MOST LITIGATED ISSUES: Significant Cases

This section describes cases that generally do not involve any of the ten most litigated issues, but nonetheless highlight important issues relevant to federal tax administration.[1] These decisions are summarized below.

In *Altera Corp. v. Commissioner*, the U.S. Court of Appeals for the Ninth Circuit held that Treasury's cost-sharing regulations were both substantively and procedurally valid.[2]

Altera Corp. (Altera), a Delaware corporation, and its foreign subsidiary agreed to share the cost of a research and development project. The agreement originally included both cash and stock compensation paid to project employees, thereby reducing Altera's ability to shift income to its foreign subsidiary by bearing a disproportionate share of the project's costs for compensation. To address income shifting, Internal Revenue Code (IRC) § 482 authorizes the Secretary to (re)allocate income and expenses among related entities "clearly to reflect the income" of the entities.

In 2005, the Tax Court held in *Xilinx* that the government could not use IRC § 482 to require related entities to share stock-based compensation under regulations applicable to tax years 1997-1999.[3] In 2003, the government had updated its regulations to require related entities to share stock-based compensation.[4] Nonetheless, Altera responded to *Xilinx* by modifying its cost-sharing agreement in 2005 to exclude stock-based compensation. Predictably, the IRS audited Altera and increased its U.S. taxable income for 2004-2007 to account for the employees' stock-based compensation, as provided by the new regulation.[5] Altera argued the regulation was invalid under the Administrative Procedure Act[6] and the Tax Court agreed.

By way of background, other regulations provide that the allocation under IRC § 482 "to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer," but they specify several different methods for reaching this so-called "arm's length" result.[7] They explain that "whether a transaction produces an arm's length result generally will be determined by reference to the results of comparable transactions under comparable circumstances."[8] However, in 1986, Congress added a sentence to IRC § 482, which says the allocation of income in connection with the transfer of intangible property must be "commensurate with the income attributable to the intangible,"[9] diluting the relevance of comparable arm's length transactions in certain circumstances.

1 When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2018, and ending on May 31, 2019. For purposes of this section, we generally used the same period. However, we included one case, *Altera Corp. v. Comm'r*, for which an opinion was issued immediately after the end of the reporting period because it is particularly significant. In addition, we have included one case, *J.B. v. United States*, which is discussed as part of a most litigated issue (Summons). We include it here because of its potential impact on IRS procedures unrelated to summons that have been discussed in prior reports (*i.e.*, third party contacts).

2 *Altera Corp. v. Comm'r*, 926 F.3d 1061 (9th Cir. 2019), *rev'g* 145 T.C. 91 (2015) [hereinafter *Altera*]. The Ninth Circuit had previously reversed the Tax Court, but the original reversal was withdrawn because Circuit Court Judge Reinhardt died after oral arguments but before the opinion was issued. *See Altera Corp. v. Comm'r*, 2018-2 U.S.T.C. (CCH) ¶ 50,344 (9th Cir. 2018), *withdrawn by* 898 F.3d 1266 (9th Cir. 2018).

3 *Xilinx Inc. v. Comm'r*, 125 T.C. 37, 57 (2005), *aff'd*, 598 F.3d 1191 (9th Cir. 2010).

4 Treas. Reg. § 1.482-7(d)(1)(i) (as amended by T.D. 9088, 2003-42 I.R.B. 841).

5 Treas. Reg. § 1.482-7A(d)(2).

6 5 U.S.C. §§ 550-596.

7 Treas. Reg. § 1.482-1(b)(1).

8 *Id*.

9 Tax Reform Act of 1986, Pub. L. No. 99-514, Title XII, § 1231(e)(1), 100 Stat. 2085, 2562-2563 (1986).

Nonetheless, the preamble to the disputed regulation proposed in 2002 did not expressly justify the rule — that cost sharing agreements must include stock-based compensation — on the basis that doing so was "commensurate with income."[10] Rather, it emphasized that the rule would produce an arm's length result. In response, stakeholders submitted information showing that unrelated parties did not share the cost of stock-based compensation because its value is speculative, potentially large, and outside of their control.

Instead of explicitly adopting another basis for the rule (*e.g.*, to ensure the allocation was "commensurate with the income"), the preamble to the final regulations reiterated that "stockbased compensation must be taken into account … [to satisfy the] arm's length standard."[11] It continued to assert that parties dealing at arm's length "generally would not distinguish between stock-based compensation and other forms of compensation."[12]

Under the framework established in *Chevron*, if a court determines that a statute is ambiguous, it generally defers to regulations unless they are arbitrary and capricious.[13] Altera argued, and the Tax Court generally agreed, that the disputed regulation was arbitrary and capricious, and therefore, invalid because the government did not explain why it rejected significant comments it received from stakeholders and did not provide a contemporaneous "reasoned explanation" for its final rule as required under *State Farm*.[14]

The U.S. Court of Appeals for the Ninth Circuit reversed. Applying *Chevron*, the Ninth Circuit determined that the statute was ambiguous, and the regulations were not arbitrary and capricious. The court observed that even before the 1986 amendment, an analysis of comparable transactions was not the only way to reach an arm's length result.[15] Congress explained in 1986 that the "commensurate with income" standard was necessary because of "difficulties in determining whether the arm's length transfers between unrelated parties are comparable."[16] Thus, the court concluded the rule was substantively reasonable.

Turning to the procedural requirements, the Ninth Circuit said "Treasury made clear that it was relying on the commensurate with income provision… [and that it would] coordinate the new regulations with the arm's length standard, suggesting that it was attempting to synthesize the potentially disparate

---

10 Prop. Treas. Reg. § 1.482-7(d)(2), 67 Fed. Reg. 48,997, 49,002 (July 29, 2002).

11 T.D. 9088, 68 Fed. Reg. 51,171, 51,173 (Aug. 26, 2003).

12 *Id*.

13 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

14 5 U.S.C. § 706(2)(A) (establishing an "arbitrary, capricious, an[d] abuse of discretion" standard of review); 5 U.S.C. § 553(c) (requiring an agency to consider comments and provide a concise statement explaining the basis and purpose for a final rule when promulgating legislative rules); *Motor Vehicle Mfrs. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983) (requiring rules to be the product of reasoned decisionmaking).

15 Because the court rejected *Altera's* argument that the rule's departure from comparability analysis and its new requirement to include stock-based compensation as a cost was a significant departure from prior policy, it also rejected Altera's argument that a more searching review was required under *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502 (2009).

16 H.R. Rep. No. 99-426, at 425 (1985) (Conf. Rep.).

standards."[17] The court also concluded that Treasury made "clear enough" its decision to abandon comparability analysis by including "citations to legislative history."[18]

Accordingly, the court reasoned that comments documenting a lack of comparable transactions between unrelated parties reinforced Treasury's decision to abandon comparability analysis. When viewed in this light, the comments might not even have been significant enough to require a response, according to the court. Nonetheless, the preamble to the final regulations addressed the comments by distinguishing the situations cited by commentators on the basis that they did not involve the "development of high-profit intangibles."[19] Thus, the regulations satisfied the procedural requirements.

