Office of Fraud Enforcement

By Thomas Kramer

Small Business / Self Employed

OFFICE OF FRAUD ENFORCEMENT

June 8th, 2023

Practitioner Awareness of Fraud Schemes

Tax Alliance

Presented by:
Tom Kramer, Acting Director, Office of Fraud Enforcement

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Office of Fraud Enforcement

- **Established in March 2020**
- **Previously NFP – Expanded Vision**
- **Led by Acting Executive Director Tom Kramer**
- **Direct report to SB/SE Deputy Commissioner, Collection & Operations Support**
- **OFE promotes compliance through strengthening IRS' response to fraud and mitigating emerging threats**

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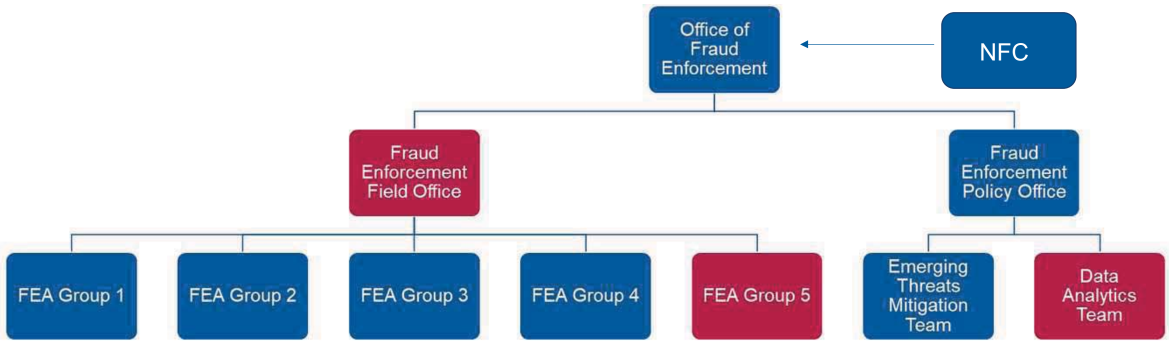
Office of Fraud Enforcement Structure



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Fraud Trifecta: Counsel - EMT - FEAs

National Fraud Counsel – A Successful Partnership

- Embedded and Dedicated Fraud Support
- Case Support and Guidance
- Fraud Awareness and Outreach
- Legal Review of IRMs, Forms and Publications

Emerging Threats Mitigation Team – Embedded Data Analytics

- Proactive threat Identification and Mitigation
- Cutting edge technology identifying Digital Assets
- Collaborate with external partners for case resolution

Fraud Enforcement Advisors – Pivotal Field Support

- Assist Compliance Employees in Detecting and Analyzing Fraud in Cases
- Fraud training to new compliance employees
- Cradle to Grave Case Support for All IRS Operating Divisions

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EMT Examples of Fraud Detection

Covid Related Fraud

- Form 7200 Fraud
- Employee Retention Credits
- 7202 Refundable Qualified Sick and Family Leave Equivalent Credits
- Improperly Forgiven Payroll Protection Program Loans are taxable
- Fabricated Entities

Natural Language Processing model for digital asset workstreams

Bank Transaction Analysis tool for field employees

Comprehensive fraud risk analysis of the Inflation Reduction Act provisions

Current Trends and Schemes

Non-Compliance among High Net Worth Individuals

- Foreign Assets Concealment
- Expatriation of Assets
- Non-filing
- Falsification of Asset Disclosure Statements

Abusive Credits and Deductions

- Abusive use of Syndicated Conservation Easements
- Inflated Research and Development Credits & Section 179D deductions
- Mischaracterization of Income as Loans
- Improper Loss Carrybacks/Carryforwards (Basis for losses)
- Refundable Credit Schemes

Current Trends and Schemes

Failure to File Tax Returns

Under-Reporting of Income

- Non-reporting of entire sources of income (example: cash transactions)
- Non-reporting of foreign income
- Failure to file FBARs
- Non-reporting or mischaracterization of virtual currency/digital assets/income

Frivolous Positions

Use of Nominees/Alter Egos to Hide Assets/Income

False Disclosures on Offers in Compromise/Collection

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Role of Tax Professionals

- Educate your clients on the tax law
- Document, Document, Document!!
- Ask clarifying questions
- Ensure your clients reviews and understands their tax returns
- Report Fraud on IRS.gov

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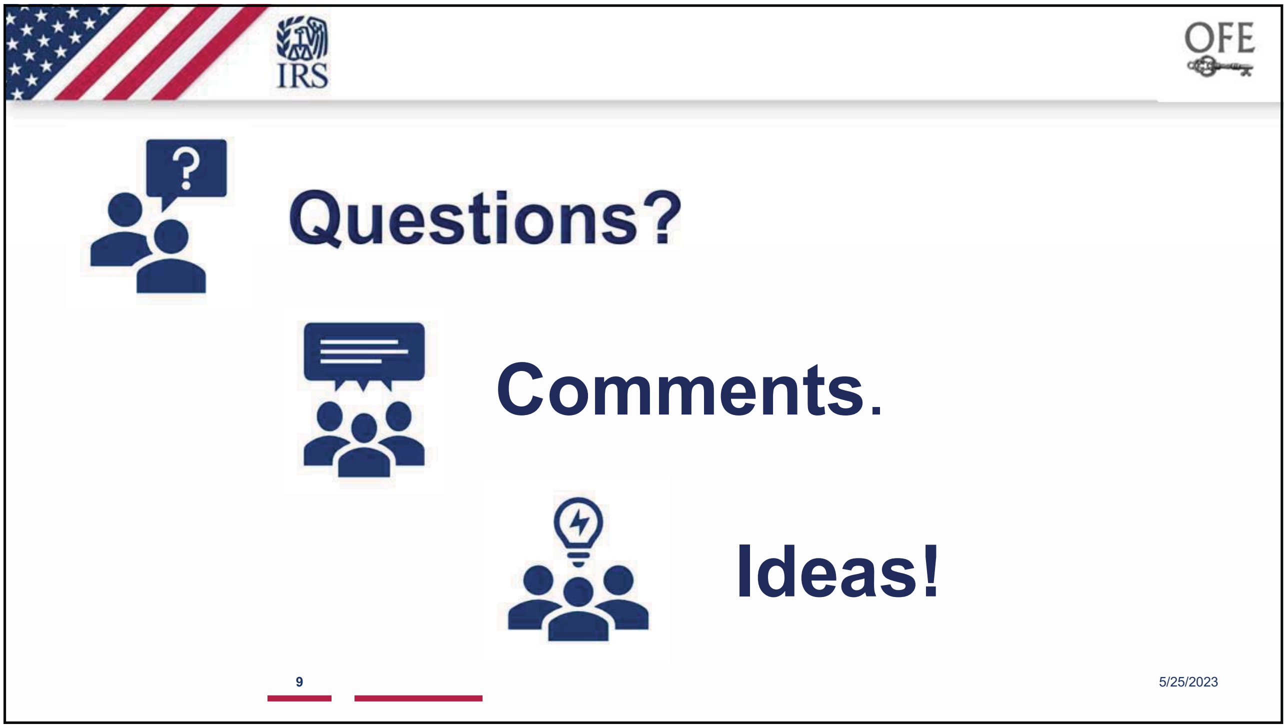

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Understanding the Assessment Statute Expiration Date

By Bryan Camp

Tax Alliance Conference
June 6-8, 2023

Presentation On

Limitation Period on Assessments[1]

by

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Introduction

The idea of an annual accounting is fundamental to our system of taxation. Brunet v. Sanford & Brooks, 282 U.S. 359, 365 (1931)("It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals"). The United States tax system relies on the taxpayer to make the initial accounting and to pay the taxes owed. Taxpayers do that by filing annual returns to account for their taxes.

The initial accounting is not final, however. The Service needs some time in which to review and correct returns for errors caused both by honest mistakes and by attempts to game the system. But that time should not be unlimited. That is the purpose of a statute of limitations. On the one hand, *"a statute of limitation is an almost indispensable element of fairness as well as of practical administration of income tax policy." Rothensies v. Electric Storage Battery*, 329 U.S. 296, 301 (1946). On the other hand, statutes of limitation *"are by definition arbitrary, and their operation does not discriminate between the just and the unjust claim, or the voidable and unavoidable delay. They come into the law not through the judicial process but through legislation. They represent a public policy about the privilege to litigate." Chase Securities Corp. v. Donaldson*, 325 U.S. 304, 314 (1945).

The Service does not have unlimited time to examine a return and re-assess the tax. The basic statute of limitations on assessment is found in §6501. The basic rule allows the Service three years after a taxpayer files their return to assess tax liabilities.

It is important to remember that in tax, the statute of limitations operates as a statute of repose. What that idea means is that if the IRS does not assess a tax liability within the applicable limitations period, that liability is extinguished. Gone. Poof. *See Illinois Masonic Home v. Commissioner*, 93 TC 145 (1989)(the Service cannot assess a transferee under § 6901 if the Service has not assessed the original taxpayer within the appropriate limitation period because expiration of the assessment limitation period bars both the remedy of collecting the tax and also extinguishes the liability of the taxpayer). I explain this in greater detail in Tax Return Preparer

Fraud and the Assessment Limitation Period, 116 Tax Notes 687 (August 20, 2007)(free link here: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1008487).

IRS computer systems and employees keep a sharp lookout for when limitations period for assessment expires. In tax parlance, the last day on which the IRS can assess is called the Assessment Statute Expiration Date (ASED). While the basic rule is that the Service gets three years to examine a return, there are two other potential assessment periods: a six year period in cases where the taxpayer understates gross income by 20% or more and an unlimited period where the taxpayer fails to even file a return or files an fraudulent return.

Section I will discuss the general three year period. Section II will discuss the six year period. Section III will discuss the unlimited time period. Finally Section IV will explain what actions by either the government or taxpayers can extend the relevant ASED.

I. The Three Year Period.

A. General Rule: Three Years From Later of Two Dates

Section 6501(a) says that the Service must assess income taxes, estate taxes, and gift taxes within three years after the *later* of two dates: the taxpayer's return is due or the date the taxpayer files the return. The Service generally makes assessments through bulk processing of returns as they are filed. If the taxpayer files the return on or before its due date, the three year period begins on the due date. §6501(b)(1). If the taxpayer files the return *after* its due date, the three year period begins on the day after the date the return is filed and thus the last day the Service may assess is the day three years from the date the return is filed. Rev. Rul. 81-269.

For purposes of computing the applicable limitation period, the due date of the return means the statutory due date, period. It does not include any extensions of that statutory due date granted by the Service, either individually via Form 4868, or systemically as, for example, under the authority of §7508A. Nor does it include any statutory extensions of time, such what §7503 allows when the filing date falls on a Saturday, Sunday or holiday. Rev. Rul. 81-269.

The due date for income tax returns is generally the 15th day of the fourth month after the close of the taxable year. §6072(a). For calendar year taxpayers that is the infamous April 15th due date. Employment taxes reported on Forms 940 and 941 get a deemed statutory due date of April 15 of year following their filing due date. § 6501(b)(2).

Example 1: Abby files her 2020 income tax return on March 1, 2021. The statutory due date for her 2020 return is Thursday, April 15, 2021. Since March is on or before April 15, 2021, Abby's return is deemed to have been filed on April 15, 2021 and the Service has until Monday, April 15, 2024 to assess her tax. Rev. Rul. 81-269.

Example 2: Bob files his 2021 return on April 18, 2022. This is a timely filed return because April 15, 2021, a Friday, is Emancipation Day in Washington D.C. Therefore, the due date is the next day that is not a weekend or holiday and that is Monday, April 18th. §7503. But the statutory due date is *still* April 15th. The three year period starts from the later of the statutory due date or the date the return is actually filed. Therefore, the Service has until Friday, April 18, 2025, to assess his tax. *Brown v. United States*, 391 F.2d 653 (Ct.Cl. 1968).

Example 3: Camila files a Form 4868 (Application for Automatic Extension to File Individual Income Tax Return) in March 2023 to extend her filing deadline for her 2022 return to October 16, 2023 (October 15th being a Sunday). She eventually files her return on Friday, July 14, 2023. The Service has until Tuesday, July 14, 2025, to assess her tax. The extension of the due date for late filing purposes is irrelevant to the start of the assessment limitation period. Rev. Rul. 81-269. That period still starts on the later of two dates: the statutory due date or the date of actual filing.

B. What is a "Return"?

The limitation period is triggered only by a document that qualifies as a return. The taxpayer bears the burden of proof to show both that a proper return was filed and the date it was filed. *In re Grynberg*, 986 F.2d 367 (10th Cir. 1993).

The Code does not define what constitutes a "return." In the leading case of *Beard v. Commissioner*, 82 T.C. 766 (1984), aff'd, 793 F.2d 139 (6th Cir. 1986), the Tax Court synthesized the Supreme Court jurisprudence on this subject into four elements, all of which must be present for a document to qualify as a "return."

"First, there must be sufficient data to calculate 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." Id. at 777.

This presentation is not about the subtleties of what constitutes a return. Suffice to say that most courts have accepted the Tax Court's synthesis as the appropriate test for what constitutes a return. *Badaracco v. Commissioner*, 464 U.S. 386 (1984). Here are some examples of how each element works:

1. Sufficient Data to Calculate Tax: Cf. *Blout v. Commissioner*, 86 TC 383 (1986)(otherwise completed return filed without an attached W-2 was valid to start the limitations period) with *United States v. Porth*, 426 F.2d 519 (10th Cir. 1970)(return that contained only taxpayer's name but otherwise contained no information was not sufficient to start the limitation period, even though a W-2 was attached). *Compare also United States v. Long*, 618 F.2d 74 (9th Cir. 1980)(tax return filled in with zeros not invalid for lack of sufficient data) and *United States v. Moore*, 627 F.2d 830 (7th Cir. 1980)(same) *with United States v. Mosel*, 738 F.2d 157 (6th Cir. 1984)(tax return filled in with zeros was invalid return) and *United States v. Rickman*, 638 F.2d 182, 184 (10th Cir. 1980)(same). *See also Sanzogno v. Commissioner*, 60 TC 321 (1973)(Form

1040C filed by a departing alien taxpayer was valid to start the limitation period even though the taxpayer did not file the required Form 1040NR).

2. Purport To Be A Return: Cf. *Parker v. Commissioner*, 365 F.2d 792, 780 (8th Cir. 1966)(held that tax information reported on a plain piece of paper could not purport to be a return, even when that had been the taxpayer's past practice) *with* SCA 199929036 (Service Centers instructed to accept incorrect forms submitted by Subchapter S corporations if the taxpayer properly signed the submitted form and it contained sufficient data to calculate the tax liability of the taxpayer). *See* Treas. Reg. 1.6011-1(b) (permitting taxpayers to file tentative return to avoid filing penalties but holding that the tentative return does not trigger the assessment limitations period); *Foutz v. Commissioner*, 24 TC 1109 (1955)(tentative return does not start assessment limitations period).

3. Good Faith Effort to Comply with the Law: *Cf. Beard, supra* (tax protestor's alteration of Form 1040 held to invalidate return) with *Bachner v. Commissioner*, 81 F.3d 1274 (3rd Cir. 1999)(tax protestor's alteration of Form 1040 did not invalidate return). See *In re Hindenlang*, 164 F.3d 1029, 1034 (6th Cir. 1998), *cert. denied*, 528 U.S. 810 (1999)("a Form 1040 is not a return if it no longer serves any tax purpose or has any effect under the Internal Revenue Code."). *Accord*: *In Re: Payne*, 431 F.3d 1055 (7th Cir. 2005)(same).

4. Signed Under Penalties of Perjury: *Lucas v. Pilliod Lumber*, 281 U.S. 245 (1930)(failure to sign return invalidates it); *Mills v. United States,* 154 Fed.Cl. 549 (2021)(placement of initials by computer on return insufficient to create valid return). *But see* *Fowler v. Commissioner*, 155 T.C. No. 7 (2020)(taxpayer validly signed electronically-filed return even though the taxpayer had not supplied his Identify Protector Taxpayer Identification Number (IP-PIN)). *See Hettig v. United States*, 845 F.2d 794 (8th Cir. 1988)(signing but crossing out the "under penalties of perjury" language invalidated return). *But see United States. v. Davis*, 603 F.3d 303 (2010)(adding words "without prejudice" to the jurat did not invalidate the return); *McCormick v. Peterson*, 94-1 U.S.T.C. ¶ 50,026 (E.D.N.Y. 1993)(Weinstein, J.), *acquiesced in* AOD 1998-005 (adding the words "under protest" to the *jurat* did not invalidate the return.

Side Note: Returns Prepared by the IRS: Section 6020 authorizes the Service to prepare a Substitute For a Return (SFR) when the Service believes a taxpayer should have filed one but did not. That section distinguishes between two types of SFRs. Under §6020(a) the Service prepares the SFR based on the taxpayer's *"consent to disclose all information necessary for the preparation thereof"* and the taxpayer signs it. Under §6020(b) the Service prepares the SFR without the taxpayer's consent or acknowledgment. Section 6020(a) returns are considered the taxpayer's return and thus start the limitation period. A §6020(a) return is treated as the taxpayer's return. See Bryan Camp, *The Function of Forms in the Substitute-For-Return Process,* 111 Tax Notes 1511 (June 26, 2006).

C. When is a Return "Filed"

To start the limitation period, a valid return must also be properly filed. To be properly filed, the return must be received in the proper Service office for processing, per §6091. That's called the physical delivery rule. *See Bongam v. Commissioner*, 146 T.C. 52 (2016). Generally, returns must be filed in Service Centers, where they are processed. Filing in the wrong office does not start the limitation period. For example, filing with the wrong Service Center does not start the limitations period. *Winnett v. Commissioner*, 96 TC 802 (1991). Nor does mailing or handing a return to a Revenue Agent, whether during audit or otherwise, since the Revenue Agent has no independent duty to transmit the return for filing. The Ninth Circuit briefly lost its mind to find that handing the return to any IRS employee constituted "filing" on the date it was received by that employee even though that document was never sent to an IRS office for processing. *Seaview Trading, LLC v. Commissioner*, 34 F.4th 666 (9th Cir. 2022)(purported copy of return filed when faxed to a Revenue Agent). But then the Ninth Circuit found sanity about a year later, reversing itself to conform with the traditional reading of §6501(a) that a return must reach the correct office to be considered "filed"). *Seaview Trading LLC v. Commissioner*, 62 F.4th 1131 (9th Cir. 2023)(en banc). So don't think you have filed a return the day you handed it, emailed it, or faxed to to some IRS employee.

What confuses folks is §7502 and §7503. I discuss the interplay of those rules with the limitation period rules in Bryan Camp, Lesson From The Tax Court: *Counting The Days*, TaxProf Blog (May 23, 2022) (Attached). Here is a brief example.

> Example 4: The statutory due date 2021 income tax returns was Friday, April 15, 2022. However, because Washington D.C. celebrates Emancipation Day on April 15, §7502 extends the penalty-free time for filing for all taxpayers until Monday, April 18, 2022. Remember, the general rule is that the limitation period starts on the later of the *statutory* due date of the return or the *actual* date the return is filed. Thus, if a taxpayer efiles their return on Saturday, April 16, that will be the later of the two dates and the IRS will have until Wednesday April 16, 2025 to audit the return and issue an NOD. If, however, a taxpayer properly snail mails their return on Saturday April 16 and it is physically delivered to the proper IRS office on Tuesday April 19th, then §7503 will deem the return to have been filed on the date of mailing, which is before the §7502 statutory extension of the April 15th due date. In that situation §6501(b)(1) provides that the return will be deemed to have been filed on the "last day prescribed by law" which mean Monday April 18th. In that situation, the IRS has until Friday April 18, 2025 to issue the NOD.

For other examples, see Rev. Rul. 81-269, 1981 C.B. 243.

What does this mean for you? Well, if you are mailing a document to the Service on or before its due date, be sure to choose a delivery option which will prove the mailing date, such as certified mail. You do not need to purchase a delivery option, such as return receipt requested, which prove the receipt date; you just need to prove the mailing date. If, however, you are mailing a document after its due date, then choose a delivery option which will prove both the mailing date and the receipt date, such as return receipt requested.

D. What is the Relevant Return?

First, only the *taxpayer's* return starts the limitation period. Thus, returns "of any person from whom the taxpayer has received an item of income, gain, loss, deduction, or credit" will not trigger the limitation period. §6501(a). For example, the return of an S corporation or partnership, or other pass-through entity will not start the limitation period for the shareholder, or partner, or other taxpayer who is the ultimate recipient of the passed-through item. *Bufferd v. Commissioner*, 506 U.S. 523 (1993). There are some special rules for partnerships that are beyond the scope of this presentation. items.

Second, only the taxpayer's original return starts the limitation period. An amended return does not extend the general three year limitation period for the Service to assess tax. The chief exception to this rule is when a taxpayer submits an amended return within 60 days before the normal three year limitation period ends and the amended return shows an increase in tax. In that situation, Congress allows the Service until the *"day 60 days after the day on which the [Service] receives"* the document amending the return to assess taxes. §6501(c)(7).

E. Three Year Period Applied to Transferee Liability

Section 6901(a)(1)(A) allows the Service to assess a liability against any person who is "at law or in equity," a "transferee of property" from taxpayers who are liable for unpaid income, estate, or gift taxes. Through § 6901, the Service may hold a third party liable for the taxes owed by a delinquent taxpayer when the third party is a transferee of property either at law or in equity. The liability imposed by § 6901 may be "assessed, paid, and collected" as if it were a tax against the third party.

Section 6901(c)(1) gives the IRS one additional one year from the end of the limitation period against the original taxpayer to assess the transferee liability against an initial transferee. The end of the limitation period against the taxpayer is the period of limitation without regard to the effect that the death (of an individual) or dissolution (of a corporate) taxpayer has under state law. §6901(e). *Phillips v. Commissioner*, 283 U.S. 589 (1931).

Section 6901(c)(2) then gives the IRS *another* additional year from the end of the first additional year to assess a transferee liability against a secondary transferee (that is, a transferee of the initial transferee) and an additional year to assess liability against a tertiary transferee (that is, a transferee of the secondary transferee). At that point, the Code calls it quits: the additional limitation periods for each additional transferee cannot exceed three years beyond the end of the limitation period against the original taxpayer.

Section 6901(a)(1)(B) also allows the Service to assess a tax liability against a fiduciary who is liable under 31 U.S.C. § 3713 (the "Absolute Priority Statute") for the taxes owed by an insolvent estate when the fiduciary uses estate assets to pay creditors or beneficiaries before paying the taxes owed the United States. The applicable limitation period for the Service assess the § 3713 liability against the fiduciary is the later of one year from the time the liability arises or the end of the collection limitation period against the estate (which is generally 10 years, per §6324).

Note: While the transferee *liability* is derivative from that of the original taxpayer, the IRS does not have to have actually *assessed* the liability against the original taxpayer in order to assess the liability against the transferee, so long as the transfer is made during the time that the original taxpayer is liable. *Espinosa v. Commissioner*, 24 F. App'x 825 (9th Cir. 2001); *Commissioner v. Kuckenberg*, 309 F.2d 202, 206 (9th Cir. 1962). If the transfer occurs after the end of the limitation period against the original taxpayer, however, and the Service has not made an assessment against the original taxpayer, the Service cannot assess the transferee because the liability upon which the transferee liability is based has been extinguished. *Illinois Masonic Home v. Commissioner*, 93 TC 145 (1989).

II. Six Year Periods for Assessment

A. General Rules

If a taxpayer *"omits from gross income an amount properly includible therein which is in excess of 25 percent of the amount of gross income stated in the return,"* the IRS has six years *"after the return was filed"* to assess. §6501(e)(1)(A). Notice this is a straightforward calculation based on the filing date, not a "later of" rule as for the three year period. However, don't forget the deemer rule in §6501(b)(1) that treats returns filed before the statutory due date as filed on the statutory due date.

Determining whether 25% of "gross income" was "omitted" can be tricky. Here are some of helpful rules to remember.

First, the term "gross income" means those items listed in section 61(a) unreduced by net losses or Cost of Goods Sold. *CNT Investors v Commissioner*, 144 T.C. No. 11 (2015). However, when gross income from the sale of property is calculated using the rules in §1001 so that it means *gains* from the sale. It does not just mean the amount realized. Nope. It is determined after accounting for the amount realized *and* basis. *Insulglass Corp. v. Commissioner*, 84 T.C. 203 (1985).

Second, the phrase "omits...an amount" in section 6501(e)(1)(A) does not just mean an understatement but really means an omission. *Home Concrete & Supply, LLC*, 566 U.S. 478 (2012). There the Supreme Court concluded that the phrase should not be read to include an an amount of gain from sale of property which had been simply understated because of inflated basis, concluding that such a reading would give too much weight to "amount" and too little to "omits." *Id. at 485-86.* Similarly, a taxpayer does not omit an amount for purposes of applying the six year limitation period when the taxpayer overstates a deduction. *See The Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958).

Third, the six year period applies to the entire return once the Service discovers the 25% omission, and applies even if the Service discovers the omission during the normal three year limitation period. *Colestock v. Commissioner*, 102 T.C. 380 (1994).

The six year period also applies to personal holding companies and certain corporate returns. See §6501(f) and (g). Those provisions are beyond the scope of this presentation, which focuses on individual returns. Suffice to say that when either (a) the corporate return omits certain information or (b) United States shareholders of foreign personal holding companies have unreported dividend income, the IRS has six years to fix the error.

B. The Adequate Disclosure Safe Harbor

An item will not be treated as omitted if the taxpayer adequately discloses it either on the return or in documents filed with the return, even if the taxpayer does not include the item in calculating the taxes owed. §6501(e)(1)(A)(ii).

The seminal case on disclosure remains *The Colony, Inc. v. Commissioner*, 357 U.S. 28, 36 (1958) where the Supreme Court explained the rationale both for the existence of the six year period and for the disclosure safe harbor in this often quoted passage:

> *We think that in enacting [the predecessor statute to § 6501] Congress manifested no broader purpose than to give the Commissioner an additional two years [now three years] to investigate tax returns in cases where, because of a taxpayer's omission to report some taxable item, the Commissioner is at a special disadvantage in detecting errors. In such instances the return on its face provides no clue to the existence of the omitted item. On the other hand, when, as here, the understatement of a tax arises from an error in reporting an item disclosed on the face of the return the Commissioner is at no such disadvantage.*

To be adequate, a disclosure must be sufficiently detailed so that a decision whether to select the return for audit may be a reasonably informed one. While the disclosure need not be "a detailed revelation of each and every underlying fact" it must still be more than "a 'clue which would be sufficient to intrigue a Sherlock Holmes" but not *Quick Trust v. Commissioner*, 54 T.C. 1336, 1347 (1970), *aff'd*. 444 F.2d 90 (8th Cir. 1971). Thus, a disclosure of omitted income items may be adequate, even if it does not disclose the exact dollar amounts of the omission. *Id.*

Disclosure on a related party's return may or may not save an omission in the taxpayer's return.

On the one hand, disclosure on taxpayer's wholly owned C corporation return was not adequate disclosure of item omitted from taxpayer's individual return, even though the Service had actual knowledge of the relationship. *Mel Dar Corp. v. Commissioner*, T.C. Memo 1960-56, *rev'd on other grounds*, 309 F.2d 525 (9th Cir.), *cert. denied*, 372 U.S. 941 (1962). Likewise, income taxable to the beneficiary that is reported on the trust return is not, by itself, an adequate disclosure of the omissions on the beneficiaries' returns even though the Service knows the beneficiaries and trusts are "related." *Harlan v. Commissioner*, 116 T.C. 31, 53 (2001).

On the other hand, where the taxpayers' individual return specifically referred to income from their related S corporation, stated the name of the corporation, and attached the corporation's balance sheet that showed the amount of the corporation's undistributed income, that was adequate disclosure. *Benderoff v. United States*, 398 F.2d 132 (8th Cir. 1968).

C. Effect of Amended Returns on Six Year Period

An amended return disclosing the omitted income items may or may not affect the limitation period. Generally, amended returns do not affect the limitation period because there can be only one properly filed and completed return for any given tax period. . *Badaracco v. Commissioner*, 464 U.S. 386 (1984); *Zellerbach Paper v. Helvering*, 293 U.S. 172, 180 (1934). However, if a taxpayer files the original return before its due date, and *then* files a second return *also* before the original return's due date, the Service will process that second return as "the" return. See IRM 21.6.7.4.10 (03-18-2022)("Superseding Returns"); SCA 1998-024 (May 12, 1998)(applying the rule in *Haggar Co. v. Helvering*, 308 U.S. 389 (1940), that a timely amended return is treated for most purposes as the taxpayer's original return). Thus, while filing a superseding return does not change the date on which the return is considered filed, *see* Chief Counsel Advisory CCA 202026002 (June 26, 2020), the Service will process the information contained in the superseding return and that can thus correct any omissions made in the first return. On the other hand, if the taxpayer files an amended return after the original return's due date, the Service will apply the six year period.

III. Unlimited Periods for Assessment

A. Fraudulent Returns

If a taxpayer files a false or fraudulent return "with the intent to evade tax," § 6501(c)(1) allows the Service to assess the tax at any time. As with other exceptions to the normal three year limitation period, the Service bears the burden of proving fraud. §7454(a). *Anastasato v. Commissioner*, 794 F.2d 884, 889 (3rd Cir. 1986)("In a fraud case both the burden of production and the ultimate burden of proof are placed on the Commissioner."). This burden must be met by clear and convincing evidence, both as to the falsity of the return and the taxpayer's intent. *See e.g. Ishijima v. Commissioner*, T.C. Memo 1994-353. When husband and wife file jointly, the fraud of either one of them will allow the Service an unlimited time to assess and collect against either of them. *Aflalo v. Commissioner*, TC Memo 1994-596.

Similar to the rules governing the six year limitation period, a return which is false in any respect keeps the entire tax period open for an unlimited period. *Lowy v. Commissioner*, 288 F.2d 517, 520 (2nd Cir. 1961). Nor can the taxpayer reinstate the three year limitation period by filing an untimely nonfraudulent amended return. *Badaracco v. Commissioner*, 464 U.S. 386 (1984).

An unlimited period of limitation for assessment means exactly that. For example, even if the Service has already assessed and collected taxes and penalties for fraud, it may still assess and collect even more penalties without regard to either the assessment or collection limitation periods. *Gum Products Inc., v Commissioner*, 38 TC 700 (1962). However, even when the Service has an unlimited time for assessment, once it makes the assessment, the general 10 year period for collections in §6502 applies.

One recurring problem is determining whether the fraud of a tax return preparer should be attributable to the taxpayer. The statute is written in passive voice, referencing only a "fraudulent return." The Tax Court takes the position that the fraud of a tax return preparer is enough to give the IRS the unlimited period to assess. *Allen v. Commissioner*, 128 T.C. 37 (2007)However, fraud requires intent and returns are just things; they don't have intent. So whose mindset is important in determining fraud? Well, the better view is that it must be the taxpayer's intent to commit fraud. See Bryan Camp, *Presumptions and Tax Return Preparer Fraud,* 120 Tax Notes 167 (July 17, 2008)(Attached); Bryan Camp, *Tax Return Preparer Fraud and the Assessment Limitation Period,* 116 Tax Notes 687 (August 20, 2007)(Attached). This better view was adopted the Federal Circuit in *BASR Partnership v. U.S.*, 795 F.3d 1338 (Fed. Cir. 2015).

B. Unfiled Returns

If the taxpayer does not file a return § 6501(c)(3) allows the Service to assess the tax at any time. Unlike the fraud exception, the reasons or motive for the failure to file are irrelevant. Thus, the taxpayer can "cure" a failure to file by...filing a valid (though delinquent) return! So unlike the situation with filing a fraudulent return, once the taxpayer files a valid return when none has been previously filed, the normal three year period begins, even if the motive for not filing any return was to evade tax. *Bennett v. Commissioner*, 30 T.C. 114 (1958). If, however, the Service files a substitute for return on the taxpayer's behalf under its authority in § 6020(b), that is not a return filed by the taxpayer and the limitation period remains unlimited. See generally, Bryan Camp, *The Function of Forms in the Substitute-For-Return Process,* 111 Tax Notes 1511 (June 26, 2006)(Attached).

IV. Actions That Extend the ASED

A. Unilateral Actions By IRS or Taxpayer That Toll the ASED

1. Notices of Deficiency and Tax Court Petitions

When the Service finishes examining a taxpayer's income, gift, or estate tax return and concludes that the taxpayer owes more taxes (that is, has a deficiency in taxes paid), §6212 requires the Service to mail a Notice of Deficiency (NOD) to the taxpayer's last known address.[2] The taxpayer then has 90 days (or 150 days if the relevant NOD is addressed to a person outside the United States) to file a petition in the Tax Court. §6213. During that time the Service is

[2] "Last known address" is a term of art beyond the scope of this chapter. For the basics, see Treas.Reg. 301.6212-2.

prohibited from assessing the tax. If the taxpayer timely files a Tax Court petition, that prohibition extends until such time as the Tax Court's decision becomes final. There are certain exceptions to that prohibition but they are beyond the scope of this presentation. See e.g. §6851 (termination assessments); §6861 (jeopardy assessments).

It should not be surprising, therefore, that the limitations period for assessment is suspended during those time periods where the Service is prohibited from making an assessment. And indeed that is what you find in §6503(a).

Section 6503(a) suspends the assessment limitation period during any time the Service is prohibited from assessing or collecting tax after it issues a NOD, and for 60 days thereafter. In addition, §6503(a) suspends the assessment limitation period, regardless of the §6213 prohibition, from the time "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," and for the same 60 days thereafter. Although not explicitly addressed in regulations, it is now well settled that one tacks together the relevant periods of time to determine the effect of an NOD on the assessment period: the period remaining on the relevant assessment limitations period, plus the period during which the IRS is prohibited from making an assessment, plus the 60 day grace period. See e.g. *United States v. Anderson*, 169 F. Supp. 2d 952 (N.D. Ind. 2001)(collecting cases illustrating principle).

If the taxpayer does not file a Tax Court petition, the calculation is relatively simple. If the taxpayer *does* file a Tax Court petition, it gets more complex because you have to figure out when the decision of the Tax Court becomes final. Section 7481 gives general rule that the decision becomes final *"upon the expiration of the time allowed for filing a notice of appeal, if no such notice has been duly filed within such time."* The final date of the Tax Court decision is important even when the taxpayer has filed an untimely petition and is dismissed for that reason.

An untimely petition—whether filed too early (before the Notice of Deficiency) or too late (after the 90 period has run—is nonetheless effective to invoke and the §6503(a) suspension on the assessment period. *See Martin v. Commissioner*, 436 F.3d 1216 (2006)(collecting cases)

In order to extend the assessment limitation period, the Service must issue a valid NOD. What constitutes a valid NOD is beyond the scope of this presentation. Suffice to note that generally an NOD is valid when it is not facially defective and when it is addressed to the taxpayer's last known address. Even if defective, however, an NOD can still be valid and trigger both the §6213(a) prohibition on assessment and, therefore, the §6503(a) suspension of the ASED, if it does not prejudice the taxpayer. For example, when an NOD is not sent to the last known address but is actually received by the taxpayer who timely files a Tax Court petition, the NOD is valid. *See e.g. St. Joseph's Lease Capital Corp. v. Commissioner*, 235 F.3d 886 (4th Cir. 2000)(no prejudice where taxpayer actually received misaddressed Notice of Deficiency and filed a timely petition).

2. Summonses

A summons is one method the Service uses to get information relevant to determining a tax liability. The Service may issue summonses to either the taxpayer per §7602, or to persons other than the taxpayer (called "third parties"), per §7609. In certain circumstances, either type of summons can suspend the ASED.

