Significant Cases

Each of the ten most litigated issues includes a discussion of the most significant cases involving those issues. For example, the accuracy-related penalty discussion (below) includes a summary of *Chai v. Commissioner*, which is significant because it held for the first time that the IRS generally has the burden of producing evidence that it obtained supervisory approval of penalties.[1] This section describes cases that do not involve any of the ten most litigated issues, but nonetheless highlight significant tax issues.[2]

In *King v. Commissioner*, the United States Court of Appeals for the Seventh Circuit held that the IRS can refuse to abate "unfair" liabilities under Internal Revenue Code (IRC) § 6404(a).[3]

On March 5, 2009, when a revenue agent asked Mr. King to sign Forms 2504, *Agreement to Assessment and Collection of Additional Tax and Acceptance of Overassessment*, which would require him to pay additional employment taxes, he asked if he could pay in installments. After the agent said he could, he signed and returned the forms. The IRS received and processed the forms by April 13, 2009. However, the IRS did not inform him that his request for an installment agreement (IA) was incomplete or how to perfect it. Instead, the IRS sent him a series of uninformative collection letters. On June 10, 2009, after Mr. King called to inquire about his IA, a TAS employee discussed the requirements for an IA with him, and forwarded his request to a revenue officer (RO). The RO denied the IA. He suggested that Mr. King could sell property to pay his liabilities.

In October 2011, Mr. King obtained a reverse mortgage and paid his tax liability.[4] At his previously-scheduled Collection Due Process hearing, he requested abatement of interest accruing after March 5, 2009. Mr. King argued that he should not have to pay the interest that accrued after the IRS provided him with erroneous information about his eligibility for an IA. He said he would have paid earlier and avoided those charges if he had known the IRS would not grant him an IA. The IRS declined to abate the interest.

Mr. King filed an appeal *pro se* before the Tax Court, which held the IRS abused its discretion in denying the abatement.[5] IRC § 6404(a) authorizes the IRS to abate liability that: "(1) is excessive in amount, or (2) is assessed after the expiration of the period of limitation properly applicable thereto, or (3) is erroneously or illegally assessed."[6]

Mr. King argued that the interest was "excessive," which the Tax Court had interpreted, based on its plain meaning, as "unfair" under the facts and circumstances.[7] The Tax Court agreed, in part,

1 *Chai v. Comm'r*, 851 F.3d 190 (2d Cir. 2017).

2 When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2016, and ending on May 31, 2017. For purposes of this section, we used the same period, except that we also included *Steele v. United States*, 2017-1 U.S. Tax Cas. (CCH) P50,238, 2017 U.S. Dist. LEXIS 84117 (D.D.C. 2017), *appeal docketed*, No. 1:14-cv-01523 (D.D.C., Sept. 6, 2017). We included it because it had such a significant effect on tax administration (as discussed below) and because it was decided shortly after the end of the normal one-year period.

3 *King v. Comm'r*, 829 F.3d 795 (7th Cir. 2016), *rev'g* T.C. Memo 2015-36.

4 *King v. Comm'r*, T.C. Memo. 2015-36.

5 *Id*.

6 Internal Revenue Code (IRC) § 6404(e) provides for abatement of interest attributable to certain unreasonable errors and delays by the IRS, provided no significant aspect of such error or delay can be attributed to the taxpayer. Our discussion focuses on IRC § 6404(a), however, because IRC § 6404(e) does not apply to employment tax liabilities.

7 *H & H Trim & Upholstery Co. v. Comm'r*, T.C. Memo. 2003-9; *Law Offices of Michael B.L. Hepps v. Comm'r*, T.C. Memo. 2005-138 (abating interest that would not have accrued "but for" the Commissioner's mistake and was, therefore, unfair and excessive).

concluding that "but for" the IRS's mistake, interest would not have accrued between April 13, 2009, when the IRS processed his Forms 2504, and June 10, 2009, when he was first informed by TAS that his IA application was incomplete. It would be unfair for the IRS to collect the interest that accrued during this period. Thus, the IRS should have abated it as "excessive in amount."

The IRS appealed to the United States Court of Appeals for the Seventh Circuit. While the appeal was pending, Mr. King died and his wife did not defend the appeal. Circuit Court Judge Posner reversed the Tax Court. First, he criticized the Tax Court's definition of "excessive," concluding that because it provided "no guidance" it was "a monkey wrench tossed into the machinery of tax collection."[8] The opinion explained that the nebulous standard of "unfairness" could invite litigation and result in a significant loss of tax revenue. By contrast, Treas. Reg. § 301.6404–1(a) defines "excessive in amount" as "in excess of the correct tax liability," which the opinion said, leaves no room to consider "unfairness."[9] Because the interest in this case was properly calculated it was not excessive, according to the opinion. Thus, the IRS's determination not to abate interest was reasonable.

This case is significant because taxpayers in the Seventh Circuit may no longer be eligible for abatement of interest (or other amounts) on the basis that it is unfair. However, similarly situated taxpayers whose cases are appealable to other circuits may continue to be eligible for such abatements.

In *Tilden v. Commissioner*, the United States Court of Appeals for the Seventh Circuit held that a Stamps.com postmark affixed by the taxpayer's representative was sufficient to make a Tax Court petition timely under IRC § 7502 (*i.e.*, the mailbox rule) because it arrived at the Tax Court when it "ordinarily" would have if it had been mailed on or before the deadline.[10]

A taxpayer filed a petition with the Tax Court after the due date. Under IRC § 6213(a), the petition was due on the 90th day after the IRS mailed the statutory notice of deficiency, but the court actually received the petition on the 98th day. The taxpayer's representative applied a mailing label, postage, a postmark, and certified mail sticker to the petition dated as of the 90th day using a system from Stamps.com.[11] U.S. Postal Service (USPS) tracking information revealed that the envelope arrived at a USPS facility on the 92nd day.

Under the mailbox rule (codified at IRC § 7502), a petition that would otherwise be late, is deemed timely if it bears a U.S. postmark showing it was deposited in the mail on or before the deadline, assuming it is properly addressed and has sufficient postage. Treas. Reg. § 301.7502-1(c)(1)(iii)(B)(1) expressly authorizes reliance on a postmark "made other than by the U.S. Postal Service," provided the

8 *King*, 829 F.3d at 798. The opinion did not discuss how the IRS is able to apply "fairness" standards in other contexts. *See*, *e.g.*, IRC § 6015(f)(1) (providing for "innocent spouse" relief if "taking into account all the facts and circumstances, it is *inequitable* to hold the individual liable…" (Emphasis added)); Treas. Reg. § 301.7122-1(b)(3)(ii) (providing the IRS will compromise liabilities when "collection of the full liability would undermine public confidence that the tax laws are being administered in a *fair* and *equitable* manner." (Emphasis added)). Nor did the opinion discuss the legislative history of IRC § 6404, which suggests it was to be used to abate interest in situations where the failure to do so "would be widely perceived as grossly *unfair*." S. Rep. No. 99-313, at 208 (1986) (Emphasis added).

