public? Does or should it matter if the IRS makes the disclosure from its records or, for purposes of the disclosure, actually retrieves the document or information from the public record and discloses on that public record document or information? In any event, what is clear is that neither § 6103 nor any other statute allows disclosure of public information that is also return information.

In a report in 2000, the JCT studied this issue in a larger study of § 6103.⁴⁷²⁶ The following is from the report:

The courts are divided on whether section 6103 applies to publicly disclosed returns and return information. Some courts have strictly interpreted section 6103, applying it despite the information's public availability. Other courts have found that returns and return information found in the public record loses its confidential status so that a person disclosing it does not violate section 6103. Still other courts have looked to the source of the information being disclosed. These courts find that section 6103 does not protect returns and return information taken directly from a public source, while information taken directly from IRS records remains protected.

The report then discusses in detail the positions of the courts (and for detailed research on the subject, that is a good place to start). The JCT staff recommend in the report that "returns and return information properly made a part of public records (i.e., court records and lien filings) pursuant to Federal tax administration activities should not be protected by section 6103."⁴⁷²⁷ Despite the recommendation, Congress has not yet acted on the issue. Hence the various approaches of the Circuits are still in play.⁴⁷²⁸

⁴⁷²⁶ Joint Committee on Taxation, Study of Present-law Taxpayer Confidentiality and Disclosure Provisions as Required by Section 3802 of the Internal Revenue Service Restructuring and Reform Act of 1998, Volume 1: Study of General Disclosure Provisions (JCS-1-00), pp. 69–81. (January 28, 2000).

⁴⁷²⁷ Id. pp. 6, 197-198.

⁴⁷²⁸ For example, in a 2015 email advice, an IRS attorney said that under the law of the applicable circuit (the Seventh Circuit), the IRS could disclose a "tax court petition as filed with the court" because the immediate source was the public record. ECC 201536019 (7/6/15). In *United States v. Zak* (N.D. Ga. No. 1:18-cv-05774-AT Order dtd 6/7/21), the Court denied the United States' motion for summary judgment on this issue, rejecting the argument that, if the immediate source of the disclosure is the IRS records rather than the public record, the IRS records within the scope of § 6103 can be disclosed.

A related issue arose in 2022 in a tax refund suit where the Government expert on life insurance testified for the Government in earlier proceedings involving other taxpayers and thus accessed and based his expert testimony on those other taxpayers' return information.⁴⁷²⁹ On deposition of the expert, the Government asserted § 6103 to limit the required disclosures of the earlier testimony because it would disclose those other taxpayers' return information. The court held that the information the taxpayer sought was return information of those other taxpayers but that “the return information sought by Plaintiffs is already public by virtue of having been disclosed in the Tax Court opinions.” The court concluded finally:

It appears to this Court, from the deposition transcript excerpts provided by the parties, that Plaintiffs attempted to ask [the Government expert] not for confidential factual return information, but rather for his impressions of and experience with return information already made public by the tax courts in order to establish his qualifications for the opinion testimony he has provided for the instant case. As long as Plaintiffs do not elicit — and [the Government expert] does not reveal — factual information not made public by the texts of the [prior cases in which the expert testified] opinions, their questioning of [the Government expert] on his impressions and experiences with the information in the opinions does not violate §6103 and is permitted.⁴⁷³⁰

B. What is Necessary to Be Disclosed.

I discussed above the controversy over what needs to be disclosed in a criminal investigation. Please review those materials here.

C. IRS Workaround for Humane Purposes (IRS as Good Guy).

Virtually everything the IRS knows about a taxpayer is subject to § 6103. That includes a taxpayer's address. So, the IRS cannot be used as a national contact directory. However, since the IRS is not prohibited from receiving information about a taxpayer, the IRS says that “In circumstances where a humane purpose may be served or in extreme emergency situations, the Service may agree to forward a letter” to the taxpayer.⁴⁷³¹ Note in this case, where it applies, all the IRS does is to forward a letter to the taxpayer, presumably to the “last known address” (this being a statutory term of art as to the place the IRS sends notification to the taxpayer of various actions taken by the IRS).

⁴⁷²⁹ See Keith Fogg, Public Records Exception to IRC 6103 (Procedurally Taxing Blog 1/19/23) (discussing *McGowan v. United States*, No. 3:19-cv-01703 (N.D. Ohio 2022)).