First, as to summonses issued to taxpayers, §6503(j) permits the Service to unilaterally extend the ASED by following a certain procedure for issuing a special type of summons called a designated summons. The rules are pretty gnarly and relate only the summonses issues with respect to the examination of a corporate return, so they are beyond the scope of this presentation.

More germane to this presentation is how some summonses issued to third parties can also suspend the applicable ASED. Section 7609 contains special provisions governing how and when the Service may summons information from a person other than the taxpayer. Section 7609(a) requires that before the Service can issue a summons to a third party, the Service must give notice to the taxpayer as well as to any person (other than the summoned person), who is identified in the summons. Section 7609(b) allows any person who is entitled to notice under § 7609(a) both a right to intervene in any summons enforcement proceeding and a right to petition a district court to quash the summons. That means both the taxpayer and other third parties who may be identified in the summons have an opportunity to be heard in court *before* the summons is enforced.

The issuance of third-party summons might suspend the ASED under two circumstances. First, if the taxpayer (or any third party under the taxpayer's control) takes action as permitted by §7609(b), then §7609(e) suspends the assessment limitation period (and, FWIW, the §6531 limitation period for criminal prosecution) for the period *"during which a proceeding, and appeals therein, with respect to the enforcement of such summons is pending."* Whether a third party will be considered under the taxpayer's control is a facts and circumstance test, found in Treas. Reg. 301.7609(b). For example, a corporation may well be under the taxpayer's control even if the taxpayer is a shareholder with less than 50% of the voting power, depending on the distribution of stock and size of the corporation. If, however, anyone other than the taxpayer or a third party under the taxpayer's control takes action as permitted by § 7609(b), the limitation period is not suspended.

The second way a third-party summons might suspend the ASED is when the summoned party has not complied with the summons after six months. §7609(e)(2). The suspension begins on the date six months after service of the summons and ends only with the "final resolution" of the summoned party's response. The Tax Court has held that the stipulation between the parties that a summons which had been issued and not complied with had been issued in error because the information needed to be obtained through letter rogatory was not a final resolution within the meaning of §7609(e)(2) when the United States had filed a petition to enforce the summons. It was only when the court entered its order dismissing the summons enforcement proceeding that the suspension period in §7609(e)(2) eneded. *Ishler v. Commissioner*, TC Memo 2002-79.

Example 5: The IRS is investigating the tax liability of N. Ron DeBakle. It issues a summons to a bank asking for "all records regarding the loan issued to N. Ron DeBakle and Arthur Anderson. Section §7609(a) entitles both DeBakle and Andersen to notice of the summons and so § 7609(b) allows both of them to either intervene or file a petition to quash. The limitation period is suspended if DeBakle intervenes or files a petition to quash. The limitation period may or may not be suspended if Andersen acts, depending on whether the facts and circumstances show that DeBakle has either the *de facto* or *de jure* ability to cause Andersen to act.

3. Request For Prompt Assessment

Ordinarily, the Service has three years after a taxpayer files an income or gift tax return to assess additional tax. Section 6501(d) permits the fiduciary of an estate to ask for what is known as a "prompt assessment" of any income or gift tax (but not estate tax) for which the decedent or the estate may be liable and for which a return was been filed. The request must satisfy the requirements of Treas.Reg. 1.6501(d)-1.

In theory §6501(d) says that taking this action will limit the assessment period to the lesser of 18 months from the date the fiduciary files the request or the time remaining on the normal three year assessment period.

The practice may be different. What I hear from folks who have done this is that the IRS has been responding to requests for prompt assessment with a letter that basically says "looks good to us but we reserve the right to examine this more closely." And, as the regulations make clear, such requests are ineffective to shorten either the special §6501(e) six year assessment period or the unlimited assessment periods in § 6501(c)(1)-(3). Treas.Reg. 1.6501(d)-1.

4. Receivership Proceedings (other than bankruptcy)

Section 6036 requires any person appointed as a receiver by a federal or state court, and any person serving in a similar fiduciary capacity, to notify the Service of the appointment as provided by regulations. Treas.Reg. 1.6036-1 extends the requirement to any assignee for the benefit of creditors and requires all such fiduciaries who gain control of all or substantially of the taxpayer's assets to notify the Service within 10 days of their appointment or assumption of fiduciary status. Section 6871 authorizes the Service to make immediate assessments of any outstanding deficiency in bankruptcy or receivership proceedings. Section 6872 provides that the assessment limitation period is suspended for up to two years from the date the fiduciary notifies the Service under the §6026 regulations, if necessary, to allow the Service to make the necessary assessments.

5. Request for Administrative Review of Proposed Section 6672 Penalty

Section 6672(a) authorizes the Service to assess a penalty against any person who is required to collect, account for, and pay over any tax who willfully fails to do so. Section 6672(b) requires the Service to give a preliminary notice of the Service's intent to make such an assessment.

Section 6672(b)(1) prohibits the Service from making the assessment until the person has an opportunity to protest the proposed assessment and obtain administrative (but not judicial) review. Similar to the rules for NODs, §6672(b)(3) suspends the assessment limitation period for the period starting with the date that the Service delivers the preliminary notice and ending with the later of 90 days after the preliminary notice was mailed or 30 days after a final administrative determination with respect to the taxpayer's protest.

B. Bilateral Actions By IRS <u>And</u> Taxpayer That Toll the ASED: Of Consents

1. Consents That Extend The Limitation Period

Section 6501(c) permits the taxpayer and the Service to agree to extend any assessment limitation period for income or gift tax (but not estate tax) as long as the agreement is made before the period otherwise ends, either because of the statute or because of a prior agreement. See also Treas. Reg. 301.6501(c)-1(d). For example, an agreement extending the limitation period is valid when executed after the three year assessment period but within the six year assessment period when the Service proves that the six year period applies because the taxpayer omitted more than 25% of its gross income from the return. *Azevoda v. Commissioner*, 246 F.2d 196 (9th Cir. 1957). The Service generally has the burden of proving the validity of the consent because it is generally the party who seeks and relies upon the consent. *See e.g. Adler v. Commissioner*, 85 T.C. 535, 540 (1985). But remember that taxpayers always bear the ultimate burden of proof on a statute of limitation defenses. *Feldman v. Commissioner*, 20 F.3d 1128, 1132 (11th Cir. 1994).

A consent to extend the assessment limitation period is not a contract, but rather a unilateral waiver of a defense by the taxpayer. *Florsheim Bros. Dry Goods v. United States*, 280 U.S. 453 (1930). *"Contract principles are significant, however, because section 6501(c)(4) requires that the parties reach a written agreement as to the extension." Piarulle v. Commissioner*, 80 T.C. 1035, 1042 (1983). Accordingly, Treas.Reg. 301.6501(c)-1(d) requires signatures of *both* the taxpayer and an authorized Service employee. Moreover, the same regulation requires that the consent be executed by both the taxpayer and the Service *before* the prior period has ended.

The two most frequent forms used to obtain the taxpayer's consent to extend the assessment period are Forms 872 and 872-A. Form 872 is very basic and straightforward. By signing it, the taxpayer agrees to extend the assessment limitation period for the listed tax periods to a date certain. Once signed, neither the Service nor the taxpayer need take any further action to terminate the extension.

In contrast, the Form 872-A is twisty. It is used for special consents where the parties want to leave the limitation period open for an indefinite period of time or want to hold the assessment period open only as to certain items or taxes. For Forms 872-A taxpayers bear the burden to prove what special subject matter restrictions are contained in the Form 872-A. *Schulman v. Commissioner*, 93 T.C. 623, 638-639 (1989)(collecting cases) The Service has published guidance on procedures governing the use of restrictive language in Form 872-A. Rev. Proc. 68-31, 1968-2 B 917, *modified by* Rev. Proc. 77-6, 1977-1 CB 539.

The most dangerous aspect of the Form 872-A is how it lasts and lasts. It is the Energizer Bunny of consents: unless either the Service or the taxpayer terminate it, the consent keeps on going and going. It lasts beyond any reasonable period that the Service may need to assess. *St. John v. United States*, 951 F.2d 232 (9th Cir. 1991)(reversing jury finding that the Service had not assessed within a reasonable time). It lasts beyond the biblical seven years. *Mecom v. Commissioner*, 101 TC 374 (1993)(seven years elapsed between consent and assessment). It lasts beyond death. *Herr v. Commissioner*, TC Memo 1992-88 (taxpayer died during eight years between consent and assessment).

The form itself contains a termination clause. Under the terms of the clause, the assessment period will end 90 days after either the Service or the taxpayer acts to trigger the 90 day termination period. The Service can trigger the termination clause by either (a) mailing a Form 872-T (Notice of Termination of Special Consent to Extend the Time to Assess Tax), to the taxpayer's last known address; or (b) mailing a proper Notice of Deficiency to the taxpayer's last known address. The taxpayer triggers the termination clause *only* when the taxpayer files a Form 872-T with the Service office considering the case. Note that no party can bring the assessment period to an immediate end. The most either party can do is trigger the 90 day termination period, so that the Service always has at least 90 days to act before the extended assessment period ends.

Courts pretty much hew to these terms of the Form 872-A. Thus, signing a later Closing Agreement which imposes a date certain for assessment will not terminate a Form 872-A. *Hempel v. United States*, 14 F.3d 572 (11th Cir. 1994)(Form 872-A kept assessment period open even when taxpayer and Service had entered into a Closing Agreement which gave the Service only one year to assess additional taxes). Nor will executing a new Form 872 terminate the old 872-A. *Kernen v. Commissioner*, 902 F.2d 17 (9th Cir. 1991). *But see Fredericks v. Commissioner*, 126 F.3d 433 (3rd Cir. 1997)(IRS could not use prior Form 872-A when it repeatedly represented to taxpayer that it did not have that Form 872-A and then entered into a series of Form 872 extensions). Filing bankruptcy will not trigger the 90 day termination period, either. *Bilski v. Commissioner*, 69 F.3d 64 (5th Cir. 1995).

The Service can trigger the 90 day termination period only by mailing either a properly executed Form 872-T or a properly executed NOD to the taxpayer's last known address. Thus, an NOD not properly addressed will be ineffective to trigger the 90 day termination period. *Coffey v. Commissioner*, 96 TC 161 (1991). This result prevents the taxpayer from claiming that an NOD is invalid to extend the assessment limitation period per § 6213(a), (discussed above) but valid to termination the From 872-A extension of the assessment period. The basic idea is that only a valid NOD will also trigger the Form 872-A 90 day termination period.

The taxpayer can trigger the 90 day termination period only by filing a properly executed Form 872-T with the proper Service office. THe usual physical delivery rule applies.

A Form 872-T from the taxpayer is not effective until received by the Service office handling the matters covered by the Form 872-A. *Coggin v. Commissioner*, 71 F.3d 855 (11th Cir. 1996); *see also* Rev.Proc. 79-22, 1979-1 CB 563.

The Form 872 series are the usual forms used to extend the assessment limitation period. However, other forms, used to implement provisions of other statutes, may also be effective to extend the assessment limitation period. For example Form 5214 is used to make the § 183(e) election to postpone a determination of whether a taxpayer is engaged in an activity for profit. The Tax Court has held that this form is effective to extend the assessment limitation period, notwithstanding that the form is signed only by the taxpayer and is unsigned by the Service. *Wadlow v. Commissioner*, 112 TC 247 (1999). *See also Grapevine Imports, Ltd. v. U.S.*, 71 Fed. Cl. 324 (Fed. Claims 2006)(collecting cases and noting that similar provisions *"have consistently been construed to be ameliorative, not prohibitive, that is, they do not represent exclusive statutes limiting the IRS, but rather minimum periods that Congress has prescribed to ensure that the IRS has sufficient time to perform certain tasks, including scrutinizing particular types of transactions."*).

2. Consents that Shorten the Assessment Period: Forms 870, 870-AD, Stipulated Decisions

In certain cases, taxpayers can ***shorten*** the assessment period by consenting to an immediate assessment and waiving the protections of § 6213. The effect of such consents on the limitation period depends on whether the taxpayer consents to immediate assessment before or after filing a Tax Court petition.

After the Service issues an NOD, the taxpayer has 90 days to file a Tax Court petition. Taxpayers may sometimes prefer to waive their opportunity to go to Tax Court and have the Service immediately assess the deficiency. For example, the taxpayer and the Service may come to some agreement compromising the proposed deficiency. In such cases taxpayers and the Service may use one of the Forms 870 to memorialize the agreement.

As with the Form 872 series, the Form 870 series comes in multiple flavors. The two most common are the 870 and the 870-AD. The Form 870 is plain vanilla. The Service routinely encloses one with every Notice of Deficiency. By signing it the taxpayer consents to an immediate assessment of the deficiency. However, both the taxpayer and the Service reserve all their legal rights. As to the taxpayer, they reserve the right to file a refund claim. As to the IRS, it reserves the right to assess more deficiencies if it finds them.

Taxpayers may attach conditions to the Form 870, however, which the Service must either accept or else reject by issuing a Notice of Deficiency. A famous case where the IRS messed it up is *Philadelphia & Reading Corp. v. United States*, 944 F.2d 1063 (3rd Cir. 1991). There a $10 million assessment was illegal because the Service ignored one of the conditions in the Form 870 by immediately assessing the tax after receiving taxpayer's executed Form 870 when the condition was that the IRS had to wait until a related refund had been approved.

The Form 870-AD is more complicated. It is not binding on either party in the same way a Closing Agreement entered into pursuant to §7121 is binding. But when signing a Form 870-AD, taxpayers agree not to file a refund claim and the Service agrees not to reopen the tax period (except for fraud). These provisions can therefore form the basis of an estoppel argument against the taxpayer's attempt to obtain a refund once the assessment limitation period has run. *See e.g. Ihnen v. United States*, 272 F.3d 577 (8^{th} Cir. 2001).

Regardless of their differences, the effect of both the 870 and 870-AD is to *shorten* the assessment period by terminating the § 6503(a) suspension period for the time in which the taxpayer is allowed to file a Tax Court petition (this is the 90 or 150 day period provided by § 6213). The IRS explains in Rev. Rul. 66-17, 1966-1 CB 272:

> *A waiver of the restrictions on assessment and collection of a deficiency given pursuant to section 6213(d) of the Internal Revenue Code of 1954 terminates the 90-day suspension of the period of limitations on assessment and collection provided by sections 6213(a) and 6503(a)(1) of the Code and starts the 60-day suspension period provided by section 6503(a)(1) of the Code.*

Both forms become effective when received by the proper Service office. The signature of a Service employee is not required so long as the taxpayer signs and returns the standard form and attaches no conditions to it. Rev. Rul. 66-17.

In contrast to pre-petition consent to immediate assessment, consents executed after a Tax Court petition is filed do not affect the assessment limitation period. Thus, if the taxpayer files a Tax Court petition and then they and the IRS enter into a stipulated decision (whereby the taxpayer is consenting to immediate assessment of that amount), that does not shorten the otherwise applicable tolling of the ASED. *Pesko v. United States*, 918 F.2d 1581 (Fed. Cir. 1990).

TaxProf Blog

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Lesson From The Tax Court: *Counting The Days*

By Bryan Camp

Most people know that the IRS generally has three years to audit a return. Calculating the proper three-year period, however, requires close attention to both the start date and the end date. You need to count those days properly. I tried to drill into my students the practice of always consulting a calendar when attempting to calculate the proper dates. Christian Renee Evert v. Commissioner, T.C. Memo. 2022-48 (May 9, 2022) (Judge Marshall), reinforces that teaching: to calculate the period in which the IRS can assess a tax, you need to properly count the days in the three year period.

Law: Calculating The Assessment Period Expiration Date (ASED)

We start with §6501(a) which says that *"the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed)...."* Section 6072 tells us that the date prescribed for individual income tax returns is April 15th. April 15th is also called the statutory due date, 'cause it's right there in the statute, doncha know.

But the statute does not really mean what it says. The ASED does not always start on the date the taxpayer files their return. Despite that parenthetical language in §6501(a), the ASED does indeed depend on whether the taxpayer has filed their return on or after the date prescribed, thanks to the interplay of three statutes: §6501(b)(1); §7503; and §7502.

First, early is on-time: §6501(b)(1). Section 6501(b)(1) provides that any return *"filed before the last day prescribed by law or by regulations promulgated pursuant to law for the filing thereof, shall be considered as filed on such last day."* It's a deemer rule.

How does this affect the ASED? It means that one ignores the actual date of filing for returns filed *before* the statutory due date. Sorry, but anxious taxpayers cannot speed up the ASED by filing early. Returns filed in February or March or anytime before April 15th are deemed filed on April 15th and it's that date that triggers the 3-year period.

Second, late is sometimes on-time: §7503. Section 7503 provides that when the last day "for performing any act" falls on a Saturday, Sunday or legal holiday, then *"the performance of such act shall be considered timely if it performed on the next succeeding day which is not a Saturday, Sunday, or a legal holiday."* We all know what Saturdays and Sundays are, but the statute further instructs us that *"for purposes of this section...the term "legal holiday" means a legal holiday in the District of Columbia."* Don't ask me why. The official list of federal holidays is over in 5 U.S.C. §6103. Perhaps those who wrote §7503 did not know that? I would welcome any comments on why the statute makes "legal holiday" mean holidays in Washington D.C.

The reason it can be important is because D.C. has a local holiday called Emancipation Day. On April 16, 1863, Abraham Lincoln signed the Emancipation Proclamation and immediately freed about 3,600 people in D.C. In 2005, DC made that an official public holiday...in D.C. Consistent with 5 U.S.C. §6103(b), when the 16th fall on a Saturday, the holiday is celebrated on Friday and when the

16th falls on Sunday, the holiday is celebrated on Monday. Hey, we would not want to waste a good holiday on the weekend, right?

How does all this affect the ASED? It doesn't! And that's what's tricky. Section 7503 does not change the statutory due date, nor is it a deemer rule like §6501(b)(1). When a taxpayer's return is timely because of §7503, that is not because the return is deemed filed on the statutory due date. It's filed when it's filed! All §7503 does is make the filing timely. The Tax Court says that the point of §7503 is to cut taxpayers a break when the due date falls on a day when IRS offices are closed and IRS employees won't be at work. Again, it does not change the statutory due date, it just excuses the late filing. *See* Winkler v. Commissioner, 56 T.C. 844, 847 (1971). The IRS agrees, writing:

> *"The purpose of section 7503 is to extend the time for filing a document when the last day for filing the document would be a Saturday, Sunday, or legal holiday. Section 7503 does not change the date prescribed for performing an act, nor does it provide that an act performed on the day following a Saturday, Sunday, or legal holiday will be deemed to have been performed on the actual due date." Rev Rul 81-269.*

The Rev. Rul.'s reasoning applies as well to other types of extensions, such as those granted to individual taxpayers in response to a Form 4868 or granted to groups of taxpayers under the Service's authority in §7508A. Those extensions allow taxpayers to avoid penalties for late filing, but do not alter the statutory due date and, thus, do not trigger the "early is deemed on-time" rule in §6501(b)(1). See Estate of Mitchell v. Commissioner, 103 T.C. 520, 523 (1994), aff'd in relevant part, 250 F.3d 696 (9th Cir. 2001). There the IRS gave taxpayer an extension of time to file and taxpayer mailed return before the end date of the extension and the return was received on the last day of the extension. The Court held that §7503 did not apply and the ASED started running from end date of the extension, and not from the earlier date when the Estate's return was mailed.

Let's see if I can give an example without messing up. Say April 15th falls on a Sunday. In that case §7503 allows returns filed on Tuesday the 17th to be treated as timely filed (remember the 16th is Emancipation Day). But that does not change the statutory due date. Thus, a taxpayer who files their return on Monday the 16th is timely, even though filing after the statutory due date. Similarly, a taxpayer who files on Tuesday the 17th files timely. But neither filing gets the §6501(b)(1) deemer rule because neither is filed on or before the statutory due date of April 15th. Thus, the ASED in each case ends three years after the day the return is actually filed (the 16th or 17th). Burnet v Willingham Loan & Trust Co, 282 US 437 (1931) (a great short rumination on the nature of time by the sainted Justice O.W. Holmes).

Ok. If I messed that up, please tell me in the chat. But be kind!

Note, however, that the while §7503 does not alter calculation of the ASED it does alter the calculation of the §6511(b) (2)(A) 2 or 3 year lookback rule for refund claims. See Lesson From The Tax Court: *The Refund Lookback Period Trap* TaxProf Blog (Aug. 23, 2021).

Third, late is sometimes early, and so is sometimes on-time! §7502, §6501(b)(1).

Ugh. This is weird. Hang in there. Sometimes a late-filed return will be deemed an early-filed return and, then, thanks to §6501(b)(1), will be deemed to have been filed on time. I call this the double-deemer rule, or "Deemer, Deemer" as Mork might say (instead of Nanu, Nanu) if he had come to Earth as a tax practitioner.

The trouble is that §6501 does not define the word "filed." So we go to case law, which establishes the general rule that returns are filed when they are received in the proper office for processing them. That's called the physical delivery rule. *See* Bongam v. Commissioner, 146 T.C. 52 (2016).

Some courts stretch that concept, such as the recent case of Seaview Trading, LLC v. Commissioner, --- F.4th --- (9th Cir. 2022) (return was filed when taxpayer gave a copy to IRS employee whose job was to collect delinquent returns although not to process them). You can find a good discussion of that case on this Procedurally Taxing Blog Post. And your return may be deemed filed even if the IRS rejects the first attempt. See Lesson From The Tax Court: *Taxpayer 'Filed' Return Even Though IRS Could Not Process It*, TaxProf Blog (Dec. 6, 2021). If you file by mail, you can request a return receipt that shows the date of receipt.

Bottom line: if the return was physically received on or before the statutory due date, then §6501(b)(1) deems the return to have been filed exactly *on* the statutory due date. See also Treas. Reg. 6501(b)-1(a). No need for further analysis.

If, however, the return was physically received *after* the statutory due date, you *do* need further analysis. That is because §7502(a)(1) provides that when a document is received late, then *"the date of the United States postmark stamped on the cover in which such return, claim, statement, or other document, or payment, is mailed shall be deemed to be the date of delivery..."* but only if *"the postmark date falls within the prescribed period or on or before the prescribed date.. "* §7502(a)(2)(A).

Yes folks, this is the famous "Mailbox Rule" that I have blogged about multiple times, most recently in Lesson From The Tax Court: *A Timely Lesson For Filing Returns*, TaxProf Blog (May 17, 2021). Today's lesson is not a mailbox rule lesson, however. Whew!

The point here is that if the mailbox rule applies, then you get the double deemer. That is, the date of filing will be the statutory due date, *regardless* of the actual date of mailing. That is because the mailbox rule first deems the return filed on the day of mailing, but then comes §6501(b)(1) and deems the now early-filed return as being filed on the statutory due date. So once again it is the statutory due date that triggers the 3-year period to calculate the ASED.

But remember, the mailbox rule is a *rescue* rule. It does not apply if the taxpayer's filing is timely. For example, when the taxpayer gets an extension of time to file and the return is received by the IRS before the last day of that extension, the ASED starts on the day the return is received and not the day it was mailed. *See* First Charter Fin. Corp. v. United States, 669 F.2d 1342, 1346–1347 (9th Cir.1982).

Let's look at two examples to see how the double deemer works and does not work.

Example 1: April 15th falls on a Saturday, the taxpayer properly mails their return on Friday the 14th, and the IRS receives the return on Wednesday the 19th. Section 7502 first deems the return to have been filed on April 14th. That's early. So §6501(b)(1) then deems that early filed return to have been filed on the statutory due date. Deemer-Deemer! The ASED period is triggered by April 15th.

Example 2: Same facts only the IRS receives the return on Monday the 17th. Now the return is not late, thanks to the extension given by §7503 (if you don't see that, go re-read above analysis). But *because* the return is not late, the mailbox rule does not apply. No deemed mailing-as-filing. And remember that §7503 does not alter the statutory due date. So the return is filed after the statutory due date and does not get the early-deemed-timely rule either. Thus it is Monday the 17th that triggers the 3-year period to calculate the ASED. See Rev. Rul. 81-89.

Law: Extending the ASED.

Assessments made after the ASED are void. *See Parsons Corp. v. United States*, 659 F. Supp. 48 (C.D. Cal. 1987) (illegal assessments are void and not merely voidable). There are two common ways that the IRS extends the ASED.

First, it sends out an NOD. For Income, Estate, and Gift taxes, the IRS may not assess a deficiency it finds until it sends the taxpayer a Notice of Deficiency (NOD) which then permits the taxpayer to seek pre-assessment review in Tax Court. §6212, §6213. It is not surprising, therefore, that sending out the NOD will toll the assessment period until after the taxpayer either fails to file a Tax Court petition or the decision of the Tax Court becomes final. §6503(a).

Second, it asks for consent. When a taxpayer's return is under audit and time is running out on the ASED---but the IRS has not completed the examination---the IRS employee working the case may ask the taxpayer to extend the ASED for a set amount of time, using Form 872. The IRM says extensions should not be requested as a matter of routine, but only under certain circumstances. One of those is when *"examination will expire within 180 days and there is insufficient time to complete the examination and the administrative processing of the case."* IRM 25.6.22.2.1 (11-17-2021). Further the IRM instructs Exam employees to offer opportunities for non-docketed protests to Appeals only when there are *"at least 365 days remaining on the statute of limitations when the case is received by Appeals." Id.*

When the IRS seeks the taxpayer's consent to extend the ASED, it sends the taxpayer a letter explaining the reason for the request, a Form 872 to fill out, and IRS Publication 1035 which is a four-page pamphlet that explains the taxpayer's options. There are different versions of Form 872, but all of them serve the same purpose: to extend the ASED by agreement.

As with all other types of agreements, the Form 872 will not be a valid extension if the taxpayer was forced to sign the Form under duress. The Tax Court has long permitted taxpayers to attack the validity of extensions on the basis of duress. Diescher v. Commissioner, 18 B.T.A. 353 (1929)(finding that the parties "were not dealing with each other at arm's length" and that the taxpayer "was not acting with a free will, but was coerced by" the IRS). Once the IRS shows the Tax Court a facially valid Form 872, the taxpayer carries the burden to show why it is invalid, such as showing duress. Id.

Judge Marshall gives this great summary of what is and is not duress:

> *"We have also held that actions that deprive another of her freedom of will are distinguishable from legally authorized actions that merely limit another to choose between options that are not desirable. Hence, it is not duress when the Commissioner makes statements informing a taxpayer that lawful means to assess and collect the tax will be used. Accordingly, we have held that a taxpayer did not sign a consent under duress when the Commissioner told the taxpayer that an opportunity for an IRS Appeals conference would not be allowed if the taxpayer failed to sign a consent."* Op. at 7 (quotes and citations omitted).

Facts

Ms. Evert timely filed her return for tax year 2015. The opinion is silent on what made it timely. I'll come back to that.

At a time not given in the opinion the IRS selected her 2015 return for audit and apparently concluded the audit quickly because the first date we get in the opinion's statement of facts is that *"on April 23, 2018, petitioner's IRS Appeals case was assigned"* to an Appeals Officer (AO). Working backwards we can assume that the assignment likely occurred about three months after Ms. Evert asked for an Appeals conference. That was the average time for Exam to transfer a protest to Appeals, according to this 2018 GAO study (see p. 2). If that is true then at the time Ms. Evert requested an Appeals review, there remained more than 365 days until the ASED.

The AO sent out the initial contact letter the same day and worked with Ms. Evert during May, June and July. Ms. Evert communicating and kept promising additional information and apparently provided some. On August 2nd, with about 256 days remaining until the ASED, the AO asked Ms. Evert's consent to extend the ASED by sending her the standard package of the request letter, the Form 872, and the IRS publication.

Ms. Evert signed and returned the Form 872, agreeing to extend the ASED until April 15, 2020. After that, it is not clear what, if anything, happened. The opinion says only that *"AO Mack continued to provide petitioner with the opportunity to present her positions and supporting documents in IRS Appeals for several months."* Op. at 5. The opinion does not say whether Ms. Evert took advantage of the opportunities.

On April 17, 2019, the AO issued an NOD. Ms. Evert timely filed a Tax Court petition.

Lesson: Counting The Days

Ms. Evert raised two issues: (1) the NOD was issued after the ASED had passed; and (2) her Form 872 consent was invalid because it had been signed under duress. Both issues involve counting the days.

Issue 1: Was the NOD Untimely (Absent the Consent)?

Remember that the opinion says only that Ms. Evert timely filed her 2015 return. It does not explain why the return was timely. That might matter because when you look at the calendar for that year, you see that April 15th was a Friday. That means it was Emancipation Day in D.C. and so, thanks to §7503, returns filed on Monday April 18th would be timely.

On the one hand, that means that for returns filed on Monday, you would count that day, Monday the 18th, as triggering the 3-year assessment period. Ms. Evert might have mailed her return on Saturday the 16th in which case she would get the timely-mailing-is-timely filing rule. But it would be Monday the 18th that started the ASED, which means the April 17, 2019 NOD would be timely. The IRS would not need to rely on the validity of the Form 872 consent to extend the limitation period.

On the other hand, the IRS Chief Counsel attorney conceded this issue! Judge Marshall wrote: *"the parties agree that... the three-year limitations period ... would have expired before the date on which respondent mailed the notice of deficiency for tax year 2015."* Op. at 6. We can assume from that concession that Ms. Evert filed her 2015 return before April 15, 2016 and so received the §6501(a)(1) early return deemer rule. Or perhaps she properly mailed the return on or before April 15th and it was received by the IRS *after* Monday April 17th thus giving her the double deemer rules. Either way, the ASED would be April 15, 2019 and the NOD was untimely. Rev. Rul. 81-89.

Ya gotta count the days.

Issue 2: Was the Consent Valid?

Ms. Evert's duress argument was a stretch. She testified that the AO pressured her into signing the Form 872. The AO testified that he did not do so. Judge Marshall believed the AO for reasons she gives in the opinion.

In this case, the objective facts supported the AO's testimony. The most important fact again has to do with counting days. When the Tax Court has found duress, it sometimes appears important that the consent was sought when only a few days were left until the ASED. *Robertson v. Commissioner*, T.C. Memo. 1973-205. That fact made a taxpayer's claim of being unduly pressured much more plausible.

In this case, however, more than 240 days remained when the AO sent the request to consent to extend the ASED. There was no reason at all to pressure Ms. Evert because if she had refused the AO had plenty of time to simply issue the NOD using the information at hand. In fact, at that time, Ms. Evert's case was not even at the 180-day mark when it would be put into an red folder and become priority workflow. IRM 8.21.1.4 (04-12-2019). That objective fact made Ms. Evert's testimony less plausible and the AO's testimony more plausible.

Ya gotta count the days.

Bryan Camp is the George H. Mahon Professor of Law at Texas Tech University School of Law. You can count the days until another Lesson From The Tax Court *appears, as it comes around on TaxProf Blog each Monday unless Monday is a Holiday in which case it Tuesday is deemed Monday!*

Doc 2007-18071 (21 pgs)

Tax Return Preparer Fraud and the Assessment Limitation Period

by Bryan T. Camp

Full Text Published by taxanalysts

Bryan T. Camp is a professor of law at Texas Tech University School of Law.

This column generally explores the laws and policies of tax administration to help guide readers through the thickets of particular procedural problems while also giving them a sense of the larger tax administration forest.

Prof. Camp sincerely thanks the ever-shy anonymous for his (or her) comments on a draft of this column. He remains responsible for all errors the reader may find and promises to do better next time. Prof. Camp dedicates today's column to Prof. Leandra Lederman, for whose guidance in the weirdly wonderful world of academics he shall always be grateful.

* * * * *

I have a confession: I can't spell. Not that you can tell from my columns, where I successfully hide behind the spell-check function and the good efforts of Tax Analysts' editors. How bad am I? Well, in sixth grade I won the English prize, but instead of the usual plaque, they gave me a dictionary. I still have it. It does not help. True, I use the dictionary when I am unsure of a word, but that is not the problem. The problem is that I *do not* use it when I am *sure* of a word, which then turns out to be misspelled. I would be a better speller if I were not so self-confidant (get it?). I suspect that many of you, dear readers, have some similar foible that shows only when you are the most certain it cannot.

So the fact that a very confident, unanimous Tax Court decided, in *Allen v. Commissioner*, 128 T.C. 4, *Doc 2007-5704, 2007 TNT 44-11* (Mar. 7, 2007), that the fraud of a tax return preparer keeps the assessment limitation period open against the taxpayer, regardless of the *taxpayer's* knowledge or intent, does not itself add any power to the court's decision. If anything, it makes me suspicious that the court misspelled the law. In today's column, I want to review carefully the general limitation period imposed on assessments in section 6501(a) and the section 6501(c) exception to it for fraudulent returns. Although now codified in the same statute, each provision has a different origin and meaning. The idea expressed in section 6501(a) dates back to 1866, while the idea expressed in section 6501(c) came into the statutes in 1918, using language derived from the fraud penalty.

My thesis is that the section 6501(a) assessment limitation period represents a very strong public policy choice in favor of closure, far stronger than a typical statute of limitation. Accordingly, I believe the fraud exception should be read to refer to the taxpayer's fraud and not the fraud of a third party such as a return preparer. I save for another day a complete review of the *Allen* opinion, including the very interesting policy issues it raises. For now I just want to explain why I think the assessment limitation period is best interpreted as a statute of repose and what that might mean for interpretive issues such as the one presented by *Allen*. Part I reviews the statutory language and current judicial interpretation of section 6501(a). Part II reviews its legislative history to show how it has evolved into what I submit is tantamount to a statute of repose. Part III reviews the history of the various fraud provisions to show how and when the section 6501(c) exception to the normal three-year limitation period for fraudulent returns first arose in 1918. Putting those parts together shows, I think, how the fraud exception historically has referred to fraud committed by the taxpayer liable for the tax.

I. Structure and Interpretation of Section 6501(a)

The idea of an annual accounting is fundamental to tax administration.[1] Our system relies on taxpayers to make the initial accounting, with a large dollop of third-party reporting to encourage accuracy. Taxpayers make their reports on the "forms and regulations prescribed" by the IRS.[2] As I have explained time and again in prior columns, taxpayers do not "self-assess" their taxes. The IRS makes the assessment, and just because it has made the institutional decision to exercise its section 6201(a) authority to accept returns as filed does not mean it is any less the IRS's judgment. Taxpayers report. The IRS assesses. Nor does the assessment *create* the liability: It just reflects the liability that arises as of the close of the annual accounting period.[3]

The taxpayer's initial accounting is not final. Nor should it be. The IRS needs some time to review and correct returns for errors caused both by honest mistakes and by attempts to game the system. It is for that reason that "a statute of limitation is an almost indispensable element of fairness as well as of practical administration of income tax policy."[4] At the same time, however, statutes of limitation "are by definition arbitrary, and their operation does not discriminate between the just and the unjust claim, or the voidable and unavoidable delay. They come into the law not through the judicial process but through legislation. They represent a public policy about the privilege to litigate."[5] So the tax administration question is what public policy should govern how much time the IRS gets to catch errors and omissions. Over the years Congress has given different answers to fit changing circumstances.

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[1] *Burnet v. Sanford & Brooks*, 282 U.S. 359, 365 (1931). ("It is the essence of any system of taxation that it should produce revenue ascertainable, and payable to the government, at regular intervals.")

[2] Section 6011(a).

[3] I give the tedious explanation of these points in Bryan T. Camp, "The Failure of Adversary Process in the Administrative State," *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=997475.

[4] *Rothensies v. Electric Storage Battery*, 329 U.S. 296, 301 (1946).

[5] *Chase Securities Corp. v. Donaldson*, 325 U.S. 304, 314 (1945).

