

Federal Tax Practice and Procedure  
Working Outline  
University of Miami School of Law  
Graduate Program (LLM) in Taxation  
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**I. Penalties**

1. ABA Opinion 85-352: a lawyer may advise a reporting position on a return provided there is some realistic possibility of success if the matter is litigated.
2. Section 6694 Penalties
  - a. Penalties on tax return preparers
    - 1) 6694(b)B \$1,000 penalty for willful understatements of tax liability or for reckless or intentional disregard of rules or regs.
    - 2) 6694(a)B \$500 for less culpable conduct.
      - a) realistic possibility of success standard: if a reasonable and well-informed analysis by a person knowledgeable in the tax law would lead such a person to conclude that the position has approximately a one in three, or greater, likelihood of being sustained on its merits.
  - b. 7701 defines who is a tax return preparer.
    - 1) failure to sign as tax return preparer subject to penalty under 6695.
    - 2) if qualify as a tax return preparer but do not sign subject to penalty under 6694.
3. Section 6662 Penalties
  - a. Penalties on taxpayer
    - 1) 6662(d)B may avoid 20% penalty only if there is substantial authority for position taken on return or if they disclose the position and the disclosed position has a reasonable basis.
      - a) higher standard
4. Circular 230
  - a. Realistic possibility of success standard
  - b. 10.2(a)B preparation of a return is not practice before IRS.
  - c. Power of Attorney
    - 1) Form 2848 special power of attorney
    - 2) Form 8821 general power of attorney
  - d. Penalties
    - 1) disbarment, suspension, reprimand, order dismissing complaint
      - a) disbarment or suspension for incompetence, disreputable conduct and violation or regulations (circular 230).

i) disreputable conduct includes conviction of any criminal offense involving dishonesty or breach of trust, giving false or misleading info, attempting to influence IRS agent, contemptuous conduct in practice before IRS.

5. Other Penalties

- a. Grievance
  - 1) state or federal bar
- b. Director of Practice penalties
- c. 6694 (a) Negligence or (b) willful
  - 1) 7206(2) aiding and abetting false statement on tax return (felony)
- d. 6701 civil aiding and abetting
  - 1) civil fraud, injunctive power
- e. Malpractice

6. Cash Reporting Requirements and Penalties

- a. 6050I requires anyone who receives more than \$10,000 in cash in one transaction or a series of related transactions in connection with his trade or business to report the transaction and info on the payor of the money to federal authorities.

1) Regs 1.6050I-1(c)(1): an attorney who receives a cashier's check for services rendered is not required to report under the designated reporting transaction rule, but may be required to report under the knowledge test.

- b. Reporting requirement is triggered by

- 1) receipt of \$10,000
  - a) in a single transaction
  - b) in a series of related transactions
    - i) any transactions b/w a payor and recipient within a 24 hour period
    - ii) transactions made outside 24 hour period that recipient knows or has reason to know is part of a series of related transactions [Reg 1.6050I-1(c)(7)]

2) report under 6050I by filing Form 8300

- c. Penalties for Noncompliance

- 1) civil penalty [6721]
  - a) unintentional failure to file a form 8300 or an incorrect/incomplete filing is \$50 per return, up to \$250,000 per year
  - b) intentionally disregarding the filing requirement or intentionally filing an inaccurate or false report is greater of \$25,000 per return or amount of cash received in transaction, up to \$100,000.

- 2) criminal penalty
  - a) willful failure to file form 8300 is a felony [6703]
  - b) wilfully filing a materially false form 8300 is a felony under 7206
  - c) structuring a transaction to avoid the reporting requirements is felony under 6050I(f) punishable under 7203.
- d. Client identity and fee information are not subject to attorney-client privilege and do not justify a lawyer=s failure to comply with 6050I
- e. Last Link Doctrine
  - 1) exception
    - a) form 4789 filed with a bank within two weeks of receiving cash eliminates obligation to file form 8300

## II. Applicable Law

- 1. Rules/Regulations promulgated by Treasury dept. following formal APA rule making procedures.
  - a. All rules, except procedural regs, are adopted in accordance with APA.
  - b. Rev. rulings, private letter rulings, determinations letters, IRS statements of position are not subject to APA rulemaking procedures.
  - c. 553 APA
    - 1) requires that all substantive or legislative regulations be published in final form in Federal Register at least 30 days prior to effective date.
      - a) exceptionBcases in which agency believes the procedures are impracticable, unnecessary or contrary to public interest.
        - i) usually invoked for temporary regulations (expire if not adopted within three years of date they are issued).
- 2. Types of Treasury regulations
  - a. Legislative
    - 1) promulgated by treasury dept. and bind treasury and IRS
    - 2) 1502 and specific sections of the code authorize issuance of regs having force and effect of law
    - 3) strongest, difficult to overturnBgreat deference from judiciary; court not free to strike down legislative regs that are properly issued procedurally and within the scope of the legislative grant.
      - a) courts can strike down legislative regs that conflict w/ statutes, are beyond scope of statute, or are unreasonable
  - b. Interpretive
    - 1) promulgated by treasury dept. and bind treasury and IRS
    - 2) 7805(a) directs Treasury Secretary to prescribe all needful rules and regs for enforcement of the code.
    - 3) have force and effect of law but given less deference by court

a) can be invalidated if inconsistent w/ statute=s legislative history

b) Vogel Fertilizer case held that a reg can be invalidate as unreasonable if it does not harmonize with the statute=s origin and purpose.

i) there must be an ambiguity in order to justify checking reg against legislative history

c) Durbin case (supplemental material)

4) factors influencing deference given to regs by courts

a) length of time reg has been in force

b) legislative reenactment doctrineBCongress is presumed to be aware of and to condone agency interpretations, especially regs, of statutes that it reenacts.

i) this grants long standing interpretive regs same deference as given to legislative regs

### c. Procedural

1) issued by IRS and not always binding on agency

a) not subject to APA requirements

b) unlike legislative and interpretive regs, may have retroactive effect

c) where procedural reg was not relied on by individual and it has no effect on his conduct, failure by IRS to comply with procedural rule does not require that the evidence obtained in violation of rule be suppressed.

2) regs that describe organization of IRS and its housekeeping rules

3) Luhring v. Glotzbach (4<sup>th</sup> Cir.)Bprocedural regs are directory not mandatory. (601. Regs for internal procedure)

4) Lansons (supplemental material)Bprocedural regs binding on taxpayer and govt. (only dictaBnot followed).

### 3. Retroactivity

a. Rules and regs generally have prospective effect only

[7805(b)]Bprohibits issuance of regs with retroactive effect, permits Service to modify or revoke retroactive ruling, determination letter, etc.

1) exception

a) reg issued within 18mos. of statute to which reg relates

b) to prevent abuse

b. Case law still applies to rev. ruling, determination letter, etc.

1) Manhattan General Equipment Co. v. CommissionerBmistake of law is a nullity.

a) court declared original reg a nullity and denied that application of new amended reg was retroactive

2) Helvering v. R.J. Reynolds Tobacco Co.Blegislative reenactment

a) b/c statute had been reenacted w/o change while the old reg was in force, Congress did not intend to authorize the

treasury to repeal the rule of law that existed during the period for which the tax was impose.

- i) based on length of time old administrative view had been in effect (14 years) and number of revenue acts passed during that time w/o changing the definition of gross income.
    - ii) supreme court did not believe the original reg was inconsistent w/ statute and unreasonable, as was the case in Manhattan General.
  - 3) IRS retroactive application of regs that contradict unofficial positions upheld.
  - 4) Retroactive revocation is abuse of discretion if it involves an arbitrary distinction between similarly situated taxpayers.
    - a) Bookwalter v. Brecklein = taxpayers w/o rulings are entitled only to be taxed the same as other taxpayers w/o rulings.

### III. Rulemaking

1. Litigation in civil tax cases and before tax court
  - a. Who can litigate
    - 1) Attorneys admitted to state bar
    - 2) CPAs
    - 3) Enrolled agents, actuaries
  - b. Source of tax litigation
    - 1) Malpractice (of accts, etc.
    - 2) Tax planning w/ no follow-up (details missing)
    - 3) revenue agents
      - a) improper case, may lead to attorney fees under 7430
    - 4) planned litigation
2. Extension of attorney-client privilege [7525]
  - a. Privilege extended to accountants, enrolled agents, etc. and covers communication that fit w/in attorney-client privilege
    - 1) does not cover
      - a) preparation of tax returns
      - b) criminal matters
      - c) corp tax shelters
  - b. Waiver
    - 1) accountants not set up to deal with issues of waiver and privilege
    - 2) Kovels case & Kovel Letter Proc
      - a) if acct senses a prob, bring in atty as atty for acct.
    - 3) Panoff feels acct no trained/equipped to w/ privilege, will prob lead to malpractice.
3. Attorney-client relations
  - a. Don't set up expectations with client that you can't meet
  - b. Reliance on counsel (criminal defense)
    - 1) 6662B 20% no fault penalty

- a) exception
      - i) 6664(c) reasonable causeBtaxpayer must act in good faith
  - c. Standard of care
    - 1) after LLM, US. V. Cheek = willfulness in tax context (good faith belief)
      - a) same criminal defenses not available, held to higher standard
- 4. IRS Rulings
  - a. Revenue (Published) ruling
    - 1) opinion of IRS, does not have force of law
      - a) issued by IRS National office, APA not followed but published in Internal Rev Bulletin
    - 2) broad application that service feels beneficial to public
    - 3) can rely on if facts substantially same as described in rev ruling, p.26
      - a) use due diligence in obtaining facts and application of rev ruling
  - b. Private Letter Ruling
    - 1) apply to a particular set of facts and addressed to a particular taxpayer
      - a) applies only to the taxpayer that requested the ruling
    - 2) IRS will only rule on prospective transactions or transaction completed but for which return has not been filed.
      - a) no rulings listBissues on which IRS will not rule; involves issues with inherently factual questions.
    - 3) 6110 states that private letter ruling may not be used or cited as precedent and must be made available to public
    - 4) user fee for a letter ruling
    - 5) should not request ruling if tax consequences uncertain or timing is an issue
    - 6) info required for ruling request found in first Rev Proc (ie, 99-1) issue each year.
- 5. Other IRS statements of position
  - a. Revenue Procedure
    - 1) outline procedures for certain actions; issued by IRS
  - b. Determination Letters
    - 1) type of private ruling w/ respect to employee benefits plan or tax-exempt status of an org
    - 2) issued for a complete transaction by District Director
  - c. Acquiescences/ Nonacquiescences
    - 1) whether IRS agrees w/ result of a case or not
      - a) acquiescenceB IRS will alter its position to accept court ruling
      - b) nonacquiescenceB IRS will continue to litigate the issue and maintain its position

- i) attorney=s fees under 7430 can apply in nonacquiescence (net worth requirement so does not apply to rich taxpayers)
    - 2) Dixon v USB retroactive revocation of an acquiescence not an abuse of discretion
  - d. Action on Decision
    - 1) determination in form of memorandum explaining why govt. should or should not appeal a tax court decision
      - a) prepared by Chief Counsel Office (IRS), Appellate div of Justice dept., and Solicitor General=s Office
6. Case law
- a. Courts deciding tax cases
    - 1) tax court (article I)
    - 2) federal district court (article III)
    - 3) court of claims (article III)
      - a) refund jurisdiction court
  - b. Golsen rule (tax court)
    - 1) tax court will generally be bound by a decision of the appellate court (circuit) for the area in which it is sitting.
      - a) may be an issue for where taxpayer is for corp or indiv.
    - 2) cases w/in own circuit are more important than those in other circuit; fed district court decision in own circuit may be important.
7. Information to rely on
- a. Statutes, legislative regs, interpretive regs (7802 retroactive limits, published ruling and private ruling (to extent of retroactive revocation of ruling))
  - b. Rev Proc 601.201 (Four R=s article, p. 769)
    - 1) revocation of a ruling/determination letter will not apply retroactive to whom the ruling was originally issued or to a taxpayer whose tax liability directly related if
      - a) no misstatement or omission of material facts
      - b) facts not materially different
      - c) no change in applicable law
      - d) ruling issued for prospective transaction
      - e) taxpayer acted in good faith in reliance on ruling to her detriment