⁴⁷³⁰ Cleaned up (slightly).

⁴⁷³¹ Policy Statement P-1-187. Examples of such urgent circumstances include: (i) “serious illness, imminent death, or death of a close relative”; (2) “The health or well being of a number of persons is involved, such as where persons are being sought for medical study to detect and treat medical defects”; and (3) notification of entitlement to assets (e.g., an estate) where the person is otherwise unlocatable.

D. Relationship to FOIA.

Section 6103 does not confer jurisdiction for court review of an agency's failure to disclosure return information or ordering the agency to disclosure return information. "To invoke the jurisdiction of a federal district court, requests for tax-return information thus must comply with the procedures set forth under FOIA, 5 U.S.C. § 552."⁴⁷³²

VI. Penalties/Remedies for Wrongful Disclosure.

A. Criminal Penalties.

"Willful" Disclosures without authority under § 6103 are subject to potential criminal penalties."⁴⁷³³ The criminal punishment for federal employees is up to 5 years and a \$5,000 fine.⁴⁷³⁴

IRS personnel and state personnel who inspect returns or return information outside the scope of their duties may be subject to a maximum fine of \$1,000, up to a year in prison, or both.⁴⁷³⁵

The IRS may disclose to taxpayers whose return information is the basis of a criminal investigation or prosecution of IRS personnel for improper access or use of the return information.⁴⁷³⁶

B. Civil Remedies.

Section 7431 authorizes the taxpayer to pursue a civil remedy for damages for wrongful disclosure of return information by the IRS (or one of its agents).⁴⁷³⁷ Disclosure of return information

⁴⁷³² *Powell v. Internal Revenue Serv.*, No. 16-1682, 2017 WL 2799934, at *1 (D.D.C. Jan. 24, 2017). (citing *Grasso v. IRS*, 785 F.2d 70, 74 (3d Cir. 1986) ("We conclude, as did the Ninth, Fifth and Eleventh Circuits, that section 6103 operates within the confines of FOIA."); *Linsteadt v. IRS*, 729 F.2d 998, 999 (5th Cir. 1984) ("[A]lthough § 6103 may furnish the criteria for the agency's duty to disclose return information, judicial review of the agency's nondisclosure is governed by the [Freedom of] Information Act."); *Marciano v. Shulman*, 795 F. Supp. 2d 35, 39 (D.D.C. 2011) (holding § 6103 does not provide independent subject-matter jurisdiction); *Surgick v. Cirella*, No. 09-3807, 2010 WL 2539418, at *4 (D.N.J. June 15, 2010) (holding "Section 6103 does not provide an independent, legally cognizable means to challenge the IRS's non-disclosure of tax information and that a person requesting such information and seeking enforcement must abide by the mechanisms prescribed by FOIA").

⁴⁷³³ § 7213. In *United States v. Littlejohn* (D. D.C. Crim. No. 1:23-cr-00343-ACR 9/29/23), the criminal information charged a violation of § 7213(a)(1) against an employee of a contractor to the IRS who had access to returns and return information and was thereby subject to the secrecy obligations under § 6103(n).

⁴⁷³⁴ *Id.* The fine is increased under the Criminal Fine Enforcement Act, 18 USC sec. 3571.

⁴⁷³⁵ § 7213A. The fine is increased under the Criminal Fine Enforcement Act, 18 USC sec. 3571.

⁴⁷³⁶ § 6103(e)(11).

⁴⁷³⁷ The disclosure must be made either by the IRS or a third party acting through the IRS. This is known as the "pass through the IRS" rule. *Stokwitz v. United States*, 831 F.2d 893, 897 (9th Cir. 1987) ("Since section 6103 applies only to information filed with and disclosed by the IRS," only if a third party obtains a taxpayer's information "directly or indirectly from the IRS."); see also *Ryan v. United States*, 74 F.3d 1161, 1163 (11th Cir. 1996) (citing *Stokwitz*, 831 F.2d at 897).

in a tax civil action, including a collection, suit is not a wrongful disclosure permitting damages under this provision.⁴⁷³⁸

The Government agent making the wrongful disclosure must have done so “knowingly or by reason of negligence,”⁴⁷³⁹ but there is no liability where the disclosure resulted from “a good faith, but erroneous interpretation of § 6103.”⁴⁷⁴⁰ The cases generally charge the agent with knowledge of the statute, regulations and IRM, so that failure to meet some specific requirement in those sources will negate good faith.⁴⁷⁴¹ The suit for damages is against the United States.

