TAX ALLIANCE CONFERENCE

IRS/PRACTITIONERS

TAX FORUM 2023

MISSION STATEMENT:

Our mission is to provide intermediate to advanced continuing education to tax professionals held in the Dallas, Texas area at an affordable cost. We are a non-profit, volunteer organization offering practical tax training to enrolled agents, CPAs and attorneys from both the private sector as well as the Internal Revenue Service. Our seminars encourage an exchange of ideas as well as networking opportunities for the attendees.

Table of Contents

TAX ALLIANCE CONFERENCE
IRS/PRACTITIONERS
TAX FORUM 2023

Responsibility for Retention of Records

This outline has been prepared from sources the authors believe to be accurate and reliable. However, the possibility of human and/or mechanical error does exist. The users of this outline are encouraged to secure additional information, as needed, to assist them in reaching a solution in any tax matter.

Credit Hours

EA's:	18 Hours CPE in Taxes & 2 hrs Ethics
CPA's:	20 Hours CPE in Taxes & no Ethics
Attorney's:	20 hrs MCLE in Tax Law /16.75 hrs MCLE with 1.75 hrs for Ethics
Program Level:	Intermediate
Prerequisite:	None

Participants, as well as seminar sponsors, must maintain a record of attendance at a CPE/CLU seminar. Circular 230 states that each individual should keep the following information for seven years: (four years forward after renewal)

- The name of the sponsoring organization;
- The location of the program;
- Program number,
- The title of the program and description of its contents;
- Written outlines, course syllabi, textbook, and/or electronic materials provided or required for the course;
- The dates attended;
- The credit hours claimed;
- The names(s) of the instructor(s), discussion leader(s), or speaker(s), if appropriate; and
- The completion and/or signed statement of the hours of attendance obtained from the sponsor.

The Tax Alliance Conference is an IRS approved continuing educator provider and is registered with the Texas Board of Accountancy as a sponsor of Continuing Professional Education, # 009389; and State Bar of Texas Course # 174046323. Ethics 2 hours: A9EFN-E-16-I. Conference 18 hours: 9EFN-T-00009-19-I.

TAX ALLIANCE CONFERENCE HISTORY

Written by Claire Edwards and Liz Melton

On September 30, 1993 an organizational Steering committee meeting was held in the Internal Revenue Service's Regional Commissioners Conference Room, 12^{th} floor, 4050 Alpha Road, Dallas, Texas 75224. Catherine Harvey, Dallas Problems Resolution officer chaired the organizational meeting.

Mission Statement: *The purpose of the Tax Alliance Conference is to create and promote equitable and efficiently tax administration for the benefit of the taxpayer through sponsorship of presentations, discussions, debates and other cooperative meetings between Tax Practitioners and the Tax Administrators (both state and federal).*

In attendance at the organizational meeting were:

- Catherine Harvey, IRS Problem Resolution Officer – Dallas District
- Sarah Phillips, EA Chairman of the Houston Tax Alliance Conference
- Alice Weir, IRS Problem Resolution Officer - Houston District
- Cyndi Hutchings, EA H & R Block
- Barbara Caldwell, University of Texas Dallas
- Tom Gillreath, ACAT Council
- William J. Sexton, EA TAFTS, Dallas
- Trisha Roberts, IRS Asst. Problem Resolution Officer - Dallas District
- Joe Melton, EA TEAS
- Liz Melton, EA TEAS
- Elaine Vandergriff, EA TAFTS Metroplex
- Bill Moore, Public Affairs IRS
- Jean Bennett, EA TXSEA
- Gary Booth, IRS District Director - Dallas District
- James E. Kelley, IRS Assistant District Director – Dallas District
- Beanna Whitlock, EA TXSEA
- Claire Edwards, CPA

At this meeting it was decided that the Dallas District would indeed host a Tax Alliance Conference and two tentative dates were selected, May 17 & 18 or May 19 & 20, of 1994. A chairman and co-chairman were selected. Claire Edwards was selected chairman and Joe Melton was selected co-chairman. A budget committee was selected with Joe Melton chairing this committee. Joe Melton was appointed to select a bank and open an account with himself and Jean Bennett as signators on the account.

Since no funds were available for seed money, it was decided that each organization would go to their respective boards and ask for a loan to be made to the TAC conference (approximately $2500 each) and that these loans would be repaid out of the first monies that were received in registrations. No organization will benefit monetarily from these conferences as any profits will be used to host the next conference.

b*y Claire Edwards, Acting Secretary of this meeting*

The committee worked well together! Each member taking a responsibility to make the Tax Alliance Conference a success. Application for Sponsorship numbers was made to the Texas State Board of Public Accountancy, IRS Office of Professional Responsibility and the State Bar of Texas. Receiving the sponsorship, records of attendance are maintained annually.

The 2-day conference was held May 17 & 18 of 1994, at the University of Texas at Dallas. To accommodate growing attendance, the conference was moved to the Plano Centre.

Continuing to keep the conference price of attendance reasonable, a goal of the committee, is due to a cadre of knowledgeable speakers who present timely, relevant topics at no fee. The Tax Alliance Conference committee also receives no compensation for their hours of service to this event. The “seed money” of $2,500.00 which came from the Texas Enrolled Agents Society (TEAS) and $2,500.00 from the Texas Association of Financial & Tax Specialists (TAFTS) was soon repaid and the TAC has been self-sufficient ever since.

I have been privileged to have been on the TAC committee since that first meeting in September 1993. My husband, Joe Melton, and Claire Edwards served the first two years as Co-Chairman. Keith Thomas chaired the committee the third year. It was Joe’s dream to unify the professional tax organizations, including both Federal and State taxing authorities to work together. The Tax Alliance Conference is a realization of a dream and its continued success a tribute to the tax professional community it serves.

Ms. Melton is a former founding Board member who served for over twenty years.

By Liz Melton

2023 Sponsors and Vendors for Tax Alliance Conference

At Coleman & Jackson, PC, we are experienced tax attorneys handling all matters related to tax controversy. Specifically, we represent individuals and corporations with respect to federal and state tax matters. Our practice includes representing clients in audits, defense of enforced collections and IRS administrative hearings. We also represent clients in federal, state and United States Tax Court litigation, state tax controversies and criminal tax defense. Additionally, we provide estate and corporate tax planning to assist our clients in implementing sensible tax strategies for their individual or corporate needs.

The members of the firm include Kyle Coleman and Robert Jackson. Each attorney of Coleman & Jackson PC has received a Master's Degree in Tax Law (LL.M). The lawyers may be reached by email or you may call us at (972) 810-4380.

Visit their website at www.coleman-jackson.com

Contact Us at:

The Fairways I
16250 Knoll Trail, Ste. 105
Dallas, Texas 75248
P (972) 810-4380 F (972) 810-4370 admin@coleman-jackson.com

A more human resource.℠

ADP (Automatic Data Processing) is an industry leader in helping small businesses reduce risks and increase profitability through human capital management. We pay one in five Americans through over 600,000 business clients, and our services offered are: Payroll, Health and Retirement Benefits, Worker's Comp, Time and Labor Management, and MORE!

In our most-valued partnership, our Accountant Channel, we partner with over 50,000 CPA/EA/accountants/bookkeepers in four different ways, so that we can be a valuable resource to both your firm and your business clients from one owner/employee on up. Prior to belonging to the ADP Family, I proudly served in the United States Navy where my brothers' and sisters' success and safety was my success and safety. I say that because as an ADP Associate who specifically works with you all, I would love to take a few moments over the week of June 7-9 and illustrate the relationship and success that I hope to build with each of you.

Madison Michael
ADP Sales Executive

TAC 2023

DIRECTORS AND COMMITTEE LIST

NAME & ADDRESS	TELEPHONE #	FAX#	EMAIL
Steve Carter, EA Carter Group Tax Service 1202 Richardson Dr., Ste. 300 Richardson, TX 75080	972-633-1040	214-239-4019	steve@cartergrouptax.com
Kyle Coleman, Atty. Coleman & Jackson, PC 16250 Knoll Trail Dr., Ste. 105 Dallas, TX 75248-2622	972- 810-4380	972- 810-4370	kyle@coleman-jackson.com
Teresa Dempsey, CPA, EA 4695 W. University, Ste.100 McKinney, TX 75071	972-548-1040 W	214-614-5139	t.dempsey@andrecpa.com
Judy Jackson, EA 1110 Elk Trail Carrollton, TX 75007	972-492-1028	972-395-3861	thejudyjackson@gmail.com
Patti Logan, EA P.O. Box 720 Westcliffe, CO 81252	719-783-3312	866-227-1042	patti@thetaxgroup.com
Richard Logan, EA P.O. Box 720 Westcliffe, CO 81252	719-783-2812	866-227-1042	richard@thetaxgroup.com
Roslyn Banks PO Box 470 Lottsburg, VA 22511	254-423-9071		roslyn@hayniebanks.com
Grace P. Bates, EA, CAA 1314 W. McDermott Drive, Suite 106-715 Allen, Texas 75013	972-332-1998	972-534-1800	grace@fintaxservices.com
Anthony Box, Atty 1601 Elm Street, Suite 4600 Dallas, TX 75201	469-320-6190	469-320-6934	abox@grayreed.com

Committee			
Velena L. McRae, IRS 1100 Commerce Dallas, TX 75242	469-320-6190	877-477-8584	Velena.L.McRae@irs.gov

Speakers	Email
Box, Anthony	abox@grayreed.com
Baucum, Dan	dbaucum@fbfk.law
Bacon, LaTonya	LaTanya.J.Bacon@irs.gov
Sheppard, Hale, ESQ.	hale.sheppard@chamberlainlaw.com
Crabtree, Randy	Randy.Crabtree@Tri-Merit.com
Davis, Clint	ccdavis@kjllp.com
Camp, Bryan	Bryan.Camp@ttu.edu
Coleman, Kyle	kyle@coleman-jackson.com
Kramer, Thomas	thomas.d.kramer@irs.gov
Camp, Bryan	Bryan.Camp@ttu.edu
Smeltzer, Joshua	jsmeltzer@grayreed.com
Clark, Brian	bclark@grayreed.com
Stubblefield, David	dstubblefield@dallascpas.com
Mondrik, Christi	Cmondrik@mondriklaw.com
Hugos, Rob	rob@texastrustlaw.com
Morice, Tiffany	tiffany.c.morice@irs.gov
Collins, Erin	Sheila.L.Andrews@irs.gov
Laurel, Stacy	Stacy.L.Laurel@irs.gov

Dan Baucum is a lawyer who draws on his business and legal acumen to aid his clients with tax planning, business issues and federal tax disputes. With more than 30 years of legal experience, he also consults with legal and accounting professionals on federal tax matters and IRS practices. After establishing a successful law career in Dallas, Dan moved to Washington, D.C., where he was appointed Special Assistant to the IRS Assistant Chief Counsel. He assisted with rulemaking and policy decisions affecting passthrough entity tax issues and estate and gift tax issues by drafting and reviewing proposed regulations, revenue rulings, private letter rulings and IRS Chief Counsel notices. Since returning to Dallas, Dan has advised clients on a full array of tax planning and business transactions.

Recognized for his deft, comprehensive knowledge of LLCs, limited partnerships, S corporations and other business entities, Dan advises clients with federal tax issues and structuring challenges commonly faced by closely held businesses, private equity firms, investors and startups. His experience lends itself to a wide variety of businesses and industries, including technology companies, real estate developers and investors, wholesale and retail outlets, logistics companies, service providers, professionals, private equity investors and family offices to name just a few. Dan has taught classes as an Adjunct Professor at Georgetown Law's Graduate Tax Law Program, Southern Methodist University's Dedman School of Law and Baylor Law School. Dan is very active in the State Bar of Texas and currently serves as the 2021-22 Chair of the Tax Section.

Dan has been named as one of The Best Lawyers in America® – Tax Law (2019, 2020, 2021, 2022), Texas Super Lawyer – Tax Law (2021), Best Lawyers in Dallas (D Magazine, 2009, 2011, 2014), Five Top Notch Lawyers – Taxation (Texas Lawyer, 2012) and Power Lawyer (Fort Worth Business Press, 2014), and was named to D CEO Dallas 500 (2022, 2023).

LaTanya J. Bacon
Senior Stakeholder Liaison
IRS Stakeholder Liaison /Communications & Liaison

LaTanya is a Senior Stakeholder Liaison in Cleveland, Ohio. As a Tax Specialist, she partners with tax professionals, small business organizations and community-based organizations to develop and deliver educational products and services to individual and small business taxpayers and to tax professionals in Ohio and Michigan. LaTanya has more than 35 years of IRS experience. LaTanya has a bachelor's degree from Central State University in Business Administration.

ANTHONY "TONY" BOX represents businesses and high-net-worth individuals in all types of civil and criminal tax controversies, white-collar defense cases, regulatory investigations and enforcement actions, and compliance matters focused on preventing government inquiries and minimizing business disruptions. He protects U.S. and international clients spanning several industries, including healthcare, technology, energy, real estate, construction, manufacturing and many more.

Before joining Gray Reed, Tony developed a diverse skill set while serving in a number of public and private sector positions. Most recently, he served as a government trial lawyer and tax coordinator responsible for leading federal tax investigations and prosecutions in the Eastern District of Missouri, as well as other high-profile cases involving white-collar crime, identity theft, illegal guns, drugs, and violent crimes.

In addition, Tony previously served as an investigator and prosecutor in the St. Louis Circuit Attorney's Office where he led the conviction integrity unit and handled many types of investigations involving violent crime, police misconduct and civil rights matters. Tony is also a licensed CPA and spent three years at a Big Four accounting firm overseeing multi-million-dollar financial audits and investigations in the U.S. and abroad.

Tony has an extensive background in federal law enforcement as well. He served as an FBI special agent for nearly a decade, initially as a financial crime investigator handling a broad range of white-collar criminal investigations, and later as a computer forensics examiner directing all FBI media examinations in the Eastern District of Missouri.

Tony's leadership skills and appreciation for collaboration were honed while serving on active duty in the Army as a tank commander and later as a JAG officer in Iraq. He also served as a senior civilian advisor in Afghanistan. Tony is a graduate of Army Airborne, Air Assault, Armor & JAG basic courses, as well as the JAG advanced course.

BRIAN CAMP - Professor Camp earned his BA from Haverford College, his JD from the University of Virginia, his MA from the University of Virginia and his LL.M. from Columbia University. He practiced law for 13 years, the last 8 of which he was a senior docket attorney in the IRS Office of Chief Counsel's Procedure and Administration division right on Constitution Ave. in Washington, D.C. At the IRS Professor Camp received numerous awards, the last one being the 2000 Attorney of the Year for the General Litigation Division. So he wasn't a slouch.

Professor Camp joined the faculty of Texas Tech University School of Law in 2001. Twenty years later Professor Camp has authored over 71 published articles and treatise chapters. He has also written more than 225 substantive blog posts, including his widely read "Lesson From The Tax Court" series, published weekly on TaxProf blog. Professor Camp's scholarship on taxation of cyberspace has taken him to London and Berlin to advise government agencies.

Professor Camp has received recognition for his scholarship. In 2007 and 2010 he was named the Law School's Outstanding Researcher. In 2008, he was awarded the George H. Mahon professorship. In 2010, the Texas Bar Foundation recognized Professor Camp for Best Law Review Article published in Texas. Professor Camp is active in the American Law Institute, and the American Bar Association Section of Taxation where he was honored to have chaired the Individual and Family Taxation Committee. He currently serves on the editorial board of the Practicing Tax Lawyer. He has given over 54 CLE presentations since 2003.

BRIAN CLARK - 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.

Brian has assisted in structuring numerous private equity transactions, representing both buyers and sellers across several industries, ranging from payment-processing technology and software development to refinery contracting and energy services. He also has substantial experience providing tax and transactional advice to technology companies, as well as structuring joint ventures between for-profit and non-profit organizations.

In addition to his tax planning and transactional practice, Brian advises clients on a variety of corporate and commercial law matters, including corporate governance, choice of entity and asset protection. He also frequently handles Affordable Care Act controversies, including employer shared responsibility payment and penalty assessments.

Brian is licensed to practice law in Texas and Louisiana, and he previously worked as a CPA at a Big Four accounting firm. He is a regular speaker on federal income tax issues at events throughout Texas. Brian can be reached at 469-320-6212 or bclark@grayreed.com.

KYLE COLEMAN - Kyle Coleman is a shareholder in Coleman & Jackson, P.C. in Dallas, Texas. Mr. Coleman's practice concentrates on federal tax related controversy matters, including litigation in Federal District Court, the United States Tax Court, and the Court of Federal Claims. Mr. Coleman also represents taxpayers in Internal Revenue Service audits, appeals, and collection actions.

Mr. Coleman has been admitted to the United States Court of Appeals for the District of Columbia Circuit, Fifth Circuit Court of Appeals Bar, the Northern District of Texas, the Eastern District of Texas, the District of Colorado, and the United States Tax Court. In addition to tax controversy, Mr. Coleman also represents clients in estate and business planning as well as asset protection. His practice includes entity formation, asset transfers, and wills and trusts.

Kyle received a BA in Finance from the University of Central Oklahoma. He earned his J. D. from the Oklahoma City University School of Law and went on to receive his L. L. M. from the Dedman School of Law at Southern Methodist University.

He can be reached at kyle@coleman-jackson.com or by calling him at (972) 810-4380.

Erin Collins is the "voice of the taxpayer" within the IRS and before Congress. Under her leadership, the Taxpayer Advocate Service (TAS), an independent organization within the IRS, helps taxpayers resolve their IRS account issues, advocates on behalf of taxpayers, and works towards systemic change to mitigate taxpayer problems. She joined the Taxpayer Advocate Service in March 2020 to advocate for taxpayers, protect their rights, and work toward improving the quality of taxpayer service and tax administration.

Erin has more than 35 years of experience in tax law, spanning 15 years in the IRS Office of Chief Counsel and 20 years at the accounting firm of KPMG LLP, where she retired in 2019 as the Tax Managing Director in charge of its tax controversy practice for the Western region. As a Special Trial Attorney for the IRS, she was responsible for the development and litigation of high-profile, complex tax cases. Erin was the Industry Counsel for Savings and Loans during the time of the S&L crisis. Over a six-year period, she worked very closely with the Treasury Department, the Commissioner, the Office of Chief Counsel, the Federal Deposit Insurance Corporation and Resolution Trust Corporation. In both 1995 and 1997, she received Chief Counsel's highest award, the National Litigation Award. In 1993, she received the Western Region's highest Litigation Award for her outstanding achievements.

At KPMG, Erin represented thousands of individuals, partnerships, small companies, and corporate taxpayers on technical and procedural tax matters. She represented clients in federal examinations and IRS appeals on domestic and international tax issues, including transfer pricing disputes, foreign tax credits, research and experimentation credit claims, net operating loss utilization calculations, restructurings, treaty interpretations, executive compensation, and application of accounting methods. She also has represented several clients before the U.S. Tax Court.

Erin was the co-author of the Practising Law Institute's IRS Practice and Procedure Deskbook and has spoken frequently on IRS practice, procedure, controversy, and litigation matters before many professional organizations. Before joining TAS, she represented a number of clients pro bono to help them resolve issues with the IRS. She was also a volunteer and board member of a non-profit organization, Step Up, whose mission was to help girls in under-resourced communities to fulfill their potential by empowering them to become confident, college-bound, career-focused, and ready to join the next generation of professional women.
"I am proud to advocate for taxpayers' rights and to work toward improving the taxpayer experience to ensure a fair and just tax administration."

RANDY CRABTREE, the co-founder and partner of Tri-Merit Specialty Tax Professionals, is a widely followed author, lecturer and podcast host for the accounting profession. Since 2019, he has hosted the bi-weekly "The Unique CPA," podcast, which ranks among the world's 5% most popular programs (Source: Listen Score). You can find articles from Randy in Accounting Today's Voices column, the AICPA Tax Adviser, CPA Trendlines, Intuit Accountants TaxPro Center and he is a regular presenter at conferences and virtual training events hosted by national accounting associations, state CPA societies and other industry associations.
Randy is a 2-time finalist for Accounting Today's "Top 100 Most Influential people in Accounting".

In May 2022 Randy was appointed, for a 3-year term, to the Intuit Tax Council.
Prior to starting Tri-Merit, Crabtree was managing partner of a CPA firm in the greater Chicago area. He has more than 30 years of public accounting and tax consulting experience in a wide variety of industries and has worked closely with top executives to help them optimize their tax planning strategies.

CLINT DAVIS is with the law firm of Krage & Janvey, LLP in downtown Dallas. He graduated cum laude from the SMU Dedman School of Law in 1980. [Yes, that was before some of you were born.] He was first licensed in Florida as an attorney in 1980 and then in Texas in 1982. He has been a licensed CPA in Texas since 1980. He has been Board Certified in Tax Law by the Texas Board of Legal Specialization since 1988, and he steadfastly refuses to take any more exams.

He has been named as a Super Lawyer, a Top Attorney in Texas by Texas Monthly, one of the Best Lawyers in Dallas by D Magazine and a Top-Rated Lawyer by the Dallas Morning News, all in the tax area.

Clint was an author and discussion leader for 8-hour CPE courses for the Texas Society of CPAs since 1991. [Some of his peers believe that the length of these courses makes him certifiable as well as board certified.]

Clint also speaks before various bar associations and is a frequent presenter and moderator on the Accountants' Continuing Professional Education Network. Clint primarily represents high net worth individuals and closely held businesses with much of his time devoted to tax planning in mergers and acquisitions and charitable organizations.

ROB HUGOS, Attorney and CPA, helps clients and their families with all aspects of general estate planning, including Wills and Living Trusts.

Certain clients benefit from Advanced Planning strategies designed to achieve more complex estate planning, tax, asset protection and business objectives. Advanced Planning clients may use enhanced Living Trust planning, Family Partnerships, Irrevocable Trusts and LLCs. Rob encourages working closely with the client's CPA and other professional advisors to achieve the most from their estate, tax, and business planning.

Rob is licensed by both the Supreme Court of the United States and the Supreme Court of Texas.

Rob is currently a member of the Texas Bar Association, College of the State Bar of Texas, Austin Bar Association, Austin Tax Study Group, Estate Planning Council of Central Texas, Texas Board of Public Accountancy, and American Association of Attorney-Certified Public Accountants.

THOMAS (TOM) KRAMER serves as the acting Director in the Office of Fraud Enforcement (OFE). In this position, he acts as the principal advisor and consultant to the IRS SB/SE Commissioner and Deputy Commissioners on all issues involving fraud enforcement strategic plans, programs, and policy. OFE provides leadership and guidance related to the development and delivery of major activities in support of IRS efforts to detect and deter fraud.

Tom is a participant in the 2021 IRS Executive Readiness Program. He has an MBA in finance from the University of Colorado. Prior to his current assignment, Tom previously served as acting Associate Director, Diversity and Inclusion Division in Equity, Diversity, and Inclusion (EDI), and as acting Director of Innovation Lab 3.0 with Research, Applied Analytics and Statistics (RAAS). Tom started his IRS career as a Revenue Officer and has been an ATAT Revenue Officer, Supervisory Revenue Officer and most recently a Territory Manager in Oakland, California. Tom is passionate about the Fraud Program and upholding fairness for our taxpayers.

BRANDON D. LEWIS is a licensed CPA and CFE. He has conducted complex white-collar fraud and tax evasion investigations for over 20 years with Federal and State government agencies, a Big Four accounting firm, a Fortune 500 company and as an independent advisor. He has conducted many of these investigations as a special agent and forensic accountant, giving him the unique ability to conduct witness and suspect interview, gather digital and documentary evidence, and thoroughly analyze large data sets of accounting, financial and other data sets.

Mr. Lewis has been recognized as a fraud expert by state courts in Arizona and Texas. He has testified as an expert witness in State court and as an investigator and special agent in both State and Federal courts and has been retained as an expert by both plaintiff and defense counsel in civil litigation matters. Mr. Lewis is passionate about fraud prevention and detection and enjoys helping businesses find solutions to their various fraud issues or assisting attorneys with their complex fraud cases and proving or disproving allegations of fraud.

TIMOTHY J. MCCORMALLY is Special Counsel to the IRS Office of Professional Responsibility. He joined OPR in February after seven years as a director in KPMG's National Tax Practice, thirty years with Tax Executives Institute (both as general counsel and executive director), and six years with the predecessor of Eversheds Sutherland. Timothy received his bachelor's degree from the University of Iowa and his law degree from Georgetown University Law Center. He is a frequent speaker and author on topics of tax ethics and professionalism, has published a book of poetry, and served four years on the Internal Revenue Service Advisory Counsel, including one as Chair of the group.

TIFFANY MORICE- First and foremost, I'm a USAF Veteran who has served three tours overseas. I hold an MBA from Washington State University in Finance. I have been with the service since 2010. I started my career in Field Collection as an RO where I became a Front Line Manager & Territory Manager over HI and LA. I came over to ACS in 2020 as the Senior Manager over the Oakland Call site. I now am the Planning and Analysis Chief for Campus Collection Fresno overseeing four call sites, two paper Operations and a Support Operation.

CHRISTI MONDRIK, attorney, dedicates her practice to resolving state and federal tax controversies and litigation. She is board certified in Tax Law by the Texas Board of Legal Specialization. Ms. Mondrik has handled IRS cases involving substantial corporate, individual and estate taxes. Her state tax experience includes disputes arising under Texas franchise tax, sales and use tax, fuel taxes, severance taxes, motor vehicle sales tax, and other state taxes. Ms. Mondrik is also a CPA.

Ms. Mondrik and her associates represent the firm's state tax clients in administrative and legal proceedings before the Comptroller's office, the State Office of Administrative Hearings and the Texas state courts. They also represent federal tax clients in audits, at the administrative appeals level and in proceedings before the United States Tax Court and the United States District Courts. Ms. Mondrik is licensed to practice in the United States Tax Court, the United States District Court, Western District of Texas, and all of the Texas state courts.

Ms. Mondrik and members of her firm are frequent authors and lecturers on federal tax controversies and state taxation. Ms. Mondrik was the 2019-20 Chair of the State Bar of Texas Tax Section. She has served twice on its governing council and has served as chair and vice-chair of its Tax Controversy, CLE and Solo and Small Firms Committee Committees. After completing her 2010-13 SBOT Tax Section council member term, Ms. Mondrik served as annual meeting committee chair for 2013-14. She was also State Bar Tax Section Leadership Academy co-chair for 2016 -17.

The Texas Society of Certified Public Accountants (TXCPA) awarded Ms. Mondrik the Young CPA of the Year Award for 2009-10 and the 2012 Rising Star Award. She was awarded the 2016-17 Special Recognition Award from the TXCPA Chairman for her work on the Federal Tax Policy Committee and Bylaws Tax Force and the 2017-18 Outstanding Committee Chair Award for chairing the Federal Tax Policy Committee. The Austin Chapter of CPAs awarded Ms. Mondrik the 2015 Distinguished Service Award.

Ms. Mondrik served as chair of the TXCPA Federal Tax Policy Committee from 2016-2018. She also serves on the State Bar of Texas and TXCPA State Taxation Committees. She also served a three-year term on the TXCPA Executive Board. Ms. Mondrik was the 2009-10 President and has served as manager of education and leadership and chair of the Oversight Council of the Austin Chapter of CPAs (now TXCPA Austin). Ms. Mondrik has also served as chair of the TXCPA Texas State Tax Conference Committee and its State Taxation Committee. As chair of the State Taxation Committee, she was a principal drafter of comments submitted by the TXCPA in response to state tax legislation and various administrative rules.

Ms. Mondrik earned her B.B.A. in Accounting and her J.D., with honors, both from the University of Texas at Austin. She has been licensed by the State of Texas since 2001.

HALE E. SHEPPARD is a Shareholder in the Tax Controversy Section of Chamberlain Hrdlicka in Atlanta. He defends individuals and businesses during tax audits, administrative appeals, and Tax Court litigation. Hale has participated in over 150 cases in the Tax Court, District Court, and Court of Appeals. In addition, he has obtained dozens of favorable Private Letter Rulings for clients from the IRS National Office on procedural, tax, and international issues.

Hale obtained five college degrees, including an LL.M. in international law from the Universidad de Chile and an LL.M. in taxation from the University of Florida, earning various scholarships and academic distinctions along the way.

Hale ranks among the most active tax writers in the country, having published over 200 articles in top law reviews and tax journals. Hale has been widely cited as a tax/legal authority in many domestic and foreign journals, inducted into the American College of Tax Counsel, invited to present at major tax conferences, and recognized as a leader in tax disputes for many years by Chambers USA and other respected organizations.

JOSHUA SMELTZER- Board Certified in Tax Law by the Texas Board of Legal Specialization, Joshua Smeltzer is a tax litigator defending clients in tax audits, tax appeals, and litigation in Federal District Court, U.S. Tax Court, the U.S. Court of Federal Claims, and tax issues in U.S. Bankruptcy Court. Joshua's previous work as a litigator for the U.S. Department of Justice provides him with first-hand knowledge of how government lawyers build and litigate tax cases. Based on his impressive track record at the Department of Justice, Joshua received the agency's Outstanding Trial Attorney Award seven times. He also has deep tax litigation experience in federal court, both as a private and government lawyer.

Joshua 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. He is often consulted on tax issues arising from significant financial events, such as large financial transactions, litigation settlements, transfers of assets to family limited partnerships or other entities, and tax issues surrounding the sale of business assets or stock.

During his 18-year practice as a tax litigator, his cases have ranged from smaller cases involving six-figure dollar amounts to high-stakes disputes where the amount in controversy totaled hundreds of millions of dollars and, in one case, over a billion dollars. As a respected thought leader in the tax field, Joshua is a regular author and presenter on numerous tax topics and has been called on to provide expert testimony on tax issues in administrative disputes and in court proceedings.

DAVID STUBBLEFIELD - While at the IRS, David served in several positions including Internal Revenue Agent, IRS Training Course Developer and Instructor, Team Member and Team Coordinator involved in Large Case Examinations, Regional Analyst responsibilities over International and Insurance Tax Law Compliance and various IRS National Office assignments. Managerial positions included IRA Group Manager, Appeals Officer, Large Case Group Manager, Examination Branch Chief and Acting Chief, Examination.

After leaving IRS, David received his Enrolled Agent Certification to practice before the I.R.S. He has served as Tax Manager with two CPA firms from December 2000 to the present, being involved in tax preparation, tax planning, IRS controversy cases, auditing, presentations to various tax professional groups and local universities and provided written published articles in various publications.

Education: The University of Texas at Austin, BBA, Major in Accounting
Dave graduated from the University of Texas at Austin with a BBA with a major in Accounting.

Dave has made presentations to various accounting and tax professional groups and has written articles for the Journal of Accounting, Journal of Taxations, Tax Practice and The Tax Lawyer. You may contact David at 214-276-5031
or dstubblefield@dallascpas.com

TAX ALLIANCE CONFERENCE
CONTINUING PROFESSIONAL EDUCATION
CREDIT FORM
Dates: June 6, 7 & 8 - 2023

You have two CPE forms. Please complete both forms and retain GREEN copy for your proof of CPE credit earned. Return YELLOW signed copy to the registration desk before you leave the conference or mail to the address below:

Tax Alliance Conference
4695 W University Suite 100
McKinney, TX 75071
Email: t.dempsey@andrecpa.com

Sponsor: Tax Alliance Conference **Program: 2023 Tax Alliance Conference**

______________________________ **EA CPA ATT'Y Other** ____________________
Print your Name (*As shown on PTIN card*) **Circle Designation** **PTIN number**

Address ______________________________ **Email** ______________________________

City ______________________________ **State** ____________________ **Zip Code** ________

See Class Schedule for a list of Credit Hours and then record your attendance below:

Boot Camp - Tax related ____ (max 4) **Attended Online __In-Person_**
June 7 - Tax related ____ (max 8)
June 8 - Tax related ____ (max 6) June 8 - Ethics ____ Professional Responsibility: Latest Developments affecting the Tax Professional Community (max 2)
Total TAX Hours ______ Total PTIN ETHICS Hrs _____ (Both EAs and CPAs will have 2 hours listed if both hours attended. CPAs 2 hours will count as Technical hours.) TOTAL HOURS ATTENDED ________(max 20)

I certify that I attended the sessions yielding the TIME above.

EA's attending all Sessions for the 3 days, you will have 18 hrs of Tax and 2 hrs of Ethics
CPA's attending all Sessions for the 3 days, you will have 20 hrs of Tax *listed* as 18 Tax 2 PTIN hours.

____
Signature of Attendee

Notice:
Ethics Credit: If attended - EAs .. 2 hrs Attorneys .. 2.00 hrs CPAs .. None
Please indicate time attended. (Consultation time does not qualify for CPE)
Regardless of your designation and attend all 3 days, you will mark the above as 18 tax hours and 2 PTIN Ethic hours to be reported to the IRS.

Everyone:
Please be sure to sign in 1st thing in the morning & sign out when you leave.
We need to have a record of your attendance in order to prove your credit hours!

IRS #A9EFN-T-00036-23-I (In-person) #A9EFN-T-00036-23-O (Online) Tax Credit 18 Hour
IRS#A9EFN-E-00037-23-I (In-person) #A9EFN-E-00037-23-O (Online) Ethics Credit 2 Hours
State Bar of TX Course #174197688 TX State Board of Public Accountancy #009389

Kyle Coleman
____
Kyle Coleman , President

TAX ALLIANCE CONFERENCE
CONTINUING PROFESSIONAL EDUCATION
CREDIT FORM
Dates: June 6, 7 & 8 - 2023

You have two CPE forms. Please complete both forms and retain GREEN copy for your proof of CPE credit earned. Return YELLOW signed copy to the registration desk before you leave the conference or mail to the address below:

Tax Alliance Conference
4695 W University Suite 100
McKinney, TX 75071
Email: t.dempsey@andrecpa.com

Sponsor: Tax Alliance Conference **Program: 2023 Tax Alliance Conference**

______________________________ **EA CPA ATT'Y Other** ____________________
Print your Name (*As shown on PTIN card*) **Circle Designation** **PTIN number**

Address ______________________________ **Email** ______________________________

City ______________________________ **State** ____________________ **Zip Code** ________

See Class Schedule for a list of Credit Hours and then record your attendance below:

Boot Camp - Tax related ____ (max 4) **Attended Online __In-Person_**
June 7 - Tax related ____ (max 8)
June 8 - Tax related ____ (max 6) June 8 - Ethics ____ Professional Responsibility: Latest Developments affecting the Tax Professional Community (max 2)
Total TAX Hours ______ Total PTIN ETHICS Hrs _____ (Both EAs and CPAs will have 2 hours listed if both hours attended. CPAs 2 hours will count as Technical hours.) TOTAL HOURS ATTENDED ________(max 20)

I certify that I attended the sessions yielding the TIME above.

EA's attending all Sessions for the 3 days, you will have 18 hrs of Tax and 2 hrs of Ethics
CPA's attending all Sessions for the 3 days, you will have 20 hrs of Tax *listed* as 18 Tax 2 PTIN hours.

____
Signature of Attendee

Notice:
Ethics Credit: If attended - EAs .. 2 hrs Attorneys .. 2.00 hrs CPAs .. None
Please indicate time attended. (Consultation time does not qualify for CPE)
Regardless of your designation and attend all 3 days, you will mark the above as 18 tax hours and 2 PTIN Ethic hours to be reported to the IRS.

Everyone:
Please be sure to sign in 1st thing in the morning & sign out when you leave.
We need to have a record of your attendance in order to prove your credit hours!

IRS #A9EFN-T-00036-23-I (In-person) #A9EFN-T-00036-23-O (Online) Tax Credit 18 Hour
IRS#A9EFN-E-00037-23-I (In-person) #A9EFN-E-00037-23-O (Online) Ethics Credit 2 Hours
State Bar of TX Course #174197688 TX State Board of Public Accountancy #009389

____
Kyle Coleman , President

IRS Evaluation Form

Continuing Education Providers must provide a means for evaluating program content to students. Your participation is voluntary, but would be appreciated and helpful to us in improving future programs.

Evaluation Form

Full Name of CE Provider: Tax Alliance Conference
IRS Issued Provider Number: A9EFN
Program Name: Tax Alliance Conference Federal Tax
IRS Issued Program Number: A9EFN-T-00036-23-O (Online) A9EFN-T-00036-23-I (In-person)
Date(s) Program was Completed: June 6-8, 2023
Name of Participant (optional*):
Instructions: Please comment on all of the following evaluation points for this program and assign a number grade, using a 1-5 scale, with 5 being the highest.

1. Were stated learning objectives met?	
2. Were program materials accurate, relevant and did they contribute to the achievement of the learning objectives?	
3. Was the time allotted to learning adequate?	
4. Were the facilities / equipment appropriate?	
5. Were the handout materials satisfactory?	
6. Were the audio and video materials effective?	
7. If applicable, were individual instructors knowledgeable and effective?	

Additional comments: 1. How was the food?
2. How could the speakers improve?
3. What topics would you like covered in future seminars?
4. Why did you decide to attend this conference?
5. How many years have you attended the TAC? 1st Year 2-5 Years 5 + Years
6. How did you hear about the TAC? (Circle all that apply)
Mailed Brochure Email Other Friend or Co-Worker Chapter Newsletter
• By providing your name you give the Tax Alliance Conference permission to use your
Comments and /or name in future marketing material unless you opt-out by checking here. ____
THANK YOU

IRS Evaluation Form

Continuing Education Providers must provide a means for evaluating program content to students. Your participation is voluntary, but would be appreciated and helpful to us in improving future programs.

Evaluation Form

Full Name of CE Provider: Tax Alliance Conference

IRS Issued Provider Number: A9EFN

Program Name: Professional Responsibility: OPR will review the latest developments affecting the tax professional community.

IRS Issued Program Number: A9EFN-E-00037-23-O (Online) A9EFN-E-00037-23-I (In-Person

Date(s) Program was Completed: 06/08/23

Name of Participant (optional):

Instructions: Please comment on all of the following evaluation points for this program and assign a number grade, using a 1-5 scale, with 5 being the highest.

1. Were stated learning objectives met?	
2. Were program materials accurate, relevant and did they contribute to the achievement of the learning objectives?	
3. Was the time allotted to learning adequate?	
4. Were the facilities / equipment appropriate?	
5. Were the handout materials satisfactory?	
6. Were the audio and video materials effective?	
7. If applicable, were individual instructors knowledgeable and effective?	

Additional comments:

TAX ALLIANCE CONFERENCE

PARTICIPANT EVALUATION

Please rate the effectiveness of the speaker(s) & the materials

5=Excellent 4=Very Good 3=Average 2=Fair 1=Poor

A. Was the speaker informative?
B. How well were your Questions answered?
C. How do you rate the written material?

WEDNESDAY, JUNE 7, 2023	A	B	C
Erin Collins: Taxpayer Advocate Presentation			
LaTonya Bacon: Data Security			
Hale Sheppard: Voluntary Disclosure Program:			
Key Aspects and Its Evolution			
Randy Crabtree			
R&D Capitalization Rules – What you need to know.			
Clint Davis: Understanding LLC & Partnership Basis			
Bryan Camp: Dealing with Erroneous Refunds			
Kyle Coleman: US Tax Court Practice & Procedure			
Tiffany Morice: ACS Updates			
THURSDAY, JUNE 8, 2023			
Thomas Kramer, IRS: Office of Fraud Enforcement			
Bryan Camp: Understanding the Assessment Statute Expiration Date			
Timothy McCormally: Office of Professional Responsibility			
Joshua Smeltzer			
Brian Clark			
Implementation and Government Enforcement of Block Chain Technology and Digital Assets			
David Stubblefield: IRS Appeals – Writing A Protest			
Christi Mondrik			
Rob Hugos			
Succession Planning for Family Businesses			

Name (optional): ________________________________

TAX ALLIANCE CONFERENCE

PARTICIPANT EVALUATION

Please rate the effectiveness of the speaker(s) & the materials

5=Excellent 4=Very Good 3=Average 2=Fair 1=Poor

A. Was the speaker informative?
B. How well were your Questions answered?
C. How do you rate the written material?

	BOOT CAMP TUESDAY, JUNE 6, 2023	A	B	C
	A Criminal Investigations Presentation			
	Tony Box			
	Brandon Lewis			
	Dan Baucum: LLCs as S Corps			

Name (optional) ________________________

June 6, 2023	Tax Alliance Conference Bootcamp	Virtual/In-Person
Time	Representation	
2:00 - 2:10	Opening Remarks Kyle Coleman	
2:10- 3:50	CI Tony Box & Brandon D. Lewis	I
3:50 - 4:10	Break	
4:10 - 5:00	CI Tony Box & Brandon D. Lewis	I
5:00 - 5:50	LLCs as S Corps: Advantages, Challenges and Busts Dan Baucum	I

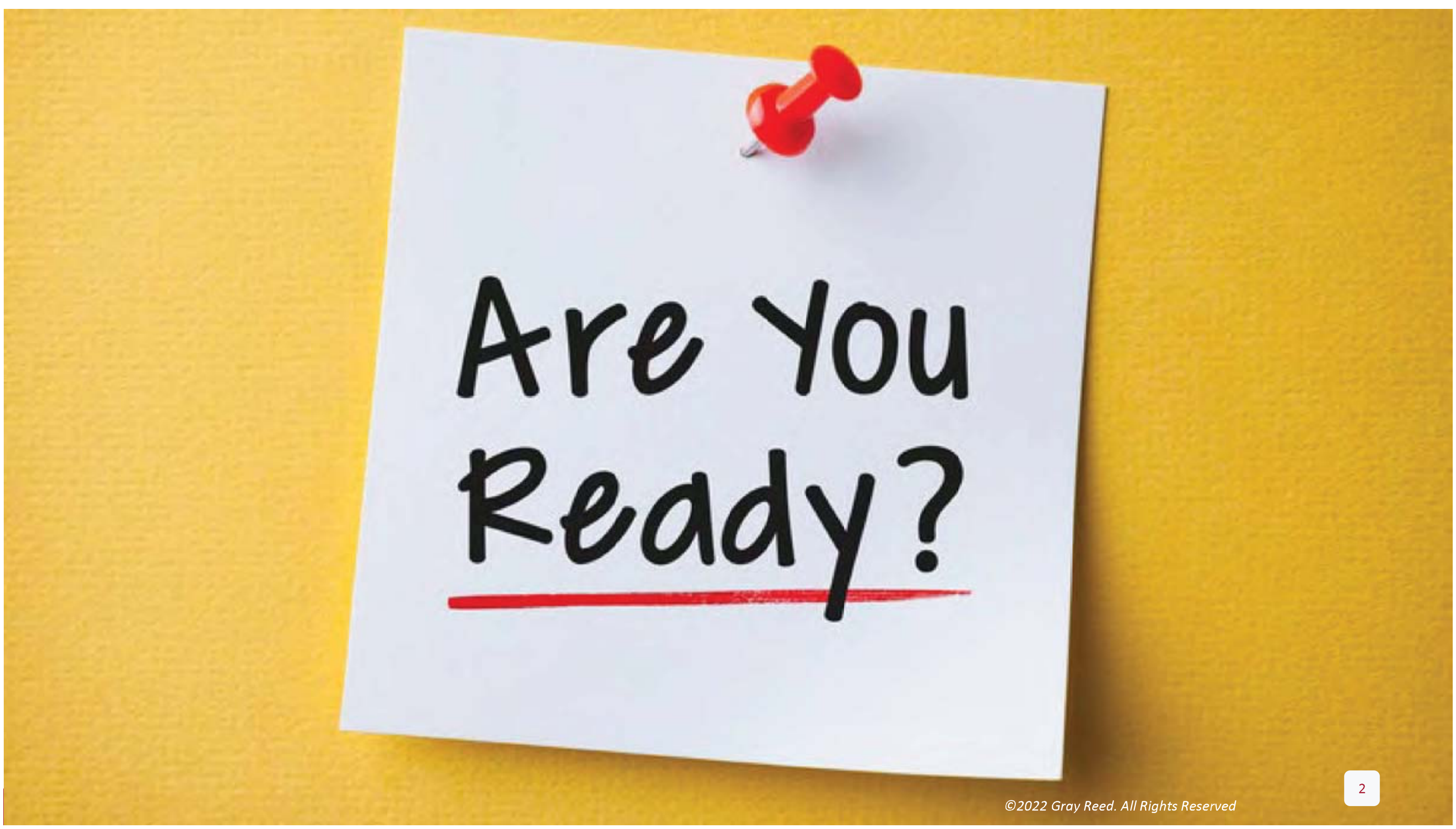
June 7, 2023	Tax Alliance Conference	Virtual/In-Person
8:00 - 8:15	Opening Remarks Vendors	
8:15 - 9:05	Taxpayer Advocate Erin Collins	V
9:05 - 9:55	Data Security LaTonya Bacon	I
9:55 - 10:15	Break	
10:15 -11:05	New Comprehensive IRS Voluntary Disclosure Program: Key Aspects and Its Evolution Hale Sheppard	V
11:05 - 11:55	R & D Capitalization Rules - What You Need to Know. Randy Crabtree	V
11:55 - 1:15	Lunch	
1:15 - 2:05	Understanding LLC & Partnership Basis Clint Davis	I
2:05 - 2:55	Dealing With Erroneous Refunds - Errors Happen Bryan Camp	I
2:55 - 3:15	Break	
3:15 - 4:05	US Tax Court Practice & Procedure Kyle Coleman	I
4:05 - 4:55	ACS Updates Tiffany Morice - IRS	v

June 8, 2023	Tax Alliance Conference	Virtual/In-Person
8:00 - 8:15	Opening Remarks Vendors	
8:15 - 9:05	Office of Fraud Enforcement Thomas Kramer, IRS	V
9:05 - 9:55	Understanding the Assessment Statute Expiration Date Bryan Camp	I
9:55 - 10:15	Break	
10:15 -11:55	Office of Professional Responsibility Timothy McCormally	V
11:55 - 1:15	Lunch	
1:15 - 2:05	Implementation and Government Enforcement of BlockChain Technology and Digital Assets Joshua Smeltzer & Brian Clark	I
2:05 - 2:55	IRS Appeals - Writing A Winning/Effective Protest David Stubblefield	I
2:55 - 3:05	Break	
3:05 - 4:45	Succession Planning for Family Businesses: State, Federal and Estate/Gift Tax Considerations Christi Mondrik & Rob Hugos	I

What To Do When The IRS Comes Calling

By Anthony Box

WHAT TO DO WHEN THE IRS COMES CALLING



ACCOUNTANT DISCLOSURE OF CONFIDENTIAL INFORMATION

- Given the confidentiality obligations, how should an accountant respond to non-compliance with laws and regulations and when, if ever, should the accountant disclose confidential information?

ACCOUNTANT DISCLOSURE OF CONFIDENTIAL INFORMATION

- The rule precluding disclosure of confidential information by a CPA relating to a crime operates similarly to the Rules of Professional Conduct governing lawyer disclosure of confidential information.
- A CPA may disclose confidential information "to state or federal authorities when the CPA concludes in good faith based upon professional judgment that a crime is being or is likely to be committed."
  - Plain language of the rule only contemplates ongoing or future criminal conduct.
  - The language of the rule does not permit a CPA to disclose confidential information relating to past, or already consummated crimes.

ACCOUNTANT DISCLOSURE OF CONFIDENTIAL INFORMATION: SUMMARY

- CPAs owe their clients and/or employers a duty of confidentiality.
- The rules discussed do permit disclosure in certain circumstances, but do not require disclosure in most instances.
- CPAs should not disclose confidential information relating to previous crimes or non-compliant conduct unless required to do so by law or in response to certain investigative or disciplinary actions.
- CPAs <u>may</u> disclose confidential information in instances of future or ongoing illegal activity or noncompliance.

HOW TO AVOID BECOMING AN UNWITTING ACCOMPLICE TO FRAUD

WILLFUL BLINDNESS

- Guiding principle in the criminal law about not becoming an unwitting accomplice to fraud is the concept of “willful blindness.”
- “The willful blindness instruction allows the jury to impute the element of knowledge to the defendant if the evidence indicates that he purposely closed his eyes to avoid knowing what was taking place around him.” United States v. Schnabel, 939 F.2d 197, 203 (4th Cir. 1991).
- To avoid criminal liability for helping your client commit fraud, keep your eyes open and look for red flags of fraud.
- When you see indirect indicia of fraud, look for more indicators.
- Start to ask questions of your client and others involved.

RED FLAGS

- What do I mean when I talk about “red flags” indicating possible fraud? What do you look for?
- In the context of your professional career, you have developed an instinct for what seems authentic and what does not. If you are a tax preparer, for example, if documents that a client is providing to you normally look a certain way, but your client’s documents look different, talk to the client further. Does the letterhead look odd? Does the signature look like it was pasted? Have a discussion.

GRAY REED

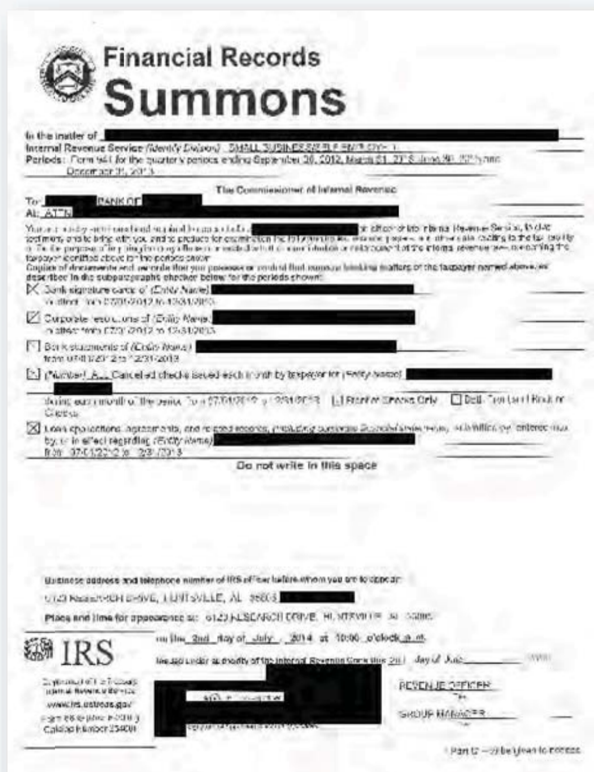
HANDLING CLIENT FINANCES AND TRUST ACCOUNTS

GUIDANCE

- Do not play games with funds received from clients.
- Keep your money separate from the client's money!

SUMMONS

SUMMONS



Financial Records
Summons

In the matter of [redacted]
Internal Revenue Service (Identify Division) SMALL BUSINESS/SELF EMPLOYED
Periods: Form 941 for the quarterly periods ending September 30, 2012, ... December 31, 2013

The Commissioner of Internal Revenue

To: [redacted] BANK OF [redacted]
At: ATTN [redacted]

You are hereby summoned and required to appear before [redacted] an officer of the Internal Revenue Service, to give testimony and to bring with you and to produce for examination ...

Copies of documents and records that you possess or control that concern banking matters of the taxpayer named above, as described in the subparagraphs checked below for the periods shown:

- [x] Bank signature cards of (Entity Name) [redacted]
- [x] Corporate resolutions of (Entity Name) [redacted] in effect from 07/01/2012 to 12/31/2013
- [ ] Bank statements of (Entity Name) [redacted] from 07/01/2012 to 12/31/2013
- [x] (Number) ALL Canceled checks issued each month by taxpayer for (Entity Name) [redacted]
- [x] Loan applications, agreements, and related records ... by or in effect regarding (Entity Name) [redacted] from 07/01/2012 to 12/31/2013

Do not write in this space

Business address and telephone number of IRS officer before whom you are to appear:
... RESEARCH DRIVE, HUNTSVILLE, AL 35805 [redacted]
Place and time for appearance at: ... RESEARCH DRIVE, HUNTSVILLE, AL ...
on the 2nd day of July, 2014 at 10:00 o'clock a.m.