9 IRC § 6404(a)(3) provides for abatement of amounts "erroneously or illegally assessed." At oral argument, Judge Posner asked how the IRS's interpretation of "excessive in amount" would avoid making IRC § 6404(a)(3) redundant and superfluous. Oral Argument, Dkt No. 15-2439 (2016), http://media.ca7.uscourts.gov/sound/external/gw.15-2439.15-2439_05_27_2016.mp3. However, the written opinion does not address this question.

10 *Tilden v. Comm'r*, 846 F.3d 882 (7th Cir. 2017), *rev'g* T.C. Memo. 2015-188.

11 Stamps.com provides a user the ability to buy and print USPS-approved postage from the user's computer, then drop the mailing into a mailbox, hand it to a postal employee, or schedule a USPS pick-up through the software. *Tilden*, T.C. Memo. 2015-188, n.4.

postmark is legible and the envelope arrives when it would "ordinarily" arrive if actually mailed on that date. The taxpayer argued that his petition was timely because it bore a timely postmark and arrived when it ordinarily would.

When an item arrives later than it ordinarily would, Treas. Reg. § 301.7502-1(c)(1)(iii)(B)(2) provides that the taxpayer only gets the benefit of the mailbox rule if he or she establishes that the item was placed in the mail within the filing deadline, that the mail was delayed, and identifies the cause of the delay. The IRS initially argued that the mailbox rule was inapplicable because the petition arrived after it ordinarily would, and the taxpayer had not identified the cause of the delay.

The Tax Court rejected both arguments. Under the "knockout" rule of Treas. Reg. §§ 301.7502-1(c)(1)(iii)(A) and -1(c)(1)(iii)(B)(3), when an item has both USPS and non-USPS postmarks, the non-USPS postmark is disregarded. The court concluded that the petition was late because it had two postmarks, one applied by the taxpayer's representative and another applied by the USPS (too late), which knocked out the representative's (timely) postmark. The court acknowledged that the USPS tracking data was not really a postmark, but cited other cases treating it as the functional equivalent of a USPS postmark.

The taxpayer filed a motion for reconsideration, at which point the IRS conceded that the taxpayer's petition was timely because it had been received within the time in which it "ordinarily" would if mailed timely. The Tax Court denied the motion, concluding that the filing deadline provided by IRC § 6213(a) was jurisdictional and the court's jurisdiction could not be conferred by mere concession of the parties.

The Seventh Circuit reversed, holding the petition was timely because the representative-applied postmark triggered the mailbox rule. It reasoned that the parties agreed the petition had arrived when it ordinarily would, and that there was no USPS postmark to trigger the knockout rule. It rejected the Tax Court's conclusion that the USPS tracking information was the functional equivalent of a postmark.

However, the Seventh Circuit agreed with the Tax Court that the filing deadline provided by IRC § 6213(a) was a jurisdictional limitation, rather than a procedural one.[12] This distinction is important because procedural deadlines may be subject to waiver, forfeiture, and equitable exceptions, but jurisdictional deadlines may not. Although the IRS could not waive a jurisdictional requirement, it could agree to facts — such as when a letter would "ordinarily" reach the Tax Court — that would trigger jurisdiction. The Stamps.com postmark was sufficient to trigger the mailbox rule and make the taxpayer's petition timely because the parties agreed the petition arrived at the Tax Court when it ordinarily would have if it had been mailed on or before the deadline.

This case is significant because it extends the statutory mailbox rule to self-service postmarking software.[13] The case is also significant because the IRS appears to have changed its position in multiple cases concerning when a document would "ordinarily" reach the Tax Court, and some of these cases

12 For a pointed critique of this part of the decision, see Carlton Smith, *Tilden v. Comm'r: Seventh Circuit Reverses Tax Court's Untimely Mailing Ruling*, Procedurally Taxing Blog (Jan. 16, 2017), http://procedurallytaxing.com/tilden-v-commr-seventh-circuit-reverses-tax-courts-untimely-mailing-ruling/.

13 The case does not address whether the rule applies to electronic communications such as fax or email. As the IRS increasingly encourages taxpayers to communicate with it electronically, the National Taxpayer Advocate has recommended that it clarify the mailbox rule applies to electronically-submitted documents. *See* National Taxpayer Advocate 2016 Annual Report to Congress 16-20 (Special Focus: IRS Future State: *The National Taxpayer Advocate's Vision for a Taxpayer-Centric 21st Century Tax Administration*).

could reach circuit courts, potentially leading to additional decisions about whether equitable exceptions (*e.g.*, equitable tolling and the common law mailbox rule) apply to tax-related filing deadlines.[14]

In *QinetiQ U.S. Holdings v. Commissioner*, the United States Court of Appeals for the Fourth Circuit held that a statutory notice of deficiency was valid even though it did not include a "reasoned explanation" because the requirements of IRC § 7522(a) superseded the requirements of the Administrative Procedure Act (APA).[15]

After an audit, the IRS issued a statutory notice of deficiency to QinetiQ U.S. Holdings, Inc. (QinetiQ). The statutory notice of deficiency said only that a specific deduction QinetiQ had claimed "under the provisions of [IRC §] 83 is disallowed in full as you have not established that you are entitled to such a deduction."[16] QinetiQ argued, in part, that the statutory notice of deficiency failed to provide a reasoned explanation, which is necessary for a court to review a final agency action under § 706 of the Administrative Procedure Act (APA).[17] The IRS's failure to articulate a "reasoned explanation" rendered the statutory notice of deficiency invalid, according to QinetiQ.

In a short unpublished order, the Tax Court held that the statutory notice of deficiency was subject to the standard provided for in IRC § 7522(a) instead of the APA.[18] Section 7522(a) says a statutory notice of deficiency "shall describe the basis for, and identify the amounts (if any) of, the tax due, interest, additional amounts, additions to the tax, and assessable penalties included in such notice. An inadequate description under the preceding sentence shall not invalidate such notice." Thus, even if the description was inadequate, the notice would have been valid under IRC § 7522(a).[19]

QinetiQ appealed to the United States Court of Appeals for the Fourth Circuit. It argued that the explanations required by IRC § 7522 and the APA were cumulative, not exclusive.

The Fourth Circuit disagreed with QinetiQ, affirming the Tax Court. It concluded the APA's requirement of a reasoned explanation does not apply to a statutory notice of deficiency issued by the IRS. Unlike other courts reviewing agency action under the APA, the Tax Court may conduct a *de novo* review of the agency's action under the IRC § 7522. The Tax Court may consider new evidence and issues not presented at the agency level. The broad scope of the Tax Court's review is incompatible with the limited judicial review of final agency actions allowed under the APA, according to the Fourth Circuit.

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14 One commentator has observed that there were several Tax Court cases in which the IRS initially moved to dismiss the case for lack of jurisdiction, but subsequently asked that the court not to dismiss because the IRS had relied on the wrong provision of the section 7502 regulations in its initial motion. *See* Carlton Smith, *Tax Court Won't Rule in Similar Stamps.com Mailing Label Cases Until the Seventh Circuit Rules in Tilden v. Comm'r,* Procedurally Taxing Blog (May 9, 2016), http://procedurallytaxing.com/tax-court-wont-rule-in-similar-stamps-com-mailing-label-cases-until-the-seventh-circuit-rules-in-tilden-v-commr/. In each of these cases, Chief Judge Thornton issued an order formally staying proceedings "pending the ultimate outcome in *Tilden*." *Id*.