Currently, Congress gives the IRS 3 years to assess and 10 years to collect based on a timely assessment. Most statutes of limitation simply bar a particular remedy or remedies but do not extinguish legal rights. Section 6501(a), however, represents a far stronger public policy in favor of closure. It functions as a statute of repose. It extinguishes the tax liability itself. That effect can be seen by looking at the relevant statutory language, the Tax Court's interpretation of section 6501(a) in transferee liability situations, and, most importantly for our purposes, the statutory history, which I will consider in Part II.

The statutory language in section 6501(a) bars more than just assessment; it also bars any "proceeding in court without assessment for the collection of such tax." That additional language effectively removes all potential collection remedies that require any type of judicial assistance. Also relevant to show the conclusive effect of the assessment limitation period is the language in section 6322, which requires a proper, timely assessment before the federal tax lien can arise.[6] Finally, section 6401(a), known as the statutory overpayment provision, provides that the IRS must treat *any* amount assessed or collected after the applicable limitations period as an overpayment of tax and either return it or credit another liability. Taken together, those statutes reflect such a strong public policy in favor of closure that they should be read as causing the tax liability itself to vanish, like some Cheshire cat, if not assessed timely.

It is true that the three provisions do not shut off *all* potential remedies to collect a tax liability. Notably, section 6901(a)(1)(A) allows the IRS to assess a liability against any third party that is a "transferee of property" from the taxpayers liable for an unpaid income tax. As its name implies, that transferee liability arises when a taxpayer who is *liable* for taxes (whether that liability has been assessed or not) transfers assets to a third party. In those cases, section 6901(c)(1) gives the IRS an additional one year from the end of the limitation period against the transferor taxpayer to assess the transferee liability against that third party.[7]

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[6] There are always exceptions for jeopardy situations. *See* sections 6331(a) and 6861. Although neither section 6321 (liens) nor section 6331(a) (levies) explicitly requires a proper assessment (only that the taxpayer be "liable to pay"), courts and regulations have inferred the assessment requirement from other language in the code or from the very structure of tax collection. *See United States v. National Bank of Commerce*, 472 U.S. 713, 719-720 (1985) (liens, requirement comes from section 6322); reg. section 301.6331-1(a) (providing that levy authority vests only in the "district director to whom the assessment is charged"). *See also G. M. Leasing Corp. v. United States*, 429 U.S. 338, 350 (discussing constitutional requirements of tax collection structure).

[7] Section 6901 also applies to beneficiaries of the decedent's estates. However, it is really the least of their worries if the estate distributes assets while still owing an estate tax liability. Section 6324(b) creates a "like lien" against a beneficiary who receives and uses property of the estate when the estate has not paid the estate tax. The "like lien" lasts for 10 years and may be foreclosed on at any time by the IRS to collect the unpaid estate tax, regardless of whether the section 6901(c) limitation period for transferee liability has run or not. Section 6324(a)(2). *See Geniviva v. United States*, 16 F.3d 522, *Doc 94-2389, 94 TNT 40-25* (3d Cir. 1994) (sections 6901 and 6324

Because transferee liability is derivative from the *liability* of the original taxpayer, the IRS need not have actually assessed the liability against the original taxpayer to assess the liability against the transferee.[8] The following question has therefore arisen in several cases: If the transfer occurs *after* the end of the assessment limitation period against the original taxpayer and the IRS has not made a timely assessment against the original taxpayer can the IRS assess the transferee? The Tax Court has repeatedly said no, on the grounds that the liability on which the transferee liability is based has been extinguished. That is, a taxpayer's tax liability "is eliminated when the period of limitations expire[s] before either formal assessment . . . or payment."[9] The Tax Court has been consistent in that view since 1962.[10] "Whether we style the statute of limitations in the Internal Revenue Code [section 6501(a)] a statute or repose or something else, its effect is, for *all* practical purposes, to extinguish a barred tax liability."[11]

II. Legislative History of Section 6501(a)

The legislative history of the language now codified in section 6501(a) strongly supports reading it as a statute of repose. The history reveals three take-home lessons: (1) that statute was enacted to extend the power to make a determination of liability, not to rein in an otherwise unlimited power; (2) it was triggered by "returns made by any persons . . . liable to tax"; and (3) until 1918 it extended the liability determination power for the *same amount of time* for both "false" and "fraudulent" returns, making no distinction between innocent mistakes and deliberate attempts to evade tax. This review also shows how the role of the limitation period cannot be divorced from how tax administration was conducted at each stage of statutory modification. I warn you, however, this review may seem at times tedious. I also confess that slogging through

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provide the IRS independent remedies for asserting liabilities against beneficiaries of estates); *Ripley v. Commissioner*, 102 T.C. 654, *Doc 94-4152, 94 TNT 77-10* (1994) (same).

[8] *See Espinosa v. Commissioner,* 2002-1 USTC para. 50,149, *Doc 2002-1185, 2002 TNT 11-9* (9th Cir. 2001); *Commissioner v. Kuckenberg*, 309 F.2d 202, 206 (9th Cir. 1962) (reasoning that the IRS need not make a futile assessment against an insolvent taxpayer and noting the congressional intent that "in proceedings against the transferee, notice need not be given to the taxpayer." *Id.* (*quoting* H.R. Conf. Rpt. No. 69-356, pt. 2 at 372 (1926)). *See also O'Neal v. Commissioner*, 102 T.C. 666, *Doc 94-4404, 94 TNT 83-23* (1994).

[9] *Hoffman v. Commissioner*, 119 T.C. 140, 144, *Doc 2002-21791, 2002 TNT 186-12* (2002). (IRS barred from assessing, collecting, or retaining any payments made on unassessed liabilities after the assessment period expired.)

[10] *See Illinois Masonic Home v. Commissioner*, 93 T.C. 145 (1989) (taxpayers who received assets from estate not liable for transferee liability because the IRS failed to timely assess transferor and the transfers occurred after the assessment period against transferor had expired); *Diamond Gardner v. Commissioner*, 38 T.C. 875 (1962) (same) (reviewing history and interplay of section 6501(a) with section 6401(a)); *Richard v. Commissioner,* T.C. Summ. Op. 2005-151, *Doc 2005-20832, 2005 TNT 198-4.*

[11] *Diamond Gardner v. Commissioner*, 38 T.C. at 881 (emphasis added).

the legislative history of any provision is a tricky proposition, especially when wandering through the maze of enactments between 1913 and 1939.[12] I am not perfect at it, and neither is the IRS nor the Tax Court. In that spirit, I invite readers to contact me if they spot any likely errors or omissions in the following analysis. But I think the following history is important to understand why the Tax Court in *Allen* may well have misread section 6501(c)(1).

A. The First Assessment Statute of Limitation

Our story starts with the first period of income taxation in the U.S., from 1862 to 1872. Congress first imposed an income tax in 1862 as a temporary measure to support the war effort and made major modifications to it in 1864, 1866, and 1870.[13] Each enactment was temporary in nature, with the 1870 renewal being particularly controversial. When that act expired by its terms in 1872, Congress did not further renew it.[14] However, when Congress again imposed an income tax on corporations in 1909, and then on individuals in 1913, it reenacted many of the administrative provisions of those statutes almost verbatim. Accordingly, one must start in 1862.[15]

In the beginning there was silence. Congress did not put a limitation period in the Revenue Act of 1862. There was no perceived need for one because of the structure of tax administration in those days, which was keyed to collection and enforcement of excise taxes. It is nonetheless critical to examine how taxes were assessed and collected

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[12] Most of my research used the invaluable compilation of revenue acts and associated reports, letters, and other materials in Bernard D. Reams Jr. (ed.), *U.S. Revenue Acts 1909-1950: The Laws, Legislative Histories and Administrative Documents* (Hein Ed. 1979) (hereinafter Fox Series). This 144-volume series was first compiled by a Department of Justice librarian named Carleton Fox and in some circles is still called the Fox Series. Mr. Reams, however, created the invaluable index to the compilation. Whatever its name, it is an extremely valuable collection of documents and should be available in any worthy law library.

[13] Revenue Act of 1862, 12 Stat. 432 (July 1, 1862); Revenue Act of 1864, 13 Stat. 223; Revenue Act of 1866, 14 Stat. 98 (July 13, 1866); Revenue Act of 1868, 15 Stat. 124 (July 20, 1868); Revenue Act of 1870, 16 Stat. 260 (July 14, 1870).

[14] The income tax provisions of the 1862 act were to be in effect for only three years. The provisions of the 1866 act were to expire in 1870 which, while reenacted, sunset in 1872. For a succinct history of those first 10 years, see Edwin R.A. Seligman, *The Income Tax* (2d Ed. 1914) at 435-480 (describing operation of the early income tax acts).

[15] Because of its unprecedented size, scope, and complexity, the 1862 act has been called "the foundation of the present internal revenue system." *See generally* Aubrey R. Marrs, "An Historical Review of the Statutory Jurisdiction and Administrative Problems of the Commissioner of Internal Revenue," at 33 (G.P.O. 1948).

in practice, because that will explain much about the first limitation period put into the tax laws.[16]

Tax administration under the 1862 act was up close and personal. The act divided the country into separate districts, authorized the president to appoint an assessor and collector for each, and authorized each assessor and collector to appoint assistant assessors and deputy collectors (who did all the work).[17] The focus of the act was on the traditional sources of revenue for the federal government -- property (notably liquor) and licenses -- so the procedures centered on obtaining accurate lists of property subject to taxation and assigning a proper value to that property. The income tax provisions simply piggybacked on the excise tax administrative provisions. Along with returns listing the articles subject to excise taxes, the assistant assessors were to collect returns of income.

The tax assessment procedure contemplated by the Revenue Act of 1862 for both excise and income taxes began on May 1. That is when section 6 required taxpayers to "make a list or return to the assistant assessor . . . of the amount of annual income, the articles or objects charged with a special duty or tax [etc.] . . . according to the forms and regulations prescribed."[18] But they did not just mail it in. Instead, section 7 directed the assistant assessors to visit taxpayers to obtain the lists and verify the value personally.[19] The commissioner of internal revenue reinforced that directive in an April 26, 1866, circular letter to assessors, directing them to "instruct their assistants to call personally upon those who have not reported their incomes on the first Monday in

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[16] For example, the current practice of declaring an unpaid assessment "currently not collectible" and inputting a computer transaction code 53 to take the account out of the queue dates back to an unnumbered Treasury regulation dated Feb. 1866, issued under the 1862 act, as modified by the 1864 act. The regulation provided:Claims on account of the insolvency or absconding of the parties taxed must be made on Form 53, and sustained by the affidavits of the deputy collector, and certificates of collector and assessor. * * * Collectors or deputy collectors using Form 53 will state, in a concise but clear manner, the reason for non-collection, under the head of "Cause of inability to collect." For example, "Insolvent before demand could be legally made." "Died before receipt of list, and estate insolvent." "Left for parts unknown before the tax could be collected." "No property liable to seizure under the law." "Property would not pay expense of distraint." * * * When credit is given on account of insolvent or absconding persons, although the collector is thereby released from the obligation created by receipting for the amount credited, the obligation to pay still remains upon the assessed parties.*Reprinted in* Charles N. Emerson, *Emerson's Internal Revenue Guide* (Samuel Bowles & Co., Springfield, Mass., 1867), at 319-321.

[17] 12 Stat. 432.

[18] Section 6 at 12 Stat. 434.

[19] Section 7 at *id.* Assistant assessors were to "proceed through every part of their respective districts, and inquire after and concerning all persons being within the assessment districts where they respectively reside." That provision is still in the code, in section 7601(a), using almost exactly the same quaint language.

May."[20] Charles Emerson, a tax lawyer of the time and the assessor for the 10th District in Massachusetts, advised assessors to get to know everyone in their district who might be liable for income taxes.[21] Tax administration was personal.

If the taxpayer was not home, the assistant was supposed to leave a note giving the taxpayer 10 days to turn in the income return. If the taxpayer was uncooperative, the assistant assessor was to make up the list himself according to the best information that he could obtain.[22] The lists were then reviewed by the assessors and posted for public viewing for 15 days to allow folks to appeal either the amount or valuation of the items listed. On review, the assessor could increase or decrease the valuations of anyone, but had to give any "party interested" at least five days' notice to object to any proposed increase.[23] Then, within 10 days of the 15-day appeal period, which pretty well meant by late May or early June, the assessors were to draw up a final list of who owed what taxes and give it to the collectors of the districts.[24] They, in turn, then went about their merry way collecting the taxes, and they were given six months to accomplish that task.[25]

The 1862 procedures proved to be unsatisfactory for income returns.[26] The problem was volume. Whereas the statutory procedure was acceptable for the relatively small number of business returns, the imposition of a return requirement on individuals for income created a problem. By 1867 more than 266,000 income returns were collected and processed.[27]

Assessors had huge powers to examine and unilaterally modify the returns during the period between their collection and the transmittal of the assessment list to the collectors, but no powers afterwards. The statute said nothing about what modifications could be made to the assessment after the assessment list was transmitted to the collector. To address the issue from the perspective of taxpayers, Congress in 1864 added language providing that "no appeal shall be allowed to any party after he shall

[20] *Reprinted in* Emerson, *supra* note 16 at 131-132.

[21] *Supra* note 16 at 257. Emerson advised his fellow assessors that they each "could do much in furthering their labors, even before blanks [blank forms for the year] are received, by making a list of all the persons in his division, who are probably liable [for income tax]."

[22] Section 11 at 12 Stat. 435.

[23] Section 15 at 12 Stat. 437.

[24] Section 16 at 12 Stat. 438.

[25] Section 23 at 12 Stat. 442. If taxpayers did not cough up the tax within 10 days of the collector giving notice that the assessment was final, the collector could begin administrative collection actions.

[26] Seligman describes the consternation this caused in Seligman, *supra* note 14 at 476-480. Emerson likewise describes this shortcoming in Emerson, *supra* note 16 at 131-132.

[27] Seligman, *supra* note 14 at 481.

have been duly assessed, and the annual list containing the assessment has been transmitted to the collector of the district."[28] But the statute still contained no provision regarding whether the assessments could be modified by the assessors after the final assessment. The number of returns later discovered to be false gave rise to an impression that "the honest taxpayer almost became the laughing-stock of his fellow citizens."[29]

That silence on reassessment authority was a great problem. Taxpayers "claimed that upon transmission of the annual or other list to the collector, the assessor was *functus officio*."[30] Courts agreed with them. For example, when the assessor for the 30th District (in Buffalo) came to suspect that one James Brown had understated his income from some bonds on his 1862, 1863, and 1864 returns, he summoned Mr. Brown for examination. Mr. Brown resisted the summons on the grounds that the assessor had no authority to reassess the liability. The matter went to the federal district court, which held for the taxpayer:

> There should be some limit of time, beyond which this inquisitorial power of the assessor to examine into all the private business transactions of every person, should not be exercised. If the assessor can exercise this power after he has transmitted the list to the collector, he may do so without limit as to time in one or ten years thereafter. The tax-payer cannot be heard after the list has gone to the collector; why then should the assessor be permitted on his own motion to review his own action, after the list has passed from him to the proper officer to whom it belongs? It appears to me that the assessor should be regarded as to such list *functus officio* -- his power is spent. If he afterwards ascertains that any list or return is false and fraudulent, he may cause the person making it to be indicted and punished therefore under the 15th section; or for perjury under the 42d section of the act.

In 1866 Congress remedied the *functus officio* problem by rewriting section 20 to explicitly give assessors the power to reexamine returns, even after the final list was

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[28] Revenue Act of 1864, section 19, at 13 Stat. at 228.

[29] Seligman, *supra* note 14 at 473. Prof. Seligman's account reflects the popular perception of that time that compliance deteriorated significantly after the Civil War was over. While section 20 of the 1864 act did allow assessors the ability to modify the annual lists, it was only to add the names of taxpayers previously omitted, not to change the prior listed assessments.

[30] Charles N. Emerson, *Emerson's Internal Revenue Guide* (Samuel Bowles & Co., Springfield, Mass., 1867), at 27. *Functus officio* is one of those great Latin common-law terms that basically means "without authority." *Black's Law Dictionary*, 606 (5th ed. 1979), defines the term as meaning "having fulfilled the function, discharged the office, or accomplished the purpose, and therefore of no further force or authority." It is chiefly used now in arbitration law; *see Trade & Transport, Inc. v. Natural Petroleum Charterers, Inc.*, 931 F.2d 191, 195 (2d Cir. 1991). ("Once arbitrators have finally decided the submitted issues, they are, in common-law parlance, '*functus officio*,' meaning that their authority over those questions is ended.").

transmitted.[31] Thus, contrary to the way we think about the statute now -- as a limitation on government power -- the history of the statute shows that it was originally enacted as a *grant* of power. But this new power to reassess was limited to "false" or "fraudulent" returns discovered to be so within 15 months of the transmittal of the assessment list. Specifically, the statute read: "In case it shall be ascertained that . . . in consequence of any omission, or understatement, or undervaluation, or false or fraudulent statement contained in any return or returns made by any persons or parties liable to tax," the assessor could, "at any time within fifteen months from . . . the time of delivery of the list to the collector," transmit a supplemental list of assessments (following the procedures given above) containing "the names of the persons or parties in respect to whose returns, as aforesaid, there has been or shall be any omission, undervaluation, understatement, or false or fraudulent statement, together with the amounts for which such persons or parties may be liable, over and above the amount for which they may have been" previously assessed. This new grant of power was retroactive.[32]

To sum up: We find, in this first period of income tax administration, the origins of both the current assessment and collection limitation periods. The assessment period was 15 months from the date of the annual assessment list, and the collection limitation period was 6 months from the date of a proper assessment.[33] The assessment period was enacted to create a power when, absent the provision, none existed. The period to reexamine was the same for all types of erroneous returns, whether the error was innocent or wicked. And, in a point I shall return to later, the "false or fraudulent statement" had to be "contained in any return or returns made by any persons . . . liable for tax."[34]

B. Modifications Through 1918

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[31] Revenue Act of 1866, section 9 (amending section 20 of the 1864 act), at 14 Stat. 103-104.

[32] When Emerson (the assessor for the 10th District) wrote to the commissioner for advice on whether this statute was retroactive, the commissioner wrote back that "such re-assessments may be made for fifteen months after the passage of the act of July 13, 1866, for any of the causes indicated in said paragraph, occurring during any period anterior to the passage of the said act." Letter of Feb. 27, 1867, *reprinted in* Emerson, *supra* note 16 at 305.

[33] Congress eliminated the statutory six-month collection period in 1865, but Treasury kept it by regulation. *See* unnumbered Treasury regulation of Feb. 26, 1866, providing that "it is, therefore, hereby prescribed that at the close of each quarter, collectors must render their final accounts for all lists which they may have held for six months or more. From and after Apr. 1, 1866, no credit will be allowed for lists which have been held for six months or longer." That last sentence meant that collectors would not earn commissions on collections on those accounts. *Reprinted in* Emerson, *supra* note 16 at 320.

[34] Revenue Act of 1866, section 9 (amending section 20 of the 1864 act), at 14 Stat. 103-104.

When Congress reintroduced an income tax on corporations in 1909, it followed the administrative structure used for income taxes during the 1862-1872 period, including the idea that the IRS could reexamine a return for errors even after making the initial assessment.[35] Between 1909 and 1918, Congress transformed this grant of power to *reassess* into a limitation on the broader power to *collect*, reflecting a congressional policy of closure. Equally important, until 1918 fraudulent returns were treated the same as merely false returns.

Section 38 of the Corporate Excise Tax Act of 1909 imposed the income tax and provided, in section 38(3), that corporations were to make, on March 1 of each year, returns of their incomes to the various collectors, who then sent them to the commissioner, who then had to make the assessment by June.[36] Section 38(4) gave the commissioner power to examine the returns so received whenever of "the belief that the return made by any corporation . . . was incorrect." Section 38(5) allowed for reexamination even after the initial assessment, using this language to limit that power to three years:

> All assessments shall be made and the several corporations . . . shall be notified of the amount for which they are respectively liable on or before the first day in June . . . and said assessments shall be paid on or before the thirtieth day of June, except in cases of refusal or neglect to make such return, and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as above provided for.

Federal courts interpreted that grant of power to "make a return" (that is, make the liability decision administratively) as a very weak restraint on government. Three recurring issues were all resolved by courts in favor of broad government power.

First, courts decided the limitation provision permitted reassessment of false returns as well as fraudulent ones. The distinction between false and fraudulent returns was well established by the early 1900s. A false return was simply incorrect, while a fraudulent return was one in which the taxpayer intended the error to evade tax.[37] Accordingly, courts refused to read the provision to mean that the commissioner could reexamine only fraudulent returns, because that would deprive the commissioner of all powers to correct an erroneous assessment and tax administration would be thrown back to the days of the 1862 act.[38]

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[35] I do not consider the abortive 1894 attempt.

[36] Corporate Excise Tax Act of Aug. 5, 1909. 36 Stat. 11.

[37] *Eliot National Bank v. Gill*, 218 F. 600 (1st Cir. 1913) (analyzing different meanings of the phrase "false or fraudulent" in each of the four times it appeared in the 1909 act); *Seaman v. Bowers*, 297 F. 371 (2d Cir. 1924) (same for the phrase as used for individual returns in section 250(d) of the Revenue Act of 1921, 42 Stat. 265).

[38] *Eliot*, 218 F. at 601. ("Unless returns merely 'incorrect' are here included within the class here called 'false or fraudulent,' the Commissioner is left without any power to correct them after having once assessed upon them.")

Second, courts decided the limitation period did not require the actual reassessment to be made within three years, but only required that it be "discovered." Thus, as long as "discovery" of the error occurred within three years of the return's due date, a later assessment outside the three-year period was still valid.[39]

Third, and most importantly, courts repeatedly denied that this provision barred the government from proceeding in court to *collect* an unassessed liability, even after the three-year period. The statute barred assessment, not collection without assessment. Courts held that "neither the limitation contained in [section 38] nor any other statute of limitations bars an action by the United States to recover the difference between the amount of the tax levied and paid and the amount which should have been levied and paid, if the corporation's return had correctly stated its income."[40] In other words, the statute limited only the power to make an assessment, and thereby the remedy of administrative collection; the U.S. could still sue on the underlying liability. It was truly a statute of limitation, not one of repose.

In 1913 Congress added an income tax on individuals in Section II of the Underwood Tariff Act of 1913.[41] The provisions addressing the income tax obligations of individuals were separated from the provisions addressing the income tax obligations of "corporations, joint-stock companies or associations, or insurance companies."[42] Both sets of administrative provisions reflected the continuation of the 1862 assessment procedure.[43] Similarly, both individual and corporate provisions used parallel language giving the commissioner authority to reassess during the three-year period from the "due date" of the individual or corporate return. It was very similar to the weak language from the 1909 statute. Paragraph E provided for individuals that:

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[39] *Id.* (upholding assessment made outside of three-year period when error discovered within three-year period).

[40] *United States v. Minneapolis Threshing Machine Co.*, 229 F. 1019 (D. Minn. 1915). *Accord, United State v. Nashville, C & St. L. Ry*, 249 F. 678 (6th Cir. 1918) (collecting cases) (government could maintain an action to recover taxes even when taxes were not assessed, because assessment was a nonexclusive remedy to collect tax liability).

[41] The act begins at 38 Stat. 114. Section II begins at 38 Stat. 166.

[42] Section II, paragraphs A through F addressed the obligations of individuals, including the procedure for assessing tax. Paragraph G, starting at 38 Stat. 172, addressed the obligations of "corporations, joint-stock companies or associations, and insurance companies." The procedural provisions of paragraph E regarding assessments are replicated exactly in paragraph G(c).

[43] One potentially important change was that it was the collectors who were responsible for gathering all the returns and sending them over to the commissioner's office, which was responsible for examining the returns and making the annual assessments. I need to research this change more closely because I suspect it reflects a planned administrative change in return processing, but I am not sure. This change does not, however, affect the current analysis.

> All assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year and said assessment shall be paid on or before the thirtieth day of June, except in cases of refusal or neglect to make such return and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, on the discovery thereof, at any time within three years after said return is due, make a return on information obtained as provided for in this section or by existing law.[44]

Reinforcing the idea that the three-year limitation did not affect liability was the language in Paragraph E: "Nothing in this section shall be construed to release a taxable person from liability for income tax."[45] A tax liability, once accrued, was not affected by the commissioner's inability to reassess it. Again, this statute affected a remedy, not a liability.

The Revenue Act of 1918 made significant changes to tax administration and, accordingly, to the context in which the limitation period on assessment operated. It still required taxpayers to submit returns to collectors and required collectors to make up a list and transmit that list to the commissioner for assessment, but it now required taxpayers to pay their taxes *with their returns*, allowing them to do so in four installments.[46] That is, no longer were taxpayers permitted to wait for the commissioner to make the formal assessment and make demands on them before being obligated to pay. No longer was the commissioner required to issue assessments by each June. Instead, taxpayers had to pay their liabilities *before* assessment, and "as soon as practicable after the return is filed, the Commissioner shall examine it."[47]

That change recognized that there was no way for the Bureau of Internal Revenue to examine all the returns by June. But the bureau was still expected to examine the returns "as soon as practicable." As for how long the commissioner had to make the assessment after his examination, the answer given in section 250(d) was five years. That is, the first time the term "assess" is used in section 250 is here, in subsection (d):

> Except in the case of false or fraudulent returns *with intent to evade the tax*, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of

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[44] 38 Stat. at 169. The parallel corporate language is in paragraph G(c), 38 Stat. at 174.

[45] 38 Stat. at 171.

[46] Revenue Act of 1918 section 250(a), 40 Stat. at 1082.

[47] Section 250(b). The Revenue Act of 1921 further confirmed and elaborated on this change by providing, in section 250(e), that "the instructions printed on the return shall be sufficient notice of the date when the tax is due and sufficient demand, and the taxpayer's [own] computation of the tax on the return shall be sufficient notice of the amount due." 42 Stat. 227, 265. That could very well be the origin of the popular perception that ours is a "self-assessment" system.

five years after the date when the return was due or was made. *In the case of such false or fraudulent returns, the amount of tax due may be determined at any time after the return is filed, and the tax may be collected at any time after it becomes due*. (Emphasis added.)

The emphasized language was brand new (to the limitation period provision), and readers will quickly recognize it as pretty much the language now codified in section 6501(c)(1). Before I turn to where that language came from, however, I want to point out two features of this statute that I think show the move to a far stronger public policy of closure than previous limitation periods: (1) It dropped the language in Paragraph E of the 1913 act (which provided that nothing in the section describing the limits on reassessment powers would eliminate a taxpayer's liability for tax); and (2) it prohibited any "suit or proceeding" as well as reassessments after the limitation period, thus limiting both assessment and collection powers to the five-year period.

The first change is, I hope, self-explanatory (especially since there is not a word about it in the committee reports that I could find). The second change was more significant.[48] It raised the question whether Congress really meant to cut off the government's ability to administratively collect a tax liability or just cut off one remedy -- suits -- while allowing administrative collection to proceed. In *Bowers v. New York & Albany Lighterage Co.*, the Supreme Court answered the question against the government.[49]

The prohibition against "suit or proceeding for the collection of any tax" was ambiguous, and the lower courts were split on how to interpret it. The Supreme Court refused to resolve the ambiguity in favor of the government. In *Bowers*, the IRS had tried to collect, after the five-year period in section 250(d) had run, taxes properly assessed within the five-year period.[50] The Court phrased the question like this: "Does § 250(d) . . . bar collection by distraint proceedings begun after the expiration of the five-year period?" The government argued that the language "no suit or proceeding for the collection of any such taxes" referred exclusively to judicial proceedings and that administrative collection was still permitted because it was not done through a "suit or proceeding." The government complained that Congress could not possibly have meant to limit all collection but meant only to limit just some remedies, namely, assessment or suit without assessment. The Court rejected that argument, reasoning:

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[48] As written in 1918 it applied only prospectively, but in 1921 Congress amended the language in section 250(d) so that the provision applied retroactively to all prior tax years. 42 Stat. 227, 265.

[49] 273 U.S. 346 (1926).

[50] While that case involved an interpretation of section 250(d) of the 1921 Revenue Act, not the 1918 act, the relevant language had not changed. The statute still read "no suit or proceeding." In 1926 Congress amended this language to read as it does today, "no proceeding in court."

> The purpose of the enactment was to fix a time beyond which steps to enforce collection might not be initiated. The repose intended would not be attained if suits only were barred, leaving the collector free at any time to proceed by distraint.[51]

C. From 1918 to 1928

Congress continued to change the context of the assessment limitations period after 1918, but the two major changes made by the 1918 legislation remained unaltered: The consequence of the failure to assess within the limitation period cut off all remedies -- both judicial and administrative -- to collect the tax; and the submission of "false or fraudulent returns with intent to evade tax" became an exception to that limitation. As to those returns, the period for reassessing or filing suit without assessment was unlimited.

Thus, when in 1924 Congress created the current system of two limitation periods, one for assessment and one for collection, that did not affect the closure policy reflected in the assessment limitation provision.[52] There, instead of a single five-year period in which the bureau must either assess and collect administratively, or file suit to collect (without assessment), Congress gave the administrative agency three years to assess (or file suit without assessment) and then six years to either collect administratively or sue on the *assessment*. Suit based on the liability without assessment was still prohibited after three years. Did the new scheme now make the assessment limitation period simply bar one remedy (suit without assessment), or did it affect the liability? Courts confronted the question through the issue of waivers.

The question of how and when taxpayers could consent to waive the limitation period tested its meaning. For example, the taxpayer in *Florsheim Bros. Drygoods Co. v. United States* had consented to extend the 1918 five-year limitations period for one year. Recall that the 1918 limitation period was on both assessment *and* collection. During the one-year extension, however, Congress created the dual limitation system, giving six years to collect timely assessed taxes. The Supreme Court noted that it was critical to the government's argument that the congressional action had occurred "while these waivers were still in force and *while the corporations' liability was thus still alive*."[53] Even in government victory one can see the Court (albeit in dicta) linking the limitations period to taxpayer liability.

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[51] 273 U.S. at 349.

[52] Revenue Act of 1924, section 278 (d), 43 Stat. 253, 300. The 1924 act also created in the new Board of Tax Appeals the special *preassessment* review process for "deficiencies" of tax, a concept introduced in the 1921 Revenue Act in section 250(b).

[53] 280 U.S. 453, 465 (1930) (emphasis supplied). *Florsheim* is, of course, better known for its holding on the issue of what constitutes a return sufficient to trigger the limitation period on assessment. That was the first issue in the case. The second issue was whether the waivers bound the government to the five-year assessment *and* collection period once Congress changed the law.

The waiver issue became critical after 1918. We have seen how Congress eliminated the requirement that the commissioner transmit the assessment list to collectors in June of each year. Instead, Congress directed the commissioner to examine each return "as soon as practicable" and gave a period of five years to do so. That was not always enough time: "Owing to the inability of the Department to audit all the complicated returns for the years during and after the war period, the Department early instituted a system of waivers of the statute of limitations against the Government."[54]

By 1926 Congress became concerned about the system of waivers. The widespread perception was that the Bureau of Internal Revenue was using strong-arm tactics to wring waivers from unwilling taxpayers. Of particular concern was a perceived pattern of securing such waivers *after* the limitation period had run and making them retroactive.[55] Waiver problems abounded. For example, the corporate taxpayer Toxaway Mills Inc. properly filed its 1917 return on April 1, 1918. In March 1921 it signed a one-year waiver to the limitation period then in force (which was three years under the 1913 statute), but the bureau treated the waiver as being good for all purposes, so when the Revenue Act of 1921 retroactively extended the limitation period from three years to five years, the bureau treated the waiver as applicable to the new period and made its assessment after April 1, 1923. The taxpayer paid the assessed deficiency and sued for a refund, claiming that the expiration of the limitations period had extinguished its liability. The Court of Claims disagreed, ruling that the limitations period simply barred remedies but not the liability, and so if the government collected the money otherwise, the taxpayer could not recover unless it proved it had actually overpaid its liability.[56]

Although *Toxaway Mills* was eventually overruled, the Court of Claims decision was handed down on December 7, 1925, right in the middle of the 1926 Revenue Act's legislative process. Until that point, there was no provision in either the House or Senate bill that year regarding the limitation period. But after the decision came down, the conference committee decided that the "amendment was deemed advisable because of an opinion in a recent decision of the Court of Claims."[57] That amendment became section 1106(a), which provided that "the bar of the statute of limitations against the United States and against the taxpayer shall operate to bar the remedy and also extinguish the liability." However, in apparent contradiction, the statute went on to say "but no credit or refund shall be allowed unless the taxpayer has overpaid the tax."[58]

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[54] Senate Finance Committee Report, S. Rep. 69-52 (Jan. 16, 1926), *reprinted in* 1939-1 C.B. (Part 2) at 357.

[55] *See* extensive discussion of this history in GCM 34790, 1972 GCM LEXIS 230 at *4-5.

[56] *Toxaway Mills v. United States*, 61 Ct. Cl. 363, 372 (1925), *rev'd,* 273 U.S. 781 (1927).

[57] Conference Report, H. Rep. 69-356 (1926), *published in* 1939-1 C.B. (Part 2) at 380.

[58] 44 Stat. 113.

The confusion caused by the hastily drafted 1926 provision led Congress, in the Revenue Act of 1928, to change the language, retroactively, to read almost as it does now: "Any tax . . . assessed or paid . . . after the expiration of the statute of limitations properly applicable thereto shall be considered an overpayment."[59] Even though the wording changed, however, the concept of statutory overpayment still reflected a view that the limitations period extinguished liability and not merely the collection of liability. Thus, the Supreme Court described the 1928 statute as providing that "a credit against a liability in respect of any taxable year shall be 'void' if it has been made against a *liability barred by limitation*."[60] Such has been the judicial construction ever since.

D. Summary

To me, the story of how the limitation period on assessments arose and took its current form makes a compelling case that the public policy embedded in section 6501(a) is so strongly in favor of closure that the statute, for all intents and purposes, functions as a statute of repose. That has been the trend of court opinions since 1918. And even the IRS has acquiesced in this view since 1972 when, in a change of position, it decided that even a voluntary payment made after the expiration of the limitation period and made with full knowledge of the expiration of the limitation period could not waive the limitation period or "revive" the liability.[61] It remains now to see how the presence of fraud affects this public policy.

III. Effect of Fraud on the Limitation Period

A. Effect of Fraud: 1862-1918

The income tax laws have contained provisions dealing with fraud since 1862, but not until 1918 did a fraudulent return affect an assessment statute of limitation differently than a false return. In 1862 submitting a fraudulent return had two consequences, both spelled out in section 9: first, it resulted in criminal prosecution and a potential $500 fine; second, it authorized the assistant assessors to make up a substitute return "according to the best information they can obtain . . . and from the valuation and enumeration so made there shall be no appeal."

The 1862 statute was clear on who had to commit the fraud: the person liable for tax. Written in the active voice, section 9 provided that the two consequences (described above) would result "if any such person . . . shall deliver or disclose to any assessor or assistant assessor . . . any false or fraudulent list or statement, with intent to defeat or evade the valuation or enumeration hereby intended to be made." The term "such person" referred to the immediately preceding section, which described the person as "any person . . . liable to pay any duty, tax, or license."

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[59] 45 Stat. 874.

[60] *R. H. Stearns Co. v. United States*, 291 U.S. 54, 60-61 (1934).

[61] Rev. Rul. 74-580.

The 1864 Revenue Act added a third consequence for fraud: a 100 percent penalty. It kept the criminal consequence, upping the fine to $1,000 and adding jail time.[62] It greatly expanded the investigative consequence by giving the assistant assessor the summons power and the power to enter the premises of "such person rendering a false or fraudulent list or return."[63] Section 14 required the assessor, as a result of any such investigation, to "assess the duty thereon, including the amount, if any, due for license and income." And then section 14 introduced the new consequence for fraud: "[I]n the case of the return of a false or fraudulent list or valuation, he shall add one hundred per centum to such duty; and in the case of a refusal or neglect, except in cases of sickness or absence . . . he shall add fifty per centum to such duty." The statute also allowed the assistant assessor to grant an extension of time to file whenever the "neglect or refusal" was because of "sickness or absence" and thereby allowed the taxpayer to escape the penalty.