IRS

www.irs.ustreas.gov
Catalog Number 25400I

[redacted]

REVENUE OFFICER
GROUP MANAGER

GRAY REED

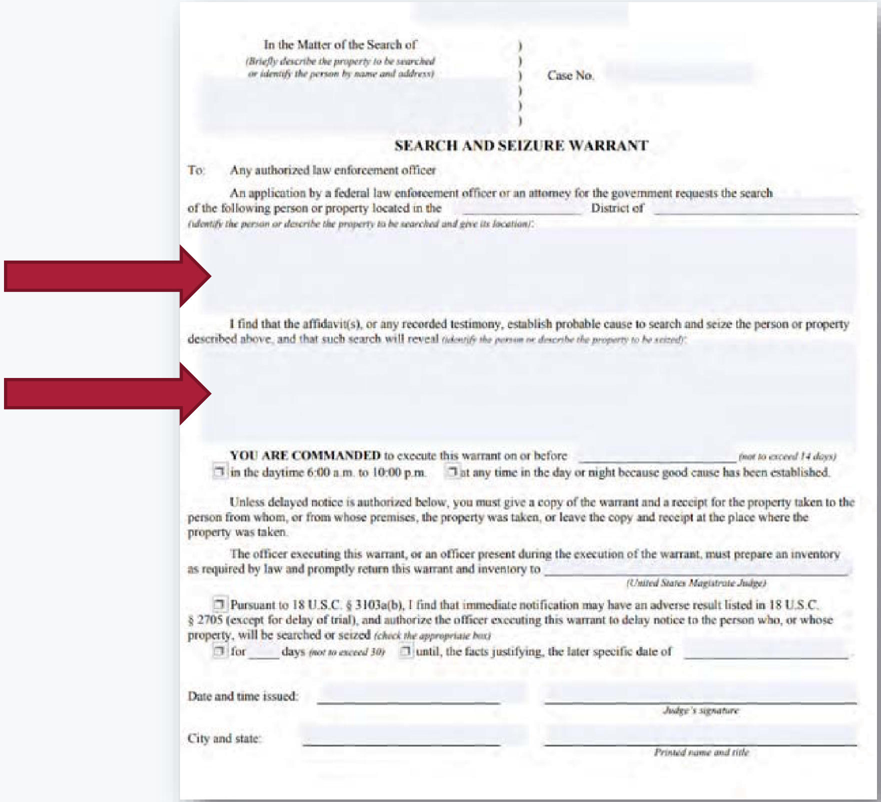
SEARCH WARRANTS

- What is a search warrant?
- Contact designee
- Identification
- Providing consent
- On-site interviews

RESPONDING TO THE IRS

MANAGING THE LOGISTICS OF AN IRS REQUEST OR SEARCH WARRANT

WHAT NOT TO DO



In the Matter of the Search of)
(Briefly describe the property to be searched or identify the person by name and address)) Case No.

SEARCH AND SEIZURE WARRANT

To: Any authorized law enforcement officer

An application by a federal law enforcement officer or an attorney for the government requests the search of the following person or property located in the ____ District of ____
(identify the person or describe the property to be searched and give its location):

I find that the affidavit(s), or any recorded testimony, establish probable cause to search and seize the person or property described above, and that such search will reveal *(identify the person or describe the property to be seized):*

YOU ARE COMMANDED to execute this warrant on or before ____ *(not to exceed 14 days)*
❒ in the daytime 6:00 a.m. to 10:00 p.m. ❒ at any time in the day or night because good cause has been established.

Unless delayed notice is authorized below, you must give a copy of the warrant and a receipt for the property taken to the person from whom, or from whose premises, the property was taken, or leave the copy and receipt at the place where the property was taken.

The officer executing this warrant, or an officer present during the execution of the warrant, must prepare an inventory as required by law and promptly return this warrant and inventory to ____
(United States Magistrate Judge)

❒ Pursuant to 18 U.S.C. § 3103a(b), I find that immediate notification may have an adverse result listed in 18 U.S.C. § 2705 (except for delay of trial), and authorize the officer executing this warrant to delay notice to the person who, or whose property, will be searched or seized *(check the appropriate box)*
❒ for ____ days *(not to exceed 30)* ❒ until, the facts justifying, the later specific date of ____.

Date and time issued: ____ ____
Judge's signature

City and state: ____ ____
Printed name and title

GRAY REED

TAKEAWAYS

LLCs as S Corps: Advantages, Challenges, and Busts

By Dan G. Baucum

LLCs as S Corps

Advantages, Challenges & Busts

Dan G. Baucum

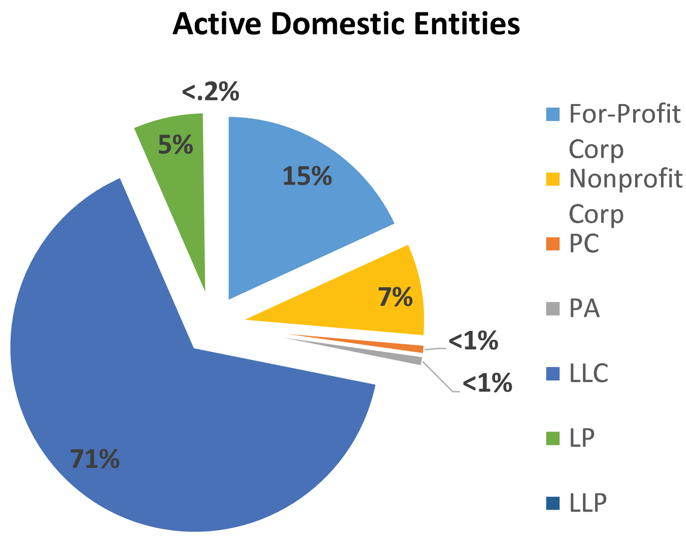
Ferguson Braswell Fraser Kubasta PC
2500 Dallas Parkway, Suite 600
Plano, TX 75093
(972) 378-9111
dbaucum@fbfk.law
www.fbfk.law

Texas Business Entity Formations

	2021	2022*
For-Profit Corporations	25,089	23,083
Professional Corporations	565	662
Professional Associations	254	227
Limited Liability Companies	350,152	351,055
Limited Partnerships	5,721	4,636
Limited Liability Partnerships (initial registrations)	478	446

SOS Census
January 1, 2023*

For-Profit Corp	358,239
Nonprofit Corp	173,394
Prof. Corp	16,789
Prof. Ass'n	17,181
LLC	1,740,308
LP	126,317
LLP	3,959



Advantages & Disadvantages

LLCs vs S Corps

Advantages of LLCs

- Flexibility –
  - Multi-member LLCs taxed as partnerships have flexibility in types of owners, businesses, and in tax allocations and cash distributions.
  - Extracting appreciate assets on tax-free basis is easier than corporation
  - Non-equity owners can share in the profits (profits interests).
- State Law Charging Order-
  - Gives added protection to entity that creditors of equity owners can't become members or take control.
- Avoids Corporate Level Tax-
  - No corporate level tax or adverse formation tax consequences.

Disadvantages of LLCs

- Multi-member LLCs are taxed as partnerships unless they elect to be C Corps or S Corps-
  - LLC governance documents and partnership tax treatment requires complex provisions.
- LLCs cannot take advantage of the tax-free organization provisions.
- Equity options and other retirement and compensation benefits are less flexible than for corporations.

Advantages of S Corps

- Tax Accounting Simplicity-
  - One Class of Stock leads to straight-forward tax return preparation compared to LLCs taxed as partnerships.
- Employees vs Partners-
  - Owners of S Corps can be W-2 employees whereas owners of LLCs (partnerships) cannot.
- Manage Employment Tax Liability-
  - Opportunity to reduce employment tax liability in some instances.

Disadvantages of S Corps

- Limited flexibility as to capital structure and eligible shareholders
- S Corps can only have a single class of stock
  - Cannot split capital and profits interests like partnerships
- Many types of persons and entities cannot be S Corp shareholders
- Former C Corps have build-in gains tax issues and passive income tax issues
- Buyers generally prefer to buy LLCs over S Corps

The care and feeding of S Corps

Eligibility, Elections, Terminations, Taxation and Sales

S Corp Eligibility Requirements

- An S Corp cannot have more than 100 shareholders
- Shareholders must be individuals with certain exceptions (certain trusts, estates, and tax-exempt entities)
- Shareholders cannot be foreign
- An S Corp must have a single class of stock
- An S Corp cannot be an ineligible corporation (certain financial institutions, insurance companies or DISCs)

S Corp Elections

- An eligible entity can make an S Corp election by filing IRS Form 2553
  - Must file within 2 months and 15 days after entity formation or beginning of its tax year or any time during the preceding tax year.
- Election is not a taxable event.
- Should a C Corp make an S election, a snapshot is taken of each asset, and the excess of the fair market value of that asset over its tax basis is "built-in gain" that will be taxed at the corporate level if the asset is sold within 5 years of the election. The gain is taxed once at the corporate level and then the net gain (built-in gain less corporate level tax) is passed through to the shareholders and taxed again—the so-called C Corp "double tax").

S Corp Terminations

- Failure to adhere to eligibility requirements will cause its S election to terminate
- Termination is effective on and after the terminating event

  <u>Example</u>: Buyer is a C corporation that purchases an S corporation. Buyer is not an eligible shareholder, so the S election terminates on the date of the purchase. The S Corp becomes a C Corp on the date of the purchase.

Taxation of S Corporations

- S Corps pass through items of income and loss to their shareholders and generally are not subject to tax
  - Corporate level tax on built-in gains and passive income if C Corp previously
  - S Corp stock basis adjustment and "accumulated adjustments account" ensures no double tax (except when earnings & profits exist from C Corp history)
  - Distributions in excess of shareholder's basis in S Corp shares will be taxable as capital gain (corporate debt does not increase basis in stock like in pernerships)
- S Corps can have a corporate subsidiary (not corporate shareholder)
  - Wholly-owned corporate subsidiary can elect to be Qualified Subchapter S Subsidiary that is a disregarded entity

S Corp Sales and Distributions

- Sale of S Corp stock generally results in capital gains tax to the owners and no tax to the corporation itself
- Gains from the sale of S Corp assets generally results in gains passed through to the shareholders and taxed at the shareholder level; no gain is taxed to the corporation (unless "Built-In Gains" tax applies)
- Distribution of appreciated property by the corporation to its shareholders triggers gain on any excess of the fair market value of the asset over its tax basis, which is passed through to the shareholders and taxed at the shareholder level; no corporate level tax unless "Built-In Gains"

LLCs as S Corps

Can LLCs be S Corps and Should they be S Corps

Can An LLC be a S Corp

- LLCs are eligible entities that may elect to be taxed as an S Corp
  - The election is actually two simultaneous elections: (i) an election to be taxed as a C Corp, and (ii) an election that the C Corp be taxed as an S Corp
  - IRS Form 2553, Election by a Small Business Corporation
- If the LLC is newly formed, and the election is made within two months and 15 days of its formation, then the entity is treated as an S Corp from its date of formation
- If the LLC has operated as a partnership previously, and then elects to be taxed as an S Corp, the LLC is treated as if it dissolved and distributed the assets to its members, who then contributed the assets to the new S Corp effective on the first day of its taxable year (or the next taxable year where applicable).
  - This could result in a taxable event upon the dissolution or upon the contribution; careful planning is needed.

Should an LLC Become an S Corp

PROS -

- Employment Tax relief in some instances
- Simplicity in tax accounting and tax reporting (compared to partnerships)

CONS -

- Second Class of Stock causes a lot of busts
- Buyers don't want to buy S Corps in many instances

Employment Taxes

- Income generated conducting a sole proprietorship or through a wholly-owned limited liability company (LLC)) is subject to both income tax and self-employment tax. The self-employment tax is imposed on 92.35% of self-employment income at a 12.4% rate for social security up to the social security maximum ($147,000 for 2022; $160,200 for 2023) and at a 2.9% rate for medicare. An additional 0.9% medicare tax is imposed on income exceeding $250,000 for married couples ($125,000 for married persons filing separately) and $200,000 in all other cases. No maximum tax limit applies to the medicare tax. If a business is conducted as a partnership in which the taxpayer is a partner, in addition to income tax taxpayer would be subject to the self-employment tax on your distributive share of the partnership's income. On the other hand, if you conduct your business as an S corporation taxpayer will be subject to income tax, but not self-employment tax, on taxpayer's share of the S corporation's income. **IRS requires that the S corporation pay taxpayer reasonable compensation for taxpayer's services to the S corporation. If not, IRS may treat a portion of the S corporation's distributions to taxes as wages and impose social security taxes on the deemed wages. [Emphasis Added]**
- Checkpoint Source: Using S corporations to reduce self-employment income
  Federal Tax Coordinator Client Letters (RIA)

S Corp Reasonable Compensation

- Reasonable compensation should be the amount that unrelated employers would pay for comparable services under like circumstances.
- Example: S corp pays annual salary to sole shareholder accountant of $24,000 along with dividends of $320,000 over two years resulted in recharacterization of part of dividend as compensation. Part of dividend is salary of over $91,000. David E. Watson PC, 714 F Supp 2d 954 (follow on case 668 F3d 1008 affg 757 F Supp 2d 877. *See also* Rev Rul 74-44 and Joseph Radtke, 895 F2d 1196, aff'd 712 F Supp 143.

Reasonable Salary Factors to Consider

- (1) the shareholder was a highly qualified accountant with an advanced degree and nearly 20 years of experience;
- (2) he worked 35–45 hours per week as **one of the primary earners** in a successful firm;
- (3) the firm had over $5 million in gross revenue over the two-year period at issue;
- (4) a $24,000 salary was unreasonably low compared to similarly situated accountants;
- (5) the $24,000 salary was exceedingly low when compared to the dividends received.
- **Capital was a material income producing factor (**Compare Radtke case sole shareholder, only significant employee)

TAX Avoidance and evasion explained

"I deal with tax avoidance - **he** deals with tax evasion."

S Corp Busts

The downside of S Corp status

Second Class of Stock Busts

- LLC elects to be taxes as an S Corporation.
- Company agreement contains typical partnership tax provisions boilerplate language requiring liquidating distributions to be made in accordance with positive capital account balances.
- Provision is incompatible with section 1361 requirement that S corporations confer identical rights in distributions and liquidation
- Can get IRS 9100 relief but new Rev Proc 2022-19 doesn't help.

Treasury regulations

S Corps: Stock Sale or Asset Sale

One more important aspect to choosing an S Corp

Considerations: Sellers and Buyers

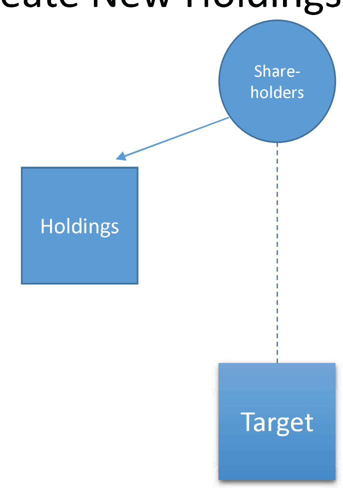
- Considerations for Seller
  - Character of After-Tax Proceeds
    - Stock sale is capital gains.
    - Some assets purchased directly could trigger ordinary income
    - Stock sale avoids Built-In Gains tax or inside-outside basis differential for S Corp shareholders
  - Roll over equity? Asset sale my be impractical (not impossible) if roll over is not pro rata
- Considerations for Buyer
  - Purchasing an S Corp's shares requires that the buyer be an eligible shareholder to avoid terminating the S Corp election resulting it acquiring target as a C Corp (double tax);
    - Buyers often desire flow-through entities (*i.e.*, LLCs) as acquisition targets.
  - Asset basis step-up is important to buyer; asset sale required.
    - Cost of acquiring assets is higher than acquiring stock.
    - Incremental additional cost of asset sale may result in downward adjustment to price

Alternatives to Asset Sales by S Corps

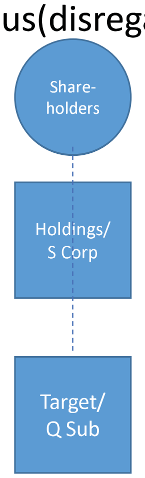
- Section 338(h)(10)/336(e) deemed asset sale by S Corp for tax purposes
  - Buyer must acquire 80% or more of the S Corp ("Target") stock for Target to taxed as if it sold its assets to a new corporation owned by Buyer.
    - Basis step-up (deemed asset sale) and capital gains/ordinary income tax for Seller as if asset sale
    - Saves cost of transferring assets in real asset sale. New target is liable for built-in gains tax.
    - Only effective if S Corp election is valid at time of sale. Otherwise, double tax to sellers (C Corp seller)
- S Corp Target drops down as Q Sub and converts to LLC through "F reorganization
  - Seller form new S Corp (Holding) that owns 100% of Target S Corp as Q Sub (disregarded entity of Holding), which converts to LLC.
  - Buyer buys Target's LLC equity from Holdings or Target merges into Buyer or LLC subsidiary of Buyer.
  - Sale of Target LLC's (disregarded entity) equity is treated as asset sale by Holdings.

F Reorganization Sale – Slide One

Create New Holdings (S Corp)

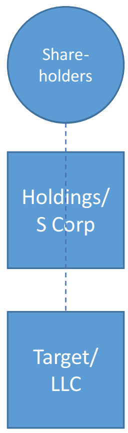


Contribute Target Equity to Holdings/ Elect Q Sub status(disregarded)

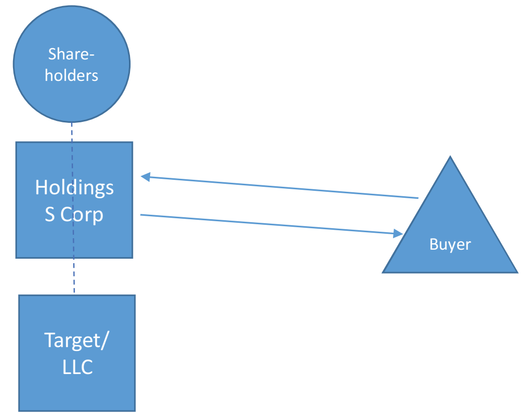


F Reorganization Sale – Slide Two

- Target Elects LLC (Disregarded)

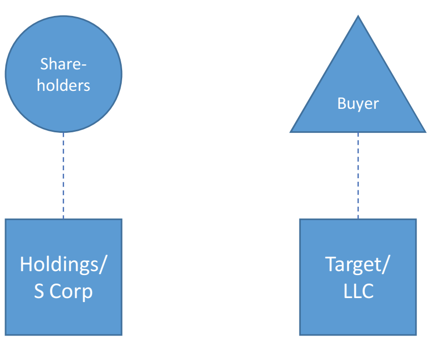


- Target LLC Equity Purchased by Buyer from Holdings

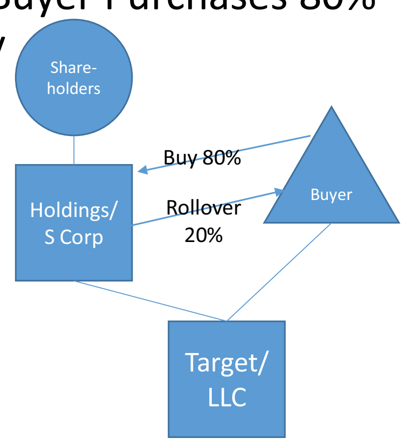


F Reorganization – Slide Three

- Buyer Purchases 100% Equity



- Seller (Holdings)Contributes 20%/Buyer Purchases 80% Equity



Thank You for your attention!

- Disclaimer:

  This presentation was prepared and presented by Dan G. Baucum of Ferguson Braswell Fraser Kubasta PC solely for informational purposes and does not constitute legal advice.

Taxpayer Rights and Service Assessment: IRS and Data Relating to Taxpayer Rights and Service

By Erin Collins

Taxpayer Rights and Service Assessment: IRS Performance Measures and Data Relating to Taxpayer Rights and Service

INTRODUCTION

The Taxpayer Rights and Service Assessment provides the IRS, Congress, and other stakeholders with a "report card" to measure how the agency is doing in protecting and furthering taxpayer rights and service while driving voluntary compliance. This report card can be integral to the IRS's ongoing implementation of the Taxpayer Bill of Rights (TBOR) and may be used to indicate areas where shifting resources impact the IRS's ability to maintain a robust adherence to TBOR in practice and provide a high level of customer service. Taxpayer rights and taxpayer customer service are discrete but closely linked considerations.

FIGURE 1.2.1[1]

The Taxpayer First Act (TFA), passed in 2019, required the IRS to submit a written comprehensive customer service strategy that "identified metrics and benchmarks for quantitatively measuring the progress of the Internal Revenue Service in implementing such strategy."[2] This strategy includes the establishment of the IRS's Taxpayer Experience Office (TXO), charged with, "focus[ing] on continuously improving the taxpayer experience across all interactions with the IRS."[3] Employing the use of metrics is vital to gauging the success of any large public-facing system, and the Taxpayer Rights and Service Assessment can be an aid to the TXO in identifying customer service channels requiring adjustment by comparing fiscal year (FY) data as the customer service strategy is implemented.[4] Traditionally, IRS metrics have focused on "efficiency" – no-change rates, cycle time, etc. As the IRS evolves in its delivery of customer experience and it gains additional funding to realize its customer service goals, it will require the development of new taxpayer-centric metrics. We look forward to working further with the IRS on its TFA implementation, customer service strategy, and development of measures for gauging successful taxpayer service.

INTRODUCTION: The Most Serious Problems Encountered by Taxpayers

IRC § 7803(c)(2)(B)(ii)(III) requires the National Taxpayer Advocate to submit an annual report to Congress that contains a summary of the ten "Most Serious Problems" encountered by taxpayers.[1] While we use the method described below to identify the Most Serious Problems, the list remains inherently subjective in many respects.

A. METHODOLOGY OF THE MOST SERIOUS PROBLEM LIST

The National Taxpayer Advocate is in a unique position to identify the most serious problems facing taxpayers because we receive input from a wide variety of sources. Through our Case Advocacy operations, TAS helps hundreds of thousands of taxpayers to resolve their account problems with the IRS every year. We help many types of taxpayers including individuals, businesses, and exempt organizations, and we work with both unrepresented taxpayers and taxpayers represented by tax professionals. Some cases come to us directly, while others come through congressional referrals.

As part of our Systemic Advocacy operations, TAS leaders meet frequently with organizations that work in the tax administration field, and we maintain an online portal through which members of the public and IRS employees can call our attention to systemic problems that affect groups of taxpayers or all taxpayers.[2] We receive hundreds of submissions each year. We review them all, and we create "advocacy projects" to address priority problems. TAS employees also work on cross-functional teams with other parts of the IRS to address areas that impact taxpayer rights and taxpayer service.

The National Taxpayer Advocate considers the input from these sources and assesses the following factors in selecting the Most Serious Problems encountered by taxpayers:

- Impact on taxpayer rights;
- Number of taxpayers impacted;
- Financial impact on taxpayers;
- Visibility, sensitivity, and interest to stakeholders, Congress, and external indicators (*e.g.*, media);
- Barriers to tax law compliance, including cost, time, and burden;
- Taxpayer Advocate Management Information System (TAMIS) inventory data; and
- Emerging issues.

B. TAXPAYER ADVOCATE MANAGEMENT INFORMATION SYSTEM LIST

The identification of the Most Serious Problems reflects not only the mandates of Congress and the IRC but also TAS's integrated approach to advocacy – using individual cases to detect trends and identifying systemic problems in IRS policy and procedures or the IRC. TAS tracks individual taxpayer cases on its internal system, TAMIS.

C. THE MOST SERIOUS PROBLEMS ENCOUNTERED BY TAXPAYERS IN 2022

For the 2022 annual report, the ten Most Serious Problems are:

1. PROCESSING DELAYS: Paper Backlogs Caused Refund Delays for Millions of Taxpayers

The IRS still depends on outdated manual practices and a human assembly line for its paper processing operations, and paper is its Kryptonite. For the past 2.5 years, millions of taxpayers have experienced significant delays waiting for the IRS to process paper-filed tax returns and issue corresponding refunds. These unprecedented paper processing and refund delays are the product of the IRS falling behind during the pandemic, combined with its reliance on antiquated processing technology and manual data entry. Collectively, this resulted in backlogs that overwhelmed the IRS and even caused it to have to transform a campus cafeteria, conference rooms, and hallways into makeshift paper storage space. The IRS needs to modernize its antiquated paper processing procedures to clear the paper backlogs, streamline processing for the future, and improve related taxpayer services and the taxpayer experience.

2. COMPLEXITY OF THE TAX CODE: The Complexity of the Tax Code Burdens Taxpayers and the IRS Alike

The tax laws are overly complex, burden America's taxpayers, and negatively impact voluntary compliance. The system of preparing and filing taxes is too difficult because it is costly and time-consuming. This is especially problematic for taxpayers who access social programs through the IRS and for small business taxpayers. Some of this complexity exists because the IRC is antiquated and does not mirror modern life. The tax code can be simplified by making it easy to understand, which would make it easier for the IRS to administer, and easier for taxpayers to comply with their tax obligations. Simplifying the Code is the most important step Congress can take to reduce taxpayer compliance burdens. Simplification is essential to the integrity of the U.S. tax system and will enhance voluntary compliance.

3. IRS HIRING AND TRAINING: Weaknesses in the Human Capital Office's Hiring, Recruitment, and Training Programs Are Undermining the IRS's Efforts to Achieve Appropriate Staffing to Meet Taxpayer Needs

Over the past decade, the IRS's budget was reduced by more than 15 percent in inflation-adjusted terms, resulting in reduced staffing levels not seen since the 1970s. As staffing declined, so did taxpayer service levels. The Inflation Reduction Act of 2022 provided the IRS with much-needed funding and presented an excellent opportunity to improve taxpayer service. With this new funding, the IRS will need to recruit, hire, and train new employees on a historic scale as the IRS has never attempted to hire beyond its current capacities. It must do this while also keeping pace with the rate of attrition and accounting for the estimated 50,000 IRS employees expected to be lost through attrition within the next six years. To hire thousands of new employees over the next decade and replace employees who have retired or otherwise left, the IRS must increase its current hiring capacity to meet this demand and focus on the training of its employees. The IRS must also prioritize recruitment and counter recruitment challenges it faces in a competitive job market. The agency must work to revamp its training quality and overall efficiency. New IRS employees cannot provide an appropriate level of service on day one; they need significant resources and time to receive quality training, which can often mean both classroom-type and on-the-job training over an extended period. A workforce equipped with next-generation skills needs advanced training throughout their careers, which requires investment and dedicated budgetary resources. For years, the IRS has been developing and implementing a comprehensive training strategy as described in the IRS's Taxpayer First Act

Report to Congress. However, the IRS Human Capital Office (HCO) did not have dedicated budgetary resources needed to launch this vision. Without the appropriate reallocation of funding and a long-term investment in training strategy, HCO will continue to struggle. Although TAS is encouraged by the incremental progress recently in the areas of hiring, recruitment, and training, the IRS has much more work to do to increase HCO hiring capacity, improve recruitment strategies, and start implementation of its robust training program.

4. TELEPHONE AND IN-PERSON SERVICE: Taxpayers Continue to Experience Difficulties and Frustration Obtaining Telephone and Face-to-Face Assistance to Resolve Their Tax Issues and Questions

Though the IRS is increasing staffing and implementing technology designed to improve the customer experience, processing backlogs caused the demand for telephone and in-person service to remain high, while customer service levels continued to remain unacceptably low. The fiscal year 2022 post-pandemic filing season saw little improvement in telephone and Taxpayer Assistance Center services. Taxpayers and practitioners rely heavily on the ability to reach an IRS employee for account actions and answers to their inquiries. Lack of sufficient service jeopardizes compliance, frustrates taxpayers, and impacts the taxpayers' *right to quality service*.

5. ONLINE ACCESS FOR TAXPAYERS AND TAX PROFESSIONALS: Inadequate Digital Services Impede Efficient Case Resolution and Force Millions of Taxpayers to Call or Send Correspondence to the IRS

Providing tax information and services accessible through a robust online account and seamlessly integrated digital communication tools are essential for taxpayers, their representatives, and IRS employees. Taxpayers or their representatives wanting to interact online need and deserve quality service options and quick responses from the IRS. Today, most taxpayers and tax professionals can't depend on receiving either, causing dissatisfaction that can lead to distrust in tax administration. In recent years, the IRS developed standalone self-assistance web applications that allow taxpayers to perform a single task, such as resolving their inquiries via an automated voicebot or chatbot, sending and receiving secure digital messages, uploading documents, and viewing basic account information. While each application and tool has standalone value and facilitates a particular interaction, the IRS has not leveraged its utility by making them accessible from a central hub that provides a seamless taxpayer experience. As the IRS continues to introduce new self-assistance applications and improve existing ones, it should determine its priorities using a taxpayer-centric approach. The IRS must prioritize the experience of individual and business taxpayers as customers and provide an intuitive central hub with one-click access to all authenticated and unauthenticated self-assistance applications.

6. E-FILE AND FREE FILE: E-Filing Barriers and the Absence of a Free, Easy-to-Use Tax Software Option Cause Millions of Taxpayers to Continue to File Paper Tax Returns

The high number of e-filed returns shows that taxpayers are committed to e-filing, despite the obstacles they sometimes encounter. It is in the IRS's best interest to encourage this trend by making the e-file process more straightforward and user-friendly. By making all forms and schedules compatible with e-filing, as well as making taxpayers' information returns and payment histories downloadable from their online accounts, the IRS can facilitate quick and accurate e-filing for individuals. Opportunities for improvement also exist for business taxpayers, who are sometimes discouraged from e-filing information returns and employment tax returns on account of cumbersome technology. Enhancing this capacity while developing an IRS-run direct e-file option could take a creaky system still managing to produce good results and create a comprehensive e-file system that would benefit both taxpayers and the IRS. This transformation would improve the taxpayer experience, remove barriers to tax filing, improve the timeliness of refunds, and further voluntary compliance.

7. IRS TRANSPARENCY: Lack of Transparency About Processing Delays and Other Key Data Frustrates Taxpayers and May Undermine Voluntary Compliance

This Most Serious Problem addresses the importance of transparency and providing taxpayers with access to information. These bedrock principles of tax administration are especially critical since the IRS has recently received a significant increase in funding to be used for enforcement, customer service, and technology enhancements. It is also critical that the IRS provide taxpayers with complete, accurate, and timely information about the status of their refunds, and clear, concise, and reliable guidance on a variety of complex tax issues. A tax administration agency fully transparent and clear about how taxpayers can comply with their tax obligations and where their return is in the processing pipeline results in trust between the IRS and taxpayers, ultimately yielding optimal voluntary compliance.

8. RETURN PREPARER OVERSIGHT: Taxpayers Are Harmed by the Absence of Minimum Competency Standards for Return Preparers

Return preparers prepare over half of individual income tax returns and play a key role in tax administration. Many taxpayers are ill-equipped to assess a preparer's expertise in tax laws and tax return preparation. The absence of minimum competency standards for preparers of federal tax returns leaves taxpayers, particularly low-income taxpayers, vulnerable to return preparers' inadvertent errors that could cause them to overpay their tax – or to underpay their tax and face subsequent IRS enforcement action. Recent IRS data shows that taxpayers are harmed by non-credentialed return preparers. For example, about 92 percent of the total amount of 2020 Earned Income Tax Credit audit adjustments (in dollars) occurred on returns prepared by non-credentialed paid return preparers. Because taxpayers are financially responsible for inaccurately prepared returns, minimum competency standards for return preparers are an important taxpayer protection measure. Taxpayers should be able to rely on and trust qualified preparers.

9. APPEALS: Staffing Challenges and Institutional Culture Remain Barriers to Quality Taxpayer Service Within the IRS Independent Office of Appeals

Appeals plays a crucial role in administrative case resolution within the IRS. However, over the past decade, Appeals has faced challenges with funding and employee attrition that made providing top-notch taxpayer service difficult. The average Appeals case takes about a year to resolve, which means that taxpayers may be frustrated and discouraged with the process by the time it runs its course. With increased hiring and training and modernized systems for electronic case files, Appeals can improve cycle times, an important step toward quality taxpayer service. Appeals can also make important strides in reinforcing its role as an independent office within the IRS by adopting more taxpayer-friendly practices regarding conferences, by empowering Appeals Officers as final decision makers, and by providing taxpayers with access to Appeals Case Memoranda and post-settlement conferences, where applicable.

10. OVERSEAS TAXPAYERS: Taxpayers Outside of the United States Face Significant Barriers to Meeting their U.S. Tax Obligations

Many taxpayers face challenges understanding their tax obligations and accessing information and services from the IRS. However, taxpayers living overseas face additional challenges in virtually every aspect of their taxpayer experience. Whether they are U.S. citizens, resident aliens living abroad, or foreign persons with U.S. tax obligations, the laws that apply to these taxpayers are very complex.

These taxpayers are subject to highly complicated rules for determining whether they need to file a U.S. tax return and, if so, their correct U.S. tax liability. They have even more limited access to IRS customer service than domestic taxpayers, and they routinely face delays in receiving correspondence. They also face barriers in obtaining Taxpayer Identification Numbers, electronically filing returns, and accessing assistance from both the IRS and private industry. The National Taxpayer Advocate urges the IRS to take concrete steps to reduce the burden on these taxpayers and to better support them in their attempts to comply with U.S. law.

Endnotes

1 Prior to 2019, Congress tasked the National Taxpayer Advocate with identifying at least 20 of the most serious problems encountered by taxpayers. This change was the result of the passage of the Taxpayer First Act, Pub. L. No. 116-25, 133 Stat. 981 (2019).

2 The Systemic Advocacy Management System (SAMS) is a database of systemic issues and information reported online to TAS by IRS employees and members of the public. IRS, SAMS, https://www.irs.gov/advocate/systemic-advocacy-management-system-sams. TAS reviews and analyzes the submissions and determines a course of action, which may include information-gathering projects, immediate interventions, and advocacy projects. Internal Revenue Manual 1.4.13.4.9.2, Systemic Advocacy Management System (SAMS) (July 16, 2021).

The Inflation Reduction Act of 2022 Has Given the IRS a Rare Opportunity to Transform and Dramatically Improve Its Customer Service – But Funding Alone Does Not Guarantee Success

In recent reports, this assessment has highlighted IRS challenges as its inflation-adjusted budget appropriation and staffing levels have declined in the face of rising workloads. TAS has maintained that without sustained, consistent, and dedicated funding, the IRS would remain challenged to develop and maintain the workforce and administrative tools necessary to deliver a high quality of customer service that all taxpayers are entitled to and should reasonably expect from their federal tax administrator.

In FY 2022, Congress passed the Inflation Reduction Act of 2022, which appropriates nearly $80 billion in additional IRS funding, including almost $3.2 billion allotted for taxpayer services, $45.6 billion for enforcement, $25.3 billion for operations support, and nearly $4.8 billion for business systems modernization.[5] This legislation provides the IRS a critical opportunity to significantly improve its delivery of taxpayer services, but increased funding alone will not guarantee improvement. On August 17, 2022, Secretary of the Treasury Janet Yellen formally requested the IRS provide a strategic plan on how the agency intends to apply this funding.[6] The plan should clearly communicate its vision and strategy with defined metrics and benchmarks to determine when resource allocations are or are not successfully improving the taxpayer experience. The choices made regarding the use of this historic funding and the level of transparency exhibited while communicating the intent behind these decisions should significantly impact the quality of IRS customer service as well as taxpayers' perception of the organization as a service-oriented provider.[7] It should be noted while reviewing this assessment that as the Inflation Reduction Act was enacted on August 16, 2022, it will not effect a change when looking at FY 2022 performance metrics. TAS will continue to pay keen attention, however, to determine how the IRS's use of this additional funding will improve taxpayer service moving forward.

FIGURE 1.2.2[8]

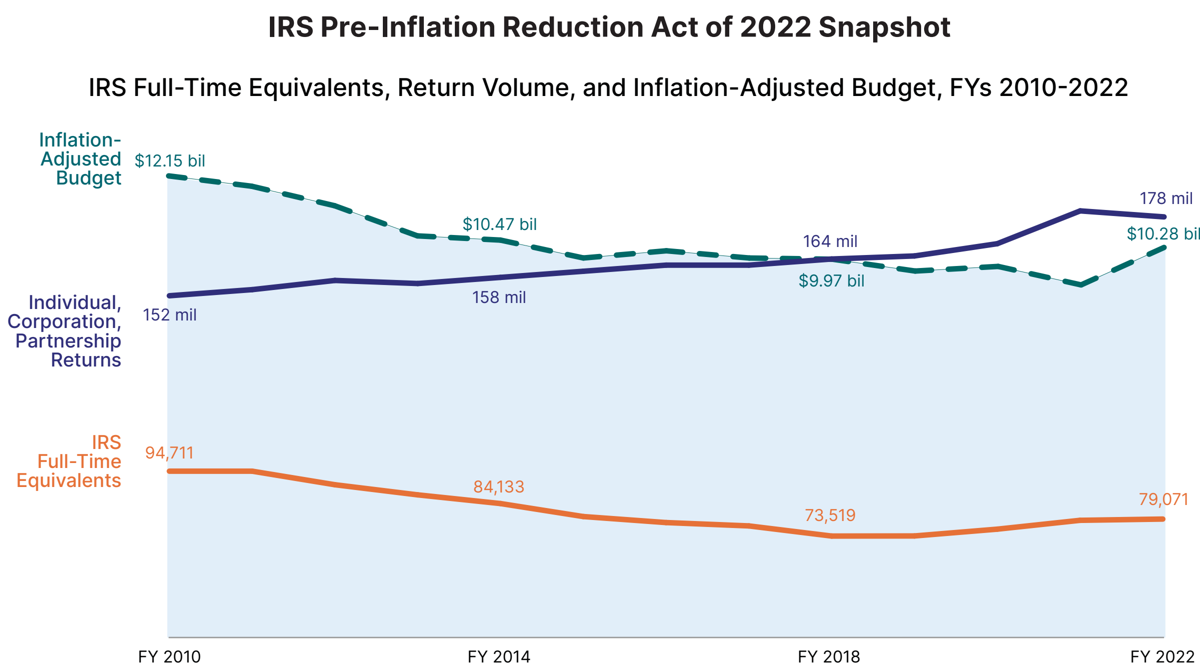
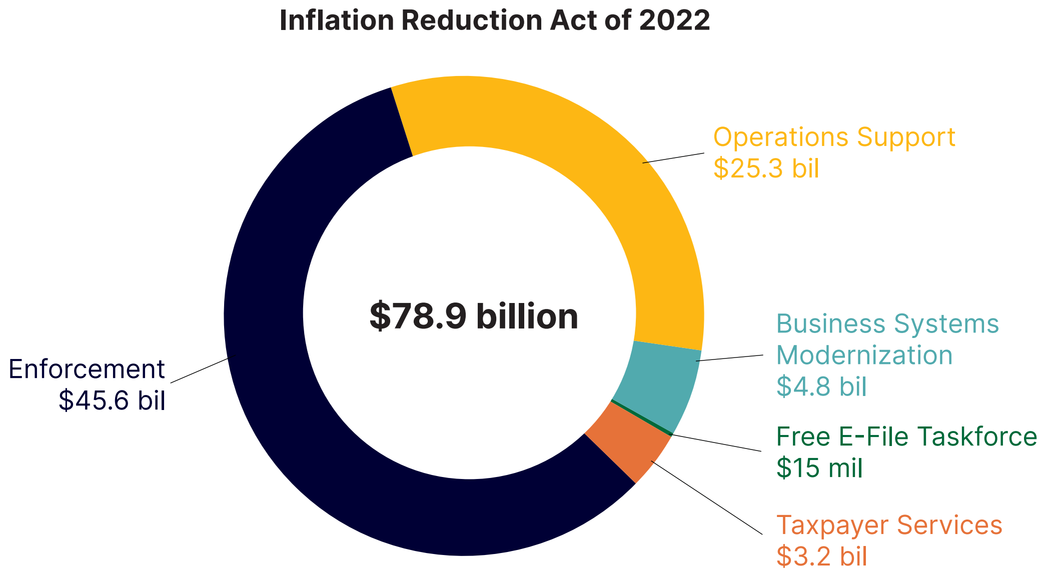


FIGURE 1.2.3[9]



TAXPAYER SERVICE: TAX RETURN PROCESSING[10]

Processing Center Closures, the Impact of COVID-19, Rising Return Inventories, and Diminishing Resources Have Negatively Influenced the Quality of Customer Service

Tax return processing is a fundamental IRS function, and return filing metrics are an important measure of IRS workload. Rising return inventories coupled with diminishing resources influence the quality of customer service taxpayers receive, and disruptions to this essential function negatively impact taxpayer rights.[11] Large paper processing backlogs experienced due to COVID-19 highlight how dramatically taxpayers are impacted when this essential process falters.[12] The number of individual, business, and other returns filed each year is on the rise, growing from 255,249,983 returns filed in FY 2019 to 271,612,000 projected returns filed for FY 2022.[13] While the majority of taxpayers opt to file electronically, millions of tax returns are still filed on paper as a percentage of our population lacks the ability or desire to file electronically, such as those without internet access; low-income or elderly taxpayers; or taxpayers who are required to file using forms that are not currently available in an electronically submittable format. The IRS must devote staffing and resources to processing these paper submissions and continue to invest in the maintenance and modernization of its systems to successfully manage paper *and* electronically filed returns. As noted by the National Taxpayer Advocate in her 2022 Taxpayer Advocate Directive (TAD) to the IRS, this effort should include an expanded use of scanning technology to efficiently speed the processing of paper-filed tax returns.[14]

FIGURE 1.2.4, Income Tax Returns Filed

Measure/Indicator	FY 2019	FY 2020	FY 2021	FY 2022
Number of Returns Filed (Projected, All Types)[15]	255,249,983	242,093,670	269,032,799	271,612,000
Total Individual Income Tax Returns[16]	154,094,555	157,195,302	167,915,264	166,076,400
Total Individual Income Tax Returns Filed on Paper[17]	16,578,426	8,749,558	16,463,292	12,918,800
Total Individual Income Tax Returns Filed Electronically[18]	137,516,129	148,445,744	151,451,972	153,157,600
Free File Consortium (Tax Year)[19]	2,528,639	4,018,163	4,997,000	2,449,458

Measure/Indicator	FY 2019	FY 2020	FY 2021	FY 2022
Fillable Forms (Tax Year)[20]	283,244	519,133	795,000	645,049
Total Corporation Income Tax Returns[21]	7,288,019	6,841,771	7,464,790	7,523,400
Total Corporation Income Tax Returns Filed on Paper[22]	1,325,429	697,421	1,062,200	963,600
Total Corporation Income Tax Returns Filed Electronically[23]	5,962,590	6,144,350	6,402,590	6,559,800

Observation: The total amount of individual and corporate income tax returns filed electronically remains high. Electronically filed returns now account for over 92 percent of individual filings and approximately 87 percent of corporate filings in FY 2022 (please note FY 2022 return counts are projected numbers).

TAXPAYER SERVICE: EXAMINATION AND COLLECTION[24]

Without Adequate Staffing, the IRS Has Had to Make Tough Decisions on Where to Focus Compliance Resources

IRS examination and collection action can lead to taxpayer anxiety, which may be exacerbated if the process is perceived as prolonged or inequitable. Declining IRS staffing levels and high case inventory volumes have posed challenges to maintaining acceptable levels of taxpayer customer service. The strategic allocation of limited workforce resources is challenging yet vital to ensuring equitable treatment across all taxpayer populations, while attention to closed case resolutions can indicate whether the IRS is applying resources appropriately and/or promoting a sense of parity. A higher rate of no-response audit[25] closures in the lower-income taxpayer category, for example, warrants consideration for adjustments in approach. Rising no-change audit[26] closures might suggest resources would be better targeted toward areas of greater non-compliance. The Inflation Reduction Act has allotted $45.6 billion in additional IRS enforcement funding through the end of FY 2031, giving the IRS's collection function a tremendous boost in its ability to hire.[27] Additional hiring addresses a critical IRS need, but hiring alone will not guarantee an improved taxpayer experience. New IRS employees must be adequately trained to perform their duties, and that training must include guidance on recognizing, understanding, and integrating a respect for taxpayer rights into the essential work they do.[28] The quality of customer service provided must always respect the taxpayers' *rights to be informed, to quality service, to pay no more than the correct amount of tax,* and *to a fair and just tax system.*[29]

FIGURE 1.2.5, Type of Audit, Outcomes, and Time to Complete by Income, FYs 2019-2022

Measure/Indicator	FY 2019	FY 2020	FY 2021	FY 2022
Examination				
Total Number of Open Audits Pending in Exam[30]	525,525	614,359	527,353	425,704
Total Number of Closed Examinations – **Individual Tax Returns**[31]	680,463	452,510	658,998	625,947
Total Positive Income (Under $50,000)				
No-Change Rate	10.1%	11.4%	8.6%	12.8%
Agreed Rate[32]	23.3%	20.6%	19.8%	17.1%
Taxpayer Failed to Respond Rate[33]	39.8%	44.7%	46.4%	44.2%
Average Days to Audit Completion	278.7	263.2	339.5	269.6
Average Total Exam Time (Hours) Correspondence Audits	1.4	1.4	1.4	1.4
Average Total Exam Time (Hours) Field Exams	20.4	25.1	28.8	28.8

Measure/Indicator	FY 2019	FY 2020	FY 2021	FY 2022
Percent of Correspondence Audit[34]	88.1%	90.0%	92.4%	91.3%
Total Positive Income (Greater than $50,000 and under $10,000,000)				
No-Change Rate	12.4%	16.0%	11.6%	13.1%
Agreed Rate	42.8%	44.6%	39.6%	40.3%
Taxpayer Failed to Respond Rate	20.0%	17.5%	22.7%	21.3%
Average Days to Audit Completion	288.2	301.2	385	317.6
Average Total Exam Time (Hours) Correspondence Audits	2.1	2.2	2.4	2.3
Average Total Exam Time (Hours) Field Exams	28.7	28.5	37.1	38.2
Percent of Correspondence Audit[35]	67.7%	62.0%	71.4%	72.2%
Total Positive Income (Greater than $10,000,000)				
No-Change Rate	21.3%	19.7%	30.3%	31.1%
Agreed Rate	50.5%	52.2%	52.1%	51.5%
Taxpayer Failed to Respond Rate	1.8%	0.8%	0.2%	0.2%
Average Days to Audit Completion	703.8	994.7	682.9	982.0
Average Total Exam Time (Hours) Correspondence Audits	11.2	9.1	8.9	7.7
Average Total Exam Time (Hours) Field Exams	117.1	94.3	91.4	110.6
Percent of Correspondence Audit[36]	37.0%	43.3%	24.3%	32.2%

Observation: Taxpayers with incomes below $50,000 had about 90 percent of their audits conducted by correspondence, nearly 40 percent or more failed to respond to the IRS, and less than 25 percent agreed to the proposed adjustments. As income levels increase, the relative number of correspondence audits and failure-to-respond rates decrease, whereas the agreed rates rise.

FIGURE 1.2.6, Offers in Compromise, Installment Agreements, and the Queue, FYs 2019-2022

Measure/Indicator	FY 2019	FY 2020	FY 2021	FY 2022
Collection				
Offer in Compromise: Number of Offers Submitted[37]	54,225	44,809	49,285	36,022
Offer in Compromise: Percentage of Offers Accepted[38]	35.3%	34.3%	30.9%	28.7%
Installment Agreements (IAs): Number of Individual & Business IAs[39]	2,821,134	1,825,378	2,361,646	2,383,849
Number of IAs With Bots[40]	0	0	0	8,505
Rejected Taxpayer Requests for IAs[41]	32,281	15,483	14,164	8,800
Percentage of Cases Pending Assignment (in the Queue) (Taxpayers)[42]	24.1%	28.1%	20.9%	17.5%
Percentage of Cases Pending Assignment (in the Queue) (Modules)[43]	33.6%	39.3%	28.5%	24.0%
Age of Individual Delinquencies Pending Assignment (in the Queue)[44]	4.8 years	4.6 years	4.3 years	4.9 years

Observation: Offers in compromise decreased by nearly 27 percent from FY 2021 to FY 2022 while IA submissions increased by less than one percent during this same period. Fewer taxpayers remained in the queue, but the average age of individual unassigned delinquencies increased by about one-half year.

TAXPAYER SERVICE: TAXPAYER-FACING COMMUNICATION CHANNELS[45]

Taxpayers Attempt to Reach the IRS Via Various Channels, But the IRS Faces Challenges in Timely Responding

Taxpayers are increasingly reaching out to the IRS through a variety of communication channels, particularly since the onset of COVID-19, but the IRS is challenged to efficiently and timely address taxpayer contacts when budget and workforce resources are down[46] or have been temporarily redirected to address the processing of paper return backlogs.[47] Individual correspondence processing cycle times, for instance, have risen considerably since FY 2019, while percentages of calls answered by IRS employees have dropped from 28.7 percent in FY 2019 to only 12.5 percent in FY 2022.[48] Increases in virtual service contacts are also important, but taxpayers' continued preference and need for face-to-face assistance must always be considered and supported. It's worth noting that while the IRS has maintained at least 358 Taxpayer Assistance Centers since FY 2018, COVID-19 protocols and limited staffing have meant that not all TACs have remained open or staffed throughout each year.[49]

Additional funding provided under the Inflation Reduction Act of 2022 will supplement and enhance IRS efforts to improve its customer service across all service channels, and the IRS announced in October that it had already successfully hired 4,000 new customer service representatives (CSRs) to help answer phones and provide other services for the next filing season.[50] A portion of these new hires will be filling positions opened though CSR attrition and turnover, so efforts to maintain a bolstered customer service workforce remain an ongoing challenge. The IRS will need to be strategic and monitor customer service measures to be sure its application of resources is generating the improvements in taxpayer service it seeks and that it maintains a balance across all service areas. Taxpayers have the *rights to quality service, to be informed, to pay no more than the correct amount of tax*, and *to a fair and just tax system*. These rights are essential to the standard of service a taxpayer receives when working with the IRS, no matter the communication channel.

FIGURE 1.2.7, In-Person Service, Correspondence, Telephone, and Online Service, FYs 2019-2022

Measure/Indicator	FY 2019	FY 2020	FY 2021	FY 2022
In-Person Service				
Number of Taxpayer Assistance ("Walk-In") Centers (TACs)[51]	358	358	358	360
Number of Face-to-Face TAC Contacts[52]	2.3 million	1.0 million	940,000	1.3 million
Number of Calls to the TAC Appointment Line That Did Not Result in a Scheduled Appointment[53]	1.4 million	694,000	922,000	501,000
Correspondence[54]				
Individual Correspondence[55]	4,134,753	2,765,003	6,306,488	6,950,094
Average Cycle Time to Work Individual Correspondence[56] (Master File (IMF))	74 days	96 days	201 days	207 days
Inventory Overage[57]	41.8%	41.6%	59.6%	44.6%
Business Correspondence[58]	2,717,819	2,038,291	4,197,132	4,599,806
Average Cycle Time to Work Business Correspondence[59] (Master File (BMF))	101 days	149 days	145 days	163 days
Inventory Overage[60]	57.8 %	71.9%	51.5%	60.4%

Measure/Indicator	FY 2019	FY 2020	FY 2021	FY 2022
Telephone Service				
Total Calls to IRS[61]	99,373,456	100,514,299	281,708,009	173,265,572
Number of Calls Answered by IRS Employees[62]	28,558,862	24,192,386	32,039,550	21,740,474
Percentage of Calls Answered by IRS Employees[63]	28.7%	24.1%	11.4%	12.5%
IRS Level of Service (LOS)[64]	56.2%	51.2%	21.3%	21.3%
IRS Average Speed of Answer[65]	16.2 minutes	18.3 minutes	22.8 minutes	28.6 minutes
Practitioner Priority: Percentage of Calls Answered (LOS)[66]	78.3%	56.3%	28.0%	16.9%
Practitioner Priority: Average Speed of Answer[67]	8.8 minutes	12.7 minutes	16.1 minutes	25.4 minutes
Online Service				
Number of Visits to IRS.gov[68]	650,989,560	1,603,938,876	1,999,988,189	1,087,210,500
Number of Page Views[69]	3,350,072,964	9,225,312,072	11,452,583,281	5,310,673,611
Online Installment Agreements[70]	786,505	719,752	1,051,708	1,184,711
Where's My Refund? Inquiries[71]	368,848,775	505,611,474	632,361,686	447,729,355

Observation: In-person visitations remain limited due to closed or virtual TACs as FYs 2020, 2021, and 2022 numbers all remain significantly less than FY 2019 levels; FYs 2021 and 2022 correspondence volumes remained significantly higher than prior years, contributing to longer processing delays; the percentage of FY 2022 calls answered by an IRS employee remained below 50 percent of FY 2019 pre-pandemic levels; and taxpayers continued to use online tools and the IRS website in dramatically greater numbers than they did prior to COVID-19.