## IV. Confidentiality vs. Disclosure

### A. Freedom of Information Act and Privacy Act

To get info about self [552(a)]

- b. 6103 B makes returns and return info private, supercedes privacy act
- c. 6103 provides the general rule that returns and return info shall be confidential and govt. employees are prohibited from disclosing it.
  - 1) return info includes



- a) taxpayer identity
  - b) nature, source, amount of income, deductions, etc.
  - c) any data received by IRS in connection w/ return
  - d) info concerning investigation of return
  - e) any part of IRS written determination of file document exempt from disclosure under 6110
- 2) exceptions (persons/agencies to whom info may be disclosed)
- a) persons designated in writing by taxpayer in a written request or consent to disclosure [6103(c)]
  - b) state tax officials and audit agencies [6103(d)]
  - c) persons or entities having a material interest in the info [6103(e)]
  - d) Committees of Congress, President, White House employees, and other federal govt. employees not involved in the administration of tax laws [6103(f), (g), (i)]
  - e) Employees of Treasury dept. and Justice dept. employees personally or directly involved in a civil or criminal case [6103(h)]
    - i) Lampert v. US B upheld the release of tax return info about taxpayers involved in a civil injunction proceeding initiated by govt.
      - B permitted public disclosure of info that had already been disclosed in court proceedings
  - f) IRS employees may reveal return info to the extent disclosure necessary in obtaining info not otherwise reasonably available [6103(k)(6)]
    - i) Barret v. US B court found was not necessary to disclose to doctor=s patients that he was under investigation
    - ii) Heller v. Plave B court found that IRS special agent was unscrupulous in disclosing to taxpayer=s clients that he was under investigation (unnecessary).
- 3) disclosures not authorized under exceptions give rise to private cause of action under 7431(c).

- a) greater of
    - i) \$1000 for each acct or
    - ii) sum of actual damages plus punitive damages if wilful or gross negligence
- 4) 7213 makes it a felony to willfully violate 6103
  - a) unlawful for any person to whom return is disclose to print, publish
    - i) fine of \$5000/5 years
  - b) unauthorized inspection of returns (IRS looking thru files)
  - c) exception to 6103
    - i) joint filer, ie spouse
    - ii) 1% shareholder

## B. §6103 : The Code's Privacy Rules

### 1. Confidentiality of Return Information

- a) §6103 provides the general rule that except as otherwise authorized by the Code *"returns and return information shall be confidential"*
- b) "returns" = defined to include any tax return, information return, declaration of estimated tax, and claim for refund, together with any amendment and any supporting documentation files with any of such documents
- c) "return information" - - includes the following
  - (1) the taxpayer's identity**
  - (2) the nature, source or amount of any income, deduction, tax liability, etc:**
  - (3) any data received by the IRS in connection with any return**
  - (4) information concerning any possible or actual investigation of a return; and**
  - (5) any part of any IRS written determination or background file document exempt from disclosure under §6110**

### 2. Exceptions Permitting Disclosure of Return Information

- a) Conditions under which return information may be disclosed
  - (1) Persons designated in writing by the taxpayer in a written request or consent disclosure (§6103(c))**

**(2) State tax officials and state audit agencies pursuant to a written request of the head of the state agency (§6103(d))**

**(3) Persons or entities having a *material interest* in the information**

**(4) Congressional Committees, the President, White House, etc**

**(5) IRS employees may disclose return information to the extent such disclosure “*is necessary in obtaining information which is not otherwise reasonably available*” in determining a taxpayer’s tax liability (§6103(k)(6))**

**(a) Would this permit an IRS special agent who is conducting a criminal investigation of a physician to send letters to the doctor’s patients asking for information from them and stating that the doctor is under criminal investigation?**

(i) Fifth Circuit reversed a district court’s summary judgment in favor of the Government in a §7431 damages action based on these facts....*Barrett v. US*

**(b) A court found that disclosing to the taxpayer’s clients that the taxpayer (a lawyer) was under criminal investigation and characterizing the taxpayer as “unscrupulous” were unnecessary and improper under §6103 (*Heller v. Plave*)**

**(c) Courts ARE SPLIT ON THE FOLLOWING: once return information is disclosed in a judicial proceeding, does it lose its confidentiality and thereby become publicly disclosable by gov’t employees?**

(i) *Lampert v. US* = said yes. **Factors that led the court to saying “yes”**

*(a) That strict enforcement of §6103 would hamper the gov’t ability to publicize its tax law prosecutions*

*(b) That court records are public documents and any member of the public is free to inspect them*

b) Unauthorized disclosure gives rise to a private cause of action for damages against the US (§7431(c))

**(1) Cause of action for damages against a Government employee who made the improper disclosure of return information**

3. Standard of Review

a) The requester of the information bears the burden of proving the arbitrariness of the refusal to disclose

C. §6110: Disclosure of IRS Written Determinations

1. §6110 = requires the IRS to disclose all “written determinations” - -

a) defined to include all letter rulings, determination letters and technical advice memos

**(1) DOES NOT ADDRESS OR APPLY TO ANY OTHER INFORMATION THAT “WRITTEN DETERMINATIONS” AND CONFIDENTIALITY OR DISCLOSURE OF SUCH INFORMATION IS GOVERNED BY FIOA AND §6103**

b) Also requires disclosure of “*background file documents*” – including the request for written determination and any documents or communications received by the IRS in connection with the request

c) Identity of taxpayers requesting rulings is protected by a “*sanitizing*” prescribed by §6110(c)

**(1) Requires that all information that could identify a taxpayer or that is otherwise privileged must be deleted from the written determination before it is made public**

**(a) Other confidential information that must be deleted include “*trade secrets and commercial or financial information obtained from a person and privileged or confidential*”**

**(b) The IRS is required to notify the taxpayer of its intent to make the information publicly available and the taxpayer has 60 days in which to furnish the IRS with a list of all information that should be deleted**

d) Also designed to discourage the use of improper influence to affect the IRS ruling

**(1) Under §6110(d) - - if a third party communicates with the IRS (in writing or otherwise) concerning any request for a written determination it, the IRS must red flag the contact by describing it in its publicly disclosed ruling**

## **V. Audits and Administrative Appeals**

### **A. Audits**

#### **1. Selecting Returns for Audit**

#### **2. Types of exam agents**

- a) Revenue agent: income tax exams, domestic issues
- b) International examiners: brought in by revenue agents for intl issues
- c) Revenue officer examiner: exams for employment and tax issues (independent contractor or employee)
- d) Pension examiner
- e) Excise tax examiner: freon and other items w/ excise tax
- f) Special agent: police officer involved w/ investigation not exam

#### **3. Types of Audits**

- a) Audits handled through the mail

**(1) Conducted by IRS Service Centers**

**(2) Known as “correspondence examinations”**

**(3) Typically they involved written correspondence from the IRS Service Center to substantiate such items as charitable contributions**

- b) Office audits

**(1) Handled by tax auditors**

**(2) Scope = typically restricted to a specific “significant item(s)” identified during the screening process**

**(3) Note: if a tax auditor discovers or uncovers significant items that were not previously detected - - the scope of the audit can be expanded**

c) Field Audits

**(1) More complex than office audits**

**(2) Handled by “revenue agents” who are not restricted in the scope of the audit to identified significant items**

**(3) The agent examines the taxpayer’s books and records usually at the taxpayer’s home or business premises**

**(4) Standard = the agent “maintain a fair and impartial attitude in all matters relating to the examination”**

d) Taxpayer compliance audit

**(1) Conducted under the Taxpayer Compliance Measurement Program (TCMP)**

**(2) Designed to evaluate taxpayer compliance through random, specialized audits**

**(3) The results of these audits are used to develop the DIF formula**

4. Examination Process

a) DIF B Discriminant Function

1) based on current statistics derived from TMCP (distorted); now based on district office of research and analysis (DORA)

a) analyze data and statistics from returns to identify returns w/ a high probability of error and a resulting significant tax change

b. Examination by infection

1) one partner or corp gets examined and causes another partners or shareholder to be examined

a) exam of one entity causes exam of the other

c. Inconsistent positions of taxpayer

1) especially w/ items such as exemption for children of divorced couple (both take the deduction)

d. Filing of refund claim

1) instigates exam that is not limited to refund issue

2) w/ income tax can come from following forms

a) 1040X B individual amendment

b) 1120X B C Corp amendment

- c) 843 B refund of penalties, excise tax, petition for abatement of penalties/interest [6404]
- e. Request for private ruling/determination letter
  - 1) if denied, then examined (might be better not to ask for one)
  - a) large transaction usually conditioned on ruling
- f. Informants
  - 1) in civil context only
  - 2) reward for informants under 7623 (\$100,000 cap on reward)
    - a) usually exspouse, former lover, exbusiness partner/shareholder, former employee

## 5. Changes in 1998 Tax Act

- a. Burden of Proof
  - 1) 7491(b) court proceeding arising out of exam
    - a) if taxpayer introduces credible evidence regarding any factual issue in a tax controversy, commissioner has the burden of proof but only if taxpayer has substantiated and maintained records and cooperated w/ all reasonable requests.
  - 2) tax court does not like nonvoluntary discovery
    - a) indirect method of proofB statistical income reconstruction, burden always on IRS w/ this method
- b. 1040 forms must include explanation of joint and several liability (married individuals)
  - 1) 6015 innocent spouse argument
- c. IRS may not contact third parties during an exam w/o taxpayer notification
  - 1) 7602(c) reasonable notice that will contact third parties
    - a) IRS supposed to supply list of contacts
  - 2) exception
    - a) good cause
      - i) notice would jeopardize collection or cause a reprisal against a third party
    - b) criminal investigation
- d. Financial status audit (Lifestyle exam) Limitations
  - 1) cannot do for just any reasonB must be reasonable indication of likelihood of unreported income (ie, informant)
- e. Tip reporting alternative committees (TRAC)
  - 1) related to tips at casinosBcan no longer do
- f. Privileged communication for tax advisors [7525]



g. Procedure for appeal of exam and collection, early intervention of appeal, exam and collection [7123]

- 1) Rev Proc 99-28: criteria to invoke early intervention
  - a) probably used in large case scenario (fortune 500)

h. Illegal tax protestor now referred to as nonfilers

Suspension of penalties and interest when taxpayer not contacted [6404(g)]

- a. Tax year prior to 2004B if IRS does not provide revenue agent report/ notice w/in 18 mos of date return filed then interest and penalties suspended until 21 days after notice is provided
- b. Tax year after 2003B 12 mos from date return filed
- c. Does not apply to failure to pay criminal penalties under 6651

## 6. Guidelines

a. Market segment specialization guidelinesBexam manual for certain industry

- b. Industry specialist programB special industry like shipping, offshore trust

## 7. Rules when dealing w/ agents

- a. Don' t volunteer
- b. Focus exam at beginning to what agent wants (request an exam plan)
- c. Be aware of nontax issues and impact on past/future years
- d. Pressure points
  - 1) agents cannot consider the hazards of litigation, but do so by hiding issues
  - 2) psychological basis

## 6. Appeals

- a. Even if not required to do a protest, do a skeletal protest unless it is a legal issues; if factual service does a rebuttal.
  - 1) if file protest, consider nontax exposure
    - a) frivolous position can result in penalties under 6673 and impairs chance for attys fees under 7430
    - b) undue delay not permitted
  - 2) protest not required if appeal from district office involving \$2500 or less
- b. Guided by hazards of litigation standard to determine how a court would likely rule.