This case is significant because it could stall Treasury's stepped-up efforts to provide taxpayers with reasonably clear advanced notice about significant shifts in policy or practice, to respond to significant comments, and to explain the reasons for those shifts.[20] Such efforts are consistent with a taxpayer's *right to be informed*.[21] This case may also be significant because commenters have suggested that given the amount of money riding on the issue in other cases, Altera is likely to appeal.[22]

In *Good Fortune Shipping v. Commissioner*, the U.S. Court of Appeals for the District of Columbia Circuit held that Treasury regulations were invalid because the explanation provided by the government for the change was unreasonable.[23]

Good Fortune Shipping SA (Good Fortune) was a foreign corporation that earned income by shipping goods to and from the United States. Such income is subject to a special transportation tax under IRC § 887 unless it is exempt. Corporations "organized in a foreign country" that "grants an equivalent exemption to corporations organized in the United States," are exempt from the transportation tax under IRC § 883(a)(1). A foreign corporation is ineligible for the exemption, however, "if 50 percent or more of the value" of its stock "is owned by individuals who are not residents" of a country providing a reciprocal exemption.[24]

Good Fortune was organized in a qualifying country, had issued shares in bearer form (*i.e.*, unregistered shares, which are not held in the owner's name), and had documentation that its bearer shares were indirectly owned by qualifying individuals. Accordingly, it took the position that it qualified for the

17 *Altera*, 926 F.3d at 1081.

18 *Id*. at 1082. For the same reasons, the Ninth Circuit concluded that the government did not violate *Chenery's* bar against post hoc justifications. *Id*. at 1083 (citing *SEC v. Chenery Corp*., 332 U.S. 194, 196 (1947)). A forceful dissent characterizes the preamble's citation to legislative history as "cryptic." *Id*. at 1087 (O'Malley, J., dissenting). It also asserts that the majority opinion: "supplies a reasoned basis for the agency's action that the agency itself has not given, … encourages 'executive agencies' penchant for changing their views about the law's meaning almost as often as they change administrations, … and endorses a practice of requiring interested parties to engage in a scavenger hunt to understand an agency's rulemaking proposals." *Id*. at 1087-1088 (Internal citations omitted).

19 T.D. 9088, 68 Fed. Reg. 51,171, 51,173 (Aug. 26, 2003).

20 Andrew Velarde, *Reg Process Could Get Slower and Less Stable, Wilkins Warns*, 2016 TNT 123-7 (June 27, 2016) (discussing the agency's response to the Tax Court decision). The Ninth Circuit arguably lowered the bar for how clearly an agency must identify what it is changing and why. On the other hand, the court may have concluded that the IRS's relatively "cryptic" explanation was only "clear enough" considering the intended audience–international corporations sophisticated enough to have tax sharing agreements. If so, the decision does not alter the requirement for regulations of more general applicability.

21 IRC § 7803(a)(3)(A).

22 Reuven Avi-Yonah, *9th Circ. Got Cost-Sharing Right in Altera v. Commissioner*, 2019 Law360 169-60 (June 18, 2019). Moreover, another taxpayer could mount a successful challenge to these very same regulations before the Tax Court because the Tax Court is not bound by the Ninth Circuit's decision in cases appealable to other circuits. *See Golsen v. Comm'r*, 54 T.C. 742, 757 (1970), *aff'd*, 445 F.2d 985 (10th Cir. 1971).

23 *Good Fortune Shipping v. Comm'r*, 897 F.3d 256 (D.C. Cir. 2018), *rev'g* 148 T.C. 262 (2017).

24 IRC § 883(c)(1).

exemption on its 2007 return. Because Good Fortune's shares were issued in "bearer" form, however, the IRS took the position based on its regulations (discussed below) that Good Fortune could not substantiate the identity of its shareholders to qualify for the exemption. Good Fortune petitioned the Tax Court, arguing that the regulations were invalid.

Between 1991 and 2003 when the disputed regulations were issued, foreign corporations were allowed to prove qualifying ownership of bearer shares.[25] Notwithstanding objections received during the notice and comment period, the IRS explained that it adopted a new categorical rule in 2003, which excluded bearer shares because of "the difficulty" of reliably tracking "the location of a given owner."[26]

The Tax Court upheld the regulations because it said the statute was ambiguous and the regulations were reasonable, but the U.S. Court of Appeals for the District of Columbia Circuit reversed. It said the regulations rewrote the meaning of "owned" in IRC § 883(c)(1) to require not only valid ownership, but also ownership that is not "difficult" to track. It might have been reasonable for the IRS to do so if it had found that their owners were "impossible" to track, but it did not. Indeed, it had determined between 1991 and 2003 that they could be tracked, and in preamble to regulations it issued under IRC § 883 in 2010, the IRS observed that bearer shares were becoming easier to track over time.[27] Thus, it was unclear why the agency seemed to decide that bearer shares were more difficult to track in 2003 than in 1991.

The court also observed that other forms of ownership make the beneficial owners difficult to track, including the appointment of nominees and trustees. Yet, the 2003 regulations treat ownership through these arrangements as qualifying if the taxpayer submits detailed statements substantiating the beneficial owners. Thus, it was unreasonable for the 2003 regulations to adopt a categorical rule to deny the opportunity to provide similar substantiation of the ownership of bearer shares without explanation.

Finally, the court observed that the IRS allowed corporations to substantiate the ownership of bearer shares when determining if a corporation is closely held.[28] It said that the IRS cannot reasonably treat bearer shares as a form of second-class ownership in some contexts but not in others where the same concerns exist unless it provides a reasonable contemporaneous explanation, which it had not done.

This case is significant to the extent it suggests that regulations are invalid, even if they provide an explanation for the rules being adopted, if that explanation does not seem reasonable. An explanation may be unreasonable if it is not consistent with reasoning or facts expressed or acknowledged by the IRS in other contexts.[29]

---

25 *Compare* Rev. Proc. 91-12, § 8.02(3), 1991-1 C.B. 473 *with* Treas. Reg. §§ 1.883-4(a), -4(b), -4(c), -4(d) (as amended by T.D. 9087, 2003-40 I.R.B. 781).

26 Notice of Proposed Rulemaking, 67 Fed. Reg. 50,510, 50,518 (Aug. 2, 2002) (re-proposed regulations); T.D. 9087, 68 Fed. Reg. 51,394, 51,399 (Aug. 26, 2003). In 2010, the regulations were amended to allow certain types of bearer shares that could be tracked. T.D. 9502, 75 Fed. Reg. 56,858, 56,860 (Sept. 17, 2010). However, this amendment is not applicable to the period at issue (*i.e.*, 2007).

27 T.D. 9502, 75 Fed. Reg. 56,858, 56,860 (Sept. 17, 2010).

28 *See Good Fortune Shipping*, 897 F.3d at 265 (citing IRC § 884(e)(4)(B) and T.D. 8432, 57 Fed. Reg. 41,644 (Sept. 11, 1992)).

29 For additional discussion of the case's significance, see, *e.g.*, Andrew Velarde, *Another Altera May Be Waiting in the Wings of the D.C. Circuit*, 2018 TNT 131-3 (July 9, 2018).

In *Baldwin v. United States*, the U.S. Court of Appeals for the Ninth Circuit held that a claim for refund was late because the common law mailbox rule was supplanted by Treas. Reg. § 301.7502-1(e)(2)(i).[30]

To claim a refund for 2005, the Baldwins were required to file an amended return by October 15, 2011. They sent the return to the IRS by U.S. mail in June 2011, but the IRS did not receive it or pay a refund. The Baldwins then brought a refund suit in district court. The main issue was whether the refund claim was timely.

Under the longstanding common law "mailbox" rule, if a taxpayer has proof that they timely mailed a document, it is presumed to have been delivered when such a mailing would ordinarily arrive.[31] In 1954, Congress enacted IRC § 7502, which said a document is deemed timely if it is: (1) postmarked on or before the deadline, and (2) *actually delivered*.[32] If the document is never delivered, this statutory mailbox rule does not apply.[33]

Although some circuits have held that the statutory rule displaced the common law rule, others, including the Ninth Circuit, have held the statutory rule provided a safe harbor that supplements the common law rule, rather than displacing it.[34] Because the IRS did not receive the Baldwins' claim, the statutory rule was no help to them. Accordingly, they sought to rely on the common law mailbox rule to establish that their claim for refund was presumptively delivered to the IRS (timely) in June 2011.