TAXPAYER SERVICE: INFORMATION TECHNOLOGY

Taxpayers have continued to experience increased frustration and difficulty resolving their IRS issues, receiving timely notices, accessing detailed information on their Online Account or IRS tools, or reaching an IRS employee,[72] and modernization efforts are challenged when a large portion of available funding is required to maintain current operations and legacy systems. The Inflation Reduction Act budgets the IRS an additional $4.8 billion in funding for business modernization, which is key for the IRS to successfully update its systems.[73] TAS looks forward to seeing the IRS use this opportunity to advance its modernization initiatives and establish more effective systems to serve taxpayers quickly and comprehensively. The modernization of aging IRS information systems and the requisite application of staffing to maintain that effort is integral to improving IRS customer service and respecting taxpayers' *right to quality service*.

Endnotes

1 See TBOR, www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in TBOR are also codified in the IRC. *See* IRC § 7803(a)(3).

2 Taxpayer First Act, Pub. L. No. 116-25, § 1101(a)(5), 133 Stat. 985-986 (2019).

3 IRS, Taxpayer First Act Report to Congress 99 (Jan. 2021).

4 These measures are presented as a sample of indicators and are not intended to be read as a comprehensive listing of performance benchmarks.

5 An Act to Provide for Reconciliation Pursuant to Title II of S. Con. Res. 14, Pub. L. No. 117-169, 136 Stat. 1831-32 (2022) [hereinafter referred to as the "Inflation Reduction Act"].

6 Memorandum from Janet L. Yellen, Sec'y of the Treasury, to Charles P. Rettig, Comm'r. Internal Revenue (Aug. 17, 2022), (on file with TAS).

7 For a further discussion of IRS transparency, *see* Most Serious Problem: *IRS Transparency: Lack of Transparency About Processing Delays and Other Key Data Frustrates Taxpayers and May Undermine Voluntary Compliance*, *infra*.

8 IRS responses to TAS fact checks (Dec. 14, 2020; Dec. 23, 2020; Dec. 8, 2022). IRS email response to TAS (Oct. 20, 2022). IRS Full-Time Equivalents (FTE) line: This figure represents the average number of FTE positions actually used to conduct IRS operations, which excludes FTEs attributable to overtime, terminal leave, and those funded by reimbursable agreements from other federal agencies and private companies for services performed for these external parties. It also excludes positions funded by private debt collection funds. Individual, Corporate, Partnership Returns line: IRS, Pub. 6292, Table 1, Fiscal Year Return Projections for the United States: 2011-2018, Fall 2011 Update 6 (Rev. 8-2011), and subsequent annual Fall Pub. 6292 updates through IRS, Pub. 6292, Table 1, Fiscal Year Return Projections of the Number of Returns To Be Filed with IRS, 2022-2029, at 4 (Rev. 9-2022). The return volume reported for FY 2022 is a projected number. Inflation-Adjusted Budget line: The budget figures include rescissions and funds provided in the administrative provisions of appropriations bills but exclude supplemental funds passed outside of the normal appropriations bills. The inflation adjustment is computed using the Gross Domestic Product Price Index from the President's Budget FY 2022, Historical Tables, Table 10.1.

9 An Act to Provide for Reconciliation Pursuant to Title II of S. Con. Res. 14, Pub. L. No. 117-169, 136 Stat. 1831-32 (2022).

10 When considering FY 2020 data, note that core IRS services were suspended or reduced for a portion of FY 2020 due to COVID-19.

11 For example, the IRS encountered a system outage on April 17, 2018 (the 2017 tax return filing deadline), and had to provide taxpayers an additional day to file and pay their taxes. *See* IRS, IR-2018-100, IRS Provides Additional Day to File and Pay for Taxpayers Through Wednesday, April 18; IRS Processing Systems Back Online (Apr. 17, 2018); Jeff Stein, Damian Paletta & Mike DeBonis, *IRS to Delay Tax Deadline By One Day After Technology Collapse*, Wash. Post (Apr. 17, 2018), https://www.washingtonpost.com/business/economy/irs-electronic-filing-system-breaks-down-hours-before-tax-deadline/2018/04/17/4c05ecae-4255-11e8-ad8f-27a8c409298b_story.html.

12 For a discussion of IRS processing issues, *see* Most Serious Problem: *Processing Delays: Paper Backlogs Caused Refund Delays for Millions of Taxpayers*, *infra*. *See also* National Taxpayer Advocate 2021 Annual Report to Congress 37 (Most Serious Problem: *Processing and Refund Delays: Excessive Processing and Refund Delays Harm Taxpayers*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2022/01/ARC21_MSP_01_Processing-Delays.pdf); National Taxpayer Advocate 2021 Annual Report to Congress 95 (Most Serious Problem: *Filing Season Delays: Millions of Taxpayers Experienced Difficulties and Challenges in the 2021 Filing Season*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2022/01/ARC21_MSP_05_FilingDelays.pdf).

13 The sudden rise in FY 2021 filed individual returns can in part be attributed to returns filed by taxpayers who traditionally are not required to file a return but who filed solely to receive the Recovery Rebate Credit in advance. IRS, Pub. 6292, Fiscal Year Return Projections for the United States: 2022-2029, at 4 (Rev. 9-2022).

14 In March 2022 the National Taxpayer Advocate issued a TAD directing the IRS "to implement 2-D barcoding or other scanning technology to automate the transcription of paper tax returns." Despite a non-committal IRS response, Secretary of the Treasury Janet Yellen subsequently pledged that "[i]n this coming filing season, the IRS will automate the scanning of millions of individual paper returns into a native digital copy." *See* Department of the Treasury, *Remarks by Secretary of the Treasury Janet L. Yellen at the IRS facility in New Carrollton, Maryland* (Sept. 15, 2022), https://home.treasury.gov/news/press-releases/jy0952.

15 IRS, Pub. 6292, Fiscal Year Return Projections for the United States: 2020-2027, at 4 (Rev. 9-2020); IRS, Pub. 6292, Fiscal Year Return Projections for the United States: 2021-2028, at 4 (Rev. 9-2021); IRS, Pub. 6292, Fiscal Year Return Projections for the United States: 2022-2029, at 4 (Rev. 9-2022). The FY 2020 figure has been updated from what was reported in the 2021 Annual Report to Congress. The FY 2021 figure has been updated from what was reported in the 2021 Annual Report to Congress to report actual return counts. The FY 2022 figures are projected numbers. The number of returns and related metrics are proxies for IRS workload and provide context for the environment in which taxpayers seek quality service and other rights from TBOR.

16 *Id.* The FY 2021 figure has been updated from what we reported in the 2021 Annual Report to Congress to report actual return counts. The FY 2022 figures are projected numbers.

17 *Id.*

18 *Id.*

19 FY 2019 and 2021 numbers updated from IRS response to TAS fact check (Dec. 17, 2021) including returns filed solely to claim the Advance Child Tax Credit (AdvCTC). FY 2020 and FY 2022 numbers are from IRS, Compliance Data Warehouse (CDW), Electronic Tax Administration Research and Analysis System Modernized e-File for Individuals and exclude about 8.5 million returns filed for the purpose of claiming Economic Impact Payments in FY 2020. The FY 2019 figures represent TY 2018 tax returns. The FY 2020 figures represent TY 2019 tax returns. The FY 2021 figures represent TY 2020 tax returns. The FY 2022 figures represent TY 2021 tax returns.

20 FY 2021 numbers updated from IRS response to TAS fact check (Dec. 17, 2021), including some returns filed solely to claim the AdvCTC. FY 2020 and FY 2022 numbers are from IRS, CDW, Electronic Tax Administration Research and Analysis System Modernized e-File for Individuals and exclude returns filed for the purpose of claiming Economic Impact Payments. The FY 2020 figures represent TY 2019 tax returns. The FY 2021 figures represent TY 2020 tax returns. The FY 2022 figures represent TY 2021 tax returns.

21 IRS, Pub. 6292, Fiscal Year Return Projections for the United States: 2020-2027, at 4 (Rev. 9-2020); IRS, Pub. 6292, Fiscal Year Return Projections for the United States: 2020-2027, at 4 (Rev. 9-2021); IRS, Pub. 6292, Fiscal Year Return Projections for the United States: 2022-2029, at 4 (Rev. 9-2022). The FY 2021 figure has been updated from what was reported in the 2021 Annual Report to Congress to report actual return counts. The FY 2022 figures are projected numbers.

22 *Id.* The FY 2021 figure has been updated from what was reported in the 2021 Annual Report to Congress to report actual return counts. The FY 2022 figures are projected numbers.

23 *Id.*

24 When considering FY 2020 data, note that core IRS services were suspended or reduced for a portion of FY 2020 due to COVID-19.

25 A no-response audit occurs when a taxpayer under exam does not respond to IRS communication attempts, and the proposed tax adjustments are subsequently input as if the taxpayer had agreed to the exam determination. This metric includes cases where the audit notice was deemed undeliverable (*e.g.*, a taxpayer may have moved without giving an updated address, and the notice was returned), and there was no response from the taxpayer.

26 A no-change audit occurs when a taxpayer substantiates all items being reviewed by the audit, resulting in no change to the reported tax.
27 An Act to Provide for Reconciliation Pursuant to Title II of S. Con. Res. 14, Pub. L. No. 117-169, 136 Stat. 1832 (2022).
28 The National Taxpayer Advocate recently partnered with the IRS in developing a mandatory IRS-wide TBOR training course and will continue to advance training opportunities that promote taxpayer rights awareness.
29 *See* IRC § 7803(a)(3); *see also* www.taxpayeradvocate.irs.gov/taxpayer-rights.
30 IRS response to TAS fact checks (Dec. 17, 2021; Dec. 9, 2022).
31 IRS response to TAS fact checks (Dec. 14, 2020; Dec. 17, 2021; Dec. 9, 2022). These numbers reflect examination cases closed by the IRS and do not account for subsequent appeal or litigation.
32 An audit is closed as agreed when the IRS proposes changes and the taxpayer understands and agrees with the changes.
33 The non-response rate includes taxpayers with undelivered IRS audit notices or statutory notices of deficiencies and taxpayers who did not respond to the IRS audit notices.
34 Represents percentage of correspondence audits for taxpayers with total positive income under $50,000.
35 Represents percentage of correspondence audits for taxpayers with total positive income greater than $50,000 and under $10,000,000.
36 Represents percentage of correspondence audits for taxpayers with total positive income greater than $10,000,000.
37 IRS, Small Business/Self-Employed (SB/SE), Collection Activity Report (CAR) No. 5000-108, Monthly Report of Offer in Compromise Activity, cumulative through September, FY 2019 (Sept. 30, 2019); FY 2020 (Sept. 28, 2020); FY 2021 (Oct. 4, 2021); FY 2022 (Oct. 3, 2022).
38 *Id.*
39 IRS, SB/SE, CAR No. 5000-6, Installment Agreement Cumulative Report, FY 2019 (Sept. 29, 2019); FY 2020 (Sept. 27, 2020); FY 2021 (Oct. 4, 2021); FY 2022 (Oct. 2, 2022). Number includes short-term payment agreements and continuous wage levies.
40 Weekly ACI and Voice Bot Reports for Week Ending 9/30/2022 (Cumulative). This service was not offered until July 2022.
41 IRS, CDW, FY 2019 (Oct. 2021); FY 2020 (Oct. 2021); FY 2021 (Oct. 2021); FY 2022 (Oct. 2022). The IRS accepts about 99 percent of requests for IAs that meet the processable criteria.
42 IRS, SB/SE, CAR No. 5000-2, Taxpayer Delinquent Account Cumulative Report, FY 2019 (Sept. 29, 2019); FY 2020 (Sept. 27, 2020); FY 2021 (Oct. 4, 2021); FY 2022 (Oct. 2, 2022). When taxpayers incur delinquent tax liabilities, the IRS sends them a series of notices during an approximately six-month period in which the taxpayers are in "notice status." If the taxpayer does not resolve his or her liability during the notice status, the account enters into taxpayer delinquent account status. The IRS then determines whether the case will be referred to the Automated Collection System (ACS), assigned directly for in-person contact by a revenue officer, assigned to the collection queue to await assignment to a revenue officer, or shelved. ACS may also assign cases to the collection queue. The IRS shelves cases prior to assigning the case to a private collection agency.
43 *Id.* Modules are the number of accounts attributable to a taxpayer. For example, an individual taxpayer may owe unpaid taxes on the 2017 and 2018 Forms 1040 – this would be one taxpayer with two modules.
44 Query by TAS Research of tax delinquent accounts with queue status in IRS, CDW, Accounts Receivable Dollar Inventory, Individual Master File (IMF), Modules. Age of balance due cases in the collection queue as of cycle 37 of FY 2019, cycle 38 of FY 2020, cycle 37 of FY 2021, and cycle 37 of FY 2022. The age of Taxpayer Delinquency Investigations is not considered.
45 When considering FY 2020 data, note that core IRS services were suspended or reduced for a portion of FY 2020 due to COVID-19.
46 *See* Most Serious Problem: *Inadequate Digital Services Impede Efficient Case Resolution and Force Millions of Taxpayers to Call or Send Correspondence to the IRS*, *infra*; Most Serious Problem: *Telephone and In-Person Service: Taxpayers Continue to Experience Difficulties and Frustration Obtaining Telephone and Face-to-Face Assistance to Resolve Their Tax Issues and Questions*, *infra*; Most Serious Problem: *IRS Hiring and Training: Weaknesses in the Human Capital Office's Hiring, Recruitment, and Training Programs Are Undermining the IRS's Efforts to Achieve Appropriate Staffing to Meet Taxpayer Needs*, *infra*.
47 *See* Oversight Subcomm. Hearing With IRS Commissioner Rettig on the 2022 Filing Season 5, 117th Congress (written testimony of Charles P. Rettig, Commissioner, Internal Revenue), "We are temporarily moving approximately 900 employees with previous relevant experience back into key areas from other organizations. In addition to this accounts management surge team, we are working to assemble a similar surge team for our submission processing area with 700 employees," https://www.irs.gov/newsroom/written-testimony-of-charles-p-rettig-commissioner-internal-revenue-service-before-the-house-ways-and-means-committee-subcommittee-on-oversight-on-the-filing-season-and-irs-operations (Mar. 17, 2022).
48 One aspect of this drop in service may be attributable to the sharp rise in volume of calls made to the IRS in FYs 2021 and 2022.
49 Secretary of the Treasury Janet Yellen has pledged that "[b]y next year, every single [Taxpayer Assistance] center will be fully staffed." *See* Department of the Treasury, *Remarks by Secretary of the Treasury Janet L. Yellen at the IRS facility in New Carrollton, Maryland* (Sept. 15, 2022), https://home.treasury.gov/news/press-releases/jy0952.
50 IR-2022-191, IRS quickly moves forward with taxpayer service improvements; 4,000 hired to provide more help to people during 2023 tax season on phones (Oct. 27, 2022), https://www.irs.gov/newsroom/irs-quickly-moves-forward-with-taxpayer-service-improvements-4000-hired-to-provide-more-help-to-people-during-2023-tax-season-on-phones.
51 FY 2019 figure from IRS response to TAS fact check (Nov. 15, 2019); FY 2020 figure from IRS response to TAS information request (Sept. 30, 2020). FY 2021 figure from IRS response to TAS information request (Sept. 2021). Due to COVID-19, a total of 49 TACs were unstaffed at some point during FY 2021. FY 2022 figure from IRS response to TAS fact check (Dec. 12, 2022). As of October 31, 2022, 326 of the 360 TACs were open, and 34 were closed or unstaffed. IRS, Status of Unopened Mail and Backlog Inventory Report (Nov. 4, 2022).
52 Wage and Investment Division, Business Performance Review, 4th Quarter, FY 2021 (Nov. 2021); FY 2021 and FY 2022 figures from IRS response to TAS fact check (Dec. 12, 2022).
53 IRS response to TAS information request (Oct. 2022); IRS response to TAS fact check (Dec. 12, 2022). Please note these numbers include both calls resolved by the CSR (thus negating the need for a TAC appointment) and calls where the taxpayer could not schedule an appointment at the available times.

54 Correspondence represents Accounts Management inquiries and responses received from taxpayers who do not belong specifically to another area.

55 IRS, Joint Operations Center (JOC), Adjustments Inventory Reports: July-September FY Comparison (FY 2020, FY 2021, FY 2022). The FY 2021 figure have been updated from what was reported in the 2021 Annual Report to Congress. These are IMF cumulative fiscal year receipts for Correspondence, Amended, Carryback, Injured Spouse and Individual Taxpayer Identification Number (ITIN). This metric measures taxpayer correspondence requesting account adjustment.

56 IRS, Research Analysis and Data (RAD), Accounts Management Reports: Collection Imaging System (CIS) Closed Case Cycle Time (FY 2020, FY 2021, and FY 2022). The FY 2021 figure has been updated from what was reported in the 2021 Annual Report to Congress.

57 IRS, Weekly Enterprise Adjustments Inventory Report, FYs 2019-2022 (weeks ending Sept. 28, 2019; Sept. 26, 2020; Sept. 25, 2021; Sept. 24, 2022). Certain IRS inventories must be worked within a specific timeframe to be considered timely. If not closed in that timeframe, the inventory item will be classified as "overaged."

58 IRS, JOC, Adjustments Inventory Reports: July-September Fiscal Year Comparison (FY 2020, FY 2021, FY 2022). This metric measures taxpayer correspondence requesting account adjustment. The FY 2021 figures have been updated from what was reported in the 2021 Annual Report to Congress.

59 IRS, RAD, Accounts Management Reports: CIS Closed Case Cycle Time (FY 2020, FY 2021, and FY 2022). The FY 2021 figure has been updated from what was reported in the 2021 Annual Report to Congress.

60 IRS, Weekly Enterprise Adjustments Inventory Report, FYs 2019-2022 (weeks ending Sept. 28, 2019; Sept. 26, 2020; Sept. 25, 2021; Sept. 24, 2022).

61 IRS, JOC, Snapshot Reports: Enterprise Snapshot (weeks ending Sept. 30, 2020; Sept. 30, 2021; Sept, 30, 2022; reports generated Oct. 18, 2022, and Nov. 27, 2022).

62 *Id.*

63 *Id.*

64 *Id.* The IRS generally defines its LOS measure as Numerator = Assistor Calls Answered + Info Messages and Denominator = Assistor Calls Answered + Info Messages + Emergency Closed + Secondary Abandons + (Add either Calculated Busy Signals OR Network Incompletes) + (Add either Calculated Network Disconnects OR Total Disconnects).

65 *Id.*

66 IRS, JOC, Snapshot Reports: Product Line Detail (weeks ending Sept. 30, 2020; Sept. 20, 2021; Sept. 30, 2022; reports generated Oct. 18, 2022, and Nov. 27, 2022).

67 *Id.*

68 IRS.gov Site Traffic Calculator (FYs 2019-2022).

69 *Id.*

70 IRS, SB/SE, CAR No. 5000-6, Installment Agreement Cumulative Report, FY 2020 (Sept. 27, 2020); FY 2021 (Oct. 4, 2021); FY 2022 (Oct. 2, 2022). Number includes short-term payment plans.

71 IRS response to TAS fact check for FY 2019 (Dec. 17, 2021); IRS Databook for FY 2020 and 2021; IRS response to TAS fact check for FY 2022 (Dec. 14, 2022). This metric measures the number of successful Where's My Refund? queries (as opposed to the total number of Where's My Refund? query attempts).

72 For a discussion of IRS information technology modernization, see National Taxpayer Advocate 2020 Annual Report to Congress 84 (Most Serious Problem: *Information Technology Modernization: Antiquated Technology Jeopardizes Current and Future Tax Administration, Impairing Both Taxpayer Service and Enforcement Efforts*), https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2021/01/ARC20_MSP_06_ITmod.pdf. *See also* Most Serious Problem: *Inadequate Digital Services Impede Efficient Case Resolution and Force Millions of Taxpayers to Call or Send Correspondence to the IRS, infra*.

73 An Act to Provide for Reconciliation Pursuant to Title II of S. Con. Res. 14, Pub. L. No. 117-169, 136 Stat. 1832 (2022).

NTA Blog: IRS Strategic Operating Plan Has Potential to Transform Tax Administration

April 6, 2023

Today, the IRS released a Strategic Operating Plan (SOP) outlining how it intends to use the nearly $80 billion in additional funding received as part of the Inflation Reduction Act of 2022 (IRA) to improve the taxpayer experience, modernize its information technology (IT) systems, and strengthen tax compliance programs in a fair and equitable manner.
This is a game changer to transform how the U.S. government administers the tax laws in a more helpful and efficient manner while focusing on providing the service taxpayers deserve.
However, of the nearly $80 billion in supplemental IRA funding, only $3.2 billion was allocated for Taxpayer Services and $4.8 billion was allocated for the IRS Business Systems Modernization (BSM) projects. Combined, that's just ten percent of the total. By contrast, 90 percent was allocated for Enforcement ($45.6 billion) and Operations Support ($25.3 billion). The additional long-term funding provided by the IRA, while appreciated and welcomed, is disproportionately allocated for enforcement activities, and I believe Congress should reallocate IRS funding to achieve a better balance with taxpayer service needs and IT modernization.

As discussed in the Estimated Allocation of Funds section of the SOP, the additional resources the IRS has deployed to meet current taxpayer service needs will deplete the entire $3.2 billion IRA allocation for Taxpayer Services in less than four years if additional annual appropriations or supplemental funding is not provided. The SOP also expresses concern about the adequacy of BSM funding to modernize the agency's antiquated IT systems.
In my opinion, the most efficient way to improve compliance is by encouraging and helping taxpayers to do the right thing on the front end. That is much cheaper and more effective than trying to audit our way out of the tax gap one taxpayer at a time on the back end. The success of IT is instrumental in accomplishing the SOP's objectives of improving compliance. Allocating more funds to service and IT is key to taxpayers and tax administration.

Even before the COVID-19 pandemic began, taxpayer service was unacceptably poor. Since the onset of the pandemic taxpayer service has fallen through the floor and the IRS has not been able to provide the service taxpayers deserve. Taxpayers and practitioners have struggled to get basic service and help understanding the tax laws and IRS procedures. This is not sustainable. As more Americans interact with the IRS each year than with any other federal agency the government has a moral and practical obligation to make those interactions as productive, fair, and painless as possible.

The vision of the SOP contemplates a significantly different experience for individuals, businesses, practitioners, and industry by providing the ability to obtain the information and help they need, when they need it, and in a variety of ways.

Although I share the long-term vision of the SOP, I want to caution that the IRS should not lose sight of its core mission and its immediate challenge of reducing the large backlog of amended tax returns and taxpayer correspondence. The IRS's customer service representatives (CSRs) alternate between answering taxpayer telephone calls and processing paper. As the IRS has

been assigning more CSRs to answer the phones this year, the paper backlog has been growing. **Although the SOP offers the promise of many positive changes in the coming years, I urge the IRS to put appropriate focus on getting its inventories under control now and not lose sight of its core mission.**
Throughout the year, my office participates on inter-agency teams and makes many recommendations to fix taxpayer problems within the IRS. I also make recommendations in my annual reports to Congress. Often, the IRS responds to our recommendations by saying, in effect, "Good idea in theory, but we barely have enough funds to keep our 1960s COBOL-based technology systems operating. We just don't have the resources to do what you're suggesting."

See my annual reports to Congress for a discussion of serious problems impacting taxpayers and practitioners over the past three years and recommendations to improve service. **With the long-term funding the IRS has received and prudent management, change is possible. There is light at the end of the tunnel.**
Several of TAS's senior leaders played leadership roles in developing the plan and beginning the process of transforming the agency. Many sections of the plan released today reflect recommendations that TAS has been making for years, as well as recommendations included in the Taxpayer First Act report to Congress, the Taxpayer Experience Office's roadmap, and outside stakeholder recommendations.

The plan is organized around 5 objectives:

1. Dramatically improve services to help taxpayers meet their obligations and receive the tax incentives for which they are eligible.
2. Quickly resolve taxpayer issues when they arise.
3. Focus expanded enforcement on taxpayers with complex tax filings and high-dollar noncompliance to address the tax gap.
4. Deliver cutting-edge technology, data, and analytics to operate more effectively.
5. Attract, retain, and empower a highly skilled, diverse workforce and develop a culture that is better equipped to deliver results for taxpayers.

Below is a select list of service recommendations and IT projects, as they appear in the SOP, that reflect prior TAS recommendations and have the potential to dramatically improve services for individuals, businesses, practitioners, and industry:

- **Improve the availability and accessibility of customer service:** Taxpayers will be able to receive on-demand customer service or schedule service ahead of time.
- **Provide comprehensive secure online account services for individual taxpayers:** The IRS will add features to Individual Online Accounts, including the ability to schedule payments, save payment information, create and change payment plans, access user-friendly tax records, view the status of returns, refunds and audits, opt into certain notifications, use secure messaging, and more. Businesses and tax professionals will be offered similar online account services.
- **Evaluate which taxpayers are most burdened during filing and remove barriers to electronic filing:** Evaluate which taxpayers face barriers during filing, such as those who may be eligible for credits and deductions; those who need information quickly from the IRS, such as residency certificates; or those who are required to paper-file in certain circumstances. Prioritize creating and improving digital pathways for these taxpayers.

- **Expand digital services and digitalization:** Taxpayers will be able to file all documents securely and exchange correspondence electronically.
- **Implement a standard case management platform:** Consolidate disparate case management systems onto one standard platform. This upgrade will make managing the foundational technology more efficient and help employees to help taxpayers resolve issues.
- **Make transcripts and account data easier to read and understand:** Use plain language for IRS transcripts for all taxpayers and make them available in additional languages.
- **Help taxpayers understand and claim appropriate credits and deductions:** Develop better tools to help taxpayers identify and claim tax benefits for which they are eligible.
- **Build status-tracking tools for taxpayers:** Taxpayers will be able to use new status-tracking tools to see real-time status updates, next steps, and estimated time to process documents and resolve issues.
- **Provide earlier legal certainty:** Expand capacity in the Office of Chief Counsel and with the Department of the Treasury Office of Tax Policy to address more taxpayer questions proactively using both formal and informal legal guidance and rulings.
- **Streamline multichannel customer assistance:** Taxpayers will be able to get the help they need quickly, securely and accessibly, resolve more issues in a single contact, and experience minimal delays during interactions with the IRS.
- **Expand service offerings across multiple service channels to meet the needs of taxpayers and tax professionals:** Use improved data and analytics to project demand, staffing, estimated wait and processing times, and service locations. Adjust policies, services offered, and locations to provide in-person, telephone, and digital services for all taxpayers and tax professionals, including those in rural and underserved areas. This includes expanding the services available through current customer service channels such as the Taxpayer Assistance Centers (TACs) and phones.
- **Provide the public with accurate wait time estimates:** Include estimated wait times in customer service channels and processing times for high-volume returns and other forms.
- **Staff customer service functions to meet projected demand:** Use enhanced data and analytics to project demand for customer services and better allocate well-equipped employees to meet demand.
- **Improve appointment scheduling and on-demand capabilities:** Offer appointment scheduling and on-demand services across service channels.
- **Develop policies and tools that support first-contact problem resolution:** Develop policies and tools that support the immediate involvement of the right people to resolve taxpayer issues quickly, even when first-contact employees do not have the information or authority to resolve the issues.
- **Enhance IRS.gov systems and content to support new digital tools, products, and services for taxpayers:** Upgrade systems and improve content development to make sure IRS.gov supports the new capabilities and is accessible to taxpayers and stakeholders, including underserved and Limited English Proficiency (LEP) populations.
- **Develop taxpayer-centric notices:** The IRS will send taxpayers notices they can understand, delivered in ways they prefer, with clear explanations of issues and steps to resolution.
- **Use improved data and analytics to tailor timely collections contacts:** The IRS will provide early, tailored contacts to all taxpayers with past-due balances and will only escalate to more intensive treatments when appropriate.

Although my primary goals as the National Taxpayer Advocate are to protect taxpayer rights and improve taxpayer service, we need to acknowledge that enforcement is also central to the IRS's tax collection mission. It is necessary both to collect the taxes essential to fund the government and to ensure equity, so that all taxpayers are paying their fair share. The SOP contains initiatives to improve tax compliance, particularly among high-income individual taxpayers, large businesses, and pass-through entities. As enforcement plans continue to develop, the IRS needs to improve and reimagine its examination process for correspondence audits, particularly for low-income taxpayers, to reduce burdens and eliminate unnecessary challenges in a more proactive and responsive manner.

The summary above reflects a small number of the planned initiatives. The report runs almost 150 pages and contains a lot of information. By design, the report is high level, with specifics left to be fleshed out. Some initiatives are contingent on attracting, hiring, training, and retaining a diverse workforce of the future to accomplish the vision of the SOP.

Conclusion

As always, the devil is in the details, and the proof is in the pudding. Developing a plan and successfully implementing it are two different things. But, for the first time in my 40 years as a tax professional, the tax administration stars seem to be aligning. Congress has provided the IRS with significant long-term funding to improve taxpayer service, modernize IT systems and enhance enforcement, the IRS has developed an ambitious, albeit general plan to transform tax administration, and a new Commissioner with significant management experience has just taken office with a mandate to implement the plan and transform the taxpayer experience.

With continued support and oversight by Congress, the Government Accountability Office, the Treasury Inspector General for Tax Administration, and my office, I am hopeful and optimistic that five years from now, tax administration will be transformed and taxpayers, for the first time in memory, will receive the service they deserve. And that any additional resources the IRS expends for enforcement will be applied in a fair and equitable manner benefiting all taxpayers.

Data Security: Scams, Security Plan, Identity Theft

By LaTanya Bacon

Communication & Liaison
STAKEHOLDER LIAISON

2023 Tax Alliance Conference
June 7, 2023

Scams, Security Plan, Identity Theft

LaTanya Bacon, Stakeholder Liaison
Cleveland Ohio

1

Security Summit

The IRS, state tax agencies, and the tax community are working in partnership to combat identity theft refund fraud to protect the nation's taxpayers.

2

Common Scams

- Email, Phishing and Malware Schemes
- Fake Charities
- Threatening Impersonator Phone Calls
- Refund Theft
- Scams targeting non-English speakers
- Unscrupulous Return Preparers

3

Spotting Phishing Emails

- The email asks you to confirm personal information
- The web and email addresses do not look genuine
- It's poorly written
- There's a suspicious attachment
- The message is designed to make you panic

4

Spear-phishing Aimed at Tax Pros

IRS

Help | News | English | Charities & Nonprofits | Tax Pros

File Pay Refunds Credits & Deductions Forms & Instructions Search

Home / News / News Releases / Dirty Dozen: IRS urges tax pros and other businesses to beware of spearphishing; offers tips to avoid dangerous common scams

Dirty Dozen: IRS urges tax pros and other businesses to beware of spearphishing; offers tips to avoid dangerous common scams

English | Español | 中文 (简体)

Topics in the News

News Releases

News Releases for Frequently Asked Questions

Multimedia Center

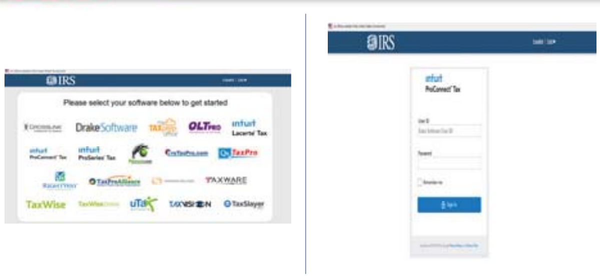
IR-2023-62, March 29, 2023

WASHINGTON —The Internal Revenue Service today warned tax professionals and businesses that they remain a top target for identity thieves and face threats from common scams on this year's Dirty Dozen list.

As part of the annual Dirty Dozen tax scams effort, the IRS and the Security Summit partners urged tax professionals and businesses to be on the lookout for a variety of suspicious email requests. Through these spearphishing emails, scammers try to steal client data, tax software preparation credentials and tax preparer identities with the goal of getting fraudulent tax refunds. These requests can range from an email that looks like it's from a potential new client to a request targeting payroll and human resource departments asking for sensitive Form W-2 information.

5

Account On Hold Landing Page



6

SMS/Smishing

Original SMS/text message

Phishing Website

7

Educate yourself on phishing scams

- **Many data thefts start with a phishing email**
  - Click on a link to a fake website
  - Open an attachment with embedded malware
- **Spear phishing email to pose as a trusted source**
  - Account Takeover
  - Ransomware

8

Reporting phishing attempts

- Unsolicited emails or social media attempts to gather information that appear to be from either the IRS or an organization closely linked to the IRS, should forward the message to **phishing@irs.gov.**

9

Signs of a Data Breach

Know the Signs of Tax-Related Identity Theft

- E-Filed return rejects due to duplicate Social Security Number.
- Letter from the IRS inquiring about a suspicious tax return that you did not file.

10

Signs of a Data Breach

Know the Signs of Tax-Related Identity Theft (cont.)

- You get an IRS notice that you owe additional tax or refund offset, or that you have had collection actions taken against you for a year you did not file a tax return
- You receive a Form W-2 or Form 1099 from an employer for whom you didn't work or benefits from a government agency, or IRS records indicate you received wages or other income from an employer you didn't work for

11

Responding to a Data Breach

Report and Respond

Report Data Loss to IRS/States

Tax practitioners should report data losses or thefts immediately to the IRS so that appropriate precautions can be made to protect clients from fraudulent returns being filed in their names. Here's how to report data thefts to the IRS:

- Contact the IRS and law enforcement:
  - Internal Revenue Service, report client data theft to your local stakeholder liaison.
  - Federal Bureau of Investigation, your local office (if directed by IRS).
  - Local police – To file a police report on the data breach.
- Contact states in which you prepare state returns:
  - Email the Federation of Tax Administrators at StateAlert@taxadmin.org to get information on how to report victim information to the states.
  - State Attorneys General for each state in which you prepare returns. Most states require that the attorney general be notified of data breaches.

Practitioner Data Loss

Point of Contact – Stakeholder Liaison

IRS.gov – Key word search: Stakeholder Liaison

12

Preventing Online Identity Theft

- Don't respond to suspicious IRS emails, Texts and Faxes
- Secure your computers (i.e., firewalls, anti-virus/anti-phishing/anti-spam, etc.)
- Use strong passwords
  Back up critical personal information
- Limit the personal information you provide on social media
- Visit OnGuardOnline.gov - IRS.gov/IDTheft – StaySafeOnline.org

13

Remember, the IRS will never…

- Contact you by email, text or social media to ask for personal or financial data.
- Call to demand immediate payment using a prepaid debit card, gift card or wire transfer.
- Threaten to bring in police, immigration or other agencies to have you arrested.
- Ask for credit/debit card or other financial account information over the phone.
- Request login credentials, Social Security Numbers or other sensitive information.

14

2023 IRS Dirty Dozen

15

DATA SECURITY PLAN

16

Create a Data Security Plan

- **Required under federal law**
  - The Gramm-Leach-Bliley (GLB) Act
  - Federal Trade Commission (FTC) Safeguards Rule

17

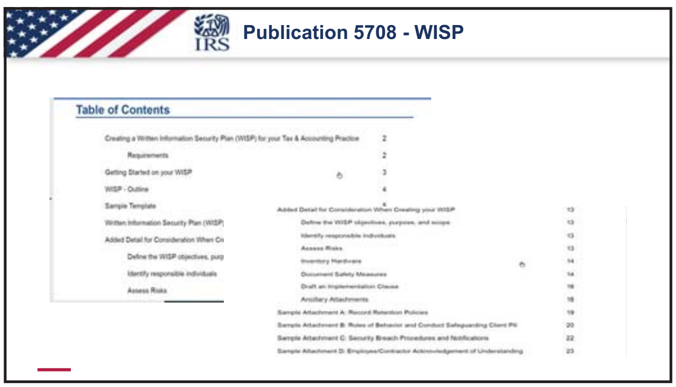
Publication 5708 - WISP

Creating a **W**ritten **I**nformation **S**ecurity **P**lan for your Tax & Accounting Practice

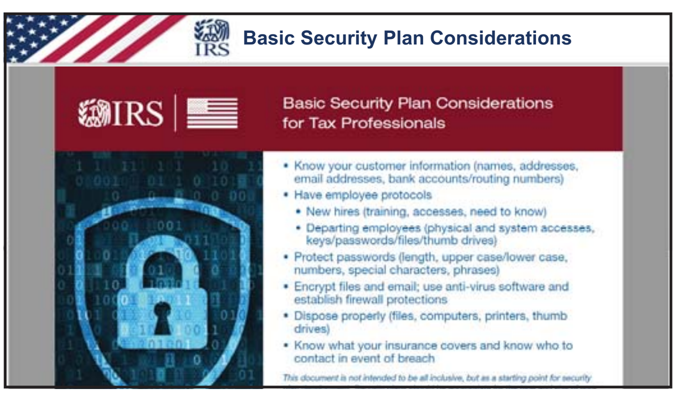
18


Publication 5708 - WISP
IRS
Creating a Written Information Security Plan
for your Tax & Accounting Practice

19


Publication 5708 - WISP
Table of Contents
Creating a Written Information Security Plan (WISP) for your Tax & Accounting Practice 2
Requirements 2
Getting Started on your WISP 3
WISP - Outline 4
Sample Template
Written Information Security Plan (WISP)
Added Detail for Consideration When Creating your WISP 13
Define the WISP objectives, purpose, and scope 13
Identify responsible individuals 13
Assess Risks 13
Inventory Hardware 14
Document Safety Measures 14
Draft an Implementation Clause 16
Ancillary Attachments 18
Sample Attachment A: Record Retention Policies 19
Sample Attachment B: Rules of Behavior and Conduct Safeguarding Client PII 20
Sample Attachment C: Security Breach Procedures and Notifications 22
Sample Attachment D: Employee/Contractor Acknowledgement of Understanding 23

20


Basic Security Plan Considerations
IRS
Basic Security Plan Considerations
for Tax Professionals
• Know your customer information (names, addresses, email addresses, bank accounts/routing numbers)
• Have employee protocols
• New hires (training, accesses, need to know)
• Departing employees (physical and system accesses, keys/passwords/files/thumb drives)
• Protect passwords (length, upper case/lower case, numbers, special characters, phrases)
• Encrypt files and email; use anti-virus software and establish firewall protections
• Dispose properly (files, computers, printers, thumb drives)
• Know what your insurance covers and know who to contact in event of breach
This document is not intended to be all inclusive, but as a starting point for security

21

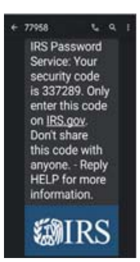
Multi-Factor Authentication

22

Multi-Factor Authentication

23

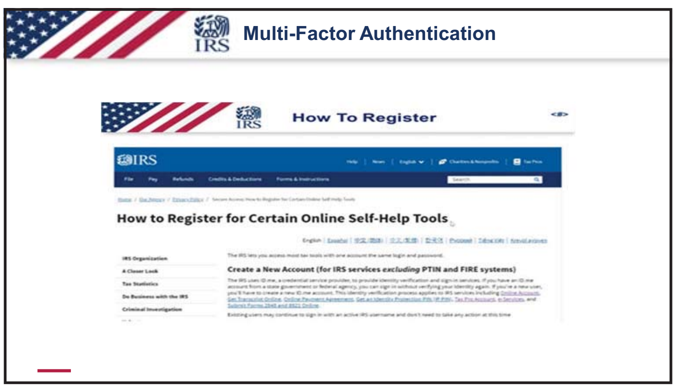
Multi-factor Authentication (MFA)



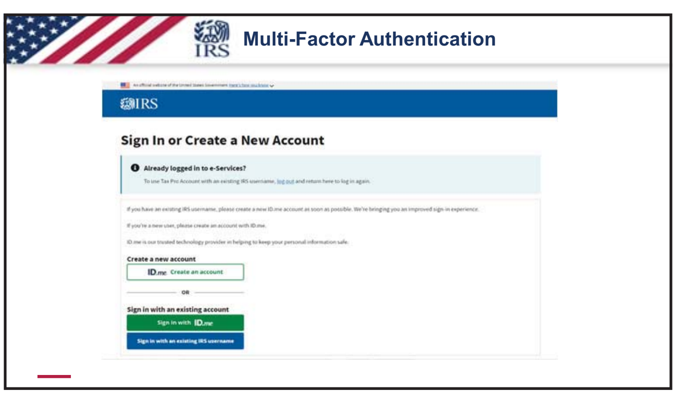
24


Multi-factor Authentication (MFA)
IRS
We sent a security code to your phone
6-digit security code
Resend Security Code
No longer have access to this phone?
CONTINUE
Logout

25


Multi-Factor Authentication
How To Register
IRS
How to Register for Certain Online Self-Help Tools
Create a New Account (for IRS services excluding PTIN and FIRE systems)

26


Multi-Factor Authentication
IRS
Sign In or Create a New Account
Already logged in to e-Services?
Create a new account
Create an account
OR
Sign in with an existing account
Sign in with ID.me
Sign in with an existing IRS username

27

The Identity Protection PIN (IP PIN)

Proactively protect your federal tax account from identity theft.

28

What is the IP PIN?

- An Identity Protection PIN (IP PIN), is a six-digit number that prevents someone else from filing a tax return using your Social Security number or Individual Taxpayer Identification Number
- Even though you may not have a filing requirement, an **IP PIN still protects your account from fraudulent filings**
- An electronically filed return filed without your IP PIN, or an incorrect IP PIN, will reject, including your return and any fraudulent returns using your Social Security Number.
- Any paper returns filed without your correct IP PIN will undergo additional scrutiny and any fraudulent returns will be removed from your account. If the return verifies to be yours, we will continue to process it.

29

IRS IP PIN Opt-in Program

- As of January 2021, all taxpayers who can verify their identities may obtain an IP PIN to protect their tax returns
- One-time registration process
- Use online tool each January to obtain your IP PIN
- Review the process at www.IRS.gov/IPPIN

30

Important Reminders

- IP PIN protects your federal tax account from Identity Theft
- An IP PIN is valid for one calendar year, each year a new IP PIN is generated for your account
- An IP PIN must be used when filing any federal tax returns during the year including prior year returns
- **Never share your IP PIN with anyone** other than your tax preparer at the time of filing
- If unable to enroll online there are alternatives
  - Form 15227, Application for an IP PIN
  - In-Person Meeting at a local Taxpayer Assistance Office, (TAC)
- IP PIN participants must keep their address current including dependents
  - By filing Form 8822, Change of Address

31

IRS Resources

- www.irs.gov/identity-theft-central
- **Publication 5477,** All Taxpayers now Eligible for Identity Protection Pins
- **Publication 5417,** Basic Security Plan Considerations for Tax Professionals
- **Publication 4557**, Safeguarding Taxpayer Data
- **Publication 5293**, Data Security Resource Guide for Tax Professionals
- **Publication 5708**, Creating a Written Information Security Plan for your Tax & Accounting Practice

32

Questions

33

IRS Policies, Practices and Procedures

34

Job Opportunities

35

Communications & Liaison
STAKEHOLDER LIAISON

Thank You!

36

Comprehensive IRS Voluntary Disclosure Program and Others: Key Aspects and Developments

By Hale E. Sheppard, Esq.

Comprehensive IRS Voluntary Disclosure Program and Others: Key Aspects and Developments

Tax Alliance Conference 2023

Hale E. Sheppard, Esq.

Chamberlain Hrdlicka White Williams & Aughtry
191 Peachtree Street, N.E.
46th Floor
Atlanta, Georgia 30303

Telephone: 404-658-5441
E-mail: *hale.sheppard@chamberlainlaw.com*

ABOUT THE SPEAKER

Hale E. Sheppard is a Shareholder in the Tax Controversy Section of Chamberlain Hrdlicka in Atlanta. Hale defends individuals and businesses during tax audits, tax appeals, and tax litigation.

Cases and Rulings. Hale has participated in over 150 tax cases before the Tax Court, Courts of Appeal, District Courts, and various State Tax Tribunals. In addition to resolving issues through tax litigation, Hale has obtained dozens of favorable Private Letter Rulings for clients from the IRS National Office on procedural, tax, and international issues.

Education. Hale holds five college degrees. At the University of Kansas, he earned a B.S., with distinction, M.A., with honors, and J.D. He later received an LL.M. degree in international law, with highest distinction, from the Universidad de Chile in South America. Finally, he obtained an LL.M. degree in tax from the University of Florida, where he was a graduate tax scholar.

Awards and Recognitions. During his studies, Hale received several awards for academic excellence, including the prestigious Harry S. Truman Foundation Scholarship, Janice Dawson Quinn Tax Scholarship, Tinker Foundation Scholarship, and Senator James B. Pearson International Fellowship. Hale also served as a graduate editor of the Florida Tax Review and member of the Kansas Journal of Law & Public Policy. Chambers USA, Legal 500, Super Lawyers, Best Lawyers in America, and other groups have recognized Hale as a leader in tax litigation for many years. He has also been inducted into the American College of Tax Counsel.

Publications. Hale ranks among the most active tax writers in the country. He has published over 225 major articles in top tax journals, including Journal of Taxation, International Tax Journal, The Tax Adviser, Journal of International Taxation, Journal of Tax Practice and Procedure, Taxes Magazine, Journal of Corporate Taxation, Practical Tax Lawyer, Journal of Passthrough Entities, Tax Management International Journal, Journal of Multistate Tax & Incentives, Tax Notes International, Taxation of Exempts, Practical Tax Strategies, Corporate Business Taxation, Trust and Estates Journal, Journal of Taxation of Financial Products, Real Estate Taxation, and others. He has also published major articles in more than 20 university law reviews, both in the United States and abroad.

Activities and Affiliations. Hale has held leadership positions in many professional and civic organizations, including: (i) Journal of Taxation, Editorial Board Member, (ii) IRS-Practitioner Liaison Committee, state bar representative, (iii) Journal of Tax Practice & Procedure, Editorial Board Member, (iv) Georgia Bar Tax Section, President, (v) Georgia Bar Journal, Editorial Board Member, (vi) GSU Low-Income Taxpayer Clinic, Advisory Committee Member, and (vii) Atlanta Bar Tax Section Board Member.

SOURCES FOR THIS OUTLINE – AVAILABLE UPON REQUEST

This outline derives from the following articles, all written by Hale. If you would like a copy of any of the articles, please send Hale an e-mail at *hale.sheppard@chamberlainlaw.com* or call him at 404-658-5441. He would be glad to send you the articles free of charge.

- Tax Court Rules that IRS Cannot Assess and Collect Form 5471 Penalties: Many Questions Triggered by Novel Ruling, ___ *INTERNATIONAL TAX JOURNAL* ___ (2023); republished in ___ *JOURNAL OF TAX PRACTICE & PROCEDURE* __ (2023).

- Canadian Retirement Plans and Accounts: Evolving Special Rules and Enduring IRS Problems, __ *JOURNAL OF TAXATION* ___ (2023); republished in __ *JOURNAL OF INTERNATIONAL TAXATION* __ (2023); republished in __ *PRACTICAL TAX STRATEGIES* __ (2023).

- IRS Concedes First Case of Form 3520 Penalties for Unreported Foreign Gifts: A Bittersweet Victory, 179(3) *TAX NOTES FEDERAL 419* (2023).

- Foreign Trusts, Foreign Gifts and Ongoing Disputes: Public Comments and Possible Changes, ___ *INTERNATIONAL TAX JOURNAL* ___ (2023).

- Does Residency Status under a Treaty Affect FBAR Duties? District Court Order Ponders Potential "Escape Hatch" for Taxpayers, __ *INTERNATIONAL TAX JOURNAL* __ (2023).

- Harbingers of More IRS Enforcement of Repatriation / Transition Taxes, __*TAXES — THE TAX MAGAZINE 41* (2022); republished *INTERNATIONAL TAX JOURNAL* ___ (2022).

- Foreign Gifts, Forms 3520, Big Penalties, and Pending Case, 177(1) *TAX NOTES FEDERAL* 57 (2022); republished in 108(1) *TAX NOTES INTERNATIONAL* 45 (2022).

- Bait and Switch? Multi-Case Dispute Shows Risks of Participating in Certain IRS Disclosure Programs, ____ *INTERNATIONAL TAX JOURNAL* ___ (2022).

- Involuntary Disclosure by the IRS about Voluntary Disclosure Program for Taxpayers: Analyzing Four Rounds of Guidance, 48(5) *INTERNATIONAL TAX JOURNAL* 29 (2022); republished in 24(3) *JOURNAL OF TAX PRACTICE & PROCEDURE* 43 (2022).

- The Rise and Fall of Malta Pensions: Taxpayer Positions, IRS Enforcement, and Remaining Solutions, 175(13) *TAX NOTES FEDERAL* 2005 (2022); republished in 106(13) *TAX NOTES INTERNATIONAL* 1625 (2022); republished in 104(13) *TAX NOTES STATE* 1343 (2022).

- Expatriating Taxpayers and Unfiled Forms 8854: Administration Proposes Disparate Treatment Based on Financial Status, 48(4) *INTERNATIONAL TAX JOURNAL* 15 (2022).

- IRS Announces Newest Version of its Comprehensive Voluntary Disclosure Program: Analyzing the Evolution during the First Five Years, 48(3) *INTERNATIONAL TAX JOURNAL* 13 (2022).

- International Tax Non-Compliance, Exit Taxes, Special Treatment for Accidental Americans, and Urgency Created by Recent Whistleblower Actions, 48(2) ___ *INTERNATIONAL TAX JOURNAL* 51 (2022).

- Achtung with Your Stiftung: Evolving Concept of Foreign Trusts and Potential Relief for Taxpayers, 33(2) *JOURNAL OF INTERNATIONAL TAXATION 48* (2022)*;* republished in ___ *JOURNAL OF TAXATION* ___ (2022)*;* republished in 108(4) *PRACTICAL TAX STRATEGIES* 4 (2022); republished in 49(4) *ESTATE PLANNING 14* (2022).

- Can Foreign Tax Credits Offset Net Investment Income Taxes? Tax Court Holds that It Depends on the Treaty, 32(11) *JOURNAL OF INTERNATIONAL TAXATION* 46 (2021)*;* republished in ___ *PRACTICAL TAX STRATEGIES* __ (2021).

- The IRS "Stacks" International Penalties in Foreign Trust Disputes: Two Recent Cases and Earlier IRS Guidance Reveal the Playbook, 99(11) *TAXES — THE TAX MAGAZINE* 39 (2021).

- International Tax Disputes: Recent Cases Show Ways Taxpayers Give the IRS Forever to Audit, Tax and Penalize, 47(6) *INTERNATIONAL TAX JOURNAL* 19 (2021).

- Recent Tax Court Case Reveals Rare Use of Form 5471 Penalty Defenses, 47(5) *INTERNATIONAL TAX JOURNAL* 53 (2021).

- Neither Death Nor Distance Erases the Issues: IRS Actions against Deceased or Absconding Taxpayers, 32(9) *JOURNAL OF INTERNATIONAL TAXATION 36* (2021); republished in 48(8) *ESTATE PLANNING* 3 (2021); republished in 31(4) *JOURNAL OF MULTISTATE TAXATION AND INCENTIVES* 4 (2021).

- Here Comes the Tax Enforcement, There Go the Passports: Analyzing the Evolution of Section 7345 during Its First Five Years, 23(3) *JOURNAL OF TAX PRACTICE & PROCEDURE* 41 (2021).

- Recent Case Highlights Convergence of Substance and Procedure in International Tax Disputes, 32(7) *JOURNAL OF INTERNATIONAL TAXATION 38* (2021); republished in 135(2) *JOURNAL OF TAXATION* 21 (2021).

- It's Not Over Till It's Over: Lessons from *Crandall* about Closing Agreements and Key Procedural Issues in Tax Disputes, 47(4) *INTERNATIONAL TAX JOURNAL* 33 (2021).

- Disputing FBAR Penalties: *Mendu* Case Clarifies How Much Taxpayers Must Pay to Play, 47(3) *INTERNATIONAL TAX JOURNAL* 33 (2021).

- Harsh Consequences of Late Forms 1120-F, New Tax Court Case, and Solutions Still Available to Foreign Corporations, 47(2) *INTERNATIONAL TAX JOURNAL* 41(2021); republished in 99(4) *TAXES — THE TAX MAGAZINE* 69 (2021).

- Court Overturns Legendary FBAR Case, *Bedrosian*, But Government Settlement Elsewhere Encourages Taxpayers with Foreign Account Issues, 47(1) *INTERNATIONAL TAX JOURNAL* 29 (2021).

- Taxpayers Die but Their International Penalties Live On: Recent Cases Addressing the Broad Scope of Post-Death Assessment and Collection, 31(10) *JOURNAL OF INTERNATIONAL TAXATION* 36 (2020); republished in 133(4) *JOURNAL OF TAXATION 16* (2020).