15 *QinetiQ U.S. Holdings v. Comm'r*, 845 F.3d 555 (4th Cir. 2016), *aff'g*, T.C. Memo. 2015-123.

16 *Id.* at 561.

17 Administrative Procedure Act (APA), 5 U.S.C. § 706(1). For further discussion of this issue, *see*, *e.g.*, Steve Johnson, *Reasoned Explanation and IRS Determination*, 63 Duke. L. J. 1771 (2014); Patrick J. Smith, *The APA's Reasoned-Explanation Rule and IRS Deficiency Notices*, 134 Tax Notes 331 (Jan. 16, 2012).

18 Order, *QinetiQ U.S. Holdings v. Comm'r*, (Docket No. 14122-13) (Jan. 3, 2014), https://www.ustaxcourt.gov/UstcDockInq/DocumentViewer.aspx?IndexID=6178478.

19 If the IRS does not describe the "basis" for the adjustment in the statutory notice of deficiency, as required by IRC § 7522(a), the Tax Court has held that the burden of proof shifts to the IRS. *See Shea v. Comm'r*, 112 T.C. 183, 196 n.20 (1999), *nonacq.*, 2000-44 I.R.B. 430.

This case is significant because it answers the longstanding question about whether the APA requires a statutory notice of deficiency to provide a reasoned explanation. However, the Fourth Circuit's reasoning leaves the door open to the possibility that other IRS actions are subject to the reasoned explanation requirement of the APA, particularly if they are subject to more limited review, such as, for abuse of discretion.[20]

In *Summa Holdings v. Commissioner*, the United States Court of Appeals for the Sixth Circuit held that the IRS could not re-characterize a transaction under the substance-over-form doctrine because its form was its substance, even though its sole purpose was to reduce taxes.[21]

In 2002, the Benensons engaged in a multi-year scheme to transfer proceeds from the family-owned business, Summa Holdings, Inc. (Summa) to their sons' Roth Individual Retirement Accounts (IRAs). Investment earnings generally accumulate tax-free in IRAs, and in the case of Roth IRAs, a person can make tax-free withdrawals after attaining 59 ½ years of age.[22] But there are limits on how much an individual can contribute to a Roth IRA each year.[23] The scheme was designed to avoid these limits.

The scheme was also designed to reduce Summa's taxable income using a domestic international sales corporation (DISC). Congress created DISCs to subsidize exports. Commissions paid by the exporter to the DISC are deductible by the exporter and not taxable to the DISC.[24] As a result, they are not subject to corporate-level tax. Rather, commissions are taxable as dividends to the DISC's shareholders when distributed by the DISC, even if the shareholder is otherwise tax-exempt.[25]

To take advantage of these tax incentives, the sons' Roth IRAs formed a company that elected to be a DISC, and contributed the DISC stock to a holding company. Summa earned income from exports and paid the earnings to the DISC as commissions. The DISC distributed its commissions to the holding company. The holding company paid tax on the commissions and distributed the remaining proceeds to the Roth IRAs tax-free. Thus, the scheme avoided the Roth IRA contribution limits.

In 2004, the IRS issued Notice 2004-8, warning that schemes to avoid the Roth IRA contribution limits through the use of closely held corporations to make transfers at less than fair market value were "listed transactions," that it would challenge using the substance-over-form doctrine.[26] True to its word, in 2012, the IRS issued statutory notices of deficiency to Summa and the Benensons for tax year 2008. It determined that the commissions Summa paid to the DISC were, in substance, non-deductible dividends to Summa's shareholders, followed by contributions to the Roth IRAs. Accordingly, it proposed to assess the sons with excise tax on excess IRA contributions, and to assess Summa with additional income tax.

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20 *See QinetiQ*, 845 F.3d at 561, n.6 (suggesting that unexplained agency actions may be invalid in "cases in which courts review agency action for abuse of discretion, rather than cases in which the tax court applies a *de novo* standard of review.").

21 *Summa Holdings, Inc. v. Comm'r*, 848 F.3d 779 (6th Cir. 2017), *rev'g* T.C. Memo. 2015-119.

22 IRC § 408A(d) (tax free withdrawals); IRC § 408(e)(1) (tax-exemption).

23 IRC §§ 408A(c)(2)-(3) (contribution limits). Excess contributions to a Roth IRA are subject to an annual excise tax. IRC § 4973.

24 The domestic international sales corporation (DISC) pays no tax on its commission income (up to $10,000,000). IRC §§ 991, 995(b)(1)(E). If the DISC does not distribute the commissions, its shareholders must pay annual interest on their shares of the deferred tax liability. IRC § 995(f).

25 IRC § 995(g).

26 Notice 2004-8, 2004-1 C.B. 333.

The taxpayers filed suit in the Tax Court. While acknowledging that there was no non-tax business purpose for any of the transactions, they argued that they had followed the law. The Tax Court agreed with the IRS. It said it was not disregarding the DISC, but merely re-characterizing the transaction to prevent abuse.[27]

The Sixth Circuit reversed, rejecting application of the substance-over-form doctrine. It reasoned that the taxpayers were using congressionally-designed tax incentives (*i.e.*, the DISC and IRA rules) that were based on form rather than substance. The court said the IRS was not merely disregarding artificial labels to recognize the economic substance of a transaction. It was substituting the Commissioner's artificial labels for the taxpayer's labels, explaining:

> It's one thing to permit the Commissioner to recharacterize the economic substance of a transaction — to honor the fiscal realities of what taxpayers have done over the form in which they have done it. But it's quite another to permit the Commissioner to recharacterize the meaning of statutes — to ignore their form, their words, in favor of his perception of their substance.[28]

The taxpayers had not used labels that did not equate with economic reality. The IRS's characterization did not capture economic reality any better than the taxpayers. The court worried: "[W]hat started as a tool to prevent taxpayers from placing labels on transactions to avoid tax consequences they don't like runs the risk of becoming a tool that allows the Commissioner to place labels on transactions to avoid textual consequences he doesn't like."[29]

The court observed that the IRS does not use the substance-over-form doctrine to reduce a taxpayer's liabilities in service of the broader purposes of the Code when a taxpayer's form does not meet the technical requirements. The IRS's approach made more sense before Congress decided to pursue a wide range of policy goals through the Code other than raising revenue, but today "[t]he Commissioner may not place *ad hoc* limits on them [tax incentives] by invoking a statutory purpose (maximizing revenue) that has little relevance to the text-driven function of these portions of the Code (minimizing revenue)."[30]

This case is significant because it illustrates the limits on the IRS's ability to use the substance-over-form doctrine to override the plain language of the tax code, even in cases where Congress created a loophole that it may not have intended.[31] These limits are particularly important in light of the relatively-new strict liability penalty that applies to transactions that lack economic substance.[32] This case also serves as a reminder that when a taxpayer is taking advantage of a tax incentive that is clearly provided by

27 *Summa Holdings*, T.C. Memo. 2015-119.

28 *Summa Holdings*, 848 F.3d at 785.

29 *Id*. at 787.

30 *Id*. at 789.

