Introduction

OVERVIEW

IRC § 7803(c)(2)(B)(ii)(XI) requires the National Taxpayer Advocate to identify in her Annual Report to Congress (ARC) the ten tax issues most litigated in federal courts (MLIs).[1]

TAS identified the MLIs from June 1, 2019, through May 31, 2020, using commercial legal research databases. This section of the Annual Report defines the term "litigated" as cases in which the court issued an opinion.[2] This year's MLIs are, in order from most to least cases:

- Appeals From Collection Due Process Hearings (IRC §§ 6320 and 6330);
- Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax (IRC § 7403);
- Accuracy-Related Penalty (IRC §§ 6662(b)(1) and (2));[3]
- Trade or Business Expenses (IRC § 162(a) and related Code sections);
- Gross Income (IRC § 61 and related Code sections);
- Summons Enforcement (IRC §§ 7602(a), 7604(a), and 7609(a));
- Failure to File Penalty (IRC § 6651(a)(1)), Failure to Pay Penalty (IRC § 6651(a)(2)), and Failure to Pay Estimated Tax Penalty (IRC § 6654);
- Schedule A Deductions (IRC §§ 211-224);
- Charitable Contribution Deductions (IRC § 170); and
- Frivolous Issues Penalty (IRC § 6673 and related appellate-level sanctions).

Summons enforcement saw the greatest decrease since last year, dropping from 60 cases to 40 (a 33 percent decrease). Civil actions to enforce federal tax liens or to subject property to payment of tax was the only category that reflected an increase in the number of cases, from 52 cases to 71 (a nearly 37 percent increase). Overall, taxpayers prevailed in full or in part in 74 cases (about 16 percent), consistent with last year. Cases involving individual taxpayers outnumbered business taxpayers by a ratio of 3:2.[4]

We analyzed each issue in five sections: taxpayer rights impacted,[5] overview of findings, analysis of the litigated cases, conclusion, and recommendations to mitigate disputes. We have also included a "Significant Cases" section summarizing decisions that are not among the top ten issues but are relevant to tax administration. In this section, we generally used the same one-year period that we used in previous reports for the ten MLIs, ending on May 31, 2020.

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1 Federal tax cases are tried in the United States Tax Court, United States District Courts, the United States Court of Federal Claims, United States Bankruptcy Courts, United States Courts of Appeals, and the United States Supreme Court.

2 Many cases are resolved before the court issues an opinion. Some taxpayers reach a settlement with the IRS before trial, while the courts dismiss other taxpayers' cases for a variety of reasons, including lack of jurisdiction and lack of prosecution. Courts can issue less formal "bench opinions," which are not published or precedential. This year, we did not include bench orders or summary judgments in this report.

3 IRC § 6662 also includes (b)(3), (b)(4), (5), (6), (7), and (8), but because those types of accuracy-related penalties were not heavily litigated, we have analyzed only subsections (b)(1), and (2).

4 Individuals filing Schedules C, E, or F are deemed business taxpayers for purposes of this discussion even if items reported on such schedules were not the subject of litigation.

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

This year the top ten MLIs included a total of 455 court opinions. That's the least number of cases we've identified since 2002.[6] Some of the 15 percent decrease in the total number of cases from last year can be attributed to court closures related to the COVID-19 pandemic;[7] however, this decrease follows a general decline in the number of litigated cases since the Great Recession. We recorded more than twice as many cases in 2007, 2008, and 2009 as we did this year. We may again see a surge in tax litigation in the wake of the pandemic's economic turmoil in years to come.

TAX LITIGATION

A variety of courts share concurrent jurisdiction over federal tax litigation. They include Article I (*i.e.*, special courts created by Congress) and Article III (*i.e.*, constitutional courts). Litigation generally includes an automatic right of appeal to the United States Courts of Appeals,[8] although some taxpayers elect to give up their appeal rights and pursue binding but less formal proceedings, pursuant to court rules.[9] The taxpayer's choice of judicial forum depends on many factors, including whether the taxpayer is required to pre-pay the tax prior to litigation, the court's procedures, the burden of proof, and the controlling precedent. Tax litigation takes place in:

- The United States Tax Court;
- United States District Courts;
- United States Courts of Appeals;
- The United States Court of Federal Claims;
- United States Bankruptcy Courts; and
- The United States Supreme Court.