The "one hundred per centum" fraud penalty added by section 14 of the 1864 act was triggered by the actions of the person having liability for the tax. The investigatory powers of section 14 were directed at the person who was liable for the tax -- that's the point of the provision authorizing a summons of "such person, his agent, or other person having possession, custody, or care of books of account containing entries relating to the trade or business of such person." Again, the term "such person" refers to the person described in the preceding section 13: "any person liable to pay any duty or tax." The thrust of section 14 was to deal with situations in which a person had not made a proper timely return. It is not clear whether the "one hundred per centum" penalty applied to all returns or just those returns produced by the investigative process, which later became known as the "substitute for return" process. I suspect the latter because the *In re Brown* case discussed above, in which the court used the doctrine of *functus officio* to deny the government the ability to reassess a return, was applying the 1864 law.[64]

Congress codified these consequences of fraud in the Revised Statutes of 1874 (R.S.) -- the first great attempt to codify all the laws of U.S. section 3173 was the analog to section 13, imposing a return filing duty on "any person . . . made liable to any duty, special tax, or other tax imposed by law." It imposed on the assistant collector the duty to visit everyone to remind them of their duty and to collect the returns.[65] And "whenever

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[62] Section 15, 13 Stat. at 227.

[63] Section 14, 13 Stat. at 226. For a comprehensive history of the summons power, see 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 (2004) at 36-77.

[64] On the other hand, one court held that this statute allowed the bureau to assess the fraud penalty against a taxpayer who had timely filed and paid. *McDowell v. Heiner*, 9 F.2d 120 (W.D. Pa. 1925).

[65] Congress had in the meantime put the duty of collecting returns on the collectors who were then to send the returns to the commissioner, who then made the assessment list and, after the period for taxpayers to appeal their proposed assessments, transmitted the list back to the collectors. That remained pretty much the scheme through the 1952

any person who is required to deliver a monthly or other return . . . delivers any return which, in the opinion of the collector, is false or fraudulent or contains any undervaluation or under-statement," the collector could use his summons power to "make the examination herein authorized." Sections 3174 and 3175 expanded on the summons procedures with language that is the forerunner of current sections 7602-7605. Finally, R.S. section 3176 contained the "100 per centum" fraud penalty.

Until 1913 the "100 per centum" penalty applied to any "false or fraudulent return." There was no "intent to evade" language in this particular penalty. Yet, as we have seen, "false" just meant "incorrect." When Congress reinstituted the income tax for individuals in 1913, it modified R.S. section 3176 so that the 100 percent penalty applied to income tax returns but not "false" returns. The modified language required an intent of the person liable for tax and, despite an obvious grammatical error, required *fraudulent* intent:

> When any person, corporation, company, or association refuses or neglects to render any return or list required by law, or renders a false or fraudulent return or list, the collector or any deputy collector shall make . . . such list or return . . . of the income, property, and objects liable to tax . . . and the Commissioner of Internal Revenue shall assess all taxes not paid by stamps, including the amount, if any, due for special tax, income or other tax, and in case of any return of a false or fraudulent list or valuation intentionally he shall add 100 per centum to such tax.[66]

The Revenue Act of 1918 corrected the grammar in R.S. section 3176 so that the 100 percent penalty would apply "in case a false or fraudulent return or list is willfully made." Again, the language of the immediately preceding statutes (R.S. 3173-3175) made it clear that the term "willfully made" referred to the intent of the person liable for tax.

B. Fraud in the 1918 Revenue Act

The Revenue Act of 1918 also added what we know today as the fraud penalty for an understatement of tax, currently codified in section 6663. The 1913 act had no such provision. Instead, Section II (D) of that act provided only that if the collector or assistant collector has "reason to believe that the amount of any income returned is understated, he shall give due notice to the person making the return to show cause why the amount of the return should not be increased." And, after assessment, Section II (E) gave the commissioner the power to reassess the tax on the discovery of a "false or fraudulent" return within three years and the power to add "the amount of 5 per centum on the amount of tax unpaid." The only penalty for fraud was the 100 percent penalty codified in R.S. section 3176, which the 1913 legislation reenacted, as modified.

The Revenue Act of 1918 started out as H.R. 12863. As passed by the House, the administrative provisions previously separated between those relating to individuals

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reorganization and, in fact, can still be seen today in that revenue officers are still tasked with collecting delinquent returns.

[66] 38 Stat. 179.

and those relating to corporations were consolidated into Part IV of the bill, titled "Administrative Provisions." Recall that section 250 of that legislation significantly changed how returns were processed. No longer was the commissioner required to review all returns and assess by June each year. Instead, taxpayers were required to pay up on filing their returns, and the commissioner was to examine the returns "as soon as practicable." The Ways and Means Committee decided to add another "100 per centum" penalty for fraud if, during such examination, the commissioner found an understatement of tax, presumably to encourage taxpayers not to play the newly created game of audit lottery.

The Ways and Means Committee thus drafted section 250 of the House bill to provide that when the commissioner's examination revealed an understatement of tax, "if the return is made in good faith and the understatement . . . is not due to *any fault of the taxpayer*, there shall be no penalty." And "if the understatement is due to negligence *on the part of the taxpayer*, but without intent to defraud, there shall be added as part of the tax 5 per centum of the total amount of the deficiency." But "if the understatement is false or fraudulent with intent to evade the tax, then, in addition to other penalties provided by law . . . there shall be added as part of the tax 100 per centum of the amount of the deficiency."[67]

The fraud exception to the five-year limitation period also came from the Ways and Means Committee. As passed by the House, section 250 also contained the new language regarding limitation periods. It read:

> Except in the case of false or fraudulent returns, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. In the case of false or fraudulent returns, the amount of tax due may be determined at any time after the return is filed, and the tax may be collected at any time after it becomes due.

You will notice that in the House version of section 250, there was no distinction made between false returns and fraudulent returns. Both triggered an unlimited assessment period. If that language had carried into the final statute, the exception would have completely swallowed the rule, per the settled distinction between false and fraudulent returns.

The Senate Finance Committee added subsections to section 250 and made two significant changes to the fraud penalty. First, it reduced the penalty. Second, it coordinated the penalty with the R.S. section 3176 provision. As proposed by the Senate, then, section 250(b) read:

> If the understatement is false or fraudulent with intent to evade the tax, then, *in lieu of the penalty provided by section 3176 of the Revised Statutes, as amended,*

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[67] 63 U.S. Revenue Acts 1909-1950 (Fox Series) at 46-47 of the act as read in the Senate and referred to committee on Sept.21, 1918. (Emphasis supplied.)

> *for false or fraudulent returns willfully made, but* in addition to other penalties provided by law for false or fraudulent returns, there shall be added as part of the tax *50* per centum of the amount of the deficiency."[68]

Most importantly for this column, in addition to modifying the fraud penalty, the Finance Committee fixed the assessment limitation period language, which it labeled section 250(d), in this way:

> Except in the case of false or fraudulent returns *with intent to evade the tax*, the amount of tax due under any return shall be determined and assessed by the Commissioner within five years after the return was due or was made, and no suit or proceeding for the collection of any tax shall be begun after the expiration of five years after the date when the return was due or was made. In the case of *such* false or fraudulent returns, the amount of tax due may be determined at any time after the return is filed, and the tax may be collected at any time after it becomes due.[69]

IV. Conclusion: The Key to the Puzzle

In my opinion, the Revenue Act of 1918 unlocks the meaning of the phrase "with the intent to evade tax" in section 6501(c)(1). The phrase means the intent of the taxpayer liable for the tax. It has that meaning because the statute that gave birth to the fraud penalty also gave birth to the fraud exception to the assessment limitation period. Those two features of the 1918 act are inextricably linked. They are legislative twins. They were born at the same time, in the same committee, as part of the same section of the code. They have the same meaning. The phrase "with intent to evade tax" came from the fraud penalties provisions, in which its reference to the intent of the person liable for the tax on the return appears well settled. The phrase was pressed into service to also define the boundaries of the new exception to the five-year assessment limitation period.

Thus, reading the phrase as referring to the intent of the taxpayer liable for the tax is supported by the legislative history of *both* fraud penalties (both the old one in R.S. section 3176 and the new one in section 250(b)). It is also supported by the use of the phrase to carve an exception to the strong public policy of closure created by the 1918 act.[70]

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[68] 64 U.S. Revenue Acts 1909-1950 (Fox Series) at 72 of the act as reported out of the Finance Committee to the Senate on Dec. 6, 1918 (italics showing Senate amendments).

[69] 64 U.S. Revenue Acts 1909-1950 (Fox Series) at 72 of the act as reported out of the Finance Committee to the Senate on Dec. 6, 1918 (italics showing Senate amendments).

[70] I welcome responses to my theory. One possible response is that times change. Contexts change. The language that may have had one meaning in 1918 might have a different meaning now. Certainly tax administration has become a bulk-processing operation on a scale likely unimaginable in 1918. Perhaps the phrase "with the intent

So when the Tax Court in *Allen* says, in footnote 3, that section 250(d) "addressed the statute of limitations that applied 'in the case of false or fraudulent return' and did not by its terms require that the fraud be that of the taxpayer," I cringe. When the IRS takes the position that the fraudulent intent required to avoid the bar of section 6501(a) is somehow broader than the intent required for imposition of the fraud penalty, I cringe. I believe my review of the legislative history of that language demonstrates that the language, coming as it did from the same source, did indeed require that the fraud be that of the taxpayer liable for the tax. I have found nothing in the subsequent history of these statutes to suggest otherwise.[71] Of course, I could be wrong. I am not exuberantly confident here. That's why I looked it up.

to evade tax" should take on a different meaning as the context of collection has changed. If the language is ambiguous (as passive voice usually is), perhaps the Tax Court *should* be free to interpret it as the times demand. There is much to that response, but I will defer discussion of it until my next column.

[71] The Tax Court points to a House Ways and Means proposal in 1934 to rewrite the phrase in active voice but properly gives no weight to the proposal's failure.

Presumptions and Tax Return Preparer Fraud

By Bryan T. Camp

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This column generally explores the laws and policies of tax administration to help guide readers through the thickets of particular procedural problems while also giving them a sense of the larger tax administration forest.

Prof. Camp thanks Diane Fahey, Keith Fogg, Mike Gompertz, and Joe Schimmel for comments on this column. Their critiques prevented both errors and embarrassments. He apologizes for any remaining goofs and promises to do better next time.

Prof. Camp dedicates this column to Eliot Fielding, whose story about the seizure of an iron lung he will never forget, nor its lesson.

Just because the IRS has the legal authority to act does not mean that it should. The Tax Court's decision in *Allen v. Commissioner*, where the court agreed to let the IRS use old language for a new purpose, is a good illustration.[1] *Allen* involved the question of whether the section 6501(c)(1) fraud exception to the normal three-year assessment limitation period in section 6501(a) was triggered, as a matter of law, by the intent of a tax return preparer to create and submit a fraudulent return, even when the taxpayer had no intent to evade tax. The Tax Court said yes, thereby turning on its head the usual presumption that a taxpayer has not committed fraud unless the IRS proves otherwise.

My last visit to this part of the tax administration forest explored the statutory and administrative history of the fraud exception to the general three-year statute of limitations.[2] There I explained how the statutory history of sections 6501(a), 6501(c)(1), and 6663 suggested that the Tax Court in *Allen* had misread section 6501(c)(1). The relevant history strongly supported reading both sections 6501(c)(1) and 6663 as being triggered only by the fraudulent intent of the person liable to report and pay the tax reported on the return. Accordingly, I questioned whether the *Allen* decision properly interpreted the statute when it allowed the fraudulent intent of a tax return preparer, standing alone, to nullify the three-year limitation period for assessment.

More than a few people I've talked with since my prior article think the *Allen* opinion correct on policy grounds, even if not technically faithful to the statutory text. Putting aside whether the Tax Court misinterpreted the law as it is, I also believe it is quite debatable whether the Tax Court properly interpreted the law as it should be. *Allen* provides a good opportunity to review the scope and operation of section 6501 as well as the operation of presumptions in tax procedure.

My thesis for this article is that the Tax Court's opinion in *Allen* was built more on a foundation of tax policy than tax law. To the extent it was a sympathetic response to an IRS tax administration problem, I believe the sympathy is misplaced. Congress has spoken to the problem of tax return preparer fraud and has expressed different policy choices than the *Allen* court. Accordingly, I think the Tax Court should have declined to read section 6501(c) as broadly as it did.

I. The Legal Issue in *Allen*

Section 6501(a) generally allows the Service "three years after the return was filed" to make the liability decision and either reflect that decision in an assessment or sue in court to collect the tax without an assessment. Congress has created several exceptions to the general three-year rule. The one currently codified in section 6501(c)(1) provides that "in the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time." How that language interacts with the general section 6501(a) limitation period was the legal issue in *Allen*. The Tax Court was asked whether section 6501(c) required fraud by the taxpayer or whether fraud committed by the return preparer, standing alone, could unblock the three-year bar to reassessment.

A statute of limitations is a reflection of congressional policy about closure. Most limitation periods reflect the idea that a particular remedy — usually litigation — should not be available after a particular period. You know the drill: memories grow stale, documents grow yellow, and aging witnesses grow hair in unexpected places. And, to update the old rationale to our modern age, electronic records become unrecoverable as technology ages. But some limitation periods reflect a policy choice that the very legal rights or duties elsewhere granted or imposed are extinguished by the running of time and circumstance.

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[1] 128 T.C. 37, *Doc 2007-5704, 2007 TNT 44-11* (2007).

[2] Bryan T. Camp, "Tax Return Preparer Fraud and the Assessment Statute of Limitations," *Tax Notes*, Aug. 20, 2007, p. 687, *Doc 2007-18071, 2007 TNT 162-30*.

My last article on this subject showed that section 6501(a) is best interpreted as a statute of repose, with the effect of extinguishing not just modes of collection, but the taxpayer's very liability for tax. This is seen in repeated congressional enactments of it and similar statutes demonstrating strong policy choices in favor of closure. Thus the doctrine of repose: If the applicable assessment limitations period has expired, so has the taxpayer's liability.[3] That part of the history forms an important predicate to much of the analysis in this article, so please, if you are unwilling to accept that idea, do review my prior discussion of why this is so.[4]

II. The Facts of *Allen*

As is common, the facts in *Allen* were fully stipulated, with a view to putting the precise legal question before the court. For tax years 1999 and 2000 Allen had used a tax return preparer and provided the preparer with documents supporting claims for mortgage interest and property tax deductions. The preparer not only claimed those deductions on Schedule A but also, it was stipulated, "claimed false and fraudulent . . . deductions for charitable contributions, meals and entertainment, and pager and computer expenses, as well as various other expenses."[5]

The return preparer timely filed the returns and sent Allen full copies after they were filed. Allen did not file amended returns, and there was no stipulated fact whether he ever reviewed them. Instead the parties stipulated that the improper deductions "made petitioner's returns false and fraudulent for the years at issue." The parties further stipulated that Allen "did not have the intent to evade tax," but that the return preparer did have that intent. The return preparer apparently performed similar "services" for other clients because he was convicted under section 7206(2) of willfully aiding and assisting in the preparation of false and fraudulent returns, none of which were Allen's. There is no doubt that the preparer was a bad actor.

The IRS discovered the fraud outside of the three-year assessment limitation period but nonetheless issued a notice of deficiency. Allen timely petitioned the Tax Court, then moved to dismiss for want of jurisdiction on the grounds that the government could not use the section 6501(c)(1) exception to the bar of section 6501(a). Allen argued that the fraud exception required the *taxpayer* to have the requisite intent to evade (which it was stipulated that he did not). The government argued that an intent to evade solely on the part of the preparer was enough to trigger the section 6501(c)(1) exception. The Tax Court agreed with the government.

III. Law: The Problem With Presumptions

The Tax Court's train of thought in *Allen* raced through three standard stops in statutory interpretation: the plain language of the statute; an interpretive presumption; and the statutory history. Here I will retrace each stop in turn. It does not appear that the court relied on any one of the three; rather, it appeared to use them collectively. Given the inherent ambiguity in the statute at issue, however, the presumption rationale probably hurt the taxpayer the most, because the court decided that the taxpayer had not met his burden to prove the negative: that the phrase "with intent to evade" did *not* mean the intent of the tax return preparer. I will briefly review the first three rationales for the holding before turning to the more explicit policy issues.

A. Plain Language

It is axiomatic that the first stop regarding issues involving statutory construction is the plain language doctrine. The Tax Court's visit here was decidedly awkward, made so by the passive voice used in the statute. The court concluded that "nothing in the plain meaning of the statute suggests the limitations period is extended only in the case of the taxpayer's fraud." While true, that statement is meaningless as a plain language analysis. One can just as easily say "nothing in the plain meaning of the statute suggests the limitations period is extended *ABSENT* the taxpayer's fraud." The statute simply says "with the intent to evade." It does not say whose intent counts.

Because the statute is written in the passive voice, any interpretation requires some degree of interpolation, purely as a matter of grammar. The court rejected the taxpayer's position ostensibly because that would require the court "to read the words 'of the taxpayer' into the statute." The court's own holding, however, also adds words. Viewed broadly, the opinion adds the words "of anyone" into the statute. Viewed narrowly, the opinion reads the words "of the taxpayer or the taxpayer's return preparer" into the statute. Either way, the Tax Court's interpretation adds words to the statute.

Because some interpolation is required, the textual question is whether the taxpayer's or the government's version reads better with the other text in the statute. To the extent there are any clues from the statutory text itself (as opposed to the legislative history or policy), they support the taxpayer's interpretation. To see that, one must look at what is written *after* the "with the intent to evade" language. The court focused only on what comes before, saying "the statute keys the extension to the fraudulent nature of the return, not the identity of the perpetrator of the fraud." The entirety of the statute suggests otherwise. It reads:

> In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

The court put only the first clause on the table for analysis. But the terms "the tax" and "such tax" refer to a specific tax because each term uses a definite article. So whose tax? The plainest answer is "the tax" of the person submitting the return. After all, it makes little sense — that is, it is *far* from "plain" — to attribute to a person an intent to evade something that is not otherwise imposed on him. There is nothing to be evaded. The *plainest* reading of the statute is that "the intent" to evade relates to "the tax" required to be reported on the return that,

[3]*See, e.g., Illinois Masonic Home v. Commissioner*, 93 T.C. 145 (1989).

[4]Camp, *supra* note 2, at p. 687-688.

[5]All quotes are from the published opinion in *Allen*.

but for the evasion, would be reported and paid by the person signing and submitting the return.

I might well have an intent to help someone else evade their liability, but while *their* action is evasion, *my* action is not generally referred to as evasion but rather as conspiracy or aiding and abetting, or some such phraseology. See, for example, section 7206(2). For example, to be convicted of felony evasion under section 7201, one must engage in some affirmative act to evade a legal duty involving the reporting or payment of a tax. Prosecution is allowed even if the tax liability to be reported is someone else's tax; it's the legal duty to report and pay by the person signing the return that is the predicate for evasion.[6] When the criminal act is helping another taxpayer evade *their* legal duty, however, criminal prosecution lies under section 7206(2) and not section 7201.[7]

So the best plain language analysis actually tells us that the phrase "with the intent to evade tax" is best read to refer to the intent of the taxpayer who is supposed to report and pay over the tax reported on the return being filed. This reading is also supported at the next stop in the interpretive journey.

B. Presumption

The *Allen* court merely paused at the hoary way station of presumption, yet this was probably the most important of its legal rationales. The court snapped off a crisp declaration that "statutes of limitations are strictly construed in favor of the Government," cited to the Supreme Court's opinion in *Badaracco v. Commissioner*,[8] and then hurried on its way. A more leisurely tour of the doctrine reveals more than first impressions suggest. It's a strange place, this repository of statutory presumptions. A court can pretty much construct whatever presumption it wants from the precedents that litter the legal landscape. I shall first look at the matter historically and then look at current doctrine.

1. Historical inconsistent presumptions. Historically, courts have applied varying presumptions when called on to construe federal taxing statutes of limitations. Sometimes they favor the government; sometimes they favor taxpayers. The earliest cases to consider the assessment limitation decided that in the absence of any specific limitation, there was no power to be limited: The government simply had no ability to correct erroneous assessments.[9] The *absence* of a limitations period in the 1862 Revenue Act rendered the assessor *functus officio*. Far from presuming to construe the statute in favor of the government's power to administer the tax, the court awarded the ambiguity of silence to the taxpayer.

In nontax cases in the late 1800s, however, the Supreme Court held that limitations periods should be construed strictly in favor of the government. For example, in *United States v. Nashville, Chattanooga & St. Louis Ry.*, a nontax case from 1886, the Court described the doctrine this way:

> It is settled beyond doubt or controversy — upon the foundation of the great principle of public policy, applicable to all governments alike, which forbids that the public interests should be prejudiced by the negligence of the officers or agents to whose care they are confided — that the United States, asserting rights vested in them as a sovereign government, are not bound by a statute of limitations, unless Congress has clearly manifested its intention that they should be so bound.[10]

Similarly, the issue in *United States v. Whited & Wheless* was whether the government could sue for the value of land granted under a patent procured by fraud.[11] The relevant statute of limitations provided that "suits by the United States to vacate and annul patents hereafter issued shall only be brought within six years after the date of the issuance of such patents."[12] The defendants argued that the government's suit for damages sprang from the grant of the patent and was reached by the statute of limitations. The government argued it just wanted a different remedy, recovery of the land's value.

The *Whited & Wheless* Court agreed that the statute was ambiguous "and the question we are considering remains unanswered, but becomes, 'What was the intention of Congress, confessedly not clearly expressed, with regards to this issue?'"[13] Given the ambiguity, the Court relied on the presumption "settled as a great principle of public policy" that limitations periods be construed strictly when employed to bar the rights of the government. It used that presumption to hold that the statute of limitations at issue barred only one remedy and not another. The *Whited & Wheless* Court had no problem finding a principle supporting that bifurcation of the bar.

Lower federal courts used the presumption favoring government to distinguish judicial remedies from administrative remedies — the assessment limitations period might bar one form of remedy but not the other.[14] The Supreme Court decision in *Bowers v. N.Y. and Albany*

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[6]*See, e.g., United States v. Wisenbaker*, 14 F.3d 1022 (5th Cir. 1994), *Doc 94-2801, 94 TNT 46-31* (taxpayer convicted of evasion under section 7201 for failing to collect and pay over gasoline excise taxes).

[7]*See, e.g., United States v. Gambone*, 314 F.3d 163 (3d Cir. 2003), *Doc 2003-656, 2003 TNT 4-14* (rejecting taxpayer argument that scheme involving submitting false W-2's could only be prosecuted as a misdemeanor under section 7204 and upholding felony conviction under section 7206(2)).

[8]464 U.S. 386 (1984).

[9]*See, e.g., Barker v. White*, 2 F. Cas. 825 (C.C.S.D.N.Y. 1874).

[10]118 U.S. 120 (1886).

[11]246 U.S. 552 (1918).

[12]26 Stat. 1095.

[13]246 U.S. at 561.

[14]*United States v. Grand Rapids & Indiana Ry. Co.*, 239 F. 153 (W.D. Mich. 1915) (construing the 1909 statute of limitations for corporations, which the 1913 statute just copied for individuals); *United States v. Minneapolis Threshing Machine Co.*, 229 F. 1019 (D. Minn. 1915) (same). *Accord United States v. Nashville, C & St. L. Ry.*, 249 F. 678 (6th Cir. 1918) (collecting cases) (government could maintain an action to recover taxes even when taxes not assessed because assessment was a nonexclusive remedy to collect tax liability).

Lighterage Co. put a stop to that by explicitly refusing to apply the general presumption favoring government to tax statutes.[15]

In *Bowers* the Court was asked to resolve a split in the lower courts over the effect of the limitations period created by the 1918 Revenue Act, which said that "no suit or proceeding to the collection of any such taxes . . . shall be begun, after the expiration of five years after the date which such return was filed."[16] The government wanted the Court to interpret the ambiguous term "proceeding" to mean "judicial proceeding" so that the government would be free to continue administrative collection actions. The Court refused. It instead construed the term broadly to include administrative collection actions as well as lawsuits. It recognized, as a general matter, that limitation periods do not bar the United States "unless, upon a strict construction in its favor, the United States and the claim sought to be enforced fairly may be held to be within the terms and purpose of the statute."[17] But the Court then interposed another general presumption it thought important: Taxing statutes "are to be interpreted liberally in favor of the taxpayers."[18]

The most remarkable aspect of the *Bowers* opinion is this statement: "There has been suggested no principle of public policy or other consideration that furnishes any reasonable support for the setting of a limitation against only one of the two authorized methods of enforcing collection" of tax liabilities. What makes this an eyebrow-raiser is not only that the federal courts had routinely done just that in construing the 1909 and 1913 tax statutes, but that the Supreme Court itself had approved the move in the earlier, nontax cases described above.

2. Current inconsistent presumptions. *Bowers* was long, long ago and one might reasonably expect the federal courts to be more uniform now than they were then. One would be wrong. Currently, federal courts do not apply a uniform or consistent presumption in favor of the government when called on to construe federal taxing statutes of limitations.

Let's start with the Supremes. The case everyone likes for the presumption that limitation periods are to be construed in favor of the government is *Badaracco v. Commissioner*.[19] However, the presumption had no role in the Court's decision, except as rhetorical window dressing.

The issue in *Badaracco* was whether a taxpayer who had already submitted an admittedly fraudulent return could use an amended return to trigger the three-year limitation period. The Court properly said "no" because there can be only one "*the* return" of the taxpayer. There is that definite article again. The Court's holding is perfectly consistent with what the Court had said since *Florsheim* in 1930, when it held that a tentative return was not "the" return that triggered the limitation period. There are no statutory provisions for either tentative returns or amended returns; they are creatures of administrative procedure and it is well settled that no action of an agency or its employees can waive a limitation period. So the issue of which document was "the return" was not really a question of interpreting a statutory ambiguity; it was a question of finding the document that best met the statutory term.[20] The claimed presumption thus had no analytical bite in *Badaracco*. It was just window dressing.

If *Badaracco really* stood for the proposition that the limitation period *must* be strictly construed in favor of the government whenever fraud taints a return, one would not expect that a taxpayer could *ever* cure a fraudulent return. But a taxpayer can indeed cure a filed fraudulent return, as long as the nonfraudulent amended return is submitted before the return due date. Just as in *Badaracco*, you have two documents in that situation, each purporting to be "the" return and one of which is fraudulent. Only one can be "the" return. If the supposed presumption in favor of the government was the reason for the Supreme Court's holding in *Badaracco*, one would have a difficult time distinguishing the two situations. Both courts and the IRS, however, have had no difficulty distinguishing the situations. The rule is that when both documents — the first fraudulent and the second nonfraudulent — are submitted before the due date of the return, only the latter document constitutes "the return."[21] The second document therefore is good to start the assessment limitations period running. Again, this is the right result because the issue in *Badaracco*, as it is in all those situations, is to determine which of several documents is "the" return. There can only be one "return" and it is the document last filed before the due date. It is the passage of the due date that bestows the blessings (or curses) of "return" on the document filed. The Supreme Court in *Badaracco* decided that the actions of IRS employees in accepting an amended return *after* the due date did not and could not affect the status of the previously filed document as "the" return.

Nor do all federal courts appear to read *Badaracco* as requiring a strong presumption in favor of the government. I'll just give one short example that may be something of a surprise to many readers because it all happened very quickly and quietly back in the mid-1990s. Although it never made it into the late Michael Saltzman's excellent treatise, he certainly knew about it because he represented the taxpayer in the lead case, *Lauckner v. United States*.[22]

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[15]273 U.S. 346 (1927).

[16]40 Stat. at 1082.

[17]273 U.S. at 349, *citing Dupont De Nemours & Co. v. Davis.*

[18]*Id.*

[19]464 U.S. 386 (1984).

[20]This is also true for other cases involving the question of what document is sufficient to constitute "the return" that triggers the limitation period. For example, the return of an S corporation, partnership, or other passthrough entity will not start the limitation period for the shareholder, partner, or other taxpayer who is the ultimate recipient of the passed-through item. *Bufferd v. Commissioner*, 506 U.S. 523 (1993), *Doc 93-1222, 93 TNT 19-17.*

[21]SCA 1998-024 (May 12, 1998) (applying the rule in *Haggar Co. v. Helvering*, 308 U.S. 389 (1940), that a timely amended return is treated for most purposes as the taxpayer's original return).

[22]1994 WL 837464 (D.N.J. 1994) (Sarokin, J.) *aff'd*, 68 F.3d 69 (3d Cir. 1995), *Doc 95-9727, 95 TNT 208-13.*

The issue there was whether the general three-year limitations period in section 6501(a) applied to the imposition of the section 6672 penalty. The penalty in section 6672 used to be called the 100 percent penalty and is now called the trust fund recovery penalty. It is assessed against any person who "willfully fails" to collect, account for, or pay over trust fund taxes. Trust fund taxes are those taxes that are imposed on employees but are supposed to be collected from the employees by the employers and remitted to the government either quarterly or every pay period, depending on the size of the employer. These are taxes such as the income tax, the employee's share of Social Security and Medicare taxes, and also include excise taxes. Section 6672 allows the IRS to assess a "penalty" on those individuals of the employer who are responsible for withholding, accounting for, or paying over the trust fund taxes. The penalty is imposed only on "willful" conduct: It requires a willful failure by the responsible person to either collect or pay over the tax.[23]

The penalty is 100 percent of the amount of the tax that was not withheld, accounted for, or paid over. Although labeled a "penalty," the IRS long ago established the policy of using section 6672 as a collection tool to recover unpaid employer trust fund taxes.[24] So if a company has failed to pay over $1,000 in trust fund taxes and there were three responsible persons, the IRS will assess each person $1,000 but will collect only a total of $1,000.

The *employer's* liability for the *employer's* share of Social Security and Medicare taxes is reported on the same forms, Form 940 or Form 941, as are the trust fund taxes. These returns are generally filed quarterly, and the three-year assessment period against the employer begins to run on April 15 of the following calendar year for all quarters of the previous calendar year. Traditionally, the IRS had used the employer's Form 941 returns to also measure the amount of time it had to assess responsible persons for the section 6672 penalty.[25]

In *Lauckner*, however, the IRS asserted a bold new position: The section 6501(a) limitation period did not apply to section 6672 assessments. Raising the *Badaracco* banner, the IRS assaulted its own long-held interpretation. The IRS argued — sensibly enough if one were writing on a blank slate — that because people did not report their actual conduct on the Form 941, those returns could not serve the function of a return that would trigger a limitations period. In fact, there simply was no form that could function as "the return" necessary to trigger section 6501(a). Just as taxpayers did not report fraud on "the return," they did not report a willful failure to account for or pay over.

The district court opinion by Judge Sarokin blasted the IRS out of the water on this one. Presumption? No way, said the court, you don't get no stinkin' presumption: "Where no fraudulent conduct on the part of the taxpayer is alleged, taxing acts, including provisions of limitation embodied therein, are to be construed liberally in favor of the taxpayer."[26]

3. Summary. Presumptions are a house of cards. The Tax Court's *Allen* opinion uses the Supreme Court's *Badaracco* opinion to construct the presumption in favor of the government. That opinion, in turn, cites to a 1924 Supreme Court opinion in *E.I. du Pont de Nemours & Co. v. Davis*, thus ignoring the later Supreme Court decision in *Bowers*, discussed above. It gives a "see also" cite to the Court's 1930 opinion in *Lucas v. Pilliod Lumber Co.*, and the Fifth Circuit's 1971 opinion in *Lucia v. United States*.[27] Those cases, in turn, refer to *United States v. Nashville, Chattanooga & St. Louis Ry.*, the nontax case from 1886 that started off our visit to this building of presumptions.

The value of the presumption raised by the *Allen* court as an analytical tool is minimal. To the extent one seeks refuge in the passive-aggressive indulgence of a presumption, the better one to apply here favors the taxpayer, not the IRS. This is because the basic justification for invoking the presumption in favor of the government is absent in this factual situation. The basic justification for a presumption in favor of the government, at least as given by the cases cited by the Supreme Court in *Badaracco*, and the Tax Court in *Allen*, is that the inaction of government employees ought not to be allowed to work to the detriment of the government.

The situation in *Allen* involves no question, as did *Badaracco*, whether the actions of the agency or of agency employees (in authorizing or accepting amended returns) could work to undo the effect of the statutory scheme. That is, for the taxpayer to win in *Badaracco*, the Court had to hold that the actions of government employees in accepting an amended return would reimpose a limitations period. This it refused to do because the congressional intent that could not be undone by government employee actions related to "the" return. Unlike *Badaracco*, *Allen* involves no dispute over what is "the" return. It does not involve deciding whether the actions of government employees will undo the statutory scheme. It just involves the question of whether a third party's intent to commit fraud against the government, which causes a taxpayer to file an incorrect return, should subject the taxpayer to everlasting audit. The historically strong congressional policy to give taxpayers closure — reviewed in detail in my article last August — would seem to be to give at least presumptive shelter to the taxpayer, not the government.

Allen is more like *Lauckner*, in which Judge Sarokin reasonably decided that when no fraudulent conduct on the part of the taxpayer is alleged, the taxpayer gets the benefit of any statutory ambiguity. This formulation of the idea supports the taxpayer's position in *Allen* that ambiguous language in section 6501 should be construed

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[23]*See Slodov v. United States*, 436 U.S. 238 (1978). The term "willful" means simply acting knowingly or intentionally or even with gross negligence and does not have the same meaning that the term has for tax evasion. *Id.*

[24]Policy Statement P-5-60, IRM 1.2.1.5.14, *available at* http://www.irs.gov/irm/part1/ch02s03.html#d0e34627.

[25]GCM 29675 (Sept. 21, 1956).

[26]This quote comes from Section I-C of the opinion, citing to *United States v. Updike*, 281 U.S. 489, 496 (1930).

[27]*Davis* is at 264 U.S. 456 (1924); *Pilliod Lumber* is at 281 U.S. 245 (1930); *Lucia* is at 474 F.2d 565 (5th Cir. 1971).

in favor of the taxpayer. The statute does not say whose intent matters; caution urges that it should be read to mean the intent of the taxpayer liable to report and pay the tax on the return. If and when Congress wants to allow the intent of someone other than the taxpayer to remove the bar of the assessment limitations period, Congress can be more explicit.

C. Legislative History

The Tax Court opinion in *Allen* peeked into the doorway of legislative history, then immediately stumbled at the threshold. It claimed (in footnote three) that "rules regarding the limitations period in the case of false and fraudulent returns have been in the code since the Revenue Act of 1918." It should have said "since 1866." As I discussed in my prior article, section 9 of that statute provided that the IRS had 15 months to reassess a tax liability "in case it shall be ascertained that . . . in consequence of any omission, or understatement, or undervaluation, or false or fraudulent statement contained in any return or returns made by any persons or parties liable to tax" the prior assessment was incorrect.[28] Unlike my footnote, that is not a trivial point.

Since I covered the statutory history in gory detail before, I will only summarize it here. Basically, the legislative history of section 6501(a) and (c)(1) provides three take-home lessons that, taken together, strongly support reading section 6501(c)(1) as referring to the intent of the taxpayer responsible for filing the return and paying the tax reported on it, and not any third party.

First, as to periods of limitation, the phrase "false or fraudulent return" by itself has historically referred to *two* types of returns, a "false" one and a "fraudulent" one. The early limitation period provisions dating back to the 1866 language quoted above allowed either type of return (that is, either a false one or a fraudulent one) to trigger a general limitation period (at first 15 months, then 3 years, then 5 years). Each type of defect, however, had the same effect on the limitations period.