31 This decision is also consistent with the view that the business purpose doctrine is becoming a dead letter. *See, e.g.*, *Wells Fargo v. United States*, 2017–1 U.S. Tax Cas. (CCH) P50,235 (D. Minn. 2017) (concluding that a bank could deduct interest it paid on a loan even though it lacked any business purpose outside of the tax considerations).

32 IRC §§ 6662(b)(6) (20 percent penalty) and 6662(i) (40 percent penalty if not disclosed).

law, he or she does not need to have a non-tax business purpose for the form of the transaction to be respected for tax purposes.[33]

In *Mescalero Apache Tribe v. Commissioner*, the Tax Court held that an employer was entitled to discovery of information in the IRS's files concerning whether its workers paid their income taxes because the employer needed to defend against the IRS's assertion it was liable for their withholding taxes.[34]

After an audit of the Mescalero Apache Tribe (the Tribe), the IRS asserted that some of its workers were misclassified as independent contractors. Under IRC § 3402(a), an employer must withhold income taxes on the wages it pays to employees. Because the Tribe did not withhold on payments to the workers it classified as independent contractors, the IRS concluded that it was liable for their income tax withholding.[35]

Even if an employer fails to withhold, however, IRC § 3402(d) provides that the IRS cannot collect the withholding tax liability from the employer (but can collect penalties) if the workers have paid their income taxes. To take advantage of this exception, the Tribe obtained statements from many (but not all) of its workers on Form 4669, *Statement of Payments Received,* affirming that they paid their taxes. In litigation before the Tax Court, the Tribe sought discovery of the IRS's records to help establish that its workers had paid their taxes.

The IRS refused, arguing that it was barred from disclosing the workers' payment information because it is confidential "return information" under IRC § 6103. The Tribe countered that the exceptions in IRC § 6103(h)(4) authorize disclosure. IRC § 6103(h)(4)(C) permits disclosure in "judicial or administrative" proceedings pertaining to tax administration if the return information "directly relates" to a "transactional relationship" between a person who is a party to the proceeding and the taxpayer, and "directly affects" the resolution of an issue in the proceeding.

The court agreed with the Tribe. It concluded that (1) the relationship between an employer and its workers is transactional, (2) the Tribe was asking for information that directly relates to this relationship, and (3) whether the workers paid their taxes directly affects resolution of this case.

Next, the IRS argued that even if the workers' information could be disclosed, it was not discoverable because (1) the employer has the burden of proving its defense under IRC § 3402(d), and (2) allowing discovery would violate the rule that each party in civil litigation generally must bear the burden of financing his or her own suit. The Tax Court also rejected this argument.

The court reasoned that Tax Court Rule 70(b) says that relevant information is discoverable "regardless of the burden of proof involved." It also observed that IRC § 3402(d) says the employer's liability "shall not be collected from the employer," which at least "*implies* that the Commissioner should have some responsibility for reviewing his own records for the proof that the Tribe may not be liable for

33 However, IRC § 7701(o) states: "In the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if — (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer's economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such transaction." Perhaps the economic substance doctrine is not "relevant" to tax incentives such as DISCs and individual retirement accounts (IRAs). For an argument that *Summa* should have been decided differently because the structure did not take advantage of the tax benefits of DISCs, see Vorris J. Blankenship, *Using DISCs to Avoid Roth IRA Limits: An Overlooked Fact in Summa*, 157 Tax Notes 973 (Nov. 13, 2017).

34 *Mescalero Apache Tribe v. Comm'r*, 148 T.C. No. 11 (2017).

35 *See* IRC § 3403.

withholding taxes."[36] For further support, the Tax Court cited a case from the Fifth Circuit where an employer was granted attorneys' fees because the IRS failed to search its own records for proof that a taxpayer did not owe withholding taxes before making a counter claim for them in litigation.[37]

The IRS did not cite Tax Court Rule 70(c), which limits discovery where it is unreasonably cumulative or unduly burdensome or if the information is more easily obtained from another source. However, the Tax Court said Rule 70(c) was inapplicable. It reasoned that the Tribe had "already exhausted its own ability to find its workers, and a request for return information for about only 70 payees is not particularly voluminous."[38] The IRS has downplayed the significance of this case by suggesting it only permits discovery of payment information in the Tax Court for the subset of workers that an employer cannot locate, and only after determining that it would not be overly burdensome for the IRS to obtain the information.[39]

This case is nonetheless significant because it establishes, for the first time, that employers can use the discovery process to defend against withholding tax liability in the Tax Court, at least after trying to obtain the information from their workers. Because IRC § 6103(h)(4) authorizes disclosure in "judicial or administrative" proceedings, this case also indicates that the IRS could help employers by providing them with tax payment information in similar cases at the "administrative" stage, such as in an audit or appeal. However, an attorney with the IRS Office of Chief Counsel has advised that the IRS is not required to do so.[40]

In addition, the decision is significant because it should prompt the IRS to search its databases to ensure it does not violate IRC § 3402(d) or taxpayer rights such as the *right to pay no more than the correct amount of tax*. If the IRS does not, the case may prompt employers to seek reimbursement for attorney fees incurred to defend against the IRS's attempt to collect amounts that a search of its records would have revealed could not be collected.

In *Whistleblower 21276-13W v. Commissioner*, the Tax Court held that criminal fines and civil forfeitures are included in the definition of "collected proceeds," which is used to compute whistleblower awards under the mandatory program.[41]

The petitioners filed Form 211, *Application for Award for Original Information*, with the IRS Whistleblower Office seeking mandatory awards authorized by IRC § 7623(b). As a result of the filing, a taxpayer pleaded guilty to a conspiracy to defraud the IRS (in violation of 18 U.S.C. § 371) by filing false returns and committing tax evasion. The IRS collected tax restitution, criminal fines, and civil forfeitures pursuant to 18 U.S.C. §§ 3571 and 981(a)(1)(A). The IRS agreed that the petitioners were entitled to a mandatory whistleblower award equal to 24 percent of the "collected proceeds" under IRC § 7623(b). However, it argued that criminal fines and civil forfeitures were not "collected proceeds" for purposes of computing the award.[42] The IRS's argument is consistent with Treas. Reg. § 301.7623-2(b),

36 *Mescalero Apache Tribe*, 148 T.C. No. 11 at n.6 (emphasis in the original).

37 *Id*. (citing *Jones v. United States*, 613 F.2d 1311 (5th Cir. 1980)).

38 *Id.* at n.7 (emphasis in the original).

39 Andrew Velarde & Matthew Madara, *Mescalero Not Expected to Open Floodgates for Return Disclosure*, 2017 TNT 93-5 (May 16, 2017). *See also* Chief Counsel Advice (CCA) 2017050511184404 (June 9, 2017).

40 *Id.*

41 *Whistleblower 21276-13W v. Comm'r*, 147 T.C. 121 (2016), *appeal docketed*, Docket No. 21276-13W (DC Cir. Apr. 21, 2017).