- Lessons from an International Tax Dispute: Three Interrelated Cases, in Three Different Proceedings, Generating Three Separate Liabilities, 46(5) *INTERNATIONAL TAX JOURNAL* 47 (2020).

- IRS Issues New Form 14457 and Instructions regarding Its Comprehensive Domestic and International Voluntary Disclosure Program: Analyzing Key Aspects, 46(4) *INTERNATIONAL TAX JOURNAL* 41 (2020).

- New IRS Enforcement Campaign to Stop Tax Violations by Nonresident Aliens Renting and Selling U.S. Real Property, 133(3) *JOURNAL OF TAXATION* 18 (2020); republished in __ *JOURNAL OF REAL ESTATE TAXATION* ___ (2020).

- Second Court Rejects "Constructive Knowledge" Theory for Willful FBAR Penalties," 46(3) *INTERNATIONAL TAX JOURNAL* 29 (2020).

- Foreign Retirement and Savings Plans, Waiver of Forms 3520 and Forms 3520-A, and Limits of Rev. Proc. 2020-17, 46(2) *INTERNATIONAL TAX JOURNAL* 29 (2020); republished in ___ *TAXES — THE TAX MAGAZINE* __ *(2020)*; republished in ___ *CANADIAN TAX TOPICS* __ (2020).

- Recent Foreign Trust Case Establishes Penalty Limits for Form 3520 and Form 3520-A Violations, 46(1) *INTERNATIONAL TAX JOURNAL* 23 (2020); republished in 21(6) *JOURNAL OF TAX PRACTICE & PROCEDURE* 25 (2020).

- IRS Introduces Relief Procedures for Former U.S. Citizens: Path to Avoid the Exit Tax, Income Taxes, and Penalties Despite Past Non-Compliance, 45(6) *INTERNATIONAL TAX JOURNAL* 27 (2019); republished in 98(4) *TAXES — THE TAX MAGAZINE* 31__ (2020).

- More FBAR Penalty Losses and Lessons: The Significance of *Rum* and *Ott*, 45(5) *INTERNATIONAL TAX JOURNAL* 17 (2019).

- *Flume*, *Boyd*, and *Cohen*: Three Recent FBAR Cases Yielding Important New Lessons, 45(4) *INTERNATIONAL TAX JOURNAL* 31(2019); republished in 98(2) *TAXES – THE TAX MAGAZINE* 67 (2019).

- IRS Amnesty Covers More than Foreign Accounts: Analyzing the Updated Voluntary Disclosure Practice, New International Tax Withholding Procedure, and Guidelines for Late Returns by Foreign Corporations, 97(6) *TAXES — THE TAX MAGAZINE* 19 (2019); republished in 45(3) *INTERNATIONAL TAX JOURNAL* __ (2019).

- What *Garrity* Teaches about FBARs, Foreign Trusts, "Stacking" of International Penalties, and Simultaneously Fighting the U.S. Government on Multiple Fronts, 20(6) *JOURNAL OF TAX PRACTICE & PROCEDURE* 27 (2019).

- *United States v. Horowitz*: Sixth Case Analyzing Constructive Knowledge as Determinant of FBAR Penalties, 45(2) *INTERNATIONAL TAX JOURNAL* 23 (2019); republished in ___ *TAXES — THE TAX MAGAZINE* __ (2019).

- Constructive Knowledge and FBAR Penalties: Does Merely Filing a Form 1040 Suffice to Establish "Willfulness?" 45(1) *INTERNATIONAL TAX JOURNAL* 35 (2019); republished in 97(5) *TAXES — THE TAX MAGAZINE* 41 (2019); republished in 21(2) *JOURNAL OF TAX PRACTICE & PROCEDURE* 41 (2019).

- Appellate Court Jeopardizes First Holding of Non-Willfulness in FBAR Penalty Case: Round Three of the *Bedrosian* Battle, 30(5) *JOURNAL OF INTERNATIONAL TAXATION* 37 (2019); republished in 130(4) *JOURNAL OF TAXATION* 20 (2019).

- Courts Hold that U.S. Government Can Pursue Executors, Representatives, Fiduciaries, Beneficiaries, Distributees, and Others for FBAR Penalties Assessed against Deceased Taxpayers, 30(3) *JOURNAL OF INTERNATIONAL TAXATION* ___ (2019); republished in 130(3) *JOURNAL OF TAXATION* 16 (2019).

- Extended Delays by IRS in Processing International Voluntary Disclosure Cases: Expatriations Thwarted, Estate Taxes Imposed, and Solutions Explored, 44(6) *INTERNATIONAL TAX JOURNAL* 13 (2019); republished in ___ *TAXES — THE TAX MAGAZINE* __ (2019).

- Court Bucks the Trend in Willful FBAR Penalty Cases: Merely Signing Tax Returns Does Not Establish Willfulness, 44(6) *INTERNATIONAL TAX JOURNAL* ___ (2018); republished in 97(1) *TAXES — THE TAX MAGAZINE* 23 (2019).

- What Constitutes a "Willful" FBAR Violation? Comprehensive Guidance Based on Eight Important Cases, 129(5) *JOURNAL OF TAXATION* 24 (2018); republished in 29(11) *JOURNAL OF INTERNATIONAL TAXATION* 33 (2018).

- Alarming U.S. Tax and Information-Reporting Duties for Foreign Retirement Plans and Accounts: Analyzing Problems and Solutions, 129(4) *JOURNAL OF TAXATION* 14 (2018); republished in 29(10) *JOURNAL OF INTERNATIONAL TAXATION* 27 (2018).

- Court Holds that Pervasive Ignorance Is No Defense to Willful FBAR Penalties: This and Other Lessons from *United States v. Garrity*, 44(4) *INTERNATIONAL TAX JOURNAL* 51 (2018).

- More IRS Guidance about Section 7345, Seriously Delinquent Tax Debts, and Passport Revocation: A Comprehensive Analysis, 20(2) *JOURNAL OF TAX PRACTICE & PROCEDURE* 19 (2018).

- New Procedures for Late Forms 1120-F and Late-Filing Waivers: The Evolution of IRS Standards and Open Issues for Foreign Corporations, 44(3) *INTERNATIONAL TAX JOURNAL* 19 (2018).

- Extended Assessment Periods and International Tax Enforcement: *Rafizadeh v. Commissioner*, Unreported Foreign Assets, and Use of FATCA Weapons, 96(6) *TAXES — THE TAX MAGAZINE* 35 (2018).

- IRS Starts Depriving Tax Debtors of Passports in 2018: New Guidance about Section 7345 and Future Tax Court Disputes, 20(1) *JOURNAL OF TAX PRACTICE & PROCEDURE* 37 (2018).

- Willful FBAR Penalty Case Shows Importance of Protecting Privileged Communications: What *Kelley-Hunter* Adds to the Foreign Account Defense Discussion, 44(1) *INTERNATIONAL TAX JOURNAL* 15 (2018).

- Analysis of the Reasonable Cause Defense in Non-Willful FBAR Penalty Case: Teachings from *Jarnagin*, 128(4) *JOURNAL OF TAXATION* 6 (2018).

- First Taxpayer Victory in a Willful FBAR Penalty Case: Analyzing the Significance of *Bedrosian* for Future Foreign Account Disputes (Part 2)," 128(3) *JOURNAL OF TAXATION* 14 (2018); republished in 29(3) *JOURNAL OF INTERNATIONAL TAXATION* (2018).

- First Taxpayer Victory in a Willful FBAR Penalty Case: Analyzing the Significance of *Bedrosian* for Future Foreign Account Disputes (Part 1)," 128(2) *JOURNAL OF TAXATION* 12 (2018); republished in 29(3) *JOURNAL OF INTERNATIONAL TAXATION* 54 (2018).

- IRS Sets Its Sights on Nonresident Aliens with U.S. Rental Property: New Study, Significant Violations, Compliance Initiative, and Remaining Options, 45(2) *JOURNAL OF REAL ESTATE TAXATION* 14 (2018).

- Assessing Tax Liabilities is One Thing, Collecting Them Abroad is Another: New Case Shows International Reach of the IRS, 127(5) *JOURNAL OF TAXATION* (2017); republished in 29(2) *JOURNAL OF INTERNATIONAL TAXATION* 34 (2017).

- Has the IRS Declared Dead the Substantial Compliance Defense for International Information Returns? Lessons from a New International Practice Unit 43(5) *INTERNATIONAL TAX JOURNAL* 57 (2017).

- Can Recent "Willful" FBAR Penalty Cases against Taxpayers Help Tax Firms Fend Off Malpractice Actions? 43(4) *INTERNATIONAL TAX JOURNAL* 33 (2017).

- *Flume v. Commissioner* and Form 5471 Penalties for Unreported Foreign Corporations: A Glimpse at Unique Aspects of International Tax Disputes, 95(8) *TAXES — THE TAX MAGAZINE* 39 (2017).

- IRS Deprives Tax Debtors of U.S. Passports under New Section 7345: Open Issues as Enforcement Begins in 2017, 19(1) *JOURNAL OF TAX PRACTICE & PROCEDURE* 27 (2017).

- Unlimited Assessment-Period for Form 8938 Violations: Ruling Shows IRS's Intent to Attack Multiple Tax Returns 95(5) *TAXES — THE TAX MAGAZINE* 31 (2017).

- IRS Finalizes Form 5472 Regulations for Foreign-Owned, Domestic, Disregarded Entities, 43(1) *INTERNATIONAL TAX JOURNAL* 13 (2017).

- Government Wins Fourth Straight FBAR Penalty Case: Analyzing *Bohanec* and the Evolution of "Willfulness," 126(3) *JOURNAL OF TAXATION* 110 (2017)*;* republished in *28(8) JOURNAL OF INTERNATIONAL TAXATION* 34 *(2017)*.

- IRS Proposes Form 5472 Filing Duty for Foreign-Owned Disregarded Entities, 42(4) *INTERNATIONAL TAX JOURNAL* 17 *(*2016).

- Formal Document Requests under Section 982: New Case Expands Definition of "Foreign-Based Documentation" 94(9) *TAXES — THE TAX MAGAZINE* 33 (2016).

- Specified Domestic Entities Must Now File Form 8938: Section 6038D, New Regulations in 2016, and Expanded Foreign Financial Asset Reporting, 42(3) *INTERNATIONAL TAX JOURNAL* 5 (2016).

- Accidental Americans: Tax and Information-Reporting Obligations for Certain Green Card Holders, 124(4) *JOURNAL OF TAXATION* 170 (2016).

- Children with Foreign Accounts: Unexpected Income, Schedule B, Form 8938, and FBAR Issues, 124(3) *JOURNAL OF INTERNATIONAL TAXATION* 134 (2016); republished in 124(3) *JOURNAL OF TAXATION* 134 (2016).

- Form 5471: How Does New IRS Guidance Impact the "Substantially Complete" Defense? 94(4) *TAXES — THE TAX MAGAZINE* 39 (2016); republished in 42(2) *INTERNATIONAL TAX JOURNAL* 33 (2016).

- Canadian Retirement Plans: What Does Revenue Procedure 2014-55 Mean for U.S. Tax Deferral, Form 8891, Form 8938, and the FBAR? 41(6) *INTERNATIONAL TAX JOURNAL* 25 (2016).

- Forms 5472 for Certain Foreign and Domestic Corporations: New Filing Procedures, New Automated Penalties, New Abatement Standards, and More, 93(5) *TAXES — THE TAX MAGAZINE* 45 (2015).

- Form 8938 and Foreign Financial Assets: An Analysis of the Reporting Rules after IRS Issues Final Regulations, 41(2) *INTERNATIONAL TAX JOURNAL* 25 (2015).

- Government Wins Second Willful FBAR Penalty Case: Analyzing What *McBride* Really Means to Taxpayers, 118(4) *JOURNAL OF TAXATION* 187 (2013).

- IRS Introduces Two Unique Tax-Compliance Remedies for U.S. Persons with Unreported Canadian Retirement Plans and Accounts, 39(1) *INTERNATIONAL TAX JOURNAL* 11 (2013).

- Third Time's the Charm: Government Finally Collects "Willful" FBAR Penalty in *Williams* Case, 117(6) *JOURNAL OF TAXATION* 319 (2012).

- The New Duty to Report Foreign Financial Assets on Form 8938: Demystifying the Complex Rules and Severe Consequences of Noncompliance, 38(3) *INTERNATIONAL TAX JOURNAL* 11 (2012).

- The Internal Revenue Service Giveth and the Department of Justice Taketh Away: Recent Opinion Jeopardizes Retroactive Administrative FBAR Relief, 114(1) *JOURNAL OF TAXATION* 18 (2011).

- District Court Rules That Where There's (No) Will, There's a Way to Avoid FBAR Penalties, 113(5) *JOURNAL OF TAXATION* 293 (2010).

- Two More Blows to Foreign Account Holders: Tax Court Lacks FBAR Jurisdiction and Bankruptcy Offers No Relief from FBAR Penalties, 11(1) *JOURNAL OF TAX PRACTICE & PROCEDURE* 27 (2009).

- When Bygones Aren't Bygones: Exploring Solutions for U.S. Persons with Undeclared Canadian Retirement Plans and Accounts, 34(4) *INTERNATIONAL TAX JOURNAL* 35 (2008).

- New Penalties for Undisclosed Foreign Accounts: Putting the Cart before the Horse? 8(3) *JOURNAL OF TAX PRACTICE & PROCEDURE* 29 (2006).

- Evolution of the FBAR: Where We Were, Where We Are, and Why It Matters. 7(1) *UNIVERSITY OF HOUSTON BUSINESS & TAX LAW JOURNAL* 1 (2006).

- You Can Catch More Flies with Honey: Debunking the Theory in the Context of International Tax Enforcement, 83(2) *TAXES — THE TAX MAGAZINE* 29 (2005).

- Only Time Will Tell: The Growing Importance of the Statute of Limitations in an Era of Sophisticated International Tax Structuring, 30(2) *BROOKLYN JOURNAL OF INTERNATIONAL LAW* 453 (2005).

- Regulating Foreign Disregarded Entities with Proposed Form 8858: Try, Try Again, 33(7) *TAX MANAGEMENT INTERNATIONAL JOURNAL* 412 (2004).

TABLE OF CONTENTS

Page

Page

I. Three Cases, Three Proceedings, Three Liabilities

A. Introduction

1. What is remarkable about international non-compliance is that it often triggers three interrelated disputes, occurring in three different venues, and generating three potential liabilities.

2. A recent trilogy of court decisions, broadly referred to in this outline as the *Flume* cases, provide a teachable moment, an opportunity to see, in real life, what a taxpayer with unreported foreign assets could face if caught.[1]

B. Key Facts for the Three *Flume* Cases

1. Husband and Wife are U.S. citizens who moved to Mexico in 1993. Before heading south, Husband worked as an urban planner and real estate developer in the United States. Husband was engaged in the same type of activities in Mexico, operating a real estate company that developed land, sold lots, and built high-end homes.

2. In 1995, Husband and another U.S. individual formed a corporation in Mexico called Franchise Food Service de Mexico S.A. de C.V. ("Franchise Food"). They started as equals, each owning 50%. Husband was also the president. Franchise Food was created in order to operate Mexican locations of Whataburger and Fanny Ice Cream.

3. In addition to Franchise Food, Husband and Wife formed at least two other foreign corporations, one of which was Wilshire Holdings, Inc. ("Wilshire"). This entity was originally formed in the Bahamas in 2000 and then reincorporated in Belize in 2001.

4. In 2005, Wilshire opened an account at UBS in Switzerland.

5. Husband and Wife filed timely Forms 1040 for 2001 through 2009, but they did not (i) report certain income generated by Franchise Food or Wilshire, (ii) report passive income generated by the UBS account, (iii) enclose Forms 5471, and (iv) separately file FBARs.

6. In the early 2000's, Husband hired return preparers with offices in the United States and Mexico to prepare annual Forms 1040 ("Mexican Accountants"). They prepared the Forms 1040 for the relevant years

[1] The *Flume* cases consist of the following: *Flume v. Commissioner*, T.C. Memo 2017-21 (Tax Court case focused on penalties for unfiled Forms 5471); *United States v. Flume*, 122 AFTR 2d 2018-5641 (S.D. Texas 2018) (Order by District Court in response to Motion for Summary Judgment filed by the U.S. government regarding FBAR penalties) and *United States v. Flume*, 123 AFTR 2d 2019-2211 (S.D. Texas 2019) (Verdict by District Court regarding FBAR penalties); *Flume v. Commissioner*, T.C. Memo 2020-80 (Tax Court case focused on federal income taxes and tax-related penalties).

disclosing only the existence of Husband's account in Mexico, but not the larger account in Switzerland.

7. Husband did not file timely FBARs for 2007 or 2008. He filed them late, in June 2010, and even then he understated the value of the Swiss account by approximately $600,000 one year.

C. <u>First Fight - Form 5471 Penalty Litigation in Tax Court</u>

1. The first fight centered on non-disclosure of Husband's interest in the two foreign corporations, Franchise Foods and Wilshire.

2. IRS Audit and CDP Hearing

    a. Husband did not pay the Form 5471 penalties, so the IRS sent him a pre-levy notice in December 2013.

    b. Husband filed a timely request for a CDP hearing, claiming, among other things, that he was not required to file Forms 5471 for Wilshire for 2001 through 2009 because he had only a 9% interest, and thus was not a "U.S. shareholder" with a filing duty.

    c. The Settlement Officer issued a Notice of Determination, concluding that the IRS was free to seize Husband's assets.

3. Tax Court Litigation Contesting Result of CDP Hearing

    a. Husband filed a timely Petition with the Tax Court challenging the conclusions in the Notice of Determination.

    b. The Tax Court reduced this case to its essence.

        i. With respect to Franchise Food, the Tax Court concluded that Husband was obligated to file a Form 5471 each year.

        ii. Regarding Wilshire, the Tax Court noted that Husband had a constant Form 5471 filing obligation, and Husband "merely provided self-serving testimony and a backdated document to support his claim that he maintained only a 9% ownership interest during the tax years in issue."

        iii. Finally, the Tax Court rejected the notion that Husband should be relieved of penalties under a reasonable reliance theory because Husband was unable to demonstrate that the Mexican Accountants had sufficient qualifications, expertise, or access to the relevant data.

D. <u>Second Fight – FBAR Penalty Litigation in District Court</u>

1. While the IRS was seeking Form 5471 penalties in Tax Court, the DOJ was busy initiating a collection action in District Court to recoup "willful" FBAR penalties for 2007 and 2008.

2. Rulings by the District Court

    a. The District Court found that Husband had willfully violated his FBAR duties and upheld large penalties for the following reasons.

    b. First, the District Court indicated that Husband's testimony was "not credible" and contained "numerous contradictions."

    c. Second, the District Court characterized the financial structure used by Husband as a "sophisticated tax evasion scheme."

    d. Third, the Mexican Accountants sent Husband an annual reminder of his FBAR duties.

    e. Fourth, the fact that Husband disclosed a Mexican account on Schedule B shows that he was aware of the requirement and "made a conscious choice" not to similarly disclose the Swiss account.

    f. Fifth, Husband learned of the IRS's investigation into UBS by mid-2008, but opted not to file any FBARs until *after* UBS announced that it planned to turn over its records to the IRS.

    g. Sixth, Husband acted with "extreme recklessness" by failing to review his Forms 1040 before signing them.

    h. Finally, the District Court claimed it was "reckless" for Husband to place total reliance on the Mexican Accountants, particularly because he did not conduct any research on their credentials.

E. <u>Third Fight – Federal Income Tax Litigation in Tax Court</u>

1. The Tax Court addressed income tax matters in separate litigation.

2. The IRS claimed that Husband and Wife, as sole owners of Wilshire, had unreported Subpart F income stemming from the UBS account held in the name of Wilshire. The IRS also asserted penalties for negligence or, alternatively, substantial understatement of the correct tax liability.

3. The Tax Court held for the IRS on the tax and penalty issues.

II. Ongoing International Disclosure Programs

A. <u>Why Are Taxpayers Still Approaching the IRS?</u>

1. The IRS continues gathering data through multiple mechanisms:

a. Computer analysis of e-filed FBARs

b. Cross-referencing of Form 8938 data and FBAR data

c. Receipt of account data from foreign banks under FATCA

d. Data from millions of disclosures made since 2009

e. Deferred prosecution agreements with foreign banks

f. Whistleblowers

g. Wikileaks, Panama Papers, etc.

B. <u>A Long Series of Voluntary Disclosure Programs</u>

1. 2003 Offshore Voluntary Compliance Initiative ("OVCI")

2. Last Chance Compliance Initiative ("LCCI")

3. 2009 Offshore Voluntary Disclosure Program ("2009 OVDP")

4. 2011 Offshore Voluntary Disclosure Initiative ("2011 OVDI")

5. 2012 Offshore Voluntary Disclosure Program ("2012 OVDP")

6. 2012 Streamline Filing Compliance Procedure ("SFCP")

7. 2014 Offshore Voluntary Disclosure Program ("2014 OVDP")

8. Streamline Foreign Offshore Program ("SFOP")

9. Streamline Domestic Offshore Program ("SDOP")

10. Delinquent FBAR Submission Procedure ("DFSP")

11. Delinquent Int. Information Return Submission Procedure ("DIIRSP")

C. <u>Challenges of Participating Now</u>

1. The taxpayer must prove that the non-compliance was "non-willful."

2. The IRS and the courts have interpreted willful behavior broadly, identifying the following items as potential evidence of willful violations:

a. The taxpayer failed to inform his accountant about the existence of foreign accounts, assets, or companies, particularly when asked by accountant about such items during meeting.

b. The taxpayer failed to ask his accountant about potential U.S. tax and compliance issues with respect to foreign assets.

c. The taxpayer failed to complete the annual questionnaire/organizer distributed by his accountant or other return preparer.

d. The taxpayer incorrectly completed the annual questionnaire.

e. The taxpayer opened accounts in the name of a foreign company.

f. The taxpayer opened a numbered account.

g. The taxpayer had a nominee (*e.g.*, attorney, accountant, investment advisor, friend, relative, etc.) hold the foreign account for him.

h. The taxpayer told the foreign bank not to send account statements.

i. The taxpayer told the foreign bank not to invest in U.S. securities.

j. The taxpayer used a foreign passport (*i.e.*, not a U.S. passport) to open the account.

k. The taxpayer worked with a foreign attorney, accountant, or adviser in opening the foreign account.

l. The taxpayer provided the bank an address outside the United States as his residence for purposes of the foreign account.

m. The taxpayer only accessed the unreported foreign account while outside the United States, using a credit card linked to the account or taking cash withdrawals.

n. The taxpayer filed an FBAR reporting only some foreign accounts.

o. The taxpayer not only violated U.S. tax laws, but also had tax non-compliance in one or more foreign countries.

p. The taxpayer held foreign accounts or other assets in foreign countries with which he had no logical connection, such as living there, working there, operating a business there, etc.

q. The taxpayer used a computer program to self-prepare his returns, such as TurboTax, which specifically ask about foreign accounts.

r. The taxpayer reviewed the annual Form 1040 (including the specific information in Schedule B about foreign accounts and the need to file FBARs), signed the Form 1040 under penalties of perjury as being accurate and complete, yet took no actions whatsoever to learn more about a possible duty to file FBARs.

s. The taxpayer checked the box "no" in response to questions on Schedule B to Form 1040 about the existence of foreign accounts.

t. After the IRS started publicly attacking certain foreign banks, the taxpayer took actions to conceal the problems, such as transferring the funds to other foreign banks, converting the funds into foreign insurance policies, etc.

III. New Comprehensive Disclosure Practice

A. Introduction in 2018

1. In conjunction with the end of the OVDP, the IRS announced an updated voluntary disclosure practice ("UVDP") in November 2018.[2]

2. The UVDP applies to *all* types of taxes, including income, gift, estate, employment, excise, etc.

3. It also covers international *and* purely domestic matters.

B. Summary of Settlement Terms

1. Relevant Years

a. Cases generally will cover the most recent six closed tax years.

b. If the IRS and taxpayer cannot resolve a case by mutual agreement, then the IRS "has discretion to expand the scope to include the full duration of the noncompliance and may assert maximum penalties under the law with the approval of management."

2. Civil Fraud Penalty

a. Generally, the IRS will assert a civil fraud penalty, equal to 75% of the tax liability, to the one year during the disclosure period with the highest tax liability.

b. In "limited circumstances," Revenue Agents may apply the civil fraud penalty to more than one year, up to all six years, "based on the facts and circumstances of the case."

3. FBAR Penalties

a. The IRS announced that FBAR penalties, possibly including those for "willful" violations, will be asserted pursuant to the existing penalty guidelines found in Internal Revenue Manual § 4.26.16 and § 4.26.17. This is one of the biggest areas of concern for taxpayers with international violations.

4. Ability to Seek Reduced Penalties

---

[2] IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

a. Taxpayers are “not precluded” from (i) seeking an accuracy-related penalty under Section 6662 in the amount of 20% of the tax liability, instead of a civil fraud penalty at 75%, or (ii) requesting non-will FBAR penalties, in place of willful ones.

b. Reduced penalties will be “exceptional,” and taxpayers must present “convincing evidence” to justify a reduction.

5. Perhaps No Information Return Penalties

a. Contrary to the harsh stance by the IRS regarding the disclosure period, civil fraud penalties, and FBAR penalties, taxpayers might escape sanctions for unfiled information returns. The IRS will not automatically assess these under the UVDP.

C. <u>IRS Introduces Form 14457 in 2020</u>

1. The UVDP, announced in 2018, was positive in theory, but it lacked initial implementation. Fortunately, in 2020, the IRS issued *new* Form 14457 (Voluntary Disclosure Practice Preclearance Request and Application), with Instructions. Some interesting aspects are examined below:

2. Part I of Form 14457 – Broad Coverage

a. In terms of what type of taxpayers can participate, Part I asks taxpayers to check the box indicating individual, partnership, corporation, trust, or executor of estate.

b. The Instructions expand on this notion, stating that the UVDP “is available to individuals (U.S. Citizens, Green Card Holders, Non-Resident Aliens, Expatriates, etc.) and business entities (Corporations, Partnerships, LLCs, Trusts, Estates).”

c. Part I confirms that the UVDP broadly covers all types of matters, breaking them down into the following categories: domestic, offshore, estate and gift taxes, employment taxes, virtual currency, and the catch-all, “other issues.”

3. Take Your Non-willful Violations Elsewhere

a. Form 14457 and the Instructions contain language throughout alerting taxpayers that the IRS designed the UVDP exclusively for “willful” violations. Samples follow:

i. “Objective. The [UVDP] provides taxpayers whose conduct involved <u>*willful*</u> tax or tax-related noncompliance with a means to come into compliance with the tax law and avoid potential criminal prosecution.”

ii. "You should consider applying for the [UVDP] if you engaged in *willful* noncompliance that exposes you to criminal liability for tax and tax-related crimes, you meet the eligibility requirements (discussed next), and you wish to come into tax compliance and avoid potential criminal prosecution."

b. "You can correct less serious non-compliance by filing amended or past due tax returns." The Instructions feature a list of "Other Compliance Options," which consist of the SFOP, SDOP, DIIRSP, DFSP, and QDP.

4. Participation without Full Payment

a. The IRS acknowledges in the Instructions that it has "historically required" taxpayers participating in disclosure programs to make full payment of all taxes, penalties, and interest. However, the IRS changed its mind when it comes to the UVDP, now allowing taxpayers to participate even if they lack the cash, provided that they make a complete financial disclosure and convince the IRS that full payment is unfeasible.

5. Pursuing Advisors

a. The IRS is not subtle about its intention of using data collected through the UVDP to pursue bad actors.

b. The IRS demands the following: (i) Identity of all "professional advisors and facilitators" (including attorneys, accountants, financial planners, private bankers, consultants, and the like) that provided any services to the taxpayer during the disclosure period, "regardless of their connection to or knowledge of your noncompliance;" (ii) Full contact information for all such individuals; (iii) Explanation about the type of advice and/or services that the individuals provided; (iv) Statement as to "whether you fully disclosed your noncompliance and/or if they helped facilitate it;" (v) Description of all interactions among the individuals related to the noncompliance; and (vi) List of all individuals who maintained records for the taxpayer.

6. Expectation of Post-UVDP Compliance

a. The UVDP, like most disclosure programs, creates an expectation of future compliance by participating taxpayers. This makes sense because, after a taxpayer fully comprehends his tax-related duties, he essentially lacks excuses for any future violations.

b. The Instructions warn that "[t]axpayers will be expected to comply with U.S. law for all tax years after the disclosure period and file returns according to standard filing procedures."

D. IRS Issues New Guidance in 2022

1. Observations

a. The IRS took action yet again, when it released the newest version of Form 14457 and Instructions in February 2022.[3]

b. Much of Form 14457 remains the same, but the IRS introduced important changes that are easy to overlook. Below is a review of *only* what is new.

2. Facilitating Initial Communications

a. Historically, taxpayers had to place an *original* signature on Part II and send it to the IRS by *mail*. This could be quite challenging when taxpayers applying for the UVDP were divorced, residing in a city different from their representatives, or living abroad. It was also difficult because of issues caused by COVID.

b. The IRS has seen the light, so to speak, deciding to simplify the application procedure. The Instructions to the newest Form 14457 state that the IRS now "accepts and encourages" submissions of both Parts I and Parts II by fax.

c. They further indicate that the IRS accepts photocopies, faxes, and scans of taxpayer signatures, provided that taxpayers or their representatives retain the original versions in their files for six years, just in case the IRS gets a hankering to see them.

3. Data about Past, Future, or Current IRS Battles

a. In determining whether it will grant "preclearance" to a taxpayer, the IRS is seeking additional information about tax disputes.

b. In particular, Line 9 of the new Part I requires taxpayers to disclose whether they, their spouses, or any related entities have received a Notice of Deficiency for any year covered by the UVDP. If so, taxpayers must acknowledge this and enclose a copy of the Notice of Deficiency.

c. In that same vein, Line 10 of the new Part I also mandates that taxpayers disclose if they, their spouses, or any related parties have litigated or are litigating any federal tax matters for any year covered by the UVDP in Tax Court, District Court, or the Court of Federal

[3] Internal Revenue Service, IR-2022-33 (Feb. 15, 2022); Form 14457 (Feb. 2022); Instructions.

Claims. If this is true, taxpayers need to reveal to the IRS the case caption, docket number, and other information.

4. <u>Non-Tax Problems</u>

   a. Part I of Form 14457 probes for more data to determine whether a taxpayer will be eligible for the UVDP.

   b. Among other things, it requires a taxpayer to reveal whether he, his spouse, or any related entities are currently under a civil audit or criminal investigation by the IRS or other authority.

   c. The newest Instructions clarify and expand on this mandate. They first explain that relevant enforcement actions encompass those by the IRS, state agencies, *and* foreign governments.

   d. However, they limit this by stating that taxpayers are not obligated to reveal criminal investigations with "zero nexus" to financial matters, such as when a taxpayer is the target of a state criminal investigation for assault charges related to a "bar room brawl."

5. <u>Definition of "Financial Account"</u>

   a. The prior version of Form 14457 demanded data from the taxpayers about all non-compliant "financial accounts," but only the most recent version defines this key term.

   b. The Instructions indicate that, for purposes of the UVDP, financial accounts encompass (i) securities, brokerage, savings, demand, checking, deposit, time deposit, and any other accounts maintained with a financial institution or a person functioning as one, and (ii) futures accounts, options accounts, insurance or annuity policies with cash surrender values, and shares in a mutual fund or similar pooled fund.

   c. The Instructions underscore that the concept of financial account pertains to accounts held directly by taxpayers or through nominees, alter egos, or transferees.

   d. Finally, the Instructions emphasize that taxpayers should "interpret broadly" the concept of financial account to cover any type of relationship with a third-party that was established to provide or engage in deposit-type services or other financial services, including virtual currency, gambling accounts, and other deposit-type arrangements, regardless of who provides such arrangements.

6. <u>Accounts Held by Entities</u>

a. Taxpayers must provide the IRS with an estimate of the highest aggregate value of the non-complaint foreign assets for each year during the six-year disclosure period.

b. The Instructions to the new Form 14457 clarify that a taxpayer can omit from this calculation values of accounts held by entities in which he had no financial interest, such as accounts over which he solely had signature authority.

c. However, warn the Instructions, if a taxpayer owns all or part of a foreign entity that holds a non-compliant account, such as a shareholder, then the taxpayer is deemed to have an interest in the account for purposes of figuring the highest value.

d. The Instructions offer the following two examples:

    i. Example 1. The taxpayer owns 50 percent of the shares in a foreign corporation, and family members own the remaining 50 percent. The corporation has an operating account in foreign bank. The taxpayer failed to file annual Forms 5471, to report his interest the corporation, and failed to file annual FBARs, to report his indirect interest in the account. For purposes of determining the highest value of non-compliant assets for the UVDP, the taxpayer must include his shares in the corporation and his "effective control" over the account.

    ii. Example 2. The taxpayer is a salaried employee of a foreign corporation, who has signature authority over a foreign account held by the corporation, but has no ownership interest in the corporation. The taxpayer can exclude the value of the account when calculating the value of non-compliant foreign assets, but he will still need to remedy his violations for not filing FBARs to report his signature authority over the account.

7. Virtual Currency

a. The previous Form 14457 was devoid of specific inquiries about virtual currency. This has completely shifted, with the newest version demanding significant data about this complex asset.

b. New Line 13 of Part I obligates taxpayers to list all noncompliant virtual currency, whether domestic or foreign.

c. Expanding on this disclosure duty, new Line 13 says that the list must cover the entire UVDP disclosure period, including virtual currency acquired or disposed of during such period, as well as virtual currency held through entities that the taxpayer directly or indirectly controlled, owned, or beneficially owned.

d. Taxpayers who used a "mixer" or "tumbler" in connection with virtual currency transactions must explain the reason for doing so.

e. The Instructions leave no doubt that the IRS is prodding taxpayers for all possible data about their cutting-edge assets. They acknowledge that virtual currency is a "dynamic area" and that the IRS is seeking, for purposes of the UVDP, information about items that might exceed what many define as "virtual currency."

8. Interviews under Oath

a. The Instructions to the new Form 14457 put taxpayers on notice that seeking relief under the UVDP likely will require more than just submitting paperwork.

b. In particular, they explain that a Revenue Agent "may require that you submit to an interview under oath to explain the facts provided in your voluntary disclosure, answer questions about return positions, provide information about promoters, and answer any other questions the [Revenue Agent] determines are relevant."

c. The Instructions caution of similar inquiries on the other end, when taxpayers accepted into the UVDP are discussing payment abilities. The Instructions indicate that a Revenue Officer "may require you to submit to an interview under oath to determine the viability of any proposed payment arrangements, verify the accuracy of statements made regarding assets and income, and answer any other questions the [Revenue Officer] determines are relevant."

9. Expanded Descriptions of Non-Compliance

a. The IRS has never wavered in its quest to gather details about wrongdoing by taxpayers.

b. The IRS has now expanded its demands to accommodate the evolution of the UVDP to cover all types of taxes.

c. The Instructions to Form 14457 set the tone, ordering taxpayers to describe the non-compliance "in complete and thorough detail."

i. With respect to estate, gift and generation-skipping transfer taxes, the Instructions broadly ask for all details, including estimates of tax liabilities.

ii. In situations involving employment tax problems, the Instructions require a schedule of unreported wages by quarter, an explanation of any issues with tax withholding, and a list of affected employees.

iii. The Instructions are the most expansive when it comes to virtual currency issues. They direct taxpayers to explain how they acquired the assets (*e.g.*, kiosk, centralized online, peer-to-peer platform, operator, exchange payment processor, custodial banker, etc.), how they held the assets (*e.g.*, exchange, hosted wallet, private wallet, etc.), the names of the virtual currencies, and an estimate of virtual currency transactions conducted.

10. <u>Penalties Galore</u>

a. The Instructions add a significant information about various types of penalties, as broken down below.

b. Fraud Penalties

i. When a voluntary disclosure involves fraud by a taxable entity, such as a Subchapter C corporation and by an individual related to such entity, the Instructions clarify that the IRS will assert a civil fraud penalty or a fraudulent failure to file penalty, as appropriate, *against both the entity and the individual for at least one year*.

c. Estate Tax Penalties

i. The Instructions indicate that the IRS will assert a civil fraud penalty or a fraudulent failure to file penalty, as appropriate, in all estate tax cases filed under the UVDP.

ii. However, the penalty will equal 50 percent of the tax underpayment, as opposed to the normal 75 percent.

iii. The Instructions offer various examples of how this fraud penalty will work, using situations involving assets omitted from, or undervalued on, Form 706 (U.S. Estate and Generation-Skipping Transfer Tax Return), deductions and credits overstated on Form 706, and an unfiled Form 706.

d. Gift Tax and Generation-Skipping Transfer Tax Penalties

i. As with estate taxes, the Instructions confirm that the IRS intends to asses a civil fraud penalty or a fraudulent failure to file penalty, as is fitting, in all UVDP cases involving gift tax and generation-skipping transfer tax.

ii. In situations involving fraudulent activity in just one year, the Instructions state that the penalty rate will be 50 percent, not 75 percent.

iii. However, in cases where the activity touches *multiple* years, the six-year disclosure period does not apply, the taxpayer must submit original or amended Forms 709 (U.S. Gift and Generation-Skipping Transfer Tax Return) for all relevant years, the IRS will impose the normal fraud penalty at a rate of 75 percent on the return with the highest tax liability, and the IRS will waive penalties on all other returns.

e. Employment Tax Penalties

i. Punishments involving employment tax violations are the most complex.

ii. On a positive note, the Instructions explain that the IRS will assert a fraud penalty to *only one* tax quarter/period, the one reflecting the highest employment tax liability, and the IRS will not impose accuracy-related penalties or delinquency penalties to any tax periods.

iii. On the negative side, the Instructions indicate that (i) the IRS will inflict failure-to-deposit penalties under Section 6656, (ii) employment tax liabilities will be calculated without applying the special reduced rates in Section 3509 and without the special interest-waiver rules in Section 6205, (iii) taxpayers cannot benefit from so-called Section 530 relief, (iv) the higher supplemental income tax withholding rate will apply where taxpayers did not withhold and remit to the IRS proper amounts from the wages of workers, and (v) taxpayers must file all necessary Forms W-2 (Wage and Tax Statement) or Forms W-2 (Corrected Wage and Tax Statement), if necessary.

iv. The Instructions contain an example.

(a) Example. The taxpayer failed to treat workers as employees and failed to withhold and remit employment taxes to the IRS. Under the UVDP, the IRS will assert one fraud penalty on the tax period with the highest tax liability, will waive accuracy-related penalties for all periods, will assert failure-to-deposit penalties for all periods, and will figure the tax liabilities by applying the higher supplemental income tax rates and without allowing reductions normally available under Section 3509 and/or Section 6205.

E. <u>Involuntary UVDP Guidance in 2022</u>

1. <u>Revelation</u>

a. The IRS *voluntarily* provided taxpayers guidance about the UVDP in 2018, 2020, and 2022. It released more data to taxpayers later in 2022, but this time it was *involuntarily*. A news source obtained the Voluntary Disclosure Practice Examiner Guide Paper ("Guide Paper") through a demand under the Freedom of Information Act and then disseminated it.[4]

2. Kicking Taxpayers Out

a. The Guide Paper contains lots of information about when and how a Revenue Agent can revoke a Preliminary Acceptance into the UVDP previously granted to a taxpayer.

b. If the taxpayer disagrees with the penalties asserted, does not fully cooperate with the audit process, or refuses to execute a Closing Agreement, then Revenue Agents "should consider recommending revocation of the taxpayer's Preliminary Acceptance."[5]

3. Multiple Theories for Extending Assessment Periods

a. The UVDP normally affects the most recent six years. However, Revenue Agents have discretion to broaden coverage to *all* prior years in which violations occurred, and the period can expand if the IRS revokes a taxpayer's Preliminary Acceptance and pursues taxes, penalties, and interest outside the UVDP framework.

b. In light of these realities, the Guide Paper urges Revenue Agents to analyze and apply *all* conceivable manners of maintaining assessment-periods open. It directs them to potential extensions resulting from civil fraud, failure to file international information returns, and substantial omissions of gross income on Forms 1040.[6]

c. The Guide Paper also warns Revenue Agents that they need to obtain all data possible to build a civil fraud case against a taxpayer instead of simply relying on the fact that participants in the UVDP generally must concede fraud in at least one year. This is because some taxpayers (who refuse to grant extensions, fully cooperate, execute a Closing Agreement, etc.) will be jettisoned from the UVDP by way of the revocation of their Preliminary Acceptance.

---

[4] Internal Revenue Service. Voluntary Disclosure Practice Examiner Guide Paper (Rev. 1/26/22); IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022); Andrew Valverde, "IRS Voluntary Disclosure Guide Reveals New Details of Practice," 2022 Tax Notes Today Federal 138-3 (July 20, 2022).

[5] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 7.

[6] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pgs. 8, 9, 16, 17

i. The Guide Paper puts it in the following manner: Revenue Agents "must develop key facts which support the civil fraud penalty determination for all years covered by the [UVDP] regardless of the UVDP fraud penalty framework."[7]

ii. The Guide Paper also cautions Revenue Agents in another way: "Do not rely on the [Internal Revenue Code provision expanding assessment-periods in cases of fraud] to hold the expiring assessment statute open before making a civil fraud determination."[8]

4. <u>Dead Taxpayers and Criminal Liability</u>

a. Deceased taxpayers can participate in the UVDP, but they obviously cannot go to jail. The Guide Paper hints that others associated with the decedent sure can, though.

b. The Guide Paper instructs Revenue Agents to review the entire Form 14457, Form 56 (Notice Concerning Fiduciary Relationship), and all attachments. It goes on to state that Revenue Agents should "review the narrative to understand whose actions might lead to criminal exposure, the actions of the decedent, or the fiduciary, or someone else connected to the decedent (*e.g.*, an heir)."[9]

5. <u>Building a Potential Case against Taxpayers</u>

a. As explained earlier, participation in the UVDP does not guarantee that the IRS will not pursue criminal penalties against the taxpayer.

b. Moreover, the Guide Paper reveals that the IRS is concerned about ensuring that it can adequately sanction any taxpayer who starts down the UVDP path, but later provides false or incomplete data, refuses to cooperate fully, etc.

c. These and other apprehensions result in multiple mandates in the Guide Paper relating to Revenue Agents developing a thorough file against the taxpayer, just in case it becomes necessary.

i. The Guide Paper tells Revenue Agents to interview the taxpayer and then prepare a Memorandum of Interview ("MOI") shortly thereafter. In crafting the MOI, Revenue Agents are supposed to note "the exact words" used by the taxpayer, explain the context, and describe the taxpayer's

---

[7] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 12.
[8] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 10.
[9] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 8.

body language to convey additional meaning to his responses.[10] The Guide Paper also tells Revenue Agents to have the taxpayer review the MOI, correct it, and sign it under penalties of perjury.[11] Unsurprisingly, the Guide Paper underscores that the MOI "is helpful in supporting civil fraud and willful FBAR penalties."[12]

ii. The Guide Paper devotes significant time explaining to Revenue Agents when and how to construct a civil fraud case against a taxpayer. In situations where a Revenue Agent recommends revocation of Preliminary Acceptance, the Guide Paper instructs him to seek assistance from Fraud Technical Advisors and Fraud Enforcement Advisors, complete a Form 11661 (Fraud Development Recommendation), and "fully develop and support a fraud determination for all years covered by the [UVDP]."[13]

iii. In deciding whether a taxpayer acted fraudulently or willfully, the Guide Paper explains that Revenue Agents should be mindful of all the publicity, over many years, triggered by the Swiss bank program starting in 2008 and a long list of international voluntary disclosure programs announced by the IRS from 2009 forward.[14]

iv. The Guide Paper also emphasizes that Revenue Agents can and should use the taxpayer's own words against him.

(a) As explained earlier, a taxpayer must provide the IRS with an expansive "narrative" when submitting Part II of Form 14457 seeking Preliminary Acceptance. The Guide Paper explains the evidentiary value of such narrative: "In some cases, the narrative may provide sufficient admissions to assert fraud . . . The key is that the narrative is direct evidence about the taxpayer's state of mind and intent, whereas evidence

[10] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pgs. 13-14.
[11] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 13.
[12] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 13.
[13] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 19.
[14] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 35.

collected by [a Revenue Agent] concerning intent is circumstantial evidence."[15]

(b) The Guide Paper further encourages Revenue Agents to "rely on relevant admissions by taxpayers in the narrative that specifically describe their affirmative acts of tax and tax-related crimes (fraud)."[16]

v. The Guide Paper tells Revenue Agents that, if a taxpayer requests lesser penalties (*e.g.*, accuracy-related penalties instead of civil fraud or non-willful FBAR penalties instead of willful ones), then they should "probe" all defenses that the taxpayer raises in writing. Doing so "will help solidify and support the assertion of fraud and willful FBAR penalties and international information return penalties if the taxpayer becomes uncooperative."[17]

6. Taxpayers Cannot Back Out

a. The Guide Paper explains that taxpayers applying for the UVDP must agree to an examination by the IRS. It goes on to emphasize that once a taxpayer has submitted Part II of Form 14457 and received Preliminary Acceptance from the IRS, he cannot back out.

b. The Guide Paper states, in bold letters to ensure that IRS personnel do not miss it, that "revocation is at the discretion of the [IRS]" and a taxpayer cannot request revocation, seek removal, or opt-out.[18]

c. The Guide Paper also clarifies that a taxpayer cannot attempt to switch disclosure programs, which might occur if he were to learn after applying for the UVDP that he could have achieved a better settlement under the SDOP, SFOP, etc. The Guide Paper succinctly states the following about capricious taxpayers: "They are not eligible to participate in other avenues for compliance."[19]

7. Opening Closed Assessment-Periods

a. When dealing with federal tax matters, the IRS must assess additional taxes, penalties and interest while the relevant

---

[15] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 19.
[16] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 12.
[17] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 36.
[18] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 29.
[19] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 29.

assessment-periods are still open. Moreover, once an assessment-period has closed, the IRS normally cannot re-open it again, even if the taxpayer were willing to allow it by signing a Form 872 (Consent to Extend the Time to Assess Tax).

b. The Guide Paper notifies Revenue Agents that things are different when it comes to FBAR penalties. It explains that the "FBAR statute may be extended or waived by the taxpayer *after* expiration. In other words, an expired FBAR statute can be resurrected with taxpayer consent."[20] The Guide Paper later states that "unlike Title 26 statutes, Title 31 FBAR statutes can be resurrected *after* the statute expires through the execution of a consent."[21] Consequently, the Guide Paper instructs Revenue Agents to solicit extensions of the FBAR penalty assessment-period in *all* UVDP cases.

IV. Updated IRS Stance on "Quiet Disclosures"

A. Historic Warnings against Quiet Disclosures

1. The IRS has warned taxpayers since 2009 *not* to make to circumvent such programs by making a so-called "quiet disclosure."

2. This means taxpayers pro-actively resolving issues by filing amended tax returns and/or information returns, without officially participating in a recognized disclosure program, with hopes that the IRS will process the returns in the regular course, not start an audit, and not impose penalties.

3. The IRS repeatedly announced that it planned to identify and harshly sanction attempted "quiet disclosures."[22]

B. IRS Reverses Position in 2019

1. With the introduction of the UVDP, the IRS has changed course, telling taxpayers that it is acceptable to make a "quiet disclosure," provided that there is no risk of criminality.[23]

2. The IRS stated the following: "Taxpayers who did not commit any tax or tax related crimes and do not need the voluntary disclosure practice to seek protection from potential criminal prosecution can continue to correct past mistakes using the procedures mentioned above or by filing an amended or

---

[20] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 39 (emphasis added).
[21] IRS Voluntary Disclosure Practice Examiner's Guide Is Available, 2022 Tax Notes Today Federal 138-24 (July 19, 2022), pg. 49 (emphasis added).
[22] *See, e.g.*, Robert Goulder, "Quiet Disclosures Get No Love from IRS," 2010 Tax Notes Today 90-1 (May 11, 2010); Marie Sapirie, "Charges against HSBC Bank Bermuda Client Raise Quiet Disclosure Questions," 201 Tax Notes Today 98-1 (May 20, 2011).
[23] IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).

past due tax return. When these returns are examined, examiners will follow existing law and guidance governing audits of the issues."[24]

C. Form 14457 and Instructions for UVDP

1. "You can correct less serious non-compliance by filing amended or past due tax returns." The Instructions feature a list of "Other Compliance Options," which consist of the SFOP, SDOP, DIIRSP, DFSP, and QDP.

V. Recent Procedures for Fixing Late Forms 1120-F

A. Overview

1. Foreign corporations with limited activities in the United States, sometimes are unaware of their duty to file annual Forms 1120-F (U.S. Income Tax Return of a Foreign Corporation).

2. In addition to normal penalties for late filing, late payment, and failure to enclose Forms 5472, foreign corporations face a formidable stick:

   a. The IRS disallows business-related deductions and credits to which the foreign corporations normally would have been entitled, such that they are taxed on *gross* income, instead of *net* income.

3. Cognizant of the harshness of the deduction-and-credit disallowance rule, the IRS created an exception. The IRS will ignore tardiness in situations where a foreign corporation can demonstrate that it acted reasonably and in good faith ("Late-Filing Waiver").[25]

4. Inconsistencies arose over the years about where foreign corporations should submit requests for Late-Filing Waivers, the degree of scrutiny to be applied by the IRS, the number of years that must be addressed, etc.

5. To standardize the process, the IRS issued instructions for handling late Forms 1120-F and requests for Late-Filing Waivers ("Guidelines").[26]

B. Description of Applicable Law – Section 882

1. Broad General Filing Duty

   a. A foreign corporation generally must file a Form 1120-F if it (i) was engaged in a U.S. trade or business, regardless of whether it derived any income that was effectively connected with such trade or business ("ECI"), (ii) has income, gains, or losses that are treated as if they were ECI, (iii) was not engaged in a U.S. trade or business,

[24] IRS Memorandum LB&I-09-1118-014 (Nov. 20, 2018).
[25] Treas. Reg. § 1.882-4(a)(3)(ii).
[26] Internal Revenue Service. "LB&I Guidelines for Handling Delinquent Forms 1120-F and Requests for Waiver Pursuant to Treas. Reg. § 1.882-4(a)(3)(ii)." February 1, 2018.

but had other US-source income that was not fully paid through tax withholding, (iv) is making a claim for refund, (v) is claiming the benefit of any deductions or credits, or (vi) needs to file a Form 8833 (Treaty-Based Return Position) to disclose to the IRS that it is taking the position that a tax treaty overrules or modifies the normal rules found in the Internal Revenue Code.

2. Disallowance of Deductions and Credits

a. Section 882 generally allows foreign corporations that derive ECI to be taxed at the rates applicable to domestic corporations on "taxable income." In determining "taxable income," foreign corporations (i) include only the amount of gross income that is ECI, and (ii) then reduce such amount by claiming all deductions and credits.

b. Section 882(c) and the corresponding regulations allow foreign corporations to claim such tax benefits *only if* they file proper, timely Forms 1120-F with the IRS.

C. IRS Waiver of "Timely" Filing Requirement

1. The IRS can grant a Late-Filing Waiver, thereby allowing a foreign corporation to claim deductions and credits, under certain circumstances.

2. Current Rules and Standards

a. The IRS will permit a Late-Filing Waiver if the foreign corporation can show it acted "reasonably and in good faith" in failing to file a timely Form 1120-F or a "protective" Form 1120-F.[27]

b. The IRS must consider the following list of factors in deciding whether a foreign corporation meets the current standard for relief:

i. Whether the foreign corporation voluntarily identifies itself to the IRS before the IRS discovers the issue;

ii. Whether the corporation did not become aware of its ability to file a "protective" Form 1120-F by the normal deadline;

iii. Whether the corporation previously filed a Form 1120-F;

iv. Whether the foreign corporation failed to file a Form 1120-F because, after exercising reasonable diligence (taking into account its relevant experience and level of sophistication), the foreign corporation was unaware of the necessity;

[27] Treas. Reg. § 1.882-4(a)(3)(ii).

v. Whether the foreign corporation failed to file a Form 1120-F because of intervening events beyond its control; and

vi. Whether other mitigating or exacerbating factors exist.

