Federal Tax Procedure

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Red Group

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Presented by:

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Federal Tax Procedure

- What is “Federal Tax Procedure”?
  - A collection of rules scattered throughout the Code, regulations, court cases, IRS pronouncements and Internal Revenue Manual that explain how the IRS will administer the tax laws
- They provide the procedures to be followed to resolve a particular tax problem
- There may be more than one procedure to follow, thereby providing you with options for how to resolve a client’s tax problem
- Takes many years to learn these rules because they’re not located in a single place
- My presentation will cover selected issues

Federal Tax Procedure

- Solve this problem:
- New client, received billing notice - $200,000
- Filed returns, but never replied to audit notices or notice of deficiency, $200,000 tax got assessed
- Client actually owes $25,000, but needs to convince the IRS to lower the bill
- Options:
  - Audit reconsideration?
  - Amended return?
  - Offer in Compromise?
  - Collection Due Process hearing?

Issues Related to Returns and Filing of Returns

- §6011 – Requirement for filing returns
  - §6012-§6017 – Income tax returns
  - §6018-§6019 – Estate and gift returns
  - §6031-§6056 – Information returns
- §6072 – Due dates for filing returns
- §6081 – Extension of due dates

Due Dates for Selected Returns

Form	Calendar Year thru 2015	Calendar Year 2016 & after	Fiscal Year thru 2015	Fiscal Year 2016 & after	Automatic Extension
1040	4/15	4/15	15th day, 4th month	15th day, 4th month	6 mos.
1041	4/15	4/15	15th day, 4th month	15th day, 4th month	5½ mos.
1065	4/15	3/15	15th day, 4th month	15th day, 3rd month	6 mos.
1120	3/15	4/15	15th day, 3rd month	**	***
1120S	3/15	3/15	15th day, 3rd month	15th day, 3rd month	6 mos.
FinCEN 114	6/30	4/15	N/A	N/A	6 mos.****

** 15th day of 4th month except for FYE 6/30 C corp. Before 2026, C corp. must file FYE 6/30 Form 1120 by 9/15. Source: §2006(a)(3)(B), Surface Transportation and Veterans Health Care Choice Improvement Act of 2015 (P.L. 114-41)

*** Before 2026, extensions are 1120 - 6 mos., FYE 6/30 1120 - 7 mos., After 2025, all 1120 extensions are 6 mos. Source: §2006(c)(1)(A) & (B), P.L. 114-41

**** Per FinCEN notice 12/16/2016, 6 mos. ext. is automatic if FBAR is filed by 10/15

Issues Related to Returns and Filing of Returns

- §6031 – Requirement for filing a partnership return
  - A partnership with no income, deductions or credits doesn't have to file a return – Reg. §1.6031(a)-1(a)(3)
  - A multi-member LLC files a partnership return, a single-member LLC is a "disregarded entity" that files as a sole proprietorship – Reg. §301.7701-3(b)
  - LLC owned by husband/wife as community property can elect to file either as partnership or sole proprietorship – Rev. Proc. 2002-69, 2002-49 I.R.B. 831
  - Mere co-ownership of property isn't a partnership - *Medlin v. Commissioner*, T.C. Memo. 2003-224
    - ✓ Partnership if rental operations are handled by a management company - Rev. Rul. 75-374, 1975-2 C.B. 261
    - ✓ Partnership if owners provide "services" to tenants – Reg. §301.7701-1(a)(2)

Issues Related to Returns and Filing of Returns

- Late-filed returns – Refunds – 2 Requirements
  1. §6511(a) – Timeliness of claim – must be filed within 3 years from time that return was filed or 2 years from time that tax was paid
     - ✓ Rev. Rul. 76-511, 1976-2 C.B. 428 – If no return is filed, claim is timely if filed within 3 years of due date
  2. §6511(b) – Amount of refund – is limited to tax paid in previous 3 years if claim filed during 3–year period, 2 years if not
     - ➢ §6511(b)(2)(A) – Extension is added to 3-year payment period