A false return was simply one that was incorrect or erroneous; a fraudulent return was one in which the taxpayer *intended* to evade the tax liability. Thus, the phrase "with the intent to evade tax" or similar phrases — such as "willfully made" or "intentionally" — were used to modify the word "false" in the phrase "false or fraudulent return" because the word "fraudulent" *already* had that meaning.[29]

Second, as to fraud penalties, the phrase "with the intent to evade tax" has historically meant the intent of the taxpayer liable for tax, not third parties. This is seen in the structure and history of the fraud penalties before 1918, which I previously reviewed.

Third, when Congress created both a new underpayment penalty and a new exception to the assessment limitation period for fraud in the 1918 Revenue Act, it used the phrase "with intent to evade" as a modifier to the phrase "false or fraudulent" in the period of limitations provision the same way it had been used for fraud penalties.[30] The House Ways and Means Committee had drafted the period of limitations exception with simply the phrase "false or fraudulent" as the trigger that would give the IRS unlimited time to discover fraudulent returns. That was the exact same language that had, in the 1909 and 1913 statutes, triggered the general limitation period. If *that* language had been enacted, then under settled law the IRS would have unlimited time for "false" as well as "fraudulent" returns and the exception would have swallowed the rule.

The Senate Finance Committee avoided that result by inserting "with intent to evade tax" after "false or fraudulent." The Finance Committee just cut that phrase from the fraud penalty provisions and pasted in the period of limitations provisions. In this way, the phrase "with the intent to evade" as used in section 6501(c)(1) comes directly from the language originally used to create the penalty for fraudulent underpayments now codified in section 6663. Both provisions were introduced together as section 250 of the Revenue Act of 1918. The same conduct that triggered one consequence (the underpayment penalty) also triggered the other consequence (the unlimited assessment period).

This legislative history also suggests that the taxpayer goofed up the stipulations in *Allen*. According to the *Allen* opinion, "the parties agree that the false deductions on the petitioner's income tax returns for the years at issue made petitioner's returns false and fraudulent for the years at issue."[31] Well, technically, that's the end of it. The phrase "with intent to evade tax" was just added to ensure that the term "false" would not be read as meaning only "incorrect." The phrase makes no sense as applied to "fraudulent" returns. After all, what else is a fraudulent return if not one made with wicked, as opposed to innocent, intent? So by agreeing that the returns were "fraudulent," the taxpayer in *Allen* sealed his own doom, properly analyzed.

D. Agency

The law of agency provides one last legal argument supporting the Tax Court's interpretation of section 6501(c)(1) that, curiously enough, did not make it into the Tax Court opinion. But it appears to be the central

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[28]Revenue Act of 1866, section 9 (amending section 20 of the 1864 Act) at 14 Stat. 103-104. And, technically, since there was no codification of the federal statutes at large until 1874, the rules could not have come into any code, much less "the" code, until then. The first United States Code came out in 1926. The first separate codification of the internal revenue laws came in 1939, which was then adapted into the U.S. Code. That, of course, was completely recodified in 1954. The 1986 amendments did not make any significant changes to the structure of the 1954 code, although they did make substantial changes to the content.

[29]*See, e.g., Eliot National Bank v. Gill*, 218 F. 600 (1st Cir. 1913) (analyzing different meanings of the phrase "false or fraudulent" in each of the four times it appeared in the 1909 act). *See* cases collected in "Notes on the Revenue Act of 1918," which was a digest of all court decisions dealing with the internal revenue laws between 1909 and 1918. This document is reprinted in 94 Bernard D. Reams, Jr. (ed.) *U.S. Revenue Acts 1909-1950: The Laws, Legislative Histories and Administrative Documents* (Hein ed. 1979).

[30]Revenue Act of 1918 section 250(a), 40 Stat. at 1082.

[31]128 T.C. at 38.

reasoning underlying the IRS internal change of position. That is, when first confronted with the *Allen*-type of fact pattern, the IRS Office of Chief Counsel concluded (rightly, in my humble opinion) that the fraud of the return preparer was not alone sufficient to trigger the section 6501(c) exception to the normal three-year limitation period.[32] However, six months later the Office of Chief Counsel shifted positions, relying in large part on an agency argument.[33]

The argument is a simple syllogism. Major premise: A principal is liable to third parties for the consequences of fraudulent acts of an agent. Minor premise: A return preparer acts as the agent of the taxpayer who engaged the preparer's services. Conclusion: Taxpayers are liable for all the consequences of fraud committed by their return preparer. There are problems with all three parts of the argument.

First, the major premise is not solid. The *Restatement (Third) of Agency* recognizes that there is no blanket rule regarding a principal's liability to a third party for fraud committed by an agent. The *Restatement* puts it this way:

> A principal is not subject to liability when an agent defrauds a third party unless the agent acts with actual or apparent authority to engage in the conduct that perpetrates or conceals the fraud. The principal's liability under this rule requires a causal connection more substantial than a peripheral or happenstance connection between the fraud and the agent's use of apparent authority.
>
> An agent does not act with apparent authority in connection with a misrepresentation made to a third party when the third party knows or has reason to know that the agent does not have authority to make the representation on behalf of the principal.[34]

More importantly, the minor premise is flawed. It is true that return preparers are agents of the taxpayer for some purposes.[35] For example, a taxpayer cannot use a return preparer's failure to attach a necessary document as "reasonable cause" to escape the consequences of that failure. In that context, the Tax Court has said that "fundamental agency law provides that the actions of the tax preparer (agent) are imputed to the taxpayer (principal)."[36]

Return preparers are not agents of the taxpayers for all purposes. Critically, "the signature of [a] paid tax return preparer does not constitute the signature of an agent."[37] It is well settled that the signature of the return preparer is insufficient to turn an otherwise unsigned Form 1040 into a "return" for purposes of assessment limitations purposes. Treasury regulations provide that a Form 1040 becomes a valid return only when the *taxpayer* personally signs the return.[38] Courts have held that "a return signed by the attorney/preparer but unsigned by the taxpayer does not satisfy the statutory requirements for a return."[39] Accordingly, a return signed by the preparer but not the taxpayer is not sufficient to trigger the section 6501 limitations period for assessment.[40] To put the matter in terms of the *Restatement*, a return preparer simply has no actual or apparent authority to speak or act on behalf of the taxpayer to assure the IRS of the *taxpayer's* representation (under penalty of perjury) that the return is a true and accurate statement.[41] In a similar situation, the Court of Appeals for the Federal Circuit decided that a patent attorney did not act as an agent for purposes of what was disclosed in a patent application, although the attorney was an agent for other purposes.[42]

Finally, the third part of the syllogism does not necessarily follow, even if both the major and minor premise are correct. That is, it is no doubt true that a taxpayer's tax liability may be adjusted because of errors committed by the return preparer. The Tax Court has time and again stressed that "taxpayers have a duty to file complete and accurate tax returns and cannot avoid this duty by placing responsibility with an agent."[43] But the taxpayer's liability, on the merits, for errors committed by the return preparer says nothing about the period in which the IRS must act to catch and correct those errors. That is, one can imagine a legal rule in which the fraud of

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[32]FSA 200104006 (Sept. 15, 2000), *Doc 2001-2586*, *2001 TNT 19-46*.

[33]FSA 200126019 (Mar. 30, 2001), *Doc 2001-17909*, *2001 TNT 127-25*.

[34]*Restatement (Third) of Agency*, section 7.08 (2006).

[35]For an example of a return preparation agreement, see http://1040tools.com/nonprint/inctaxretprep.htm.

[36]*Caulkins v. Commissioner*, T.C. Memo. 1984-504.

[37]*In re Lee*, 186 B.R. 539 (S.D. Fla. 1995), *Doc 95-369*, *95 TNT 5-61*.

[38]Reg. section 1.6061-1(a). This provision also allows "an agent who is duly authorized in accordance with paragraph (a)(5) or (b) of §1.6012-1" to sign on the taxpayer's behalf. Both of the referenced sections are narrowly drawn to deal with circumstances when the taxpayer is unable to sign by reasons of physical or mental disability or being out of the country. Return preparers are quite explicitly *not* generally allowed to verify the correctness of the return on behalf (or as agents of) the taxpayer. *See generally* reg. section 1.6065-1. Instead, they must sign on their own line and make their own representations on their *own* behalf. *Id.* This regulatory structure argues strongly in favor of separating taxpayer intent from preparer intent and is yet one more reason to doubt the solidity of the *Allen* court's conclusion.

[39]*In re Lee*, *supra* note 37, at 541 (collecting cases).

[40]*Overbeck v. Commissioner*, T.C. Memo. 1955-243 (signature of taxpayer's attorney alone did not make the filed document a return).

[41]The IRS has likewise recognized that return preparers lack the authority to act as agents for taxpayers when signing documents. For example, the IRS has recognized that an unenrolled return preparer holding a valid power of attorney from the taxpayer was nonetheless not the taxpayer's agent for purposes of signing an appeal of a rejected offer in compromise. ILM 200034001 (May 1, 2000), *Doc 2000-22051*, *2000 TNT 167-52*. *But see* ILM 200526001 (June 2, 2005), *Doc 2005-14251*, *2005 TNT 127-14*, in which the IRS uses agency rationale to impose section 6702 frivolous return penalties on taxpayers who executed a Form 2848, "Power of Attorney and Declaration of Representative," but did not sign the submitted "composite" return.

[42]*Glaxo v. Novopharm*, 52 F.3d 1043, 1052 (Fed. Cir. 1995).

[43]*Bilzerian v. Commissioner*, T.C. Memo. 2001-187, *Doc 2001-20036*, *2001 TNT 143-12* (collecting cases and disbelieving a taxpayer who claimed he reviewed his return but "missed" a $4 million omission of income).

an agent is attributable to the principal for purposes of determining liability but not for purposes of determining the running of a limitations period. It's substance versus procedure.

Running through the *Allen* opinion are policy concerns by the Tax Court that by refusing to attribute preparer fraud to taxpayers, the Court would be encouraging bad behavior by taxpayers and would hinder IRS audits. It is to those policy concerns I now turn.

IV. Policy: The Problem With Stipulated Facts

The two central stipulations in this case were that (a) the return preparer made knowingly false claims for deductions on Allen's return that resulted in a lower reported tax liability for Allen than he was truly liable for, and (b) Allen did not intend to evade his taxes. Based on those stipulations, the court articulated two policy rationales that it thought justified its reading of section 6501(c)(1). But those rationales only make sense if one reads between the lines of the stipulated facts. While the court did not explicitly ding the taxpayer for poorly worded stipulations, I suggest that its policy rationales necessarily went beyond the facts as stipulated.

First, as noted above, the Tax Court rejected the taxpayer's interpretation that the intent of the tax return preparer to submit a fraudulent return should not remove the three-year bar for assessment. The expressed policy concern here was that such an interpretation would hinder the IRS's ability to catch bad actors. In the court's words, it would result in a "special disadvantage to the Commissioner in investigating these types of returns." It cited again to *Badaracco* for support.

I am all in favor of helping the IRS catch bad actors, but that is not the situation presented here, at least on the stipulated facts. The stipulated facts say that the taxpayer here was *not* a bad actor. The taxpayer was innocent of any bad intent. The situation in *Badaracco* was very different. There, the taxpayers (father and son) were bad actors who later changed their intent (after they were indicted for tax evasion) and filed a corrected amended return. The Badaraccos most assuredly intended to defraud the government when the first return was filed and later asked the Court to allow them to either (a) cure the fraud or, at least, (b) restart the limitation period by filing a second document. The Court rejected both ideas. The first would "make sport of the so-called fraud penalty," said the Court. "A taxpayer who had filed a fraudulent return would merely take his chances that the fraud would not be investigated or discovered, and that, if an investigation were made, would simply pay the tax which he owed anyhow and thereby nullify the fraud penalty."[44] The second idea was equally bad. "Where fraud has been practiced, there is a distinct possibility that the taxpayer's underlying records will have been falsified or even destroyed."[45]

To understand why the *Badaracco* rationale does not apply to the situation stipulated to exist in *Allen*, one must understand that the discovery of an erroneous return is really a two-stage process. First, a return must be selected for audit; second, it must be examined. As to the first step, the IRS uses a variety of tools to select returns for audit. The most common selection methods are the information return matching programs, the Discriminant Function (DIF) system, and specific special projects. The first method is an automated matching of third-party information returns — such as W-2's and 1099's — against taxpayer returns.[46] According to the Government Accountability Office, "as a result of the matching, the IRS annually contacts about 3 million taxpayers regarding potential discrepancies in their tax information; another 2 million taxpayers are contacted to resolve potential nonfiler situations."[47] This is a great method to spot unreported income, but is a lousy way to catch improper deductions or other problems. The second method does that. Each year, the IRS computers classify returns according to risk of noncompliance using the DIF algorithm. Returns classified by the computer as higher risk are then manually screened by experienced classifiers and sorted into potential audits.[48] Finally, the IRS engages in periodic special audit projects, targeting particular industries for audit or specifically defined problem areas. Current examples are projects focusing on National Research Programs, Abusive Tax Avoidance Transaction Promoters and Participants, Offshore Credit Card users, High Income Taxpayers, and High Income Nonfilers.[49]

The *Badaracco* policy argument was addressed to the second stage of return review, the actual examination of a selected return. It has little application to the first stage, the selection of returns for audit. Fraud rarely makes a return more difficult to *select* for audit but, once selected, discovery of fraud becomes difficult because the taxpayer is now working to conceal the fraud.

For example, assume that two taxpayers each commit the exact same errors by claiming excessive deductions for charitable contributions, meals and entertainment, and pager and computer expenses, which were the errors on the return in *Allen*. One taxpayer makes the errors innocently but the other makes them "with the intent to evade." While there would be no difference in the ability of the IRS to select either return for audit, there could be a difference in the ability of the IRS to verify the entries on the return *during* the audit because the bad actor might work to conceal the false deductions by false substantiation, misdirection, or otherwise. In contrast,

[44]464 U.S. at 394.

[45]464 U.S. at 398.

[46]*See* Internal Revenue Manual, Part 4 (Examination Process), Chapter 19 (Liability Determination), for descriptions of the Automated Underreported program.

[47]Treasury Inspector General for Tax Administration, "Mismatched Names and Identification Numbers on Information Documents Could Undermine Strategies for Reducing the Tax Gap," Aug. 31, 2007, *Doc 2007-20828*, *2007 TNT 177-14*.

[48]*See* IRM Part 4 (Examination Process), Chapter 1 (Planning and Special Programs), Part 3 (Source of Returns — Priority Programs — DIF and Ordering), for a more detailed description of the return selection process.

[49]IRM 4.1.3.1.

the taxpayer who did not intend to defraud would more quickly admit and agree to the error.[50]

The *stipulated* facts in *Allen* said the *taxpayer* was not a liar; the return preparer was. The *taxpayer* was not trying to cover up anything. The return preparer was. So there was no "special disadvantage" to the IRS in auditing the return because the taxpayer, by definition, would respond truthfully once the examination started. The only way to apply the *Badaracco* policy argument in *Allen* is to assume either (a) the taxpayer was motivated to conceal relevant information, even though it was stipulated that he was not, or (b) the taxpayer would be the puppet of the tax return preparer, who would control all information flow. The latter scenario is most likely what underlay the IRS and Tax Court concern about this case because Form 1040 allows taxpayers to designate the return preparer as a contact person to discuss any issues about the return with the IRS.[51]

The Tax Court's second policy argument to support its broad reading of section 6501(c) was a repeatedly expressed concern about the taxpayer "hiding behind the preparer." Here is its main passage:

> We do not find it unduly burdensome for taxpayers to review their returns for items that are obviously false or incorrect. It is every taxpayer's obligation. Petitioner cannot hide behind an agent's fraudulent preparation of his returns and escape paying tax if the Government is unable to investigate fully the fraud within the limitations period.

The second policy rationale proves both too little and too much, at least on the *stipulated* facts. First, it proves too little. As with other exceptions to the normal three-year limitation period, the IRS bears the burden of proving fraud.[52] This burden must be met by clear and convincing evidence, concerning both the falsity of the return and (at least up to *Allen*) the *taxpayer's* intent.[53] Thus, it would be proper for the IRS to prove that Allen either reviewed his returns and *deliberately* did nothing in the face of blatantly incorrect deductions, or that he *deliberately* did not review his returns because he knew what he would find. That would be fraud in my book. But the mere failure of a taxpayer to review and correct returns may as well be due to negligence or press of time as to an intent to evade tax. The *stipulated* facts demonstrate nothing about why Allen failed to correct his returns. So for the Tax Court to chastise him for "hiding" behind returns makes little sense unless one assumes fraudulent behavior on the part of Allen when the parties expressly stipulated otherwise.

This second policy rationale also proves too much. The Tax Court seems to say that a failure to review a return preparer's work when there is a blatant error on the return is per se fraud. That is, the court does not explain why the return preparer's *mens rea* matters a whit to "every taxpayer's obligation" to ensure the accuracy of his return. If the true policy reason for allowing the IRS an unlimited period of limitations to review a tax return is to force taxpayers to monitor their return preparers more closely, then the intent of the tax return preparer should not matter at all! If a taxpayer "should" have reviewed a return and, on review, "should have known" that something was amiss, the relevance of the return preparer's *mens rea* in committing the error is unclear. The Tax Court's policy would punish equally two taxpayers who each negligently fail to review their returns and are alike in every other respect except that one chose a stupid tax preparer and the other chose a wicked one. That cannot be the right policy call.

V. Policy: The Tax Court's New Rule Unclothed

The Tax Court's new rule — that the fraudulent conduct of tax return preparers will be attributed to the taxpayers — is not only doubtful on the law, it is dubious policy. Aside from the reasons given above to doubt its wisdom, other reasons counsel that the IRS should decline to invoke it, even if the Tax Court's interpretation of section 6501(c) stands.

What am I afraid of? First, I fear overbreadth. Suppose a wicked return preparer takes the taxpayer's information and properly prepares a return on which the taxpayer is properly due a refund of $1,000. The taxpayer signs that return. But the return preparer then files a fraudulent return that claims a refund of $6,000. The return preparer — using the new nifty dual direct deposit feature — sends $1,000 of the refund to the taxpayer's bank account and sends the other $5,000 to the preparer's own bank account. The return preparer then gives a copy of the proper return to the taxpayer. The Tax Court's rule would allow the IRS to forever tag the taxpayer for the deficiency created by the fraudulent conduct of the return preparer.

You laugh. You think I am making up some bizarre academic hypothetical. I am not. I got those above facts from an attorney who had a client with a similar scenario. I did simplify it a bit: In the actual case even the taxpayer's claimed $1,000 refund was erroneous because the taxpayer claimed a huge deduction for business mileage when it consisted entirely of commuting costs.[54] It was blatant, the kind of blatancy that would allow the IRS to prove the taxpayer's fraudulent intent.

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[50]That, at least, is the theory. In practice, bad actors often play innocent. They do actually provide information, and claim forgetfulness or other excuses. That is why the IRM instructs revenue agents to look for "badges of fraud."

[51]Circular 230 also allows return preparers limited ability to represent taxpayers for the return they prepared, even if they are not otherwise qualified to represent taxpayers before the IRS. 31 C.F.R. section 10.7(c).

[52]Section 7454(a). *Anastasato v. Commissioner*, 794 F.2d 884, 889 (3d Cir. 1986) ("In a fraud case both the burden of production and the ultimate burden of proof are placed on the Commissioner.").

[53]*Ishijima v. Commissioner*, T.C. Memo. 1994-353, *Doc 94-7030, 94 TNT 145-25*; *Gaspar v. Commissioner*, T.C. Memo. 1968-131.

[54]And the return preparer had the entire $6,000 deposited in his account. The taxpayer caught the scheme because she noticed that on the copy of the return he had given her the preparer had put down his sister-in-law as one of the taxpayer's dependents.

Second, I fear that allowing the IRS to piggyback on return preparer fraud is an easy out for the IRS. One can be entirely sympathetic to the problem faced by the IRS. Bad tax return preparers abound and the scope of the problem demonstrates the potential impact the *Allen* decision might have. Every week the Justice Department announces another case in which it shuts down an abusive return preparer. For example, on July 5, 2007, it announced it had shut down one Mary Powell who had prepared over 1,000 returns since 1983.[55] When the IRS examined 109 of her returns, it found the average under-reported tax was $2,794 per return. Since 2001 Justice has obtained more than 330 injunctions against bad return preparers.[56]

So what happens to those 1,000 taxpayers, or the 109 whose returns the IRS examined? Say that Powell pleads guilty to a criminal violation and part of that plea agreement is that she prepared all 1,000 returns with fraudulent intent. Courts have held that conviction of a taxpayer for criminal tax fraud under section 7201 will relieve the Service from proving the fraud against that taxpayer in a later civil case.[57] My fear is that the criminal conviction will allow the IRS to automatically get the benefit of section 6501(c)(1) for all 1,000 taxpayers, or for as many as it cares to audit.

Because the taxpayer was a nonparty to the criminal litigation, it is quite doubtful that the IRS would be able to benefit from issue preclusion as a matter of law. That would be an instance of nonmutual issue preclusion, which would raise (at least in my mind) serious due process concerns.[58] However, the criminal conviction would still be probative evidence to support a finding of the return preparer's fraud (remember, under the *Allen* rule, the IRS would no longer have to prove fraud on the part of the taxpayer, just the return preparer). In this way, the *Allen* holding effectively puts the burden on the taxpayer to "unprove" the return preparer's fraud, which is exactly backward from how Congress structured the burden of proof in fraud cases. I do not think that is wise policy.

Third, I fear doctrinal confusion. The Tax Court noted that the IRS was not asserting the actual fraud penalty against Allen. Apparently, the IRS is taking the position that it still must prove fraud on the part of the taxpayer to assert the fraud penalty, even though section 6663(a) is written in the same passive voice as section 6501(c)(1).[59] The IRS Office of Chief Counsel defended this bifurcation by postulating that the two provisions had different purposes: The purpose of the section 6501(c) exception was to allow the IRS "to assess a correct tax liability" and the purpose of section 6663 was to "punish and deter wrongful conduct."[60] While facially plausible, the distinction is made up out of whole cloth and has no basis in the legislative history of the two statutes. The history of the two provisions shows them to have been enacted with the same objective: giving the IRS two additional tools to respond to the same behavior. The legal meaning of one has always tracked the legal meaning of the other. A taxpayer has either committed fraud or not. If so, particular consequences apply. If not, those consequences do not apply. To read the passively voiced section 6501(c)(1) as creating a different requirement than the passively voiced section 6663(a) is to ignore the history of those sections and to create a policy seemingly designed to beguile a court to accept a loosey-goosey interpretation of section 6501(c)(1).

Fourth, I fear overreaching. Yes, this is where I lament that policy decisions are to be made by Congress and not the court. To tweak the meaning of section 6501(c) on the policy grounds that doing so will help in the fight against return preparer fraud ignores the tools Congress has already given the IRS to use against the Mary Powells out there: injunctive relief under sections 7402 and 7407; penalties under section 6694 or 6695. In fact, Congress has recently sharply increased the preparer penalty, and upped the standard of care, attracting the attention of mainstream media.[61] But Congress did not do anything in those sections about extending time to audit the *taxpayer's* liability. Certainly Congress considered it because section 6696(d) provides the same three-year limitation period for a tax return preparer negligence penalty

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[55]*See* Justice Department press release, *available at* http://www.usdoj.gov/tax/txdv07484.htm.

[56]For the latest lists, see http://www.usdoj.gov/tax/taxpress2008.htm.

[57]*Amos v. Commissioner*, 43 T.C. 50 (1964), *aff'd*, 360 F.2d 358 (4th Cir. 1965); *Timek v. Commissioner*, T.C. Memo. 1976-357. *See generally*, Marcus Schoenfeld, "A Critique of the Internal Revenue Service's Refusal to Disclose How It 'Determined' a Tax Deficiency, and of the Tax Court's Acquiescence With This View," 33 *Ind. L. Rev.* 513, 547 (2000).

[58]*See generally*, James, Hazard, and Leubsdorf, *Civil Procedure*, (5th Ed. 2001) section 11.27 et seq., discussing application of issue preclusion against someone who was not a party to the prior litigation. The doctrine of issue preclusion provides that once an issue is actually and necessarily determined by a court, that determination is conclusive in subsequent suits based on a different cause of action involving a party to the prior litigation. The use of issue preclusion "offensively" by one party against a nonparty was permitted by the Supreme Court in *Parklane Hosiery Co. v. Shore*, 439 U.S. 322, 326 n.5 (1979). But that was in a situation when the nonparty was wielding the doctrine against a party who had litigated and lost the issue. When parties who win an issue later try to assert issue preclusion against parties who had not participated in the prior litigation, courts allow it only when (a) the nonparty had succeeded to the legal interests of the party; (b) the nonparty had sufficient control over the prior litigation as to have been substantively a party; and (c) the nonparty's interests in the prior litigation were adequately represented by the prior party. So, for example, courts would permit a taxpayer to use a criminal conviction for fraud in a later civil suit against a preparer to preclude the preparer from relitigating the issue of the preparer's fraud.

[59]Section 6663(a) reads: "If any part of any underpayment of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 75 percent of the portion of the underpayment which is attributable to fraud." I covered the history of this section in my last column. One can see, however, that just as section 6501(c)(1) does not say whose fraud triggers the exception, neither does that section say whose fraud triggers the penalty.

[60]FSA 200126019, *supra* note 33.

[61]*See* Tom Herman, "The IRS Has a New Weapon: Your Tax Pro," *The Wall Street Journal*, July 11, 2007, p. D1.

assessed under section 6695(a), and unlimited time for a fraud penalty assessed under section 6695(b). But Congress again put nothing in section 6695 about extending the period of assessment for the *taxpayer's* liability.

One can also be entirely sympathetic to the Tax Court's voiced frustration at taxpayers who "hide" behind return preparers without reaching for the result in *Allen*. Taxpayers play the game of "avert the eyes" and then, only if caught, fess up. Taxpayers have done this since 1862 and will not stop anytime soon. But, again, in the face of this repeated and long-standing behavior, *Congress* made the policy call that closure would occur three years from the date of filing the return. It is not up to the Tax Court to set up a new policy.

VI. Conclusion

The *Allen* opinion runs against what I conceive as one of the fundamental principles of judicial conservatism. As the Supreme Court warned in *Badaracco*, the very case cited and relied on by the government and the Tax Court, policy concerns should not drive the legal analysis:

> The relevant question is not whether, as an abstract matter, the rule advocated . . . accords with good policy. *The question we must consider is whether the policy the petitioners favor is that which Congress effectuated by its enactment of section 6501.*[62]

The ultimate weakness in the Tax Court's opinion is evidenced by the field service advice memorandums referenced by Michael Gompertz in his March 19, 2007, letter to *Tax Notes*.[63] These documents are well thought out and are well worth reading. But they are completely contradictory. If there is any conclusive rationale for interpreting section 6501(c)(1) as has the Tax Court, it has yet to be expressed. The decision in this case is not a matter of legal analysis; it is a matter of policy. But even if the Tax Court were right on the law, that does not mean that the IRS should move forward in reliance on it.

Long ago, a young chief counsel attorney was asked by a revenue officer whether the officer had to seize a taxpayer's iron lung. An iron lung is a piece of medical equipment, still sometimes used today, to allow people who cannot breathe on their own to survive.[64] The attorney's response was twofold: Yes, the statute (section 6301) did say "shall," yes, the tax lien attached to the iron lung, and yes, the levy statute required surrender of the property on demand, but no, despite the statutory language, the officer did not have to exercise his legal authority against that particular property. In wielding its enormous powers, the IRS has a corresponding enormous discretion to ameliorate imperfections in the law, either by overlooking action or declining to enforce an applicable statute when enforcement would be wrong.[65] Here, even if the Tax Court is correct and the statute allows it, it is nonetheless wrong to automatically attribute the intent of a tax return preparer to the taxpayer through tricks of presumption. The IRS should walk away from these new powers that it has been granted and focus on the tools that Congress gave it to combat the problem of tax return preparer fraud.

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[62]464 U.S. at 398 (emphasis supplied).

[63]*See Tax Notes*, Mar. 19, 2007, p. 1168, *Doc 2007-6271, 2007 TNT 54-53*. *Compare* FSA 200126019, *supra* note 33 (concluding that fraud solely on the part of the return preparer would suffice to trigger section 6501(c)(1)), *with* FSA 200104006, *supra* note 32 (coming to the opposite conclusion).

[64]*See* http://en.wikipedia.org/wiki/Iron_lung (last visited Feb. 26, 2008).

[65]*See* GCM 36137, *supra* note 32 (Jan. 15, 1975) (collecting examples).

taxanalysts camp's compendium

The Function of Forms in the Substitute-for-Return Process

By Bryan T. Camp

Bryan T. Camp is a professor of law at Texas Tech University School of Law.

This column generally explores the laws and policies of tax administration to help guide readers through the thickets of particular procedural problems while also giving them a sense of the larger tax administration forest.

Prof. Camp dedicates today's column to the many "workhorse" attorneys in the IRS Office of Chief Counsel, whose commitment to the cause of good tax administration cannot be questioned, even though their work products sometimes can and should be.

As for his own work product, Prof. Camp hopes that readers will call to his attention any errors they find or questions they have, whether big or small.

Today's column considers further the question of what constitutes a return. I previously suggested the answer to that question depends on what purpose, or function, the return is supposed to serve. A return is not simply a form, but a form that serves a function.[1] One should ignore neither form nor function, but I submit the latter is more important. The *primary* function of a return is to satisfy the legal obligation imposed on taxpayers by section 6011 to self-report their financial transactions. If a document does not sufficiently satisfy the section 6011 purpose, it should not constitute a return — regardless of its form — and the taxpayer should be subject to the appropriate sanction for failing to comply with the law.[2] At the same time, the law requires forms for the excellent reason that the IRS must process hundreds of millions of returns. If taxpayers could fulfill their section 6011 responsibility using just any old scrap of paper, "the business of tax collecting would result in insurmountable confusion."[3] That is why section 6011 and its regulations require taxpayers to use the "prescribed return forms."[4] The forms are necessary for the IRS to perform its return processing function.

The issue of what constitutes a return, therefore, is one of balance. This column continues my look at how that balance between form and function should apply to taxpayers who participate in the substitute-for-return process under section 6020. My last column reviewed how the IRS, in Rev. Rul. 74-203, had decided that a signed Form 870 should be treated "as the return of the taxpayer" within the meaning of section 6020(a) when presented to taxpayers by the IRS during the substitute-for-return process.[5] The IRS reached that result even though the Form 870 was not one of the prescribed return forms. The gist of Rev. Rul. 74-203, followed by over 30 years' worth of other IRS guidance and court opinions on the issue, was that a signed Form 870 sufficiently fulfilled the function of a return to be treated as the return of the taxpayer. In the section 6020 context, where it was the IRS preparing the return, the taxpayer should not be held accountable for the IRS's choice of what form to use. In short, form followed function.

The current IRS position is out of balance. In Rev. Rul. 2005-59, 2005-37 IRB 505, *Doc 2005-17431, 2005 TNT 162-9*, the IRS decided form was more important than function, even in the substitute-for-return process, and so reversed Rev. Rul. 74-203. It is now the IRS's position that taxpayers who sign a Form 870 presented to them by the IRS during the substitute-for-return process may not be treated as having filed a return because the Form 870 is not signed under penalties of perjury and does not "purport to be a return." In so concluding, Rev. Rul. 2005-59 relies heavily on the Tax Court's widely cited opinion in *Beard v. Commissioner*.[6] I believe the IRS misapplied *Beard* in the section 6020 context and, accordingly, Rev. Rul. 2005-59 should not have overturned Rev. Rul. 74-203. Part I gives the context and content of Rev. Rul. 2005-59. Part II explains why I think its conclusion about the law is wrong. Part III then questions the ruling on policy grounds. In short, the ruling moves the IRS onto weak legal ground for no discernable tax administration purpose.

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[1]*See* Bryan T. Camp, "The Function of Forms," *Tax Notes*, Jan. 30, 2006, p. 531.

[2]*Beard v. Commissioner*, 82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986).

[3]*Parker v. Commissioner*, 365 F.2d 792, 780 (8th Cir. 1966).

[4]Reg. section 1.6011-1(b).

[5]*See* Bryan T. Camp, "The Never-Ending Battle," *Tax Notes*, Apr. 17, 2006, p. 373. Rev. Rul. 74-203 is at 1974-1 C.B. 330. That revenue ruling also applied to other forms, such as Form 4549, by which the taxpayer waived the section 6213 restrictions on assessment and agreed to an immediate assessment of the stated liability. In this column the term "Form 870" encompasses other forms, such as Form 4549, that serve the same purpose as Form 870 and are used the same way in the same circumstances.

[6]82 T.C. 766 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986).

I. Context and Content of Rev. Rul. 2005-59

A. Context

Rev. Rul. 2005-59 explores the question of what constitutes a return in the context of two statutory processes: section 6020 and section 6013. As I detailed in my last column, section 6020 kicks in when a taxpayer has not filed a return. In those situations, sometimes the taxpayer needs help filing a return and so section 6020 authorizes the IRS to prepare the return for the taxpayer. Section 6020(a) provides that if the taxpayer (a) discloses "all information *necessary* for the preparation thereof" (my emphasis) and (b) "consents to sign" the document prepared by the IRS, then that document "shall be received as the return." Typically, the IRS sends a taxpayer a package of documents, some of which explain what tax liability is proposed and one of which is a consent form whereby the taxpayer agrees to the liability and forgoes the right to petition the Tax Court. That latter document is usually a Form 870, "Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment." Traditionally, the courts and the IRS have allowed a signed Form 870 to be received as the taxpayer's return under section 6020(a). In contrast, if the taxpayer either cannot be found or just blows off the IRS, then what the IRS prepares will *not* be treated as the return of the taxpayer. But it will be a section 6020(b) return, considered "prima facie good and sufficient for all legal purposes."[7] As I have maintained, once a certain point in the tax determination process is reached, it is simply too late for taxpayers to comply with their section 6011 responsibilities and they are and should be forever labeled a nonfiler for that tax period. The trick is finding that point.[8]

> ***The central conclusion in Rev. Rul. 2005-59 is that both section 6065 and Beard categorically deny a signed Form 870 the status of return.***

Section 6013 permits married taxpayers to elect to file their returns jointly. Section 6013 imposes two pertinent restrictions on that election. First is a restriction on retroactive elections, similar to the general three-year limitation for amending returns. If either taxpayer has filed a return for the year in question, section 6013(b)(2)(A) prohibits a retroactive election for that year unless it is one of the three previous years. Second, section 6013(b)(2)(B) prohibits an election after either taxpayer has, in response to a notice of deficiency, petitioned the Tax Court within the 90-day period. Thus, if neither spouse has filed a return for a given year, they can make the section 6013 election up until they choose to contest a proposed deficiency in Tax Court. If either spouse has filed a previous return, however, they basically have three years to make the joint election for that year. Finally, once taxpayers have filed a valid joint return, they cannot simply undo the election.[9] They must instead apply for relief under section 6015.[10]

B. Content

The central conclusion in Rev. Rul. 2005-59 is that both section 6065 and *Beard* categorically deny a signed Form 870 the status of return because the document fails two formal requirements: It does not "purport to be a return" and it does not contain a perjury clause.[11] The ruling comes to that conclusion by examining three situations that concern the interplay of sections 6020 and 6013. All three concern a hypothetical husband and wife who failed to file a return for 1999. An IRS employee is assigned to secure their return under section 6020.[12] In all three cases, the IRS employee prepares some documents and presents them to the taxpayers for signature. In all three cases, the question is whether the taxpayers have filed a return within the meaning of section 6013 to trigger the limitations on retroactive election of joint return status in section 6013(b). The important differences and conclusions are as follows:

> *Situation 1*: The taxpayers do not provide "all the information necessary" to prepare the documents and do not sign the documents prepared by the IRS employee. *Conclusion*: The documents "are not returns . . . for purposes of section 6013 because they did not sign the [documents] under penalties of perjury."