- 1) docketed or nondocketed issues
  - 2) burden of proof for new issues is on govt.
- c. Arises from
  - 1) reject of refund claim at exam level
  - 2) rejection of offer and compromise based on inability to pay or doubt as to liability w/ rev officer in collection division
- d. Collection appeals program (CAP) [7823]
- e. Under 7123, appeals now required by statute
- f. Appeals office has final authority and its decisions are not appealable to any other office.
  - 1) can raise new issue that was not detected by examining agent
  - 2) cases are automatically referred to Appeal office for settlement after Tax Court
- g. if settle w/ appeals office execute form 870-A which is binding on taxpayer and govt
- 7. Strategies for use w/ a 30 day letter
  - a. Request an extension to respond
  - b. Ignore til 90 day letter (freezes issues)
  - c. Agree to it
    - 1) form 4549 or 870, form 2504 employment and excise tax
      - a) form 870 B agreement b/w taxpayer and govt. reach prior to appeals office conference or agreement w/ appeals office where govt. made no concessions to taxpayer
        - i) effect of form is that it waives statutory notice of deficiency so taxpayer consents to immediate assessment and collection
        - ii) may sue for refund but may NOT litigate in Tax Court
        - iii) court may assess additional fees later for same tax year
      - B) form 870-AD B settlement reach w/ appeals office that is a waiver of statutory notice of deficiency in exchange for govt. concessions
        - i) final and binding on both taxpayer and govt.
        - ii) prohibited from filing a claim for refund/credit
        - iii) govt. cannot reopen case in absence of fraud, misrepresentation, or concealment of material fact
    - 2) closing agreement form 866 (tax liability agreement) or 906 (specific agreement)

- a) finality of these forms recognized under 7121B only forms recognized by code as final and binding
  - b) taxpayer must show good reason that govt. will not be disadvantaged by entering into this agreement
  - c) may be set aside by taxpayer or govt. only for fraud, misrepresentation, or malfeasance
- 3) if agree on appeal, AD forms do not allow refund action
- d. Sign, pay, file claim for refund
  - 1) in tax court must show commissioner erred (Golson rule re: precedent forum shopping)
  - 2) must show correct amt of tax

## 8. Collateral agreement

- a. Usually involves exam at estate level re: valuation
  - 1) beneficiaries must agree to valuation method used in return

## 9. Taxpayer protections

- a) The Omnibus Taxpayer Bill of Rights Act created important new safeguards for taxpayers

### **(1) The IRS must deliver a comprehensive notice of taxpayer rights to every taxpayer it contacts concerning determination or collection of tax**

**(a) Notice must be in plain, nontechnical language**

**(b) Must explain, among other things, taxpayer rights; how to appeal and adverse decision (both administratively and through the courts); how to file complaints; and how the IRS can collect the tax it determines is due and owing through various collection procedures**

### **(2) §7605 – Reasonable Time and Place**

**(a) the IRS must issue regulations under §7605 specifying standards for determining that audits be conducted at a reasonable time and place**

### **(3) rights to Representation and Consultation**

**(a) during an interview with the IRS personnel, a taxpayer is entitled to consult with and be represented by an attorney, a certified public accountant, an enrolled agent or other person authorized to practice before the IRS**

**(i) if the taxpayer is unrepresented but clearly indicates during the interview that he/she wishes to be represented to consult with a representative, the interview must be suspended immediately**

**(4) audio recordings**

**(a) taxpayers may make sound (though apparently not video) recordings of interviews with IRS personnel**

**(b) taxpayer must request permission**

**(5) notice of rights during audit and collection**

**(a) before or during the first audit or collection interview the IRS must explain the process to the taxpayer**

**(6) exceptions for criminal investigations**

**(a) the safeguards in (3),(4),(5) above, do not apply to criminal investigations**

**(7) additional safeguards**

**(a) no “financial status” or “economic reality” audits unless there is a likelihood of unreported income**

**(b) The IRS may not base an audit solely on the taxpayer’s lavish lifestyle without a reasonable indication that the taxpayer is concealing income from the federal tax authorities**

## B. Resolution of the Audit

### 1. Agreed Cases

a) If the taxpayer agrees with the proposed adjustment he/she is given a form to execute that will usually prevent the taxpayer from challenging any deficiency in Tax Court

**(1) Execution of the form (usually a Form 4159 or a Form 870) will not prevent the taxpayer from paying the tax and filing a refund suit - - consent and execution of one of the Forms merely bars a Tax Court suit**

### 2. “Unagreed Cases”

a) if the taxpayer does not agree with the proposed adjustments he can request a conference with the Appeals Office

**(1) the conference must be requested within 30 days after the “30-day letter” is sent to the taxpayer, notifying the taxpayer of the auditor’s (or agent’s)**

**(2) findings and requesting that the taxpayer agree to the findings and advise him of his appeal rights**

**(3) to qualify for a conference with Appeals following a field audit**

**(a) taxpayer must submit a written protest within 30 days of receipt of the “30-day letter” if the total proposed deficiency for the period exceeds \$2,500 for any period**

**(4) if the taxpayer takes no action in response to the “30-day letter” the IRS will issue a “90-day letter” following which the taxpayer has 90 days to pay the tax or file a Tax Court petition**

## C. Administrative Appeals

### 1. Appeals Offices Conferences

- a) The majority of tax disputes are settled out of court and the Appeals office affords an excellent opportunity to avoid the expense and delay of litigation
- b) Appeals office has “exclusive and final authority” to settle tax cases originating in districts within the region of the various appeals offices
- c) Considerations worth remembering before you go

**(1) Appeals office can raise a new issue that was not detected by the examining agent**

**(a) Note:** the Internal Revenue Manual recognizes this could justify a PISS OFF TAXPAYER so they do it infrequently

**(2) Failure to pursue administrative remedy is a basis for the Tax Court to impose the §6673 penalty for frivolous cases or cases maintained merely for delay**

**(3) Taxpayer will not qualify for an award of attorneys’ fees against the Gov’t if she bypasses the appeals conference or other administrative remedies**

**(4) The case will be referred to the Appeals office for settlement *after* the Tax Court petition is docketed - - appeals will get involved, it’s just a question of when**

**(5) It is almost always advisable to seek an appeals conference because of**

**(a) The genuine possibility of settlement**

**(b) To avoid statutory penalties for failure to do so**

**(c) Because Appeals will get involved ultimately if the taxpayer chooses to skip the appeals conference and file a Tax Court petition**

**(d) It is better to meet with Appeals before the suit is filed in hopes of settling the matter, than**

**to be forced to meet with them on an expedited schedule when the litigation has begun**

**(6)**

**2. The Protest**

- a) If the proposed adjustments result from an office audit or involve \$2,500 or less - - NO WRITTEN PROTEST IS REQUIRED TO QUALIFY FOR AND Appeals office conference
- b) No specified form - - advisable to think of a protest as a counsel's opportunity to influence the case by thoroughly explain and document their position

**(1) Skeletal protests that offer no new information and simply incorporate by reference other documents or information can be rejected as not constituting valid "protests"**

**(2) Recommended contents**

**(a) Taxpayer's name and identification number**

**(b) The representative's name and the Power of Attorney on Form 2848 (if not already on file)**

**(c) Reference to the "30-day letter" and the audit report identifying the tax years in involved and the proposed adjustments**

**(d) Statement that the protest is timely**

**(e) Description of the issues and the statement of the taxpayer's position**

**(f) Request for and Appeals Office conference**

**(g) Taxpayer's signature, under penalties of perjury, that the facts alleged are true (or representative's statement that he prepared the protest and knows the facts alleged to be true and correct)**

**(h) Exhibits supporting or amplifying the taxpayer's position may be attached**

**(i) It is important to emphasize that there is legal or factual uncertainty involved and the Gov't would not be assured a victory in litigation**

(i) WHY? Because Appeals is guided by the “hazards of litigation” standard – under which it must review the entire case (including the credibility of witnesses and the probative value of the taxpayer’s evidence) to determine how a court would likely rule

#### D. Settlements and Closing Agreements

##### 1. General

a) The Form the taxpayer executes in settling his case determines the effect of the settlement on possible litigation

##### 2. Form 870

a) Reflects an agreement between the taxpayer and the Gov’t that is reached prior to an Appeals Office conference

b) Form is also used to reflect an agreement reached with Appeals Office in which the Gov’t made no concessions to taxpayer

c) Effect of execution (FORM 870 or FORM 890)

**(1) Waive the statutory notice of deficiency (the “90-day letter”)**

**(2) Consent to immediate assessment and collection**

**(3) Taxpayer may not litigate the tax deficiency in Tax Court but, taxpayer may sue for refund after paying the tax and filing a refund claim**



### 3. Form 870-AD

- a) Form 870-AD is intended to be final and binding on both the taxpayer and the Gov't
- b) Settlements reached with Appeals Office normally done with a Form 870-AD

**(1) Executed by the taxpayer = an offer to waive the statutory notice of deficiency in exchange for the Gov't concessions in the settlement**

- c) Ways to avoid the problems of Form 870-AD=suing for refunds and claiming that Form 870-AD is not binding because it does not conform to the statutory requirements of §7121

**(1) §7121 = rules governing closing agreements : §7122 = rules for compromises**

**(a) the only types of agreements recognized by the Code as final and binding**

**(2) issue in such litigation = whether the taxpayer should be equitably estopped to litigate the claim OR whether the execution of the form should not be final and binding because it does not conform to the requirements of §7121**

**(a) the Claims Court ruled that a taxpayer would be equitably estopped to litigate a refund claim covered by a Form 870-AD if**

- (i) execution of the Form 870-ad resulted from mutual concessions or compromises
- (ii) there was a meeting of the minds that the claims would be extinguished
- (iii) and to permit the taxpayer to reopen the issue would be prejudicial to the Gov't in light of its reliance on the Form. *Kretchmar v. US* (Cl.Ct.1985.), *accord, Schneider v. US* (W.D.Mich.1989)

### 4. Closing Agreements Forms 866 and 906

- a) The only agreements that satisfy the formal requirements of §7121 are Form 866 (which settles conclusively the taxpayer's

liability for the years in question) and Form 906 (settling only one or more issues, but which can apply to future years for questions such as the proper basis of an asset that will affect future tax liability)

b) Because of the finality of these agreements, the Service enters into such closing agreements “with great caution”

c) If a taxpayer wishes to have a closing agreement he must show good reason for it and convince the Service that the Gov’t will not get screwed by entering into it (Reg. §301.7121-1(a))

d)

## 5. Collateral Agreements

a) When an issue has been settled that will affect other taxpayers’ liability, the service may condition any settlement on the execution of collateral agreements by the other taxpayers to abide by the settlement in filing their returns

b)

## VI. Federal Tax Returns and Statutes of Limitations

A. Note: Usual basis for malpractice action (§§6501, 6502, 6503)

B. What Constitutes a Return?

a) Zellerbach

### **(1) return test (before 6011)**

**(a) must purport to be a return**

**(b) must be sworn to as such**

**(c) must evince an honest and genuine endeavor to satisfy the law**

- b) sol starts at the date of the original return (nonfraudulent) so that if an amendment is filed later, sol relates back to date of original return
- c) Generally the law requires that the return be filed on the proper form, signed under penalties of perjury and contain enough information that the Service can calculate tax
- d) *Beard* court said altered return was not a return w/in meaning of 6011 and regs due to administrative convenience of IRS