Issues Related to Returns and Filing of Returns

- Late-filed returns – Refund Example
  - 2021 Form 1040 – Form 4868 (extension) filed 4/15/2022 with $20,000 payment
  - Taxpayer failed to file return by 10/15/2022
  - Taxpayer files original return 10/15/2025 showing tax liability $5,000. Is $15,000 refund allowable?
    - ✓ Yes. §6511(a) – return filed within 3 years of due date
    - ✓ Tax paid within 3 years plus 6 month extension
    - ✓ This scenario: *Weisbart v. U.S.*, 222 F.3d 93 (2d Cir. 2000)
    - ✓ Since IRS will receive return after 10/15/2025, advisable to send by certified mail so there's proof of mailing

Issues Related to Returns and Filing of Returns

- Late-filed returns - Refunds
  - *Omohundro v. U.S.*, 300 F.3d 1065, (9th Cir. 2002) – claim is timely if filed within 3 years from the time the tax return was filed, regardless of when the original return was filed
  - CC-2003-021 – IRS will follow *Omohundro* case
  - If no return is filed and IRS issues notice of deficiency, refund is limited to tax paid in 2-year period before issuance of notice of deficiency ("lookback period"). § 6512(b)(3); *Lundy*, 516 U.S. 234 (1996); *Butts*, T.C. Memo. 2015-74; *Krape*, T.C. Memo. 2007-125
  - IRC § 6511(h) – time for filing claim is suspended during the period that the taxpayer is "financially disabled"

Issues Related to Returns and Filing of Returns

- Late-filed return – Crediting the refund to estimated tax
  - IRC § 6402(b) and Reg. § 301.6402-3(a)(5) – Taxpayer may elect to credit the refund on an original or amended return to next year's estimated tax
  - IRM 8.17.6.10.2(5)b. – the return doesn't have to be timely-filed (can make election on amended return)
    - ✓ Return must still be filed within IRC § 6511 claim period. *Stephenson*, T.C. Memo. 1995-32; *Niski*, T.C. Sum. Op. 2017-33
  - Can the election be revoked?
    - ✓ Yes, before the original due date – Rev. Rul. 55-448, 1955-2 C.B. 595
    - ✓ Not after the original due date - IRC § 6513(d); Reg. §301.6513-1(d); *Georges v. IRS*, 916 F.2d 1520 (11th Cir. 1990)
    - ✓ After the original due date, IRS will allow election to be revoked if the taxpayer can show that he/she will suffer "undue financial hardship" if the refund isn't made – Policy Statement 3-14, IRM 1.2.1.4.14

Issues Related to Returns and Filing of Returns

- Late-filed returns – Penalties
  - §6651(a)(1) – Failure to file (5%/month, max 25%)
  - §6651(a)(2) – Failure to pay (0.5%/month, max 25%)
    - ✓ Reduces FTF to 4.5% for months that both penalties apply
  - §6656 – Failure to deposit (2%, 5%, 10%)
  - §6698 – Failure to file partnership return
    - ✓ $255/month x no. of partners, max 12 months (RP 2024-40)
    - ✓ Rev. Proc. 84-35, 1984-1 C.B. 509 – No penalty for small partnerships (≤ 10 partners) if requirements met (still applies after 2017 per PMTA-2020-01)
  - §6699 – Failure to file S corporation return
    - ✓ $255/mo. x no. of shareholders, max 12 months (RP 2024-40)

Issues Related to Returns and Filing of Returns

- Late-filed returns - Penalties
  - IRM 20.1.1.3.2 – Relief due to reasonable cause
    - ✓ Death, serious illness, unavoidable absence, fire, casualty, natural disaster, other disturbance, records unavailable, mistake, erroneous advice, ignorance of the law, forgetfulness, undue hardship, may provide relief
    - ✓ Send letter replying to IRS notice to request relief, provide facts that constitute reasonable cause
  - IRM 20.1.1.3.3.2.1 – First Time Abate (FTA)
    - ✓ Applies to all penalties listed on previous page
    - ✓ Taxpayer must not have had any penalties assessed in previous 3 years except for estimated tax penalty
    - ✓ IRS will apply FTA first before considering relief due to reasonable cause. See IRM 20.1.1.3.3.2.1(12)

Issues Related to Returns and Filing of Returns

- Superseding return
  - Filed after original return but before due date
  - Takes the place of the original return, is not treated as an amended return
  - Useful for making or not making elections that can't be made on an amended return
  - May be filed on original form or amended form
  - Return filed after original due date but before extended due date is not a superseding return for certain irrevocable elections, e.g. MFJ to MFS
  - Superseding returns are discussed in IRM 21.6.7.4.10 and CCA 200645019