The government countered that regulations had eliminated the circuit split and supplanted the common law rule. Specifically, Treas. Reg. § 301.7502-1(e) was amended in 2011 to say:

> Other than direct proof of actual delivery, proof of proper use of registered or certified mail, and proof of proper use of a duly designated [private delivery service] … are the *exclusive means* to establish prima facie evidence of delivery …. *No other evidence of a postmark or of mailing will be prima facie evidence of delivery or raise a presumption that the document was delivered*.[35]

The district court held the regulations invalid. It reasoned that the plain language of IRC § 7502 unambiguously supplemented the common law rule, leaving no gap in the law for the regulations to fill.[36]

---

30 *Baldwin v. United States*, 921 F.3d 836 (9th Cir. 2019), *reh'g denied*, 2019 U.S. App. LEXIS 18968 (9th Cir. June 25, 2019), *petition for cert. filed*, 2019 WL 4673331 (U.S. Sept. 23, 2019) (No. 19-402).

31 *See, e.g.*, *Detroit Automotive Products Corp. v. Comm'r*, 203 F.2d 785, 785-786 (6th Cir. 1953) (per curiam); *Arkansas Motor Coaches, Ltd. v. Comm'r*, 198 F.2d 189, 191 (8th Cir. 1952).

32 The National Taxpayer Advocate has recommended extending the mailbox rule to cover electronic transmissions. *See* National Taxpayer Advocate 2019 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 22-23 (*Treat Electronically Submitted Tax Payments as Timely if Submitted Before the Applicable Deadline*); National Taxpayer Advocate 2017 Annual Report to Congress 278 (Legislative Recommendation: *Electronic Mailbox Rule: Revise the Mailbox Rule to Include All Time-Sensitive Documents and Payments Electronically Transmitted to the IRS*).

33 *See Miller v. United States*, 784 F.2d 728, 730 (6th Cir. 1986) (per curiam).

34 *Anderson v. United States*, 966 F.2d 487, 491 (9th Cir. 1992) ("The statute itself does not reflect a clear intent by Congress to displace the common law mailbox rule. Accordingly, we decline to read section 7502 as carving out exclusive exceptions to the old common law physical delivery rule.").

35 T.D. 9543, 76 Fed. Reg. 52,561 (Aug. 23, 2011) (emphasis added).

36 *Baldwin v. United States*, 2:15-cv-06005-RGk-AGR, 2016 WL 11593219 (C.D. Cal. 2016), *rev'd and remanded*, 921 F.3d 836 (9th Cir. 2019).

On appeal, the U.S. Court of Appeals for the Ninth Circuit reversed. It applied the two-step analysis set forth in *Chevron*.[37] It found that although IRC § 7502 applies a presumption of delivery to documents sent by registered mail, electronic filing, certified mail, and private delivery services, it is silent as to whether any presumption of delivery applies to documents sent by regular mail. Thus, IRC § 7502 left a gap for the regulations to fill.

Under *Brand X*, "[a] court's prior judicial construction of a statute trumps an agency construction otherwise entitled to *Chevron* deference only if the prior court decision holds that its construction follows from the unambiguous terms of the statute and thus leaves no room for agency discretion."[38] In this case, the Ninth Circuit said its prior decision made clear that it was filling a statutory gap. Thus, the Treasury Department was free to fill that gap by adopting its own reasonable interpretation of IRC § 7502.

This case is significant because it confirms that the common law mailbox rule has been superseded in the Ninth Circuit. It is perhaps even more significant because it highlights the increasingly controversial Supreme Court decisions in *Chevron* and *Brand X*, which generally allow reasonable agency regulations to trump judicial interpretations where the statute is silent or ambiguous.[39] Litigators have indicated this case may be the perfect vehicle for the Supreme Court to consider overruling those decisions.[40] If it overrules *Chevron* and *Brand X*, commenters have speculated that the common law mailbox rule could spring back to life in the Ninth Circuit.[41]

In *JB v. United States*, the United States Court of Appeals for the Ninth Circuit held that IRS Publication 1 did not provide the taxpayer with "reasonable notice in advance" of third-party contacts, as required by IRC § 7602(c)(1).[42]

Mr. Baxter is an attorney who accepts appointments from the California Supreme Court to represent indigent defendants. In July 2013, the Baxters received a letter indicating their joint return for 2011 had been selected for an audit as part of the IRS's National Research Program. The letter came with IRS Publication 1, Your Rights as a Taxpayer (Pub 1), which says, in relevant part, that "we sometimes talk with other persons if we need information that you have been unable to provide, or to verify information we have received." Two months later, the IRS requested documents from the Baxters. The Baxters responded by asking the IRS to excuse them from the audit because of Mr. Baxter's poor health and the couples' advanced age. The IRS refused, and in May 2015, the Baxters filed a separate suit to stop the audit based on health concerns.

37 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984).

38 *Baldwin*, 921 F.3d at 843 (quoting *National Cable & Telecom. Assoc. v. Brand X Internet Services*, 545 U.S. 967, 982 (2005)).

39 *See, e.g.*, Andrew Velarde, *Can the Humble Mailbox Rule Bring Monumental Changes to Chevron?* 94 Tax Notes Int'l 412 (Apr. 29, 2019) (noting that Justices Thomas, Gorsuch, Kavanaugh, Alito, Breyer, and Chief Justice John Roberts have arguably expressed reservations about an overly broad reading of *Chevron*).

40 *See id.*

41 Carlton Smith, *Ninth Circuit Holds Reg. Validly Overrules Case Law; Disallows Parol Evidence of Timely Mailing*, Procedurally Taxing Blog (Apr. 18, 2019), https://procedurallytaxing.com/ninth-circuit-holds-reg-validly-overrules-case-law-disallows-parol-evidence-of-timely-mailing/.

42 *JB v. United States*, 916 F.3d 1161 (9th Cir. 2019), *aff'g sub nom. Baxter v. United States*, 117 A.F.T.R.2d (RIA) 694 (N.D. Cal. 2016).

In September 2015, the IRS issued a summons to the California Supreme Court (Mr. Baxter's employer) seeking invoices or other documents that resulted in payment to Mr. Baxter for the 2011 calendar year.[43] The Baxters filed a timely petition to quash, arguing that the IRS had not followed the requirement of IRC § 7602(c)(1) to provide "reasonable notice in advance" that third parties may be contacted. The district court agreed that Pub 1 did not provide sufficient notice, reasoning that "the implementing regulations contemplate notice for each contact, not a generic publication's reference that the IRS may talk to third parties throughout the course of an investigation."[44]

The U.S. Court of Appeals for the Ninth Circuit affirmed. It explained that the requirement for "reasonable notice in advance" means the IRS must provide enough specific information that it gives the taxpayer a "meaningful opportunity to volunteer records on his own, so that third-party contacts may be avoided if the taxpayer complies with the IRS's demand."[45] Its holding was based, in large part, on the unambiguous plain language of the statute and the Supreme Court's interpretation of similar notice requirements in other laws.

Just as a taxpayer is given notice of a summons under IRC § 7609 and a meaningful opportunity to file a petition to quash it, the advance notice requirement is supposed to protect the taxpayer's reputation because it "gives the taxpayer a meaningful opportunity to resolve issues and volunteer information before the IRS seeks information from third parties, which would be unnecessary if the relevant information is provided by the taxpayer himself."[46] Pub 1 is so general that without more, it provided no such meaningful opportunity in this case, according to the court.