**(1) four part test**

- (a) must be sufficient data to calculate tax liability**
- (b) document must purport to be a return**
- (c) must be an honest and reasonable attempt to satisfy the requirement of the tax law**
- (d) taxpayer must execute the return under penalties of perjury**

**(2) if a document satisfies this test, then sol starts running even if service must return doc to taxpayer**

- e) Blount

**(1) court said under 6501(a) sol starts at date of original return and since omission of W-2 not material/critical substantial compliance w/ statute**

- (a) substantial compliance when all else is satisfied except for procedural matter that does not go to the heart of the statute, it is enough (Perfection is not required).**

2. Electronic Filing
3. Mechanics of Electronic Filing
4. Electronic Filing Fraud

C. Time Limits on Assessing Deficiencies

1. General Rule: 3-year Statute of Limitations

- a) §6501(a), requires that tax must be “assessed within three years after the return is filed

**(1) “assessment: = the recording of the tax liability together with the taxpayer’s name and address and the date of assessment in the office of the district director**

**(a) date of assessment is the date the assessment office signs an official form recording the taxpayer’s name, identifying number and the type and amount of tax liability**

**(b) generally, assessment of tax deficiency cannot be made until the Service has mailed the taxpayer a “notice of deficiency” (the “90-day letter”) AND 90 days have passed since in which the taxpayer has neither paid the asserted deficiency no filed a petition in Tax Court seeking a “redetermination”**

**(c) “deficiency” = means the excess of tax due over the amount of tax actually paid for any taxable year (§6211)**

2. When Return is Deemed filed

- a) §7502 timing scenarios

**(1) return mailed on or before the due date = timely filed, even though it will not be received until after the due date**

**(a) the date of mailing (as evidenced by the post mark) is the date of filing**

- (i) a note on postmarks

*(a) this postmark rule is subject to qualification, depending on whether it is a post office postmark or a private meter post mark.*

(i) The mailbox rule applies only to those private delivery services designated by the service as acceptable (§7502(f))

**(2) Return filed after the due date = not considered filed until actually received by the Service (*Emmons v. Com'r* (Tax.Ct. 1989))**

**(3) Returns filed early = treated as filed on the due date, for SOL purposes (§6501(b)(1))**

3. No time limit if no return filed

a) If no return then there is no time limit on the assessing and collecting the tax (§6501(c)(3))

**(1) Note: the Service does not notify the taxpayer that no “return” has been filed in such cases**

b) This exception can apply to a taxpayer who files a form with the Service that he thought constituted a tax return but did not comply with all requirements

**(1) Rule = a return must be made “according to the forms and regulations prescribed by the [Comm’r]” and “the information required by such forms or regulations” must be furnished. (§6011(a)).**

**(a) The Supreme Court held, “*perfect accuracy or completeness is not necessary to rescue a return from nullity*” *Zellerbach Paper Co. v. Helvering***

**(b) Some errors and/or omissions are fatal**

(i) A return that is not signed under penalties of perjury does not constitute a return – thus does not begin the running of the SOL *Campise v. Com’r*

c) Four part test for determining whether a document constitutes a “return” that will commence the running of the statute of limitations

**(1) There must be sufficient data to calculate the tax liability**

**(2) The document must purport to be a return**

**(3) There must be an honest and reasonable attempt to satisfy the requirements of the tax law**

**(4) The taxpayer must execute the return under penalties of perjury (*Beard v. Comm’r* (Tax.Ct.1984))**

**(5) Any document that satisfies this test will start the SOL running DESPITE THE FACT THAT THE service MUST RETURN THE DOCUMENT TO THE TAXPAYER FOR ADDITIONAL INFORMATION (*Blount v. Comm’r* (Tax.Ct.1986))**

d) In re: tax protestors

**(1) There are numerous cases in which “protest” returns containing insufficient data on which to calculate the tax did not constitute “returns” , thus not starting the SOL and subjecting the taxpayers to penalties under §6651 for failure to file a return**

e) The SOL will begin to run on the date that the taxpayer files a delinquent nonfraudulent return *Bennett v. Comm’r* (Tax.Ct.1958)

#### 4. No time limit for Fraudulent Return

a) Another exception to the 3-year rule is §6501(c)(1), permitting assessment and collection “at any time” for “a false or fraudulent return with intent to evade tax”

**(1) *See also*, §6501(c)(2) – providing for an unlimited time for assessment in “case of a willful attempt to defeat or evade tax”**

**(2) The government has the burden of proving fraud**

**(a) Note:** if the taxpayer has been convicted of criminal fraud (attempted tax evasion under §7201) then the taxpayer will be collaterally estopped to

challenge an assessment made after the 3-year SOL has expired

b) **Note:** the Supreme Court has held that the filing of a nonfraudulent amended return does not cure the filing of the fraudulent return and that **tax may still be assessed at any time on the basis of the original fraudulent return** *Badaracco v. Comm'r*

**(1) The Court reasoned that “the taxpayer’s later repentance does not cure or eliminate the original fraud**

## 5. 6-Year Time Limit for Substantial Omissions of Gross Income

a) 6-year SOL on assessment for omissions from gross income of an amount that is more than 25% of the gross income stated in the return (§6501(e))

**(1) “gross income” = broadly defined**

b) the 6-year SOL applies **only if** the item is completely omitted from the return

**(1) if the taxpayer includes the item but *merely* miscalculates or understates it, the general 3-year SOL will apply *Colony, Inc. v. Comm’r***

c) if the omission is serious enough to cause the return to be “false or fraudulent” or the result of a “willful attempt to defeat or evade” tax, under §6501(c)(1) or (2), then there is no time limit on assessment of the tax (Reg. §301.6501(e)-1(d))

d) staking of additional deficiencies that are unrelated to the omissions and thus would ordinarily be time-barred?

**(1) The Tax Court has held that the IRS may assert those additional deficiencies, thus allowing them to be “piggy-backed” on the substantial omission after the general 3-year statute of limitations has expired *Colestock v. Comm’r***

## 6. Computing time [7502, 7503]

a) Timely mailing is timely filing and paying (if mailed on/before due date)

**(1) date of mailing is date of filing**

b) If mailed after due date, timely receipt (receipt of return)

**(1) returns filed after due date are considered filed when actually received**

c) Actual performance if falls on Sat, Sun. or holiday

**(1) if due falls on Sun and mail on Mon then timely filed**

d) If file early, considered received on due date<sup>B</sup> April 15  
[6501(b)(1)]

e) Mailbox rule has been extended to foreign postmarks and private delivery services under 7502(f)

## 7. Extension by Agreement

a) §6501(c)(4) permits the SOL to be extended by written agreement between the taxpayer and the Service entered into **before** the time for assessment has expired

**(1) if the taxpayer refuses to execute such an agreement the Service might simply issue a notice of deficiency (resolving any questions in its own favor and asserting the maximum tax liability) – forcing the taxpayer to either to pay the disputed amount or file a Tax Court petition within 90 days of an issuance of the notice**

b) 2 types of consents

**(1) “regular” consent (Form 872) that extends the statute of limitations to a specific date**

**(2) “special” or “restricted” consent (Form 872-A) that keeps the SOL period open until 90 days after either the taxpayer or the service terminates the consent**

**(a) the taxpayer can terminate a form 872-A only by filing form 872-T**

(i) the termination is effective only when the received by the IRS

**(b) Service may terminate a Form 872-A in two ways**

(i) By *mailing* a Form 872-T to the taxpayer; OR



(ii) By *mailing* a notice of deficiency to the taxpayer

(iii) **Note:** the service's termination is effective upon mailing

**(c) Upon termination, the service has 90 days in which to assess a tax deficiency**

(i) Note, a Service termination is invalid and ineffective if it is not mailed to the taxpayer's last known address (§6212) *Roszkos v. Comm'r* (9th Cir. 1988) (reviewed)

(ii) The 9<sup>th</sup> Circuit held that the improperly addressed notice *did not* terminate the Form 872-A consent, and thus the later assessment was not time-barred

**D. Time Limits on Refunds of Overpayments**

**1. When the refund claim must be filed**

a) Claim for a refund of overpaid taxes must be filed on or before the **later of the following**

**(1) 3 years from the date the return was filed; OR**

**(2) 2 years from the date the tax was actually paid §6511(a)**

**(3) Note: if the SOL has been extended by agreement between the Service and the taxpayer then the refund claim may be filed any time within six months after the extended period has expired (§6511(c)(2))**

a.

**2. Special rules B6501(h), (i), and (j)**

a) If have a loss that is carried back or a carryback credit (foreign tax credit) then IRS can examine the carryback year as long as the loss/credit year is open and can go back three years from the loss year

Loss/Credit Year > → Carryback Year > → Year affected by carryback

(can look at carryback only and no other issue)

b)

3. when the refund suit must be filed

a) the suit may not be filed until either 6 months have passed from the date the refund claim was filed, or the service has disallowed the claim by issuing a statutory notice of claim disallowance under §6532(a)(1)

**(1) the claim is *deemed* filed when it is received by the Service**

b) the refund suit will be **premature** if filed before 6 months after the refund claim was filed unless the IRS issued a notice of disallowance prior to the passage of 6 months

**(1) a refund suit filed prematurely is subject to dismissal for lack of jurisdiction - - with out prejudice, and the taxpayer may simply refile the suit after the appropriate time has passed**

c) the suit will be too late, and time-barred, unless it is filed within 2 years from the date the IRS mailed the statutory notice of disallowance or the date the taxpayer filed a Form 2297 waiving the statutory notice of disallowance

**(1) a refund suit filed after the SOL on filing has expired is subject to dismissal with prejudice**

**(2) Note: because the SOL periods are statutory THEY MAY NOT BE WAIVED**

## E. Mitigation of the Statutory Time Limits

- a) §1311-1314 override and displace the judge-made doctrines in cases to which the statutory provisions apply
- b) the judicially made doctrines continue to apply to cases that are not covered by the statutory provisions

## 2. Equitable Recoupment

- a) Permits the bar of the statute of limitations to be avoided in certain circumstances in which equity demands relief
- b) Permitted **only when** the same transaction or taxable event has been subjected to two taxes based on inconsistent legal theories

**(1) Properly invoked only when the prior treatment cannot be challenged because of the statute of limitations, while the present claimed treatment is not time-barred**

- c) Doctrine permits the court to examine the transaction or event as a whole to determine a fair result
- d) Designed to prevent unjust enrichment of either the taxpayer or the Gov't

**(1) Taxpayer may invoke to prevent unjust double taxation**

**(2) Gov't may invoke to prevent unfair tax avoidance**

## 3. Statutory Mitigation Provisions

- a) Designed to permit a taxpayer or the gov't to take a qualified 'peek' into a time-barred year to use an inconsistent position to offset or increase current tax liability

**(1) Permits refunds or assessments that would otherwise be barred by the statute of limitations or other rule of law (such as *res judicata*)**

b) Party seeking to take advantage of mitigation must show that the other party took a position in an open year that is inconsistent with the position taken by that party in a now-closed year

c) Most courts and commentators have concluded that the statutory mitigation rules apply only to income taxes (see, *Provident National Bank v. US* (E.D.Pa.1981))

**(1) Note: some courts have applied the rules outside of the income tax context (see, *Chertkof v. US* (4th Cir.1982))**

d) Four requirements for obtaining relief

**(1) There must be a “determination” that an error was made concerning the proper treatment of an item**

**(2) The operation of any law or rule of law must prevent correction of the error**

**(3) The “determination”, coupled with the erroneous inconsistent treatment, must result in one of seven “circumstances of adjustment” listed in §1312**