Issues Related to Returns and Filing of Returns

- Claims
  - §6511(a) and (b) – previously discussed
  - NOL and ITC carrybacks
    - ✓ §6511(d) – 3 years from due date of NOL or ITC year
    - ✓ §6411 – tentative allowance filed on Form 1045 (individual) or Form 1139 (corporation), must be filed by end of tax year following NOL or ITC year
  - Tax claims – file amended return
    - ✓ 1040-X
    - ✓ 1120X
    - ✓ 1041, 1065, 1120-S (mark “Amended return” box)
    - ✓ 941-X

Issues Related to Returns and Filing of Returns

- Claims
  - When to use Form 843 instead of amended return
    - ✓ Listed at top of form
    - ✓ Refund or abatement of employment, estate, gift, excise tax, not for income tax
    - ✓ Refund or abatement of interest or penalties
  - Protective claim
    - ✓ Filed to preserve taxpayer's right to a refund where the refund is contingent on a future event that may occur after the statute of limitations expires
    - ✓ Use Form 843 or a letter, not Forms 1040-X or 1120X
    - ✓ IRM 25.6.1.10.3.2.5; CCA 200547011; CCA 200848045

Issues Related to Audits of Returns

- Audits
  - What constitutes an audit and why should we care?
    - ✓ IRC §7605(b) restricts IRS from auditing a return more than once
    - ✓ Audit must include an examination of the taxpayer's books of account or other records
  - Rev. Proc. 2005-32, 2005-23 I.R.B. 1206
    - ✓ Discusses what constitutes an audit and what doesn't
    - ✓ Math error notice isn't an audit
    - ✓ CP2000 – Matching info returns to the filed return is not an audit. See also PMTA 2011-21 and *Essner*, T.C. Memo. 2020-23
  - Today, most audits are correspondence
    - ✓ Taxpayer has right to face-to-face interview in local office
    - ✓ Taxpayer has right to be represented
    - ✓ IRM 4.11.29 - Transfer to another office is at IRS discretion

Issues Related to Audits of Returns

- Statute of Limitations for Assessment
  - §6501(a) – Assessment must be made within 3 years of filing the return (general rule)
  - §6501(b)(1) – Early-filed return is deemed filed on due date
  - §6501(b)(2) – 941s are all deemed filed on 4/15 after year
  - §6501(c) – No statute of limitations for a fraudulent return
    - ✓ The fraud need not be attributable to the taxpayer; it's enough that the return was prepared fraudulently by the return preparer. See *Allen v. Commissioner*, 128 T.C. 37 (2007); *Finnegan v. Commissioner*, T.C. Memo. 2016-118, aff'd No. 17-10676 (11th Cir. 2019)

Issues Related to Audits of Returns

- Statute of Limitations for Assessment
  - §6501(e) – 6-years for 25% omission of income
    - ✓ 25% applies to gross income reported on return
    - ✓ Applies to gross receipts from business, not gross profit
    - ✓ Applies to overstatement of basis for 2012 and later returns
    - ✓ Applies to omission of more than $5,000 of foreign assets required to be reported on Form 8938
    - ✓ §6501(e)(1)(B)(iii) – Doesn't apply if omission of income was adequately disclosed on return (this rule doesn't apply to an overstatement of basis)

Issues Related to Audits of Returns

- Extending the Statute of Limitations for Assessment
  - §6501(c)(4) – May extend by agreement (Form 872, Pub. 1035)
    - ✓ IRM 25.6.22.2.1 – Examiners are required to solicit 180 days before the statute of limitations expires
    - ✓ IRM 8.21.3.1.1 – Must be 365 days remaining on statute for case received in Appeals
    - ✓ Taxpayer has right to limit consent to certain issues and to specify extension date, but IRS rarely agrees to this
  - §6501(c)(7) – If IRS receives amended return within 60 days before end of assessment statute, and it shows additional tax owed, IRS has 60 days to assess