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[7]Section 6020(b).

[8]I have suggested that the proper point will generally be when the taxpayer files a petition in Tax Court in response to a 90-day letter, or else when the IRS makes an assessment when no Tax Court petition is filed. *See, e.g.*, Camp, *supra* note 1. That is the point suggested by the case law on bankruptcy discharge for nonfilers. It is also the point suggested by section 6013's restriction on the joint filing election. And it has other reasons to commend it, which are beyond the scope of today's column.

[9]Reg. section 1.6013-1(a)(1).

[10]Recall that while the Senate would have allowed a straight-up "opt out" regime in the 1998 reforms, the House wanted to stick to the traditional "innocent spouse" concept and that is basically what the Conference Committee adopted. For a detailed review of the legislative history of section 6015, see Bryan T. Camp, "The Unhappy Marriage of Law and Equity in Joint Return Liability," *Tax Notes*, Sept. 12, 2005, p. 1307.

[11]Note that the ruling, and other chief counsel documents, use the term "jurat" to mean a perjury clause. The terms are not formally synonymous, and I don't know if they are functionally synonymous. But jurat means "sworn to." A jurat clause is one in which signers swear to God (or affirm, if they are Quaker) that they are telling the truth. A perjury clause is, in effect, a secular jurat in which the signer agrees to be criminally liable for false statements.

[12]As I explained in my last column, the section 6020 process is more commonly worked through the bulk processing operations in the IRS campuses in the automated substitute for return (ASFR) program. In that process no IRS employee is assigned to secure a return. Instead, the computers attempt to secure the return using third-party information returns and the taxpayer's last known address. The 30-day letter package and 90-day letter package are automated. *See* IRM 5.18.1 (*ASFR Handbook*). Note that since my last column was published on Apr. 17, 2006, the IRS has removed the *ASFR Handbook* from its Web site. I do not know why.

Situation 2: The taxpayers do provide "all the information necessary" to prepare the documents, sign a "document prepared by the Service under the authority of section 6020(a)," and the signature is made "under penalties of perjury." *Conclusion*: The unspecified document is a return for purposes of section 6013 because it meets the four criteria listed in *Beard* including, most importantly, being "executed under penalties of perjury."

Situation 3: The taxpayers do not provide "all the information necessary" to prepare the documents, but consent "to the immediate assessment of the taxes reflected in the documents for the 1999 tax year by signing [a] Form 870," which, however, is not signed "under the penalties of perjury." *Conclusion*: The Form 870 is not a return for purposes of section 6013 because it "does not purport to be a return and it is not signed under penalties of perjury as required by section 6065." *Further conclusion*: Rev. Rul. 74-203 (which treated signed Form 870s as returns) is overruled because it "is inconsistent with *Beard* and the cases cited therein on what constitutes a valid return, because a Form 870 does not purport to be a return and is not executed under penalties of perjury." Accordingly, "A Form 870 signed by taxpayers . . . is not a return under section 6020(a). . . . This holding also applies to Form 1902 . . . and Form 4549 . . . and any successor forms to these forms, because these documents do not purport to be returns and do not contain a jurat with a penalties of perjury clause."[13]

While I have tried to give an honest and fair reading of the ruling, I ran into a couple of problems trying to understand it. One problem is that it states several times as a "fact" that the IRS employee did or did not prepare a return. But the entire legal issue is *whether* the documents used constitute a return for purposes of the section 6013 election. So to label a document in the facts as being or not being a return simply begs the *legal* question. For example, in giving the facts under Situation 3, the ruling states that the IRS employee "did not prepare a joint return and instead prepared a Form 870." Well, if one states as a fact that there was no return, that pretty much assumes the legal conclusion!

Second, the ruling is inconsistent and nonparallel in presenting the three situations. For example, in Situation 2 the ruling says the IRS employee prepared "documents authorized by section 6020(a)." In addition to assuming the legal conclusion (since section 6020(a) provides that those documents are to be "received as the return"), the ruling does not say whether the documents prepared by the IRS employee in the other two situations were or were not "authorized by section 6020(a)." It would have been more helpful if the ruling had the IRS employee prepare the same set of identified documents in each of the three situations. Similarly, while the ruling states that the taxpayers tell the IRS employee they want to file jointly in Situation 2, it is silent about whether they do so in Situation 3 or whether the IRS employee proposes to assess them on a joint or separate basis.

I have resolved the ruling's interpretive problems by reading Rev. Rul. 2005-59 in light of what appears to be its central purpose.

I have resolved those interpretive problems by reading Rev. Rul. 2005-59 in light of what appears to be its central purpose: to overrule Rev. Rul. 74-203. Accordingly, I assume that Situation 3 is meant to parallel the situation addressed in Rev. Rul. 74-203. That means I assume a couple of facts about Situation 3 that are not explicitly set out. First, since an important fact in Rev. Rul. 74-203 was that the taxpayers told the IRS employee that they wanted to file jointly, I assume that likewise in Situation 3 the taxpayers have told the IRS employee they want joint filing status and that this is reflected in the documents that accompany the Form 870.[14] Second, the ruling is strangely silent about what else accompanies the Form 870 in Situation 3. But taxpayers do not sign a Form 870 in a vacuum; it accompanies either a 30-day or 90-day letter.[15] Again, since Situation 3 is supposed to knock out Rev. Rul. 74-203, I have assumed the same facts as in that earlier ruling. In short, I have tried to resolve the internal inconsistencies and ambiguities in light of Rev. Rul. 2005-59's apparent purpose to overrule Rev. Rul. 74-203. I invite the reader to see if I missed anything.

II. Misapplication of Law

Revenue rulings "represent the conclusions of the Service on the application of the law," and their purpose is "to promote a uniform application of the tax laws."[16] I think Rev. Rul. 2005-59 misinterprets the law and fails to promote its uniform application. First, it misapplies both the legal rules it relies on: section 6065 and *Beard*. Second, it reverses over 30 years of solid legal precedents without articulating a strong legal or policy rationale for the turnaround. Third, its approach to the operation of section 6020 conflicts with the approach taken in the recently revised section 6020 regulations, creating a

[13]All quotes are from Rev. Rul. 2005-59.

[14]This assumption is strengthened by the ASFR program's automatic selection of a filing status of unmarried individuals for each taxpayer. If taxpayers want a different status, such as married filing jointly, they need to provide that necessary information in their response to the 30-day package or 90-day package. *See ASFR Handbook*. IRM 5.18.1.9.

[15]IRM 5.18.1.9.21. *See also* IRM 4.12.1.17 (May 3, 1999) ("If the nonfiler does not provide a delinquent return, all adjustments, tax, and penalties will be proposed on an income tax change report (Form 1902-B or Form 4549). If the nonfiler signs this report, it becomes a return filed by the Service under IRC 6020(a)."). No doubt the IRS will now change that last sentence to conform to Rev. Rul. 2005-59. But it should not.

[16]This is the standard language from the Introduction to the Cumulative Bulletins. *See, e.g.*, 2001-2 C.B. at ii.

goose-and-gander problem. I will explain each critique in turn (except the second one, which I covered in my last column).[17]

A. Misinterpretation of Section 6065

Rev. Rul. 2005-59 twice claims that under section 6065 a document *must* contain a perjury clause before it can be a return. It first states in the "law" section that "section 6065 *requires* that a return 'shall contain or be verified by a written declaration that it is made under the penalties of perjury'" (emphasis added). It later concludes that a Form 870 (presumably with accompanying schedules or other documents showing how the tax was determined) cannot be a return because, in part, "it is not signed under penalties of perjury *as required by section 6065*" (emphasis added).

Section 6065 reads, in full, as follows:

> Except as otherwise provided by the Secretary, any return, declaration, statement, or other document required to be made under any provision of the internal revenue laws or regulations shall contain or be verified by a written declaration that it is made under the penalties of perjury.

Rev. Rul. 2005-59 makes two mistakes regarding section 6065. First, it fails to mention, much less interpret, the meaning of the initial clause of the statute. That failure creates the misimpression that the IRS has no discretion as to whether a document must be signed with a perjury clause. Second, the ruling fails to address the meaning of the phrase "required to be made under any provision of the internal revenue laws or regulations" and so assumes without analysis that what the IRS prepares during the section 6020 substitute-for-return process falls within the ambit of section 6065. Let's look at each mistake more closely.

> ***It is disingenuous for Rev. Rul. 2005-59 to suggest that the weak words of the statute twist the mighty arms of the IRS.***

Folks, I trust I do not have to underline, italicize, bold, or highlight in neon green the very plain language of the opening clause — "Except as otherwise provided by the Secretary." It should jump right out at you. It certainly appears, on its face, to negate any claim that section 6065 binds the IRS. It seems to allow the IRS full discretion to decide which documents must be signed under penalties of perjury. The Supreme Court sure seemed to think so in *United States v. Bishop*, noting, with reference to returns prepared and filed by the taxpayer, that "the Secretary or his delegate has the power under section 6065 (a) to provide that no perjury declaration is required."[18] It is disingenuous for Rev. Rul. 2005-59 to suggest that the weak words of the statute twist the mighty arms of the IRS.

Nor does the legislative history of section 6065 suggest that the opening clause means anything less than what it plainly says. Section 6065 was enacted as part of the 1954 codification. It drew together in one statute several other provisions relating to signature requirements of various returns and documents of both individual and corporate taxpayers. Previously, some returns had to be signed under oath, others had to be signed under penalties of perjury, and still others simply had to be signed. Section 6065 was originally drafted to reflect all of those possibilities but to make signature under penalty of perjury the default rule. The section's language originated in the House bill and was unchanged by the Senate. The House and Senate reports use the same language to explain that under the consolidated statute "all returns, etc., are to be made under penalties of perjury, except that the Secretary may permit them to be made without such declaration or the Secretary may exercise his authority . . . to require them to be made under oath."[19] So what seems to be true is indeed true: The IRS has complete discretion to require or not require perjury declarations.[20]

The second interpretive problem lies in the application of section 6065 to the section 6020 process. There are two good reasons why it probably does not apply. First, as the legislative history of the statute shows, the entire statute is directed at documents required to be submitted *by*

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[17]In my previous column I detailed how, even before Rev. Rul. 74-203, the IRS and the courts took a functional approach in concluding that a signed Form 870 could constitute a section 6020(a) return. For the blow-by-blow analysis, see Camp, *supra* note 5. *Beard* was decided in 1984. After *Beard*, both the IRS and the courts continued to follow Rev. Rul. 74-203. It thus seems a bit late for Rev. Rul. 2005-59 to say, as it cheekily does, that Rev. Rul. 74-203 is "inconsistent with *Beard* and the cases cited therein."

[18]412 U.S. 346, 357 (1973) (*dicta*). Before 1976, section 6065 had two subsections.

[19]H. Rep. 1337, *reprinted in* 1954 USCCAN at 4548; S. Rep. 1662, *reprinted in* 1954 USCCAN at 5215.

[20]One might read the revenue ruling as simply declining to exercise the discretion permitted by section 6065 and invoking the default rule of a perjury declaration for the Form 870. Or reinvoking, since the IRS has ever since Rev. Rul. 74-203 consistently concluded that signed Forms 870 or like documents should be "received as the return of such person." The problem with that reading of Rev. Rul. 2005-59 is that an agency cannot exercise its discretion arbitrarily. It must provide a reasoned basis for its decision and the ruling here does not, especially in view of the clear policy reasons for adopting the contrary holding that a signed Form 870 can constitute a return, spelled out in Rev. Rul. 74-203 and in GCM 34919, 1972 LEXIS GCM 205. Once one concedes that neither section 6065 nor *Beard* compels the result as a matter of law, the ruling amounts to mere fiat. There may be good policy reasons for the ruling's position (I consider them below), but they are unexplained. That leaves Rev. Rul. 2005-59 vulnerable under the general principle of administrative law that an agency must provide a reason for the exercise of a discretionary action or else its decision will be void. *See Securities and Exchange Commission v. Chenery*, 332 U.S. 194 (1947) ("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. . . . 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.").

taxpayers, and not documents prepared by the IRS.[21] As I detailed in my last column, the whole history of the section 6020 return process shows that it authorizes the IRS to step in when taxpayers either cannot or will not prepare their own returns. The IRS, not the taxpayer, prepares the documents necessary to calculate the tax, and the IRS can use any documents or forms it wants to as long as the documents and forms contain "sufficient information . . . to compute the tax liability."[22] If the taxpayer provides necessary information and signs, then the signed documents are "received as the return" of the taxpayer under the plain language of section 6020(a). *That* language does not require a perjury clause. If the taxpayer does not provide necessary information or a signature, the same set of documents will comprise a section 6020(b) return.[23] Either way, because the IRS employee prepares the documents to be signed, section 6065 does not apply because the documents are not being submitted to the IRS *by the taxpayer* but are being submitted to the taxpayer by the IRS.

Second, regardless of who prepares them, the statute applies only to documents "required to be made under any provision of the internal revenue laws or regulations." Section 6020 returns are not required to be made. Courts have routinely rejected bizarre taxpayer assertions that the IRS is somehow required to prepare returns for the taxpayer under section 6020.[24] As I explained in my last column, the IRS does not have to prepare a return for nonfilers; it can simply send out the notice of deficiency. And if the IRS does prepare a substitute-for-return package, which includes the Form 870, no law or regulation "requires" the taxpayer to sign it. I suggested in my last column that the section 6020 process is best thought of as a congressional decision about when taxpayers who have initially failed in their section 6011 duty to file returns may be treated as compliant taxpayers. The basic deal is that taxpayers who give the cooperation necessary for an immediate assessment are rewarded by being treated as if they *have* fulfilled their section 6011 obligation. Taxpayers who choose to continue their contumacious ways are not treated so well. In effect, section 6020 gives taxpayers a second chance to do their section 6011 duty, but does not *require* them to take it. Section 6065 is best thought of as applying to the duty itself, not to the second chance.

One could argue that since a section 6020 return is a substitute for the required return, allows taxpayers to fulfill their section 6011 duty to file a return, and is to be received as their return, section 6065 should apply regardless of who prepares the documents. That argument has some force, but the important counterpoint for me is that the IRS itself still controls the forms used in the process. The IRS could have its employees or the computer prepare a Form 1040 and send that for the taxpayer to sign instead of a Form 870. I suspect that in field cases, local practices may vary between IRS employees filling out an actual Form 1040 for taxpayers and simply attaching a Form 870 to a revenue agent report. Heck, the IRS could put a perjury clause on the Form 870. But to decide whether a taxpayer has filed a return based on which form the IRS has chosen to send the taxpayer seems to me excessive formalism.

> ***In effect, section 6020 gives taxpayers a second chance to do their section 6011 duty, but does not require them to take it.***

In sum, Rev. Rul. 2005-59's claim that section 6065 requires signatures to be made under penalty of perjury before *any* document can be a return is weak. Section 6065 does not really support, much less compel, a conclusion that a document (a) *prepared by the IRS* (b) *during the section 6020 process*, may not be, according to the plain terms of that statute, "received as the return of such person" if the conditions in section 6020 are met. A perjury declaration is not one of the conditions. Even if it were, the IRS can waive that requirement and it is not clear that a single revenue ruling will suffice to recant the 30-year history of waiver that I discussed in detail in my last column.[25]

B. Misinterpretation of *Beard*

Rev. Rul. 2005-59 also invokes *Beard* to conclude that a signed Form 870 cannot be a section 6020(a) return. The ruling claims that *Beard* requires a document to "purport to be a return." It points out that Form 870 does not purport to be a return because, on its face, it is just a waiver of restriction on immediate assessment. It then concludes that Form 870 fails to qualify as a return. I think that logic is suspect and unsupported by *Beard*. The "purport to be a return" test is not about whether a document is labeled "return" but is about whether a document *functions* as a return. That is particularly true in the context of the section 6020 substitute-for-return process. To conclude that a document is not a return when it is used by the IRS to function as one, places form over function. I will review *Beard* and then explain how Rev. Rul. 2005-59 misapplies it.

1. Untangling *Beard*. *Beard* was a case in which a taxpayer submitted altered Forms 1040 to reflect his tax protestor theories.[26] At issue was whether the IRS had correctly applied the section 6651(a)(1) additions to tax

[21]*See, e.g., Morelli v. United Alexander*, 920 F. Supp. 556, *Doc 96-14968, 96 TNT 99-59* (S.D.N.Y. 1996) (collecting cases).

[22]*Millsap v. Commissioner*, 91 T.C. 928, 930 (1988).

[23]*Id.*

[24]*Morelli, supra* note 21; *In re Vines*, 200 B.R. 940, *Doc 96-7271, 96 TNT 49-10* (M.D. Fla. 1996) (collecting cases); *United States v. Harrison*, 72-2 USTC para. 9573 (S.D.N.Y. 1972) (Weinstein, J.) (prescient discussion of automation's effect on section 6020 process).

[25]Rev. Rul. 2005-59 does not cite *Beard* for the proposition that the taxpayer must sign a document under penalties of perjury. I assume, however, that would be an alternative basis that the ruling would take if section 6065 were unavailable. Accordingly, I will address that issue during my discussion of *Beard*.

[26]*Beard v. Commissioner*, 82 T.C. 766 (1984).

for failure to file a return. Deciding the issue required the Tax Court to rule on whether the altered Forms 1040 constituted returns so as to prevent the additions to tax.

While "everyone knows" that the Tax Court applied a four-part test in *Beard*, a fresh reading of the case reveals that it actually employed a two-step analysis to answer the question presented. It first looked to see whether the altered forms were returns within the meaning of the applicable regulations. Only then did it apply the now-famous four-part test.

The Tax Court's first step was to see whether the taxpayer had fulfilled his section 6011 duty to file returns by following the section 6011 regulations.[27] It emphasized *function*: The purpose of the "proper official form" was "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."[28] After establishing the reason for requiring taxpayers to conform to the rules written by the IRS, the court then looked at whether Beard had submitted "a return *according to the forms and regulations* prescribed by the Secretary as required by section 6011(a)." It concluded he had not.[29]

But the court did not stop there. It took a second step: looking to see whether the altered Form 1040s could be returns under a line of (mostly) Supreme Court cases concerning:

> factual circumstances in which the courts have treated as returns, for statute of limitations purposes, documents which did not conform to the regulations as prescribed by section 6011(a). Since the instant case is one of first impression, we will consider these cases that were decided on the statute of limitations issue because a return that is sufficient to trigger the running of the statute of limitation must also be sufficient for the purpose of section 6651(a)(1).

The court then synthesized the "factual circumstance" cases into a four-part test:

> First, there must be sufficient data to calculate 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.[30]

This review of *Beard* reveals how Rev. Rul. 2005-59 may have committed two errors in relying on the "purport to be a return" element of the *Beard* four-part test. First, one does not even get to that test unless the documents under consideration fail to conform to the applicable rules and regulations. If the documents at issue meet the requirements of the IRS, they are returns. Second, even if one applies the four-part test, one should not read the "purport to be a return" element in isolation from the rest of the elements. I shall discuss each error in turn.

> ***The Office of Chief Counsel has long recognized that the rules and regulations governing forms selected and used by taxpayers do not apply to forms selected and used by the IRS.***

2. *Beard* four-part test does not apply. *Beard's* four-part test is inapplicable to Forms 870 used in the section 6020 process. *Beard* was about whether documents *prepared by the taxpayer* conformed to the rules and regulations promulgated by the IRS. But the section 6020 process is about documents *prepared by the IRS*. I submit that is an important distinction. In other words, the first step in *Beard* is to ask whether the document in question conforms to the IRS requirements for returns. In the section 6020 process, the Form 870, almost by definition, does conform to the IRS requirements. Taxpayers do not select the forms; the IRS selects the forms, which creates a strong presumption that the forms conform to the IRS requirements for a return. The Office of Chief Counsel has long recognized that the rules and regulations governing forms selected and used by taxpayers do not apply to forms selected and used by the IRS. The reason is purely functional, as GCM 34673 explained in 1971:

> It would be employing our own rules to restrict the reasonable and feasible administration of the tax laws for the Service to conclude that in preparing a return under the requirements of section 6020(b)(1) the return must be prepared in the fashion and on the form designed for taxpayers. The forms designed for taxpayer use were intended to provide a convenient method of setting out the required information in relation to the type of records that the taxpayer is expected and required to maintain. The same information may not be available to the Service upon audit, or at least not in the same form; thus, a different mode or form of presentation of the information required to arrive at the proper tax liability may be more convenient to the Service. When a taxpayer fails to file an employment tax

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[27]Reg. section 1.6011-1(a).

[28]82 T.C. at 775, *quoting Commissioner v. Lane-Wells Co.*, 321 U.S. 219, 223 (1944) (emphasis supplied by Tax Court). The Tax Court then quoted this passage from *Parker v. Commissioner*, 356 F.2d 792, 800 (8th Cir. 1966): "Taxpayers are required to file timely returns on forms established by the Commissioner. * * * The Commissioner is certainly not required to accept any facsimile the taxpayer sees fit to submit. If the Commissioner were obliged to do so, the business of tax collecting would result in insurmountable confusion."

[29]82 T.C. at 777 ("There can be no doubt that due to its lack of conformity to the official form, it substantially impedes the Commissioner's physical task of handling and verifying tax returns. Under the facts of this case, taxpayer has not made a return *according to the forms and regulations* prescribed by the Secretary as required by section 6011(a)" (emphasis in original)).

[30]82 T.C. at 777.

return, the Service is required to gather the information essential to determine and collect the tax from the non-filing taxpayer. In this situation, it is illogical to conclude that the Service, in preparing a section 6020(b) employment tax return, must use Form 941 for that purpose when the same function can be served by using a different procedure.

While that general counsel memorandum concerns an employment tax and the definition of a section 6020(b) return, the IRS adopted the same rationale in situations involving the preparation of a section 6020(a) return for income tax.[31] The rationale is a good one, consistently used by the Office of Chief Counsel over the years, but it is one that Rev. Rul. 2005-59 completely fails to address.

Tax Court cases on section 6020(b) returns support that IRS analysis. The Tax Court itself has not applied *Beard* to judge whether documents prepared *by the IRS* during the examination and deficiency process constitute returns.[32] In deciding whether documents prepared by the IRS constituted section 6020(b) returns, the court has instead relied on a strongly functional analysis in a string of cases going back to *Phillips v. Commissioner*, decided in 1986, two years after *Beard*.[33] Those cases make no mention of *Beard* and instead test whether a document is a section 6020(b) return by looking to see how closely it is associated with the underlying documents from which a tax liability can be computed (and whether it meets the section 6020(b) signature requirement).[34]

As one Tax Court judge has noted, *Beard* simply does not apply "in some circumstances where the statutory scheme directs a different inquiry."[35] Like section 6020(b), section 6020(a) is most reasonably read as directing such a different inquiry because it expressly requires only that the taxpayer (1) "consent to disclose all information necessary" and (2) sign "such return." The rules and regulations governing *taxpayer*-prepared documents do not apply in the same way to IRS-prepared documents. Thus, the *Beard* inquiry is simply inappropriate in this context.

3. Form 870 meets the *Beard* four-part test. Even if one concluded that *Beard* applied to forms selected, prepared, and presented to the taxpayer by the IRS during the section 6020 process, Rev. Rul. 2005-59 misapplies the four-part test by reading the "purport to be a return" element as a formal element in isolation from the other elements. It is not a formal element. It is a functional element. And it is just one of four. Recall that the Tax Court reached the four-part test only *after* it had already decided that Beard's return was not proper "according to the forms and regulations." That first step was the formal test. Did the taxpayer use the right forms? If yes, end of story. If no, proceed to the four-part test. Once one applies a functional analysis, then, for the reasons I detailed in my last column, one easily reaches the same conclusion that the IRS and case law have reached for over 30 years, that the signed Form 870 constitutes a section 6020(a) return and should therefore be "received as the return of the taxpayer."

The Tax Court itself has not applied Beard to judge whether documents prepared by the IRS during the examination and deficiency process constitute returns.

But even if one reads "purport to be a return" as a formal element, it alone is neither necessary nor sufficient to determine whether a particular document is a return. It must be read with the other elements. *Beard* itself shows how it is not sufficient. The taxpayer there argued that what he had submitted to the IRS was labeled a Form 1040 and so it purported to be a return. The Tax Court agreed that the document *did* purport to be a return because it was titled "Form 1040," but it was still not a return because he had altered it so much that it could not *function* as a Form 1040. Thus, the taxpayer had not made an honest and reasonable attempt to satisfy the requirements of the tax law. On this view, the functional analysis of the "honest and reasonable" element trumped the formal "purport to be a return" element.

The Supreme Court cases cited in *Beard* demonstrate how the "purport to be a return" element is also not necessary to a finding that a document is a return within the meaning of the applicable statute. In *Germantown Trust v. Commissioner*, the Supreme Court had held that a return filed on one form in a good-faith belief that the taxpayer was one type of entity (trust) could start the limitation period — if it contained the information necessary to calculate tax — even if the IRS later determined that the taxpayer was another type of entity (corporation)

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[31]GCM 34919, 1972 GCM LEXIS 205 at *4 (relying on GCM 34673 to conclude, "A Service-prepared return need not be on the forms prescribed for use when a taxpayer prepares his own return."); GCM 38627, 1981 GCM LEXIS 107 at *10 (relying on GCM 34673 to conclude, "Thus we would draw a distinction between returns prepared by the taxpayer and those prepared by the Service. The basis for this distinction is explained in GCM 34673 and relied upon in GCM 34919. Though GCM 34673 concerns returns prepared and executed pursuant to section 6020(b), rather than section 6020(a), the following analysis of that memorandum applies equally to returns prepared under the latter section.").

[32]*See Spurlock v. Commissioner*, T.C. Memo. 2003-124, *Doc 2003-10782, 2003 TNT 83-10*, 2003 Tax Ct. Memo. LEXIS 123 at *41.

[33]86 T.C. 433 (1986), *aff'd*, 851 F.2d 1492 (D.C. Cir. 1988) (no reference to *Beard*). *See also Cabirac v. Commisioner*, 120 T.C. 163, *Doc 2003-10230, 2003 TNT 78-10* (2003) (no reference to *Beard*); *Millsap v. Commissioner*, 91 T.C. 926 (1988) (no reference to *Beard*).

[34]It is true that Judge Vasquez has recently suggested applying *Beard* to judge whether documents prepared during the section 6020 process were returns. *See, e.g., Mendes v. Commisioner*, 121 T.C. 308, 329, *Doc 2003-26296, 2003 TNT 239-9* (2003) (Vasquez, J., concurring). But once again, his opinion deals with documents prepared and submitted *by taxpayers* on Forms 1040 during the section 6020 process.

[35]*Mendes v. Commissioner*, 121 T.C. 308, 332 (2003) (Goeke, J., concurring).

and so had used the wrong form.[36] One might interpret *Germantown* as meaning that the "purport to be a return" element is functional — the wrong form was a return because it was meant to function as a return and it *did* function as a return (because it contained all the necessary data). Or one might interpret *Germantown* as meaning that the "honest and reasonable" element trumped the "purport to be a return" element. Either way, the form yields to function.

The Tax Court has applied this idea of function over form in other contexts as well. For example, the IRS requires charities to report unrelated business income on Form 990-T. Nonetheless, the Tax Court has held that a Form 990 will suffice to start the assessment limitations period when an organization in good faith reports income on a Form 990 and the IRS later determines it is unrelated business income.[37]

But wait! What about that perjury clause? After all, another one of the elements in the *Beard* four-part test is that, to be a return, the document should be signed under penalties of perjury. At first blush, that appears a slam-dunk formal requirement. A closer reading, however, shows that the element is directly tied to statute law; it is not an independent requirement created by the courts. The *Beard* formulation is simply a restatement of the various rules stated over time by the Supreme Court. The Tax Court pulled the perjury clause rule from the Supreme Court's 1934 opinion in *Zellerbach v. Helvering*, which, in turn, pulled it from the 1930 opinion in *Lucas v. Pilliod Lumber Co.*[38] That last case, however, pulled the signature-under-oath requirement *from the then-governing statute!*[39] Accordingly, the signature requirement in *Beard* simply comes from statute law and is not a judicially created rule. As I explained above, the current statute governing the signing of returns — section 6065 — gives the IRS complete discretion on what type of signature to require. It is true that the taxpayer must sign a document.[40] That is because section 6020(a) does indeed require a signature. But it does not require a perjury clause.

For these reasons I think Rev. Rul. 2005-59's reading of *Beard* is wrong. The *Beard* four-part test is not meant to be a mechanical formalist test. How that test was used in *Beard* demonstrates that it was meant as a functional backup analysis to the primary inquiry of whether the document at issue conforms to the applicable rules and regulations *for documents submitted by the taxpayer*. Proper application of *Beard* should not change in any way the IRS's 30 years of rulings that a signed Form 870 constitutes a section 6020(a) return when it functions as a return.

C. The Section 6020 Regulations

The position staked out by Rev. Rul. 2005-59 appears to be that the taxpayer must prepare, sign, and send in a Form 1040, or somehow sign a Form 1040 during the section 6020 process to be considered to have filed a return. That position does not promote the uniform application of the laws because it directly contradicts the position the IRS takes on what constitutes a section 6020(b) return.

Recall that during the section 6020 process, the IRS will send out either a 30-day package or a 90-day package to the taxpayer. That package consists of a report that proposes a deficiency and explains the basis for the proposed deficiency. It also consists of a consent form, usually the Form 870, for the taxpayer to sign if the taxpayer agrees with all the proposed items. If the taxpayer disagrees, the taxpayer can either fill out a Form 1040 or contact an IRS employee who will revise the report per the information provided by the taxpayer. Because the default filing status used by the automated substitute for return (ASFR) program is that of an unmarried individual, married taxpayers often will need to contact the IRS to get the filing status changed.[41] Thus, in the situations described in Rev. Ruls. 2005-59 and 74-203, one can say with great confidence that the taxpayers have supplied "necessary" information to the IRS: their filing status election.

As I explained at length in my last column, when a taxpayer does not respond to the proposed deficiency (either the 30-day letter or the 90-day letter), it is difficult to tell whether the IRS has prepared a section 6020(b) return or has chosen simply to proceed against the taxpayer with a notice of deficiency. The IRS has had

[36] *Germantown Trust v. Commissioner*, 309 U.S. 304 (1940) (a taxpayer's erroneous but good-faith filing of a fiduciary return instead of a corporate return was valid to start the limitation period for assessment of corporate income tax). *Cf. Commissioner v. Lane-Wells*, 321 U.S. 219 (1944) (regular corporate income tax return of a taxpayer was not valid to start the limitation period for assessment of separate personal holding company tax because the regular return did not contain the information needed to calculate the latter tax). Congress showed a preference for the functional *Germantown Trust* approach by enacting section 6501(g) to overrule several cases that had followed the rule laid down in *Lane-Wells*. *See* GCM 38382; 1980 GCM LEXIS 236 (May 23, 1980) (giving legislative history of section 6105(g)(2)).

[37] *California Thoroughbred Breeders Ass'n. v. Commissioner*, 47 T.C. 335 (1966), *acq. in result only*, 1969-1 C.B. 21. There, the Tax Court liberally construed section 6501(g)(2) to hold that the filing of a Form 990 would start the running of the period of limitations with respect to the tax on unrelated business income, even though Form 990 was not the proper "prescribed return form" per reg. section 1.6011-1(b). The IRS agreed to follow the Tax Court's functional approach in Rev. Rul. 69-247, 1969-1 C.B. 303, but was careful to limit its agreement to situations in which the taxpayer has disclosed sufficient facts on the improper form to alert the IRS of the potential existence of unrelated business taxable income.

[38] *Zellerbach* is at 293 U.S. 172 and *Pilliod Lumber* is at 281 U.S. 245.

[39] 281 U.S. at 248, *citing* to section 239 of the Revenue Act of 1924, c. 234, 43 Stat. 253 ("That the so-called return of May 31, 1919, unsupported by oath, did not then meet the definite requirements of Section 239 is manifest."). Taxpayers were required by statute to sign returns under oath until 1942, 56 Stat. 798, 836, when the requirement was downgraded to a perjury clause and then, in 1954, became the discretion of the IRS.

(Footnote continued in next column.)

[40] *See, e.g., In re Wright*, 244 B.R. 451, *Doc 2000-3500, 2000 TNT 25-19* (Bankr. N.D. Cal. 2000) (no section 6020(a) return when taxpayer cooperated with preparation and assented but never signed a waiver form).

[41] *See ASFR Handbook* at IRM 5.1.18.

some recent trouble convincing the Tax Court that a notice of deficiency was based on a section 6020(b) return.[42] In the 1970s the Office of Chief Counsel warned the commissioner about the difficulty in distinguishing between a bare notice of deficiency and a notice of deficiency based on a section 6020(b) return.[43] I explained in my last column how the distinction is an accident of legal history, with no real substantive purpose. But there it is. The Tax Court has therefore had to come up with some distinction between an assessment based on some mythical creature called a section 6020(b) return and an assessment based on an unagreed notice of deficiency — and it has rejected the IRS's assertion that the entire administrative file can be the section 6020(b) return.

In 2005, in reg. section 301.6020-1T, the IRS addressed the issue of what constitutes a section 6020(b) return.[44] To create a test that would meet the processing demands of tax administration and give some formal indication of a section 6020(b) return, the regulation provides that *any* set of documents will be a section 6020(b) return if the documents (a) contain sufficient information from which to compute the taxpayer's tax liability and (b) are certified as such by a Form 13496, "IRC Section 6020(b) Certification," or "*any* other form that an authorized internal revenue officer or employees signs and uses to identify a set of documents . . . as a section 6020(b) return."[45]

Notice what the IRS is doing here. The regulation not only allows the IRS to use a special form to identify a set of documents as constituting a section 6020(b) return, but it also provides that *any other* form an IRS employee uses for the same function will suffice. The regulation is very careful to emphasize that many different forms may accomplish the same function. It is also careful to emphasize that the supposed signature of the IRS employee can be "mechanically affixed" and that both the "document and signature may be in written or electronic form." In other words, that allows the IRS to automate the authentication process by creating another computer-generated document in the ASFR 30-day and 90-day packages so that they will constitute a section 6020(b) return if a taxpayer does not or cannot timely respond to them. And that is so even though these documents are potentially prepared (as they can and should be) with no human intervention. The regulation provides for that because that is what the IRS needs to make the ASFR work. The form follows function.

Rev. Rul. 2005-59 is inconsistent with the approach taken in the regulations for section 6020(b) returns. It demands that a taxpayer who responds to a 30-day or 90-day package from the ASFR actually fill out a Form 1040. Simply corresponding with or contacting the IRS and then signing the accompanying Form 870 to consent to the tax will not suffice. Just as the Form 870 does not formally "purport to be a return" on its face, neither does a notice of deficiency. But whereas the IRS allows itself huge flexibility on how to designate a notice of deficiency or accompanying documents as section 6020(b) returns, it does not allow taxpayers who timely cooperate the benefit of having those same documents "received as the return of the taxpayer" under section 6020(a).

> ***So under Rev. Rul. 2005-59, taxpayers are at the mercy of whatever an IRS employee decides to prepare and send them. That gets the section 6020 regime exactly backward.***

The potential upshot of the interplay between reg. section 301.6020-1T and Rev. Rul. 2005-59 is that taxpayers who cooperate, who provide information, and yet who merely sign the Form 870, will now be forever adjudged nonfilers because of the IRS's new standard operating procedure to designate the 30-day letter or 90-day letter package as a section 6020(b) return. What is good for the IRS goose is apparently not good for the taxpayer gander. But it should be.