D. New IRS Guidelines about Late-Filing Waiver

1. Centralized Filing - The Guidelines create two main categories.

a. Scenario 1 contemplates a foreign corporation that is not under audit, which voluntarily approaches LB&I about its unfiled Forms 1120-F for prior years. Here, the Guidelines tell LB&I personnel to instruct the foreign corporation to file late Forms 1120-F in the regular manner, pursuant to the Instructions to Form 1120-F.

b. Scenario 2 arises when LB&I gets assigned to audit a foreign corporation with respect to a late Form 1120-F. The actions of LB&I depend on whether the foreign corporation has already filed a request for a Late-Filing Waiver. If yes, then the Exam should develop the facts relevant to the request for a Late-Filing Waiver, reach a recommendation, and then follow the recommendation-processing rules. Conversely, if the foreign corporation has not previously filed a request for a Late-Filing Waiver, then Exam notifies the foreign corporation in writing of its ability to do so.

2. Penalties Anyone?

a. The Late-Filing Waiver allows a foreign corporation to escape the harsh treatment contemplated by Section 882(c)(2); that is, paying U.S. taxes on *gross* income effectively connected with a U.S. trade or business, without the benefit of many deductions and credits.

b. This is beneficial to a foreign corporation, no doubt, but it is far from *carte blanche*. Foreign corporations filing late Forms 1120-F often are subject to *other* penalties, like the following:

i. Delinquency penalties for late filing and/or payment

ii. Failure to disclose treaty position on Form 8833

iii. Failure to File Forms 5472

c. Silence Is Ominous

i. The standard for achieving a Late-Filing Waiver is "reasonable cause" and "good faith." This is identical or very similar to the thresholds for obtaining abatement of delinquency penalties, Form 8833 penalties, and Form 5472 penalties. Therefore, logic dictates that, if the IRS were to grant a Late-Filing Waiver then the IRS should also eliminate the potential penalties. However, the Guidelines are silent on this critical issue.

VI. Easing of Foreign Trust Reporting Rules

A. Overview

1. Taxpayers must file Forms 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts) and Forms 3520-A (Annual Information Return of Foreign Trust with a U.S. Owner) in certain situations.

2. Duties of Responsible Parties

   a. A "responsible party" generally must file a Form 3520 within 90 days of certain "reportable events." For these purposes, the term "responsible party" means (i) the grantor, in cases involving the creation of an inter vivos trust, (ii) the transferor, where there is a reportable event, other than a transfer upon death, and (iii) the executor of a decedent's estate.

   b. The term "reportable event" includes creation of a foreign trust by a U.S. person, the transfer of money or other property (directly, indirectly or constructively) to a foreign trust by a U.S. person, and the death of a U.S. person, if such person was treated as the "owner" of any portion of the foreign trust under the grantor trust rules or any portion of the foreign trust was included in the person's gross estate.

3. Duties of Owners

   a. If a U.S. person is treated as the "owner" of any portion of a foreign trust under the grantor trust rules at any time during a year, then the person (i) "shall submit" such information as the IRS prescribes with respect to the trust, and (ii) "shall be responsible to ensure" that the trust files Form 3520-A and furnishes the information required by the IRS to each U.S. person who is treated as the owner of any portion of the trust, or who receives (directly, indirectly, or constructively) any distribution from the trust.

4. Duties of Beneficiaries

   a. A U.S. person ordinarily must file a Form 3520 if such person receives (directly, indirectly, or constructively) during the year any distribution from a foreign trust.

5. Penalties for Violations

   a. The penalty for not filing a timely, complete, accurate Form 3520 is $10,000 or 35% of the so-called "gross reportable amount," whichever is larger.

b. If the violation involves Form 3520-A (pertaining to owners of foreign trusts) instead of Form 3520 (pertaining to responsible parties *and* beneficiaries), the penalty decreases from 35% to 5%.

c. Taxpayers might also be hit with a so-called "continuation penalty" of $10,000 per month if they refuse to become compliant within 90 days of notice from the IRS.

B. Taxpayer Relief under Rev. Proc. 2020-17

1. Overview

a. The primary purpose of Rev. Proc. 2020-17 is to create an *exemption* from certain information-reporting requirements (but not from income-reporting and tax-payment requirements) for some individuals with respect to their ownership of, and transactions with, certain types of foreign trusts.

2. Key Definitions

a. Understanding the key terms is tedious, but is necessary in order to grasp the benefits and limits of Rev. Proc. 2020-17.

b. Eligible Individual

i. An "eligible individual" is any individual who is, or who was at any time, (i) a U.S. citizen or U.S. resident, (ii) who, for any year whose general assessment-period remains open, was compliant "or comes into compliance" with his duty to file Forms 1040, and (iii) to the extent required, has reported as income on Forms 1040 or Forms 1040X contributions to, accretion in, and/or actual distributions from an "applicable tax-favored foreign trust."

ii. Rev. Proc. 2020-17 also states that only "U.S. individuals who have been compliant with respect to their income tax obligations related to such trusts may rely on" it.

c. Applies to Retirement *and* Non-Retirement Trusts

i. An "applicable tax-favored foreign trust" includes *both* "tax-favored foreign retirement trust" *and* "tax-favored foreign non-retirement trust," as described below.

ii. Tax-Favored *Retirement* Trust

(a) A "tax-favored retirement trust" means (i) a "trust, plan, fund, scheme, or other arrangement" (ii) created, organized, or otherwise established under the laws of a foreign country (iii) to operate exclusively (or almost exclusively) to provide, or to earn income for the provision of, pension or retirement benefits and ancillary or incidental benefits, and (iv) meets *all* the following requirements established under local law.

(1) The trust is generally tax-exempt or otherwise tax-favored under local law.

(2) Annual information-reporting with respect to the trust, its participants, or its beneficiaries is filed with, or otherwise available to, the local tax authorities.

(3) Contributions are limited to income earned from performing personal services.

(4) Contributions cannot exceed a percentage of earned income by the participant, they cannot surpass $50,000 per year, or they are subject to a lifetime max of $1 million.

(5) Withdrawals, distributions, or payments from the trust are contingent upon death, disability, or reaching a set retirement age, or penalties apply for earlier ones.

iii. Tax-Favored <u>*Non-Retirement*</u> Savings Trust

(a) A "tax-favored non-retirement savings trust" means (i) a "trust, plan, fund, scheme, or other arrangement" (ii) created, organized, or otherwise established under the laws of a foreign country (iii) to operate exclusively (or almost exclusively) to provide, or to earn income for the provision of, medical, disability, or educational benefits, and (iv) meets *all* the following items under local law.

(1) The trust is generally tax-exempt or is otherwise tax-favored under local law.

(2) Annual information-reporting with respect to the trust, its participants, or its beneficiaries is filed with, or otherwise available to, the local tax authorities.

(3) Contributions cannot exceed $10,000 per year or $200,000 over a lifetime.

(4) Withdrawals, distributions, or payments from the trust are conditioned upon the provision of medical, disability, or educational benefits, or penalties apply to those occurring for any other purpose.

C. Prospective Matters – Future Filing Waiver

1. This IRS waives the duty to file Forms 3520 and Forms 3520-A to "eligible individuals" with respect to "tax-favored retirement trusts" or "tax-favored non-retirement savings trusts."

2. What was the IRS thinking?

a. These items are restricted under foreign law; and

b. Taxpayers already report them to the IRS on other international information returns.

D. Retroactive Matters – Abating Past Penalties

1. Generally, any "eligible individual" against whom the IRS has already assessed a penalty related to Forms 3520 and/or Forms 3520-A can seek an abatement or a refund, as appropriate, by filing a Form 843 (Claim for Refund and Request for Abatement).

E. Limitations of Rev. Proc. 2020-17

1. First, to be an "eligible individual," a taxpayer must have filed his annual Forms 1040 and reported *all* worldwide income, which ordinarily includes all contributions to, accretion in, and/or actual distributions from the "applicable tax-favored foreign trust."

2. Second, even if a taxpayer were entitled to a future filing waiver under Rev. Proc. 2020-17, he likely still would need to report the "applicable tax-favored foreign trust" on Form 8938, the FBAR, Part III of Schedule B of Form 1040 and, perhaps, elsewhere. The taxpayer, therefore, will not be relieved of any information-gathering or record-retention duties.

3. Third, the time for claiming an abatement or refund of penalties assessed for prior years might have already expired.

VII. International Withholding Compliance Program

A. Synopsis of Duties

1. Generally, if a foreign person derives investment-type income from U.S. sources, then the *gross amount* of such income is taxed at a flat rate of 30%.

2. The burden of collecting such tax and then remitting it to the IRS is placed on the person controlling the payment, commonly known as a U.S. withholding agent ("USWA").

3. These USWAs have an incentive to get the withholding done correctly, because they are personally liable if they fail to meet their duties.

4. There are three main U.S. tax withholding tax regimes.

   a. The first is the Foreign Account Tax Compliance Act, which imposes withholding in situations where foreign payees fail to provide information about U.S. recipients of payments.[28]

   b. The second is the withholding regime related to payments to foreign persons of fixed, determinable, annual, or periodic ("FDAP") income from U.S. sources.[29]

   c. There is a different set of withholding rules applicable to foreign persons selling U.S. real property. These were promulgated pursuant to the Foreign Investment in Real Property Tax Act ("FIRPTA"), which generally dictates that gains or losses realized by foreign persons from the sale, exchange, or other disposition of a "U.S. real property interest" are taxed in the same manner as income that is effectively connected to a U.S. trade or business.[30]

5. Complying with the information-reporting and tax-withholding duties is complicated. Depending on the circumstances, this might involve preparing and filing the following:

   a. Form 1042 (Annual Withholding Tax Return for U.S. Source Income for Foreign Persons),

   b. Form 1042-S (Foreign Person's U.S. Source Income Subject to Withholding),

   c. Form 8804 (Annual Return for Partnership Withholding Tax),

   d. Form 8805 (Foreign Partner's Information Statement of Section 1446 Withholding Tax),

   e. Form 8813 (Partnership Withholding Tax Payment Voucher), or

   f. Form 8828 (U.S. Withholding Tax Return for Dispositions by Foreign Persons of U.S. Real Property Interests).

[28] Sections 1471 through 1474.
[29] Treas. Reg. § 1.1442-1; Treas. Reg. § 1.1442-2; Treas. Reg. § 1.1442-3.
[30] Section 897(a)(1).

B. <u>New Mechanism to Rectify Foreign Payment Problems</u>

1. Introduction

a. The IRS recognizes that significant non-compliance exists, many problems are caused by ignorance or confusion about complicated rules, taxpayers are reluctant to voluntarily remedy matters if doing so will trigger penalties, and getting as many taxpayers as possible back in the system is fundamental.

b. Therefore, the IRS introduced a new mechanism for resolving past international withholding issues ("Foreign Payment Program").[31]

2. Eligibility Criteria

a. To participate in the Foreign Payment Program, the USWA must (i) file all outstanding withholding tax returns, including related information returns, (ii) make "full payment" of the taxes due, and (iii) provide a statement containing an explanation of the areas or lines of business for which there was non-compliance, a clarification of how the non-compliance was discovered, a description of the corrective procedures implemented to ensure compliance in future years, and a copy of the communications by the USWA to employees or other relevant parties about the corrective procedures.

b. A USWA is not eligible for the Foreign Payment Program if he/it is already under audit.

3. Disclosure Period / Relevant Years

a. On a positive note, USWAs are required to file late returns for only the past six years. Extending beyond this six-year period requires managerial approval within the IRS.

4. Seeking Penalty Relief

a. When returns are filed under the Foreign Payment Program, Revenue Agents will review them *and* consider any acceptable penalty-abatement request.

5. Relevant IRS Office

a. The IRS instructs USWAs to send the materials to a particular IRS office in Illinois.

VIII. Disclosure Procedure for Former U.S Citizens

[31] IRS Memorandum LB&I-04-0219-002 (Feb. 27, 2019); Tax Analysts Document 2019-8432.

A. Overview

1. The IRS introduced in late 2019 the Relief Procedures for Certain Former Citizens ("RPCFC").

2. The RPCFC is designed to benefit taxpayers who (i) were U.S. citizens, (ii) have already expatriated, (iii) had no or minimal U.S. income tax liability in the years preceding expatriation, (iv) were effectively "off the grid" in terms of U.S. tax compliance in that they never filed Forms 1040 or international information returns, (v) would not have been subjected to the exit tax as a result of the Tax Liability Test or Net Worth Test, (v) but who were liable for the exit tax because they failed the Certification Test (*i.e.*, they did not have full U.S. tax compliance in the five years preceding expatriation), yet did not pay such tax.

B. General Information

1. The IRS recognizes that "[s]ome U.S. citizens, born in the United States to foreign parents, or born outside the United States to U.S. citizen parents, may be unaware of their status as U.S. citizens or the consequences of such status."

2. To meet the Certification Test and thus avoid being classified as a "covered expatriate," taxpayers must file a Form 8854 with their Form 1040 for the year of expatriation and certify full U.S. compliance for the past five years.

3. The RPCFC is an alternative means for satisfying the Certification Test for U.S. citizens who expatriated after March 18, 2010.

4. If the individuals submit the mandatory documents and meet the eligibility requirements for the RPCFC, then they will *not* be considered "covered expatriates" under Section 877A and thus will not be subject to the exit tax, will not be required to pay back income taxes, and will not be penalized for unfiled international information returns.

5. The IRS clarifies that the RPCFC is only available to taxpayers whose failure to file Forms 1040, international information returns, and FBARs was due to "non-willful conduct."

C. Qualification Criteria

1. Taxpayers must "strictly meet" all the following criteria:

   a. They relinquished U.S. citizenship after March 18, 2010;

   b. They have no filing history with the IRS;

   c. They had a net worth of less than $2 million, both at the time of expatriation and at the time of making a submission under the RPCFC, without taking into account any exceptions;

d. They have an aggregate tax liability of $25,000 or less for the five years before expatriating, calculated after applying all deductions, exclusions, exemptions, and credits, omitting any potential exit tax, and omitting any penalties and interest;

e. They complete and file all necessary U.S. tax returns and information returns for the relevant six years; and

f. They did not willfully violate any U.S. tax-related duties.

D. Example Provided by the IRS

1. "John was born in the United States while his non-U.S. parents were attending university for post-graduate studies. Shortly after John was born, the family returned to Country E. John is a citizen of Country E and lives and works in Country E. John renounced his citizenship on October 1, 2019, and received a Certificate of Loss of Nationality. John has never filed a U.S. income tax return and never applied for or received a Social Security Number. He wants to use the RPCFC to come into compliance with his U.S. tax obligations. He must report his worldwide income on Form 1040 for 2019 and the preceding five tax years (and may claim all available deductions and credits, including foreign tax credits, to the extent permitted) to determine the total tax. In each year, John had various sources of income, including small amounts of income from foreign mutual funds that are passive foreign investment companies. For 2014 through 2019, John submits the following tax returns required under these procedures: (i) 2019 Form 1040NR (with Form 1040 attached as an information return reporting worldwide income through October 1, 2019), with a total tax of $1,000, and (ii) Forms 1040 for 2014 through 2018, each of which shows a total tax of $4,800 on line 63. John uses his best efforts in computing his total tax for each year. John computed the income from his foreign mutual funds and reported them as ordinary income on the "other income" line of his Forms 1040. He should have also used Form 8621 (Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund) to make additional computations, but he failed to include that form with his return. John adds the "total tax" amounts for all his six tax returns submitted under the procedures; the amount is $25,000. John's total tax liabilities are within the limit for these procedures. John is eligible to use the RPCFC."

IX. Solutions for NRAs with U.S. Real Property Violations

A. Overview of General Rules

1. Passive income (including rent), from by U.S. sources, not connected with a U.S. trade or business, and received by a nonresident alien ("NRA") generally is subject to 30% income tax on the *gross* amount.

2. This means that the so-called USWA (normally the renter, lessee, or property manager) must reserve a significant portion of the total income and send it to the IRS, as opposed to the NRA.

3. By comparison, an NRA who is engaged in a U.S. trade or business during a year is taxed at the normal graduated/progressive rates on *net* income; that is, after taking into account the deductions that are effectively connected with the business.

B. Special Rules Exist for Certain Rental Real Estate

1. Section 871(d) provides that an NRA who obtains income from U.S. real property held for the production of income or from any interest in such property, which is not otherwise treated as income effectively connected with a U.S. trade or business, has the option of *electing* to treat all such income (including rental income) as effectively connected income.

2. The main benefits of the Section 871(d) election for an NRA are he can:

a. convert the passive renting of U.S. real property into an active trade or business for U.S. tax purposes,

b. avoid a flat tax rate of 30%on gross income, effectuated by tax withholding at source, and

c. claim a multitude of tax deductions related to the property.

3. Once an NRA makes a Section 871(d) election for one year, it remains in effect for all later years, unless the IRS gives permission to revoke it.

4. An NRA who makes the Section 871(d) election reports income and deductions related to the U.S. real property on Schedule E (Supplemental Income and Loss from Rental Real Estate, Royalties, Partnerships, S Corporations, Estates, Trusts, REMICs, etc.) to Form 1040NR.

C. How to Make the Section 871(d) Election

1. Section 871 is vague about how to make the relevant election, limiting itself to stating that it "may be made only in such manner and at such time as the [IRS] may by regulations prescribe."

2. The regulations explain the election procedure in the following manner:

a. "An election made under this section without the consent of the [IRS] shall be made for a taxable year by *filing with the income tax return* required under Section 6012 and the regulations thereunder for such taxable year a *statement* to the effect that the election is being made."

b. "This statement shall include (a) a complete schedule of all real property, or any interest in real property, of which the taxpayer is titular or beneficial owner, which is located in the United States, (b) an indication of the extent to which the taxpayer has direct or beneficial ownership in each such item of real property, or interest in real property, (c) the location of the real property or interest therein, (d) a description of any substantial improvements on any such property, and (e) an identification of any taxable year or years in respect of which a revocation or new election under this section has previously occurred."

D. Need for a Timely Tax Return

1. Section 874(a) generally provides that an NRA is not permitted to claim deductions, unless the NRA files an accurate, and timely Form 1040NR. This includes deductions related to rental real estate that become available to NRAs after making a Section 871(d) election.

E. Recent Report

1. NRAs are buying lots of U.S. property

a. A recent report by the Tax Inspector General for Tax Administration ("TIGTA") explains that NRAs have purchased a significant amount of U.S. real property in recent years, a large portion of which is used to generate rental income.

b. NRAs purchased \$34.8 billion in 2013, \$45.5 billion in 2014, \$54.4 billion in 2015, and \$43.5 billion in 2016.[32]

2. Main Categories of Non-Compliance

a. *First*, TIGTA discovered that lots of NRAs were claiming net income treatment on the annual Forms 1040NR, despite the fact that they never made a proper Section 871(d) election.

b. *Second*, TIGTA learned that some NRAs are double dipping, taking inconsistent tax positions in order to acquire two improper benefits. This is made possible, according to the TIGTA Report, because the IRS's systems do not adequately input or track the data about U.S. rental property that is supplied to the IRS in the first-year Section 871(d) election statement attached to Form 1040NR.

i. The initial benefit is that certain NRAs deduct rental expenses annually and subject the remaining net income to

[32] Treasury Inspector General for Tax Administration. Additional Controls Are Needed to Help Ensure that Nonresident Alien Individual Property Owners Comply with Tax Laws. Report No. 2017-30-048 (Aug. 23, 2017), pages 2-3.

the graduated tax rates, which are often less than the standard 30% withholding rates on gross income.

ii. The additional benefit comes when the property is later sold. Some unscrupulous NRAs conveniently forget to reduce their basis in the property by the amount of the depreciation expenses that they took over the years, thereby diminishing the total gain when they sell the property.

c. *Third*, some NRAs never file Forms 1040NR, never notify USWAs that they should be subject to a 30% tax rate on gross income, and thus never pay any amount of U.S. income taxes on rental income from U.S. real property.

3. IRS Accepts Suggestion from TIGTA

a. The most important recommendation by TIGTA was to develop and implement a "*compliance initiative*" to address the problems caused by NRAs who do not properly report U.S. rental income.

b. The IRS announced its "compliance campaign" in March 2020.[33]

F. <u>Solutions for NRAs Who Filed Form 1040NR But Did Not Make Election</u>

1. Make a Late Election Pursuant to Section 871 Regulations

a. NRAs can file an amended Form 1040NR within the designated period to retroactively make the Section 871(d) election, without seeking advanced permission from IRS.[34]

2. Make a Late Election Thanks to Section 9100 Relief

a. If an NRA is unable to file a retroactive election to cover all affected years because the first Form 1040NR was filed beyond the general refund-period, or if the NRA wants the explicit, advanced blessing of the IRS, another option remains: Seeking a PLR from the IRS pursuant to Treas. Reg. § 301.9100-3. This is commonly known as getting "Section 9100 relief."

b. The IRS has discretion to grant reasonable extensions for filing certain elections. The regulations provide that extension requests "will be granted" by the IRS when the taxpayer provides sufficient evidence to establish that (i) the taxpayer acted reasonably and in good faith, and (ii) granting the extension will not prejudice the interests of the U.S. government.

---

[33] Andrew Velarde. "Latest LB&I Campaign Targets Nonresident Rental Income," Federal Tax Notes Today, Document No. 2020-11378 (Mar. 26, 2020).

[34] Treas. Reg. § 1.871-10(d)(1)(i).

G. Solutions for NRAs Who Never Filed Forms 1040NR

1. Section 874(a) generally deprives an NRA of the deductions related to U.S. rental property, unless he files a timely Form 1040NR.[35]

2. The IRS can waive the timely-filing duty if the NRA demonstrates to the satisfaction of the IRS that, based on all the facts and circumstances, he acted reasonably and in good faith in failing to file a Form 1040NR.[36]

X. Foreign Gifts, Big Penalties, and Concession

A. Introduction

1. Receiving a significant gift of money from a foreign person is a good-news-bad-news situation for U.S. persons.

a. On the positive side, receipt of cash from abroad generally does *not* trigger U.S. income taxes; they get the money tax free.

b. On the negative side, they must disclose the gift by filing a timely Form 3520 (Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts). If U.S. persons fail to submit this obscure international information return, the IRS penalizes them, of course.

2. Case of first impression, *Wrzesinski v. United States*.[37]

B. Special Rules - Receipt of Foreign Gifts

1. If a U.S. individual receives a gift of property (including money) from an individual who is not a U.S. person totaling more than $100,000 during a year, then he generally must file a Form 3520 with the IRS.[38]

2. The receipt of the foreign gift does *not* trigger any immediate U.S. income taxes for the recipient, solely an information-reporting duty.

3. The penalty is five percent of the unreported gift for each month Form 3520 is late, with a maximum penalty of 25 percent.[39]

---

[35] Section 874(a); Treas. Reg. § 1.874-1(a); Treas. Reg. § 1.874-1(b).
[36] Treas. Reg. § 1.874-1(b)(2).
[37] *Wrzesinski v. United States*, Case No. 2:22-cv-03568, Eastern Dist. of Penn, Complaint, Sept. 1, 2022; Andrew Veldarde, "Son of Polish Lottery Winner Challenges Foreign Gift Penalty," 2022 Tax Notes Today Federal 174-26 (Sept. 7, 2022).
[38] Section 6039F(a); IRS Notice 97-34, Section VI.
[39] Section 6039F(c)(1)(B); IRS Notice 97-34, Section VI.

4. The IRS has authority to waive the penalty, though, if the taxpayer can demonstrate that the violation was due to reasonable cause.[40]

5. The IRS recently acknowledged that most taxpayers are oblivious to the need to file Form 3520 when they receive a foreign gift, particularly because such event does not trigger a taxable event for U.S. purposes. The IRS stated the following in a recent training guide:

   a. "In general, gifts and inheritances are not taxable to the recipient. Many taxpayers and representatives know that basic tenant of tax law but are not aware of the requirement to report large foreign gifts and inheritances under [Section] 6039F."[41]

C. <u>Foreign Trust Compliance Campaign</u>

1. In May 2018, the IRS introduced a "Compliance Campaign" centered on foreign trusts, Forms 3520, and Forms 3520-A.[42]

2. The Compliance Campaign was designed to stop shenanigans associated with foreign trusts. Unfortunately, taxpayers failing to file Forms 3520 to report foreign gifts got caught in the IRS's enforcement net, too.

D. <u>First Case</u>

1. The relevant case, *Wrzesinki v. United States*, centers solely on Form 3520 penalties linked to the receipt of foreign cash gifts.

2. The taxpayer file a Complaint in District Court in September 2022. The allegations relevant to this article consist of the following.

   a. The taxpayer was born, raised and educated in Poland, immigrating to the United States when he was 19 years old.

   b. He has been in public service, working as a police officer for nearly a decade.

   c. In 2010, his mother, both a citizen and resident of Poland, won the lottery there and decided to gift the taxpayer $830,000.

   d. The taxpayer called his tax advisor from Poland to inquire about any U.S. duties triggered by the receipt of the gift. The tax advisor, who

---

[40] Section 6039F(c)(2); IRS Notice 97-34, Section VII; I.R.M. § 20.1.9.10.5 (01-29-2021); I.R.M. § 8.11.5.6.3 (12-18-2015).
[41] Voluntary Disclosure Practice Examiner Guide Paper, 2022 Tax Notes Today Federal 138-24 (7/9/2022), pg. 44; *See also* IRS Chief Counsel, INFO 2013-0015 (March 29, 2013)
[42] Frank Agostino et al. "Examination of Large Foreign Gifts and Inheritances: Code Sec. 6039F, Notice 97-34 and Form 3520," 20 Journal of Tax Practice & Procedure 5 (2018).

is an Enrolled Agent with the IRS, expressly told the taxpayer that the gift did not cause U.S. income tax liabilities or any other duties.

e. The mother made the gift via four separate transfers, from Poland to the United States, spanning 2010 (a total of $350,000) and 2011 (a total of $480,000). Thus, the taxpayer received over $100,000 in cash gifts from a foreign person each year.

f. In early 2011, during preparation of the taxpayer's Form 1040 for 2010, he again asked the tax advisor if he needed to file anything with in connection with the gift from his mother. The tax advisor, as before, incorrectly told the taxpayer that nothing was due.

g. Nothing happened for a long time; the taxpayer did not receive additional gifts, and the IRS never audited him.

h. Things changed in 2018. The taxpayer wanted to engage in some re-gifting, sending a portion of the money that he received from his mother years ago to his godson in Poland.

i. The taxpayer thought that he, as a U.S. person, might have some tax-related duties when sending a gift abroad. Therefore, he did some searches about "foreign gifts" on the Internet.

j. This led him to various articles about duties of U.S. persons who receive, as oppose to give, money from foreign persons. Shocked by this information, the taxpayer contacted a local attorney with experience regarding international matters.

k. The attorney informed the taxpayer of his duty to file Forms 3520 in 2010 and 2011 to report the cash gifts from his mother. He also explained to the taxpayer that there might be a way for him to rectify matters with the IRS on a penalty-free basis, the DIIRSP.

l. The taxpayer, with the assistance of the attorney, filed Forms 3520 for 2010 and 2011 pursuant to the DIIRSP, along with statements explaining reasonable cause. This occurred in August 2018.

m. After nearly a year, the IRS sent the taxpayer two notices in May 2019, indicating that he owed total penalties of $207,500 for the late Forms 3520. That figure represented the highest possible amount, which was 25 percent of the gifts received.

n. In rejecting the DIIRSP application, the IRS notices concluded that ordinary business care and prudence requires taxpayers to make themselves aware of their duties and that ignorance of tax laws could not serve as a basis for reasonable cause.

o. The taxpayer disputed the IRS notices and penalties of $207,500 by filing a Protest Letter in June 2019. To strengthen his position, the taxpayer later filed a Supplemental Protest Letter, attaching a letter from the tax advisor in which he admits that the facts in the Complaint described above are accurate. The advisor, in other words, corroborated the taxpayer's reasonable-reliance defense.

p. Another year and a half passed. In December 2020, the Appeals Officer assigned to review the IRS penalties, Protest Letter and Supplemental Protest Letter issued a so-called Case Memo. He agreed to abate $166,000 of the total penalty of $207,500. That left a penalty of $41,500, or five percent of the total gifts that the taxpayer received from his mother.

q. The taxpayer paid the remaining $41,500. He then filed Claims for Refund with the IRS in March 2022, which the IRS swiftly denied. In doing so, the IRS took the position that the Claims for Refund did not establish reasonable cause and were "frivolous."

r. The taxpayer next filed his Complaint with the District Court, thereby initiating the Suit for Refund in September 2022.

E. Significance of Case

1. *Wrzesinki v. United States* might be of importance to the tax world.

2. First, the case will educate the public about the obscure duty to file Form 3520 upon receipt by U.S. persons of certain foreign gifts.

3. Second, the IRS will be forced to clarify its stance regarding what, exactly, constitutes reasonable cause in the context of complex international information returns.

4. Third, the IRS must explain the functioning, or perhaps malfunctioning, of the DIIRSP and its enticement to taxpayers of penalty-free resolution.

5. Fourth, the IRS will have to address whether its longstanding prohibition against "nuisance settlements" still exists.

6. For this and other reasons, taxpayers facing Form 3520 penalties, now and in the future, should be paying attention to this evolving case.

F. Government Concedes Case

1. The IRS quickly came under scrutiny for its handling of Form 3520 penalties in *Wrzesinski v. United States*, with commentators warning that an unfavorable decision for the IRS could open the proverbial can of worms.[43]

[43] Hale E. Sheppard, "Foreign Gifts, Forms 3520, Big Penalties, and Pending Case," 177 Tax Notes Federal 57 (Oct. 3, 2022).

2. The tax attorneys at the Department of Justice ("DOJ"), who are charged with handling refund litigation, swiftly arrived at the same conclusion. They agreed to fully concede the case in favor of the taxpayer before they even filed an Answer to the initial Complaint lodged by the taxpayer.[44]

3. In other words, the IRS fully surrendered before it submitted any pleadings with the District Court, engaged in any discovery procedures, filed any legal briefs, or otherwise attempted to defend the IRS's earlier position that the taxpayer should be stuck with penalties totaling $41,500 for 2010 and 2011.

4. Taxpayers were so close to finally getting some guidance, from a court, on critical issues about foreign gifts and the large penalties for not reporting them. Unfortunately, because the government elected to quickly concede a case of first impression, taxpayers now must await future opportunities.

XI. IRS Lacks Authority to Assess Form 5471 Penalties

A. Introduction

1. The IRS must cherish certain aspects of tax enforcement, such as its ability to *automatically* assess penalties and collect when taxpayers file international information-returns that are late, inaccurate and/or incomplete.

2. Why is automatic assessment a big deal? Well, it means that the IRS is *not* required to first issue an Examination Report proposing penalties, then give the taxpayer a chance to seek pre-assessment review by the Appeals Office, and later issue a Notice of Deficiency, thereby triggering the taxpayer's right to dispute matters in Tax Court, again on a pre-assessment basis.

3. Among the returns historically hit with automatic penalties are Forms 5471 (Information Return of U.S. Persons with Respect to Certain Foreign Corporations).

B. Form 5471 Requirements and Penalties

1. Various categories of U.S. persons who are officers, directors, and/or shareholders of certain foreign corporations must file a Form 5471.[45]

2. If a person fails to file a Form 5471, files a late Form 5471, or files a timely but "substantially incomplete" Form 5471, then the IRS may assert an initial penalty of $10,000 per violation.[46]

---

[44] *Wrzesinski v. United States*, District Court for the Eastern District of Pennsylvania, Status Report in Lieu of Answer, Case No. 2:22-cv-03568 (March 7, 2023); "Foreign Gift Penalties to be Refunded and Case Dismissed," 2022 Tax Notes Today 49-13 (March 7, 2023); Andrew Velarde, "DOJ Concedes in Polish Lotto Foreign Gift Penalty Case," 2023 Tax Notes Today 49-5 (March 14, 2023).
[45] Section 6038; Treas. Reg. § 1.6038-2; Section 6046; Treas. Reg. § 1.6046-1; Section 6679; Treas. Reg. § 301.6679-1; Instructions to Form 5471.
[46] Section 6038(b)(1); Treas. Reg. § 1.6038-2(k)(1)(i); Section 6046(f); Treas. Reg. § § 1.6046-1(k).

3. The IRS then imposes a so-called continuation penalty, at a rate of $10,000 per month, if the problem persists after notification by the IRS.[47] The continuation penalty is capped at $50,000.

4. The IRS will not levy penalties if there was "reasonable cause" for the violation. Additionally, the IRS will refrain from assessing penalties if the taxpayer filed a timely Form 5471 with certain omissions or inaccuracies, provided that it was "substantially complete."[48]

C. <u>New Case of First Impression</u>

1. Background and Procedure

a. The taxpayer in *Farhy v. Comissioner* owned two corporations in Belize during the relevant years.[49]

b. According to the Tax Court, the taxpayer participated in an "illegal scheme" to reduce his income taxes, signed an affidavit admitting it, and was granted immunity from criminal prosecution, presumably in exchange for cooperating with the U.S. government in its investigation of others.

c. The taxpayer did not file timely Forms 5471 to disclose the Belizean corporations.

d. The Tax Court noted that the taxpayer's inactions were "willful" and "not due to reasonable cause."

e. In 2018, the IRS assessed initial penalties of $10,000 per violation, followed by continuation penalties reaching the maximum of $50,000. The IRS then commenced collection actions, sending the taxpayer a pre-levy notice in early 2019.

f. The taxpayer reacted by filing a timely request for a CDP hearing with the Appeals Office. He challenged the proposed levies on grounds that the IRS lacked authority to assess Form 5471 penalties in the first place.

g. The Appeals Office apparently disliked the taxpayer's argument because it issued a Notice of Determination approving the IRS's proposed levy to collect penalties. The taxpayer disagreed, of course, and filed a Petition with the Tax Court.

2. Decision by the Court

[47] Section 6038(b)(2); Treas. Reg. § 1.6038-2(k)(1)(ii); Section 6046(f); Treas. Reg. § § 1.6046-1(k).
[48] Treas. Reg. § 1.6038-2(k)(3)(i) and (ii).
[49] *Farhy v. Commissioner*, 160 T.C. No. 6 (2023).

a. The Tax Court began by describing the genesis of Form 5471 penalties, Section 6038 and Section 6038A.

b. It concluded that "[t]here is no statutory provision, in the [Internal Revenue] Code or otherwise, specifically authorizing assessment of these penalties."[50]

c. Next, the Tax Court turned to Section 6201 and other provisions, which *generally* allow the IRS to assess certain items and take collection actions. It underscored that, while Section 6201 includes the term "assessable penalties," it fails to define it. This oversight creates "uncertainty about which penalties the IRS may assess and ultimately collect through administrative means."[51]

d. The Tax Court discussed various tax provisions to support the notion that Congress has explicitly authorized the IRS to assess many types of penalties, but *not* Form 5471 penalties.

e. The Tax Court then identified a catch-all provision, which states that "[w]henever a civil fine, penalty, or pecuniary forfeiture is prescribed for the violation of an Act of Congress *without specifying the mode of recovery or enforcement thereof*, it may be recovered in a civil action."[52]

f. It explained that Section 6038 creates a Form 5471 filing duty and penalty, but omits an enforcement mechanism. The Tax Court exhibited restraint in holding in favor of the taxpayer, deciding that the IRS could *not* carry out its proposed levy to collect penalties.

3. Questions Raised by Case

a. *Farhy v. Commissioner* solves one issue, which is whether the IRS, under current law, can assess and collect Form 5471 penalties.

b. However, the case elicits many more questions than answers, such as the following:

i. Will the IRS challenge the Tax Court decision in with the proper Court of Appeals?

ii. Will the IRS issue an Action-on-Decision essentially announcing that it plans to ignore *Farhy v. Commisioner* for the moment and continue assessing and collecting Form 5471 penalties?

[50] *Farhy v. Commissioner*, 106 T.C. No. 6 (2023), pg. 5.
[51] *Farhy v. Commissioner*, 106 T.C. No. 6 (2023), pg. 6.
[52] *Farhy v. Commissioner*, 106 T.C. No. 6 (2023), pg. 7 (citing 28 U.S.C. § 2461(a) (emphasis added)).

iii. Will the IRS cease assessing Form 5471 penalties?

iv. Will the IRS begin referring Form 5471 penalty matters to the Department of Justice, such that it can pursue actions against taxpayers in District Court?

v. Will large numbers of taxpayers who previously paid Form 5471 penalties, or who currently face such penalties, take administrative or judicial actions to recover or avoid them?

vi. Will the IRS concede such refund or abatement actions once filed?

vii. To avoid the drain on resources resulting such actions, will the IRS pro-actively grant penalty refunds or abatements?

viii. Will the IRS urge Congress to amend the Internal Revenue Code to ensure that *all* international information return penalties are subject to deficiency procedures, thereby allowing taxpayers to challenge penalties *before* the IRS assesses them, during audits, conferences with the Appeals Office, or Tax Court litigation?

Hale E. Sheppard (B.S., M.A., J.D., LL.M., LL.M.T.) is a Shareholder in the Tax Controversy Section of Chamberlain Hrdlicka. He specializes in tax audits, tax appeals, and tax litigation. You can reach Hale by phone at (404) 658-5441 or by e-mail at *hale.sheppard@chamberlainlaw.com*

30786445.v1

Using Tax Incentives to Increase Your Advisory Services

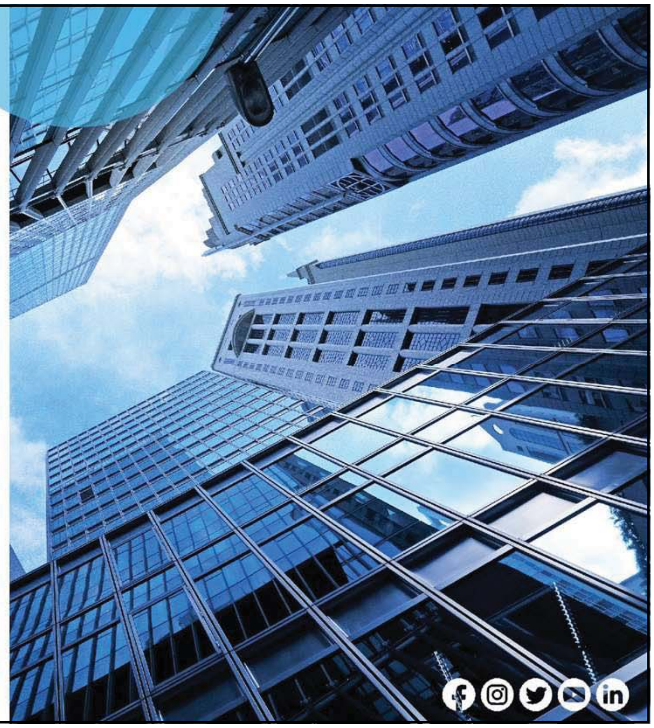
By Randy Crabtree

TRI▲MERIT
SPECIALTY TAX PROFESSIONALS

Using Tax Incentives to Increase your Advisory Services

Presented by: Randy Crabtree

847.616.0432 INFO@TRI-MERIT.COM



1

Presenter – Randy Crabtree

- Co-founder and partner of Tri-Merit Specialty Tax Professionals.
- Host of The Unique CPA podcast, which is in the top 5% of all podcasts.
- Author for articles in Accounting Today, AICPA Tax, CPA Trendlines, Intuit.
- Frequent speaker on webinars, at conferences, and at accounting firms.
- A member of the Intuit Tax Council.
- Accounting Cornerstone Foundation board member

2

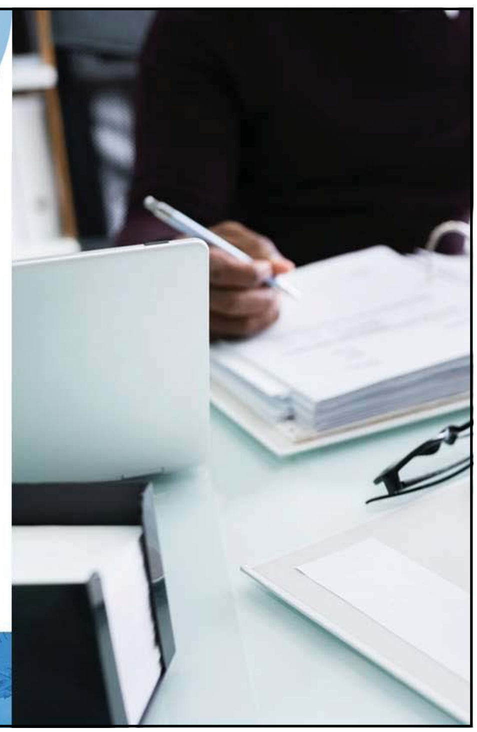
About Tri-Merit

- Tri-Merit supports Tax Preparers by serving as an extension of their advisory team to lessen the tax burden and increase cash flow for their clients.
- We spend more time on qualifying, quantifying and documenting which allows us to spend less time on defending credits and incentives.
- We work with companies to uncover tax savings opportunities through:

3

About Tri-Merit

- R&D tax credit, Cost Segregation, WOTC – The Work Opportunity tax Credit, 179D – the energy efficient commercial building deduction and 45L – a credit for developers of energy efficient residential property and ERC.
- We are comprised of engineers, scientists, CPAs and attorneys.
- We have offices across the country and serve clients in every state.



4

Tax Advisory Services

- Why lead with tax advisory services?
  - Proactively serving your clients needs
    - 79% of clients are willing to pay more for tax advice
    - 35% of tax professionals are providing tax planning services
  - Being able to show the value of the advice you are providing
  - Getting paid a premium based on the value provided
    - Do not undervalue your knowledge and expertise
  - Balancing seasonality and workload compression
  - Creating a better work-life balance
  - Avoid Burnout

5

Tax Advisory Services

- Examples of tax advisory services?
  - Effective and tax-efficient strategies for optimal tax management
  - Advising on specific entity types
  - Maximizing retirement savings
  - Representation in audits
  - Transfer pricing planning and compliance advice
  - Effective and tax-efficient planning for investments
  - Identity structure to maximize tax savings
    - Qualified Business Income Deduction QBI
    - Qualified Small Business Stock (QSBS)
  - Mergers and acquisition tax consulting
  - Maximizing SALT benefits
  - Identifying tax credits and incentives

6

R&D Tax Credit

7

R&D TAX CREDIT

- R&D tax credit planning opportunities:
  - Who can qualify:
    - Manufactures, Software Developers, Architects, Engineers, any taxpayer meeting the 4-part test.
  - Innovation occurring in response to COVID-19.
    - Pivoting to manufacturing new products, retail stores creating online stores, etc.

8

R&D TAX CREDIT

- How to qualify
  - 4-part test to qualify
    - Permitted purpose
    - Technological in nature
    - Technical uncertainty
    - Process of experimentation
  - Overriding factor of economic risk

9

R&D TAX CREDIT

- Expenses that qualify
  - Salaries and wages
  - Outside services
  - Supply costs (potential increase due to 174 pilot/prototype rules)
  - Rental or lease cost of computers

10

R&D TAX CREDIT

- R&D Tax Credit Benefit
  - Benefit is about 6-10% of the qualified expenses.
  - Can be claimed on any open tax return.
    - NOL years could be brought forward to the current year
  - Companies with $50M or less in average gross receipts for the last 3 years that can claim the credit against AMT.

11

R&D TAX CREDIT

- R&D Tax Credit Benefit for Start-up Companies
  - Companies can make an election to claim the credit against payroll taxes if they have:
    - Less than $5M in gross receipts in the current year.
    - No gross receipts further back than the last 5 tax years.
    - IRA increases this from a max of $250K to now $500K
    - IRA allows the credit to now also offset Medicare as well as Social Security tax.

12

R&D TAX CREDIT

- IRS FAQs on Research Credit Claims (January 3rd, 2022)
  - Defined the information required when submitting a refund claim:
    - All the business components related to the credit claim
    - For each business component:
      - Identify all research activities performed
      - Name the individuals who performed each research activity
      - Note the information each individual sought to discover
    - The total qualified employee wage expenses, total qualified supply expenses, and total qualified contract research expenses for the claim year

13

Required Capitalization of §174 Expenses

14

Who is Affected

- Common industries with §174 expenses:
  - Manufacturing
  - Software development
  - Architecture
  - Engineering
  - Need to look at any company that is using technology to develop or improve processes or products

TRI-MERIT SPECIALTY TAX PROFESSIONALS

15

What is a §174 Expense?

- A "research and experimentation" expenditure is broadly defined as "all costs incident to the development or improvement of a product, process, technique, pilot model, formula, invention, patent, or similar property".

- R&E expenditures generally include all costs incidental to the development or improvement. Examples include costs of obtaining a patent, attorney fees, wages, utilities, overhead, materials, rent, depreciation, and software development costs, regardless of whether they are for the taxpayer's own use or held for sale to others.

TRI-MERIT SPECIALTY TAX PROFESSIONALS

16

What's New?

- The Tax Cuts and Jobs Act of 2017 (TJCA) amended §174 to require capitalization of all research and experimentation (R&E) costs incurred in tax years beginning **after** December 31, 2021.
- Domestic R&E expenditures must be amortized over a 60-month period and international R&E expenditures must be amortized over a 180-month period.
- Depending on the scoring method used, this amendment was intended to generate between $15 and $150 billion in additional revenue over a 10-year period.

TRI-MERIT
SPECIALTY TAX PROFESSIONALS

17

What's the Problem?

- This was never intended to go into effect, with Washington insiders, industry lobbyists, and legislators themselves being of the understanding that this would be reversed prior to the implementation date.

- Taxpayers never had to separately identify §174 expenditures since they were fully deductible. Without a fix, many companies will be left scrambling to calculate and document §174 expenses for their 2022 tax year, with many presumably needing to make considerable tax payments based on increased income resulting from lack of first year deductions.

TRI-MERIT
SPECIALTY TAX PROFESSIONALS

18

Change in Accounting Method

- The IRS issued Rev Proc 2023-8 which clarified that, so long as the current year is the first year that these expenses are amortized, then a simple statement can be included with the return in lieu of a 3115 or 481(a).

TRI-MERIT SPECIALTY TAX PROFESSIONALS

19

Interplay with the R&D Credit

- The R&D credit will offset some of the additional tax but not all of it.
- The R&D Credit (§41) is different from the calculation of §174 R&E expenses, with §174 expenses having broader inclusion.
- The R&D Credit still uses all expenses incurred during the year rather than just the amortization amount.

TRI-MERIT SPECIALTY TAX PROFESSIONALS

20

§174 vs §41

Expense	174	41
Wages	Yes	Yes
Non-Taxable Benefits	Yes	No
Outsourced Expenses	Yes @ 100%	Yes @ 65%
Supply Costs	Yes	Yes
Depreciation	Yes	No
Overhead	Yes	No
G&A	Yes	No
Utilities	Yes	No
Indirect Expense Allocation	Yes	No
Rent	Yes	No
Securing a Patent Costs	Yes	No
Acquiring a Patent	No	No

21

How to Advise the Client

Section 41 R&D Expenses + NQ Software Dev and Other Expenses + Wage Burden and Added Contract Costs + Foreign Research Expenses + Indirect Expenses = Section 174 Expenses

22

EXAMPLE

(No increase in research expenses)

Example 1 – No increase in expenses

Example 1 - Flat R&D Expenses								
Tax Year	174 R&D expenditures	41 R&D Expenses	Ammortization expense	Net income old	Net income new	Increase in tax at 35%	280C Reduced R&D Tax Credit	Net Tax Increase
2022	$ 1,000,000	$ 800,000	$ 100,000	$ 1,500,000	$ 2,400,000	$ 315,000	$ 41,080	$ 273,920
2023	$ 1,000,000	$ 800,000	$ 300,000	$ 1,500,000	$ 2,200,000	$ 245,000	$ 41,080	$ 203,920
2024	$ 1,000,000	$ 800,000	$ 500,000	$ 1,500,000	$ 2,000,000	$ 175,000	$ 41,080	$ 133,920
2025	$ 1,000,000	$ 800,000	$ 700,000	$ 1,500,000	$ 1,800,000	$ 105,000	$ 41,080	$ 63,920
2026	$ 1,000,000	$ 800,000	$ 900,000	$ 1,500,000	$ 1,600,000	$ 35,000	$ 41,080	$ (6,080)
2027	$ 1,000,000	$ 800,000	$ 1,000,000	$ 1,500,000	$ 1,500,000	$ -	$ 41,080	$ (41,080)
Total Tax Increase						$ 875,000	$ 246,480	$ 628,520

23

179D Energy Efficient Commercial Building Tax Deduction

24

179D–Energy Efficient Commercial Building Deduction

- Two main users of the credit are:
  - Commercial building owners
  - Designers of government building and beginning in 2023 tax-exempt entities.
- Energy Policy Act of 2005
  - Created under the Energy Policy Act of 2005.
- Consolidated Appropriations Act, December 27th, 2020
  - The deduction was made permanent
- Inflation Reduction Act
  - Significant changes to the deduction

25

179D–Energy Efficient Commercial Building Deduction

- Types of improvements
  - Completed new construction
  - Interior remodel
  - Additions
  - Enlargements
  - Retrofits
  - Improvements

26

179D–Energy Efficient Commercial Building Deduction

- Current Program Benefits
  - Accelerated depreciation for energy efficient commercial buildings.
  - A 50% reduction in energy or more results in a $1.80/$1.88 ft2 deduction.
  - Partial deductions (this changes in 2023)
    - HVAC | requires a 15% reduction* in energy for 60¢/SF
    - Lighting | requires a 25% reduction* in energy for 60¢/SF
    - Building Envelope | requires a 10% reduction* in energy for 60¢/SF

27

179D–Energy Efficient Commercial Building Deduction

- Program Changes from the Inflation Reduction Act
  - Expands the Section 179D tax deduction for energy efficient commercial buildings to include tax-exempt entities.
  - Raises the maximum deduction value from $1.80/1.88 ft2 to $2.50-5.00 ft2 beginning 1/1/2023.
  - Reduces the threshold to qualify to 25% with credit increases as efficiency increases.
  - Eliminates the partial deduction and interim lighting rules
  - The deduction can now be taken on a specific commercial building every 3 years (previously, the deduction was permitted once over the life of the building).

28

179D–Energy Efficient Commercial Building Deduction

- Commercial Buildings
  - Offices
  - Retail
  - Manufacturing
  - Parking garages
  - Warehouses
  - Storage facilities
  - Hospitals
  - Hospitality
  - Apartment buildings (4 Stories or more)
- Government Buildings
  - Schools and universities
  - Police and fire stations
  - Library
  - Village offices
  - Park district buildings

29

179D–Energy Efficient Commercial Building Deduction

- Tax-Exempt
  - Charitable organizations
  - Churches and religious organizations
  - Private schools and universities
  - Private foundations
  - Political organizations
  - Other nonprofits
  - Native American tribal governments
  - Alaska Native Corporations

30

179D–Energy Efficient Commercial Building Deduction

- Current 179D Program Example:
  - 100,000 square foot building
  - HVAC all qualified @ $0.60 for $60,000 deduction.
  - Lighting all qualified @$0.60 for $60,000 deduction.
  - Envelope all qualified @$0.60 for $60,000 deduction.
  - Total deduction of $180,000 at 37% created a tax savings of $66,000
- For the building owner that is a time value of money benefit.
- For the designer of a government building, it is an additional deduction.
  - Schedule M adjustment

31

179D–Energy Efficient Commercial Building Deduction

- Starting 2023 179D Example:
  - 25% reduction and wage rules meet
    - 100,000 square foot building
    - Total deduction of $250,000 at 37% created a tax savings of $92,500 (100,000 x $2.50 x .37)
  - 50% reduction and wage rules meet
    - 100,000 square foot building
    - Total deduction of $500,000 at 37% created a tax savings of $185,000 (100,000 x $5.00 x .37)

32

179D–Energy Efficient Commercial Building Deduction

- 179D Example IRA -
  - 25% reduction and wage rules not meet
    - 100,000 square foot building
    - Total deduction of $50,000 at 37% created a tax savings of $18,500 (100,000 x $.50 x .37)
  - 50% reduction and wage rules not meet
    - 100,000 square foot building
    - Total deduction of $100,000 at 37% created a tax savings of $37,000 (100,000 x $1.00 x .37)

33

45L Credit For Developers of Energy Efficient Residential Properties

34

45L–Energy Efficient Credit for Residential Developers

- Developers of residential property
- Was defined in the Energy Policy Act of 2005
  - The CAA extended it through 2021
  - The Inflation Reduction Act further extended the program through 2032 and changed the program requirements.
- Allows developers/contractors of energy efficient properties to earn a tax credit for each qualifying unit.
  - General business credit, cannot offset AMT
- The credit must be claimed on the return for the year the property was leased or sold.