Issues Related to Audits of Returns

- Audit-Related Penalties
  - §6662 – Accuracy-related penalty
    - ✓ Only imposed if return has been filed
    - ✓ 20% penalty for negligence, substantial understatement, substantial valuation misstatement, others
    - ✓ §6662(d) – Substantial understatement is greater of 10% of tax required to shown on return or $5,000 ($10,000 for corps), reduced for items adequately disclosed on return
    - ✓ 40% penalty if attributable to undisclosed transaction that has no economic substance
    - ✓ §6664(c) – No penalty if there was reasonable cause
    - ✓ Reg. §1.6664-2(c)(3) – No penalty if taxpayer files qualified amended return before audit began

Issues Related to Audits of Returns

- Audit-Related Penalties
  - §6663 – Civil fraud penalty
    - ✓ Only imposed if return has been filed (for unfiled returns, §6651(f) penalty for fraudulent failure to file is 15%/mo. max 75%)
    - ✓ Penalty is 75% of the underpayment due to fraud
    - ✓ On joint return, applies only to culpable spouse(s)
    - ✓ If only part is due to fraud, IRS may impose §6662 penalty for part not due to fraud
    - ✓ IRS has burden of proving fraud by "clear and convincing evidence" (higher standard than "more likely than not")
  - §6751(b) – Audit-related penalties must be approved in writing by immediate supervisor (in 9th Cir., before Notice of Deficiency is issued) – many court cases on this issue

Issues Related to Audits of Returns

- Alternate Dispute Resolution Programs
  - SBSE Fast Track Settlement – Issue(s) sent to Appeals Officer to resolve while case remains with examiner (Rev. Proc. 2017-25, 2017-14 I.R.B. 1039)
  - SBSE Fast Track Mediation (Collection) – Appeals Officer mediates between taxpayer and Revenue Officer to convince parties to reach agreement (Rev. Proc. 2016-57, 2016-49 I.R.B. 786)
  - Many other ADR programs, e.g. for LMSB, post-Appeals, Tax Court (Pub. 3605)
  - I have had very little success with these programs, IRS often denies the taxpayer's request to use the program

Issues Related to Audits of Returns

- Appealing the Results of an Audit
  - 30-Day Letter (Proposed Audit Adjustments)
    - ✓ If tax & penalties owed for any one year is $25,000 or less, submit Form 12203, *Request for Appeals Review*
    - ✓ If tax & penalties owed exceeds this amount, must submit a formal protest. See Pub. 5 for how to prepare a protest.
    - ✓ Expect to wait as much as 2-3 years for a meeting with an Appeals Officer since these cases are usually low priority
  - 90-Day Letter (Notice of Deficiency)
    - ✓ Must file petition with Tax Court (easier than a protest to prepare)
    - ✓ Referral to Appeals is usually automatic (Rev. Proc. 2016-22)
    - ✓ Waiting period for meeting with Appeals Officer is less (8-12 months from date petition was filed) since the Tax Court, not IRS, sets the time schedule

Issues Related to Audits of Returns

- Appealing the Results of an Audit
  - 90-Day Letter (Notice of Deficiency)
    - ✓ Tax Court has fill-in PDF forms available on its website (www.ustaxcourt.gov)
    - ✓ Filing fee is $60.00
    - ✓ EAs and CPAs who are not attorneys and are not admitted to practice in Tax Court may assist a *pro se* taxpayer in filling out the petition and other forms, but may not give out legal advice
    - ✓ Make sure to send forms and fee by USPS certified mail so that you have proof of mailing
    - ✓ EAs & CPAs **can** represent at Appeals
    - ✓ Fogel will file the petition with the Court for a nominal fee, then will let you represent the client in Appeals

Issues Related to Audits of Returns

- Appealing the Results of an Audit
  - 90-Day Letter (Notice of Deficiency) - Rescinding
    - ✓ Early in 90-day period, try first to resolve case with IRS
    - ✓ IRS has a procedure for rescinding a notice of deficiency (Rev. Proc. 98-54, 1998-43 I.R.B. 7, IRM 4.8.9.28, Form 8626), but IRS rarely grants this
    - ✓ To rescind, either the notice was issued for the wrong amount, wrong taxpayer, wrong tax period, issued due to imminent statute but TP signed Form 872, IRS failed to consider info submitted during audit, or TP requested Appeals and case is susceptible to settlement