**(4) The party in whose favor the “determination” is made must have maintained an inconsistent position with respect to the “determination” in a year that is now barred from litigation (§1311(b))**

e) The statutory scheme depends on a “determination” establishing the correct treatment of an item and thereby establishing that the prior inconsistent treatment of the (other wise time-barred) item was erroneous

**(1) “*determination*” is defined (§1313(a)) as including only the following**

**(a) a court order or division that is final**

**(b) a closing agreement made under §7121**

**(c) final disposition of a claim for refund**

**(d) an agreement entered into pursuant to §1313(a)(4)**

f) FINISH THIS

4. Equitable Tolling

a) `

**VII. Choice of Forum in Civil Tax Litigation**

A. Introduction

B. United States Tax Court

1. No need to first pay the tax

a) This is the most important feature of the Tax Court

2. Article I court

a) Established pursuant to Article I not Article III - - jurisdiction is strictly limited by statute

3. Where the Tax Court Trial Occurs

4. No Jury Trials; Some Rules Relaxed

a) No trial by jury

b) Rules of evidence are enforced much less stringently than in a jury trial in a US District Court

c)

5. Jurisdictional Requirements

a) Limited to specific statutory grants of authority - -including: income, estate and gift tax cases: windfall profits tax and certain excise cases; and some declaratory judgment and disclosure cases

b) Jurisdiction is further dependant on strict compliance with several statutory prerequisites

**(1) The commissioner must “determine” that a tax “deficiency” exists**

**(a) No required form for the notice of deficiency - - any document that fairly informs the taxpayer that the Comm’r has “determined a deficiency” and that identifies the taxable year and the**

**amount of the deficiency is usually upheld under §6212(a)**

(i) A notice that is vague or bore no relationship to the return filed did not meet the requirements of §6212 because the Comm'r did not “determine” a deficiency as required by the statute (*Scar v. Comm'r*)

(ii) §7512 requires that all deficiency notices describe the basis for and identify the amounts sought as tax due, interest and penalties and addition to tax

*(a) failure to comply with these requirements will not automatically invalidate the notice*

**(2) The IRS must mail a notice of deficiency to the taxpayer**

**(3) And the taxpayer must file a petition in the Tax Court within 90 days of the mailing of the notice of deficiency**

**(a) The petition may not be filed until the Service has issued the taxpayer a statutory “notice of deficiency” (the “90-day letter”)**

(i) 90-day letter = “ticket to the Tax Court”

(ii) must be mailed to taxpayer’s last known address

(iii)**Note:** actual assessment of the tax is barred during the 90 days after issuance of the notice of deficiency

(iv)**Note:** if taxpayer files a petition with the tax court during the 90-day period then the statute of limitations on assessment of tax is suspended during the pendency of the case (§6503(a)(1))

(v)

c) **Note:** once a taxpayer has invoked the Tax Court's jurisdiction by timely filing a petition --- THE ELECTION IS IRREVOCABLE (*Estate of Ming, Jr. v. US*)

d)

6. The taxpayer's "last known address"

a) Must be mailed to taxpayer's last known address

b) If taxpayer never receives the notice:

**(1) Plan A = seek and injunction barring collection of the deficiency on the theory that the notice of deficiency was never mailed by the Service and therefore, assessment and collection are barred under §6213(a)**

**(2) Plan B= challenge the validity of the notice by claiming that it was not mailed to their "last known address"**

**(a) If the SOL has not run then the Service may simply correct the error and remail the notice**

**(b) If the SOL has expired then the taxpayers success depends on the following factors**

(i) If the court finds that the notice was in fact mailed to the taxpayer's last address then the notice is valid despite the fact that the taxpayer never received it (see *Harrison v. Comm'r* (holding notice valid despite evidence that there had been a fire in the post office that could have caused the taxpayer's alleged nonreceipt of the notice

(ii) If the taxpayer actually receives the notice without prejudicial delay, then the notice is valid **even though it was not mailed to the taxpayer's last known address** (*Frieling v. Comm'r*)

(iii) Receipt by an agent (attorney, accountant) following delivery to the taxpayer of a copy of the notice of deficiency is sufficient *McKay v. Comm'r*

## 7. Small Tax Cases

- a) Taxpayers with asserted deficiencies of \$50k or less for any taxable year **have the option** of election the more informal procedures available under §7463

**(1) Less expensive alternative for taxpayers who do not have the funds or the desire to litigate their tax deficiency in a regular tax Court trial**

- b) Special features

**(1) Decision of the trial judges in these cases are final and nonappealable and are not treated as precedent for any other case**

**(a) Thus the taxpayer gains informality in exchange for forfeiting the opportunity to have their case heard by the regular Tax Court and their right to appeal from an adverse judgement**

## 8. Governing Precedent in Tax Court – The *Golsen Rule*

- a) *Golsen v. Comm't* declared that the Tax Court would follow the governing precedent in the court of Appeals to which the case before it is appealable

## 9. “Reviewed”, “Regular”, and “Memorandum” Decision in the Tax Court

- a) “reviewed”

**(1) means that the case was reviewed by all 19 Tax Court judges**

**(2) greatest precedential value**

- b) “regular”

**(1) results in a “memorandum” opinion**

**(2) have been reviewed by the Chief Judge and are published in the official Tax Court Reports but are not reviewed by all 19 judges of the tax Court**



## C. The United States District Court

### 1. Jury Trial Available

- a) The only forum in which jury trial is available

### 2. Refund Suits Only: Formal Refund Claims

- a) The taxpayer must first pay the disputed tax and file a claim for refund of the tax paid (§7422; 28 USC §1346(a)(1))

**(1) Because the refund claim will serve as the basis of the suit, it should be carefully drafted to comply with all the requirements in the Regulations and to specify the exact amount to be refunded**

**(2) Note: once the statute of limitation has expired on the time for making a refund claim, the taxpayer may not amend the claim to cure a defect or add new issues or grounds (Regs. §103-6402-2(b)(1))**

- b) If the Government either denies the claim for refund by issuing a statutory notice of claim disallowance under §6532(a)(1) or 6 months have passed in which the refund claim is not granted, the taxpayer may then file a refund suit in the US district court

- c) Refund suits may be brought to recover any amount of tax allegedly overpaid regardless of how small

- d)

### 3. Informal Refund Claims

- a) If the SOL has expired on the time to file a formal refund claim then it is still possible that some communication from the taxpayer to the Service might qualify as an informal but valid refund claim

- b) Requirements

**(1) The claim must be in writing**

**(2) The Service must know or reasonably know that a refund was being sought, the grounds of the claim and the taxable year involved**

c) Form 870 can serve as an informal refund claim

d) **Note:** an informal refund claim that is timely but inadequately specific **can be cured** retroactively by a subsequent formal claim filed after the SOL has expired **but before** the Service rejects the informal claim (*American Radiator & Standard Sanitary Corp. v. US*)

#### 4. Waiver of Defects in Refund Claims

a) Under certain facts and circumstances, claims for refund that satisfy the requirements imposed by statute but that do not satisfy the requirements imposed by the Regulations are sometimes upheld on the theory that the service has waived its right to insist on strict compliance

**(1) Note: failure to comply with the statutory requirements (such as the SOL) can never be waived**

**(2) But when the defect pertains only a requirement in the regulations - - then waiver may occur even as late as during the trial of the case (*US v. Smith (holding defects waived when Government failed to object to introduction of evidence that cured the defects)*)**

b) Taxpayer bears burden in establishing that the service has waived it's right to demand strict compliance

5. The “full payment” rules

a) Full payment of the entire tax assessed is a jurisdictional prerequisite to filing a refund suit *Flora v. US*

b) Service position is that this requires payment of all applicable interest and penalties, as well as the full underlying tax (Reg. 201.6201-1(a))

c) **EXCEPTION** = divisible taxes

d)

D. United States Court of Federal Claims

1. Article I Court

2. Where Court of Federal Claims Trial Occurs

3. No jury trials; Refund suits only

4. Governing Precedent

E. Strategic Considerations

1. Governing Precedent

2. Taxpayer's Ability to Pay the Tax: Interest Payable

3. Tax Court Trap: Government May Assert Additional tax due

**VIII. Additional Civil Litigation Considerations**

A. Burden of Proof

1. Tax Court

2. Refund Suits

3. “Naked Assessments:

B. Res Judicata and Collateral Estoppel

1. mutuality of parties

2. “Ultimate” versus “evidentiary” facts
3. Estoppel in civil penalty cases after criminal convictions

C. Attorneys’ fees

1. historical development
2. “prevailing party”
3. “The position of the United States”
4. Fees and costs that can be recovered
5. Exhaustion of administrative remedies

## IX. The Collection Process

A. Assessment, notice and demand

1. a mandatory prerequisite to the Government’s ability to begin enforced collection activities are:
  - a) notifying the taxpayer of the assessment
  - b) and demanded payment
2. notice
  - a) notice and demand are to be made “*as soon as possible*”
  - b) under no event is notice and demand to be made later than 60 days after the date of assessment (§6303(a))
  - c)
3. assessment = merely recordation of the liability of the taxpayer on an official list (§6203)
4. accomplished by a designated assessment office signing a form (For 23-C) that reflects the taxpayers name, identification number, the tax period involved and the nature and amount of tax assessed
  - a) **Note:** the date that this form is signed is the date of assessment

**(1) Consequence = triggers**

(2) The gov't has 60 days from the date of assessment in which to notify the taxpayer of the assessment and demand payment;  
AND

(3) The gov't has 10 years from the date of assessment in which to collect the tax

## **B. The Federal Tax Lien**

### **1. Creation and Validity**

a) The tax lien is the foundation of the entire collection process

#### **(1) CRITICAL THAT THE IRS COMPLY WITH THE STATUTORY PREREQUISITES**

(a) Timely assessment

(b) Timely notice and demand

(c) The passage of the 10-day grace period

(d) **Note:** *IF ANY OF THESE ARE NOT SATISFIED* → the lien does not arise by operation of law & taxpayer can bring suite to enjoin (§6213(a))

(e) **Note:** the mere existence of the lien does not transfer title or constructive possession to the Gov't - - IRS must either **levy** on property or bring civil action to collect the tax

b) if taxpayer neglects or refuses to pay **within the 10-day grace period** → a general assessment lien (aka: *general tax lien* or *federal tax lien*) arises **automatically**

**(1) attaches to “all property and rights to property, whether real or personal, belonging to” taxpayer as of the date of assessment or subsequently acquired by the taxpayer during the existence of the lien (§6321, §6322)**

**(2) EFFECT OF THE GENERAL TAX LIEN = once it arises no further gov't action is required before the gov't can seize the taxpayer's property**

## 2. Scope of the Lien

a) attaches to all property or rights to the property ... belonging to the taxpayer on the date of assessment or acquired after assessment but during the existence of the lien

b) **Note:** state law governs issues of the nature and extent of a taxpayer's interest in property

**(1) BUT the federal tax lien is not affected or limited by state law provisions exemption certain property (HOMSTEAD EXEMPTION WON'T BLOCK IRS COLLECTION)**

c)

d)

**(1) Note: state law gover**

## X. Civil Penalties and Interest

### A. Delinquency Penalties

#### 1. §6651

a) penalty 1 = imposes a penalty of up to 25% fo the net tax due for delinquency in filing a return

**(1) imposed at a rate of 5% per month subject to a 25% ceiling**

b) penalty 2= separate penalty of up to 25% of the net tax due for delinquency in paying tax