35

45L–Energy Efficient Credit for Residential Developers

- Current Program Requirements (through 2022)
  - Must be three stories or less above grade.
  - Developers can earn a $2,000 credit per unit.
  - Qualifying units must be substantially completed and be sold or have an initial lease in place.
  - The units must provide complete independent living facilities for one or more persons, that includes provisions for sleeping, eating, cooking and sanitation.

36

45L–Energy Efficient Credit for Residential Developers

- Current Program Requirements (cont.)
  - Properties must show an annual level of heating and cooling energy consumption at least 50% below the annual level of heating and cooling energy consumption of a "comparable dwelling unit"
    - Building envelope improvements must account for at least 1/5 of the 50% reduction.
  - Comparable dwelling unit is determined using 2006 IECC standards.
  - Manufactured Homes can meet a lesser energy consumption target and qualify for a $1,000 credit per unit.

37

45L–Energy Efficient Credit for Residential Developers

- Upcoming Changes from the IRA
  - Extends 45L program through 2032.
  - Qualification requirements change 1/1/2023
  - Credit now range from $2,500 to $5,000 per unit for Single-Family and Manufactured homes, and $500 to $5,000 per unit for Multifamily homes.
  - There is no longer a height limitation for multifamily properties
  - Sleeping units like dormitories, residence halls, support housing and cohousing can now be considered for 45L under the Multifamily program

38

45L–Energy Efficient Credit for Residential Developers

- Upcoming Changes from the IRA (cont.)
  - Properties must be certified through one of the following Energy Star Programs to be eligible for the $,2,500 credit.
    - ENERGY STAR Residential New Construction Program
    - ENERGY STAR Manufactured New Home Program
    - ENERGY STAR Multifamily New Construction Program
  - For the additional $2,500 credit properties must also meet the DoE Zero Energy Ready Home (ZERH) program requirements.
  - Credits for Multifamily properties will be reduced if prevailing wage requirements are not met ($500 vs $2,500)

39

45L–Energy Efficient Credit for Residential Developers

- Example – Developer of apartment buildings
  - In 2020 develops a 50 unit apartment building
    - 50 units qualified @ $2,000 = $100,000 credit
  - In 2023 the same 50 unit apartment building
    - Meets prevailing wage and ZERH requirements
    - 50 units qualified @ $5,000 = $250,000 credit

40

Cost Segregation

41

Cost Segregation

- Commercial or residential rental property owners.
- Breaking down depreciable real estate into individual components and identifying which components can be depreciated quicker.
  - Accelerating depreciation, deferring income taxes.
    - Taking assets otherwise depreciated at 27.5 or 39 years and reclassify them to 5, 7, or 15 years.
    - Certain assets can be bonus or 179 eligible.
  - New construction, purchases, remodels, additions, improvements

42

Cost Segregation

- Bonus Depreciation
  - Eligible property must have a 20-year useful life or less
  - Eligible property receives 100% bonus if acquired and placed in service after 9/27/17 and before 1/1/23
  - Bonus will phase down by 20% each year from 2023-2026
  - Used property now eligible

43

Cost Segregation

- Qualified Improvement Property (QIP)
  - Defined in the PATH act
  - Mistake on asset life in the TCJA
  - CARES Act fixes the mistake and now allows bonus on QIP.
  - Improvement to the interior of a nonresidential building.
    - Must be made after the building was placed in service.
    - Excludes enlargements, elevators, escalators, and internal structural framework of the building.
    - Improvements must be made by the entity claiming the deduction.

44

Cost Segregation

- Example – remodel of medical office.
  - Total costs were $2,464,000 originally classified as 39-year
  - After cost seg – 5/7-year $862,000, 15-year $148,000, 15-year QIP $1,208,000 and 39-year $246,000.
  - First year accelerated deprecation $2,224,300 compared to $63,000 without a cost seg study.

45

ERC Claims

46

The Employee Retention Credit

Qualifying Business

Any private-sector business or tax-exempt organization that carries on a trade or business and that meets EITHER of the following:

The business had a significant decline in gross receipts during any quarter. 50% in 2020 20% in 2021 Compared to 2019	The business was fully or partially suspended due to orders from the federal, state or local government limiting commerce, travel, or group meetings (for commercial, social, religious, or other purposes) due to COVID-19.

47

The Employee Retention Credit

- Partial Suspension
  - Limiting occupancy to provide for social distancing
    - Example restaurants
  - Requiring services to be performed only on an appointment basis (for businesses that previously offered walk-in service)
    - Would need to impact the ability to continue servicing the same number of customers.
  - Changing the format of service
    - Example going from indoor dining to carryout
  - Required reduction in hours of operations

48

Employee Retention Credit

	2020	2021
Credit Calculation	50% of up to $10,000 of **eligible** wages per employee per year. (3/13-12/31)	70% of up to $10,000 of **eligible** wages per employee per quarter (1/1/21-9/30/21)
Wages/Health Costs Capped	Annually	Quarterly
Maximum Credit Per Employee	$5,000	$21,000

49

The Employee Retention Credit

- Can supply chain issues qualify a business?
  - IRS FAQs and IRS Notice 2021-20
    - An employer may be considered to have a full or partial suspension of operations due to a governmental order if, under the facts and circumstances, the business's suppliers are unable to make deliveries of critical goods or materials due to a governmental order that causes the supplier to suspend its operations.

50

The Employee Retention Credit

- Can customer base issues qualify a business?
  - An employer that suspends some or all of its operations because its customers are subject to a government order requiring them to stay at home or otherwise causing a reduction in demand for its products or services is not considered to have a full or partial suspension of its operations due to a governmental order.

51

The Employee Retention Credit

- Do OSHA and CDC guidelines qualify as a government mandate?
  - OSHA's guidance for COVID-19 is not mandatory.
  - CDC's guidance for COVID-19 is not mandatory.
  - OSHA's memo to agents on enforcement creates no new obligations for businesses.
  - OSHA's General Duty Clause is a law predating the pandemic and therefore not an order due to COVID-19.
  - Even if this was able to create a mandate (which it cannot) you still need to meet the 10%, more than nominal, rule.
    - The above is from Dan Chodan's article published In "Think Outside the Tax Box"

52

The Employee Retention Credit

- Income tax affects
  - IRS notice 2021-49
    - To the extent that an employer files an adjusted or amended return to reflect these clarifications and consequently owes additional tax, any penalties for failure to timely pay or deposit tax will not apply if the taxpayer can show reasonable cause and not willful neglect for those failures.

53

Work Opportunity Tax Credit

54

Work Opportunity Tax Credit (WOTC)

- Typically, employers that have at least 50 new hires per year are the best candidates
  - Restaurants, Manufacturers, Nonprofit, etc.
- New hire credit
- Was set to expired at the end of 2020 but was extended until 2025 in the CAA
- Incentivizes the hiring of individuals from targeted demographic groups who faced barriers to gaining/sustaining employment or with special employment needs

55

Work Opportunity Tax Credit (WOTC)

- Credit is between $2,400 and $9,600 per eligible employee
- Employees need to work at least 120 hours to qualify
- Need to apply within 28 days of hire
- For profit businesses offset federal income tax
- Nonprofit can qualify for veteran categories and use the credit to offset employer portion of SS taxes

56

Work Opportunity Tax Credit (WOTC)

- Employee Target Groups
  - SNAP Recipients - $2,400
  - Long-term Unemployed - $2,400
  - Temporary Assistance for Needy Families (TANF) - $2,400
  - Long-term TANF - $9,000
  - Supplemental Security Income Recipients - $$2,400
  - Vocational Rehabilitation Recipients - $2,400
  - Ex-felons - $2,400
  - Designated Community Residents - $2,400
  - Summer Youth Program - $1,200

57

Work Opportunity Tax Credit (WOTC)

- Veteran Target Groups
  - Veterans receiving SNAP - $2,400
  - Service-related Disability - $4,800 - $9,600
  - Temporary Assistance for Needy Families (TANF) - $2,400
  - Long-term Unemployed - $5,600
  - Short-term Unemployed - $2,400

58


TRI-MERIT
SPECIALTY TAX PROFESSIONALS
THANK YOU
info@tri-merit.com
(888) 227-1553
www.Tri-Merit.com

59

Understanding LLC & Partnership Basis

By Clint Davis

Understanding LLC and Partnership Basis

Opening Pandora's Box?

Clint Davis
Krage & Janvey, L.L.P.
ccdavis@kjllp.com

1

Basis Introduction

Section 752 separates partnership liabilities into two categories: recourse liabilities and nonrecourse liabilities.

- **Section 1.752-1(a)(1) provides that a partnership liability is a recourse liability to the extent that any partner or related person bears the economic risk of loss (EROL) for that liability under §1.752-2.**
- **Section 1.752-1(a)(2) provides that a partnership liability is a nonrecourse liability to the extent that no partner or related person bears the EROL for that liability under §1.752-2.**

2

BUT, Schedule K-1 gives you three blocks

- Recourse ________________
- Nonrecourse _________________
- Qualified Nonrecourse _________________

- Qualified Nonrecourse is an at-risk term, not a basis term.
- So, the nonrecourse block is only for nonrecourse debt that does not qualify as qualified nonrecourse debt.

3

QUALIFIED NONRECOURSE FINANCING

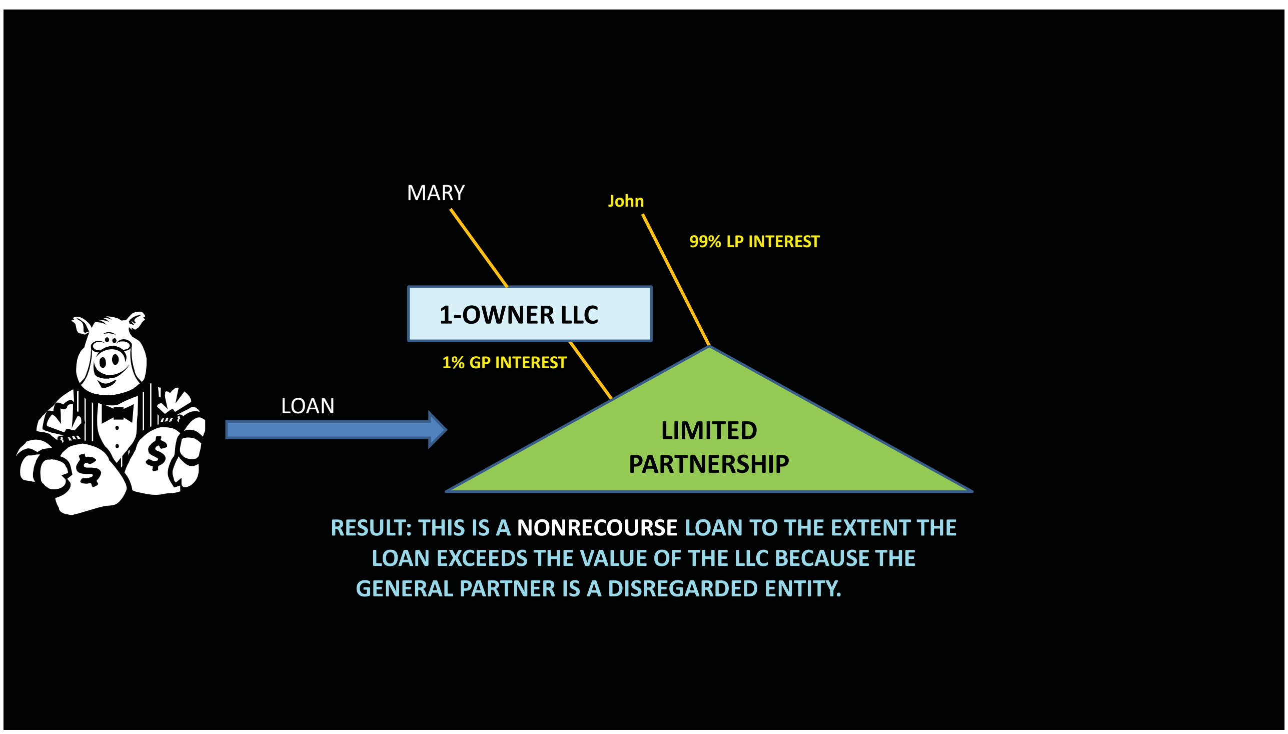
- NONRECOURSE
- NO CONVERSION
- HOLDING REAL PROPERTY
- GOVERNMENT OR QUALIFIED LENDER
  - NOT SELLER OR BROKER
  - IF RELATED, COMMERCIALLY REASONABLE

4

More Complexity: Special Rule for Single Member LLCs

But in determining the extent to which a partner who owns an interest through a disregarded entity bears the economic risk of loss for a partnership recourse liability, payment obligations of the disregarded entity (including a disregarded single member LLC) are taken into account under Sec. 752 only to the extent of the disregarded entity's net value as of the allocation date. (However, this rule does not apply to an obligation of a disregarded entity to the extent that its owner otherwise is required to make a qualifying payment with respect to the entity's obligation e.g., through a guarantee.)

5



6

John

99% LP INTEREST

S CORPORATION

1% GP INTEREST

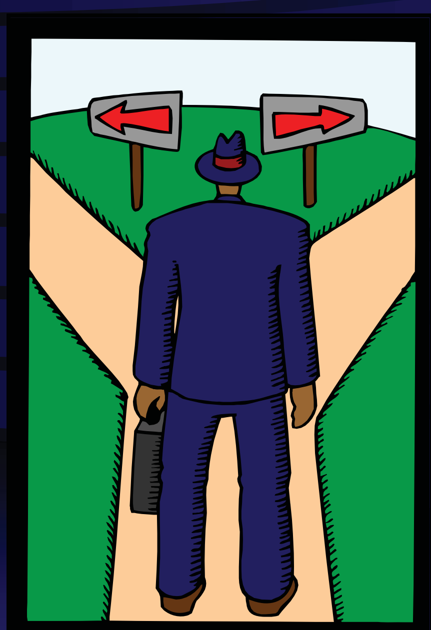
LOAN

LIMITED PARTNERSHIP

RESULT: THIS SHOULD BE A RECOURSE DEBT BECAUSE THE GENERAL PARTNER IS A REGARDED ENTITY AND THE GP IS LIABLE

More on this one later—Was once simple and is now very complex

7



THE LLC

- Agreements often require different allocation schemes for recourse v. nonrecourse deductions and may have various types of debt
- MUST identify
- Need to trace

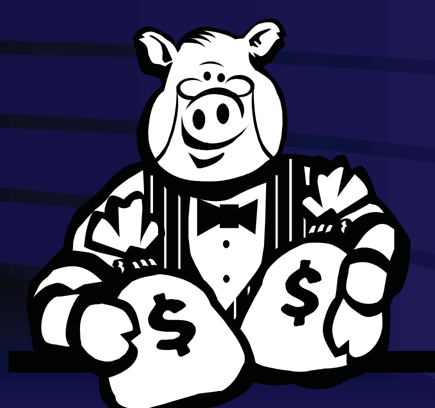
8

Different Types of Nonrecourse Debt

- •Security Limited to Specific Property
- •Recourse to the Entity but Nonrecourse to the Owners [Exculpatory Liabilities]
  - An LLC or LLP
  - A Limited Partnership where no GP is liable

9

KEY IS ALWAYS THE SAME



IDENTIFY THE COLLATERAL POOL:

WHAT CAN THE CREDITOR REACH?

10

Errors are often made with respect to nonrecourse and recourse deductions where there is exculpatory debt [nonrecourse under 752]

- In acting as a discussion leader for CE courses, I have found that approximately half of participants answer the following question incorrectly:
- On the following fact pattern how is the first-year loss allocated?

11

ASSETS		LIABILITIES AND CAPITAL	
CASH	$4,000,000	NONRECOURSE DEBT (EXCULPATORY LIABILITY TO BANK) (COMPANY LIABLE; NO MEMBER LIABLE; NO GUARANTEES)	$10,000,000
BUILDING	$10,000,000		
LAND	$1,000,000	CAPITAL:	
		A MEMBERS	$5,000,000
		B MEMBERS	-0-
TOTAL ASSETS	$15,000,000	TOTAL L&C	$15,000,000

Members have agreed to generally share profits and losses equally between classes.

First year loss is $250,000 solely attributed to depreciation on the building. Who gets the loss and why?

12

The first-year loss is a RECOURSE DEDUCTION and thus allocable solely to the Class A Members.

- Many participants were misled by the existence of a nonrecourse debt and were confused by the distinction between a nonrecourse debt and a nonrecourse deduction.
- It is common for an LLC to have nonrecourse debt and recourse deductions.
- Note that this is an "exculpatory liability" where the lender's recourse is to all Company assets and not merely to the building.
- Note that the answer in this example does not change if the lender's recourse is limited to real property as there is no minimum gain. Even after the deduction there would be $10,500,000 in basis against a debt of $10,000,000.

13

Partner Nonrecourse Debt Minimum Gain Chargeback

- **(ii) Notwithstanding any other provision of this Section ______ (other than Section __(i) which shall be applied first), if there is a net decrease in Partner Nonrecourse Debt Minimum Gain with respect to a Partner Nonrecourse Debt during any taxable year or other period for which allocations are made, any Partner with a share of such Partner Nonrecourse Debt Minimum Gain (determined under Treasury Regulations Section 1.704-2(i)(5)) as of the beginning of the year will be specially allocated items of Partnership income and gain for that period (and, if necessary, subsequent periods) in an amount equal to such Partner's share of the net decrease in the Partner Nonrecourse Debt Minimum Gain during such year determined in accordance with Treasury Regulations Section 1.704-2(g)(2). The items to be so allocated will be determined in accordance with Treasury Regulations Section 1.704-2(g). This Section ___(ii) is intended to comply with the partner nonrecourse debt minimum gain chargeback requirements of the Treasury Regulations, will be interpreted consistently with the Treasury Regulations and will be subject to all exceptions provided therein.**

14

MEMBER NONRECOURSE DEBT EXAMPLE

- JOHN AND MARY EACH CONTRIBUTE $1,000 AS CAPITAL TO JM, LLC. EACH RECEIVES 1,000 LLC SHARES.
- THE COMPANY AGREEMENT ALLOCATES GAINS AND LOSSES BY THE NUMBER OF SHARES.
- JOHN ALSO LOANS $100,000 TO THE LLC.
- THE FIRST PERIOD LOSS IS $50,000. HOW SHOULD IT BE ALLOCATED?

15

ANSWER

- **$2,000 OF LOSS IS A RECOURSE DEDUCTION AND IS ALLOCATED EVENLY TO JOHN AND MARY PER THE AGREEMENT.**
  - **NOTE: THE ALLOCATION HAS ECONOMIC EFFECT.**
- **THE REMAINING $48,000 IS A PARTNER NONRECOURSE DEDUCTION THAT MUST BE ALLOCATED SOLELY TO JOHN.**

16

PROOF

- Liquidate the LLC.
- The LLC has $52,000 in remaining assets and a $100,000 debt to John.
- Therefore, John is bearing the economic effect of $48,000 of loss.
- Even though allocation regulations say this is partner nonrecourse debt, for your reporting purposes, it's recourse debt on the K-1 to John.

17

De minimis Exception for Certain Partner Nonrecourse Debt

- Under a de minimis rule, a partner is not deemed to bear the economic risk of loss for a nonrecourse partnership loan from that partner (or that partner's affiliate) if the partner's interest in each and every item of income, gain, loss, deduction, or credit is 10% or less over the partnership's life, and if the loan constitutes qualified nonrecourse financing under the at-risk rules.

18

Recourse Liability

- A partnership liability is a "recourse liability" to the extent that one or more partners (or a related party) bears the ***economic risk of loss [EROL]***. IRC § 1.752-1(a)(1).

19

Related Persons Very Generally

- ***Constructive ownership of stock:*** Under Regs. Sec. 1.752-4(b)(1), a person is related to a partner if the person and the partner bear a relationship to each other that is specified in Sec. 267(b) or Sec. 707(b)(1), except for the following: "80 percent or more" is substituted for "more than 50 percent" each place it appears in those sections; a person's family is determined by excluding brothers and sisters; and Secs. 267(e)(1) and 267(f)(1)(A), containing related-person rules for passthrough entities and controlled groups, are disregarded.

20

Related Persons Very Generally

- The constructive-ownership-of-stock rules under Sec. 267(c)(1) provide that stock owned, directly or indirectly, by or for a partnership is considered as being owned proportionately by or for its partners.

When in doubt, go read the Regulations; they are extensive and contain exceptions.

21

Allocating Recourse Debt Basis

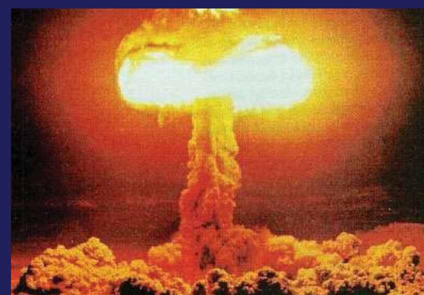
Congress instructed the Treasury Department to revise the regulations to address the problems caused by *"guaranties, assumptions, indemnity agreements and similar arrangements.“*

Did they do that?

22

General Background: Basis Regulations Allocating Recourse Liabilities

- Economic risk of loss.
- Constructive Liquidation.
- Who ends up paying the liabilities when all the assets are gone?
- A mechanical test that does not always follow reality?
- Subject to an anti-abuse rule.



"Atom Bomb Test"

23

Final Regulations:

Bottom dollar payment obligations do not represent real EROL

Because those payment obligations are structured to insulate the obligor from having to pay their obligations. Moreover, bottom dollar guarantees are not relevant to loan risk underwriting generally. These obligations generally lack a significant non-tax commercial business purpose. Therefore, bottom dollar payment obligations should not be recognized as payment obligations.

24

NOT necessarily bottom-dollar payment obligations:

a maximum amount is placed on the partner's or related person's payment obligation,

a partner's or related person's payment obligation is stated as a fixed percentage of every dollar of the partnership liability, or

there is a right of proportionate contribution running between partners or related persons who are co- obligors with respect to a payment obligation for which each of them is jointly and severally liable.

25

A bottom dollar payment obligation is recognized when a partner or related person is liable for at least 90 percent of the partner's or related person's initial payment obligation despite an indemnity, a reimbursement agreement, or a similar arrangement.

90% RULE

26

What are bottom-dollar payment obligations?

(1) with respect to a guarantee or similar arrangement, any payment obligation other than one in which the partner or related person is or would be liable up to the full amount of such partner's or related person's payment obligation if, and to the extent that, any amount of the partnership liability is not otherwise satisfied; AND

27

What are bottom-dollar payment obligations?

(2) with respect to an indemnity or similar arrangement, any payment obligation other than one in which the partner or related person is or would be liable up to the full amount of such partner's or related person's payment obligation, if, and to the extent that, any amount of the indemnitee's or benefited party's payment obligation is recognized; AND

28

What are bottom-dollar payment obligations?

(3) an arrangement with respect to a partnership liability that uses tiered partnerships, intermediaries, senior and subordinate liabilities, or similar arrangements to convert what would otherwise be a single liability into multiple liabilities if, based on the facts and circumstances, the liabilities were incurred pursuant to a common plan, as part of a single transaction or arrangement, or as part of a series of related transactions or arrangements, and with a principal purpose of avoiding having at least one of such liabilities or payment obligations with respect to such liabilities being treated as a bottom dollar payment obligation.

29

REGULATIONS Allocating Recourse Debt Basis: T.D. 9877 (10/09/2019)

- **Rules on bottom dollar payment obligations generally apply to liabilities incurred or assumed by a partnership, and payment obligations imposed or undertaken with respect to a partnership liability, on or after October 5, 2016, other than liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken pursuant to a written binding contract in effect prior to that date.**

30

NEW REGULATIONS
Allocating Recourse
Debt Basis: T.D. 9877
(10/09/2019)

- **All the other final regs apply to liabilities incurred or assumed by a partnership and to payment obligations imposed or undertaken with respect to a partnership liability on or after 10/9/19, other than liabilities incurred or assumed by a partnership and payment obligations imposed or undertaken pursuant to a written binding contract in effect prior to that date.**

31

Transition Relief

- **The final regs provide transition relief for any partner whose allocable share of partnership liabilities under Reg. § 1.752-2 exceed its adjusted basis in its partnership interest on October 5, 2016. Under this transitional relief, the partner can continue to apply the regs as they existed before the 752 temporary regs were issued with respect to a partnership liability for a seven-year period beginning October 5, 2016 to the extent that the partner's allocable share of partnership liabilities exceeds the partner's adjusted basis in its partnership interest on October 5, 2016.**

32

EXAMPLE 10

(10) Example 10. Guarantee of first and last dollars. (i) A, B, and C are equal members of a limited liability company, ABC, that is treated as a partnership for federal tax purposes. ABC borrows $1,000 from Bank. A guarantees payment of up to $300 of the ABC liability if any amount of the full $1,000 liability is not recovered by Bank. B guarantees payment of up to $200, but only if the Bank otherwise recovers less than $200. Both A and B waive their rights of contribution against each other.

33

EXAMPLE 10

(ii) Because A is obligated to pay up to $300 if, and to the extent that, any amount of the $1,000 partnership liability is not recovered by Bank, A's guarantee is not a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) of this section. Therefore, A's payment obligation is recognized under paragraph (b)(3) of this section. The amount of A's economic risk of loss under §1.752-2(b)(1) is $300.

34

EXAMPLE 10

(iii) Because B is obligated to pay up to $200 only if and to the extent that the Bank otherwise recovers less than $200 of the $1,000 partnership liability, B's guarantee is a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) of this section and, therefore, is not recognized under paragraph (b)(3)(ii)(A) of this section. Accordingly, B bears no economic risk of loss under §1.752-2(b)(1) for ABC's liability.

(iv) $300 of ABC's liability is allocated to A under §1.752-2(a), and the remaining $700 liability is allocated to A, B, and C under §1.752-3.

35

EXAMPLE 11

11) Example 11. Indemnification of guarantees. (i) The facts are the same as in paragraph (f)(10) of this section (Example 10), except that, in addition, C agrees to indemnify A up to $100 that A pays with respect to its guarantee and agrees to indemnify B fully with respect to its guarantee.

36

EXAMPLE 11

(ii) The determination of whether C's indemnity is recognized under paragraph (b)(3) of this section is made without regard to whether C's indemnity itself causes A's guarantee not to be recognized. Because A's obligation would be recognized but for the effect of C's indemnity and C is obligated to pay A up to the full amount of C's indemnity if A pays any amount on its guarantee of ABC's liability, C's indemnity of A's guarantee is not a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) of this section and, therefore, is recognized under paragraph (b)(3) of this section. The amount of C's economic risk of loss under §1.752-2(b)(1) for its indemnity of A's guarantee is $100.

37

EXAMPLE 11

(iii) Because C's indemnity is recognized under paragraph (b)(3) of this section, A is treated as liable for $200 only to the extent any amount beyond $100 of the partnership liability is not satisfied. Thus, A is not liable if, and to the extent, any amount of the partnership liability is not otherwise satisfied, and the exception in paragraph (b)(3)(ii)(B) of this section does not apply. As a result, A's guarantee is a bottom dollar payment obligation under paragraph (b)(3)(ii)(C) of this section and is not recognized under paragraph (b)(3)(ii)(A) of this section. Therefore, A bears no economic risk of loss under §1.752-2(b)(1) for ABC's liability.

38

EXAMPLE 11

(iv) Because B's obligation is not recognized under paragraph (b)(3)(ii) of this section independent of C's indemnity of B's guarantee, C's indemnity is not recognized under paragraph (b)(3)(iii) of this section. Therefore, C bears no economic risk of loss under §1.752-2(b)(1) for its indemnity of B's guarantee.

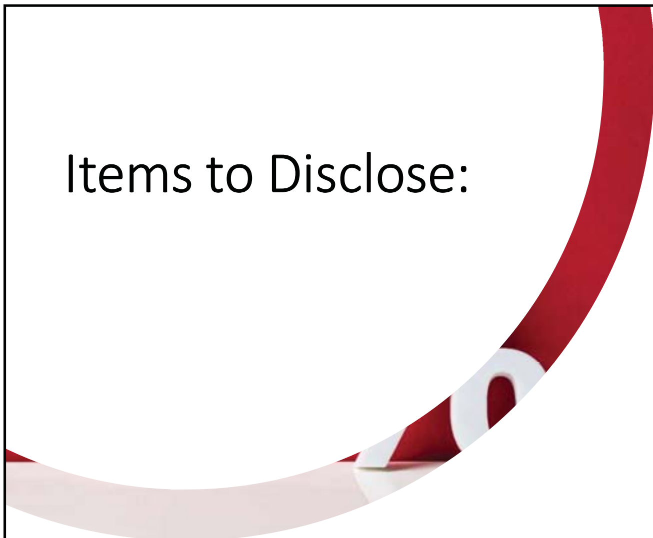
(v) In sum, $100 of ABC's liability is allocated to C under §1.752-2(a) and the remaining $900 liability is allocated to A, B, and C under §1.752-3.

39

Disclosure Required:

Taxpayers must affirmatively disclose bottom dollar payment obligations by filing Form 8275, Disclosure Statement, or any successor form, with the return of the partnership for the taxable year in which a bottom dollar payment obligation is undertaken or modified. The final regulations clarify that identifying the payment obligation with respect to which disclosure is made includes stating whether the obligation is a guarantee, a reimbursement, an indemnity, or deficit restoration obligation.

40



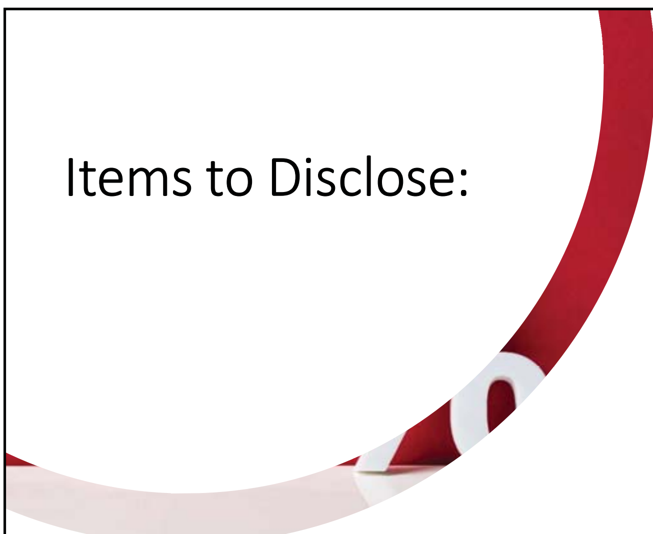
Items to Disclose:

(1) Identify the statement as a disclosure of a bottom dollar payment obligation under section 752.

(2) Identification of the payment obligation with respect to which disclosure is made (including whether the obligation is a guarantee, a reimbursement, an indemnity, or an obligation to restore a deficit balance in a partner's capital account).

(3) The amount of the payment obligation.

41



Items to Disclose:

(4) The parties to the payment obligation.

(5) A statement of whether the payment obligation is treated as recognized for purposes of Regulation Section 1.752-2 (b)(3).

(6) If the payment obligation is recognized under Regulation Section 1.752-2 (b)(3)(ii)(B), the facts and circumstances that clearly establish that a partner or related person is liable for up to 90 percent of the partner's or related person's initial payment obligation and, but for an indemnity, a reimbursement agreement, or a similar arrangement, the partner's or related person's initial payment obligation would have been recognized under this paragraph (b)(3).

42

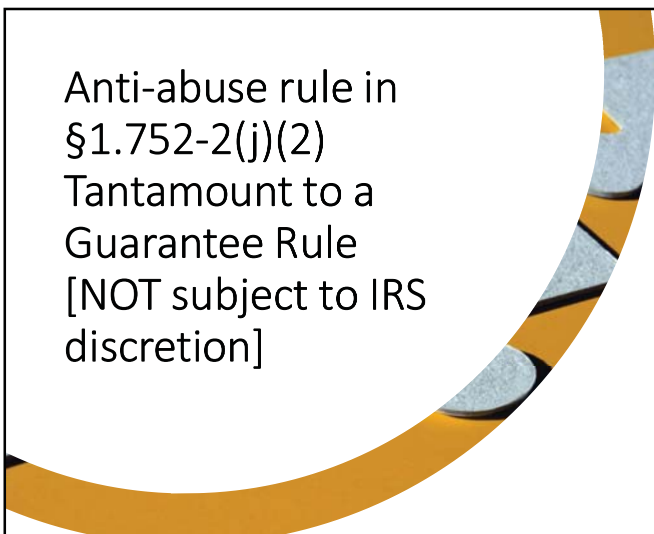
Anti-abuse rule in §1.752-2(j)(2) Tantamount to a Guarantee Rule [NOT subject to IRS discretion]

Arrangements tantamount to a guarantee--(i) In general. Irrespective of the form of a contractual obligation, a partner is considered to bear the economic risk of loss with respect to a partnership liability, or a portion thereof, to the extent that—

(A) The partner or related person undertakes one or more contractual obligations so that the partnership may obtain or retain a loan;

(B) The contractual obligations of the partner or related person significantly reduce the risk to the lender that the partnership will not satisfy its obligations under the loan, or a portion thereof; and

43



Anti-abuse rule in §1.752-2(j)(2) Tantamount to a Guarantee Rule [NOT subject to IRS discretion]

(C) With respect to the contractual obligations described in paragraphs (j)(2)(i)(A) and (B) of this section—

(1) one of the principal purposes of using the contractual obligations is to attempt to permit partners (other than those who are directly or indirectly liable for the obligation) to include a portion of the loan in the basis of their partnership interests; or

(2) another partner, or a person related to another partner, enters into a payment obligation and a principal purpose of the arrangement is to cause the payment obligation described in paragraphs (j)(2)(i)(A) and (B) of this section to be disregarded under paragraph (b)(3) of this section.

44

Anti-abuse rule in §1.752-2(j)(2) Tantamount to a Guarantee Rule [NOT subject to IRS discretion]

(ii) Economic risk of loss. For purposes of this paragraph (j)(2), partners are considered to bear the economic risk of loss for a liability in accordance with their relative economic burdens for the liability pursuant to the contractual obligations.

- **For example, a lease between a partner and a partnership that is not on commercially reasonable terms may be tantamount to a guarantee by the partner of the partnership liability.**

45

EXAMPLE

- **A partnership is formed by A and B for the purposes of buying and leasing computer equipment. A invested in this partnership, in part, to obtain the tax benefits arising from partnership losses The partnership borrows money on a nonrecourse basis to acquire a computer that is subject to an existing 2-year lease. In order to induce the lender to make the loan, B agrees to lease the computer under a "hell or high water" lease agreement that requires B to maintain the computer and continue making lease payments even if the computer is damaged or destroyed. The rental payments under the master lease are sufficient to fully amortize all amounts due under the loan and the master lease is pledged to the lender.**

46

EXAMPLE

- A will have sufficient basis in its partnership interest to take full advantage of its share of partnership losses only if the loan is treated as a nonrecourse liability (which would be shared among the partners according to their partnership profits interests). Under the anti-abuse rule, however, the master lease may be treated as tantamount to a guarantee, with the result that the partnership liability will be treated as a recourse liability allocable only to B, the partner who, because of the master lease, may be treated as having the economic risk of loss for the entire liability.

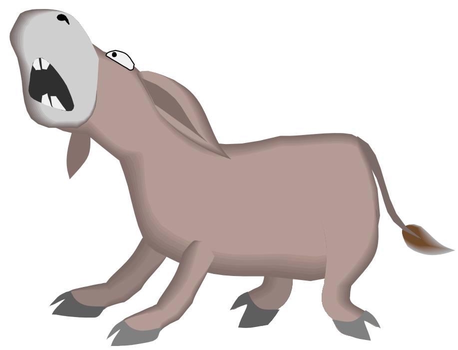
47

Regulations are clear—a guarantee by a limited partner does not create basis if the GP is liable on the debt

- What is the deemed satisfaction rule?
- What are the subrogation rights of a guarantor who pays the debt?

48

- **Under Regulations, you generally ASS-U-ME payment of obligations without regard to ability to actually pay—subject to an anti-abuse rule.**



49

EXAMPLE 3. GUARANTEE BY LIMITED PARTNER; PARTNER DEEMED TO SATISFY OBLIGATION.

E and F form a limited partnership. E, the general partner, contributes $2,000 and F, the limited partner, contributes $8,000 in cash to the partnership. The partnership agreement allocates losses 20% to E and 80% to F until F's capital account is reduced to zero, after which all losses are allocated to E. The partnership purchases depreciable property for $25,000 using its $10,000 cash and a $15,000 recourse loan from a bank. F guarantees payment of the $15,000 loan to the extent the loan remains unpaid after the bank has exhausted its remedies against the partnership. In a constructive liquidation, the $15,000 liability becomes due and payable. All of the partnership's assets, including the depreciable property, are deemed to be worthless. The depreciable property is deemed sold for a value of zero. Capital accounts are adjusted to reflect the loss on the hypothetical disposition.

50

E, as a general partner, would be obligated by operation of law to make a net contribution to the partnership of $15,000. Because E is assumed to satisfy that obligation, it is also assumed that F would not have to satisfy F's guarantee. The $15,000 mortgage is treated as a recourse liability because one or more partners bear the economic risk of loss. E's share of the liability is $15,000, and F's share is zero. ***This would be so even if E's net worth at the time of the determination is less than $15,000, <u>unless the facts and circumstances indicate a plan to circumvent or avoid E's obligation to contribute to the partnership</u>.***

51

New Regulations Regarding Anti-Abuse T.D. 9877 (10/09/2019)

An obligation of a partner or related person to make a payment is not recognized if the facts and circumstances evidence a plan to circumvent or avoid the obligation.

So what looks like a recourse debt could become a nonrecourse debt OR vice versa.

52

52

Factors indicating plan to circumvent or avoid an obligation

The presence or absence of a factor is based on all of the facts and circumstances at the time the partner or related person makes the payment obligation or if the obligation is modified, at the time of the modification.

The weight to be given to any particular factor depends on the particular case and the presence or absence of a factor is not necessarily indicative of whether a payment obligation is or is not recognized.

53

53

Seven factors indicating plan to circumvent or avoid an obligation

The partner or related person is not subject to commercially reasonable contractual restrictions that protect the likelihood of payment, including, for example, restrictions on transfers for inadequate consideration or distributions by the partner or related person to equity owners in the partner or related person.

The partner or related person is not required to provide (either at the time the payment obligation is made or periodically) commercially reasonable documentation regarding the partner's or related person's financial condition to the benefited party.

54

54

Seven factors indicating plan to circumvent or avoid an obligation

(C) The term of the payment obligation ends prior to the term of the partnership liability, or the partner or related person has a right to terminate its payment obligation, if the purpose of limiting the duration of the payment obligation is to terminate such payment obligation prior to the occurrence of an event or events that increase the risk of economic loss to the guarantor or benefited party (for example, termination prior to the due date of a balloon payment or a right to terminate that can be exercised because the value of loan collateral decreases). This factor typically will not be present if the termination of the obligation occurs by reason of an event or events that decrease the risk of economic loss to the guarantor or benefited party (for example, the payment obligation terminates upon the completion of a building construction project, upon the leasing of a building, or when certain income and asset coverage ratios are satisfied for a specified number of quarters).

55

55

Seven factors indicating plan to circumvent or avoid an obligation

(D) There exists a plan or arrangement in which the primary obligor or any other obligor (or a person related to the obligor) with respect to the partnership liability directly or indirectly holds money or other liquid assets in an amount that exceeds the reasonable foreseeable needs of such obligor.

(E) The payment obligation does not permit the creditor to promptly pursue payment following a payment default on the partnership liability, or other arrangements with respect to the partnership liability or payment obligation otherwise indicate a plan to delay collection.

56

56

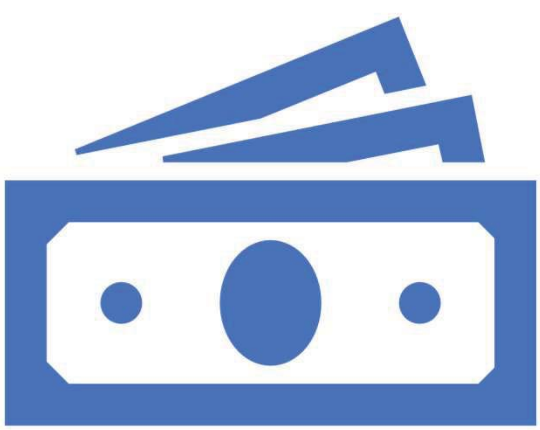
Seven factors indicating plan to circumvent or avoid an obligation

(F) In the case of a guarantee or similar arrangement, the terms of the partnership liability would be substantially the same had the partner or related person not agreed to provide the guarantee.

(G) The creditor or other party benefiting from the obligation did not receive executed documents with respect to the payment obligation from the partner or related person before, or within a commercially reasonable period of time after, the creation of the obligation.

57

57



Plan to circumvent or avoid an obligation

- **Whether a debtor will have the ability to make payments when due, not necessarily to whether the debtor has sufficient assets to satisfy an obligation currently. Includes disregarded entities.**

58

Example

In 2020, A, B, and C form a domestic limited liability company (LLC) that is classified as a partnership for federal tax purposes. Also in 2020, LLC receives a loan from a bank. A, B, and C do not bear the economic risk of loss with respect to that partnership liability, and, as a result, the liability is treated as nonrecourse under §1.752- 1(a)(2) in 2020. In 2022, A guarantees the entire amount of the liability. **The bank did not request the guarantee and the terms of the loan did not change as a result of the guarantee. A did not provide any executed documents with respect to A's guarantee to the bank. The bank also did not require any restrictions on asset transfers by A and no such restrictions exist.**

A's 2022 guarantee (payment obligation) is not recognized if the facts and circumstances evidence a plan to circumvent or avoid the payment obligation.

59

In this case, the following factors indicate a plan to circumvent or avoid A's payment obligation:

- **the partner is not subject to commercially reasonable contractual restrictions that protect the likelihood of payment, such as restrictions on transfers for inadequate consideration or equity distributions;**
- **the partner is not required to provide (either at the time the payment obligation is made or periodically) commercially reasonable documentation regarding the partner's or related person's financial condition to the benefited party;**
- **in the case of a guarantee or similar arrangement, the terms of the liability are the same as they would have been without the guarantee; and**
- **the creditor did not receive executed documents with respect to the payment obligation from the partner or related person at the time the obligation was created.**

Absent the existence of other facts or circumstances that would weigh in favor of respecting A's guarantee, evidence of a plan to circumvent or avoid the obligation exists and, A's guarantee is not recognized. As a result, LLC's liability continues to be treated as nonrecourse.

DID THE TAX PREPARER LOOK INTO THE FACTS BEHIND THE GUARANTEE IN REPORTING?

60

Doesn't this create (or at least continue) confusion?

FOR EXAMPLE:

- **S corp GP with minimal capitalization.**
- **LP guarantees the debt.**
- **Existing regs say that the basis goes to the GP on an unrelated party loan to the limited partnership unless there is a plan to circumvent or avoid.**
- **Anti-abuse seems to be for IRS benefit ONLY!**
- **But can't the IRS assert the deemed plan to circumvent or avoid language any time it is to the Service's advantage?**

61

So is the IRS able to play heads we win and tails you lose?

62

Deficit Restoration Obligations (DROs)

- 2019 final regulations differentiate DROs under the section 704(b) capital account rules from payment obligations, such as guarantees and indemnities. As a result of their differences, the regulations refine the list of factors in determining whether DROs will be respected for purposes of section 704(b) allocations and allocations of liabilities under section 752.

63

NEW FINAL REGULATIONS
Deficit Restoration Obligations

Under §1.704-1(b)(2)(ii)(c)(2) of the existing regulations, a partner's DRO is not respected if the facts and circumstances indicate a plan to circumvent or avoid the partner's DRO.

New final regulations add a list of factors specific to DROs, to indicate when a plan to circumvent or avoid an obligation exists.

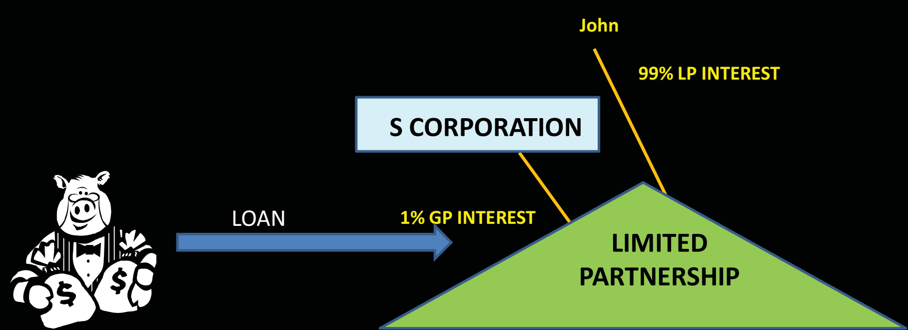
64

Factors indicating a plan to circumvent or avoid:to circumvent or avoid a DRO:

- **The partner is not subject to commercially reasonable provisions for enforcement and collection of the obligation;**
- **The partner is not required to provide (either at the time the obligation is made or periodically) commercially reasonable documentation regarding the partner's financial condition to the partnership;** ***{Must you now ask for this?}***
- **The obligation ends or could, by its terms, be terminated before the liquidation of the partner's interest in the partnership or when the partner's capital account as provided in §1.704-1(b)(2)(iv) is negative; and**
- **The terms of the obligation are not provided to all the partners in the partnership in a timely manner.** ***{Presumably, a copy of the partnership/company agreement will suffice.}***

65

So, can the IRS now say this is a plan to circumvent or avoid?



Recall that the GP was getting the basis because of its deficit restoration obligation in the agreement or under state law.

66

Some thoughts from BDO:

- **The allocation of liabilities by many partnerships may be altered to the extent that they run afoul of new anti-abuse provisions.**
- **Partners whose share of partnership liabilities are reduced may recognize gain on deemed distributions as a result.**
- **Taxpayers relying on allocations of recourse partnership liabilities to claim losses and support negative tax basis capital balances should consider whether changes to guarantees and similar arrangements are necessary to avoid gain recognition.**

67

Some thoughts from BDO:

- **In addition, partners relying on deficit restoration obligations to support negative capital accounts may be allocated income to reduce or eliminate the negative balances if their restoration obligations are no longer respected.**
- **In particular, partners who have implemented limited or terminable DRO's should consider whether changes to their DRO obligations are necessary to avoid chargebacks of income.**

68

Remember:

The Last Thing in Pandora's Box Was

HOPE

69

Dealing With Erroneous Refunds – Errors Happen

By Bryan Camp

Erroneous Refunds

Presentation for 2023 Tax Alliance Conference

by
Bryan Camp
Professor of Law
Texas Tech University
School of Law

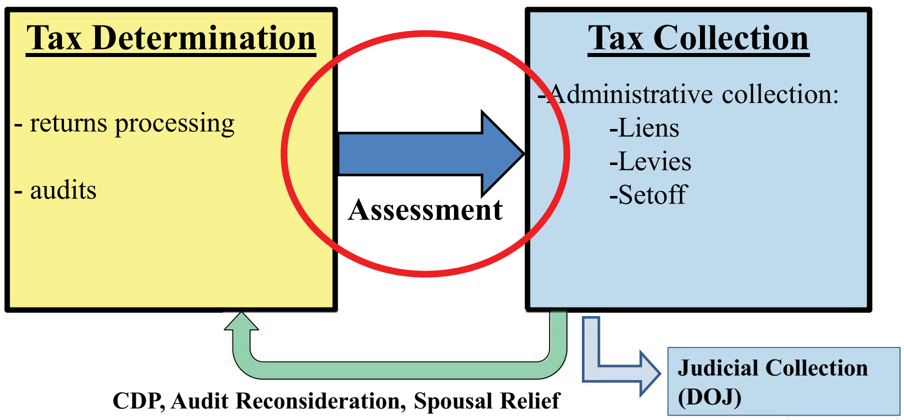
1

Objectives

- ►Learning Terms:
  - **Assessments,**
  - **Abatements,**
  - **Overpayments,**
  - **Refunds**
- ►Rebate v. Non-Rebate Refunds
- ►Dealing with Erroneous Refunds

2

The Two Functional Boxes



3

Assessments

1. Assessments v. Liabilities
   Liabilities arise at end of tax period.
   Assessments just record liabilities. §6203.
2. Illustrations
   - *Ewing*, 914 F2d 499 (4^{th} Cir. 1991)
   - *Espinosa*, 24 Fed.Appx. 825 (9^{th} Cir. 2001)
3. Functions of Assessments
   - *Reflect* liability determination.
   - Predicate for *administrative* collection.
     -Sets amt to be collected by NFTLs/Levies.

4

Assessments

4. The Legal Act of Assessment

☛appropriate signature on summary record of assessments. Treas. Reg. 310.6203-1.

☛Electronic summary ok. RACS Report 006. Rev. Rul. 2007-21 (collecting cases)

☛supporting documents; not in the summary.

5. Transactions Codes Are **NOT** Assessments

Just as assessments are not liabilities, TCs are not assessments! They *reflect* the act of assessment. E.g. TC 150 (returns); 300 (exam)

5

Abatements

1. IRS Abates Assessments not Liabilities. §6404

*"(a) General rule. The Secretary is authorized **to abate** the unpaid portion of **the assessment** of any tax or any liability in respect thereof, which—*

(1) is excessive in amount, ...

***

*(c) Small tax balances. The Secretary is authorized **to abate** the unpaid portion of **the assessment** of any tax...if...the administration and collection costs involved would not warrant collection of the amount due."*

6

Abatements

2. Transaction Codes **ARE** Abatements

☛ Abatements are made by using an offsetting TC to the TC reflecting an assessment. *see* IRM 5.1.15. ADP Handbook (IRS Document 6209)

E.g. TC 291 can offset a prior TC 150; TC 301 can offset a prior TC 300.

7

Abatements

3. Effect of Abatement TCs on *Liabilities*

None! Abatements *never* eliminate *liabilities*. E.g. *U.S. v. Buckner*, 264 B.R. 908 (2001).

8

Abatements

4. Effect of Abatement TCs on Assessments

☛**Substantive** abatement under 6404(a) nukes assessment. *Crompton-Richmond Co. v. U.S.*, 311 F. Supp. 1184 (SDNY 1970).

☛**Non-substantive** abatement does **NOT** undo *act* of assessment. *In re Becker*, 407 F.3d 89 (2005) (erroneous abatements creating zero balance due didn't eliminate prior timely assessments and could be reversed after ASED). *In Re Buggee*, 99 F.3rd 740 (5th Cir. 1996)(same).

9

Overpayments

1. The Common Law Meaning.
Excess of *payments* over *liabilities*. *Jones v. Liberty Glass Co.*, 332 U.S. 524, 531 (1947).

2. The Statutory Meaning. §6401
Any payment received after CSED or for unassessed liability received after ASED. *E.g. Cohen v. U.S.*, 23 Cl. Ct. 717 (1991)(Payment made in response to untimely assessment was statutory overpayment).

10

Overpayments

3. Overpayments Are Not Refunds!

IRS has discretion. §6402(a). *Pettibone Corp. v. U.S.*, 34 F.3d 536, 538 (7th Cir.1994)(*"Until the Commissioner exercises this discretion, the taxpayer has no right to payment."*)

11

Refunds!

1. Rebate Refunds
Refund based on **substantive** determination or re-determination of liability. §6211(b)(2). E.g. one based on taxpayer claim on Form 1040 or 1040X. Or one based on a §6404(a) abatement.

2. Non-Rebate Refunds
A refund based on non-substantive reason, such as clerical error. *O'Bryant v. U.S.*, 49 F.3d 340 (7th Cir.1995)(IRS erroneously double-posted a claimed tax credit).

12

Dealing W/ Rebate Refunds

1. Administrative Collection
IRS can use administrative collection tools if it re-assesses liability within applicable ASED. Re-assessment gives TP full Tax Court rights. *In Re Becker, supra*.

2. Judicial Collection
IRS (via DOJ) can file suit in federal district court under §7405. SOL is 2 years or 5 years. §6532(b).

13

Dealing W/ Non-Rebate Refunds

1. Administrative Collection
Depends! Extinguishment theory: once paid, a tax is gone and an erroneous refund does not revive it. *Bilzarian v. U.S.*, 86 F.3d 1067 (11th Cir. 1996). IRS reduced to beg letters. But error unrelated to actual payment does not extinguish liability; IRS can still collect administratively.

2. Judicial Collection
IRS (via DOJ) can file suit in federal district court under §7405. SOL is 2 years or 5 years. §6532(b).