III. Tax Administration Policy

Operationally, Rev. Rul. 2005-59 may well result in diverse applications of the section 6020 return process, to the detriment, in at least three ways, of many taxpayers. First, and most obviously, taxpayers are now at the mercy of the IRS. Whether what the IRS does will be received as the return of the taxpayer under section 6020(a) or will be received as a section 6020(b) return will *not* depend on the cooperation and participation of the taxpayer as much as on the selection of forms that the IRS happens to send the taxpayer. Presumably, the IRS will alter the ASFR 30-day and 90-day packages to include a Form 1040 instead of a Form 870. One should hope, although I have seen no indication that this change will happen or is happening. But even if it does, there are still a lot of substitutes-for-return that get worked in the field. And field procedure is notoriously local. So under Rev. Rul. 2005-59, taxpayers are at the mercy of whatever an IRS employee decides to prepare and send them. That gets the section 6020 regime exactly backward. Section 6020 is not about IRS behavior; it is about taxpayer behavior. Taxpayers who cooperate sufficiently with the IRS and allow the IRS to "help . . . them meet . . . their tax responsibilities" should be rewarded under section 6020(a). The previous IRS functional approach to that section accomplished that result more effectively than does this new formalist approach.

Of course, as you read this the IRS has not yet changed its ASFR programming. That will take months and perhaps years. Meanwhile, taxpayers who sign Forms 870 instead of filling out and sending in their own Forms 1040 will (at least according to the IRS) be stuck with a section 6020(b) return. In November 2005 the Office of Chief Counsel announced that it would now follow Rev.

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[42] *See, e.g., Cabirac v. Commissioner*, 120 T.C. 163 (2003) (denying the section 6651(a)(2) addition to tax because the IRS has not prepared a section 6020(b) return); *Spurlock v. Commissioner*, T.C. Memo. 2003-124 (same). The IRS difficulties in this regard go back to at least *Phillips v. Commissioner*, 86 T.C. 433 (1986).

[43] GCM 35487, 1973 GCM LEXIS 109 (Sept. 21, 1973).

[44] The IRS published simultaneous temporary and proposed rules. The temporary rules are at 70 *Fed. Reg.* 41144 (July 18, 2005); the proposed rules are at 40 *Fed. Reg.* 41165.

[45] Reg. section 301.-6020-1T(b)(2) (emphasis supplied).

Rul. 2005-59 in bankruptcy cases for taxpayers who signed Form 870 after September 12, 2005.[46] So taxpayers who would have had old tax liabilities discharged in bankruptcy now will be unable to receive a discharge — assuming courts follow Rev. Rul. 2005-59, which I sure hope they won't.

Second, and worse, when the tax liability proposed by the IRS is correct and the taxpayer has no information to add — because the IRS was already in possession of all the relevant information, thanks to third-party information returns — the taxpayer is now stuck with a section 6020(b) return. Even if the IRS now starts sending out Form 1040 with the 30-day notice packages and the 90-day notice packages, that does not address this issue. Previous case law and IRS guidance focused on whether the taxpayer had any "necessary" information to provide. If not, it was simply the consent to assessment that allowed the document to be treated as a section 6020(a) return.[47] I think that is the proper position and should remain so.

Third, there does not appear to be a strong policy reason to require a perjury clause during the substitute-for-return process, whether on the Form 870 or any other form. A perjury clause requirement serves at most three purposes: deterring taxpayers from playing the audit lottery by emphasizing to the taxpayer the seriousness of what is being signed; assuring the IRS that the return provides a substantially correct basis for assessment; and providing a predicate for criminal prosecution under section 7601.[48]

None of those reasons apply in the section 6020 substitute-for-return process, which is very much like an audit. The process is more like an examination than it is like a simple return processing. The IRS uses third-party information returns such as Forms 1099 and W-2, leaving little room to omit income items. For deduction items, the taxpayer bears the burden to verify, to the satisfaction of the IRS employee, any deduction items claimed during the substitute-for-return process.[49] Form 870 and others like it are presented *to* the taxpayer by the IRS, which does not ask, "Is this correct?" but asks, "Will you consent to this?" The IRS has already prepared the report based on the information at hand, including any information provided by the taxpayer. The question "Will you consent to this?" is the final chance for the taxpayer to meet the section 6011 duty. If the taxpayer consents, and has supplied any "necessary" information, then section 6020(a) — as historically interpreted — deems that good enough to treat the documents as the taxpayer's return. There seems little reason to ask for more.[50]

Nor does the lack of a perjury clause prevent the IRS from criminally prosecuting a taxpayer who signs the Form 870 knowing the information being consented to is false. Although section 7601(a) makes a perjury clause a prerequisite for prosecution for some false statements, and so might be unavailable, the government has other criminal statutes in its arsenal, notably section 7201 or 18 U.S.C. section 1001.[51]

The final point on administration is that Rev. Rul. 2005-59 does not appear to help taxpayers fulfill their responsibilities, which the history of section 6020 suggests is one of its main purposes. As far as married nonfilers go, some might say it can help one spouse who later wants to file a Form 1040 to claim the status of unmarried individual when he or she had previously cosigned a Form 870 agreeing to be assessed as joint filers. Since the signing of a Form 870 is now not a return, the spouse will now not have been deemed to have elected the joint filing status. That was the situation in *United States v. Olgeirson*.[52] But because there will still be a prior assessment against that spouse — and now one based on a section 6020(b) return — I seriously doubt either the courts or the IRS will agree that a later-filed Form 1040 will constitute a return. The long-standing IRS position — widely adopted by the courts — is that a taxpayer can no longer file a valid return once the IRS has made the assessment on the basis of a section 6020(b) return. That was the subject of the debate between Judges Posner and Easterbrook that I discussed in a previous column.[53] The previous assessment will now have been

[46]Chief Counsel Notice 2006-002, *Doc 2005-24052, 2005 TNT 229-6*.

[47]As one chief counsel memo explained: "Although [case law and previous IRS guidance] can be viewed as indicating that taxpayer should be the source of the information permitting the Service to calculate the liability, *Olgeirson* and *Carapella* concluded that as long as the Service has the information, regardless of the source, that part of the requirement is satisfied. We believe the courts will be inclined to follow the *Olgeirson* rationale and therefore a Form 870 signed by the taxpayer and as to which the Service has sufficient information to calculate the tax liability is, or will be held to be, a 6020(a) return for purposes of dischargeability." Memorandum to District Counsel, Seattle, from Chief, Branch 2, General Litigation Division, dated June 20, 1990, as reported in General Litigation Bulletin 358 (July 1990), 1990 GLB LEXIS 5 at *38.

[48]*Borgeson v. United States*, 757 F.2d 1071 (10th Cir. 1985) (failure to sign perjury clause on Form 1040 is sufficient predicate for section 6702 frivolous return penalty and necessary predicate for section 7601 false return criminal charge). *See also Schneider v. United States*, 594 F. Supp. 611 (E.D. Mich. 1984) (perjury penalty deters taxpayers from playing the audit lottery); *Lange v. Commissioner, Doc 2005-15332, 2005 TNT 138-10*, T.C. Memo. 2005-176 (alterations to perjury clause that called into question the accuracy or completeness of the figures reported invalidated the return, but alterations such as "under protest" that simply disclaimed liability did not invalidate returns) (collecting cases).

[49]The Internal Revenue Manual contains multiple and detailed instructions on how IRS employees working the ASFR program are to handle taxpayers who send in correspondence claiming deductions and denying the accuracy of the information returns. *See* IRM 5.18.1.9.124. They are to kick over to various examination functions any claims of itemized deductions or Schedule C or Schedule E items.

[50]If a taxpayer prepares and submits a return form, such as the Form 1040, which contains a perjury clause, during the section 6020 process, then the issue becomes moot.

[51]*Cohen v. United States*, 201 F.2d 386 (9th Cir.), *cert denied*, 345 U.S. 951 (1953) (section 7601 does not supercede 18 U.S.C. section 1001).

[52]284 F. Supp. 655 (D. N.D. 1968).

[53]*See* Camp, *supra* note 1.

made based on a section 6020(b) return, per the new regulation. So what the IRS takes with one hand it does not seem to give back with the other hand, to either spouse.

IV. Conclusion

The history of tax administration and the relevant decisions of courts and the IRS show that the basic rationale for the disparate treatment of section 6020(a) returns and section 6020(b) returns comes down to one idea: timely cooperation. As I hope I have convinced you in my previous columns, whether a taxpayer has filed a section 6020(a) return or not should turn on the behavior of taxpayers, not the IRS. That is how the courts and the IRS have interpreted the statute for over 30 years. Rev. Rul. 2005-59 is a formalist departure from that functionalist interpretation. In my opinion it misapplies the relevant law and, read in conjunction with the newly issued section 6020 regulations, interprets the statute exactly backward. The IRS now wants to distinguish between a section 6020(a) return and section 6020(b) return on the basis of the decisions made by IRS employees on what forms to ask the taxpayers participating in the substitute-for-return process to sign. Whether those are bulk processing decisions made by upper-level National Office employees that affect all taxpayers in the ASFR, or individualized processing decisions made on the ground by field employees, the result is the same: The status of a document as a section 6020(a) return or section 6020(b) return is now a matter of the form used and not the function fulfilled. I do not think that new position is either a good reading of the law or good tax administration policy.

Circular 230: Practicing “Inside the Lines” throughout the Tax Engagement Lifecycle

By Timothy J. McCormally
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Circular 230: Practicing "Inside the Lines" throughout the Tax Engagement Lifecycle

June 6-8, 2023

Tax Alliance Conference

Timothy J McCormally Acting Director,
Office of Professional Responsibility

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Agenda

- Tax Engagement Lifecycle
- Framework for Regulating Practice before the Internal Revenue Service
- How Circular 230 Applies throughout the Tax Engagement Lifecycle
- Other Important Circular 230 Provisions
- OPR Investigative and Disciplinary Process
- Overview of Tax Pro Account
- Contact Information
- Resources and Guidance

2

What is the Tax Engagement Lifestyle

Stage 1: Beginning an engagement -- finding, vetting, and securing client

Stage 2: Providing tax planning, advice, or representational services

Stage 3: Representing client during examination or other interactions with IRS (such as appeals, negotiating an offer in compromise, installment agreement, etc.)

Stage 4: Ending the relationship

Framework for Regulating Tax Practitioners

Section 330 of Title 31 of the US Code authorizes:

- Regulation of the practice of representatives of persons before the Department of the Treasury, including the IRS, and determinations of practitioner "fitness" to practice. (31 USC §330(a))
- Types of disciplinary action, to include monetary penalties. (31 USC §330(c))
- Regulation of certain appraisers. (31 USC §330(d))
- Standards for certain written advice. (31 USC §330(e))

Treasury Circular No. 230

Circular 230 is the document containing the statute and regulations detailing a tax professional's duties and obligations while practicing before the IRS

- Subpart A – Rules governing practice (licensing, renewals, continuing education)
- Subpart B – Duties and restrictions relating to practice before the IRS
- Subpart C – Sanctions for violations of Circular 230
- Subpart D – Rules applicable to disciplinary proceedings (due process)

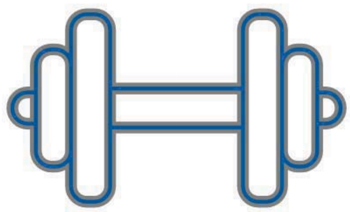
5

Office of Professional Responsibility (OPR)

- Administers the laws and regulations governing practice of tax professionals before the IRS;
- Interprets and applies the standards of practice for tax professionals in Circular 230 in a fair and equitable manner;
- Investigates allegations of misconduct by practitioners in their practice before the IRS and imposes disciplinary sanctions if warranted; and
- Supports the IRS's strategy to enhance enforcement of the Internal Revenue Code by ensuring tax practitioners adhere to professional standards and follow the law.

6

Fitness to Practice



- **Overarching focus of OPR's oversight of practitioners is their "fitness to practice.**
  - Good character
  - Good reputation
  - Necessary qualifications to provide valuable service to the client
  - Competency to advise and assist persons in presenting their cases

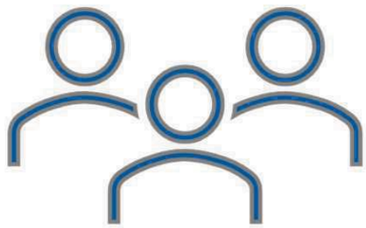
7

Practice (§10.2(a)(4))

- **All matters under laws or regulations administered by the IRS relating to a taxpayer's rights, privileges, or liabilities.**
  - Examples of Practice
    - Representing a client in an audit or before IRS Collections, or appearing before IRS Appeals
    - Preparing documents for submission to the IRS
    - Advising clients regarding tax positions
    - Providing written opinion (advice to clients regarding planned or completed transactions)
  - Not mere tax return preparation

8

Who Are the Practitioners?



- Attorneys
- CPAs
- Enrolled Agents
- Enrolled Retirement Plan Agents
- Enrolled Actuaries
- Annual Filing Season Program Record of Completion Holders
- Appraisers who submit appraisals supporting tax positions

9

Applying Circular 230 throughout the Tax Engagement Lifecycle

10

Procedures to Ensure Compliance (§10.36)

- Under Circular 230, §10.36, ***Procedures to Ensure Compliance***, a firm that has a Circular 230 practice must have in place "adequate procedures" ensuring compliance by its members, associates, or employees with Circular 230.
- These procedures apply from the beginning of an engagement to its end.
- This obligation extends to ensuring technological competence by tax practitioners and support staff.

11 OPR Circular 230

11

Best Practices (§10.33)

Circular 230, §10.33 encourages practitioners to adhere to "best practices" in providing advice on Federal tax issues and preparing or assisting in the preparation of a submission to the IRS. Examples:

- Clearly communicate with clients on engagement terms (including fees and expenses) and throughout the engagement;
- Establish the relevant facts, evaluate the reasonableness of any assumptions or representations, relate applicable law to relevant facts, and reach a conclusion supported by the law and the facts;
- Advise clients regarding the import of conclusions reached; and
- Act fairly and with integrity in practice before the IRS.

12 OPR Circular 230

12

Procedures to Ensure Compliance (§10.36)

- **"Reasonable steps" to ensure employees understand their obligations under Circular 230:**
  - Create a firm policy on adhering to Circular 230 and an environment that supports ethical behavior;
  - Put controls in place to ensure oversight and review of employees and their work product;
  - Set policies and procedures for the assignment of work and workload to ensure matters are handled by employees with competence to do the work and the time to do a thorough, complete job;
  - Take prompt remedial action for failures to adhere to Circular; and
  - Support mentorship and continuing education (including ethics training) so employees gain the knowledge needed to be competent advisors and understand their obligations.

Procedures to Ensure Compliance (§10.36)

- **Firms should recognize that "practicing inside the lines" is not always easy because it is not always clear where the line is.**
  - Given the nature and complexity of the law, the principles-based nature of many Circular 230 provisions, and the sometimes conflicting duties to clients and the tax system, firms should consider whether their employees may benefit from ethics training focused on the intersection of regulatory ethics (including Circular 230) and behavioral ethics (which focus on factors affecting why people make the decisions they do).

Stage 1: Beginning an Engagement

15 OPR Circular 230

15

Beginning an Engagement

- **The first stage of the tax engagement lifecycle covers the finding, vetting, and securing of clients. In addition to Circular 230, §10.36, procedures to ensure compliance, and Circular 230, §10.33, best practices, these topics are significant:**
  - Solicitation
  - Ensuring competence to provide services
  - Assessment of possible conflicts of interest with other clients and practitioner
  - Fees
  - Engagement letter

16 OPR Circular 230

16

Solicitation (§10.30)

- Practitioners are prohibited from making a false, fraudulent, or deceptive statement or claim.
- Practitioners may publish a fee schedule and disseminate this fee information to the public.
- Any statement of fee information must disclose whether the client will be responsible for phone charges, copy charges, filing fees, etc.
- Practitioners can charge no more than the published rates for at least 30 days after the last publication of the fee schedule.

Competence (§10.35)

- The first question a practitioner should ask is "Am I qualified to provide the services that the client wants?"
- Circular 230, §10.35 requires that practitioners have the knowledge, skill, thoroughness, and preparation — as well as the time — necessary for the matter.
  - Competence requirement extends to use of software and other technology and the obligation to maintain data security.
- Competence is essential throughout the tax engagement, but perhaps especially when deciding whether to solicit a client (or respond positively to an inquiry from a prospective client)
- Practitioners need to know when they are not competent.

Competence (§10.35) continued

- **A practitioner can provide competent representation by:**
  - Researching and educating themselves on an issue.
  - Consulting with other tax professionals who have established competence in the field in question.
  - Retaining/bringing in other tax professionals who are competent.
  - Knowing when and how to ask for help is a key aspect of satisfying Circular 230, §10.35.
  - Sometimes you must "just say no."

Conflicting Interests (§10.29)

- **Before agreeing to provide services, the practitioner should assess whether a conflict of interest exists.**
- **Circular 230 prohibits conflicts of interest, which arise if:**
  - One client's interest is directly adverse to another
  - There is a significant risk of material limitation of responsibilities to:
    - Another client or former client,
    - A third-person, OR
    - Personal interests of the practitioner.
- **Examples of potential conflicts include spouses, a partnership and its partners, and perhaps the client and the practitioner (e.g., if they were the promoter of a transaction that might be challenged).**

Conflicting Interests (§10.29) continued

- **Even if a conflict exists, a practitioner may accept or continue an engagement if:**
  - The practitioner has a reasonable belief in their ability to provide competent, diligent representation to each affected client;
  - The representation is not legally prohibited; and
  - Each affected client waives the conflict by giving informed consent in writing within a reasonable time of the conflict becoming known by the practitioner (and not later than 30 days).
- **Written waivers must be retained for at least 36 months after representation ceases and made available to the IRS upon request.**

Fees (§10.27)

- **A practitioner may not charge an unconscionable fee in connection with any matter before the IRS.**
  - Unreasonably excessive; grossly unfair
    - Generally, Circular 230, §10.27 violations involve charging high fees for lousy advice (e.g., raising numerous trivial augments long-rejected by the IRS and by case law).
- **Limitations on contingent fees.**
  - In connection with an IRS examination or challenge to an original return, amended return, or refund claim.
  - For services rendered in connection with the determination of statutory interest or penalties assessed by the IRS.
  - For services in connection with any judicial proceeding.

Best Practice — Communications

- **Consistent with aspirational "best practices" under Circular 230, §10.33, practitioners should inform clients, via an engagement letter or otherwise, of the terms of the engagement, including —**
  - Form and scope of advice or assistance to be rendered (§10.33(a)(1));
  - Fees (§10.27) and responsibility for expenses (§10.30(b));
  - Procedures for return of client records (§10.28); and
  - Practitioner's obligation to inform client of any errors or omissions identified (§10.21), as well as potential penalties concerning positions taken on a return and the opportunity to avoid penalties by disclosure (§10.34(c)).

Stage 2: Providing Tax Professional Services

Providing Tax Professional Services

- **The next stage of the tax engagement lifecycle covers the practitioner's provision of tax planning, advice, or representational services to their clients.**
  - Ensuring competence to provide services
  - Exercising due diligence (client & third parties)
  - Standards and Returns/Written Advice
  - Knowledge of client error or omission
  - Failure to sign return
  - Inappropriate disclosure of taxpayer information
  - Maintaining communication with client

Due Diligence (§10.22)

- **A practitioner must exercise due diligence in:**
  - Preparing, approving, or filing tax returns, documents, affidavits, etc. relating to IRS matters.
  - Determining correctness of oral/written representations made to the client or Treasury personnel.
- **Willful blindness violates a practitioner's due diligence responsibilities under Circular 230.**

Due Diligence (§10.22) – Reliance on Client

- **Relying on information furnished by clients**
  - Generally, may rely in good faith without verification upon information furnished by the client.
  - Cannot ignore the implications of information furnished to or known by the practitioner.
  - Must make reasonable inquiries if the information furnished appears incorrect, incomplete, or inconsistent with other facts or assumptions.
  - Cannot be willfully blind.

Due Diligence (§10.22) – Reliance on Third Party

- **Relying on another's work product**
  - Can rely on other professionals' work product with reasonable care.
  - Cannot ignore other information furnished to you or known by you.
  - Duty to make reasonable inquiries if information furnished appears to be incorrect, incomplete, or inconsistent with other facts or assumptions.

Standards for Tax Returns/Documents

- **Under Circular 230, §10.34(a), a practitioner may not sign a tax return or advise a position on a tax return that willfully, recklessly, or through gross incompetence:**
  - Lacks reasonable basis
  - Has an unreasonable position (IRC §6694(a)(2))
  - Is a willful attempt to understate liability (IRC §6694(b)(2)(A)), or
  - Sets forth a reckless, intentional disregard of rules and regulations (IRC §6694(b)(2)(B))
- **Patterns matter**

Standards for Tax Returns/Documents

- **Similarly, under Circular 230, §10.34(a) and §10.34(b), a practitioner —**
  - May not advise taking frivolous positions
  - May not advise submissions:
    - To delay or impede tax administration
    - That are frivolous
    - Containing or omitting information that demonstrates an intentional disregard of rules or regulations
- **Patterns matter!**

Standards for Tax Returns/Documents

Reasonable Basis (25%)
When a reasonable and well-informed analysis by a person knowledgeable in the tax law concludes there is at least a 25% likelihood a position would be upheld on its merits. MUST be paired with disclosure.

Realistic Possibility of Success (33%)
When a reasonable and well-informed analysis by a person knowledgeable in the tax law concludes there is at least an approximately one-in-three likelihood a position would be upheld on its merits.

Tax Return Position

Substantial Authority
When a reasonable and well-informed analysis by a person knowledgeable in the tax law concludes there is at least a greater than 40% but less than 50% likelihood a position would be upheld on its merits.

More Likely Than Not (>51%)
When a reasonable and well-informed analysis by a person knowledgeable in the tax law concludes there is at least a greater than 50% likelihood a position would be upheld on its merits.

Penalties and Client Reliance

- **Under Circular 230, §10.34(c) and §10.34(d), a practitioner must advise client of potential penalty exposure regarding:**
  - A position taken on the return if the practitioner advised the client regarding the position OR the practitioner prepared or signed the return
  - Any document, affidavit or other paper submitted to the IRS
- **A practitioner must also advise client of penalty avoidance through disclosure**

Written Advice (§10.37)

- **Circular 230, §10.37 elaborates on a practitioner's due diligence obligation when providing written advice, requiring the practitioner to:**
  - Identify and ascertain the material facts and reasonably consider material facts and circumstances;
  - Not *unreasonably* rely on representations, statements, findings, or agreements;
  - Relate applicable law to the material facts;
  - Make reasonable factual and legal assumptions; and
  - Not consider the likelihood of an audit in making your determinations.

Practicing Inside the Line — Client's Error/Omission (§10.21)

- **If a practitioner knows a client has not complied with US revenue laws or made an error in, or omission from, any return, affidavit, or other document client submitted or executed under US revenue laws —**
  - Duty to promptly inform client of noncompliance, error, or omission and advise client regarding consequences under the Code and regulations of that noncompliance, error, or omission.
- **Best practice is to advise the client what to do.**
- **If the error or omission is attributable to a prior tax professional's misconduct, discuss whether the client wants to make a referral to OPR.**

Practicing Inside the Line — Client's Error/Omission (§10.21)

Example

- **A new client asks you to prepare their Federal tax return. As part of your regular due diligence, you review the client's prior year's return and discover numerous errors. You also noticed the prior preparer had not signed the return.**
  - What are your obligations concerning the prior year's return?
- **Despite errors in the prior year's return, your client declines to correct the errors (e.g., via filing an amended return).**
  - What are the implications for you in terms of preparing the current year's return?
- **Can you refer the preparer of prior year's return to OPR?**

Stage 3: Engaging with the IRS

Engaging with the IRS

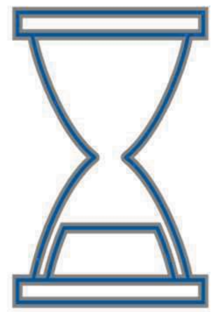
- The third stage of the tax engagement lifecycle covers the practitioner’s engaging with the IRS (e.g., representing the client during examination or other interactions with IRS, such as appeals or negotiating an offer in compromise or installment agreement.
  - Responding to requests for information.
  - Prompt disposition of pending matters.
  - Statements to and interactions with IRS representatives.

Duty to Provide Information (§10.20)

- Upon a proper and lawful request for records or information from IRS, a practitioner has a duty to promptly submit requested information unless in good faith reasonably believe information sought is privileged.
- If requested information is not in the practitioner’s or client’s possession, the practitioner must promptly inform IRS and provide any information regarding who has possession of the requested information.

Prompt Disposition of Pending Matters (§10.23)

- A practitioner may not unreasonably delay the prompt disposition of any matter before the IRS.



39 OPR Circular 230

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Disreputable Conduct (§10.51(a))

- Circular 230, §10.51(a) is a general provision under which a practitioner may be sanctioned for incompetence and <u>disreputable conduct</u>.

40 OPR Circular 230

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Giving False or Misleading Information (§10.51(a)(4))

- **When interacting with tax authorities, a practitioner must not participate in any manner in giving false or misleading information to the Treasury or any officer/employee.**
  - Testimony.
  - Federal tax returns.
  - Financial statements
  - Applications.
  - Affidavits, declarations, and any other document or statement (written or oral).

41 OPR Circular 230

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Willfully Assisting Noncompliance (§10.51(a)(7))

- **When interacting with clients, a practitioner must not willfully assist, counsel, encourage, suggest to a client/prospective client:**
  - An illegal plan to evade Federal taxes or payment thereof.
  - Violation of any Federal tax law.

42 OPR Circular 230

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Improper Attempts to Influence (§10.51(a)(9))

- A practitioner may not directly or indirectly attempt to influence, or offer or agree to attempt to influence, the official action of any officer or employee of the IRS by the use of threats, false accusations, duress or coercion, by the offer of any special inducement or promise of an advantage or by the bestowing of any gift, favor or thing of value.

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Contemptuous Conduct (§10.51(a)(12))

- A practitioner may not engage in contemptuous conduct in connection with practice before the IRS, including the use of abusive language, making false accusations or statements, knowing them to be false, or circulating or publishing malicious or libelous matter.

44

Giving a False Opinion (§10.51(a)(13))

- A practitioner may not give a false opinion, knowingly, recklessly, or through gross incompetence, including an opinion which is intentionally or recklessly misleading, or engaging in a pattern of providing incompetent opinions on questions arising under the Federal tax laws.

45

Other Disreputable Conduct (§§10.51(a)(13)–(18))

- Willfully failing to sign a tax return prepared by the practitioner when required to do so.
- Willfully disclosing or otherwise using a tax return or tax return information in an unauthorized manner.
- Willfully failing to file on magnetic or other electronic media a tax return when required to do so.
- Willfully preparing all or substantially all of, or signing, a tax return or claim for refund when the practitioner does not possess a valid PTIN.
- Willfully representing a taxpayer before the IRS unless the practitioner is authorized to do so.

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Stage 4: Ending the Relationship

Ending the Relationship

- **The final stage of the tax engagement lifecycle involves the termination of the practitioner's relationship with the client.**
  - Return of client records
  - Taxpayer refunds/Negotiation of IRS checks
  - Withdrawal of POA
  - Maintenance of confidentiality
  - Retirement or sale of practice

Returning Client's Records (§10.28)

- **At the request of the client, a practitioner must promptly return all records of the client necessary for the client to comply with any federal tax obligations.**
  - Includes documents or other materials obtained from a client or another source, as well as any return, claim for refund, schedule, affidavit, appraisal, or any other document prepared by the practitioner (or their employee or agent).
  - Practitioner may retain copies of the records returned to client.
- **Existence of a fee dispute does not relieve practitioners of obligation to return client records.**

Negotiation of Taxpayer Checks (§10.31)

- **Practitioners may NOT direct or accept payment from IRS to a taxpayer into an account owned or controlled by them.**
  - No cashing, endorsing, or negotiating the client’s refund.
  - No depositing the client's refund to the practitioner’s trust account.
  - No split electronic transfers from the IRS.
- **Client consent is irrelevant.**
- **IRC §6695(f) penalty exposure.**
- **Form 2848 has been revised to omit authority to receive client's refund check.**

Maintaining Client Confidentiality and Other Administrative Matters

- **A practitioner's obligation to remain client confidences and to safeguard tax return information never ends, even after a tax engagement ends.**
  - Circular 230, §10.51(a)(15) provides that willfully disclosing or using tax return information is disreputable conduct.
  - At the end of an engagement the practitioner should withdraw their power of attorney.
  - When retiring or selling their practice, the practitioner should take care to safeguard tax return information and to keep clients appropriately informed.

Other Important Circular 230 Provisions

Practitioner Conduct Beyond the Tax Engagement

- **Willful Tax Noncompliance by Practitioner — §10.51(a)(6)**
  - Circular 230, §10.51 covers not only incompetence and disreputable conduct during the tax engagement, but also the practitioner's personal conduct.
    - Tied to 31 USC §330's focus on the practitioner's "fitness to practice."
  - Most notably, disreputable conduct includes willfully failing to make a Federal tax return or the willfully evading, attempting to evade, or participating in any way in evading or attempting to evade any assessment or payment of any Federal tax.
  - Note: When a referral is made to OPR, the practitioner's own tax compliance is always checked.

Practitioner Conduct Beyond the Tax Engagement

- **Other Disreputable Conduct**
  - Conviction of any criminal offense under Federal tax laws (§10.51(a)(1)).
  - Conviction of any criminal offense involving dishonesty or breach of trust (§10.51(a)(2)).
  - Conviction of any felony where the conduct involved renders the practitioner unfit to practice (§10.51(a)(3)).
  - Disbarment or suspension from practice as an attorney or CPA (§10.51(a)(10), §10.82(b)(1)).
  - Conviction of any crime under Title 26, any crime involving dishonesty or breach of trust, or any felony that renders the practitioner unfit to practice (§10.82(b)(2)).

OPR Investigative and Disciplinary Process

OPR Investigate and Disciplinary Process

- **Sanctions — §10.50**
  - This section addresses OPR's authority to sanction practitioners for misconduct.
  - Requires notice to the practitioner and an opportunity for a proceeding

OPR Investigate and Disciplinary Process

- **OPR Referral Sources**
  - Individuals outside the IRS (e.g., tax professionals, clients, other government agencies, etc.) can make referrals to OPR on Form 14157. The form is sent to Return Preparer's Office and if the tax professional is under OPR's jurisdiction, then routed to OPR.
    - For *practitioners* (covered under Circular 230), individuals can fax a referral to OPR's eFax: 855-814-1722.
  - IRS employees use a different form when they come across misconduct by a tax professional and, in some circumstances, they are *required* to make referrals.

OPR Investigate and Disciplinary Process

- **Mandatory referral to OPR**
  - Willful attempt to understate tax liability. IRC §6694(b)
  - Promoting abusive tax shelters. IRC §6700
  - Aiding and abetting understatement of tax liability (appraisers). IRC §6701(a)
  - Action to enjoin Tax Return Preparers. IRC §7407
  - Action to enjoin specific conduct re: tax shelters and reportable transactions. IRC §7408

OPR Investigate and Disciplinary Process

- **Discretionary referral to OPR**
  - Failure to furnish copy of return; sign a return; keep copies/lists of tax returns prepared. IRC §6695
  - Negotiation (direct/indirect, electronic, or paper) of refund checks. IRC §6695(f)
  - Frivolous tax returns or submissions. IRC §6702
  - Fraud and false statements. IRC §7206

59 OPR Circular 230

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OPR Investigate and Disciplinary Process

- **Discretionary referral to OPR (continued)**
  - Accuracy related penalty with facts suggesting lack of due diligence. IRC §6662
  - Negligent or intentional disregard of tax rules and regulations (Need a Pattern). IRC §6694(a)
  - Failure to comply with tax shelter registration requirements. IRC §§6111, 6112

60 OPR Circular 230

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OPR Investigate and Disciplinary Process

- **OPR Complaint Process**
  - Jurisdiction
  - Investigation
    - Evaluate evidence received
    - Database searches
    - Interview referent/complainant and other witnesses
  - Pre-Allegation or Allegation Letter
    - Written notice to practitioner
      - Before or soon after investigation begins
      - Outlines allegations (information received and developed, Circular 230 implications), with opportunity to respond

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OPR Investigate and Disciplinary Process

- **OPR Complaint Process (continued)**
  - Conference/settlement opportunity
    - Complaint-pleading/charging document
    - Administrative hearing (ALJ)
    - Decision
    - Appeal

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OPR Investigate and Disciplinary Process

- **Closing a Case and Sanctions**
  - Non-disciplinary Closure
  - Private Reprimand (Director's discretion)
  - Censure

OPR Investigate and Disciplinary Process

- **Closing a Case and Sanctions (continued)**
  - **Suspension** (1–59 months)
  - **Disbarment** (for at least 5 years)
  - **Disqualification** (appraisers)
  - **Monetary Penalty** (limited to the gross income derived from the conduct giving rise to the penalty)

OPR Investigate and Disciplinary Process

- **Expedited Suspension — §10.82**
  - OPR can impose a suspension before filing a complaint if the practitioner has received an opportunity to be heard in another forum
    - Suspension or revocation of law license **or** CPA certificate for cause by the licensing authority (State Bar **or** Board of Accountancy)
    - Criminal convictions
    - Violation of conditions imposed based on a prior OPR sanction
    - Certain court sanctions

OPR Investigate and Disciplinary Process

- **Expedited Suspension — §10.82 (continued)**
  - OPR can also impose a suspension before filing a complaint when the practitioner is non-compliant with respect to their own individual tax matters or tax matters for entities for which they are responsible.
    - Failure to file returns, late-filing returns, underreported income, etc.

Key Points

- Circular 230 (Rev. 6.2014), contains the Regulations Governing Practice before the IRS.
- The Office of Professional Responsibility supports effective tax administration by ensuring all tax practitioners, tax preparers, and other third parties in the tax system adhere to professional standards and follow the law.
- The beneficiaries of effective oversight of tax practitioners are taxpayers, the tax practitioner community as a whole, and the tax system.

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Key Points

- Circular 230 imposes duties on practitioner during every stage of the tax engagement lifecycle – from finding clients, to serving clients and interacting with the IRS, to ending their client relationship.
- Circular 230 contains not only rules relating to practice before the IRS, but also information on possible sanctions for misconduct, the OPR disciplinary process, and the due process protections provided to practitioners.