The court reasoned that the statutory exceptions to the advance notice requirement suggest that Congress intended the pre-contact notice to reference a specific contact or piece of information. IRC § 7602(c)(3) waives the requirement if (a) the taxpayer has authorized the contact; (b) the Commissioner, with good cause, believes the notice may jeopardize the IRS's tax collection efforts or open a third party to reprisal; or (c) there is a pending criminal investigation. These exceptions would be unnecessary if the requirement could always be satisfied with a generic notice such as Pub 1. Only if the notice reveals who the IRS plans to contact or what the IRS plans to request does the taxpayer have enough information to authorize the contact, jeopardize collection efforts, retaliate against the third parties, or interfere with a pending criminal investigation. Thus, the IRS's interpretation of the notice requirement would make the statutory exceptions superfluous.

Next, the court rejected the IRS's argument that the requirement under IRC § 7602(c)(2) to provide the taxpayer with a post-contact report of who it contacted would be superfluous if their names had to be furnished beforehand under IRC § 7602(c)(1). First, the court said that IRC § 7602(c)(1) only requires reasonable notice, and what is reasonable depends on the facts. Reasonable notice may not always require the IRS to provide a list of names in advance. Second, the pre-contact notice requirement applies to

43 The Ninth Circuit remarked that [according to the National Taxpayer Advocate], the Baxters' "experience receiving notice after a third party has been contacted is becoming more common." *JB*, 916 F.3d at 1166 n.6 (9th Cir. 2019) (citing statistics from the National Taxpayer Advocate 2015 Annual Report to Congress 123, 128 (Most Serious Problem: *Third Party Contacts: IRS Third Part Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers' Businesses and Reputations*), and the National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress 98-101 (Area of Focus: *IRS Third Party Contact (TPC) Notices Should Be More Specific, Actionable, and Effective*).

44 *Baxter v. United States*, 117 A.F.T.R.2d (RIA) 694, 2016 U.S. Dist. LEXIS 15855, at *8 (N.D. Cal. 2016), *aff'd sub nom.*, *JB v. United States*, 916 F.3d 1161 (9th Cir. 2019).

45 *JB*, 916 F.3d at 1173; *J.B.*, 916 F.3d at 1168 (citing S. Rep. No. 105-174, at 77 (1988) and quoting Internal Revenue Manual (IRM) 4.11.57.2(3), Definition of TPC (May 26, 2017), and *Third Party Contacts*, 67 Fed. Reg. 77,419, 77,419-77,420 (Dec. 18, 2002)).

46 *JB*, 916 F.3d at 1168.

those the IRS "may" contact, whereas the post-contact report must list those the IRS did contact (with certain exceptions). Thus, neither requirement is superfluous because they apply to two different groups.

The IRS also argued that the subsection title for IRC § 7602(c)(1) (*i.e.*, "General Notice") and the subsection title for IRC § 7602(c)(2) (*i.e.*, "Notice of Specific Contacts") lend support to its argument that the statute was at least ambiguous about whether the pre-contact notice could be "general." The court cited cases holding that titles cannot limit the plain meaning of a statutory text, reasoning that titles cannot create ambiguity where, as in this case, the statutory language is clear.[47] It also cited legislative history suggesting that both the pre- and post-contact notices were intended to protect the taxpayer's reputation, and to do so they had to be specific enough to be meaningful (*i.e.*, actionable).[48]

In addition, the IRS argued that when the Conference Committee clarified that "in general," the IRS could provide advance notice to the taxpayer "as part of an existing IRS notice provided to taxpayers," it meant that the IRS could include a general notice in Pub 1. The court explained that Congress knew how to refer to Pub 1 when it wanted to — it referenced Pub 1 by name three times in the same legislation — but did not reference it by name in connection with the pre-contact notice requirement. The court also observed that immediately after enactment, the IRS itself did not believe that a single general notice like Pub 1 was sufficient to comply with the statutory requirement, as discussed in the National Taxpayer Advocate's report.[49] Moreover, even the agency's regulations support an interpretation of "reasonable notice" that requires meaningful notice to the taxpayer.[50]

Next, the court addressed the IRS's argument that every court to have considered the issue has held that Pub 1 satisfied the pre-contact notice requirement. It pointed out that other courts have recognized that IRC § 7602(c)(1) requires a context-dependent inquiry, and in some contexts the Pub 1 might be sufficient. In this case, it was particularly troubled by the fact that (1) the IRS had reason to know that the billing records at issue might have been subject to attorney-client privilege, (2) the taxpayers would have been able to provide the pertinent records if the IRS had given them a meaningful opportunity, and (3) the Pub 1 was "divorced from any specific request for documents."[51]

Although the Ninth Circuit acknowledged that a context-dependent inquiry might be difficult to administer, it said this concern was a matter for Congress. Nonetheless, it was "doubtful that Publication 1 alone will ever suffice to provide reasonable notice in advance to the taxpayer, as the statute requires."[52]

The National Taxpayer Advocate previously recommended changes to the IRS's pre-contact procedures that would give taxpayers a meaningful opportunity to provide information and avoid contacts that could damage their reputations.[53] This case is significant because it suggests that IRS procedures did

47 *JB*, 916 F.3d at 1169 (citing for example, *Oregon Public Utility Comm'n v. ICC*, 979 F.2d 778, 780 (9th Cir. 1992)).

48 *JB*, 916 F.3d at 1170 (citations omitted).

49 *Id*. at 1170-1171 (citing National Taxpayer Advocate 2015 Annual Report to Congress 123, 127 n.23 (Most Serious Problem: *Third Party Contacts: IRS Third Part Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers' Businesses and Reputations*)).

50 Treas. Reg. § 301.7602-2 ("the pre-contact notice may be given either orally or in writing").

51 *JB*, 916 F.3d at 1169.

52 *Id*. at 1172 n.15. The Tenth Circuit appears to disagree. *See High Desert Relief, Inc. v. United States*, 917 F.3d 1193 (10th Cir. 2019) (assuming without deciding, after JB, that Pub. 1 did provide sufficient notice under section 7602(c)(1)).

53 *See* National Taxpayer Advocate 2015 Annual Report to Congress 123-142 (Most Serious Problem: *Third Party Contacts: IRS Third Party Contact Procedures Do Not Follow the Law and May Unnecessarily Damage Taxpayers' Businesses and Reputations*); National Taxpayer Advocate Fiscal Year 2018 Objectives Report to Congress 98-101 (Area of Focus: *IRS Third Party Contact (TPC) Notices Should Be More Specific, Actionable, and Effective*).

not always comply with the requirement to provide reasonable notice in advance.[54] Subsequently enacted legislation now requires the IRS to issue a notice when it actually intends to make a third-party contact and to specify approximately when the contact(s) will be made.[55] However, it removed the requirement to provide reasonable notice in advance.[56] Nonetheless, the case remains significant because of its analysis of what constitutes reasonable notice could apply in other contexts.[57]

In *Haynes v. United States*, the U.S. Court of Appeals for the Fifth Circuit held that when an e-filed return was timely submitted by a preparer and rejected by the IRS without notice, a taxpayer had reasonable cause to avoid a negligence penalty if the preparer was not negligent (*i.e.*, the preparer had reasonable cause).[58]

On October 17, 2011, Mr. Dunbar, the Hayneses' accountant, electronically transmitted their 2010 income tax return to the Lacerte Software Corporation for filing with the IRS. The same day, he notified Mr. Haynes that the return had been timely filed. Although Mr. Dunbar did not receive a rejection notice from the IRS, the IRS had rejected the return because Mrs. Haynes's Social Security number (SSN) erroneously appeared on the line designated for an employment identification number. Neither Mr. Dunbar nor the Hayneses took further action to confirm that the IRS had received the return or acknowledged its acceptance for processing. Additionally, although the Hayneses' return reflected an unpaid balance due of more than $40,000, they made no tax payment prior to August

54 For the IRS's initial response to the National Taxpayer Advocate's concerns, see National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 72-79 (*Review of the 2016 Filing Season*). For further analysis of this case, see, *e.g.*, Leslie Book, *Ninth Circuit Rejects IRS's Approach to Notifying Taxpayers of Third Party Contacts*, Procedurally Taxing Blog (Mar. 4, 2019), http://procedurallytaxing.com/ninth-circuit-rejects-irss-approach-to-notifying-taxpayers-of-third-party-contacts/. The IRS appears to be planning to defend its prior practice. See IRM 5.17.6.7, Third-Party Contact Requirements of IRC § 7602(c) (Aug. 1, 2019) ("If challenged, the IRS intends to defend third-party contacts that its employees previously made (before the effective date of section 1206 of the Taxpayer First Act of 2019), in accordance with then-existing instructions …).