14

How To Tell?

IRS categorizes erroneous refunds and permissible recovery options in IRM 21.4.5.5 ("Erroneous Refund Categories and Procedures").

Category A-C are rebate refunds

Category D are non-rebate refunds

15

Examples

1. Alex: Reports liability of $4k on return, reports payments of $5k, requests refund of overpayment.

This is rebate refund. If later audit shows it to be erroneous---for example, the IRS erroneously allowed a duplicative Child Tax Credit for Alex and Alex's ex-spouse---IRS can follow deficiency procedures to assess correct amount and collect administratively. Standard stuff.

16

Examples

<u>2. Jody:</u> Reports liability of $4k. Reports $3k in withholding, includes a check for $1k. Check gets recorded twice, resulting in $1k refund.

This is non-rebate refund. Reversal of TCs cannot correct error. Liability was fully paid, so cannot administratively revive it. TP owes IRS $1k for money had and received, not $1k in taxes. IRS can collect this $1k only by beg letter or suit. ...ain't gonna be no suit for $1k.

17

Examples

<u>3. Pat</u>: Reports liability of $4k on return. Reports $3k in withholding but includes *no* payment for remaining $1k. One year later a different TP's $5k payment is posted to Pat's account generating a $4k refund.

This is a non-rebate refund. BUT now extinguishment theory not apply because Pat did not fully pay the liability. Not clear how IRS will deal with it. See IRM 21.4.5.5.

18

Dealing w/ Erroneous Refunds

1. If refund came by check, don't cash it!
  - avoids it being income
  - avoids IRS adding interest
  - avoids possible criminal prosecution under 18 U.S. Code § 641

2. Return, if possible, in 3 weeks.
  - IRS website gives instructions...but
  - maybe better to call PPS?

19

taxanalysts camp's compendium

The Mysteries of Erroneous Refunds

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 thanks Danshera Cords, Kristin Hickman, Phillip N. Jones, Leandra Lederman, and the usual anonymous suspects for their brave attempts to keep him from looking stupid. He takes full responsibility for any resulting failures.

Prof. Camp dedicates this column to his former boss, Lawrence H. Schattner, one of the finest attorneys in the IRS Office of Chief Counsel, and a reviewer who consistently added value to all drafts presented to him. (Note: Per 5 U.S.C. 2635.204(a), this dedication's fair market value is less — much less — than $20.)

I love my yearly tax refund. I know I'm not supposed to, but I do. Theorists argue that my refund represents an interest-free loan to the government and I am supposed to resent that for reasons grounded in the obsessive individualism of our culture. But even accepting the argument's premise, the value to me of that yearly manifestation of my forced savings outweighs the value of the interest I would theoretically earn in my checking account. I don't worry; I be happy.

I am not alone. In fiscal 2005 the IRS made lots of folks happy, refunding about $227.6 billion to individual taxpayers.[1] By almost any measure, the IRS does a great job of getting the right refund to the right taxpayer in a timely fashion. But errors happen. Worse, given the huge amounts involved, even small error rates add up. For example, even if the IRS had an error rate of just 1 percent, that would mean it issued more than $2.2 billion in erroneous refunds in 2005. That represents a lot of bridges to nowhere.

No one knows the actual error rate. That's part of the critique in a recent report from the Treasury Inspector General for Tax Administration: The IRS could do better in tracking and preventing erroneous refunds.[2] While TIGTA's suggestions might decrease the slippage in the gears of IRS campus operations, the report gives scant attention to how the IRS can recover erroneous refunds once they are issued. After all, once we accept that erroneous refunds inevitably happen, it makes sense to consider how to recover them. But TIGTA's sole recommendation on how to improve collection of erroneous refunds, which I discuss below, is simply laughable in light of how courts have interpreted the relevant statutes in the past 10 years.

Usually, the amount of erroneous refunds escapes attention. Recently, however, *USA Today* reported in horror that the IRS let slip some $200 million erroneous refunds from the failure of one computer program during 2005.[3] Worse, IRS Commissioner Mark Everson acknowledged that there is "little chance IRS will collect the bulk of the erroneously issued checks."[4] While the amount issued in error represents less than 0.1 percent of all refunds, it was enough for then-Senate Finance Committee Chair Chuck Grassley, R-Iowa, to grumble that "it is not just that they're getting off scot-free — it's that the honest taxpayers become the suckers."

Honest taxpayers are suckers because current law renders the IRS impotent to collect erroneous refunds. As a result, tens of thousands of taxpayers receive the government's unintended largesse and wallow in their windfalls. That is bad tax administration that no amount of TIGTA oversight can fix. It did not used to be that way. The IRS used to be able to collect most of the erroneous

[1] 2005 Data Book, Table 1.

[2] TIGTA Report 2006-40-137, "Improvements Are Needed to Better Identify and Prevent Erroneous Refunds." TIGTA notes that while the IRS campuses are supposed to create quarterly reports about erroneous refunds, the reports are not consistently produced by all campuses nor retained nor reviewed at a national level. "No effort has been made to use these reports to track the increase or decrease in the numbers and types of errors being made that cause erroneous refunds." *Id.* at 5. Note that for the 2007 filing season, the IRS plans to offer split refunds for the first time, allowing taxpayers to split their refund among up to three direct deposit accounts. *See* Dustin Stamper, "Taxpayer Assistance Blueprint Will Be 'Mind-Shaking,' DuMars Says," *Tax Notes*, Nov. 13, 2006, p. 612, *Doc 2006-22837, 2006 TNT 217-4*. That added complexity potentially increases the error rate.

[3] *See* "How the IRS Failed to Stop $200M in Bogus Refunds," *USA Today*, Dec. 4, 2006, *available at* http://www.usatoday.com/money/perfi/taxes/2006-12-04-irs-bogus-refunds_x.htm (last visited Dec. 6, 2006).

[4] *Id.*

refunds efficiently. Now it must all too often write them off. This article tells the sad story of how the IRS lost its mojo and what must be done to get it back.

At one level, erroneous refunds are low-hanging fruits. In light of all the huffing and puffing about the tax gap — that mythical beast smokily mirrored more by assumptions than hard data — it is amazing that no one has suggested an admittedly modest, yet simple and solid, reform that would enable a quick and easy recovery of the occasional unavoidable erroneous refund. At another level, as the following details will demonstrate, this is an intricate and arcane area, a part of the tax administration forest that few visit without mishap.

> ***Honest taxpayers are suckers because current law renders the IRS impotent to collect erroneous refunds. Thousands of taxpayers receive the government's unintended largesse and wallow in their windfalls.***

Part I explains how erroneous refunds occur and how they relate to the law of tax administration. Part II reviews the legal doctrines governing their recovery and demonstrates how, as result of a contentious legal battle in the 1990s, current law leaves the IRS basically shooting blanks in trying to recover taxpayer windfalls. The TIGTA report focuses on *ex ante* solutions precisely because the IRS ability to collect them efficiently *ex post* is so compromised. Part III explains why the TIGTA collection recommendation makes little sense and, as is my habit, offers a simple legislative provision to help the IRS get its groove back. What is needed is a little statutory power pill to allow the IRS to interact firmly with taxpayers who try to keep money they should not have.

I. What Are Erroneous Refunds, Anyway?

Erroneous refunds come in two flavors: rebate and nonrebate. How they arise involves the interplay of several tax administration powers: the powers to assess, abate, and refund overpayments. I'll discuss each in turn and explain the difference between rebate and nonrebate erroneous refunds. That difference has important consequences for the recovery of the erroneous refund.

A. Assessments

Section 6201 gives the IRS the power to assess all taxes owed. Section 6203 says that an assessment is made by ''recording the liability of the taxpayer'' on the IRS books of account. Three points about assessments are important for understanding rebate and nonrebate erroneous refunds: the distinction between the dual functions of an assessment; the distinction between an administrative bookkeeping act and a legal assessment; and the distinction between the summary and the deficiency assessment procedures.

1. Liability versus collection. Tax administration boils down to two main functions: determination of liability and collection. Assessment plays a role in both. It has a dual function, pointing backwards to the determination function and forwards to the collection function. As to the first, assessment is more than just a simple bookkeeping entry. It is the result of an administrative process that represents the IRS's institutional judgment of what taxes are owed.[5] That the IRS usually accepts the liability shown on the taxpayer's return as the basis for the assessment does not in any way diminish the fact that it is the IRS's decision. That is why, as I have repeatedly emphasized, it is erroneous to say that taxpayers ''self-assess.'' It is also why one must always be alert to distinguish between *assessment* of the tax and *liability* for the tax.[6]

Assessment also plays an important role in the second function of tax administration: It is the culmination of the administrative liability determination process, and it also triggers the start of the collection process. That collection-propelling function is seen in two ways: A proper assessment enables the IRS to invoke its administrative collection powers of lien and levy, and a proper assessment triggers the separate 10-year period of limitations in which the IRS can collect the tax liability.[7]

2. Legal versus administrative. Legally, the act of assessment culminates in the ''recording'' authorized by section 6203. Reg. section 301.6203-1 expands on the statute by providing that ''the assessment shall be made by an assessment officer signing the summary record of assessment. The summary record, through supporting records, shall provide identification of the taxpayer, the character of the liability assessed, the taxable period, if applicable, and the amount of the assessment.'' Since the early 1960s, the IRS has kept its books electronically in a master file database.[8]

---

[5]*Rambo v. United States*, 492 F.2d 1060, 1061 n.1 (6th Cir. 1974) (''Assessment is an administrative determination that a certain amount is currently due and owing as a tax. It makes the taxpayer a debtor in much the same way as would a judgment''); *Cohen v. Mayer*, 199 F. Supp. 331, 332 (D. N.J. 1961), *affirmed sub nom., Cohen v. Gross*, 316 F.2d 521 (3d Cir. 1963) (''assessment is a prescribed procedure for officially recording the fact and the amount of a taxpayer's administratively determined tax liability, with consequences somewhat similar to the reduction of a claim of judgment''); *Simon v. United States*, 261 F. Supp.2d 567, 573, *Doc 2003-20449, 2003 TNT 181-21* (M.D. La. 2003) (assessment ''is the culmination of a process whereby liability is determined''); *Pipola v. Chicco*, 169 F. Supp. 229, 231 (S.D.N.Y. 1959) (''The assessment is an administrative determination that one is indebted to the Government for taxes — in effect, it is a judgment for taxes found due'').

[6]Taxpayers are *liable* for taxes independent of the assessment. *See Ewing v. United States*, 914 F.2d 499, 502-503 (4th Cir. 1990), *cert. denied*, 111 S. Ct. 1683 (1991) (rejecting taxpayer's argument that, before assessment, there can be no tax liability and therefore no ''payment'' of taxes). That is why section 6501(a) allows the IRS to either assess *or* bring proceedings in court without assessment within three years after the return is filed. Think ''form'' for assessments and ''substance'' for liabilities.

[7]*Hibbs v. Winn*, 542 U.S. 88, 102, *Doc 2004-12400, 2004 TNT 115-11* (2004).

[8]Discussion of the woeful deficiencies of the master file database is beyond the scope of this article. I was once a small part of a large task force to develop a replacement, called the customer account data engine (CADE). CADE is a relational database that can be accessed and updated in real time and will

(Footnote continued on next page.)

A legal assessment is thus made on a ''summary record of assessment'' signed by an authorized IRS employee. Typically, all liabilities to be assessed over a given time period (usually one or two weeks) are aggregated onto a Form 23-C, ''Summary of Assessments,'' which is printed and signed once a week.[9] Each Form 23-C completes a cycle that begins with the receipt of the return or other supporting list or record identifying a particular tax liability and the creation of an account in the computerized IRS master file system. Each account, called a tax module, tracks a specific tax liability for a specific taxpayer for a specific tax period.[10] As its name suggests, a Form 23-C represents the sum of *all* assessments made during the cycle; it does not reflect any particular taxpayer account. That really frustrates taxpayers who request ''the'' record of assessment only to receive a simple one-page form that has a very large number on it and says nothing about *their* liabilities.

The supporting records required by the regulations come from computer entries in the tax module. When requested, the IRS will transpose the relevant data in the tax module onto a Form 4340, ''Certificate of Assessments and Payments.'' That is what links a given tax module to a given summary record. A Form 4340 creates a rebuttable presumption of a proper assessment, but really it is just a translation of the computer account and, as such, may be flawed.[11]

hopefully eliminate many of the problems with the creaky master file system. *See* Dustin Stamper, ''Support Growing for IRS E-Filing Portal, Everson Says,'' *Tax Notes*, Nov. 6, 2006, p. 608, *Doc 2006-22589*, or *2006 TNT 214-1* (''The IRS is tentatively planning to process 30 million returns in CADE in 2007''). My particular task force worked on developing definitions for various data elements in the database. CADE has great potential to significantly improve tax administration.

[9]The newer RACS Report-006 also serves as the summary record of assessment and, as I understand it, is signed electronically.

[10]There are two master file systems, one for individual taxpayers and one for business taxpayers. The IRS also keeps a separate system of non-master-file accounts whenever it needs to account for situations not covered by the software written for the master file. Changes to the master file software can take years to implement, and the barrage of tax code changes made by Congress means that the master file system is almost always out of date in some respect. The term ''tax module'' is imprecise, and while it is most commonly used the way I describe it in the text, it has other meanings as well. *See* my discussion in ''Failure of Collection Due Process, Pt. 1: The Collection Context,'' *Tax Notes*, Aug. 30, 2004, p. 969, n.12, *Doc 2004-16770*, *2004 TNT 169-32*.

[11]For an example of an erroneous Form 4340, see *Freije v. Commissioner*, 125 T.C. 14, *Doc 2005-15064, 2005 TNT 135-11* (2005) at note 5. The presumption of correctness is, however, very strong. The ''*Pursifull* saga'' contains a most illuminating discussion. *Compare Pursifull v. United States*, 92-2 U.S.T.C. para. 50,346 (S.D. Ohio 1992) (IRS motion for summary judgment denied and taxpayer entitled to further discovery on showing genuine dispute of the validity of the Form 4340 presented), *with Pursifull v. United States*, 1993 U.S. Dist. LEXIS 11738 (S.D. Ohio 1993) (taxpayer convinces magistrate judge to reject IRS renewed summary judgment motion after discovery), *and with Pursifull v. United States*, 849 F. Supp. 597, *Doc 93-9370, 93 TNT 184-12* (S.D. Ohio 1993) (district judge reverses magistrate's recommendation and grants IRS summary judgment on strength of Form 4340).

(Footnote continued in next column.)

Administratively, the IRS uses a three-digit computer transaction code (TC) to record each event in a tax module on the master file.[12] Importantly, no transaction recorded in the IRS computers is ever erased. Instead, the IRS enters an offsetting TC. A TC itself is not the assessment. For example, tax modules are generally opened with a debit TC 150, most often resulting from the liability reported on a taxpayer's return. The amount associated with the TC 150 is what gets rolled up into the weekly Form 23-C, but it's not until the Form 23-C is signed that the legal ''assessment'' has occurred. The act of inputting the computer code is not the legal act of assessment. Similarly, if a payment is erroneously credited to the wrong account, the erroneous credit TC cannot be erased. Instead, an offsetting TC is entered to reverse the mistake by inserting a debit amount equal to the erroneous credit. The offsetting TC is not an assessment and the question whether the amount reflected in the offsetting TC has to be rolled up into any summary document is a legal question, one that goes to the heart of erroneous refunds.[13]

> ***The mere entry of computer transaction codes cannot erase an assessment in the sense that the administrative process by which the assessment was recorded is somehow undone.***

In sum, the legal assessment document, the weekly Form 23-C, does not reflect all the TCs in any individual tax module. Moreover, the amount reflected in the Form 23-C does not necessarily include all TCs that adjust accounts. The administrative accounting for the taxpayer's balance due for any particular tax module is not conterminous with the legal concept of assessment. The court in *Simon v. United States* got it right when it said:

> Thus the positivistic equation of assessment with entry of a debt on the books is misguided. A debt

[12]Transaction codes and their explanations are collected into a yearly bound publication, IRS Document 6209, *ADP Handbook*. The one I work from in this article is from 2003 and can be found at http://www.irs.gov/pub/irs-utl/document_6209-2003.pdf. Transaction codes are complex and difficult to decipher, even for most IRS employees. Each primary three-digit code can have secondary and tertiary codes associated with it. The *ADP Handbook* covers many other database coding systems as well and is useful for understanding transcripts.

[13]For example, TC 610 records a credit from a payment submitted along with the return and TC 612 records a debit equal to the amount of an erroneous TC 610 credit. The amount recorded by TC 612 is not reflected in a summary record of assessments.

entry is only the culmination of an assessment, which begins when the IRS determines that a taxpayer is liable.[14]

One important consequence of the distinction between the legal act of assessment and the administrative act of bookkeeping is that the latter can never undo the former. That is, the mere entry of computer transaction codes cannot erase an assessment in the sense that the administrative process by which the assessment was recorded is somehow undone. For example, in *United States v. Reid* the court held that the insertion of credits on a taxpayer's account to reduce the balance due to zero did not ''eliminate'' the assessments: ''Crediting the taxpayer's account — no matter what the amount of the credit — does not undo this act of recording described in section 6203.''[15]

3. Summary versus deficiency procedures. The IRS uses a variety of procedures to assess tax liabilities. The two most relevant to the subject of erroneous refunds are the summary procedure and the deficiency procedure.

The summary procedure is the general rule, authorized by section 6201. All other assessment procedures are either statutory or administrative exceptions to the summary assessment process. It is called the summary procedure because the IRS simply and summarily records the taxpayer's liability, payments, and credits, based on the information before it, and then notifies the taxpayer if there is a balance due. The most typical example is when the IRS makes an assessment based on the taxpayer's return, such as the Form 1040 for income taxes or the Form 941 for employment taxes. The form might also be generated by an IRS employee. Before 1924 the IRS also used the summary process to record the results of income tax audits. It still uses that procedure to record the results of excise tax audits.

The key to section 6211 is the phrase 'tax imposed.'

The main statutory exception to summary assessment applies to the assessment of income, estate, and gift tax deficiencies. Whenever the IRS seeks to assess a deficiency, it must follow the special procedures set out in section 6213. Those require the IRS to send the taxpayer a notice of deficiency to the taxpayer's last known address. The notice of deficiency opens a window of opportunity for the taxpayer to petition for Tax Court review. While that window is open, the IRS cannot assess, absent a determination of jeopardy. The window stays open for at least 90 days, and if the taxpayer timely petitions the Tax Court, it stays open until the Tax Court issues its decision and the decision has become final. Only when that window closes can the IRS assess the tax liability and start to collect any balance due.

Understanding when the IRS must use the special deficiency procedures turns on what constitutes a deficiency. Section 6211 defines a deficiency. Good luck understanding it! It has to be one of the most difficult and densest statutes in the tax code. For this column, however, the important point of section 6211 is how it reinforces the distinction between a tax liability and an assessment. Section 6211 is all about finding the true and correct tax liability.

The key to section 6211 is the phrase ''tax imposed.'' That phrase means the true tax liability — the one that arose at the end of the applicable tax period — and is distinct from what is reflected on the IRS books. To see if what the IRS seeks to assess is a deficiency, the statute instructs one to first find what has been previously recorded in the IRS books. That is, section 6211(a)(1) says to first add the tax reported by the taxpayer to any tax previously assessed for that tax period. Call that the recorded tax. From that amount, one subtracts any rebates as defined in subsection (b)(2). A rebate results from the IRS's substantive redetermination of tax, a discovery that the true tax was less than what was previously recorded on the books. Let's call what remains on the IRS books after a rebate the recorded tax as substantively adjusted.[16] If what the IRS claims to be the tax imposed is greater than the recorded tax as substantively adjusted, the IRS seeks to assess a deficiency and must follow the special procedures.[17]

---

[14]261 F. Supp.2d 567, 573, *Doc 2003-20449, 2003 TNT 181-21* (M.D. La. 2003).

[15]2000-1 U.S. Tax Cases (CCH) para. 50,340 (S.D. Ga. 2000). I will return to this point again when discussing how and why the IRS should be allowed to recover administratively erroneous refunds that result from bookkeeping errors.

[16]A rebate is any adjustment on the IRS books ''as was made on the ground that tax imposed . . . was less than the excess of the amount specified in subsection (a)(1) [that is, the recorded tax] over the rebates previously made.'' The iterative and self-referential nature of the definition makes it difficult to understand. The easiest way to approach it is to read the definition as if there were no prior rebates. Then one quickly sees that a rebate refers to some substantive redetermination of the proper tax owed. The ''rebate'' language was added in 1944 to deal with the new ''pay as you go'' system of tax collection. *See* S. Rep. No. 78-885, 78th Cong. 2d Sess., 1944 C.B. 858.

[17]For another good explanation, see Judge Niemeyer's excellent dissent in *Singleton v. United States*, 128 F.3d 833, *Doc 97-28978, 97 TNT 203-11* (4th Cir. 1997), gently pointing out the majority's complete failure to understand the concept. It is the iterative nature of the statute that makes it difficult to read. One sees that not only in the definition of rebate but also in the definition of deficiency, which is defined with reference to prior deficiencies. The self-referential structure of the statute makes it read like a chicken-and-egg puzzle. I think section 6211 could be successfully simplified by making more explicit the distinction between what the IRS now has determined to be the true and correct tax and what is recorded as reflecting the true tax. But taxwriters are loath to change administrative provisions. In 1952, as a young man of 25, Sheldon Cohen read through the entire IRC as part of a team making comprehensive revisions to the regulations. He noted in an e-mail to the author that, even today, most of the administrative provisions have not changed. He's right. In fact, a significant amount of language dating to the various revenue acts of the 1860s is still in the code — like statutory DNA — chopped up and recombined through the various codifications, but still there. For one example of that, see Bryan T. Camp, ''Tax Administration as Inquisitorial Process

(Footnote continued on next page.)

B. Abatements

Section 6404 gives the IRS the power to abate assessments. Just as assessments do not create tax liabilities, abatements do not extinguish tax liabilities. Abatements simply adjust the record on the IRS books. An abatement may or may not have anything to do with the taxpayer's tax liability. Moreover, just as not every upward adjustment to a tax module is an assessment, neither is every downward adjustment an abatement. I'll now expand on both points.

First, some abatements result from (and reflect) a substantive redetermination of tax and some do not. When the IRS discovers that the true tax liability (the tax imposed) is *less* than what is reflected in the assessment on the IRS books (the recorded tax as substantively adjusted), or when the assessment was made illegally, section 6404(a) authorizes abatement to properly reflect the liability or eliminate the illegal assessment. A common cause of a section 6404(a) abatement is an audit reconsideration after a section 6020(b) substitute for return.[18]

> ***Just as assessments do not create tax liabilities, abatements do not extinguish tax liabilities. Abatements simply adjust the record on the IRS books.***

If a section 6404(a) abatement later proves to have been erroneous on the merits, the IRS must follow the applicable assessment procedure to reassess the proper liability.[19] For income, gift, and estate taxes, that means the IRS must follow the deficiency procedures to reassess the tax and will be bound by the section 6501 limitations period.[20] That's a sensible result because in that situation, there is a potential disagreement over the true tax liability; requiring the IRS to follow the deficiency procedure here gives taxpayers not just prepayment but *preassessment* access to judicial review.

Other abatements do not result from (or reflect) a substantive redetermination of tax. For example, when the IRS decides that the assessed amount is not worth collecting because the costs of collection outweigh the amount to be recovered, section 6404(c) authorizes an abatement of the assessment. In contrast to section 6404(a) abatements, if the IRS later decides that an abatement made per section 6404(c) was erroneous (perhaps having found taxpayer assets that can be collected), it may reinstate the prior assessment without going through the deficiency procedures because no deficiency is at issue.[21] That is, there is no concern that the assessment may not properly reflect the true tax any more than when it was first made. So the taxpayer has no need for any preassessment judicial review.

A good example of the distinction between section 6404(a) and section 6404(c) abatements is *United States v. Buckner*, 264 B.R. 908, *Doc 2001-10251, 2001 TNT 69-13* (N.D. Ind. 2001). There, the IRS levied on the taxpayer's retirement plan. The taxpayer then filed bankruptcy and was personally discharged from liability for three years of income taxes. But the retirement account, not being part of the bankruptcy estate, remained liable *in rem*.[22] After receiving the discharge order, the IRS abated the assessments for those years but did not remove the levy from the retirement accounts. The taxpayer asked the bankruptcy court to order the IRS to release the levy, arguing that the abatement extinguished the assessment and the IRS could not revive it without creating a new assessment for the discharged years, which the bankruptcy discharge injunction forbade. The court refused to issue the order and instead held that the IRS could accept the levy proceeds and reverse the abatement without having to make a new assessment because the abatement did not result from a substantive redetermination of the taxpayer's liability. ''Stated simply, a § 6404(c) abatement reflects a determination by the I.R.S. of a taxpayer's

---

and the Partial Paradigm Shift in the IRS Restructuring and Reform Act of 1998,'' 56 *Fla. L. Rev.* 1, 36-77 (2004) (reviewing history of the summons powers). The historical reluctance to revise the administrative provisions means that the administrative provisions of the code no longer reflect a unified vision of tax administration. They are a jumble and in serious need of an overhaul.

[18]Similarly, section 6404(d) authorizes abatement when the IRS determines that interest assessed on a tax liability resulted from an unreasonable error or delay on the part of an IRS employee. That is again a redetermination of the liability decision represented by the assessment.

[19]*Carlin v. United States*, 100 F. Supp. 454, 455 (Ct. Cl. 1951) (referring to a time when the abatement power in section 6404(a) was lodged with the commissioner only and the abatement power in section 6404(c) was lodged with the collectors only, the court noted, ''If the Commissioner abates the assessment, it ceases to exist or to have any effect thereafter. The Commissioner cannot subsequently rescind his actions or restore the assessment, but must rather make a new assessment unless, of course, the statute of limitations has previously expired'') (citations omitted).

[20]*Id*. The running of the assessment limitations period, however, does not require the IRS to return money it has properly collected within the limitation period if the true and correct tax is more than the amount collected, even if the assessment is incorrect. *See Lewis v. Reynolds*, 284 U.S. 281 (1932) (expiration of assessment limitations period without assessment being recorded does not bar the IRS from retaining payments already received if they do not exceed the amount that could have been — but was not — properly assessed within the limitations period).

[21]*See, e.g., Crompton-Richmond v. United States*, 311 F. Supp. 1184, 1186 (S.D. N.Y. 1970) (''An assessment abated under (a)(1) is thereby canceled and cannot be resurrected if the IRS later decides that its decision was incorrect. On the other hand, the IRS can revive an assessment abated under (c), because the abatement of an uncollectible tax . . . in effect . . . excuses its collector's obligation (in this case the Brooklyn District Director) to account for the tax liability, but does not excuse the taxpayer's liability'').

[22]*See Johnson v. Home State Bank*, 501 U.S. 78, 84 (1991) (''A bankruptcy discharge distinguishes only one mode of enforcing a claim — namely, an action against the debtor in personam''); *see also In re Conston,* 181 B.R. 769, 773 (D. Del. 1995) (collecting cases).

collectability, and since the I.R.S. may account for collectable assets by simply entering a debit to reverse a prior credit, no formal reassessment procedure must be followed.''[23]

As to the second point, not every downward adjustment to a tax module is an abatement within the meaning of section 6404. For example, because erroneous increases cannot be erased, they must be offset by downward adjustments. It is not always clear, however, which administrative actions constitute a legal abatement and which do not. Unlike the careful description in the code of what constitutes an assessment, neither section 6404 nor its regulations provide guidance as to what it takes to effect a legal abatement. In practice, IRS employees may use different forms to make section 6404(a) abatements.[24] Further, one of the forms used to make a section 6404(a) abatement is also used to make a section 6404(c) abatement for taxes discharged in bankruptcy.[25]

It's not always clear which administrative actions constitute a legal abatement and which do not.

In deciding which accounting adjustments represent legal abatements (and, if so, what kind of an abatement), courts have traditionally looked at the substance of the transaction over the IRS form used to initiate it or the label of the transaction code used to enter it. The most important substantive issue is whether the administrative action represents, as does a proper assessment, the culmination of a proper administrative process, or whether it is just the result of a glitch in the system, a miscommunication, or a processing error. If the latter is the case, courts hold that no abatement has occurred and the IRS will not be bound by the administrative action of its employees, unless equity demands.[26] And, as anyone experienced in government litigation can tell you, getting equity against the government is a very demanding task.[27]

An excellent example of the focus on substance over form is *In re Bugge*.[28] There, in the course of preparing a taxpayer's account for collection, a revenue officer thought he discovered that the computer account was double-counting one of the taxpayer's liabilities. He therefore filled out the proper form and sent it to the service center, requesting that it abate the liability, '''since this is a duplicate assessment that [has] already been done using the correct [master file tax] and tax period.'''[29] The Fifth Circuit analyzed the situation as follows:

> The collections manager in this case never intended or approved an abatement of Bugge's entire tax liability. * * * In requesting the abatement, the collections officer intended, and received approval from his manager for, a reduction of Bugge's tax liability from two assessments of $327,379.82 each . . . to a single assessment of $327,379.82. This request was in accord with the IRS's discretionary authority under section 6404(a)(1) to abate an assessment that is ''excessive in amount.'' * * * However, when the regional service center processed the request and inadvertently eliminated Bugge's entire tax liability, it failed to act within the scope of the request that had been approved by the collections manager. In addition, by abating Bugge's actual and correct tax liability, it failed to act within the IRS's statutory authority to abate an excessive amount. * * * Because of a purely accidental and unintended processing error, the regional service center executed an unintended abatement lacking any authorization.[30]

Note that the *Bugge* opinion refers neither to the particular form used to request the abatement nor to the label of the particular transaction code used to reflect the adjustment to the taxpayer's account. Both were irrelevant to the court's analysis. Instead, the proper legal interpretation of the IRS action required consideration of institutional intent: whether the administrative action at issue resulted from a process truly reflective of an institutional decision to perform a section 6404(a) abatement or whether it resulted from serendipity, a comedy of errors.[31]

---

[23]264 B.R. at 912.

[24]Form 5344, ''Examination Closing Record,'' is generally used for cases in Exam, *see* IRM 4.15.5.2, while Form 3870, ''Request for Adjustment,'' is used by other IRS functions; *see also* IRM 8.20.7.7.2 (01-31-2002), ''Abatement of Interest Claim Cases,'' for use of Form 3870 to make interest and penalty abatements per section 6404(e).

[25]IRM 5.19.17.15, ''Adjustment Methods for Discharged Liabilities.''

[26]*See, e.g., Kroyer v. United States*, 55 F.2d 495, 499 (Ct. Cl. 1932) (the government will not be ''bound by the bookkeeping errors of its agents, when such errors in no way affect the real equities of the case or result to the prejudice of'' the taxpayer).

[27]*See In re Becker*, 407 F.3d 89, *Doc 2005-9433, 2005 TNT 86-9* (2d Cir. 2005) (discussing the requirements of proving estoppel against the government for misapplication of payments).

[28]99 F.3d 740, *Doc 96-30396, 96 TNT 226-14* (5th Cir. 1996).

[29]*Id*. at 744 (quoting the request).

[30]*Id*. at 745 (footnote omitted).

[31]*See also Crompton-Richmond v. United States*, 331 F. Supp. 1184, 1187 (S.D. N.Y. 1970) (''whenever an abatement is issued because of a mistake of fact or bookkeeping error, the assessment can be reinstated, at least so long as this does not prejudice the taxpayer'' because the government is not bound by clerical errors of its agents); *In re Range v. United States*, 245 B.R. 266, 274-275 (S.D. Tex. 1999) (upholding as not clearly erroneous the Bankruptcy Court's decision that administrative action was not an abatement). The Second Circuit in *In re Becker*, 407 F.3d 89, 100, *Doc 2005-9433, 2005 TNT 86-9* (2d Cir. 2005), thought *Bugge* inconsistent with *Crompton-Richmond*, but despite some difference in language, both cases hold that not all administrative acts taken by IRS employees rise to the level of legal acts that bind the IRS as a matter of law. Both cases also leave open the possibility that equity (through the doctrine of estoppel) will undo any undue harm resulting from the legal rule.

In sum, despite the lack of applicable code provisions, cases like *Buckner* establish that not all abatements involve substantive redeterminations of a taxpayer's liability, and cases like *Bugge* establish that not all downward adjustments of the taxpayer's liability have the legal effect of abatements.

C. Rebate and Nonrebate Refunds

Section 6402 authorizes the IRS to refund overpayments to taxpayers. Practitioners and academics alike often overlook the distinction between an overpayment and a refund. They are two separate concepts. An overpayment occurs when a tax module shows a credit balance.[32] A refund is what gets paid to the taxpayer. Section 6402(a) does not *require* the IRS to refund an overpayment but instead permits the IRS to set off the overpayment against other outstanding kinds of taxes or other tax periods owed by the taxpayer. Section 6402(c), (d), and (e) also requires the IRS to set off any remaining overpayments against some state and federal nontax liabilities — such as federal contractor debt or child support payments — if properly requested by the benefiting entity. Thus, a refund is whatever the taxpayer gets after the IRS either exercises its discretion or obeys the statutory commands regarding disposition of the overpayment.[33]

A rebate refund occurs when the taxpayer gets money back because the amount paid or credited is greater than the true liability properly reflected in the IRS books.

A rebate refund occurs when the taxpayer gets money back because the amount paid or credited is greater than the true liability properly reflected in the IRS books.[34] My yearly refund that I love so much is a rebate refund because my amount paid is greater than my true tax. Erroneous earned income tax credit refunds are rebate refunds because the refundable credit is greater than the true tax liability. Likewise, the IRS sometimes determines the previous assessment was excessive because a taxpayer files an amended return that is accepted by the IRS, or because an audit results in a lower tax liability. In those cases, the assessment is abated under section 6404(a) and any resulting refund becomes a rebate within the meaning of section 6213(b). If the IRS later determines that it committed a substantive error in crediting my payments, in crediting the refundable credit, or in making the abatement, the refund becomes a rebate erroneous refund.[35]

In contrast, a nonrebate refund results from an action other than a redetermination of tax liability. For example, a refund arising from a section 6404(c) abatement would be a nonrebate refund. If that abatement was later determined to be erroneous, the refund would be a nonrebate erroneous refund. Likewise, a refund arising from a clerical error — either in adjusting the assessed tax downwards or adjusting the payments or credits upwards — is a nonrebate erroneous refund. In those cases, because the substance of the transaction does not involve a redetermination of tax liability, neither does the resulting refund. For the same reason, the erroneous crediting of another's payment, or a math error involving the taxpayer's own payments or refundable credits, are acts that result in nonrebate erroneous refunds.[36]

II. The Problem of Collecting Erroneous Refunds

A. Collecting Rebate Erroneous Refunds

On one hand, the law regarding the collection of rebate erroneous refunds is settled. The IRS and the courts have long agreed that just as the IRS must make a new assessment to undo an abatement made under section 6404(a), the IRS can collect a rebate erroneous refund — such as one resulting from a section 6404(a) abatement — only by reassessing the abated tax liability.[37] That's because the amount of the error (the difference between the true tax and the tax reflected in the IRS

---

[32]Section 6401 also provides that payments assessed or collected after the expiration of the relevant limitation period are to be treated as overpayments. Those are statutory overpayments.

[33]*See, e.g., Pettibone v. United States,* 34 F.3d 536, 538, *Doc 94-8454, 94 TNT 182-15* (7th Cir. 1994) ("The Internal Revenue Code leaves to the Commissioner's discretion whether to apply overpayments to delinquencies or to refund them to the taxpayer. Until the Commissioner exercises this discretion, the taxpayer has no right to payment") (internal citations omitted); *In re Luongo*, 259 F.3d 323, *Doc 2001-23380, 2001 TNT 175-46* (5th Cir. 2001) (mere overpayment could not constitute "property of the estate" within meaning of Bankruptcy Code section 541 because debtor had no interest in the overpayment until after the IRS had exercised its discretion to offset overpayment against other tax liabilities).

[34]Refunds are deemed made as of the date that an authorized IRS employee signs a schedule of overassessments, another summary document similar to the summary record of assessments. Reg. section 301.6407-1. That document used to be Form 1166 but can now be various other forms, some computer-generated. *See* Rev. Rul. 2001-40, 2001-2 C.B. 276, *Doc 2001-23872, 2001 TNT 180-10* (modifying Rev. Rul. 78-127, 1978-1 C.B. 436). The signing date is chiefly important for calculating interest, if any, due on refunds.

[35]There is an open question whether the IRS's erroneous determination that a prior assessment was illegal — and thus abated under section 6404(a)(3) — gives rise to a rebate or nonrebate refund. Discussion of that point is beyond the scope of this article.

[36]*See United States v. Frontone*, 383 F.3d 656, *Doc 2004-18042, 2004 TNT 176-13* (7th Cir. 2004) (discussing distinction).

[37]The earliest case I can find is *Carney Coal Co. v. Commissioner*, 10 B.T.A. 1397 (1928), and the latest case to reiterate the rule is *In re Becker*, 407 F.3d 89, 97 (2d Cir. 2005) ("If an assessment is properly abated pursuant to subsection (a)(1), (2), or (2) of I.R.C. § 6404, quoted above — all of which pertain to assessments made in error — the abatement entirely extinguishes the assessment. In order to undo that abatement, the IRS would be required to impose a new assessment; and, to be effective, that new assessment would need to be imposed within the limitations period"); *see also* GCM 36263, "Legality of

(Footnote continued on next page.)

books after the abatement) is an error of judgment about the amount of true tax liability and so constitutes an alleged deficiency of tax. If the IRS discovers the error within the applicable limitations period, the taxpayer deserves the protections of the deficiency procedure (access to preassessment judicial review) before the liability can be assessed and collected.

B. Collecting Nonrebate Erroneous Refunds

On the other hand, the law regarding the collection of nonrebate erroneous refunds has long been confused and haphazard. Recall that nonrebate erroneous refunds do *not* represent any redetermination of the taxpayer's tax liability. They result from either an erroneous collection decision (abatement under section 6404(c)) or an erroneous processing action (for example, a clerical error). In theory, the IRS can collect nonrebate erroneous refunds in one of three ways: moral suasion; authorizing the Department of Justice to file a lawsuit under section 7405 (within the limitation period set out in section 6532(b)) for recovery of the erroneous refund; or administrative collection action. It is the last one in which confusion prevails. I'll now discuss each possibility in turn.

> ***The law regarding the collection of nonrebate erroneous refunds has long been confused and haphazard.***

The first two methods are not controversial. The IRS engages in moral suasion through pattern ''beg letters'' (forms 510C and 4728, ''Notice of Erroneous Refund''). The letters ask for the money back, explaining that the taxpayer has no right to the money. As to legal action, the government has the same common-law cause of action as does any other litigant for money wrongfully or erroneously paid. ''No statute is necessary to authorize the United States to sue in such a case. The right to sue is independent of statute.''[38] That common-law action for ''money had and received'' is declared in section 7405. Congress has self-imposed a limitation period in section 6532(b), which allows two years from the ''making of such refund'' to file suit under section 7405, unless the refund was induced by the taxpayer's fraud or misrepresentation of a material fact, in which case the IRS has five years to act. The courts have interpreted the phrase ''making of such refund'' to mean the date the check was cashed and ''cleared the Federal Reserve.''[39]

Although not controversial, neither of those two collection methods is satisfactory. The problem with moral suasion is, I hope, self-evident. I am not aware of any studies on how effective the IRS letters are. I assume many taxpayers do the right thing and return the payments. I also assume many taxpayers may not read the letters, may be confused about their account, may not believe the refund is erroneous, or else believe that nine-tenths of the law allows them to keep it anyway. Practitioners can help persuade clients to voluntarily return refunds by reminding them that taxpayers have been criminally prosecuted for cashing erroneous refund checks.[40]

Recovering erroneous refunds by suit under section 7405 is unsatisfactory for multiple reasons. First, it is a retail solution for a wholesale problem. It is working the case at the individual level and not the bulk processing level. And each case is worked, not by just one field agent, but by teams of government employees. First, the IRS team must discover the error and authorize the Department of Justice to sue. Then the DOJ team must file suit, and the court ''team'' must adjudicate, which by itself can take well over a year, assuming a summary judgment resolution.[41] So it forces collection of what is usually an obvious error into an inefficient adversarial process. Second, a section 7405 liability is harder to collect than is a tax liability. Courts are unlikely to treat a section 7405 judgment as a tax debt, which means no tax lien arises to protect the claim, no priority is given the claim in an ensuing bankruptcy, and the IRS cannot perform administrative levies.[42] Finally, the DOJ may not even agree to file suit. Only erroneous refunds larger than a specified base amount will be worth the cost to the government to prosecute. While I have no idea what that amount might be, of the few section 7405 cases reported, most are for hundreds of thousands, or millions, of

---

Overpayment Offsets to Collect Unassessable Erroneous Refunds'' (1975) (reviewing case law).

[38]*United States v. Wurts*, 303 U.S. 414, 415 (1938).

[39]*United States v. Greene-Thapedi*, 398 F.3d 635, *Doc 2005-3339, 2005 TNT 33-17* (7th Cir. 2005); *United States v. Commonwealth Energy*, 235 F.3d 11, *Doc 2001-145, 2000 TNT 248-72* (1st Cir. 2000). That is consistent with the rule that interest owed on erroneous refunds starts on the date the taxpayer cashes or negotiates the check. *United States v. Mallah*, 882 F. Supp. 779, *Doc 95-1847, 95 TNT 26-34* (S.D. Ind. 1995); *La Follette v. United States*, 173 F. Supp. 388 (S.D. Cal. 1959). Accordingly, taxpayers who receive an erroneous refund should neither cash the check

(Footnote continued in next column.)

nor send it back, but should instead hold onto it, inform the IRS of the error, and wait for instructions. They should send it back only to someone who knows it is coming and knows how to process it. Sending it back blind just invites additional error.

[40]*United States v. McRee*, 7 F.3d 976 (11th Cir. 1996) (*en banc*) (upholding conviction under 18 U.S.C. section 641 of a taxpayer who, even though doing nothing to induce the erroneous refund, took elaborate actions to disperse the $350,000 refund check in offshore accounts).

[41]*See, e.g., United States v. Daum*, 968 F. Supp. 1037, *Doc 98-7010, 98 TNT 35-36* (W.D. Pa. 1997) (error discovered in Feb. 1995, moral suasion letter issued that Mar., followed by suit in Apr., and motion for summary judgment in Oct.; summary judgment granted 18 months later, on Apr. 30, 1997).

[42]*See, e.g., In re Able Roofing & Sheet Metal Co.*, 425 F.2d 699, 701 (5th Cir. 1970) (refusing to give a section 7405 claim the same priority in bankruptcy as taxes because ''a claim for refund erroneously made does not create a liability for taxes''). The status of a section 7405 judgment is not settled but treating it as a nontax debt is the most consistent result from the string of cases that I discuss below denying the IRS the ability to administratively recover nonrebate erroneous refunds.

dollars. I cannot find a reported case of the government suing for less than $10,000.[43]

C. The Erroneous Refund Revival Theory

The IRS would much prefer to fix administratively what is, almost by definition, an administrative error. And from the mid-1970s until early 1998 it did just that. The idea was first raised in 1970. The IRS Office of Chief Counsel studied the issue, and in two important general counsel memoranda, one issued in 1975 and the other in 1976, it developed a theory whereby the IRS could administratively recover so much of a nonrebate erroneous refund as was equal to or less than the original assessment.[44] The gist of the reasoning was this:

> If a non-rebate erroneous refund is made with respect to a year for which the taxpayer's tax has been assessed, which it would be if tax were shown by the taxpayer on a return, and to the extent that the amount of erroneous refund is not greater than the amount of tax that has been assessed and paid, then the erroneous refund is in effect a giving back to the taxpayer of his payment of assessed tax. In this case the tax has already been assessed, and in our opinion there is no requirement that the tax be reassessed before the normal collection procedures can be utilized.[45]

Based on that reasoning, the GCMs concluded that, as to nonrebate erroneous refunds, "the amount of the refund may be recovered by the usual tax collection procedures, including offset under Code § 6402(a), without use of the assessment or deficiency procedures."[46] Further, the IRS was bound by the 10-year limitation period for collection in section 6502 and not the 3-year period for assessment in section 6501.

That theory became known as the erroneous refund revival theory and resulted in a significant change in IRS practice.[47] To see how the IRS theory worked — and why it ultimately was rejected by the courts — I will use three simplified examples (I omit interest and penalties). The examples also illustrate how refunds may be smaller or larger than the assessed tax and how refunds may arise because of either erroneous crediting of payments or erroneous abatements of assessments.

> Example 1 (Alex): Alex reports a tax liability of $4,000 on the return, claims $2,000 in withholding credits, and sends a check to cover the $2,000 balance due. During processing, a clerk erroneously inputs the check twice. Assuming no setoffs, the system generates a refund to Alex of $2,000. When the error is discovered, a clerk enters a new debit TC to reverse the error and the tax module shows a balance due of $2,000. The new debit TC is not rolled into the summary record of assessments.
>
> Example 2 (Blair): Blair reports a tax liability of $4,000 on the return, claims $2,000 in withholding credits, and sends no payment to cover the balance due. The return is properly processed and shows a balance due of $2,000. A year later, Blair sends in the remaining payment. However, at that time a clerk also erroneously credits Blair's tax module with a payment of $7,000 received from another taxpayer for another tax liability. Assuming no setoffs, the system generates a refund to Blair of $7,000. When the error is discovered, the clerk enters new TC codes to reverse the error, leaving the account with a balance due of $7,000. Again, no new assessment is made.
>
> Example 3 (Cody): Cody reports a tax liability of $4,000 on the return, claims $2,000 in withholding credits, and does not pay the balance. The return is properly processed and shows a balance due of $2,000. However, four years later, when a field employee later submits a Form 3870, "Request for Abatement," requesting abatement of a different taxpayer's account in the amount of $4,000, the IRS campus processing clerk erroneously processes the request on Cody's account. The TC used by the clerk (TC 291) is translated onto the Form 4340 as "abatement prior to tax assessment." The reduced liability results in the tax module showing an overpayment of $2,000 that is then refunded. When the error is discovered, the IRS clerk enters a new debit TC to reverse the credit, thus creating a balance due of $4,000 in Cody's account. Again, the entry of the reversing credit transaction is not a new assessment.

The IRS erroneous refund revival theory would allow the IRS to administratively collect all $2,000 of the erroneous refund to Alex, $4,000 of the $7,000 erroneous

---

[43]The smallest amount I could find, in an admittedly quick search, was at issue in *United States v. Korda*, 2005-2 U.S.T.C. para. 50,541 (M.D. Fla. 2005) ($10,209.81).

[44]GCM 36263 (May 9, 1975), *as modified by* GCM 36624 (Mar. 11, 1976) ("We regret that our reply to your inquiry of June 17, 1970 has been so long delayed"). I would sure love to know the story behind that unusual delay. The 1975 GCM thought that the IRS had to reassess, but the 1976 GCM concluded that to require reassessment made no sense for nonrebate refunds because the error causing the refund could not undo the prior assessment and the IRS could make only one assessment of a tax liability.

[45]GCM 36624 (Mar. 11, 1976).

[46]Recall that, as discussed above in note 16, the distinction between rebate and nonrebate refunds did not arise until after 1944. The GCMs pointed out that before 1944 the IRS had established the right to reassess erroneous refunds through the deficiency procedures. They reasoned that when Congress put the distinction between rebate and nonrebate refunds into section 6211's definition of deficiency, it could not have meant to suddenly deny what had previously been allowed: the ability to rectify the error administratively. If the IRS no longer had to reassess the nonrebate liability, that meant the original assessment's power to unleash the administrative collection tools was revived.

[47]*See* GCM 36624 ("We believe it would be particularly desirable to publish a decision to recover non-rebate erroneous refunds through the usual tax collection procedures, since this represents a change in past practice"). The IRS eventually put the procedure to recover nonrebate erroneous refunds in IRM 3.17.79.16. I can no longer find that section of the IRM online.

refund to Blair, and $4,000 from Cody (the $2,000 erroneous refund and the $2,000 unpaid on the original assessment). All of those amounts represent proper assessments that were never legally abated and remain unpaid. Even though Alex and Blair paid all their liability, the IRS theory says that the erroneous refunds mistakenly returned their tax payments to them (and then some, in Blair's case). In that way, the IRS theory focuses on the liability determination function of an assessment, reasoning that if the assessment properly reflects the true tax liability and if the account shows a balance due, what remains unpaid is a tax liability.[48]

> ***The IRS would much prefer to fix administratively what is, almost by definition, an administrative error.***

Thus, the IRS could administratively collect the entire $2,000 refund from Alex because Alex could not gainsay that the properly made assessment reflects the true tax liability. Likewise, the IRS can administratively collect $4,000 from Blair because that is the amount of the true tax liability that — when all is said and done — remains unpaid. However, because the erroneous refund to Blair exceeded the true tax liability by $3,000, the IRS would have bifurcated remedies: It could collect the $4,000 tax liability administratively but would have to file suit under section 7504 to collect the excess $3,000. Similarly, the IRS can collect $4,000 from Cody because the clerical error that caused the refund was not a legal abatement.[49]

D. The Extinguishment Theory

For the first 20 years, the IRS often won challenges to its erroneous refund revival theory in the lower courts.[50] However, the GCMs that developed the theory acknowledged one weakness: the doctrine of extinguishment. The courts first articulated that idea in 1929, in *Kelley v. United States*: "Once paid, a tax is gone, and a refund of the money does not restore it."[51] Thirty years later, the district court in *In re Marshall* relied on *Kelley* to reject the idea that a bankruptcy claim based on an erroneous refund was a claim for taxes entitled to special treatment.[52] In turn, the district court in *Rodriguez v. United States* relied on *Marshall* to conclude that "a refund is not, properly speaking, a tax amount," and therefore "the act of sending a refund cannot of itself revive or continue a preexisting tax liability."[53] The Fifth Circuit picked up on that argument in *United States v. Wilkes* in 1991 and, agreeing with both *Rodriguez* and *Marshall,* rejected the IRS erroneous refund revival theory. After that, it was all downhill, as the government lost in four other courts of appeals over the next six years.[54] Ultimately, the IRS conceded the issue in an action on decision dated May 4, 1998.[55] The government then abandoned the position on two appeals from lower court decisions that had upheld the theory, and the IRS changed its collection procedures in the Internal Revenue Manual.[56]

In contrast to the erroneous refund revival theory, the extinguishment theory focuses on the second function of an assessment as a precursor to administrative collection. The idea is that once a taxpayer pays any portion of the liability, the assessment can no longer serve as a proper precursor to administrative collection. Thus, as applied to the above three examples, the IRS would have no power to administratively collect any amount from Alex or Blair because they had fully paid the assessed liability. The extinguishment theory would permit collection of $2,000 from Cody because that was the portion of the original assessment that remained unpaid. But Cody's partial payment (the $2,000 in withholding credits) could not be

---

[48]This reasoning is best seen in *Groetzinger v. Commissioner,* 69 T.C. 309 (1977).

[49]*Bugge, supra* note 28.

[50]*Davenport v. United States,* 136 B.R. 125 (W.D. Ky. 1991); *Sanfellipo v. United States,* 1990 U.S. Dist. LEXIS 18654 (N.D. Cal. 1990); and *Groetzinger v. Commissioner,* 69 T.C. 309 (1977). One district judge bravely rejected the opinions of five courts of appeals, only to have the government abandon the argument on appeal. *See Mildred Cotler Trust v. United States*, 2 F. Supp.2d 264, 270, *Doc 98-11750, 98 TNT 67-10* (E.D.N.Y. 1998), *rev'd*, 184 F.3d 168, 171, *Doc 1999-23590, 1999 TNT 132-10* (2d Cir. 1999) ("I recognize that a number of courts have reached a different conclusion in similar or related situations. Relying on a doctrine known as 'extinguishment,' these courts have concluded that a payment of taxes 'extinguishes' an underlying assessment, thus barring collection of taxes on the basis of that assessment. I find these opinions to be unpersuasive") (citations omitted).

[51]30 F.2d 193 (9th Cir. 1929). There, the IRS had erroneously refunded an estate tax and brought suit, on the equity side of the court, to recover the amount as an unpaid tax. The circuit court dismissed the suit because the government had an adequate

(Footnote continued in next column.)

remedy at law — being an action under the predecessor to section 7405 for recovery of an erroneous refund. Thus, the court made the critical distinction between liability for tax and liability for return of erroneously paid money, a distinction picked up later by the Seventh Circuit in *O'Bryant*.