**(1) this failure to pay tax penalty is imposed at a rte of ½% per month**

c) **Bottom line** = a taxpayer who nonfraudlently fails to file a return and pay the tax due in a timely fashion *is subject to a maximum penalty under §6651 of 50% of the net tax due*

d) Penalty 3 = fraudulent failure to file

**(1) Subject to a penalty of 15% per month up to a max of 75% of the net tax due (§6551(f))**

**(2) Under §7454(a) the burden of proving the fraud element is on the IRS**

**(a) If the IRS does not sustain its burden - - whether any penalty can be imposed for the failure to file depends on the contents of the notice of deficiency**

2. "Net tax due" is the amount of tax owing less any amount paid or withheld before the due date and less also any credits allowable

3. Defenses

a) "reasonable cause"

**(1) Note: the Supreme Court has held that the duty to file and pay is a personal and nondelegable duty, and reliance on an attorney to file an estate tax return does not constitute "reasonable cause" (*US v. Boyle*)**

**(2) Internal Revenue Manual lists several "reasonable cause" excuses**

**(a) Death or serious illness of the taxpayer or a member of his immediate family**

**(b) Destruction by fire or other casualty of the taxpayer's residence, business premises or business records**

**(c) Through no fault of his own, the taxpayer is unable to obtain the records necessary to complete his return**

**(3) What about inability to pay?**

**(a) The regulations state that failure to pay will be considered due to reasonable cause if the taxpayer shows that he exercised ordinary business care and prudence in providing for payment of his taxes but was still unable to pay the tax or would suffer undue hardship if he paid the tax (Regs. §301.6651-1(c)(1))**

**(4) In re: tax protest returns**

**(a) Protestors who file incomplete returns are subject to the failure to file and failure to pay penalties of §6651**

(i) 6654 imposes a separate penalty for failure to pay, or for underpayment of, estimated tax

*(a) this penalty also applies to under withholding of federal*

**(b)**

b) Absence of “willful neglect”

B. Accuracy Penalties

1. the accuracy-related penalties can be imposed only if a return was filed

2. §6662 imposes a penalty of 20% of the underpayment attributable to the penalized conduct

a) applies in the following situations

**(1) negligence or disregard of the rule or regulations**

**(2) any substantial understatement of income tax**

**(3) any substantial valuation overstatement**

**(4) any substantial estate or gift tax valuation understatement**

3. definitions

a) “Underpayment” = see §6664(a)

**(1) is the amount by which the correct tax exceeds the sum of the amount shown as due on the taxpayer’s return plus amounts not shown that were previously assessed or collected over the amount of any rebates made**



b) “rebate” is a credit or refund

4. Defenses – the §6662 20% penalty and the §6663 fraud penalty are subject to the following

a) “reasonable cause”

**(1) no penalty should be imposed if he taxpayer establishes that there was reasonable cause for the underpayment and the taxpayer acted in good faith**

C. Negligence or Disregard of rules and regulations

1. §6662(c)

a) “negligence” “includes and failure to make a reasonable attempt to comply” with the code and

b) “disregard” “includes any careless or intentional disregard”

c) when the Service imposes the negligence penalty, the penalty is presumptively correct and the TAXPAYER has the burden of proving (BY A PREPONDERANCE OF THE EVIDENCE) *BOTH* that he was not negligent and that he did not carelessly, recklessly or intentionally disregard rules and regulations

2. when the Service imposes the fraud penalty the burden is on the Gov’t has the burden of proving fraud

a) if the Comm’r only asserts the fraud penalty and fails to carry it’s burden - - the court may not impose the negligence penalty, EVEN IF it finds that the taxpayer was negligent

b) BOTTOM LINE: the service will usually assert the negligence penalty in the alternative when it asserts the fraud penalty

3. Examples of when a court will find taxpayer’s conduct *negligent*

a) Inadequate Books and Records

b) Reliance on Advisors - - the penalty will be sustained if the taxpayer failed to give accurate and complete information to the advisor

**(1) But good faith and reasonable reliance after full disclosure rebuts the negligence claim**

- c) Good faith but mistaken view of the law

**(1) If the underpayment is due to a taxpayer's mistaken but honestly held interpretation of the tax laws the negligence penalty usually will not be sustained, PARTICULARLY if the issue is complex and the taxpayer attempted to comply with the code**

#### 4. defenses

- a) complete and specific disclosure of a nonfrivolous return position will generally demonstrate that taxpayer did not intentionally disregard rules or regulations

**(1) merely completing the tax form will not satisfy the disclosure requirement**

- b) a good-faith challenge to a regulation identified as such in a disclosure statement will not subject the taxpayer to the negligence penalty

**(1) frivolous challenges will not immune to the negligence penalty, however**

#### D. Substantial understatement penalty

1. penalty rate is 20% of the underpayment of tax
2. imposed if there is a substantial understatement of tax liability of tax - - defined to mean that the correct tax liability exceeds the reported liability by the greater of 10% of the correct tax or \$5k (\$10k for corporations)
3. Note: this penalty can be imposed upon taxpayers who make honest and reasonable efforts to comply with the Code but whose tax liabilities are increased after audit
4. was to avoid/defenses
  - a) non-tax shelter situations

**(1) should not be imposed if taxpayer either**

**(a) discloses the relevant facts on OR with the return (and the position has a reasonable basis);  
OR**

(i) disclosure should normally be made on a FORM 8275 OR on a statement attached to the return explaining the facts and identifying the attachment as a disclosure under §6662

(ii) disclosure of a frivolous (or even a nonfrivolous) position for which there is no reasonable basis will not shield the taxpayer from the penalty

**(b) substantial authority exists for the position**

(i) types of authority upon which the taxpayer may rely include: the Code and Regulations (including temporary and proposed Regulations), revenue rulings and procedures, court cases, congressional intent as reflected in committee reports, General Explanations of tax legislation prepared by the Joint Committee on Taxation (the “Blue Book”), and private letter rulings, technical advice memoranda and other statements of position issued by the IRS

*(a) **Note:** conclusions reached in legal treatises, periodicals or opinions are not “authority” (Regs. §1.6662-4(d)(3)(iii))*

(ii) Authority is “substantial” only if the weight of the authorities supporting the treatment is substantial in relation to the weight of authorities supporting the contrary positions (Regs. §1.662-4(b))

*(a) The taxpayer’s jurisdiction is to be ignored*

(i) If the federal district court in the taxpayer’s district has ruled favorably on the issue, **this does not constitute substantial authority**

(ii) Only if the Circuit court of Appeals to which an appeal would lie has ruled in

favor of the taxpayer's position will precedent in the taxpayer's position will precedent in the taxpayer's jurisdiction constitute substantial authority (§Regs. 1.6662-4(b))

b) "tax shelter" items

**(1) more difficult to avoid the penalty**

**(2) "tax shelter" for purposes of §6662(d) is defined to mean "a partnership or other entity, any investment plan or arrangement, or any other plan or arrangement, if the principal purpose of such partnership, entity, plan or arrangement is the avoidance or evasion of Federal income tax"**

**(a) if the plan is principally motivated by the desire to decrease or avoid tax, then it is a "tax shelter" for purposes §6662(d)**

**(3) defenses**

**(a) there must be substantial authority for the position; AND**

**(b) the taxpayer must reasonably believe when he files his return that the position taken was "*more likely than not*" the proper treatment of the item**

(i) belief will be "more likely than not" proper will be reasonable only if he performs the analysis required by the Regulations and concludes that there is a greater than 50% likelihood that his position would be upheld in litigation; **OR**

(ii) if he relies **in good faith** on the "unambiguous" opinion of a professional tax advisor that the chances are greater than 50% that the position would be upheld in litigation

**(c) disclosure of an item on or with the return will not preclude the penalty**

**(d) Note:** the **Service may waive** the penalty if the taxpayer shows

(i) It acted in good faith; **AND**

(ii) That there was reasonable cause of the understatement

(iii) See §6664(c)

**(e) Note:** taxpayer can avoid the penalty if taxpayer **files an amended return** either disclosing the item in question **OR** showing additional tax due

#### E. Valuation penalty

1. penalty under §6662 for underpayment based on inflated property valuation

a) the penalty applies to both

**(1) overvaluations by tax partnerships**

**(2) understatement of estate or gift tax due to valuation understatements**

2. the 20% penalty only applies to valuation overstatements of 200% or more

a) §6662(h) provides for a 40% penalty for “gross” valuation overstatements as those exceeding 400% of the correct value or adjusted basis

b) the penalty is to apply **only if** the underpayment attributable to the valuation overstatement exceeds \$5k (or \$10k for corporate tax payers)

c) for substantial overstatements of **pension liabilities** the uniform 20% (or 40% for “gross” misstatements) penalty of §6662 *will be imposed only* if the overstatement exceeds 200% of the correct amount

**(1) the threshold underpayment triggering the penalty is \$1,000**

F. Civil fraud - §6663

a) fraud

**(1) the essence is the taxpayer's state of mind**

**(2) motivation or intent to evade a known tax**

**(3) "fraud is the intentional commission of an act or acts for the specific purpose of evading a tax believed to be owing. Fraud implies bad faith, intentional wrongdoing, and sinister motive. It is never imputed or presumed. Estate of Spruill v. Comm'r (Tax. Ct. 1987)**

**(4) for §6663(d), "fraud" is synonymous with tax evasion, the "*willful attempt in any manner to evade or defeat any tax*" under the criminal fraud provision, §7201**

b) the existence of fraud is a question of fact to be determined by the entire record

**(1) the Gov't must establish additional facts sufficient to convince the trier of fact that the taxpayer understated his income (or overstated his deductions) *with the intent to evade tax***

**(a) this burden is analyzed using the "*badges of fraud*" analysis**

**(b) partial list of "*badges of fraud*" in which the penalty has been upheld include:**

(i) taxpayer was convicted of criminal evasion under §7201. Such a conviction will collaterally estop the taxpayer from challenging the civil fraud penalty

(ii) pattern of underreporting income (or overstating deductions) over several years

(iii) secret bank accounts or unexplained deposits

(iv) falsified or inadequate books and records

(v) undisclosed sources of income from outside the us taxpayer's regular business, including illegal income

(vi) willful failure to file tax returns, coupled with some other indication of fraudulent intent

(vii) concealment of assets

**(c) Internal Revenue Manual on civil and criminal fraud cases:**

*(i) The major difference between civil and criminal fraud cases is the degree of proof required. In criminal cases the Gov't must present sufficient evidence to establish guilt beyond a reasonable doubt. A lesser degree of proof is required in civil fraud cases. The evidence relating to the adjustment may not be sufficient to prove criminal fraud, but may be adequate for civil fraud. (IRM 4231 §921(3))*

**(2) Avoiding the fraud penalty**

**(a) If it appears that the taxpayer honestly believes his position is allowable under the Code → the taxpayer should not be subject to the penalty - - even if his position is not upheld**

(i) Why? → because such a taxpayer lacks the intent to evade a tax believed to be owing - - the essence of fraud

(ii) Note: if taxpayer's position is so clearly contrary to existing authority that the taxpayer's claim that he believed in good faith that it was legal is not credible, then the fraud penalty will probably be upheld, particularly if the taxpayer attempted to conceal or misrepresent his actions

**(b) Defenses**

(i) Ignorance of the law or incompetence in keeping books and records generally are not fraudulent

(ii) Mental or physical illness can vitiate the fraud penalty

(iii) Good faith reliance on an attorney or other tax advisor after full disclosure of relevant facts

## 2. Burden of Proof

a) Gov't has the burden of proving fraud by "clear and convincing evidence"