55 Taxpayer First Act, Pub. L. No. 116-25, § 1206, 133 Stat. 981 (2019) (codified at IRC § 7602(c)(1)) (requiring a third party contact to occur only "during a period (not greater than 1 year) which is specified in a notice which — (A) informs the taxpayer that contacts with persons other than the taxpayer are intended to be made during such period, and (B) except as otherwise provided by the Secretary, is provided to the taxpayer not later than 45 days before the beginning of such period.").

56 Due, in part, to the fact that the notice is no longer required to be "reasonable," the IRS does not believe it is required to include the information it needs on the TPC notice. *See, e.g.*, IRS, Interim Guidance on Third-Party Contact Notification Procedures, SBSE-04-0719-0034 (July 26, 2019). For a legislative recommendation to require the IRS to inform the taxpayer of what information it needs, see National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 101-102 *(Require the IRS to Specify the Information It Needs in Third Party Contact Notices)*.

57 For example, we wonder whether the Ninth Circuit's analysis of the requirement to provide "reasonable notice" before making third party contacts under IRC § 7602(c)(1) provides any insight about how a court might interpret the requirement for agencies to provide reasonable notice of the basis for rule changes in the preamble to proposed regulations that apply to individuals and small businesses. As noted in the discussion of *Altera* (above), the Ninth Circuit found the requirement for the IRS to provide a "reasonable" explanation for a rule was satisfied by a reference to legislative history that the dissent called "cryptic." Although the court was applying a different statute, *Altera* and *JB* could be reconciled on the basis that to be "reasonable" the IRS needs to provide more specific information to individuals under audit, than it must provide to experts representing international businesses.

58 *Haynes v. United States*, 760 F. App'x 324 (5th Cir. 2019) (unpublished, per curiam), *vacat'g and remand'g* 119 A.F.T.R.2d (RIA) 2202 (W.D. Tex. 2017). The Hayneses subsequently requested a rehearing, urging the court to decide if the taxpayers could have reasonable cause even if the preparer was negligent. *Appellants' Petition for Panel Rehearing, Haynes v. United States*, 123 A.F.T.R.2d (RIA) 570 (5th Cir. 2019) (No. 3:16-CV-112) (Feb. 25, 2019). For a legislative recommendation addressing these issues, see National Taxpayer Advocate 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 57-59 *(Extend Reasonable Cause Abatement of the Failure-to-File Penalty to Taxpayers Who Rely on Return Preparers to E-File Their Returns)*.

2012.[59] After the IRS assessed a late fling penalty, they paid the penalty and requested a refund on the basis that their failure to timely file did not result from "willful neglect," and was due to "reasonable cause" under IRC § 6651(a)(1).[60] The IRS denied their claim, and they timely filed a refund suit in district court.

In *Boyle*, the Supreme Court explained in 1985 that reasonable cause may exist for failure to file when a taxpayer relies on the erroneous advice of counsel concerning a substantive question of law (*e.g.*, whether a liability exists or a return is required), but generally not when a taxpayer relies on an agent to file.[61] The Court reasoned that no expertise is required to know that returns have fixed filing deadlines. The Hayneses argued before the District Court:

> (1) that *Boyle* only applies to paper-filed returns; (2) that the act of e-filing a tax return itself is a form of substantive legal advice; (3) that a defective return transmitted to and rejected by the IRS is nonetheless a timely-filed return; (4) that the alleged failure of the Lacerte software to provide notification of the IRS's rejection of the tax return amounts to circumstances beyond Plaintiffs' control and establishes reasonable cause; and (5) that reliance on Plaintiffs' experienced, educated, and prominent accountant constitutes 'reasonable cause.'[62]

Unpersuaded, the District Court granted the government's motion for summary judgment based on the bright line rule expressed in *Boyle*. On appeal the U.S. Court of Appeals for the Fifth Circuit did not decide whether to extend *Boyle* to e-filed returns.[63] It explained that in *Boyle* the preparer was negligent in missing the deadline and his negligence was imputed to the taxpayer, whereas the negligence of Mr. Dunbar had not been established in this case. Thus, even if the logic of *Boyle* were extended to e-filing, the government was not entitled to summary judgment because it was not clear, as a factual matter, whether Mr. Dunbar was negligent or if his actions met the reasonable cause standard (*i.e.*, whether ordinary business care and prudence would demand that he personally contact the IRS to ensure acceptance). Accordingly, the Fifth Circuit vacated and remanded the decision.

59 A fact finder might view a couple who did not take the time to ensure they had timely paid their liabilities as less likely to have exercised reasonable care to ensure they filed timely.

60 *See also* Treas. Reg. § 301.6651-1(a) ([a penalty applies] "unless the failure to file the return within the prescribed time is shown to … be due to reasonable cause and not to willful neglect"); Treas. Reg. § 301.6651-1(c)(1) ("If the taxpayer exercised ordinary business care and prudence and was nevertheless unable to file the return within the prescribed time, then the delay is due to a reasonable cause.").

61 *United States v. Boyle*, 469 U.S. 241, 250-52 (1985).

62 *Haynes v. United States*, 2017 U.S. Dist. LEXIS 106252, at *10 (W.D. Tex. June 15, 2017).

63 Amici argued that the bright line rule of *Boyle* should not apply to e-filed returns. *See* Brief of Amicus Curiae, American College of Tax Counsel, In Support of Appellants and Reversal, *Haynes v. United States*, 123 A.F.T.R.2d (RIA) 570 (5th Cir. 2019) (No. 17-50816) (Nov. 27, 2017). They point out that if the return had been mailed on the same date, it would have been timely filed under the mailbox rule (*i.e.*, IRC § 7502). Applying *Boyle* unfairly discriminates against e-filers who are forced to depend on third parties to determine if the IRS has accepted their returns, according to the brief. As noted above, the National Taxpayer Advocate has recommended legislation to extend the mailbox rule to electronic submissions. *See, e.g.*, National Taxpayer Advocate, 2020 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 14-15 (*Treat Electronically Submitted Tax Payments and Documents as Timely If Submitted Before the Applicable Deadline*); National Taxpayer Advocate 2019 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 22-23 (*Treat Electronically Submitted Tax Payments as Timely if Submitted Before the Applicable Deadline*).

This case is significant because its analysis is likely to shape whether and how the late filing penalty will apply to e-filed returns that are timely transmitted to the IRS but not timely accepted.[64] We can expect taxpayers to continue to argue that they have reasonable cause for late e-filing on the basis that: (1) the preparer was not negligent (*e.g.*, because the IRS did not timely alert him or her to an error), and (2) the taxpayer can reasonably rely on a preparer's confirmation that an e-filed return was timely filed because the bright line rule established in *Boyle* does not apply to e-filing deadlines.[65]

In *BASR Partnership v. United States*, the U.S. Court of Appeals for the Federal Circuit awarded attorney fees to a partnership with no assets after the government rejected a qualified offer of $1 to settle.[66]

The Pettinati family formed the BASR partnership to shelter the gain from the sale of their printing business in 1999. It was not until 2010 that the IRS issued a Final Partnership Administrative Adjustment (FPAA), proposing to disallow the purported tax benefits from the sale under procedures established by the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA").[67] Mr. Pettinati, BASR's tax matters partner, filed suit in the U.S. Court of Federal Claims, challenging the FPAA as untimely. While the case was pending, BASR, which had no assets, made a "qualified offer" to settle for $1.[68] The government rejected the offer.