Damages are the greater of either (1) minimum damages of \$1,000 per act of disclosure⁴⁷⁴² or (2) actual damages plus, if the disclosure was willful or the result of gross negligence, punitive damages.⁴⁷⁴³ The purpose of the minimum damage recovery is to allow some minimum because Congress recognized that it would be difficult and sometimes impossible for the taxpayer to show actual damages.

⁴⁷³⁸ E.g., *Shwarz v. United States*, 234 F.3d 428, 432-33 (9th Cir. 2000) (§ 7433 is the exclusive remedy).

⁴⁷³⁹ § 7431(a)(1).

⁴⁷⁴⁰ § 7431(b)(1).

⁴⁷⁴¹ *Huckaby v. United States Dept. of Treasury, I.R.S.*, 794 F.2d 1041, 1048 (5th Cir. 1986); *Barrett v. United States*, 51 F.3d 475, 479 (1995). Even where disclosures are otherwise permitted to other Government agencies (or foreign tax administrators under tax treaties), the disclosure of knowingly false information is a violation of § 6103 and is not subject to the good faith disclosure exception. *Aloe Vera of America, Inc. v. United States*, 699 F.3d 1153 (9th Cir. 2012) (alleging disclosure of knowing false information to the Japanese tax administrator under the U.S. Japan Double Tax Treaty); *Aloe Vera of Am., Inc. v. United States*, 2015 U.S. Dist. LEXIS 16605 (D. Ariz. 2015), aff’d in part and rev’d in part by *Aloe Vera of Am., Inc. v. United States*, 686 Fed. Appx. 451 (9th Cir. Ariz., 2017), and *Aloe Vera of Am., Inc. v. United States*, 2017 U.S. App. LEXIS 11145 (9th Cir. Ariz., June 22, 2017).

⁴⁷⁴² Act of disclosure is not defined. If an agent tells a third party that a taxpayer is under investigation and that disclosure is not reasonably necessary to the investigation, that certainly is an act of disclosure. Does it matter if, in addition, the agent disclosed in the conversation multiple items of information (say amount and sources of the taxpayer’s income)? *Minda v. United States*, 851 F.3d 231 (2d Cir. 2017) (one act where single disclosure of a document of examination report containing many items); and *Snider v. United States*, 468 F.3d 500, 509 (8th Cir. 2006) (verbal disclosure of multiple items in single interview was multiple acts of disclosure); see AOD 2007-03, I.R.B. 2007-30 (7/23/07) (nonacquiescence in this aspect of *Snider*). What if an agent makes the disclosure in a speech before 100 people? One court of appeals has held that the disclosure is a single act of disclosure, but another court of appeals disagrees. *Siddiqui v. United States*, 359 F.3d 1200, 1202-03 (9th Cir. 2004) (single act of disclosure). Finally, what if an agent discloses to a person with the expectation and even desire that that person disclose to other people? To use a possible example, suppose the disclosure is to a reporter who the agent would have reason to believe will publish the information in a newspaper with a circulation of 1,000,000 readers, with statistical data showing that it is likely that 200,000 persons read the information in the newspaper. The courts seem to reject liability for such secondary disclosures by other persons (e.g., *Snider, supra*, agreeing with *Miller v. United States*, 66 F.3d 220 (9th Cir. 1995)). However, this seems a formalistic reading; if the evidence is strong that the audience the agent intended in making the disclosures was the newspapers’ readership and was using the reporter as a tool to make the disclosures.

⁴⁷⁴³ § 7431(c). The statute says that the taxpayer may recover “the sum of * * * actual damages * * * plus * * * [if willful or grossly negligent] punitive damages.” There is a split in authority as to whether the taxpayer must have actual damages in order to obtain punitive damages. Compare *Mallas v. United States*, 993 F.2d 1111, 1126 (4th Cir. 1993) (actual damages not required) with *Siddiqui v. United States*, 359 F.3d 1200 (9th Cir. 2004) (actual damages required). See also *Castillo v. United States*, 2022 U.S. Dist. LEXIS 55999 (S.D. N.Y. 3/28/22) (discussing the split and holding actual damages are not required).