**(1) Comm'r can satisfy this standard by showing that the taxpayer intended to evade taxes known to be due by conduct designed to mislead, conceal or otherwise prevent collection of the tax**

**(2) Once the Comm'r has proven that any portion of an underpayment was attributable to fraud, THE ENTIRE UNDERPAYMENT IS TREATED AS DUE TO FRAUD AND THE BURDEN SHIFTS TO THE TAXPAYER TO ESTABLISH (BY A PREPONDERANCE OF THE EVIDENCE) THAT ANY PORTION OF THE UNDERPAYMENT IS NOT ATTRIBUTABLE TO FRAUD (§6663(b))**

## 3. Statute of Limitations

a) There is no time limit on assessing tax deficiencies (and the civil fraud penalty) when the return is fraudulent (§6501(c)(1))

b) If any portion of any return is fraudulent, a tax deficiency and the fraud penalty may be assessed at any time

c) **Note:** if the Comm'r asserts the fraud penalty after the normal 3-year SOL has expired and the court refuses to uphold the penalty → the asserted tax deficiency **will be time barred**

## 4. persons liable for the penalty

a) spouses

**(1) filing joint returns → the fraud of one may not be imputed to the other §6663(c)**

**(2) filing separately → fraud by one certainly should not be attributed to the other, absent knowledge and participation in the fraud**



- b) corporations
- c) partners

**(1) in a general partnership → the fraud penalty can be upheld against the partners**

- d) deceased tax payer filing fraudulent return during lifetime → his estate will remain liable
- e) bankruptcy → the penalty survives the bk of the taxpayer

#### G. Preparer penalties - §6694

1. “income tax preparers” – defined in §7701(a)(36) as any person or entity that prepares for compensation any return or claim for refund or a substantial portion of a return or claim for refund

- a) under the Regs, furnishing legal advice that is directly relevant to determining the proper treatment of any item on a return can make a lawyer a “preparer”, if the legal advice relates to a completed (rather than contemplated) action (Reg. §301.7701-15)

2. §6694(a)

- a) imposes a \$250 fine on a return preparer if all of the following occur

**(1) any part of any understatement of the liability with respect to any return or claim for refund is due to a position for which there was not a realistic possibility of being sustained on its merits**

**(2) any person who is an income tax return preparer with respect to such return or claim knew (or reasonably should have known) of such position; AND**

**(3) such position was not disclosed as provided in §6662(d)(2)(B)(ii) or was frivolous**

b) the penalty is not to be imposed if there was reasonable cause for the tax understatement and the preparer acted in good faith (§6694(a))

3. §6694(b)

a) penalty for willful understatements is \$1000

b) penalty applies both to willful understatements and to those caused by reckless or intentional disregard of the rules or regulations by an income tax return preparer

4. preparer's are subject to a penalty of \$50 for each failure to

a) furnish a complete copy of a return to a taxpayer

b) to sign a return

c) furnish the preparer's identification number on a return

d) **Note:** an annual max penalty for each of these three omissions is now \$25,000

e) **Note:** the penalty is not to be imposed for an omission due to reasonable cause and not due to willful neglect

5. §6701

a) imposes penalties on anyone who "aides or assists in, procures, or advises with respect to, the preparation or presentation of any material portion of a return, affidavit, claim or other document in connection with any matter arising under" the tax laws

b) the aiding and abetting penalty can only be imposed if the person:

**(1) knows or has reason to believe that the document will be used in connection with any material matter arising under the tax laws**

**(2) knows that if it is used, an understatement of tax liability will result**

**(3) Note: the penalty can be imposed for "ordering (or otherwise causing) a subordinate to do an act"**

**(a) BUT, providing purely mechanical or clerical assistance, such as typing or photocopying, is not sufficient to trigger the penalty**

**(b) Note: the IRS has the burden of proving the propriety of imposing the aiding and abetting penalty (§6703)**

c) the penalty is \$1,000 unless the actions pertain to a corporation's return, in which case the penalty is \$10,000

d) Note: if the §6701 penalty is imposed then the §6694 penalty may not also be imposed

#### H. Frivolous returns

1. §6702 imposes a penalty on anyone who files a return that does not contain sufficient information on which the correctness of the tax liability can be judged OR that contains information that on its face indicates that the tax liability shown on the return is incorrect

a) aimed at "tax protestors"

2. conditions for imposition of the penalty

a) taxpayer's conduct must be based on a frivolous position; OR

b) taxpayer's conduct must be based on a desire to delay or impede the administration of the tax laws

3. penalty is to be imposed IN ADDITION TO other penalties

4. can be imposed EVEN IF THE TAXPAYER HAS DOES NOT HAVE TAX LIABILITY

#### I. Sanctions for Delaying or frivolous returns

1. §6673 authorizes the TAX COURT to impose a penalty of up to \$25,000 if it determines that the proceeding was instituted or maintained merely for delay or that the taxpayer's position was frivolous or groundless

a) **Note:** as amended, an unreasonable failure by the taxpayer to pursue an administrative remedy can justify the Tax Court's imposition of the penalty

2. historical application – not restricted to the typical "tax protestor" cases

a) Tax Court has imposed it in cases involving highly leveraged tax shelters - - particularly in situations in which the underlying issues have already been litigated and resulted in Gov'

3. §6673(a)(2)

a) authorizes the Tax Court to impose sanctions against attorneys and others representing parties before the Tax Court

b) if the Tax Court finds that the person “has multiplied the proceedings in any case unreasonably and vexatiously” the courts may require the person to “pay personally the excess costs, expenses, and attorneys’ fees reasonably incurred because of such conduct”

4. §6673(b)(1)

a) authorizes courts other than the Tax Court to impose penalties of up to \$10,000 against taxpayers who bring frivolous or groundless tax suits

b) under §6673(b)(2) any penalties, costs or damages assessed by any court under §6673(b)(1) may be assessed by the IRS and collected in the same manner as a tax

**(1) purpose = to permit sanctions imposed by all courts in connection with federal tax proceedings to be assessed and collected in the same manner as penalties imposed by the Tax Court**

5. §6673(b)(3) provides that Federal Appellate courts may impose monetary sanctions, penalties or court costs in favor of the Gov't for frivolous appeals of Tax Court decisions and tax decisions of other federal tribunals

a) such awards may be assessed and collected in the same manner as tax

J. Failure to make timely deposits of tax - §6656

1. four tiered penalty - - the amount of the penalty increasing as the length of the delinquency increases

a) 2% of the underpayment if full payment is made within 5 days of the due date

b) 5% of the underpayment if full payment is made within 6 to 15 days of the due date

c) 10% of the underpayment if the delinquency continues more than 15 days after the due date, but full payment is made within 10 days of the first delinquency notice sent to the taxpayer under §6303

d) 15% of the underpayment if full payment is not made within 10 days after the first delinquency notice

K. Interest on deficiencies and overpayments

1. interest on deficiencies

a) interest on tax delinquencies begins to accrue on the date of the tax return

b) if civil penalties are assessed, the taxpayer must also pay interest on the penalties

c) interest on the negligence and fraud penalties, the substantial understatement penalty (§6662(d)), the valuation penalties and the delinquent filing penalty **begins to accrue on the due date of the return (§6601(e)(2)(B))**

d) interest rate is the short term Federal rate plus 3% points, adjusted quarterly (§6621(a)(2))

2. interest on overpayments

- a) interest on overpaid taxes begins to accrue on the date of overpayment (§6611(b))
- b) the date of overpayment for taxes withheld from wages or estimated taxes is the date the return is due

## **XI. Federal Tax Crimes**

### **A. Criminal provisions of the Code**

#### **1. §7201 – Attempted Evasion**

- a) the “capstone of the system of sanctions”
- b) makes it a felony willfully to attempt to evade or defeat any tax or the payment of any tax
- c) felonies → the max fine for individuals is \$250,000 and the max fine for corporations is \$500,000
- d) misdemeanors → the max fine for both individuals and corporations is \$100,000
- e) defines two (2) distinct crimes

**(1) the attempt to defeat or evade tax (for example, by underreporting income on a return)**

**(2) the attempt to defeat or evade the payment of any tax (for example, by concealing assets after the assessment and during the collection process)**

#### **2. to get a conviction the Gov’t must establish**

- a) an affirmative act of evasion or attempted evasion;
- b) an additional tax due and owing; and
- c) willfulness
- d) **Note:** unless there is a deficiency in tax A CONVICTION UNDER §7201 CANNOT BE SUSTAINED

**(1) Some courts have indicated that the deficiency must be “substantial”**

**(a) “substantiality” is not measure in terms of gross or net income nor by any particular percentage of the tax shown to be payable. All**

**the attendant circumstances must be taken into consideration” *US v. Nunan (2ndCir.1956)***

**(b) but this element is not based on either the statute or the principal Supreme Court decisions construing it**



e) **Note:** the Gov't need not prove the exact amount of the deficiency

3. filing a false tax return is itself a sufficient affirmative act to support conviction under §7201 (*Sansone v. US*)

4. “badges of fraud” supporting an inference of the required “*willful attempt to evade*” includes:

- a) keeping a double set of books
- b) destruction of books or records
- c) concealment of assets or converging up sources of income
- d) any conduct the likely effect of which would be to mislead or to conceal
- e) lying to the IRS agents
- f) consistently overstating deductions
- g) holding property in nominee names
- h) diverting corporate funds to pay an officer's personal expenses
- i) concealing bank accounts

B. §7203 – Willful Failure to file or Pay

1. it is a misdemeanor willfully to fail to file any return or keep any records or supply any information required by the Code

- a) it is a **felony** to fail to comply with the cash transaction reporting requirements of §60501

2. elements

- a) failure to make a return, to pay a tax, to keep records or supply information

**(1) easily proven**

**(2) Gov't uses this frequently against tax protestors who either file no returns or file returns lacking sufficient information from which to computer the tax**

**(a) See *US v. Daley* (8th Cir. 1973) (§ 7203 conviction upheld against person whose “return” contained only demographic information and documents questioning the constitutionality of the tax laws)**

**(3) Note: fifth amendment returns often appear under § 7203 “hit list”**

**(a) Returns that make a blanket 5<sup>th</sup> Amendment claim is not a “return” or a valid assertion of the 5<sup>th</sup> Amendment protection against self-incrimination**

**(b) Note: to avoid the “no return” problem and validly invoke the 5<sup>th</sup> Amendment → the claim must be made as to only specific types of questions, such as source of the taxpayer’s income, and the return must otherwise be correct and complete (see, *US v. Edwards* (11th Cir. 1985))**

- b) by a person under a legal duty to do so
- c) at the time required by law; and
- d) willfulness

3. can be committed by a person other than the taxpayer - - thus a corporate officer responsible for filing corporate tax returns or a tax lawyer who advises against the filing of a return CAN BE CONVICTED UNDER §7203

#### C. §7206(1) – False Statements

1. felony under §7206(1) for any person willfully to make and subscribe “any return, statement or other document, which contains or is verified by a written declaration that is made under penalty of perjury and which he does not believe to be true and correct as to every material matter”

2. elements

- a) willful subscription of a return, statement or other document
- b) under penalties of perjury
- c) that the subscriber did not believe to be true in every material respect

**(1) “materiality” is a question of law for the judge to decide, NOT A QUESTION OF FACT**

**(2) things that have been held to be “material”**

**(a) falsely identifying one’s source of income, even though the correct amount of income was reported**

**(b) reporting income from one spouse as having been earned in part by the other spouse (*US v. Greenberg*)**

(c) the court there said that ‘any statement that could hinder the IRS in its mission of administering and enforcing the tax laws is material