The Court of Federal Claims held that BASR's limitations period had expired.[69] BASR then moved for an award of litigation costs under IRC § 7430, which the Court of Federal Claims granted, and the U.S. Court of Appeals for the Federal Circuit affirmed.

A "party" to a court proceeding meeting the net worth requirements of 28 U.S.C. § 2412(d)(2)(B) can be awarded litigation costs under IRC § 7430(c)(1) if he or she is the "prevailing party" and the tax liability pursuant to the judgment is equal to or less than the taxpayer's "qualified offer" to settle with respect to the tax "at issue" in the proceeding.

The government argued that BASR was not eligible because: (1) the BASR partnership could not be a "party" because only partners are parties in TEFRA litigation, (2) the amount of tax liability was not "at issue" because BASR had none — tax liability is determined at the partner level, (3) BASR did not incur any litigation costs — the costs were incurred by the Pettinati family, (4) the Pettinati family was the real-party-in-interest, but they did not meet the net worth requirement, and (5) the trial court abused its

64 For helpful commentary, see, *e.g.*, Leslie Book, *Update on Haynes v US: Fifth Circuit Remands and Punts on Whether Boyle Applies in E-Filing Cases*, Procedurally Taxing Blog (Feb. 12, 2019), http://procedurallytaxing.com/update-on-haynes-v-us-fifth-circuit-remands-and-punts-on-whether-boyle-applies-in-e-filing-cases/; Leslie Book, *Delinquency Penalties: Boyle in the Age of E-Filing*, Procedurally Taxing Blog (Nov. 30, 2017), http://procedurallytaxing.com/delinquency-penalties-boyle-in-the-age-of-e-filing/ ("If there is no timely notification and little way for the taxpayer to independently check whether the return was rejected, it seems unfair to apply *Boyle* in these circumstances"); Andrew Velarde, *Circuit Court Punts on Application of Boyle to E-Filing*, 2019 TNT 5-35 (Feb. 4, 2019).

65 Similar arguments were recently rejected on the basis that even if a taxpayer uses a preparer he is free to file by mail. *See Intress v. United States*, 2019 U.S. Dist. LEXIS 130504 (M.D. Tenn. 2019).

66 *BASR Partnership v. United States*, 915 F.3d 771 (2019), *aff'g* 130 Fed. Cl. 286 (2017).

67 IRC § 6221 *et seq*.

68 In certain circumstances, a taxpayer may recover reasonable litigation costs if their liability turns out to be less than or equal to a "qualified offer" they made to settle the dispute with the government. *See generally* IRC § 7430; Treas. Reg. § 301.7430-1 *et. seq*.

69 *BASR Partnership v. United States*, 113 Fed. Cl. 181 (2013), *aff'd*, 795 F.3d. 1338 (Fed. Cir. 2015). We discussed this case in the 2014 report. *See* National Taxpayer Advocate 2014 Annual Report to Congress 427, 437 (Most Litigated Issues: *Significant Cases*).

discretion in awarding costs because BASR's settlement offer of $1 was not a good faith effort to settle. The Federal Circuit rejected these arguments.

This case is significant because it confirms that partnerships can obtain litigation costs under IRC § 7430 if they — and not necessarily their partners — meet the requirements in 28 U.S.C. § 2412. More importantly, it rejected the government's suggestion that it would be an abuse of discretion to award litigation costs when a qualified offer is too low.[70] Low-income taxpayers who have had their refunds frozen and believe they will prevail often submit $1 offers, hoping a qualified offer will prompt the government to resolve their cases more quickly. Time is of the essence because they often need the refunds to meet their basic living expenses.

In *Montrois v. United States*, the U.S. Court of Appeals for the District of Columbia Circuit held the IRS had authority to impose a fee to issue and renew Preparer Tax Identification Numbers (PTINs) because PTINs provide a specific benefit to preparers by protecting the confidentiality of their SSNs.[71]

A group of tax return preparers filed suit arguing that the IRS lacks authority under the Independent Offices Appropriations Act of 1952 (IOAA) to charge for obtaining and renewing PTINs. Under the IOAA, agencies may only establish a fee "for a service or thing of value provided by the agency."[72] The IOAA only permits agencies to charge for special benefits that are voluntarily requested and not shared by the general public.[73]

Before 2010, anyone could prepare and file a tax return for someone else. Preparers were required to enter their SSN or a PTIN on the returns they prepared.[74] In 2010, the government began to regulate return preparers, issuing regulations requiring that preparers have a PTIN (not just an SSN), which would only be issued to those who paid a user fee.[75] The regulation noted that the requirement would benefit preparers by helping to "maintain the confidentiality of [their] SSNs."[76] The IRS issued another regulation to establish a fee for the initial PTIN registration and for each annual renewal.[77]

In 2014, the U.S. Court of Appeals for the District of Columbia Circuit held in *Loving* that the Treasury Department lacked authority to regulate the conduct of registered tax return preparers.[78] Following *Loving*, the only remaining parts of the regulatory scheme were the requirements to obtain and use PTINs and to pay PTIN fees. The preparers filed suit challenging the fee.[79]

---

70 Two low income taxpayer clinics submitted an amicus brief because of the importance of this issue to low-income taxpayers. *See* Brief for the Harvard Federal Tax Clinic and the Philip C. Cook Low-Income Taxpayer Clinic of Georgia State University as Amici Curiae in Support of the Appellees, *BASR Partnership v. United States*, 123 A.F.T.R.2d (RIA) 691 (2019) (No. 17-1925) (Nov. 2, 2017); Ted Afield, *Nominal Qualified Offers and TEFRA*, Procedurally Taxing Blog (Feb. 25, 2019), http://procedurallytaxing.com/nominal-qualified-offers-and-tefra/; *Tax Clinic Amicus Brief Argument Supported*, Georgia State Law Clinical Programs Blog (Feb. 8, 2019), https://georgiastatelawclinicalprograms.blog/2019/02/08/tax-clinic-amicus-brief-argument-supported/.

71 *Montrois v. United States*, 916 F.3d 1056 (D.C. Cir. 2019), *petition for cert. filed* (May. 24, 2019) (No. 18-1493).

72 31 U.S.C. § 9701(b).

73 *See Nat'l Cable Television Assn. v. United States*, 415 U.S. 336 (1974).

74 *Furnishing Identifying Number of Income Tax Return Preparer*, T.D. 8835, 64 Fed. Reg. 43,910 (Aug. 12, 1999).

75 *Furnishing Identifying Number of Tax Return Preparer*, T.D. 9501, 75 Fed. Reg. 60,309, 60,315 (Sept. 30, 2010).

76 *Id.* at 60,309.

77 *User Fees Relating to Enrollment and Preparer Tax Identification Numbers*, T.D. 9503, 75 Fed. Reg. 60,316 (Sept. 30, 2010).

78 *Loving v. Comm'r*, 742 F.3d 1013 (D.C. Cir. 2014), *aff'g* 920 F. Supp. 2d 108 (D.D.C. 2013).