42 The IRS conceded that "the tax restitution payment qualified as collected proceeds (even though the restitution was made pursuant to 18 U.S.C. § 3556) because it was assessed as a tax and collected by the IRS under IRC § 6201(a)(4)." *Whistleblower 21276-13W*, 147 T.C. at 126 n.10.

which limits "collected proceeds" to "amounts collected under the provisions of title 26," but the regulation did not apply to this case.[43]

By way of background, the IRS has long had the authority to pay discretionary awards to whistleblowers under IRC § 7623(a) for the information it needed for: "(1) detecting underpayments of tax, or (2) detecting and bringing to trial and punishment persons guilty of violating the *internal revenue laws* or conniving at the same." (Emphasis added). IRC § 7623(a) states that these payments "shall be paid from the proceeds of amounts collected by reason of the information provided… ." In 2006, Congress created a mandatory awards program under IRC § 7623(b), which in certain circumstances requires the IRS to pay awards of between 15 and 30 percent of: "collected proceeds (including penalties, interest, additions to tax, and additional amounts) resulting from the action (including any related actions) or from any settlement in response to such action."[44]

First, the IRS argued that criminal fines and civil forfeitures were not "collected proceeds" under IRC § 7623(b) because they were not assessed and collected under the "internal revenue laws," which it interpreted to mean Title 26. Second, it argued that if they were "collected proceeds," a conflict would be created between IRC § 7623(a), which allows the IRS to use them to pay whistleblowers, and other laws that earmark those funds for other purposes.[45] Finally, it argued that "collected proceeds" is limited to "penalties, interest, additions to tax, and additional amounts," which have specific meanings under Title 26.

The Tax Court held that the term "collected proceeds," as used in IRC § 7623(b), includes criminal fines and civil forfeitures under other titles. First, it reasoned that they can arise out of violations of "internal revenue laws" not found in Title 26. IRC § 7623(a) derives from legislation enacted in 1867.[46] It was amended in 1996 to clarify that awards could be paid for information leading to the detection of civil violations (not just criminal violations), and that the rewards would be paid out of the proceeds.[47] In 1867, Title 26 did not exist and the term "internal revenue laws" meant all revenue laws, including criminal laws. There are numerous instances of revenue laws that are not codified in Title 26.[48] Even today, IRC § 6531(8) refers to 18 U.S.C § 371 as an "internal revenue law."

Second, the Tax Court observed that only the discretionary award program under IRC § 7623(a) permits the IRS to pay whistleblowers out of what it collects. The mandatory award program under

43 *Whistleblower 21276-13W*, 147 T.C. at 125 n.9 (the IRS "denied each petitioner's claim for an award on or about Aug. 13, 2013, and the parties agree that the regulations do not apply in these cases"); Treas. Reg. § 301.7623-1(f) ("This rule applies to information submitted on or after August 12, 2014, and to claims for award under sections 7623(a) and 7623(b) that are open as of August 12, 2014.").

44 *Whistleblower 21276-13W*, 147 T.C. at 124 (citing the Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 406, 120 Stat. at 2958). One of the requirements to receive payment under the mandatory program is that "the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000." IRC § 7623(b)(5)(B). But Congress did not tie this computation to collected proceeds, according to the court.

45 *Whistleblower 21276-13W*, 147 T.C. at 126 (citing 31 U.S.C. § 9705, which earmarks these amounts for the Department of the Treasury Forfeiture Fund).

46 *Id*. at 124 n. 8 (citing Act of Mar. 2, 1867, ch. 169 sec. 7, 14 Stat. 471, 473).

47 *Id*. (citing Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 1209(a), 110 Stat. 1473 and H.R. Rept. No. 104-506, at 51 (1996)).

48 For example, relief from employment tax obligations is found in uncodified section 530 of the Revenue Act of 1978, Pub. L. No. 95-600, 92 Stat. at 2885. Uncodified section 3463(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. at 767, requires the IRS to include on a notice of deficiency the last day on which the taxpayer may file a petition with the Tax Court. Even the law establishing the Whistleblower Office is not codified in Title 26. *See* Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, div. A, sec. 406(b), 120 Stat. at 2959-2960.

IRC § 7623(b) has no such provision. It simply measures the amount that the IRS must pay the whistleblower by reference to "collected proceeds." Thus, the court did not find a conflict.

Finally, the Tax Court observed that even if the phrase "penalties, interest, additions to tax, and additional amounts" has a special meaning, the definition of "collected proceeds" is not limited to these amounts because IRC § 7623(b) only says it "includes" them.[49] Under IRC § 7701(c) and various other authorities, "includes" does not mean "only includes." Thus, "collected proceeds" also includes amounts collected as a result of criminal fines and civil forfeitures.

This case is significant because it suggests that mandatory whistleblower awards under IRC § 7623(b) are not limited to a percentage of the "penalties, interest, additions to tax, and additional amounts" imposed under Title 26. The IRS must also pay whistleblowers a percentage of certain amounts collected under Title 31. Because the decision is based on the plain language of the statute, the more limited definition of collected proceeds provided by Treas. Reg. § 301.7623-2(b) may not be valid. Thus, this case suggests that collected proceeds may include penalties for failure to file Foreign Bank Account Reports (FBAR), as recommended by the National Taxpayer Advocate.[50] However, the court's reasoning suggests that "the proceeds of amounts collected" under IRC § 7623(a), the IRS's discretionary awards program, does not have the same meaning as "collected proceeds" under IRC § 7623(b) because it may not include amounts collected under Title 31.

The case is also significant to the extent it suggests that the IRS should be paying mandatory awards out of its appropriation.[51] If the IRS agreed, it would have an incentive to minimize mandatory whistleblower program awards.

In *Fleischer v. Commissioner*, the Tax Court held that the sole shareholder of an S corporation was liable for self-employment tax on income from the business.[52]

Mr. Fleischer, a licensed financial consultant, set up his business (called Fleischer Wealth Plan or FWP) as an S corporation. He was the president, secretary, treasurer and sole shareholder. Pursuant to an employment agreement, which he signed for both himself and FWP, FWP paid him a salary to represent FWP and conduct its business.

Mr. Fleischer signed contracts in his individual capacity to sell financial products for two financial service companies, Mass Mutual and Linsco/Private Ledger Financial Services (LPL). Mr. Fleisher's contracts generated commissions, which Mass Mutual and LPL reported to him on Forms 1099. He generally reported the commissions as nonpassive flow-through income on Schedule E, rather than as self-employment income on Schedule C. On audit, the IRS recharacterized the commissions as Mr.

49 The court found no conflict between this reasoning and its holding in *Whistleblower 22716-13W v. Commissioner*, 146 T.C. 84 (2016), wherein it held that foreign bank accounts report (FBAR) proceeds are *excluded* in determining whether the whistleblower meets the threshold for receiving a mandatory whistleblower award based on a determination that the "the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000," under IRC § 7623(b)(5)(B).

50 National Taxpayer Advocate 2015 Annual Report to Congress 419-25 (Legislative Recommendation: *Amend IRC §§ 7623 and 6103 to Provide Consistent Treatment of Recovered Foreign Account Tax Compliance Act (FATCA) and Report of Foreign Bank and Financial Accounts (FBAR) Penalties for Whistleblower Award Purposes*).

51 The IRS currently pays all awards out of collected proceeds. *See, e.g.*, Internal Revenue Manual (IRM) 25.2.2.13(1) (Aug. 7, 2015) ("Whistleblower awards are paid from collected proceeds").

52 *Fleischer v. Comm'r*, T.C. Memo. 2016-238.