Issues Related to Audits of Returns

- Appealing the Results of an Audit
  - Remitting a deposit to stop the running of interest
    - ✓ IRC §6603 permits a taxpayer to remit a deposit in response to a proposed assessment in order to stop the running of interest
    - ✓ The deposit doesn't affect the taxpayer's appeal rights
    - ✓ If the ultimate tax assessed is less, the IRS is required to refund the excess deposit (without interest)
    - ✓ See Rev. Proc. 2005-18, 2005-13 I.R.B. 798 for procedures and for language to include in the cover letter

Issues Related to Audits of Returns

- Appealing the Results of a Disallowed Claim
  - 30-Day Letter (Proposed Claim Disallowance)
    - ✓ If amount of claim disallowed for any one year is $25,000 or less, submit Form 12203, *Request for Appeals Review*
    - ✓ If amount of claim disallowed exceeds this amount, must submit a formal protest.
    - ✓ Expect to wait as much as 2-3 years for a meeting with an Appeals Officer since these cases are usually low priority
  - Notice of Claim Disallowance (Certified Mail) – IRC §6532
    - ✓ May appeal by requesting reconsideration (IRM 1.2.1.5.22)
    - ✓ During 2-year period after notice issued, may file suit in either U.S. District Court or U.S. Court of Federal Claims
    - ✓ Dist. Court and CFC websites have fill-in forms & instructions

Issues Related to Collection of Tax

- Statute of Limitations on Collection
  - §6502 – 10 years after assessment
  - §6503 – Might be extended or suspended for many reasons, including –
    - ✓ §6503(h) – Bankruptcy filing
    - ✓ §6331(k) – Offer in Compromise
    - ✓ §6502(a)(2) – Installment Agreement & Form 900 waiver
      - ► In *Grauer v. Commissioner*, T.C. Memo. 2016-52, the taxpayer denied signing an installment agreement, the IRS couldn't produce it, and as a result, IRS lost the case
    - ✓ §6015(e)(2) – Request for innocent spouse relief
    - ✓ §6330(e) – Collection Due Process appeal
    - ✓ §6503(c) – Taxpayer outside U.S. > 6 months

Issues Related to Collection of Tax

- Ways to Challenge the Liability
  - Collection Timeline and Options (see last page)
  - Pub. 3598 – Audit Reconsideration
    - ✓ Tax assessed & unpaid, follow instructions in Pub., must submit docs with request, taxpayer has right to appeal, doesn't stop collection
  - Form 656-L – Offer in Compromise, Doubt as to Liability
    - ✓ Worked by examiner, no application fee, taxpayer has right to appeal, stops collection – Reg. §301.7122-1(g)
  - Form 12153 – Request for Collection Due Process Hearing
    - ✓ Must file within 30 days from lien or levy notice that provides right to a CDP hearing, worked by Appeals personnel, may challenge liability if no prior opportunity to dispute, may raise collection alternatives, right to appeal to Tax Court

Issues Related to Collection of Tax

- Ways to Resolve Inability to Pay
  - Form 656 – Offer in Compromise, Doubt as to Collectibility
  - Form 8857 – Request for Innocent Spouse Relief
  - Form 9423 – Collection Appeal Request
  - Form 9465 – Installment Agreement Request (or online)
  - Form 12153 – Request for Collection Due Process Hearing
  - Form 12277 – Application to Withdraw Notice of Federal Tax Lien
  - §6325 – Request release of lien
  - Bankruptcy – tax must be due more than 3 years before filing and assessment must have been final for 240 days, see Pub. 908

Federal Tax Procedure

- When all else fails, contact the Taxpayer Advocate Service
  - Such as an unprocessed claim, repeated letters to IRS that are being ignored, IRS's responses are incongruent
  - TAS has the authority to order the IRS to take appropriate action (§7811 – Taxpayer Assistance Order)
  - Form 911, *Request for Taxpayer Advocate Assistance (and Application for Taxpayer Assistance Order)* – Complete and fax to appropriate TAS office, don't mail, don't call
  - I've had relatively good success in having TAS cut through all of the B.S.
  - When TAS fails, contact U.S. Representative or Senator

Federal Tax Procedure

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- Filed returns, but never replied to audit notices or notice of deficiency, $200,000 got assessed
- Actually owes $25,000, but needs to convince IRS to lower the bill
- Options:
  - Audit reconsideration?
  - Amended return?
  - Offer in Compromise?
  - Collection Due Process hearing?

Federal Tax Procedure

Questions?

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COLLECTION ACTION TIMELINE AND OPTIONS