79 While the case was pending before the district court, the IRS reduced the amount of the PTIN fee from $50 to $33 (not including a vendor fee) to reflect the fact that fee proceeds were no longer needed to cover the regulation of preparers. *Preparer Tax Identification Number (PTIN) User Fee Update*, T.D. 9781, 81 Fed. Reg. 52,766 (Aug. 10, 2016).

The district court ruled in favor of the preparers, issued an injunction barring the IRS from charging the PTIN fee, and ordered the IRS to refund previously collected fees.[80] It reasoned that if every member of the public could obtain a PTIN, as they could after *Loving*, the IRS was not providing a special benefit that was not available to the general public. Moreover, the regulations did not indicate that SSNs were being inadvertently disclosed or find that their confidentiality was at risk.

The District of Columbia Circuit vacated the district court. It concluded that the protection of the confidentiality of tax return preparers' SSNs was a special benefit. Although the preamble to the regulations did not discuss the confidentiality concern when the agency adopted the fee,[81] the concern runs throughout the regulatory history of the requirement, including the legislative history of Congress's authorization for the IRS to mandate the use of PTINs. In addition, H&R Block and others had submitted comments in support of mandatory PTINs because the requirement would "protect the confidentiality of SSNs."[82] In summary, the IRS could rely on the special benefit of confidentiality even though this benefit was not articulated in the user fee regulations because the benefit was articulated in related regulations, comments, and legislative history pertaining to the requirement to use a PTIN.

This case is significant because it clarifies that the IRS is authorized to charge preparers for PTINs under the IOAA, even though the use of PTINs is mandated by the IRS.[83]

In *Gaylor v. Mnuchin*, the U.S. Court of Appeals for the Seventh Circuit held the federal parsonage housing tax exemption is constitutional because it is neutral towards religion (*i.e.*, it does not violate the Free Exercise or the Establishment clauses of the U.S. Constitution).[84]

Under the longstanding "convenience of the employer" doctrine (later incorporated into IRC § 119(a)(2)) housing provided to employees for the convenience of their employer (*e.g.*, for sailors aboard ships) was not income, but in 1921, the Treasury Department said that housing provided to ministers was income.[85] Congress responded by enacting IRC § 107, which provides that a "minister of the gospel" may exclude housing provided in-kind (under IRC § 107(1)) or in the form of a housing allowance (under IRC § 107(2)).

Seeking to challenge constitutionality of IRC § 107, the Freedom from Religion Foundation (FFRF) paid a housing allowance to employees and former employees, none of whom were ministers. The employees filed amended tax returns claiming refunds for their housing allowances under IRC § 107(2). After six months, the FFRF and its employees filed suit in district court as permitted by IRC § 6532(a)(1). The district court permitted several pastors and their religious organizations to intervene to defend IRC § 107(2).

80 *Steele v. United States*, 260 F.Supp.3d 52 (D.D.C. 2017), *vacated and remanded by Montrois v. United States*, 916 F.3d 1056 (D.C. Cir. 2019). For a discussion of *Steele*, see, *e.g.*, National Taxpayer Advocate 2017 Annual Report to Congress 351, 364-366 (Most Litigated Issues: *Significant Cases*).

81 *Id.* (citing *SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947)). The IRS had discussed the benefit in connection with regulations imposing the requirement to use a PTIN (cited above).

82 *Montrois v. United States*, 916 F.3d 1056, 1066 (D.C. Cir. 2019).

83 For concerns about user fees, see, *e.g.*, National Taxpayer Advocate 2015 Annual Report to Congress 14-22 (Most Serious Problem: *IRS User Fees: The IRS May Adopt User Fees to Fill Funding Gaps Without Fully Considering Taxpayer Burden and the Impact on Voluntary Compliance*); National Taxpayer Advocate Memo to Associate Chief Counsel (Procedure and Administration), *Comments on User Fees for Offers in Compromise* (Nov. 28, 2016), https://www.regulations.gov/document?D=IRS-2016-0038-0003.

84 *Gaylor v. Mnuchin*, 919 F.3d 420 (7th Cir. 2019).

85 O.D. 862, 4 C.B. 85 (1921).

Both parties filed for summary judgment. The District Court for the Western District of Wisconsin held the statute violates the Establishment Clause of the First Amendment,[86] but the U.S. Court of Appeals for the Seventh Circuit reversed.[87]

To determine if IRC § 107(2) violates the Establishment Clause, the Seventh Circuit applied the *Lemon* test and the historical significance test.[88] Under the *Lemon* test, the statute must: (1) have a secular legislative purpose; (2) have a principal or primary effect that neither advances nor inhibits religion; and (3) not foster excessive government entanglement with religion.

First, the Seventh Circuit deferred to the government's sincere articulation of three secular purposes: to eliminate discrimination against ministers, to eliminate discrimination between ministers (*i.e.*, between those who receive in-kind housing and those that do not), and to avoid excessive entanglement with religion. It reasoned that IRC § 107(2) is simply one of many *per se* rules that provide a tax exemption to employees with work-related housing requirements.[89] The ease of administration represented by a categorical exclusion is a secular purpose. While the exclusion applicable to ministers is overbroad, it is no more overbroad than the other categorical exclusions, according to the court. Although the IRS must still determine whether a taxpayer qualifies as a "minister," the court found that this inquiry is less intrusive than an inquiry into how a religious organization uses its facilities. Thus, IRC § 107(2) has a secular purpose to avoid entanglement, which satisfies both the first and third prongs of the *Lemon* test.[90]

Moving to the second prong of the *Lemon* test, the court rejected FFRF's argument that the tax exemption for ministers under IRC § 107(2) has the principal effect of advancing religion by subsidizing it. After acknowledging the economic equivalence of a tax exemption and a subsidy, the court said that a tax exemption is not the same as a subsidy for purposes of this test.[91]

Turning to the historical purpose test, the court said that for over two centuries, states have implemented church property tax exemptions. While the provision at issue was an income tax provision, the income tax was not constitutional before 1913 and Congress excluded parsonages within a few years of income

86 *Gaylor v. Mnuchin*, 278 F. Supp. 3d 1081, 1104 (W.D. Wis. 2017).

87 *Gaylor*, 919 F.3d at 420.

88 *Lemon v. Kurtzman*, 403 U.S. 602 (1971) (the *Lemon* test); *Town of Greece v. Galloway*, 572 U.S. 562 (2014) (the historical significance test).

89 For example, IRC § 132 and § 162 exclude housing provided to an employee away on business for less than a year; IRC § 134 excludes housing provided to current or former members of the military; IRC § 911 excludes housing above a certain level provided to citizens or residents living abroad; IRC § 912 excludes housing provided to civilian officers and employees of the U.S. government living abroad. These categorical exemptions allow a wide range of employees to receive tax-exempt housing without needing to prove it was provided for the convenience of the employer under IRC § 119(a)(2).

90 Critics have observed that defining "minister of the gospel" is a "really hard and invasive question." *See, e.g.*, Amy Lee Rosen, *Clergy Tax Exemption Problematic Despite 7th Circ. Ruling*, 2019 Law360 78-138 (Mar. 19, 2019) (quoting Samuel D. Brunson, a professor at Loyola University Chicago School of Law). Moreover, several tax professors, including Brunson, signed an amicus brief to the Seventh Circuit arguing the clergy housing tax exemption should be quashed because it entangles church and state and subsidizes religion. Amicus Curiae Brief of Tax Law Professors in Support of Appellees, *Gaylor v. Mnuchin*, 919 F.3d 420 (2019) (No. 18-1277), 2018 WL 3311509.