Fleisher's earnings from self-employment, which were subject to self-employment taxes.[53] The Tax Court agreed with the IRS.

A service provider generally cannot avoid self-employment taxes by organizing a business as a wholly-owned partnership or limited liability company (LLC).[54] However, self-employment taxes generally do not apply if the service provider organizes his or her business as an S corporation.[55]

Although Mr. Fleisher organized FWP as an S corporation, the court concluded that he, and not FWP, should be taxed on the income because he was the one who "control[led] the earning of the income."[56] According to the court, income belongs to a corporation, rather than a service provider, only if (1) the service provider is an employee whom the corporation can "direct and control in a meaningful sense," and (2) the service recipient(s) sign(s) a "contract or similar indicium recognizing the corporation's controlling position."[57] Applying the second prong, the court found no indication that Mass Mutual or LPL recognized FWP's controlling position. The court did not reach the first prong of the test (*i.e.*, FWP's meaningful control of Mr. Fleisher).

This case serves as a reminder that when a tax result depends on the form of a transaction, it is particularly important for taxpayers to use the proper form. The case is significant because it highlights the need for clear and consistent rules about when self-employment taxes apply — clarity that becomes even more important as more workers become self-employed.[58]

In *Biggers v. IRS*, the U.S. District Court for the Middle District of Tennessee held that a tax debt shown on a late-filed tax return may be subject to discharge in bankruptcy, even if the late return is identical to the IRS's substitute for return, provided it represents a subjectively reasonable attempt to satisfy the law.[59]

After the Biggers failed to file timely federal tax returns for 2001-2004, the IRS filed substitute for returns (SFRs) assessing tax against Mr. Biggers. The Biggers said their returns had been delayed

53 For 2017, the self-employment tax rate is 12.4 percent for Social Security, 2.9 percent for Medicare, and an additional 0.9 percent tax applies to self-employment income in excess of $250,000 (if married filing jointly, $200,000 if single). IRC § 1401. Thus, the total self-employment tax burden can be as high as 16.2 percent before considering the deduction for one-half of the self-employment tax as permitted by IRC § 164(f).

54 Under IRC § 1402, a partner's distributive share of partnership income is included in self-employment income, but IRC § 1402(a)(13) provides an exception for a limited partner's distributive share of partnership income (other than guaranteed payments). However, IRC § 1402(a)(13) generally does not apply when the limited partner has management powers, particularly if his or her services generated the income. *See*, *e.g.*, *Renkemeyer, Campbell & Weaver, LLP v Comm'r*, 136 T.C. 137 (2011). Moreover, IRC § 1402(a)(13) generally does not apply to members of limited liability companies (LLC) because they are not limited partners and may have management powers. *See Riether v. United States*, 919 F. Supp. 2d 1140 (D. N.M. 2012). For a discussion of other relevant authorities, *see* CCA 2014-36049 (May 20, 2014).

55 *See* Rev. Rul. 59-221, 1959-1 C.B. 225. The IRS proposed regulations in 1997 that would have harmonized the treatment of service providers in Limited Liability Partnerships and LLCs, but they expired in 1998 after Congress imposed a temporary moratorium on finalizing them, as described in CCA 2014-36049 n.3 (May 20, 2014). However, the proposed rules did not apply to S corporations. For further discussion of this dichotomy, *see*, *e.g.*, Tony Nitti, *IRS: Partners' Share of LLC Income Is Subject to Self-Employment Tax*, Forbes (Sept. 10, 2014, 11:28 AM), http://www.forbes.com/sites/anthonynitti/2014/09/10/irs-partners-share-of-llc-income-is-subject-to-self-employment-tax/#42bf0e1676da.

56 *Fleischer*, T.C. Memo. 2016-238 at 10 (citing a two-part test set forth in *Johnson v. Comm'r*, 78 T.C. 882, 891 (1982)).

57 *Id*. (citing *Johnson*, 78 T.C. at 891; Treas. Reg. § 31.3121(d)-1(c)(2), and *Sargent v. Comm'r*, 929 F.2d 1252, 1256 (8th Cir. 1991)).

58 *See*, *e.g.*, *The Sharing Economy: A Taxing Experience for New Entrepreneurs: Hearing Before the H. Comm. on Small Business*, 114th Cong. (May 26, 2016) (statement of Nina E. Olson, National Taxpayer Advocate); Emilie Jackson *et. al.*, Treasury Department, Office of Tax Analysis, Working Paper 114, *The Rise of Alternative Work Arrangements: Evidence and Implications for Tax Filing and Benefit Coverage* (Jan. 2017).

59 *Biggers v. IRS*, 557 B.R. 589 (M.D. Tenn. 2016).

because their records were seized by a bank, they had moved 11 times, and had been deceived by a tax return preparation firm. In 2007, the Biggers filed joint returns for each of the years at issue. More than two years later, they filed for bankruptcy, seeking to discharge their tax debts.

A taxpayer may not discharge in bankruptcy tax liabilities "with respect to which a return … was not filed or given."[60] Whether a document is a return for tax purposes depends on whether it satisfies the *Beard* test, which requires that it be, among other things, an honest and reasonable attempt to satisfy the law.[61] In 2005, Congress attempted to clarify the bankruptcy discharge rules by amending 11 U.S.C. § 523(a) to include a so-called "hanging paragraph."[62] This paragraph defines a "return" as "a return that satisfies the requirements of applicable non-bankruptcy law (including applicable filing requirements)."

Some courts have suggested that a late-filed return that mirrors a SFR and, thus, serves no tax purpose could, nonetheless, be treated as a return under the (subjective) *Beard* test, if it is an "honest and reasonable attempt" to satisfy the law.[63] Others have suggested that a filing that mirrors an SFR could not be a return under the (objective) *Beard* test because it could not be an honest and reasonable attempt to satisfy the law.[64] Still others have held that such a filing could not be a return for purposes of the "hanging paragraph" because it could not satisfy the "applicable filing requirements."[65]

Applying the *Beard* test, the Bankruptcy Court held that the Biggers late-filed returns, which reflected amounts previously assessed by the IRS, were not returns. It reasoned that they could not be reasonable attempts to satisfy the law under *Beard* because they served no purpose (the objective test). Accordingly, the self-assessed liabilities reflected on them were non-dischargeable.

The district court agreed that the hanging paragraph did not displace the *Beard* test, but reversed and remanded. It observed that late-filed returns can serve a tax purpose because the IRS requires them to be filed before it will consider a taxpayer's offer in compromise.[66] Thus, even an objective version of the *Beard* test would not necessarily require the court to conclude the filings were not returns. However, it observed that the Tax Court generally describes the *Beard* test as requiring an inquiry into the filer's subjective intent. Thus, it remanded the case so that the Bankruptcy Court could make such an inquiry.

60 11 U.S.C. § 523(a)(1)(B)(i). Tax liabilities on a late return that was filed within two years of the bankruptcy petition are also exempt from discharge. 11 U.S.C. § 523(a)(1)(B)(ii).

61 *Beard v. Comm'r*, 82 T.C. 766, 777 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986) (applying a test set forth in *Zellerbach Paper Co. v. Helvering*, 293 U.S. 172 (1934)).

62 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 714, 119 Stat. 23, 128 (2005) (modifying 11 U.S.C. § 523(a)).