**(3) a return preparer who knowingly makes a false statement on a return CAN BE CONVICTED UNDER**

**§7602(1) as well as §7602(2). *US v. Shortt Accounting Corp* (9thCir. 1986)**

3. unlike §7201

- a) the max prison term is 3 years (rather than 5)
- b) §7206 does not require proof of tax deficiency (or additional tax owing)
- c) THE CRIME IS COMPLETE WHEN THE TAXPAYER SIGNS AND ELIVERS ANY RETURN, OR OTHER DOCUMENT UNDER PENALTIES OF PERJURY KNOWING THAT IT IS FALSE AS TO ANY MATERIAL MATTER

D. §7206(2) – Aiding and Assisting

- 1. the aiding and assisting provision is VERY BROAD
- 2. makes it a felony (with the same max 3-year prison term as §7206(1))
- 3. elements
  - a) willfulness
  - b) aiding or assisting or counseling with respect to the preparation of any document in connection with any matter arising under the internal revenue laws
  - c) falsity of the document with respect to any material matter
- 4. does not requires proof that a tax deficiency exists or that the defendant intended to evade tax
- 5. CRIME IS COMPLETE WHEN THE DEFENDANT ASSISTS IN PREPARING A FALSE DOCUMENT
- 6. conviction can be sustained even if the taxpayer had no knowledge of the falsity of the taxpayer's knowledge or intent is irrelevant
- 7. illustrative prosecutions
  - a) backdating documents
  - b) using inflated appraisals to increase a taxpayer's writeoff's
  - c) tax lawyers and accountants are frequent subjects

E. §7207 – Submitting A False Document

1. misdemeanor under §7207 to willfully deliver to the IRS “any list, return, account, statement, or other document” known to be fraudulent or false as to any material matter
2. differs from §7206(1)
  - a) the false document need not be subscribed under penalties of perjury
  - b) the person who delivers the false document is liable under this section (while §7206(1) applies only to the signer of the document)

F. §7212(a) – Impeding or Obstructing Administration of the Internal Revenue Code

1. prohibits corrupt endeavors to intimidate or impede any Gov’t employee involved in the administration of the Code
2. also prohibits “force or threats of force (including any threatening letter or communication)”
3. prior approval from the Department of Justice is required for use of §7212(a) in an indictment
4. use of the section is appropriately normally for conduct occurring after the tax return is filed when a conspiracy charge under 18 USC §371 is unavailable because of the absence of evidence of a conspiracy

G. Criminal Activities of Government Employees

1. two statutory provisions are of concern here – the ANTI-BROWSING RULES
  - a) §7213 – making it a felony for a current or former gov’t employee to make an unauthorized disclosure of confidential tax return information

**(1) the unlawful disclosure must have been made willfully to come within the statute**

b) §7213A – makes it a misdemeanor for any state, federal or other governmental employee willfully to inspect confidential return information without authorization to do so

c) violation of either provision gives rise to a private cause of action by taxpayers under §7431

#### H. State of Limitations for Tax Crimes

##### 1. §6531 sets the SOL for prosecution

a) general rule = 3 years

**(1) EXCEPTIONS TO THE GENERAL RULE - all of the crimes previously mentioned as well as conspiracy to defeat or evade any tax the SOL is 6 years**

b) SOL begins to run when the offense is committed, which is usually the date the tax return is filed

**(1) If the return is filed early → the SOL begins to run on the due date of the return**

**(2) If the return is filed late → the SOL begins to run when the return is received by the IRS**

**(3) NOTE: if taxpayer's post-return conduct - - such as lying to the IRS auditors or destroying records - - is the "affirmative willful act" upon which §7201 evasion prosecution is premised → the SOL begins running on the date of the post-filing conduct. *US v. Beacon Brass Co.* (S.Ct.1952)**

## I. Related Federal Criminal Statutes

### 1. 18 USC §371 – Conspiracy

- a) probably the most frequently employed general criminal charge in tax prosecutions
- b) conspiracy = felony punishable by up to 5 years imprisonment and a fine up to \$250,000 for individuals
- c) if the underlying crime is a misdemeanor, the punishment may not exceed the punishment for the misdemeanor
- d) elements

**(1) an agreement by two or more persons**

**(2) to commit an offense against the United States or to defraud it in any manner; and**

**(3) an overt act in furtherance of the object of the conspiracy committed by one or more conspirators. The overt act committed in furtherance of the conspiracy need not be illegal in and of itself**

- e) Gov't often uses conspiracy to charge accountants and lawyers in addition to the taxpayer

**(1) The Gov't can use the conspiracy statute to prosecute in a situation where the underlying tax crime is time-barred, BUT an overt act in furtherance of the conspiracy occurred within the 6-year period prior to the Government's discovery of the scheme**

- f) The SOL for tax-related conspiracies is 6 years (§6531(8))

**(1) SOL begins to run when the last overt act in furtherance of the object of the conspiracy is committed**

- g) **Note:** Conspiracy is a “free standing” crime - - the defendant can be convicted of conspiracy but acquitted of the underlying specific tax crime

- h) A far reaching application = *the “KLEIN CONSPIRACIES”*

**(1) Where defendants can be convicted of conspiracy to defraud the Gov't by impeding the lawful functions of the IRS by deceit or dishonesty**



**(2) *US v. Klein* (2<sup>nd</sup> Cir. 1957)**

**(a) FACTS: Gov't prosecuted the taxpayer, lawyer, accountant and top corporate officials of the taxpayer for evasion under §7201 and conspiracy. Defendants, who impeded the IRS investigation by making false and misleading entries in corporate books, were acquitted of the evasion, but convicted on the conspiracy charge**

**(b) Second Circuit upheld the convictions on the basis that the defendant's conduct amounted to a conspiracy to defraud through impeding the IRS in its functions of investigating taxpayers and collecting tax**

J. 18 USC §1001 – False Statements

1. provision makes it a felony to “knowingly and willfully” falsify, conceal, or cover up any material fact by any scheme or trick, or to make or use any false writing in connection with any matter within the jurisdiction of an US department or agency
2. taxpayers and their advisors who attempt to cover up a problem during an audit or investigation can be convicted under this section

K. 18 U.S.C. §1621 – Perjury

1. makes it a felony to make any oral or written statement under oath that the maker knows is false or untrue as to any material matter
2. BOTTOM LINE: for false statements made under oath or under penalties of perjury the Gov’t can prosecute under:
  - a) 18 USC §1621 – the general perjury section
  - b) for false statements under 18 USC §1001
  - c) and under one or more of the criminal tax provisions (such as §7201 attempted evasion or §7206(1))

L. Mail And Wire Fraud and RICO

1. Mail fraud statute (18 USC §1341) applies to anyone who devises or intends to devise a scheme to defraud for the purpose of obtaining money or property by false pretense and who uses the mail to execute the scheme
2. is mailing a fraudulent income tax return a violation of the mail fraud statute?
  - a) Yes, so long as there is a scheme to defraud
  - b) Examples of upheld convictions

**(1) Where taxpayer filed false income tax returns under fictitious names to obtain refunds *US v. Anderson* (8thCir.1980)**

- c) defendant can be convicted of both tax and mail fraud
- d) because the Gov't need not prove "willfulness" in a mail fraud prosecution it may elect to proceed under the mail fraud statute, rather than a criminal tax provision

3. Wire Fraud statute (18 USC §1343) applies to anyone who transmits across state lines by wire, radio or television any pictures, writing or sounds for the purpose of executing a fraudulent scheme

4. both mail and wire fraud are felonies carrying a max jail sentence of 5 years, are *in pari material*, so that decisions under one apply equally to the other

5. significance? Importing the mail and wire fraud statutes into the tax fraud arena means that conviction under either will support civil and criminal penalties under RICO (18 USC §1961, *et seq*)

- a) thus, if the same conduct supports both a tax fraud charge and a mail fraud charge then *the same indictment charging these two offenses can also include a RICO charge*

#### M. Stacking Criminal Charges ; Lesser Included Offenses

1. the lesser included offense rule permits a jury to convict the defendant of a lesser charge and acquit on the greater charge ONLY if the greater charge requires the jury to find a fact that is not required for the lesser offense. *Sansone v. US* (S.Ct.1965)

2. the virtue of the lesser included offense rule is that it permits the jury to reach a compromise verdict in cases in which it believes the defendant should not go unpunished, but it does not believe that her conduct warrants felony conviction

#### N. Methods of Proof of Unreported Income

1. the most difficult problem for the Gov't can be proving that the defendant actually had more income than reported on their return

- a) essential ingredient to a §7201 prosecution is proof of a deficiency

2. although the Gov't need not prove the exact amount, it must establish beyond a reasonable doubt that the defendant had greater income than she reported

a) 2 basic methods of proving unreported income

**(1) the direct or “specific items’ method**

**(a) Gov’t bases its case on specific, identified transactions - - such as receipt of interest, dividends or constructive dividends, wages or bribes**

**(b) Where there is proof such as W-2’s → the only realistic defense is that the item in question is not in fact income**

**(2) the indirect method – 4 schemes**

**(a) the *Net Worth Method***

(i) compares a taxpayer’s net worth at the end of the period to establish unreported income,

(ii) the ‘essential condition’ to the successful use of this method is the establishment with “reasonable certainty” of an opening net worth for the year

*(a) accomplished by identifying and caluating all of taxpayer’s assets as of the beginning of the year in question*

*(b) the beginning net work is then compared with the net worth at the end of the year, with adjustment for living expenses and provable nontaxable receipts to establish the taxpayer’s income*

(iii)after proving a discrepancy between the taxpayer’s net worth and her reported income → Gov’t must introduce evidence supporting the inference that the income is taxable

*(a) can do this by establishing a “likely source” for the income OR by negating all possible nontaxable sources of income see, US v. Massei (S.Ct.1958)*

**(b) the *Bank Deposits* method**

(i) simply compares the total deposits in the taxpayer's bank accounts to the reported income for the period, after subtracting "non-income" deposits such as loans

(ii) the excess of income as shown by this computation over the amount of income reported for the year is the unreported income

(iii)**Note:** there must be some evidence to support the inference that the unreported income is taxable

**(c) The *Cash Expenditures Method***

(i) Employed to convict persons whose expenditures exceeded their apparent means - - but for whom no records exist to trace the income to bank deposits or net worth increases reflected in identifiable assets

(ii) The unreported income is the excess of expenditures for the period over the reported income, nontaxable items and cash on hand

(iii)**Note:** there must be some evidence to support the inference that the unreported income is taxable

**(d) Additional Methods**

## **XII. The Collection Process**

- A. Assessment, notice and demand
- B. The federal Tax lien
  - 1. creation and validity
  - 2. scope of the lien
  - 3. duration of the lien
  - 4. notice of the lien- due process rights
  - 5. releasing the lien
- C. Judicial and Administrative collection procedures
  - 1. government suits involving tax liens
  - 2. levy
  - 3. installment agreements
  - 4. offers in compromise
  - 5. civil damages
  - 6. sale of seized property
- D. jeopardy and termination assessments

## **XIII. Third party liability**

- A. “Innocent spouse” rules
  - 1. pre-1998 rules
  - 2. 1998 amendments
- B. transferees and fiduciaries
  - 1. transferees
  - 2. fiduciaries
- C. trust fund taxes and responsible persons

1. “responsible persons”
2. time limits and other procedural aspects
3. lender liability

#### **XIV. Criminal Investigations**

- A. Selecting cases for criminal investigation
- B. Steps and personnel involved in the investigation
- C. The decision to prosecute
- D. Plea agreements
  1. expedited plea procedures
  2. major count policy
  3. nolo contendere plea

#### **XV.**