91 Amici observed that "[T]reating targeted exemptions differently from direct spending would permit Congress to subvert the First Amendment by offering refundable tax credits to churches, exempting all ministerial income from tax, or exempting all religious people from the income tax." Amicus Curiae Brief of Tax Law Professors in Support of Appellees, at 13, *Gaylor v. Mnuchin*, 919 F.3d 420 (2019) (No. 18-1277), 2018 WL 3311509. For further analysis of the constitutionality of tax exemptions, see Edward A. Zelinsky, *Winn and the Inadvisability of Constitutionalizing Tax Expenditure Analysis*, 121 Yale L.J. Online 25 (2011).

becoming taxable; and a few decades later it excluded cash housing allowances as well.[92] Thus, it held IRC § 107(2) does not violate the Free Exercise Clause or the Establishment Clause.

This case is significant because over 200,000 congregations provide a housing allowance to their ministers.[93] Because it raises controversial constitutional issues, however, we might expect further litigation in this area.[94]

In *Wagner v. United States*, the U.S. District Court for the Eastern District of Washington held that the two-year period for filing a refund claim under IRC § 6532(a) was subject to equitable tolling due to confusing correspondence from the IRS.[95]

The Wagners timely filed their 2012 federal income tax return, claiming a refund of $1,364,363. They asked for $500,000 to be refunded and for the remainder ($864,363) to be applied to their tax liability for 2013. In November 2014, the IRS sent a letter, which indicated it was allowing only $839,999 of the claim and disallowing the remainder ($524,364). On December 5, 2014, the Wagners appealed.

The IRS did not respond until May 2016, when it sent another letter, this time stating it "allowed only $0.00 of the claim," apparently disallowing the $839,999 of the claim for the first time. Because there was an outstanding and unexplained credit of $523,686 on the account, the IRS took only $335,871 (rather than the entire $859,357 then owed for 2012 – the original $839,999 plus interest and penalties) from the Wagners' 2014 refund and applied it to their 2012 tax liability.[96]

On March 1, 2018, the Wagners filed suit seeking a refund of $839,999. The government moved to dismiss, arguing that the portion of the claim that was not offset against the credit from tax year 2014 (*i.e.*, $523,686) was time barred.[97] It reasoned that the two-year period provided by IRC § 6532(a) to bring suit commenced when the IRS sent its first letter in November 2014, and ended in November 2016.

The court denied the government's motion, holding that the filing was timely for two reasons. First, it reasoned that the two-year period for filing suit did not commence until May 2016, when the IRS issued the second letter, which was the first time it informed the taxpayer of its decision to disallow the $839,999 claim. Therefore, the March 1, 2018, filing was within the two-year period.

In the alternative, if the two-year period commenced in November 2014, the court said the period was tolled and the filing deadline was extended because of "equitable considerations" generated by the IRS's confusing correspondence, "including the fact that Plaintiffs were informed that $839,999 of the

92 Amici observe that without a property tax exemption, the state might lien or levy on church property if the tax went unpaid, whereas if a housing allowance were subject to the income tax, no similar entanglement would ensue. Amicus Curiae Brief of Tax Law Professors in Support of Appellees, at *17, *Gaylor v. Mnuchin*, 919 F.3d 420 (2019) (No. 18-1277), 2018 WL 3311509.

93 *Gaylor*, 919 F.3d at 424 n.3.

94 *See* Amy Lee Rosen, *Clergy Tax Exemption Problematic Despite 7th Circ. Ruling*, 2019 Law360 78-138 (Mar. 19, 2019); Amicus Curiae Brief of Tax Law Professors in Support of Appellees, *Gaylor v. Mnuchin*, 919 F.3d 420 (2019) (No. 18-1277), 2018 WL 3311509. Moreover, the *Lemon* test was subsequently questioned by the Supreme Court. *See Am. Legion v. Am. Humanist Ass'n*, 139 S. Ct. 2067 (2019).

95 *Wagner v. United States*, 353 F. Supp. 3d 1062 (E.D. Wash. 2018).

96 The decision does not indicate when the IRS offset the 2014 refund against the 2012 liability. The IRS presumably applied the refund to 2012 (rather than 2013, as requested) because it arose in 2012 and the IRS did not believe there was an overpayment in 2012.

97 The court did not address the question of whether it lacked jurisdiction because the Wagners had not fully paid the liability. *See Flora v. United States*, 362 U.S. 145 (1960). For a proposal to repeal or limit this rule, see National Taxpayer Advocate 2018 Annual Report to Congress (Legislative Recommendation: *Fix The* Flora *Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*).

requested refund claim was not going to be allowed less than 6 months before the statute of limitations expired…”[98]

Because equitable tolling does not apply to jurisdictional deadlines, the court examined whether the filing deadline was jurisdictional. Filing deadlines are non-jurisdictional unless Congress makes them jurisdictional through a “clear statement.”[99] “Congress must do something special, beyond setting an exception-free deadline, to tag a statute of limitations as jurisdictional and so prohibit a court from tolling it,” according to the Supreme Court.[100]

The District Court reasoned that the distance between the waiver of sovereign immunity, which is found in 28 U.S.C. § 1346(a)(1), and the filing deadline, which is found in IRC § 6532(a) under a subtitle labeled “Procedure and Administration,” is a strong indication that the deadline is procedural and not jurisdictional. The deadline does not explicitly limit the court’s power and is not cast in jurisdictional terms. Moreover, it reasoned that the recovery of amounts wrongfully withheld is akin to the common law tort of conversion, and the grant of jurisdiction does not in any way limit the court’s usual equitable powers.

This case is significant because it suggests for the first time that the period for filing a refund claim under IRC § 6532(a) is subject to equitable tolling.[101] Equitable tolling is consistent with the taxpayer’s *rights to appeal an IRS decision in an independent forum* and *to a fair and just tax system*.

---

98 *Wagner*, 353 F. Supp.3d at 1069.

99 *United States v. Wong*, 135 S. Ct. 1625 (2015) (citation omitted) (finding the filing deadlines for Federal Court Claims Act suits in 28 U.S.C. § 2401(b) non-jurisdictional and subject to equitable tolling). *See also Volpicelli v United States*, 777 F.3d 1042 (9th Cir. 2015) (holding the filing deadline in IRC § 6532(c) to bring suit to recover a wrongful levy in district court was non-jurisdictional and subject to equitable tolling).

100 *Wong*, 135 S. Ct. at 1632.

101 *See, e.g.*, *Hessler v. United States*, 2016 U.S. Dist. LEXIS 1210, at *12 n.5 (E.D. Cal. 2016) (“Whether equitable tolling applies to section 6532(a)(1) remains an open question”); *Drake v. United States*, 2011 U.S. Dist. LEXIS 22563 *6 (D. Ariz. 2011) (“We find no authority to apply equitable tolling to this statute and decline to do so when plaintiff does not expressly raise it”). *But see Smith v. United States*, Dkt No. 1:19-cv-271 (W.D. Mich. 2019) (concluding the filing deadlines under IRC §§ 7422(a) and 6432(a)(1) are jurisdictional in the Sixth Circuit). For further discussion of the Wagner case and advocacy on this issue, see Carlton Smith, *District Court Equitably Tolls 2-Year Deadline to File Refund Suit*, Procedurally Taxing Blog (Nov. 28, 2018), http://procedurallytaxing.com/district-court-equitably-tolls-2-year-deadline-to-file-refund-suit/. The National Taxpayer Advocate has recommended extending equitable doctrines, such as equitable tolling, to periods prescribed by the IRC. *See* National Taxpayer Advocate 2017 Annual Report to Congress 283 (Legislative Recommendation: *Equitable Doctrines: Make the Time Limits for Bringing Tax Litigation Subject to the Judicial Doctrines of Forfeiture, Waiver, Estoppel, and Equitable Tolling, and Clarify That Dismissal of an Untimely Petition Filed in Response to a Statutory Notice of Deficiency Is Not a Decision on the Merits of a Case*).