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Overview of Tax Pro Account

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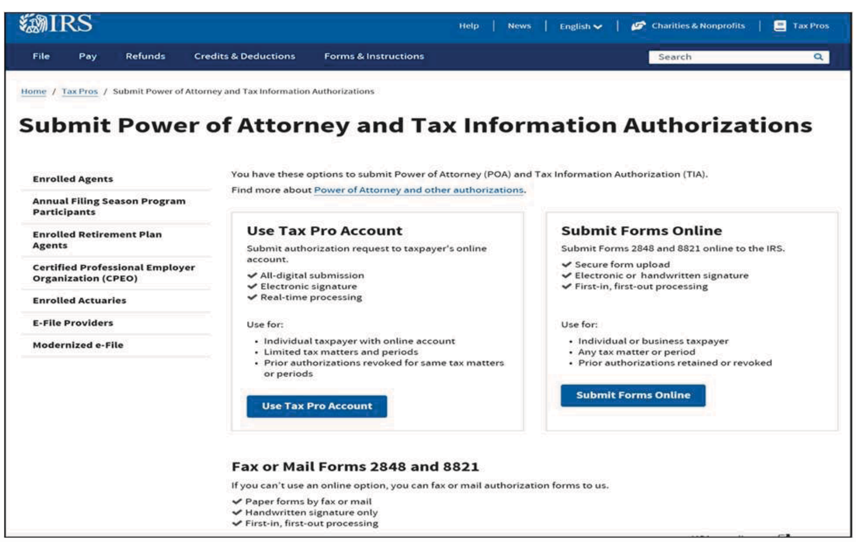
Tax Pro Account: Options for Submit POAs and TIAs



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Expanding Services for Taxpayers

Expansion of Taxpayer Options for 3rd Party Authorizations launched in the summer of 2021

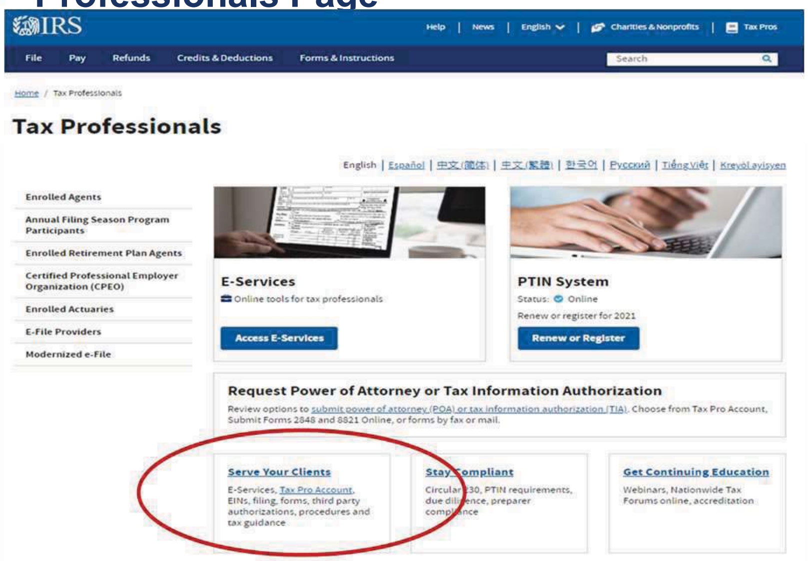
- Added "authorization" feature to individual Online Accounts.
- Launched Tax Pro Account on IRS.gov to allow tax professionals to initiate online POA or TIA requests.
  - Tax professional initiates a POA or TIA, using checkbox as electronic signature for POAs.
  - POA or TIA requests automatically transfers to individual taxpayer's Online Account.
  - Taxpayer accesses their Online Account and under the "Authorization" tab they can approve the request and use a checkbox as signature.
  - Upon approval, authorization is posted immediately to CAF.

Registering to Access the Tax Pro Account

To use Tax Pro Account, individuals must create an account and verify their identity.

- Individuals already registered for Secure Access (e.g., Get Transcript, e-Services) can use the Tax Pro Account to initiate POAs and TIAs.
- New users will need to create an account with ID.me.
  - To verify your identity with ID.me, you will need a photo ID and a device with a camera.
- Frequently asked questions with help links are available right on the sign-in page for Tax Pro Account & Online Account in case you or your clients have any questions.

Tax Pro Account: Tax Professionals Page



73 OPR Circular 230

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Tax Pro Account: Help Topics

Help Topics

- Online Account Access
- Display of Request Status
- Display of Authorization History
- CAF Address
- Taxpayer Address
- Multiple Representatives
- Overlapping Tax Periods
- Tax Year and Tax Matter Limitations
- Copy of Authorization Request
- If You Don't Have a CAF Number
- Tax Pro Account vs. Submit Forms 2848 and 8821 Online

74 OPR Circular 230

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Tax Pro Account: Future State

- IRS will continue to expand Tax Pro Account capabilities to improve its features for authorization requests and to add functionality as resources allow.
- Here are just some of the features we are working, planning, or considering:
  - Notification to the taxpayer regarding action in their Online Account, including pending authorization requests
  - Email alerts letting the tax professional know when taxpayer approves their authorization request
  - Taxpayer's ability to view complete authorization history
  - Tax professional's ability to view and manage all active authorizations on CAF processed through all channels

Contacting & Referrals to OPR

- **Office of Professional Responsibility**
  - 1111 Constitution Ave., NW, SE:OPR Rm. 7238, Washington, DC 20224
  - Efax: (855) 814-1722
  - Visit http://www.irs.gov/ and search "Circular 230 Tax Professionals"
- **Referrals**
  - To make a referral regarding a return preparer, file Form 14157. It will go to RPO and, if the preparer is under OPR's jurisdiction or has representational activities, the information will be routed to OPR.
  - For practitioners covered under Circular 230, send Form 8484 via fax to OPR's eFax.

Resources and Guidance

- Treasury Department Circular No. 230 (Rev. 6-2014)
- IRS Pub. 947, *Practice Before the IRS and Power of Attorney*
- IRS Pub. 4557, *Safeguarding Taxpayer Data: A Guide for Your Business*
- IRS Form 2848, *Power of Attorney and Declaration of Representative*
- IRS Form 8275, *Disclosure Statement*
- IRS Form 8867, *Paid Preparer's Due Diligence Checklist*
- OPR Website
- News & Updates from the Office of Professional Responsibility
- Rights and Responsibilities of Practitioners in Circular 230 Disciplinary Cases
- Guidance on Restrictions During Suspension or Disbarment from Practice Before the Internal Revenue Service

Recursos y Guías en Español

- Formulario 2848, *Poder Legal y Declaración del Representante* y Instrucciones para el Formulario 2848(SP)
- Formulario 8821, *Autorización para recibir Información Tributaria* y Instrucciones para el Formulario 8821
- Pub. 947, *Como Ejercer ante el Servicio de Impuestos Internos (IRS) y el Poder Legal*
- Circular 230 del Departamento del Tesoro (Rev. 6-2014), *Reglamentos que rigen el ejercicio ante el Servicio de Impuestos Internos*

IRS

QUESTIONS?

Implementation and Government Enforcement of BlockChain Technology and Digital Assets

By Joshua Smeltzer and Brian Clark

GRAY REED

Implementation and Government Enforcement of BlockChain Technology and Digital Assets

Presented by Joshua Smeltzer and Brian Clark

1

WHY CRYPTOCURRENCY?

- An entirely digital medium of exchange
- No intrinsic value (e.g. cannot exchange for gold)
    - It has value because the users of the network give it value.
- No physical form (i.e. only exists on the network)
    - Public and private keys identify ownership
- Supply limited or at least not controlled by governments
    - Market manipulation but not government manipulation

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2

NFTs (Non-Fungible Token) – Not Just Digital Art

- Digital representation of a digital or physical asset
- Recorded on the blockchain (artwork, music, title to property, contracts)
- Potential Uses
  - A more secure and efficient way to track title
  - Ticket sales or Membership Verification
  - Logistics applications
  - Raise capital and sell stakes in assets without intermediaries
  - Sell music, art, books, and host of other creative works

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3

3

WHAT IS A DECENTRALIZED AUTONOMOUS ORGANIZATION?

- Are DAOs the new LLCs (Texas is considering LLC amendment)
- No central governing body (i.e. no board of directors)
  - Bottom up management (one token one vote).
  - All terms of organization public as well as votes on actions.
- Who is legally responsible? Who accepts service?
- Does this provide any protection for token holders or are they all liable?
  - If so, how do you sue a pseudonym?
- DAO as PACs – Where decentralization and campaign finance collide.
- Limitations
  - Slower without centralization, harder for everyone to stay informed, and requires technical knowledge to trust system.

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4

4

CONTINUED FOCUS ON DISCLOSURE AND REPORTING

Bloomberg
US Edition

Live Now | Markets | Technology | Politics | Wealth | Pursuits | Opinion | Businessweek | Equality | Green | CityLab | Crypto | More

Politics

Crypto Investors Are Likely Paying Less Than Half the Taxes They Owe

- Decentralized finance would add to the gap, Barclays says
- IRS is boosting attention to crypto audits and enforcement

- Infrastructure Investment and Jobs Act ("IIJA")
  - Broad reporting responsibilities for "brokers" – 1099-DA
  - "any person who (for consideration) is responsible for providing any service effectuating transfers of digital assets on behalf of another person."
  - IRS Announcement 2023-2 (No Regulations – Reporting on Hold Until Issued)
- Operation Hidden Treasure
  - IRS Office of Fraud Enforcement
- John Doe Summonses (Coinbase, Kraken, Circle, sFOX, Next?)
  - Shareholder challenges to information disclosures – Harper v. Rettig, No. 21-1316 (1st Cir.)

TAX LOSS HARVESTING

News Analysis

SEC Calls 9 Cryptos 'Securities' in Insider Trading Case

The SEC and DOJ brought insider trading charges against three people Thursday, but assertions cryptocurrencies are securities may hold greater implications.

- Wash Sale Rules
  - No specific definition of security in IRC 1091
  - Rev. Rul. 2014-21 Says property not security
  - NFTs didn't even exist as an asset in 2014.
  - Securities and Exchange Commissions (The list of 9 and expanding)
    - AMP, RLY, DDX, XYO, RGT, LCX, POWR, DFX and KROM
    - Bitcoin and Ether – commodities?

CLAIMING CRYPTOCURRENCY LOSSES

- CCA 202302011 (IRC Section 165 – Cryptocurrency Declined in Value)
  - IRC 165 Deductions
    - Closed and Completed Transactions
    - Fixed and Determinable
  - IRC 6045(g)(3)(D) – Definition of Digital Assets
  - Worthlessness – When does it happen?
  - Abandonment – When does it happen?

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7

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LIKE KIND EXCHANGES (APPLES AND ORANGES?)

- Legal Standard Pre-TCJA
- Like Kind Exchanges Post-TCJA
- CCA 2021240008 (Bitcoin, Ether, Litecoin are NOT like kind)
  - Are any cryptocurrencies like kind?
  - Other potential misinterpretations of property tax rules?

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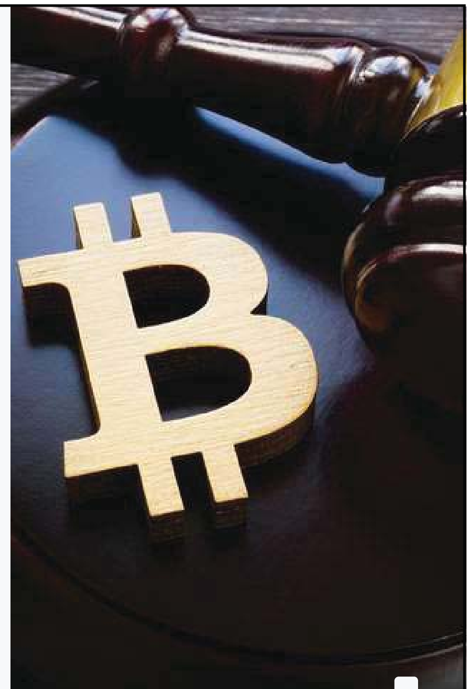
8

8

PENDING LITIGATION ON DIGITAL ASSETS

- SEC – Insider Trading, Exchange Investigations, Public Announcements
- Digital Asset Companies in Bankruptcy
- Tax Court Litigation
- Federal District Court Litigation
- Administrative Level Disputes



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LEGISLATION RELATED TO DIGITAL ASSETS

- Lummis (R-WY) and Gillibrand (D-NY) Responsible Financial Innovation Act
- Toomey (R-Pa.) and Sinema (D-Ariz.) Virtual Currency Tax Fairness Act
- EU proposal for full scale regulation - Markets in Crypto-Assets (MiCA)
- UCC Article 12 (Transfers of "controllable electronic records" (CER) (i.e. Digital Assets).
- OECD – Recent Reporting Standards for Digital Assets.
- Future Legislation?

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10

10

GOVERNMENT ENFORCEMENT ACTIVITY

U.S. SECURITIES AND EXCHANGE COMMISSION

ABOUT | DIVISIONS & OFFICES | ENFORCEMENT | REGULATION | EDUCATION | FILINGS | NEWS

Press Release

SEC Nearly Doubles Size of Enforcement's Crypto Assets and Cyber Unit

FOR IMMEDIATE RELEASE

SEC Investigating Binance, All U.S. Crypto Exchanges: Forbes

12 hours ago

The U.S. Securities and Exchange Commission is reportedly probing Binance and every U.S. cryptocurrency exchange.

PERSONAL FINANCE

IRS steps up efforts to target U.S. taxpayers who failed to report and pay taxes on cryptocurrency transactions

THE UNITED STATES DEPARTMENT of JUSTICE

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FOUNDER AND MAJORITY OWNER OF CRYPTOCURRENCY EXCHANGE CHARGED WITH PROCESSING OVER $700 MILLION OF ILLICIT FUNDS

RELATED LINKS

Justice Department Announces Major International Crypto Enforcement Action

The department held a press conference at noon Eastern time on Wednesday.

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INDUSTRY UPDATES ON DIGITAL ASSETS

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ENERGY


SUSTAINABLE BUSINESS
Carbon-Credit Registry Proposes Rules for Crypto Tokens
Verra, the world's largest registry for carbon credits, is seeking more transparency from crypto platforms

Technology
Crypto

Bitcoin Miners Shut as Texas Power Grid Nears Brink

- Almost all large Bitcoin miners have shut down as demand peaks
- Over 1,000 megawatts load is released from mining operations


Bitcoin energy consumption catches ire of US senator Elizabeth Warren

- Tokenization of oil and gas interests (funding through crypto/blockchain)
- Proof of Work vs. Proof of Stake Systems
- Title work and other recordkeeping on the blockchain

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HEALTHCARE

Blockchain in Healthcare: 17 Examples to Know

Blockchain in healthcare is used for everything from securing patient data to managing the pharmaceutical supply chain.

CRYPTOCURRENCY

Top Hospitals Using Cryptocurrencies for Payment

- Medical records on blockchain or linked to NFTs
  - Places the patient at the center of the ecosystem
  - More efficient transfer of medical records
- Payment for services via cryptocurrency

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WAGES AND PAYROLL

HOME ‹ NEWS ‹ MARKETS

Crypto Increasingly Used To Pay Salaries in Developing Economies

PERSONAL FINANCE

Fidelity, ForUsAll now offering 401(k) investors access to cryptocurrency

- News reports of politicians taking their salaries in Bitcoin.
- Aaron Rogers turned part of his NFL salary into Bitcoin.
- Department of Labor points out that Fair Labor Standards Act provides that wages be made in cash or negotiable instrument payable by check.
  - Fluctuations in value could cause problems under FLSA

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REAL ESTATE

FORBES › SMALL BUSINESS

How Blockchain And NFTs Could Revolutionize Real Estate Investment

Johan Hajji Forbes Councils Member
Forbes Business Council COUNCIL POST | Membership (Fee-Based)

April 20 2023

MyEListing, With Help from Coinbase Commerce, Creates the World's First Place to Buy and Sell US Real Estate With Crypto

- Barriers to investment entry are lowered and available to wider audience
- Participation in worldwide real estate markets, not just local investment
- Operational efficiency through smart contract deal closing
- Faster liquidation because of less need for third party intermediaries

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DIGITAL ASSETS: PERSONAL REPORTING AND TRANSACTIONAL TAX CONCERNS

- Where are we now?
    1. Cryptocurrency compliance
    2. New blockchain uses
    3. Common tax partnership questions

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INDICATIONS OF ONGOING IMPORTANCE

- Page 1 of IRS Form 1040 (2022):

  "At any time during 2022, did you: (a) receive (as a reward, award, or payment for property or services); or (b) sell, exchange, gift, or otherwise dispose of a digital asset (or a financial interest in a digital asset)?"

- Compliance campaign focuses on underreporting due to the anonymous nature of virtual currency; e.g. in 2021 former IRS Commissioner Charles Rettig testifies to Senate Finance Committee that crypto market cap is around $2 trillion and by design intended to stay off the IRS enforcement radar.

- The Internal Revenue Manual indicates the IRS will use standard techniques for virtual currency discovery, such as bank and credit card analysis, John Doe summonses, Form 1099-K review (payment card and 3rd party network transactions), FinCEN reports, and public document reviews. I.R.M. 5.1.18.20.3 (7-17-19).

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PERSONAL REPORTING FOR VIRTUAL CURRENCY

- Supplemental income payments – report on Schedule E (royalties, rental real estate, S-corporation income, partnership income, etc.) at FMV in U.S. dollars as of the date and time of transaction;
- Contractor payments – report on Schedule C at FMV in U.S. dollars at time of payment was received;
- Sale of virtual currency – report on Schedule D at FMV in U.S. dollars as of the date and time of transaction (if capital asset, consider Form 8949);
- As previously discussed, consider FATCA reporting (Form 8938) and FBAR reporting (FinCEN Form 114). FATCA reporting is *in addition to* FBAR reporting.

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EVOLVING BLOCKCHAIN USES: TOKENIZATION

- Real estate developers and funds have had the option to tokenize project interests for a few years;
- Almost any asset has tokenization potential.
- Selling points:
    - Blockchain technology provides secure and easily reviewed ownership transfers;
    - Tokenized equity can be offered to a wider investor group;
    - Potentially lower investor costs;
    - Ideally the tokenized equity allows ready conversion of illiquid real estate into cash.

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INITIAL STRUCTURING CONCERNS

- Gating issue: "what" is being tokenized? Tokens might represent:
    - Entity equity;
    - Debt interests secured by hard assets;
    - Economic rights / profit sharing;
    - Commodities.
- Some Non-Tax Concerns:
    - If tokenizing equity, where is the entity formed? Delaware is common but consider state investor and creditor protections;
    - PPM terms;
    - Securities law compliance (Reg-S, Reg-D).
    - Post-PPM / structuring, tokens are issued and documents "hashed". Tokens are transferred to project developer's wallet on token platform which are later sold to investors.

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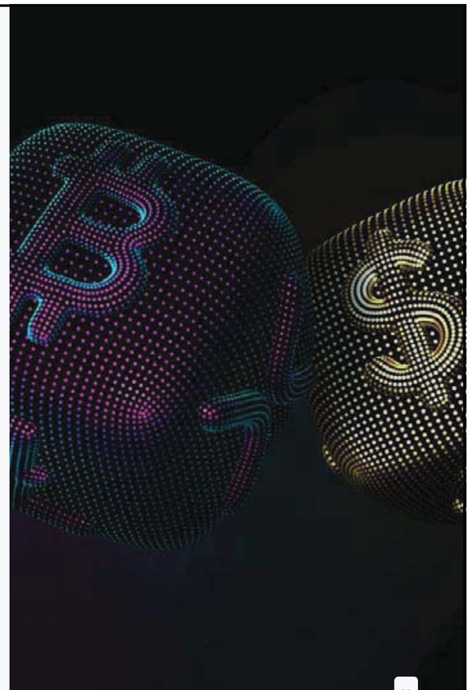
INITIAL STRUCTURING CONCERNS

- Identify quality tokenization platform;
- Smart contracts power the tokens, and must ensure securities law compliance. As such, identifying a quality platform is important;
- Prepare investors for AML and KYC compliance in offering materials to avoid surprises – each investor will have a KYC process with the platform;
- Marketing services may be required to find and educate investors.



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TAX SPECIFIC CONCERNS

- As noted, the IRS views tokens as property. Since this is another form of asset securitization, identifying the type of property and transaction at issue is important:
  - Debt (and debt versus equity)
  - Stock – holding period, dividend rights, management rights
  - Tax partnership – PTP, basis adjustments, transfer allocations, book-ups, etc.

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TOKENIZATION EXAMPLES

- 2018. St. Regis Aspen Resort.
    - Approximately 19% of property equity was sold in Reg. D offering in the form of digital tokens representing equity in Aspen Digital Inc.;
    - Tokens are now traded on tZERO ATS (FINRA broker-dealer that operates an alternative trading system).
- 2022. T27 Silcoin / Tower 27 Partners – Woolworth Building, San Jose, California.
    - Intended $100M capital raise using 100 million $1 tokens for 300+ unit multifamily project.
    - T27 Silicoin token represents equities in Tower 27 Partners, LP (Ethereum based token).

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COMMON TAX PARTNERSHIP ISSUES: CURRENT THOUGHTS

- Investment Company Rules. Bitcoin type cyrptocurrencies do not seem to be the type of property that fits in the "investment company" rules of Section 721(b);
    - Referesher: Investment company rules apply if contributor diversifies investments and as to transferee-partnership, immediately after transfer, 80% of value of assets (excluding cash and certain debt) are held for investment in readily marketable securities. If Section 721(b) applies it turns off nonrecognition.

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COMMON TAX PARTNERSHIP ISSUES: CURRENT THOUGHTS

- Marketable Securities Rules for Distributions. Section 731(c) states that marketable securities are (absent exception) treated as money for purposes of Section 731(a). At present:
  - Bitcoin type cryptocurrencies are not within the classical definition of money (physical, electronic, or book representation of the coin and paper money of the United States which circulates, and is customarily used and accepted as a medium of exchange); and
  - Bitcoin type cryptocurrencies do not neatly fit into the Code's "securities" definitions but facts and circumstances control. This is a closer case, but arguably these types of assets are usually marketable securities. (If the cryptocurrency was perhaps exchangeable of convertible into securities or cash the Section 731(c) rules would arguably apply and you would need an exception).
- Exception. Investment partnership rules – no trade or business, eligible partners contributed only cash/securities, and 90% of value of assets are qualifying (cash, securities, etc.). Meeting investment partnership rules turns of 731(c)'s general rule.

COMMON TAX PARTNERSHIP ISSUES: CURRENT THOUGHTS

- Consider PTP rules.
  - Section 7704 treats partnerships that are publicly traded as corporations for FIT purposes: (1) actually traded on securities market or (2) readily tradeable on a secondary market.
  - A partnership that is "publicly traded" is excepted from PTP rules if 90% or more of its gross income consists of qualifying income.
  - The qualifying income rule excepts from entity level tax those partnerships that engage in activities commonly considered as no more than investing or that have traditionally been conducted in partnership form.
  - Partnership that hold only bitcoin or similar cryptocurrencies treated as commodities may have only one activity (buying and selling commodities). But if the partnership has other investments, e.g. securities or cryptocurrencies treated as securities, then safe harbors may need necessary.

JOSHUA SMELTZER

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TAX LAW

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JOSHUA SMELTZER
Partner
Tax Controversy
Blockchain and Digital Assets

Joshua Smeltzer represents individuals, corporations, partnerships, and estates in a variety of tax issues involving tax reporting for cryptocurrency and foreign bank accounts, captive insurance arrangements, investments in conservation easements, charitable donations, a variety of tax deduction and tax credit disputes, as well as various transactions involving cryptocurrency and blockchain technology.

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EDUCATION:

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BRIAN CLARK

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BRIAN CLARK
Associate
Tax Structuring
Blockchain and Digital Assets

With a unique background in business law and accounting, Brian Clark guides clients through a broad range of matters that impact their businesses, including tax planning and corporate transactions. He advises clients on the federal income tax consequences of a variety of transactions, including the acquisition and disposition of businesses and assets, structuring joint ventures and partnerships, and business succession planning.

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ABOUT GRAY REED

- A full-service commercial law firm with 30 organized practice groups
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IRS Appeals – Preparing a Winning and Effective Protest

By David Stubblefield, EA
Smith, Jackson, Boyer & Bovard, PLLC

IRS APPEALS – PREPARING A WINNING AND EFFECTIVE PROTEST

OUTLINE

1. Introduction
2. Current status of IRS and Office of Appeals
3. Appeals Mission Statement
4. Appeals Hazards of Litigation
5. Pre-Requisites to Writing the Protest
6. Format and Content of the Protest
7. Submitting the Protest
8. Conclusion

IRS APPEALS – PREPARING A WINNING AND EFFECTIVE PROTEST

Presented by David Stubblefield, EA
Smith, Jackson, Boyer & Bovard, P.L.L.C.

The cornerstones in accomplishing this task are PREPARATION AND PRESENTATION and they are vital before, during and after the actual formal protest is written.

The IRS examination has been completed, you have discussed the proposed audit adjustments with the examiner, as well as your client, during the course of the audit, and some of the audit adjustments remain unagreed. You have conducted the closing conference with the examiner, elevated the unagreed issues to a meeting with the group manager, but the unagreed issues still remain unresolved. Now, after discussing the case with the client and obtaining their approval to move forward, you are faced with the preparation of a formal written protest to forward the case to IRS Appeals. The journey begins.

Our session today will cover the mechanics of drafting a successful protest letter and package that will set the stage for fair and desired results. Prior to discussing the format and content of the protest, let us discuss key points and actions that have to be addressed prior to the actual writing of the protest.

First, let us revisit the Office of Appeals Mission Statement: To resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service.

Now that the IRS has recovered from the horrific impact of COVID on its overall operations, it is moving toward improved functions. The hiring of new examiners and the resumption of field and office examinations will generate an increase in unagreed issue cases going to Appeals and will ultimately impact you and your clients.

Due to the heavy retirement volume within the IRS, that also impacted Appeals, you will encounter new Appeals Officers in the ranks of that Office. Many of these "rookies" will be former Revenue Agents or Tax Auditors. This will require you, in representing your client, to "size up" the expertise and ability of the Appeals Officer early in the Appeals process to get a handle on how you think they will understand and pursue the unagreed issues, as well as their ability to process and understand your protest.

As you did during the early stages of the IRS examination, you want to identify the Appeals Officer's immediate supervisor and obtain their direct telephone number in case you encounter problems during the Appeals process and need to elevate the case.

Due to workload imbalance, Appeals is still spreading case assignments around the country. Therefore, some of your future Appeals cases could be initiated by an Appeals Officer outside your immediate area. Due to the complexity of the case, if you feel that you could give your client stronger representation, you can request in writing that the case be transferred, say, back to the Dallas Appeals Office, if that is the office that serves your area. The request should give specific reasons why holding a face-to-face conference in Dallas would be more effective.

If for any reason the Appeals case remains under the jurisdiction of the distant Appeals office, you should then request a Zoom-type face-to-face conference. IRS Appeals is under a National Office requirement to accommodate taxpayers' request for such conferences. Appeals conferences via telephone or by fax have proven to be not as effective as face-to-face conferences.

In the preparation of the protest, remember that the Appeals Officer considers the "hazards of litigation" in evaluating an appeal. (Regs. Sec. 601.106(f)(2); IRM 8.1.10.4 (1). Hazards of litigation stem from uncertainties related to the facts and/or the application of the law (IRM 8.25.2.6.3). Factual hazards examples include facts and/or their substantiation are missing or incomplete, facts from different sources conflict, you interpret the facts differently than the examiner, the credibility of an expert witness is suspect and disagreements about what constitutes relevant legal authority and how to apply it to the facts of the case.

Hazards of litigation cases can many times lead the Appeals Officer to offer to "settle the case at 50%" or another alternative rather than take a hard position and recommend that the case be forwarded to Tax Court for resolution.

You, in the capacity of representing your client before the IRS, should never get discouraged with the examiner during the completion of an audit and take the position, "to heck with it, write up your report and I will take my chances in Appeals". It is not fair to dump these types of cases on Appeals and there are avenues you can take to get clarification of the unagreed issues at the examination level to allow you to prepare an effective protest.

Some of the key pre-requisites to writing the protest to consider, are as follows:

- Writing the protest to win, using logic, organization, readability and persuasion.
- Writing the protest with the Appeals Officer in mind. Make their job easier.
- Keep the narrative as simple and direct as possible in order that the Appeals Officer can understand what you are saying.
- Do not use flamboyant phrases and over-the-top words to try and impress the Appeals Officer.
- Avoid any harsh or critical comments about the examiner on the case.
- The write up should give the impression to the reader that you are seasoned and have command of the content of the protest.
- Regardless of how good you think the protest is, be prepared during the face-to-face conference to ask the Appeals Officer to repeat back to you their understanding of what you are trying to communicate. You will find that in many cases you will have to clarify and explain your write-up and overcome the Appeals Officers misconceptions and inability to process your facts and positions.
- It is essential that you clarify and "sell" your written protest verbally at the face-to-face meeting with the Appeals Officer.
- Based on how the Appeals conference progresses, be prepared to concede your position or positions based on the discussions of the law and the strength of the Appeals Officer's arguments. You may pivot on your possessions and offer a settlement proposal. Finally, you may feel strong

enough that the Service’s position is still weak and consider petitioning the Tax Court.

- At the conclusion of the Appeals Conference, make sure that the Appeals Officer has clearly communicated to you their reasons, law, etc. of why their decision overrides your protest positions. If they are unable to do this, then you need to request a meeting with their Section Chief supervisor to present your concerns and position.
- When drafting a protest, you must be specific in your appeal of the tax items in dispute. If you introduce new information at Appeals that was not provided to the examiner, this may result in Appeals releasing jurisdiction of the case and returning the file to Examination for further development.

FORMAT AND CONTENT OF THE PROTEST

- The protest letter is addressed to the Appeals Officer, in line with the letter Appeals sent to you and the client, that acknowledges the case. The use of firm letterhead is recommended.
- Subject matter on the letter is the taxpayer’s name, form number, tax years and tax identification number.
- A statement that you want to appeal specific findings to the Office of Appeals.
- Consider at this point of the letter to identify any other audit adjustments wherein you agree with the examiner’s proposed changes.
- Refer to and include a copy of the letter received from the Appeals Officer that reflects the proposed changes.
- In the Appeals Officer’s letter, be alert in identifying the deadline you need to meet in submitting the protest via fax or certified mail.
- Set forth a separate section for each proposed audit adjustment with which you disagree, that includes facts that support your position, identification of facts where you and the examiner disagree, the law or authority that supports your position on the issue and your comments that override law or authority that the examiner and Appeals Officer are relying on to support their position.
- Include the penalties of perjury statement as follows: “Under the penalties of perjury, I declare that the facts stated in this protest and any accompanying documents are true, correct and complete to the best of my knowledge and belief”.

- Include a statement that a current power of attorney is attached to the protest letter and note your CAF number.
- In the concluding "thank you for your consideration" paragraph include your direct telephone number, fax number and email address.

Depending on how close you are in submitting the protest by the deadline date, following the sending of the protest package via certified mail, you should set a date to call the Appeals Officer and verify that the package has been received and determine, based on the Appeals Officer's schedule, when they will call or write to set a conference date. You should be the one to follow up. Do not let weeks or months go by with no action on the case.

Appeals protests can go in all different directions in regard to the size, format and content, the number of unagreed issues and the complexity of the issues. However, they should all follow the same strategic actions as set forth above and the on-going application of PREPARATION AND PRESENTATION principles.

With the foundation of the above techniques and principles, you, as the Power of Attorney and representative of your client before the IRS, have a great opportunity to win for the client, as well as for yourself.

Business Succession Planning: Practical Tax and Estate Planning Issues with Transferring a Business to the Next Generation

By Rob Hugos, Attorney, CPA, LLM

And

Christi Mondrik, Attorney, CPA, TBLS

TAX ALLIANCE CONFERENCE

Business Succession Planning

PRACTICAL TAX AND ESTATE PLANNING ISSUES WITH TRANSFERRING A BUSINESS TO THE NEXT GENERATION

PLANO, TEXAS ~ JUNE 8, 2023

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Presenters

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TAX LAW

Christi Mondrik, Attorney, CPA, TBLS (Tax)
Principal Attorney
MONDRIK & ASSOCIATES

2

Agenda

- Overview of Business Succession
- Issues with Family Members as Officers
- Most Common Succession Plans
- Liability and Tax Issues in Business Transfers
- Family Limited Partnerships
- S Corporation Opportunities and Pitfalls

3

Overview of Business Succession

- Over 2/3 do not survive into the 2^{nd} Generation
- Over 4/5 do not survive into the 3^{rd} Generation
- Average life span is < 25 years

4

Failures in Business Succession

- Not planning for transfer of:
  - Ownership
  - Control
  - Management
- Inadequate Estate planning for transfer of:
  - Family wealth

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Tax Issues for Family Businesses

- Listing children as officers
  - Franchise tax forfeiture liability (Texas Tax Code Sec. 171.251 *et seq.*)
  - Responsibility to oversee sales tax collection/reporting (Texas Tax Code Sec. 111.016)
  - Responsible person liability for trust fund recovery penalties (federal payroll tax withheld) (IRC Sec. 6672)

6

Tax Issues for Family Businesses

- Paying children as employees
  - Documenting work performed / services rendered
  - Adequate work product for amount paid
- Listing children on corporate documents
  - Communication is important
  - Concerns when older generation starts losing capacity

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Most Common Succession Plans

- Buy-Sell Agreements
- Family Limited Partnerships
- S Corporations
- Employee Stock Ownership Plans
- Sale to "Intentionally Defective Grantor Trust"

8

Buy-Sell Planning

- Triggers
- Redemptions or Cross Purchase
- Advantages:
  - Protection
  - Liquidity
- Disadvantages:
  - No wealth transfer achieved

9

Texas sales and use tax issues

- Sales tax exemption for transfer of a business
  - Occasional Sale (Texas Tax Code Sec. 151.304 (b)(2))
  - Entire operating assets of business, division, branch, or identifiable segment
  - Comptroller interprets to be a single transaction

10

Texas sales and use tax issues

- Transferee liability
  - Request for Certificate of no Tax Due (Texas Tax Code Sec. 111.020)
  - Comptroller to issue certificate in 60 days (may trigger an audit)
  - If no certificate is issued after 90 days – no liability
  - Amount is due – withheld from purchase price
  - No certificate – liable up to purchase price

11

Texas sales and use tax issues

- Fraudulent transfer liability (Texas Tax Code Sec. 111.024)
  - Sham transaction
    - Intent to hinder, delay, prevent tax collection
    - Without receiving reasonably equivalent value
  - Intent factors include transfer to former business insider, associate, employee, or third degree relative by blood or by marriage
  - Purchaser is jointly and severally liable with seller for full amount of liabliity

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Family Limited Partnership Planning

- Separates control and non-voting ownership
- Gift non-voting units to Next Generation
- Advantages:
  - Asset protection
  - "Discounting" gifts to Next Generation
  - Retain control with significant wealth transfer
- Disadvantages:
  - Fiduciary duty to non-voting members
  - IRS Scrutiny

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S Corporation Planning

- Very similar to FLP Planning
- One class of stock, e.g. "common stock"
- Can have more than one **kind** of stock
  - Voting and non-voting
- Advantage compared to FLP Planning:
  - Perhaps less IRS scrutiny
- Disadvantage compared to FLP Planning:
  - Greater premium on voting stock (less effective wealth transfer)

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S Corporation Opportunities/Pitfalls

- Reasonable wage requirement for owners
  - Possibility to save on employment tax
  - Issues for service businesses where only owner(s) perform work
- Maintaining S Corporation status
  - Second class of stock issues for former partnerships converted to LLCs
  - E.g. private equity investor F reorgs with QSubs

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Employee Stock Ownership Plan

- ESOP borrows funds to purchase stock
- Senior Generation elects IRC Sec. 1042 rollover or exchange ("Qualifying Replacement Securities")
- Advantages:
  - Seller – liquidity; defers or eliminates capital gains
  - Employees – ownership; retirement benefits
- Disadvantages:
  - Requires established management & employee buyers
  - Requires analysis, with many rules & regulations

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Intentionally Defective Grantor Trust

- Sell business to "defective" Trust
- Children are beneficiaries
- Advantages:
  - Seller – no capital gain on sale
  - "Freezes" value of business
  - Trust's income tax paid by Seller (**<u>not</u>** a gift)
  - Trust controls distributions to children

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Intentionally Defective Grantor Trust

- Disadvantages:
  - Risk – Cash flow might not satisfy note
  - Balance of note included in Seller's estate
  - After Seller's death, undistributed income taxed at Trust's high income tax rate

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Summary of Succession Planning Techniques

- Many factors to determine the best approach
- Each family and business is unique
- Must include planning to effectively transfer:
  - Ownership, Control, Management
- In coordination with Estate Planning to efficiently transfer:
  - Family Wealth

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Questions?

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