[52]158 F. Supp. 793, 795 (N.D. Tex. 1958) ("When the plaintiffs paid their respective income taxes for the year 1943, such taxes as to the plaintiffs were extinguished and the subsequent refunds to the plaintiffs of a portion or all of the money paid by them as 1943 income taxes did not restore the taxes").

[53]629 F. Supp. 333, 344 (N.D. Ill. 1986).

[54]The circuits in which the IRS argued for the theory and lost were, in chronological order of the opinions being issued: *United States v. Wilkes*, 946 F.2d 1143, 1152 (5th Cir. 1991); *O'Bryant v. United States*, 49 F.3d 340, *Doc 95-3184, 95 TNT 57-15* (7th Cir. 1995); *Clark v. United States*, 63 F.3d 83, *Doc 95-8258, 95 TNT 171-10* (1st Cir. 1995); *Bilzerian v. United States*, 86 F.3d 1067, *Doc 96-19205, 96 TNT 130-4* (11th Cir. 1996); *Singleton v. United States*, 128 F.3d 833 (4th Cir. 1997).

[55]AOD GL-118964-97, 1998-1 C.B. 972 (action only), 1998 AOD LEXIS 8 (full memo). The acquiescence was for *Bilzerian*.

[56]*Mildred Cotler Trust v. United States*, 184 F.3d 168, 171 (2d Cir. 1999), *reversing* 2 F. Supp.2d 264 (E.D.N.Y. 1998) ("On appeal, the government has expressly abandoned its argument below, on which the district court relied"); *Stanley v. United States*, 140 F.3d 1023, 1027-1028, *Doc 98-11458, 98 TNT 65-62* (Fed. Cir. 1998), *reversing* 35 Fed. Cl. 493, *Doc 96-13281, 96 TNT 88-15* (Ct. Fed. Cl. 1996) ("the Government argued before the Court of Federal Claims that the erroneous refund could nevertheless be recovered on the basis of that [previous] assessment. . . . The Government on appeal wisely does not pursue this argument"). The new IRM provisions are at 25.6.7.

recovered, even by courts that improperly apply the extinguishment theory and say the IRS can perform a supplemental assessment of a nonrebate erroneous refund if done within three years. In short, properly applied, the extinguishment theory holds that the IRS can recover nonrebate erroneous refunds of ''paid taxes'' only through suit under section 7405.

In sum, under both the revival and extinguishment theories, the IRS will sometimes be forced into bifurcated remedies for administrative errors. The chief difference is that the IRS theory uses the original assessed liability to measure what can be recovered administratively because the assessment's liability determination function was unimpaired by the error. In contrast, the extinguishment theory focuses only on the *unpaid* assessed liability as the proper measure of what can be recovered administratively because the assessment's ''collection-propelling'' function is impaired, or cut down, by the taxpayer's payment.

E. Problems With Extinguishment Theory

The extinguishment theory does not jibe with good tax administration. It characterizes nonrebate erroneous refunds as a nontax liability yet insists the IRS can collect it using administrative collection tools if the IRS just timely assesses it. But the IRS can assess only tax liabilities. So by saying that nonrebate erroneous refunds are not tax liabilities, courts in fact disable the IRS from pretty much any administrative collection action.[57] Make no mistake about it: A nonrebate erroneous refund, by definition, results in a windfall to the lucky taxpayer. Whether the taxpayer is fully aware of the windfall or not does not change its character. The taxpayer is still getting the free use of the government's money. We're talking handouts here.[58] In that way, the extinguishment theory hurts those taxpayers who comply with their obligations and rewards taxpayers who avoid returning (whether through ignorance or obstinance) their undeserved (even if unsolicited) gain.

There is a central contradiction to the extinguishment theory. On one hand, courts hold that nonrebate erroneous refunds are *nontax liabilities* that neither raise nor revive any tax liability. They are instead simply common-law liabilities that arise from the wrongful holding of the government's money by the taxpayer. On the other hand, the same courts say that the IRS can reassess the refund if it acts within the assessment limitations period, using either its authority under section 6201 to assess or under section 6204 to make a ''supplemental assessment whenever it is ascertained that any assessment is imperfect or incomplete in any material respect.'' Here is how the *O'Bryant* court explained it:

> The money the O'Bryants have now is not the money that the IRS' original assessment contemplated, since that amount was already paid. Rather, it is a payment the IRS accidentally sent them. They owe it to the government because they have been unjustly enriched by it, not because they have not paid their taxes. Because it is a refund, the money the O'Bryants received is not part of the taxpaying transaction as the IRS asserts and therefore cannot be recovered through the § 6502 post-assessment collection procedures. It would not make sense to allow the IRS to use those procedures (which are premised on the taxpayer's not having paid his tax debt) to recover money it accidentally sent to the taxpayer. Rather, the agency is confined to the erroneous refund collection procedures available to it under the Tax Code — § 7405 and the deficiency/assessment procedures.[59]

Some courts — the ones that do not understand the difference between rebate and nonrebate refunds — insist the IRS must use the deficiency procedures to perform that theoretical reassessment. Look at the language from *Singleton*:

> Sections 6204(b) and 6213(a) [prescribing deficiency procedure] prohibit the IRS from issuing a supplemental assessment without first issuing a notice of deficiency and giving the taxpayer an opportunity to contest the assessment in Tax Court. The Court finds no applicable exception to these procedural requirements. Section 6213(a) applies to all assessments; it does not distinguish between assessments intended to reclaim rebate refunds versus those intended to reclaim non-rebate refunds.[60]

---

[57]The IRS still has a limited ability to collect the erroneous refund through setoff, but courts do not permit setoffs after the applicable section 6532(b) limitations period for filing an erroneous refund recovery suit has expired. *PG&E v. United States*, 417 F.3d 1375, *Doc 2005-17029, 2005 TNT 154-7* (Fed. Cir. 2005).

[58]Some examples are *Stanley, supra* note 56 ($600,000 + windfall); *O'Bryant, supra* note 54 ($7,000 + windfall); *Wilkes, supra* note 54 ($20,000 + windfall); *Clark, supra* note 54 ($25,000 + windfall); *Bilzerian, supra* note 54 ($125,000 + windfall); *Mildred Cotler Trust, supra* note 56 ($175,000 + windfall).

[59]49 F.3d at 347-348 (citations omitted). *Accord, Clark, supra* note 54, at 87 (''there is a fundamental difference between money taxpayers possess as the result of an erroneous refund and money they originally owed the IRS (their tax liability); taxpayers who received erroneous refunds owe the IRS because they have been unjustly enriched by it, not because they have not paid their taxes'') (quotations omitted); *Bilzerian, supra* note 54, at 1069 (''Today, we join these circuits and hold that once a tax liability is paid, no erroneous refund — whether rebate or non-rebate — can revive it''). *But see United States v. Frontone, supra* note 36 (answering yes to the question ''whether a claim for taxes based on an erroneous refund is a claim for taxes'' and noting that ''we acknowledge the tension between *O'Bryant*'s conception of when assessment is available [for erroneous refunds] and the broader conception suggested by *Bilzerian* and *Clark*'') (citations omitted).

[60]*Singleton v. United States, supra* note 17, at 837. In *Singleton* the IRS did try to make a supplemental assessment under section 6204. What the majority got wrong was reading section 6204 as always requiring the IRS to use deficiency procedures for all supplemental assessments. As the dissent correctly pointed out: ''The Tax Code does not prohibit supplemental assessments without a notice of deficiency. It prohibits supplemental assessments of a deficiency without a notice of deficiency.'' *Id.* at 840. But from the facts as recited in the case, it

(Footnote continued on next page.)

The contradiction here is that the IRS can assess only "taxes . . . imposed by this title."[61] If the liability to return nonrebate refunds is not "imposed by this title" but is instead a common-law liability for money had and received, the IRS *cannot* assess them. It has no authority to do so. And yet courts insist — in *dicta* mostly — that the IRS can.[62]

The reason courts keep saying that the IRS can assess refunds is because the legislative history to section 7504 instructs that the section was not meant to limit the IRS to recovery of erroneous refunds by lawsuit. When Congress first enacted the language now in section 7504, back in 1928, the committee report was clear that it did not intend the legislation to cut off the IRS's administrative remedies: "Obviously, if the limitations period on the making of the assessments has not expired, the erroneous refund may be recovered by assessment in the ordinary manner."[63]

The extinguishment theory hurts taxpayers who comply with their obligations and rewards taxpayers who avoid returning their undeserved (even if unsolicited) gain.

When the 1928 committee report was written, it was well established that erroneous refunds created tax liabilities. Recall that the distinction between rebate and nonrebate refunds did not arise until 1944: In 1928 *all* refunds were rebate refunds.[64] Recall further that the courts and the IRS have always agreed that to recover erroneous rebate refunds, the IRS must reassess.[65] That's based on the view that rebate refunds result from redetermination of the tax liability.[66] So, in 1928 it was true that every erroneous refund resulted in a deficiency of tax. The above quote from *Singleton* would have been perfectly true . . . in 1928.

So the question becomes whether Congress in 1944, when it changed the definition of rebate in section 6211, meant to undo what had been true in 1928. Did Congress mean to no longer allow the IRS the ability to administratively recover that class of refunds now removed from the definition of deficiency? Did Congress intend, by a definitional change, to suddenly restrict the IRS to suits under section 7504 to recover refunds that no longer qualified as a deficiency? The two GCMs issued in 1975 and 1976 thought not. The 1975 GCM expressed its conclusion this way:

> A rational interpretation of the statutory collection scheme as a whole requires the conclusion that tax collection procedures are applicable here [in the case of a nonrebate refund] as well as in the case of a rebate. If the procedures were not available here, the only means for recovery of the refund would be civil suit under Code § 7405. Yet there seems no reason why Congress [in 1944] would have intended a more restrictive rule for recovering refunds which are not rebates than for recovering rebates. Rather, the logical interpretation would be that rebates and non-rebate refunds may be recovered in the same manner except that the deficiency procedure must be used prior to the assessment of a rebate so the taxpayer may have access to the Tax Court where there is a question of liability for tax, whereas a non-rebate refund, not made on the basis of a determination of tax liability, may be recovered by simple assessment.[67]

The 1976 GCM modified that analysis by eliminating the requirement for reassessment. Focusing on the liability determination function of the assessment, it pointed

---

appears the majority correctly identified the error as substantive. The taxpayer had included a schedule reporting a business tax credit but had correctly not taken the credit against the reported tax liability. The error correction/reject unit in the processing function determined that the taxpayer had made a mistake and so allowed the credit and assessed a much smaller tax liability than reported. That determination was an error. But it was substantive. Accordingly, the IRS was required to follow the deficiency procedures before making the supplemental assessment.

[61]Section 6201(a).

[62]*O'Bryant v. United States*, 839 F. Supp. 1321, 1325 (C.D. Ill. 1993), *aff'd*, 49 F.3d 340 (7th Cir. 1995) ("Most courts hold that the government is not limited to a Section 7405 action to recover an erroneous refund, but may collect by assessment in the ordinary manner, because the refund creates an underpayment") (citations omitted) (collecting cases); *see also Bilzerian v. United States*, 887 F. Supp. 1509, 1514 (M.D. Fla. 1995), *rev'd on other grounds*, 86 F.3d 1067 (11th Cir. 1996) (The IRS "is not limited to filing an action under § 7405 to recover an erroneous refund. Where the IRS has made [a] new assessment [of] the erroneously refunded amount, the IRS may collect this amount through ordinary collection procedures within a ten (10) year period after the assessment of the tax. 26 U.S.C. § 6502") (citations omitted); *Purcella v. United States*, 1992 U.S. Dist. LEXIS 426 (D. Colo. 1992) ("The IRS could have recovered the [erroneous] refund by assessment in the ordinary manner. Yet it never assessed the [erroneous] refund as a tax and the previous assessment had already been satisfied") (citations omitted).

[63]S. Rep. No. 960, 70th Cong., 1st Sess. 42 (1928).

[64]*See* note 16 *supra*.

[65]*See* note 37 *supra*. The requirement to reassess was independent of the process required for reassessment. For example, courts permitted the IRS to use the summary process to reassess erroneous refunds of excise taxes. *United States v. Tuthill Spring Co.*, 55 F.2d 415 (N.D. Ill. 1931). Recall that assessment of excise taxes never requires the IRS to follow the deficiency procedures, which apply only to income, estate, and gift taxes.

[66]The 1975 GCM lists the additional cases upholding the recovery of erroneous rebate refunds by reassessment: *Burnet v. Porter*, 283 U.S. 230 (1931); *Clark v. Comm'r*, 158 F.2d 851 (6th Cir. 1946); *Comm'r v. Newport Industries*, 121 F.2d 655, 657 (7th Cir. 1941); *Page v. Lafayette Worsted*, 66 F.2d 339 (1st Cir. 1933); *Richard E. Warner*, T.C. Memo. 1974-243; *Lucy L. Lawton*, 16 T.C. 725 (1951); *Etta Craig*, 18 B.T.A. 86 (1929).

[67]The *O'Bryant* court disregarded that argument, snapping, "It is an unjustified leap of logic to say that because nonrebate refunds cannot be recovered by reassessment, they must be collectible by resort to the original assessment. There is no indication in the Code that Congress intended such a result and we refuse to reach it, especially when doing so would require us to mischaracterize an erroneous refund as a tax liability." 49 F.3d at 347.

out that a nonrebate refund did not change the true liability, which was already accurately reflected in the existing assessment. That is, just as a clerical error does not result in an abatement of tax under section 6404(a), neither does a nonrebate refund result in a new tax *liability* because it is just the giving back of a tax *payment*. Accordingly, not only was no reassessment necessary but it was not even permitted because there was no new tax liability to assess.

F. Problems With the Revival Theory

Although more rational than the extinguishment theory, the revival theory is far from perfect. It creates the opposite problem of the extinguishment theory: It gives the IRS more power to collect erroneous nonrebate refunds than rebate refunds. That is, while one cannot say that Congress, in changing the definition of rebate in 1944, intended to make the IRS *less able* to collect nonrebate erroneous refunds, neither can one say that Congress intended to suddenly enhance the IRS's ability to collect erroneous nonrebate refunds over rebate refunds. Yet that is what the revival theory does.

The first way in which the revival theory prefers nonrebate refunds concerns how liens arise. The law under section 6321 is well settled that the tax lien arises when there is a proper assessment, proper notice and demand of the unpaid amount, and a failure to pay.[68]

Alex illustrates the problem. Recall that Alex fully paid the assessed tax and so, under the established law regarding section 6321, no tax lien arises. Further, the IRS could not administratively collect a rebate erroneous refund made to Alex unless it could reassess within the section 6501 assessment limitations period, which is generally three years. But the revival theory allows the IRS to administratively collect a nonrebate erroneous refund from Alex at anytime within the section 6502 collection limitations period, which is generally 10 years. That's because the erroneous revival theory views an assessment, once established, as inviolate, so once the nonrebate refund is issued, all that would be needed to trigger the tax lien would be notice and demand and a failure to pay. The revival theory would thus give more tax lien protection to nonrebate refunds than rebate refunds.

The revival theory transforms section 6321 into the zombie lien statute.

The second way in which the revival theory prefers nonrebate refunds over rebate refunds concerns how liens are satisfied. Section 6322 provides that the tax lien "continues until the liability for the amount so assessed . . . is satisfied or becomes unenforceable by reason of lapse of time." The revival theory transforms section 6321 into the zombie lien statute.

Blair illustrates the problem. Recall that Blair did not fully pay the tax initially. Accordingly, after notice and demand was made, and he continued his failure to pay, the tax lien arose. But then Blair sent in the remaining payment. At that point, when the "liability for the amount so assessed . . . [was] satisfied," the tax lien was extinguished; it died.[69] But according to the revival theory, the processing error creating the nonrebate refund brings the tax lien back from the dead.

Cody illustrates how the tax lien is supposed to work. There, the tax lien arises because Cody has an unpaid balance due when the assessment is made. As long as any part of the assessment remains unpaid, the tax lien remains outstanding. It may secure a greater or lesser claim, depending on the payments and credits, but it can be extinguished only by full payment or running of the limitations period on collection. Once extinguished, however, it's dead and should stay dead. That is the teaching of section 6325, which provides that once the IRS determines a taxpayer has satisfied the "liability," the IRS *must* issue a certificate releasing the lien. And the effect of the certificate of release is that the lien is extinguished and cannot be reinstated, in explicit contrast to the statute's allowance for the revival of liens on property from which they had been removed (through certificates of discharge or nonattachment).

III. The Needed Legislative Solution

A. The Limits of Administrative Solutions

In its September 29, 2006, report, TIGTA criticized the IRS for not doing more to collect erroneous refunds. After harrumphing about how much better the IRS could be in tracking and analyzing erroneous refunds, it came up with this recommendation for how the IRS might better collect them:

> The Wage and Investment Division, with input from the IRS Office of Chief Counsel, should consider revising its erroneous refund procedures to include a financial analysis conducted electronically by Submission Processing Accounting function employees working erroneous refund cases to determine collectibility on cases above a specific

[68]*United States v. National Bank of Commerce*, 472 U.S. 713, 719-720 (1985) (proper assessment); *Blackston v. United States*, 778 F. Supp. 244 (D. Md. 1991) (notice and demand); *United States v. Wintner*, 200 F. Supp. 157 (N.D. Ohio 1961), *aff'd*, 312 F.2d 749 (6th Cir. 1963), *rev'd on other issues*, 375 U.S. 393 (1964) (failure to pay).

[69]This is another area in which the tax code needs rewriting. Section 6322 provides that the tax lien is extinguished when the taxpayer's liability is satisfied. Likewise, section 6325(a) requires the IRS to issue a certificate of release when it determines that a tax liability is satisfied. However, section 6432 provides for damages only when the IRS negligently or knowingly failed to release a lien within 30 days of determining that the related assessment is satisfied. Thus, current law leads to the anomalous result that the tax lien may be extinguished but the IRS incurs no penalty for not issuing a certificate of release, leaving in place the notice of federal tax lien declaring to the world that the tax lien still exists. *See Henderson v. United States*, 91 F. Supp.2d 995, *Doc 2000-23495*, *2000 TNT 176-67* (E.D. Wis. 2000) (no damages to the taxpayer who claimed to have satisfied his liability but concededly did not satisfy the erroneously assessed amount).

> dollar tolerance, and to refer those cases with collection potential directly to the local IRS Office of Chief Counsel. We believe adopting this change would be a more efficient use of resources.

That is a laughably lame suggestion. TIGTA wants low-level IRS employees to figure out whether taxpayers who have received erroneous refunds have enough assets to make the effort of obtaining a judgment worthwhile. The IRS management politely objected to the recommendation, citing lack of training. But there are much worse problems with TIGTA's idea.

First and most fundamentally, TIGTA's proposed solution puts the collection cart before the judgment horse. TIGTA wants the IRS to first determine whether a taxpayer has assets and only then refer the case to the DOJ. In almost no other context does the IRS make a collectibility decision before a liability decision. You do not see revenue agents inquiring whether taxpayers have the wherewithal to pay a deficiency![70] And for good reason: What is here today can be gone tomorrow, and vice versa. There is no correlation between a taxpayer's assets today and the ability of the government to collect from the taxpayer some two or three years down the road whenever the DOJ gets the section 7504 judgment.

TIGTA's suggestion is laughably lame: Low-level IRS employees should figure out whether taxpayers who have received erroneous refunds have enough assets to make the effort of obtaining a judgment worthwhile.

Second, TIGTA's suggestion would badly misapply IRS resources by draining significant amounts of full-time equivalents (FTEs) — the measurement of worker hours — from the primary mission of submissions processing. That's because a collectibility determination requires financial information about the taxpayers. The only source of financial information readily available to submission processing employees is the data used by the automated collection system (ACS): the data in the IRS data systems gathered from various returns by the taxpayer and third parties. That data is not reliable. People change bank accounts. People change employers. That data is also incomplete: Just because a bank sent in a 1099-INT for a taxpayer doesn't mean you know anything about the balance in that account.

At the collection stage, that bad and incomplete data does not matter because ACS just sends out a levy and if it hits, it hits. But what works well to collect an assessed tax would not at all work well to perform TIGTA's suggested financial analysis. You cannot use a levy to collect information unless you have an assessed tax. TIGTA's suggestion would require submissions-return employees to issue and track summonses. They would have to track down taxpayers to secure a valid Form 433A, "Collection Information Statement." That is the work of field agents. It takes huge hunks of FTEs. Even if you could train submission processing employees to do all that, you would throw them into a hugely inefficient operation.

The basic problem facing the IRS is that current law does not provide a satisfactory framework for the collection of nonrebate erroneous refunds, no matter which theory you subscribe to. The IRS's erroneous revival theory and the alternative extinguishment theory create problems in the law. Meanwhile, the inability of the IRS to administratively collect nonrebate erroneous refunds results in huge windfalls for many taxpayers. What is needed is a legislative fix.

B. The Legislative Fix

In many ways, the current situation parallels that facing Congress when, in 1954, it enacted section 6201(a)(3). That section allows the IRS to assess the entire amount of erroneously allowed withholding credits, even when the resulting refund is larger than the assessed tax liability. The Senate committee report explained that Congress believed the IRS faced a problem with bifurcated recovery of erroneous refunds based on overstated withholding credits and accordingly wrote the statute to allow the IRS to make a single assessment to recover the entire erroneously refunded amount.[71] For example, if the erroneous refund to Cody had resulted from a mistake in recording the withholding credit (erroneously posting it as $12,000 instead of $2,000), resulting in a $10,000 refund, section 6201(a)(3) would permit the IRS to assess the entire $10,000 refund as a tax liability (thus allowing the IRS to administratively collect $12,000, the $2,000 erroneously applied to satisfy Cody's liability and the $10,000 refund). Unfortunately, while the purpose of section 6201(a)(3) was to prevent the necessity of bifurcated recovery procedures for a single erroneous refund, it covers only refunds made on the basis of one particular type of error.

Congress should act to prevent the necessity of bifurcated recovery procedures for any erroneous nonrebate refund. Congress should create two new provisions, one in Chapter 68, "Additions to Tax, Additional Amounts, and Assessable Penalties," and one in Chapter 66, "Limitations." The first would be a new section 6658 (current section 6658 would be renumbered as section 6659), titled "Failure to Return Erroneous Refund." It would read: "In the case of any person failing to return or repay any nonrebate erroneous refund after the Treasury secretary has requested its return or repayment by written notice (either in hard copy or electronic form) delivered in the manner prescribed in section 6303, the secretary may assess and collect a penalty in the amount of the erroneous refund." The second would be a new subsection

[70]While there are provisions for evaluating offers in compromise during examination, IRC 4.18.7.1(4) ("Offer in Compromise Filed During Audit") and 5.8.26.1(4) (same), those provisions are used only in exceptional circumstances. *See* IRM 35.5.2.6(1) (stating that considering collection aspects of a deficiency determination should be "highly unusual").

[71]*See* H. Rep. No. 1337, 83d Cong., 2d Sess. (1954) at A404; S. Rep. No. 1622, 83d Cong., 2d Sess. (1954) at 572.

(n) in 6501 (the assessment limitations period; current sections 6501(n) and 6501(o) would be renumbered). It would be titled "Special Rule for Certain Erroneous Refunds" and would read: "Assessment of the amount authorized by section 6658 must be made within five years from the date that the erroneous refund has cleared the Federal Reserve or otherwise been released to the person assessed."

The reason that I suggest that particular arrangement, instead of adding another subsection to the section 6201 assessment authority, is that the policy behind the three-year period for assessments of liabilities is inapplicable to the kind of errors that create nonrebate erroneous refunds. The three-year limitations period for assessment represents congressional policy that the substance of the taxpayer's liability be settled — that is, properly reflected in an assessed liability — within three years from the due date of the return. A substantive error resulting in a rebate refund does not affect that policy because the policy goes toward the first function of an assessment — to properly reflect the true tax liability of a taxpayer. But a nonrebate refund does not implicate that policy because it has nothing to do with the first function of an assessment: the proper reflection of a tax liability. That is the insight from the 1975 and 1976 GCMs and is what formed the basis for the revival theory. Further, because a nonrebate erroneous refund is not connected with a substantive redetermination of tax, it can happen at any time. It does not make sense that the IRS's ability to administratively collect a nonrebate erroneous refund should turn on the happenstance of when it occurred.[72]

For those reasons, Congress should give the IRS a reasonable time in which to discover and collect back money erroneously refunded to taxpayers for reasons unconnected with substantive redeterminations of tax. The $200 million in erroneous refunds identified by *USA Today* should not be given up without giving the IRS a reasonable shot at collecting it back.

IV. Conclusion

I view law in general, and tax law in particular, as a slow-moving conversation between the various rulemaking authorities: the courts, Congress, and the government agencies charged with administering the law (here, the IRS). The conversation is ongoing and in the great tradition of fragmented democracy, each participant acts to check and balance the others. Sometimes that works to make the law better, but sometimes it makes the law worse. In the area of erroneous refunds, there has been a long awkward pause in the conversation and it is Congress's turn to speak. I hope Congress will do so here to advance the cause of good tax administration.

---

[72]The proposal also parallels how the IRS uses the section 6672 trust fund recovery penalty.

U.S. Tax Court Practice & Procedure

By Kyle Coleman

United States Tax Court Practice & Procedure

By: Kyle Coleman, LL.M., J.D.
16250 Knoll Trail, Suite 105 • Dallas, Texas 75248
Phone (972) 810-4380 • Fax (972) 810-4370
kyle@coleman-jackson.com
www.coleman-jackson.com

1

BIOGRAPHY

Mr. Coleman's practice concentrates on federal tax related controversy matters, including litigation in Federal District Courts, the United States Tax Court, and the Court of Federal Claims. Mr. Coleman also represents taxpayers in Internal Revenue Service audits, appeals and collection actions. Kyle has been admitted to the Fifth Circuit Court of Appeals Bar, the United States Court of Appeals for the District of Columbia, the Northern District of Texas, the Eastern District of Texas, the District of Colorado and the United States Tax Court.

In addition to tax controversy, Mr. Coleman also represents clients in estate and business planning as well as asset protection. His practice includes entity formation, asset transfers and wills and trusts.

2

HISTORY OF THE TAX COURT

- Created by Congress in 1924.
  - The Tax Court was created to provide a forum for taxpayers to contest tax deficiencies without first paying the tax.
- Mandated to "ride circuit"
  - The Tax Court comes to you (or nearby).
- The Court is comprised of 19 Judges appointed by the president and subject to Senate confirmation.

3

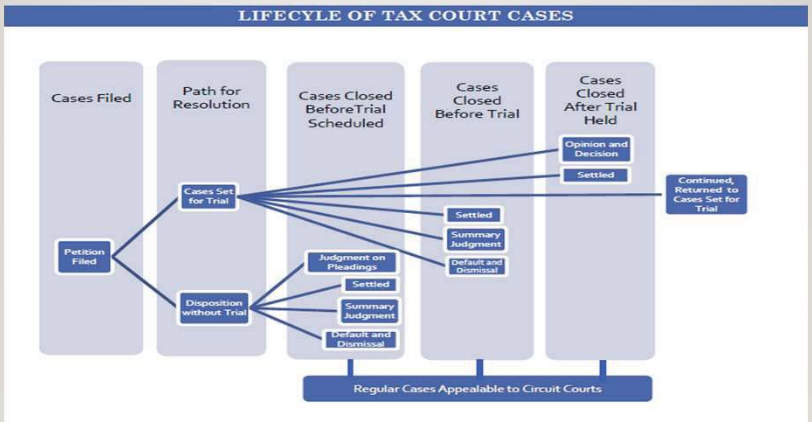
TAX COURT STATISTICS

Congressional Budget Justification for Fiscal Year 2024

- Requested Budget - $65,700,000, a 14% increase over fiscal year 2023.
- FYE 2022
  - 29,002 cases filed; 17,569 (regular) – 11,433 (small cases).
  - 32,290 cases closed.

4

LIFECYCLE OF TAX COURT CASES



5

CASED FILED BASED ON JURISDICTION TYPE FYE 2022

CASES FILED BASED ON JURISDICTION TYPE FISCAL YEAR 2022

JURISDICTION TYPE	FILED	PERCENT
Deficiency	27,854	96.04%
Lien/Levy	1,064	3.67%
Whistleblower	46	0.16%
Passport	25	0.08%
Declaratory Judgment, Exempt Organization	8	0.03%
Declaratory Judgment, Retirement Plan Revocation	5	0.02%
Disclosure	-0-	0.00%
TOTAL	29,002	100%

6

TAX COURT JURISDICTION

- The Tax Court has limited jurisdiction.
- The following issues may be heard by the Tax Court under express statutory authorization.
  1. A notice of deficiency. [Secs. 6212, 6213]
  2. Notice of liability to transferee or fiduciary. [Sec. 6901]
  3. A notice of determination. [Secs. 7476, 7477, 7478, 7479, and 7428.]
  4. A notice of intention to disclose a redacted ruling, determination letter, technical advice memorandum or Chief Counsel advice. [Sec. 6110]

7

TAX COURT JURISDICTION

- Tax Court issues continued.
  5. A notice of final partnership administrative adjustment. [Sec. 6226]
  6. A denial of an administrative adjustment request. [Sec. 6228]
  7. A denial of an award for administrative costs. [Sec. 7430(f)]
  8. A notice of final determination not to abate interest. [Sec. 6404(h)]
  9. A determination of employment status. [Sec. 7436]
  10. A notice of partnership adjustment. [Sec. 6247]

8

TAX COURT JURISDICTION

- Tax Court issues continued.
  11. A notice of adjustment with respect to nonpartnership items in an oversheltered return action, wherein the taxpayer seeks a declaratory judgement. [Sec. 6234]
  12. A denial of relief from joint and several liability on a joint return. [Sec. 6015]
  13. A notice of determination concerning collection action(s) under section 6320 and/or 6330. [Sec. 6320, 6330]
  14. A final determination denying the taxpayer's claim for a whistleblower award. [Sec. 7623]
  15. A notice of denial of or revocation of passport. [Sec. 7345]

9

SHOULD I FILE IN TAX COURT? PROS VS CONS

- Pros
  - Judge appointed to Court - very knowledgeable on tax issues.
  - No Full Payment First Rule – Notice of Deficiency is ticket to Tax Court.
  - Possible chance to have two bites at the apple to settle.
    1. IRS Appeals.
    2. IRS Trial Counsel.
  - Intended to be informal and less expensive Forum. See *Branerton Corp. v. Commissioner*, 61 T.C 691(1974).

10

BRANERTON

Discovery and request for admissions may not be commenced by a party until after that party has made a meaningful, good-faith attempt to attain the Objections of Discovery through informal consultation or communication. The Tax Court is insistent that the parties use informal efforts to obtain needed information for the preparation of the case for trial. The Court expects the parties to discuss, deliberate, and exchange ideas, thoughts, and opinions on an informal basis for resorting to the methods specified in the Tax Court rules. Shortcuts to the use of formal Discovery will not be tolerated. See IRM 35.4.3.2(08-11-2004).

11

SHOULD I FILE IN TAX COURT? PROS VS CONS

- Cons
  - Judge appointed to Court – very knowledgeable on tax issues.
  - If able to pay, may go to Federal District Court and have the case tried to a jury.
  - May be limited by Court's jurisdiction:
    - For example, 90 days to file Petition after receiving a Notice of Deficiency. If > 90 days, Tax Court is not an option.

12

FILING A TAX COURT PETITION

- The taxpayer must have a "ticket."
  - Notice of Deficiency
  - Any Notice of Denial listed previously under Tax Court Jurisdiction.
- If no "ticket," Tax Court is not available.

13

THE UNITED STATES TAX COURT RULES OF PRACTICE AND PROCEDURE

- IRC § 7453
  - The proceedings of the United States Tax Court and its divisions shall be conducted in accordance with such rules of practice and procedure (other than rules of evidence) as the Tax Court may prescribe and in accordance with the Federal Rules of Evidence.

14

PETITION
TAX COURT RULE 34

- A Petition to the United States Tax Court must contain the information required by the Tax Court rules and must identify the issues presented. If the Petition does not comply with the rules, the case may be dismissed.
  - The specific requirements for a deficiency or a liability action are contained in subsection (b).
  - Petitions and other actions are contained under subheading (c).

15

DISCOVERY

- Rule 70(a)
  - The general provisions for discovery are contained in Tax Court Rule 70. Again, the parties must observe the informal requirements of Branerton and Tax Court Rule 70(a) which specifically states, "The Court expects parties to attempt to attain the objectives of discovery through informal consultation or communication before utilizing Discovery procedures provided in these rules."
  - As a practical matter, no Discovery can be initiated in the United States Court until the parties have held a Branerton Conference as mentioned previously.

16

TYPES OF DISCOVERY

- Rule 71 – Interrogatories. Limited to 25 written interrogatories.
- Rule 72 – Production of Documents. Unlimited in number.
- Rule 90 – Admissions. Unlimited in number
- Rules 74 – Depositions
  - With consent of the parties.
  - Without consent of the parties if certain circumstances met.
  - Under prior versions of the Rules, a party deposition could not be taken absent consent. No longer the rule!

17

STIPULATIONS FOR TRIAL

- Rule 91 - The parties are required to stipulate, to the fullest extent to which complete or qualified agreement can or fairly should be reached, all matters not privileged that are relevant to the pending case, regardless of whether those matters involve fact or opinion or the application of law to fact. Included in matters required to be stipulated are all facts, all documents and papers or contents or aspects thereof, in all evidence that fairly should not be in dispute.
- 91(f) – Noncompliance is subject to judicial review.

18

NOTICE SETTING CASE FOR TRIAL

- The Notice issued by the Court setting a case for trial is key to discovery deadlines.
- Rule 70(a)(2) - Discovery may not be commenced, without leave of Court, before the expiration of thirty (30) days after joinder of issue (see Rule 38). Discovery must be completed in the Motion to Compel or any other Motion with respect to that Discovery must be filed, unless the court orders otherwise, no later than 45 days before the date set for call of the case from a trial calendar.
- All procedural deadlines must be walked back from the trial date. For example, formal discovery must be served at least 75 days before trial for you to be able to have discovery responses reviewed by the Court.

19

SAMPLE

Notice Setting Case for Trial

The Court's Standing Pre-Trial Order

20

SUMMARY JUDGEMENT

- Rule 120 – Judgement on the Pleadings
- Rule 121 – Summary Judgement by Motion
- Rule 122 – Submission without Trial. Judge rules based upon briefing by the parties.
- Rule 123 – Default & Dismissal. Similar to the dreaded State Court DWOP!

  Dismissal for Want of Prosecution.

21

PRETRIAL MEMORANDUM

Key Document for the Court. Gives the Court a road-map. There are also consequences if not complete.

Sample

Pretrial Memorandum

22

TRIAL

- All Tax Court cases tried before the judge.
  - No Jury.
- Governed by Federal Rules of Evidence. Rule 143.
- Rule 131. Trial calendars.
- Rule 140. Place of Trial.

23

POST-TRIAL BRIEFS

- Rule 151 – Briefs must be filed after trail or submission of a case, except as otherwise directed by the presiding Judge or Special Trial Judge. The presiding Judge or Special Trial Judge may permit or direct the parties to make oral argument or file Memoranda of Points and Authorities, in addition to or in lieu of briefs. The Court may strike any brief that does not conform to the requirements of this rule.
- Rule 152 – Oral Findings of Fact or opinion.
  - In 25 years, I have never seen a Tax Court Judge utilize this Rule.

24

PRO SE LITIGANTS

- Majority of litigants in Tax Court are *Pro Se*.
  - The Tax Court website is very taxpayer orientated.
  - Frequently Asked Questions.
  - Sample Petition

25

Automated Collection System Updates

By Tiffany Morice

IRS

ACS- Automated Collection System

Presented by: Tiffany Morice

ACS Automated Collection System | SB/SE Collection

1

IRS

Text Chat

Voice Bots

Chat Bots

Collection Technology Efforts

2 ACS Automated Collection System | SB/SE Collection

2

Voice and Chat Bots

Launched

- Commissioner designated funding to implement Voice Bots and Chat Bots to improve telephone Level of Service and the Taxpayer experience.
- Unauthenticated Chat Bots launched December 2021
- Unauthenticated Voice Bots launched January 2022
- Authenticated Voice Bots launched June 2022
- Voice Bots are software powered by Artificial Intelligence (AI).
- Bots are designed to handle most basic collections concerns. This allows live assistors to work the complex issues.
- Both Voice and Chat Bots have English and Spanish applications to ensure continued services to taxpayers who speak limited English.

Voice bots

Unauthenticated (launched January 2022)

Offered on Accounts Management and Automated Collections Services Toll Free Phone Lines

Option to escalate to an assistor

Assist One-time payments, FAQ, Notice clarification

Authenticated (launched June 2022)

Offered on Accounts Management and Automated Collections Services Toll Free Phone Lines

Establish or modify short term (up to 180 days) and long-term payment plans.

Request transcripts, payment and payoff information

Ability to hear account/payment history and obtain current balance owed.

Text chat

Statistics

- Launched: 2017
- Utilizes a live assistor
- Unauthenticated vs. Authenticated
- Volume: 1,450,548 thru January 2023
- Average wait: 40 seconds
- Average handle: 6:25 (Unauthenticated) / 22:28 (Authenticated)
- Offered while searching IRS.GOV

DUT

Document Upload Tool (DUT)

- The DUT tool is a new way to help Taxpayers more efficiently submit documentation to the IRS
- Once the documents are uploaded into the tool, the phone assistor can see the documents in real-time
- It will not replace eFax
- Rolling out to all Call sites during Q1 and Q2 of FY23
- This program will be scalable in the future

Chat bots now available

Available through IRS.gov

www.irs.gov/payments

www.irs.gov/payments/payment-plans-installment-agreements

www.irs.gov/es/payments (Spanish)

www.irs.gov/es/payments/payment-plans-installment-agreements (Spanish)

Option to escalate to a live assistor

Offered while searching IRS.GOV- added for tax practitioners as well

Help taxpayer make one-time payments, provide FAQ & Notice clarification

If escalated to a live assistor:

- Gives assistors the ability to direct taxpayers to resources on irs.gov with direct hyperlinks and topic numbers.
- Allows live assistors to save resources for both the Service and the Public by directing taxpayers to the correct department before they ever make a phone call.

Voice and Chat Bots

Benefits

- Provide general information to taxpayers through authenticated and unauthenticated voice and digital channels with an emphasis on self-help options for taxpayers to resolve common collection questions without the need to speak with a live telephone assistor.
- Provide responses to taxpayers acting as a customer service “first responder” quickly fulfilling common requests for general information. The bots free up IRS telephone assistors to concentrate on more complex inquiries.
- Improve telephone level of service by satisfying taxpayers’ need to create and manage installment agreements through self-service conversational interactions; avoiding long wait times.
- Shows the IRS is stepping into the future for the benefit of our taxpayers and their representatives.

ACS Phone Assistors

ACS Tool Updates

- ✓ AMS update completed in 2022 which allows CRs to quickly navigate taxpayer accounts.
- ✓ IAT tool updates regularly to improve functionality and resolve errors which helps the call site representative help the taxpayer faster and more accurately with their concerns.
- ✓ Call in lines now have an automatic callback feature so the taxpayer no longer has to wait on the line and will be called back when it's their turn.
- ✓ Conversion to a new phone system was completed smoothly for all call site representatives.

Questions

Office of Fraud Enforcement

By Thomas Kramer

Small Business / Self Employed

OFFICE OF FRAUD ENFORCEMENT

OFE

June 8th, 2023

Practitioner Awareness of Fraud Schemes

Tax Alliance

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

1

Office of Fraud Enforcement

OFE

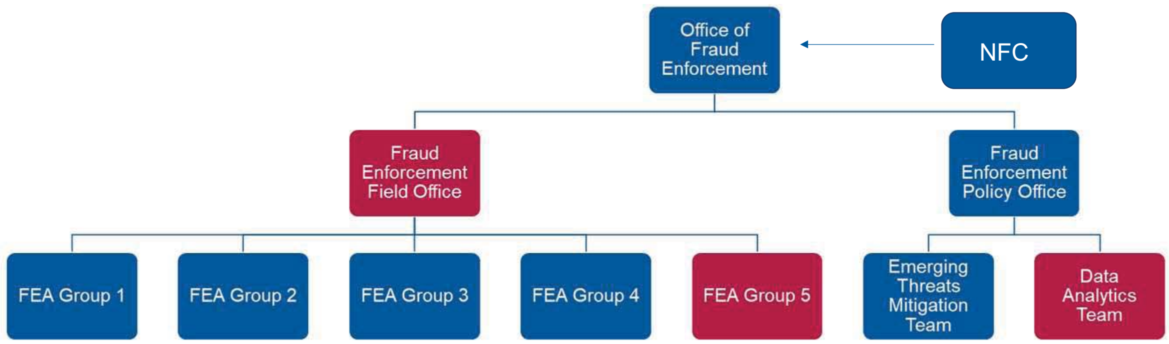
- Established in March 2020
- Previously NFP – Expanded Vision
- Led by Acting Executive Director Tom Kramer
- Direct report to SB/SE Deputy Commissioner, Collection & Operations Support
- OFE promotes compliance through strengthening IRS' response to fraud and mitigating emerging threats

2

5/25/2023

2

Office of Fraud Enforcement Structure



3

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

4

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

5 5/25/2023

5

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

6 5/25/2023

6

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

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

IRS

OFE

Questions?

Comments.

Ideas!

Understanding the Assessment Statute Expiration Date

By Bryan Camp

Tax Alliance Conference
June 6-8, 2023

Presentation On

Limitation Period on Assessments[1]

by

Bryan T. Camp
George H. Mahon Professor of Law
Texas Tech University School of Law

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 <u>and</u> 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 And 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 (8th 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

Monday, May 23, 2022

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!*

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.

---

[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]

---

[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

---

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

---

[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

---

[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

---

[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

---

[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]

---

[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:

---

[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

---

[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:

---

[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.

---

[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]

---

[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."

[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

---

[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

---

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,*

---

[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]

---

[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

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 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.

[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*

---

[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]

---

[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

---

[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

---

[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

---

[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.

---

[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

---

[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.

---

[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).

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.

---

[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."

---

[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*

---

[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

---

[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)

---

[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

(Footnote continued in next column.)

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.

[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.

---

[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
Acting Director
Office of Professional Responsibility

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

1

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

3 OPR Circular 230

3

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))

4 OPR Circular 230

4

Treasury Circular No. 230

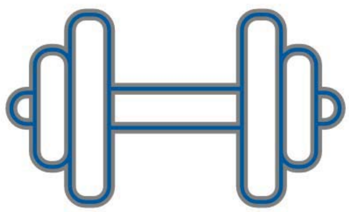
Circular 230 is the document containing the statute and regulations detailing a tax professional's duties and obligations while practicing before the IRS

- 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)

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.

Fitness to Practice

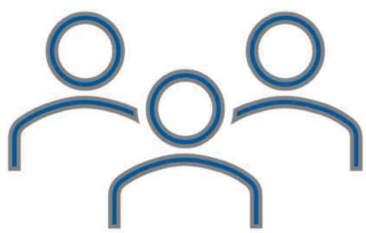


- **Overarching focus of OPR's oversight of practitioners is their "fitness to practice.**
  - Good character
  - Good reputation
  - Necessary qualifications to provide valuable service to the client
  - Competency to advise and assist persons in presenting their cases

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

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

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

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

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

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**

29

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!**

30

Standards for Tax Returns/Documents

Tax Return Position

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.

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?**

35

Stage 3: Engaging with the IRS

36

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.

37

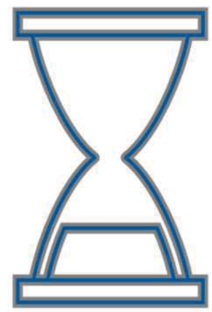
Duty to Provide Information (§10.20)

- 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.

38

Prompt Disposition of Pending Matters (§10.23)

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



39

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

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

41

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

42

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.

43 OPR Circular 230

43

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 OPR Circular 230

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.

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.

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.

51

Other Important Circular 230 Provisions

52

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

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

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

OPR Investigate and Disciplinary Process

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

OPR Investigate and Disciplinary Process

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

63 OPR Circular 230

63

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)

64 OPR Circular 230

64

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

65 OPR Circular 230

65

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.

66 OPR Circular 230

66

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.

67

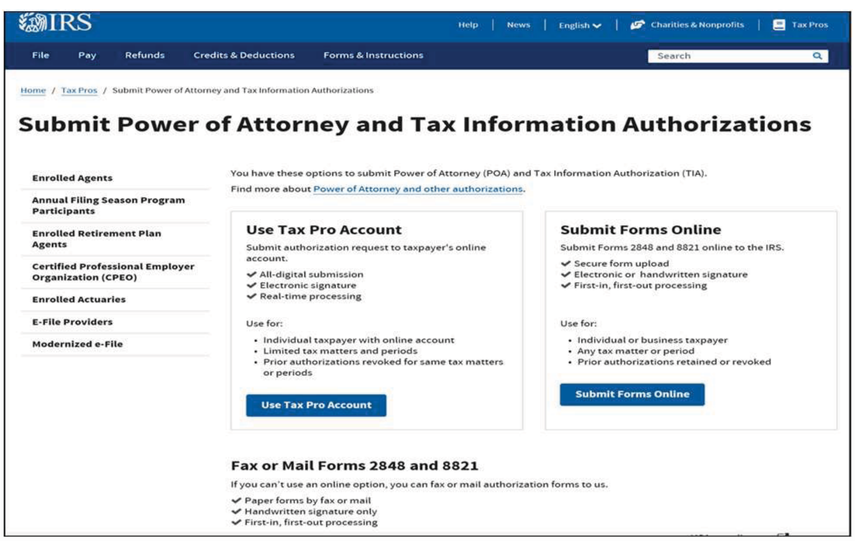
Key Points

- 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.

68

Overview of Tax Pro Account

Tax Pro Account: Options for Submit POAs and TIAs



Expanding Services for Taxpayers

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

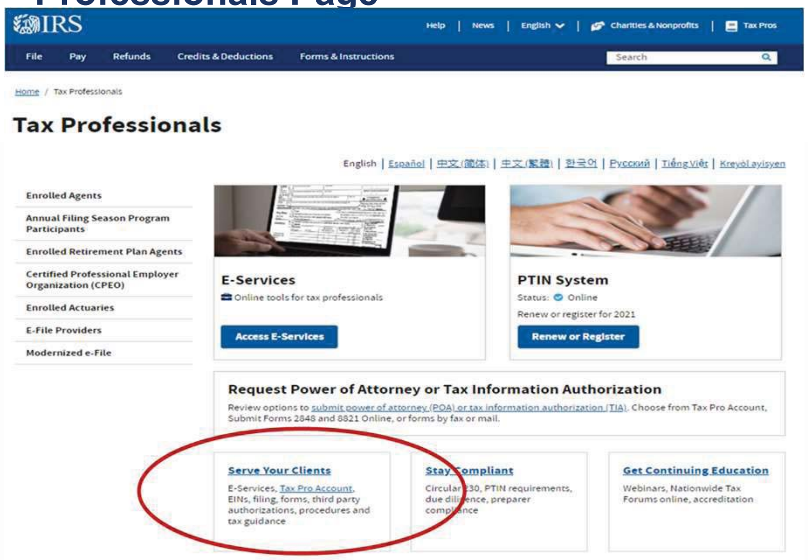
- Added "authorization" feature to individual Online Accounts.
- Launched Tax Pro Account on IRS.gov to allow tax professionals to initiate online POA or TIA requests.
  - Tax professional initiates a POA or TIA, using checkbox as electronic signature for POAs.
  - POA or TIA requests automatically transfers 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

73

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

74

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

75 OPR Circular 230

75

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.

76 OPR Circular 230

76

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*

QUESTIONS?

Implementation and Government Enforcement of BlockChain Technology and Digital Assets

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

GRAY REED 2

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

GRAY REED

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.

GRAY REED

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
Sign In | Get Unlimited Access

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?

GRAY REED 7

7

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?

GRAY REED 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

GRAY REED 9

9

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?

GRAY REED 10

10

GOVERNMENT ENFORCEMENT ACTIVITY

U.S. SECURITIES AND EXCHANGE COMMISSION

Press Release

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

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

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

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.

GRAY REED

11

11

INDUSTRY UPDATES ON DIGITAL ASSETS

12

12

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

Deep dive

- 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

GRAY REED

13

13

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

GRAY REED

14

14

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

GRAY REED 15

15

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

GRAY REED 16

16

DIGITAL ASSETS: PERSONAL REPORTING AND TRANSACTIONAL TAX CONCERNS

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

GRAY REED

17

17

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).

GRAY REED

18

18

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).

GRAY REED 19

19

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.

GRAY REED 20

20

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.

GRAY REED

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.

GRAY REED

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.

GRAY REED

23

23

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.

GRAY REED

24

24

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).

GRAY REED 25

25

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.

GRAY REED

26

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.

GRAY REED

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.

GRAY REED

JOSHUA SMELTZER

BOARD CERTIFIED®
Texas Board of Legal Specialization
TAX LAW

Rated by Super Lawyers® 2023 visit SuperLawyers.com

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.

FORMER EXPERIENCE:

- Litigator, U.S. Department of Justice – Tax Division

EDUCATION:

- J.D., American University Washington College of Law
- B.S., University of Utah

CONTACT: Joshua Smeltzer
jsmeltzer@grayreed.com
469.320.6225
Dallas, Texas

BRIAN CLARK

Best Lawyers ONES TO WATCH GRAY REED 2023

Rated by Super Lawyers® 2023 visit SuperLawyers.com

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.

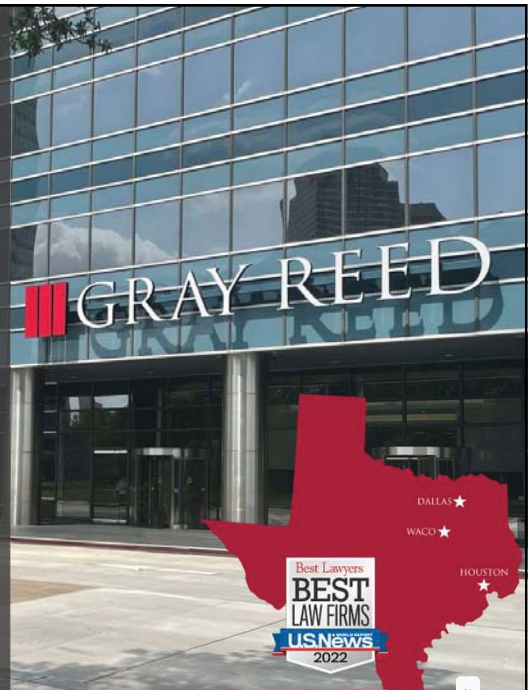
EDUCATION:

- LL.M., New York University School of Law
- J.D., Louisiana State University
- M.A., Accounting, Texas Christian University
- B.B.A., Accounting, Baylor University

CONTACT: Brian Clark
bclark@grayreed.com
469.320.6212
Dallas, Texas

ABOUT GRAY REED

- A full-service commercial law firm with 30 organized practice groups
- More than 140 attorneys
- All of Gray Reed's tax attorneys are either CPAs, Board Certified by the Texas Board of Legal Specialization, have advanced law degrees or have government experience
- Visit grayreed.com and follow us on social media for latest firm news and thought leadership



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

1

Presenters

BOARD CERTIFIED® Texas Board of Legal Specialization
ESTATE PLANNING AND PROBATE LAW

Rob Hugos, Attorney, CPA, LLM (Tax)
Partner, Director of Advanced Planning
TEXAS TRUST LAW

BOARD CERTIFIED® Texas Board of Legal Specialization
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 2nd Generation
- Over 4/5 do not survive into the 3rd 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

5

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

7

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

12

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

13

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)

14

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

15

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

16

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 (**not** a gift)
  - Trust controls distributions to children

17

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

18

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

19

Questions?

- **Rob Hugos, Attorney, CPA, LLM (Tax)**
- Partner, Director of Advanced Planning
- Texas Trust Law
- Austin - Principal Office
- Georgetown | Horseshoe Bay | San Antonio | Wimberley
- Rob@TexasTrustLaw.com
- (512) 480-8828

- **Christi Mondrik. Attorney, CPA, TBLS Certified – Tax Law**
- Founder and Principal Attorney
- Mondrik & Associates
- 11044 Research Blvd Ste B-400 Austin, TX 78759
- Cmondrik@MondrikLaw.com
- (512) 542-9300 x 104

20