63 *See In re Biggers*, 528 B.R. 870, 872 (Bankr. M.D. Tenn. 2015), *rev'd*, *Biggers*, 557 B.R. 589 (M.D. Tenn. 2016) (compiling cases). Some courts have recently concluded that a taxpayer does not make an honest and reasonable attempt to satisfy the law when his filing is significantly delinquent, particularly if there is no good reason for the delay. *See, e.g.*, *Giacchi v. United States*, 856 F.3d 244 (3d Cir. 2017); *In re Smith*, 828 F.3d 1094 (9th Cir. 2016). We cover *Biggers*, rather than *Smith* or *Giacchi* because *Biggers* discusses both the objective and subjective versions of the *Beard* test.

64 *United States v. Hindenlang*, 164 F.3d 1029 (6th Cir. 1999).

65 *In re Mallo*, 774 F.3d 1313 (10th Cir. 2014). For a summary of *In re Mallo*, see National Taxpayer Advocate 2015 Annual Report to Congress 431, 437 (*Significant Cases*).

66 Treas. Reg. § 301.7122-1(d).

This case is significant because it shows that taxpayers who file returns that reflect amounts already assessed on SFRs may be subject to discharge in some jurisdictions but not in others. The National Taxpayer Advocate has recommended legislation that would establish a uniform rule.[67]

In *United States v. Bohanec*, the United States District Court for the Central District of California held that a taxpayer may be subject to the penalty for "willfully" failing to file a Foreign Bank Account Report (FBAR) even if the government only proves the failure was reckless by a preponderance of the evidence.[68]

Mr. and Mrs. Bohanec were naturalized citizens who ran a successful U.S. camera shop in the 1970s. In the early 1980s, they began to broker international camera sales, depositing their commissions into an offshore account at UBS. In the late 1980s, they closed the shop, but continued brokering international sales. In 2000, they also began selling cameras on eBay.

The Bohanecs' tax return for 1998 included Schedule B, which asks about foreign bank accounts and refers to the Foreign Bank Account Report (FBAR) filing requirement. Between 1998 and 2011, however, they did not file returns or FBARs. The Bohanecs would occasionally withdraw money from their UBS account and deposit it into bank accounts in Austria and Mexico.

In 2010, the Bohanecs applied to the IRS's offshore voluntary disclosure program (OVDP). As part of that process, they filed FBARs and tax returns for 2003-2008, which disclosed the UBS account. Because those filings did not disclose their accounts in Mexico or Austria, and omitted unreported income from internet sales, the IRS rejected their application and audited their returns.

In 2013, the IRS assessed additional taxes and penalties, including fraud penalties for 2003-2010. For 2007, the IRS also sought to impose a penalty for the Bohanecs' willful failure to report the UBS account on an FBAR.

The Bohanecs argued that to apply the penalty for willfully failing to file an FBAR, the IRS must show they were not just reckless but that they intentionally violated a known legal duty. They cited both the Supreme Court's decision in *Ratzlaf* and the Internal Revenue Manual (IRM).[69] They also asserted the government must prove willfulness by clear and convincing evidence, rather than a mere preponderance of the evidence, citing IRS Chief Counsel Advice (CCA) 2006-03026 (Jan. 30, 2006).

Government attorneys argued and the district court agreed that in the context of a civil FBAR penalty, willfulness includes merely reckless conduct, which the government only needs to establish by a preponderance of the evidence. The court discounted the IRM and CCA as non-precedential, and distinguished *Ratzlaf* as inapplicable to civil penalties.[70] It applied the preponderance standard

67 *See* National Taxpayer Advocate 2014 Annual Report to Congress 417-22 (Legislative Recommendation: *Clarify the Bankruptcy Law Relating to Obtaining a Discharge*).

68 *United States v. Bohanec*, 118 A.F.T.R.2d (RIA) 26757 (C.D. Cal. 2016).

69 *See Ratzlaf v. United States*, 510 U.S. 135 (1994) (holding that the government's showing that a defendant was aware of the reporting requirements and intentionally avoided them was insufficient to establish that he willfully violated the prohibition on structuring transactions to avoid the reporting requirements); IRM 4.26.16.4.5.3 (July 1, 2008).

70 The court cited *Safeco Ins. Co. of America v. Burr*, 551 U.S. 47, 57 (2007) for the proposition that in civil cases willfulness may include recklessness.

because it said the clear and convincing standard only applies in civil cases where particularly important individual interests or rights are at stake.[71]

The district court found that the Bohanecs were reasonably sophisticated because they successfully operated a camera business. The court also focused on the actions they took to conceal their foreign accounts, including: their incorrect OVDP submissions, their failure to tell anyone (including a preparer) other than their children about the UBS account, their failure to inform UBS of their home address, their failure to consult a lawyer or accountant about the UBS account, their failure to keep books, and their unconvincing assertion that they thought they did not have to report the UBS account because the money would be used for retirement.

This case is significant because it provides much-needed guidance about the facts that could lead a court to apply the FBAR penalty for willful violations. Some observers have noted, however, that the decision may make it more difficult for taxpayers to participate in the IRS's streamlined offshore filing compliance programs because those programs require taxpayers to certify that their violations were non-willful.[72] In addition, the case provides a reminder that government litigators and courts may ignore legal conclusions set forth in the IRM and CCAs. The National Taxpayer Advocate has urged the IRS to issue more authoritative guidance in this area.[73]

In *Steele v. United States*, the United States District Court for the District of Columbia held that the IRS does not have the authority to charge for preparer tax identification numbers (PTINs).[74]

The plaintiffs filed a class action suit challenging the validity of regulations requiring tax return preparers to pay fees for PTINs. Both parties moved for partial summary judgment.

Before 2010, anyone could prepare and file a tax return on behalf of someone else. In 2010, the government began to regulate return preparers, requiring among other things, that they must have a

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71 The court did not discuss *Addington v. Texas*, 441 U.S. 418 (1979) or *Woodby v. Immigration and Naturalization Service*, 385 U.S. 276 (1966), which suggest the clear and convincing standard is applicable in civil cases involving allegations of fraud or some other quasi-criminal wrongdoing. Nor did it mention that the clear and convincing standard generally applies to civil tax fraud penalties under IRC §§ 6663 and 6701. For further discussion of this issue, see National Taxpayer Advocate 2017 Objectives Report to Congress 164, 171-76 (Area of Focus: *The IRS's Offshore Voluntary Disclosure (OVD)-Related Programs Have Improved, But Problems Remain*).

72 *See* Nathan Richman, *District Decision on FBAR Willfulness Standard Set for Appeal*, 2016 TNT 241-3 (Dec. 13, 2016). The IRS has defined willfulness for this purpose as "negligence, inadvertence, or mistake or conduct that is the result of a good faith misunderstanding of the requirements of law." IRS, *U.S. Taxpayers Residing in the United States* (Feb. 22, 2017), https://www.irs.gov/individuals/international-taxpayers/u-s-taxpayers-residing-in-the-united-states.

73 *See*, *e.g.*, National Taxpayer Advocate 2017 Objectives Report to Congress 164, 171-76 (Area of Focus: *The IRS's Offshore Voluntary Disclosure (OVD)-Related Programs Have Improved, But Problems Remain*).