The taxpayer may also recover costs of the action, including attorneys' fees.⁴⁷⁴⁴

The suit must be brought "within 2 years after the date of discovery by the plaintiff."⁴⁷⁴⁵ The Ninth Circuit has said that the statute runs when the claimant "knew or reasonably should have known of the government's allegedly unauthorized disclosures."⁴⁷⁴⁶ If the person making the wrongful disclosure is criminally charged with the disclosure, the IRS must notify the taxpayer as soon as practical.⁴⁷⁴⁷

VII. Return Preparers Prohibited from Disclosing Return Information.

Obviously, in our tax universe, not only does the IRS have the return information, but the ubiquitous tax return preparer also has return information. If return information is leaked to the detriment of a taxpayer, it doesn't matter whether it came from the IRS or from the return preparer. Accordingly, § 7216 imposes misdemeanor criminal penalty upon preparers who disclose return information.⁴⁷⁴⁸ There are certain exceptions (such as authorized disclosures and disclosures required by court order).⁴⁷⁴⁹ Unauthorized disclosures are also subject to a parallel civil penalty of \$1,000 per disclosure up to a maximum of \$50,000 per calendar year.⁴⁷⁵⁰

Readers should note that there are also other professional prohibitions on disclosure of confidential information that may include return information. Thus, information a client provides to attorneys and CPAs may be subject to state law prohibitions on disclosure. Some of this may be return information (e.g., if the CPA is also a return preparer and if the attorney, although not preparing the return itself, is treated as a return preparer with respect to an item that is included on a return). As with § 7216's prohibitions on disclosure, there are exceptions to these state law prohibitions.⁴⁷⁵¹

⁴⁷⁴⁴ § 7431(c)(2) and (3).

⁴⁷⁴⁵ § 7431(d). Two courts have held that this time limitation is jurisdictional and thus not subject to equitable tolling. *Aloe Vera of Am., Inc. v. United States*, 580 F.3d 867, 872-73 (9th Cir. 2009); and *Gandy v. United States*, 234 F.3d 281, 283 (5th Cir. 2000). One court has held that it is nonjurisdictional and thus potentially subject to equitable tolling. *Bancroft Global Development v. United States of America*, 330 F. Supp. 3d 82 (D. D.C. 2018).

⁴⁷⁴⁶ *Aloe Vera of Am., Inc. v. United States*, 699 F.3d 1153, 1166 (9th Cir. 2012) (calling this inquiry notice).

⁴⁷⁴⁷ § 7431(e).

⁴⁷⁴⁸ The IRS has issued final and temporary regulations under § 7216. See Reg. § 301.7216-2, promulgated by T.D. 9479 (12/29/09); see also Rev. Rul. 2010-4; 2010-4 I.R.B. 1.

⁴⁷⁴⁹ § 7216(b); Reg. § 301.7216-1. For a discussion of the application of this statute to civil discovery of tax refunds in nontax civil litigation between private parties, see *Cooper v. Hallgarten & Co.*, 34 F.R.D. 482 (S.D.N.Y. 1964) (establishing a relevance and need requirement); William A. Edmunson, *Discovery of Federal Income Tax Returns and the New "Qualified" Privileges*, 1984 Duke L.J. 938, 944-45 (1984); and OPR Webinar Followup - Responding to Subpoena for Client Records (Alerts from Office of Professional Responsibility Issue No. 2018-02 2/16/18) (viewed.2/25/18).

⁴⁷⁵⁰ § 6713(a), as added by Taxpayer First Act of 2019, § 2009, P.L. 116-25, 133 Stat 981 (July 1, 2019).

⁴⁷⁵¹ See e.g., *In re Grand Jury Proceedings, Grand Jury No. 08-4*, 607 F. Supp. 803 (W.D. Tex. 2009) (involving exception to Texas CPA prohibitions for grand jury subpoena).

VIII. Summary.

I could only summarize selected highlights of the confidentiality issue. I hope that you have a good sense from this discussion that Congress perceives confidentiality as quite important to the proper functioning of the revenue system, even though it has provided many targeted exceptions to confidentiality.

APPENDIX - RESOURCES

1. **Federal Tax Procedure Book - Resources (formerly Appendix A), [here](#).**
2. **Federal Tax Procedure Book - Acronyms and Initialisms (formerly Appendix B), [here](#).**
3. **On Footnotes and the Demise of Appendix C from FTPB, [here](#).**
4. **Leading Tax Procedure Cases, [here](#).**
5. **On the Internal Revenue Code (Title 26) and Statutes, [here](#).**