74 *Steele v. United States*, 2017-1 U.S. Tax Cas. (CCH) P50, 238, 2017 U.S. Dist. LEXIS 84117 (D.D.C. 2017), *appeal docketed*, No. 1:14-cv-01523 (D.D.C., Sept. 6, 2017).

PTIN that they applied for and received after paying a user fee.[75] The IRS began to charge for the initial PTIN registration fee and for each annual renewal.[76]

In 2014, the United States 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.[77] Following *Loving*, the only remaining parts of the new regulatory scheme were the requirements to (1) obtain and use PTINs, and (2) pay PTIN fees.

IRC § 6109(d) authorizes the IRS to issue regulations requiring the exclusive use of PTINs. It provides that social security numbers (SSNs) "shall, *except as shall otherwise be specified under regulations of the Secretary*, be used as the identifying number for such individual for purposes of this title." (Emphasis added). The IRS's regulations justified the exclusive use of PTINs, explaining that a single number would, among other things, "enable the IRS to accurately identify tax return preparers, match preparers with the tax returns and claims for refund they prepare, and better administer the tax laws with respect to tax return preparers and their clients."[78] Thus, the United States District Court for the District of Columbia concluded that the IRS had provided a reasonable explanation of its decision to require the exclusive use of PTINs, and declined to set aside the requirement as arbitrary and capricious.

Next, the court turned to the IRS's authority to charge PTIN fees. Under the Independent Offices Appropriation Act of 1952 (IOAA), agencies may only establish a fee "for a service or thing of value provided by the agency."[79] The IOAA only permits agencies to charge for special benefits that are voluntarily requested and are not shared by the general public.[80] The IRS argued that in promulgating the user fee regulations, it had determined that a PTIN is a "service or thing of value" because "without a PTIN, a tax return preparer could not receive compensation for preparing" a return or claim for refund.[81] In related regulations, the IRS had also determined that PTINs would "help maintain the confidentiality of SSNs," which the IRS argued was also a valuable benefit.[82]

First, the court concluded 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. The court explained:

> Hypothetically, every member of the public could obtain a PTIN, which means that every member of the public would also get the supposed "benefit" …. There is therefore no special

75 *Furnishing Identifying Number of Tax Return Preparer*, T.D. 9501, 75 Fed. Reg. 60,309, 60,315 (Sept. 30, 2010); Treas. Reg. § 1.6109-2(d) ("Beginning after December 31, 2010, all tax return preparers must have a preparer tax identification number or other prescribed identifying number that was applied for and received at the time and in the manner, including the payment of a user fee, as may be prescribed by the Internal Revenue Service in forms, instructions, or other appropriate guidance… to obtain a preparer tax identification number or other prescribed identifying number, a tax return preparer must be an attorney, certified public accountant, enrolled agent, or registered tax return preparer authorized to practice before the Internal Revenue Service under 31 U.S.C. 330 and the regulations thereunder."). The IRS also required individuals other than attorneys and Certified Public Accountants to pass a one-time competency exam and suitability check, and fulfill continuing education requirements. 31 C.F.R. §§ 10.4-10.6.

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

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

78 *Furnishing Identifying Number of Tax Return Preparer*, TD 9501, 75 FR 60309, 60314 (Sept. 30, 2010).

79 31 U.S.C. § 9701(b).

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

81 *User Fees Relating to Enrollment and Preparer Tax Identification Numbers*, T.D. 9503, 75 Fed. Reg. 60,316, 60,317 (Sept. 30, 2010).

82 *Furnishing Identifying Number of Tax Return Preparer*, T.D. 9501, 75 Fed. Reg. 60,309, 60,310 (Sept. 30, 2010).

> benefit for certain individuals not available to the general public. It seems that if a benefit exists, it inures to the IRS, who, through the use of PTINs, may better identify and keep track of tax return preparers and the returns that they have prepared.[83]

The court acknowledged the IOAA permits agencies to charge a fee for services necessary to comply with valid licensing requirements and get a license.[84] However, it reasoned that such fees are only authorized if the agency is authorized to issue a valid license that not everyone can obtain.

The government argued that the fact that anyone may obtain a PTIN is irrelevant because anyone may enter a national park if they pay the fee. However, the court distinguished park entrance fees on the basis that those fees are specifically authorized by another statute (not the IOAA).[85] The fact that such specific authorization was necessary suggested that general entrance fees would not be authorized under the IOAA, according to the court.

The court acknowledged that the Eleventh Circuit Court of Appeals had upheld the initial PTIN fee in *Brannen,* and that a district court had followed *Brannen* to uphold the PTIN renewal fee in *Buckley*.[86] It distinguished *Brannen* on the basis that it was decided before the United States Court of Appeals for the District of Columbia rendered its decision in *Loving*, and disagreed with *Buckley's* conclusion that the outcome of *Loving* was irrelevant.

Finally, the court discounted the alleged benefit to PTIN applicants of being able to protect the confidentiality of their SSNs. It observed that the regulations did not indicate that SSNs were being inadvertently disclosed or that their confidentiality was at risk. Accordingly, it held that because PTINs are not a "service or thing of value," the IRS may not charge fees for issuing them and the regulations requiring payment of fees for PTINs are unlawful.

This case is significant to the extent it suggests the IOAA does not authorize the IRS to charge fees for fundamental government services that anyone can obtain by merely paying a fee.[87] It is unclear if the case goes that far, however, because under that rationale any SSN-masking benefit of PTINs, which anyone could obtain, should not have been relevant to the outcome. Nonetheless, the decision could prompt challenges to other fees for IRS services that anyone may obtain. The decision is also significant because the IRS may have to refund the PTIN fees that it has collected.[88] It began issuing PTINs without charge on June 21, 2017.[89]

83 *Steele*, 2017 U.S. Dist. LEXIS 84117, at *33.

84 *Id. at* *26-29 (citing *Engine Mfrs. Ass'n v. EPA*, 20 F.3d 1177, 1180 (D.C. 1994); *Seafarers Int'l Union of N. Am. v. U.S. Coast Guard*, 81 F.3d 179 (D.C. Cir. 1996); *Elec. Indus Ass'n v. FCC*, 554 F.2d 1109 (D.C. Cir. 1976)).

85 16 U.S.C. § 6802(a).

86 *See Brannen v. United States*, 682 F.3d 1316 (11th Cir. 2012); *Buckley v. United States*, 2013 U.S. Dist. LEXIS 184758 (N.D. Ga. 2013).

87 For a discussion of related issues, see, e.g., National Taxpayer Advocate 2015 Annual Report to Congress 14-22 (Most Serious Problem: *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.

88 *See, e.g.*, William Hoffman, *IRS Suspends PTIN Registrations and Renewals after Court Holding*, 2017 TNT 107-3 (June 6, 2017); William Hoffman, *Court Strikes Down IRS PTIN Fees; Agency Could Owe Millions*, 2017 TNT 106-3 (June 5, 2017).

89 *See* IRS, *IRS Reopening Preparer Tax Identification Number (PTIN) System* (June 21, 2017), https://www.irs.gov/tax-professionals/irs-reopening-preparer-tax-identification-number-ptin-system.