The United States district courts and the United States Court of Federal Claims have concurrent jurisdiction over tax matters in which (1) the tax has been assessed and paid in full[10] and (2) the taxpayer has filed an administrative claim for refund.[11] The United States district courts, along with the bankruptcy courts in very limited circumstances, provide the only fora in which a taxpayer can request a jury trial.[12] Bankruptcy courts can adjudicate tax matters not adjudicated prior to the initiation of a bankruptcy case.[13]

Congress created the Tax Court as a forum where taxpayers can bring suit to contest IRS proposed assessments and determinations without prepayment.[14] It has jurisdiction over a variety of issues, including deficiencies,

6 Our MLIs section in our first two reports (2000 and 2001 Annual Report to Congress) reviewed cases by sampling.

7 *See, e.g.*, https://www.ustaxcourt.gov/covid.html.

8 See IRC § 7482, which provides that the United States Courts of Appeals (other than the United States Court of Appeals for the Federal Circuit) have jurisdiction to review the decisions of the Tax Court. There are exceptions to this general rule. *See* 28 U.S.C. § 1294 (appeals from a United States district court are to the appropriate United States Court of Appeals); 28 U.S.C. § 1295 (appeals from the United States Court of Federal Claims are heard in the United States Court of Appeals for the Federal Circuit); 28 U.S.C. § 1254 (appeals from the United States Courts of Appeals may be reviewed by the United States Supreme Court).

9 For example, IRC § 7463 provides special procedures for small Tax Court cases (where the amount of deficiency or claimed overpayment totals $50,000 or less) for which appellate review is not available.

10 28 U.S.C. § 1346(a)(1). *See Flora v. United States*, 362 U.S. 145 (1960), *reh'g denied*, 362 U.S. 972 (1960). *See* National Taxpayer Advocate 2021 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* (*Repeal* Flora *and Expand the Tax Court's Jurisdiction: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*).

11 IRC § 7422(a).

12 The bankruptcy court may only conduct a jury trial if the right to a trial by jury applies, all parties expressly consent, and the district court specifically designates the bankruptcy judge to exercise such jurisdiction. 28 U.S.C. § 157(e).

13 *See* 11 U.S.C. §§ 505(a)(1) and (a)(2)(A).

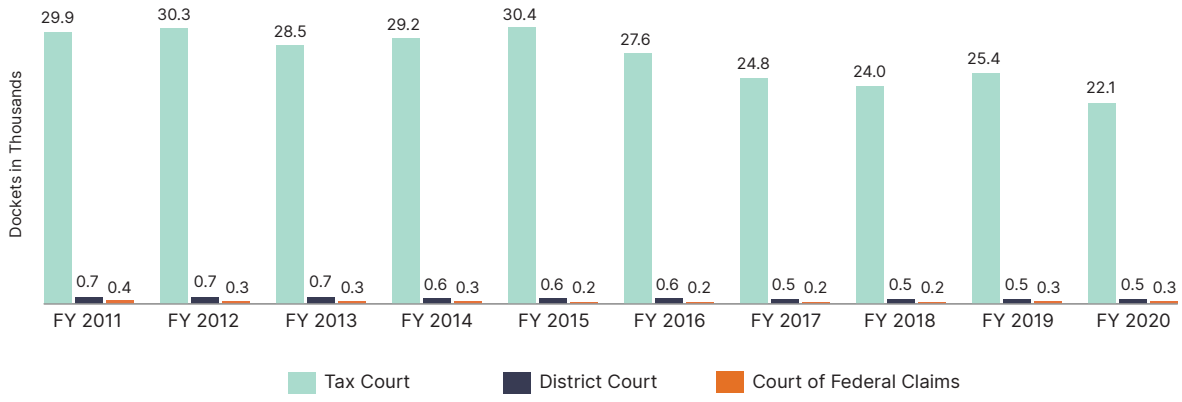
14 *See* IRC § 7441.

certain declaratory judgment actions, appeals from administrative hearings, relief from joint and several liability, and determination of employment status.[15] The Tax Court is the only "prepayment" forum which is one major advantage for taxpayers as they can adjudicate the merits of the issue without paying the disputed tax in advance. As a result, over 96 percent of all tax-related litigation is adjudicated in the Tax Court.

Comparing the number of dockets (*i.e.,* petitions filed with the court), the Tax Court receives at least 40 times as many cases as district courts, and 70 times as many cases as the Court of Federal Claims. Figure 2.0.1 compares the number of docketed cases in inventory in the Tax Court, the Court of Federal Claims, and the district courts at the end of the past ten fiscal years (FYs).[16]

FIGURE 2.0.1[17]

Docketed Inventory in Tax Court, District Court, and Court of Federal Claims, FYs 2011-2020



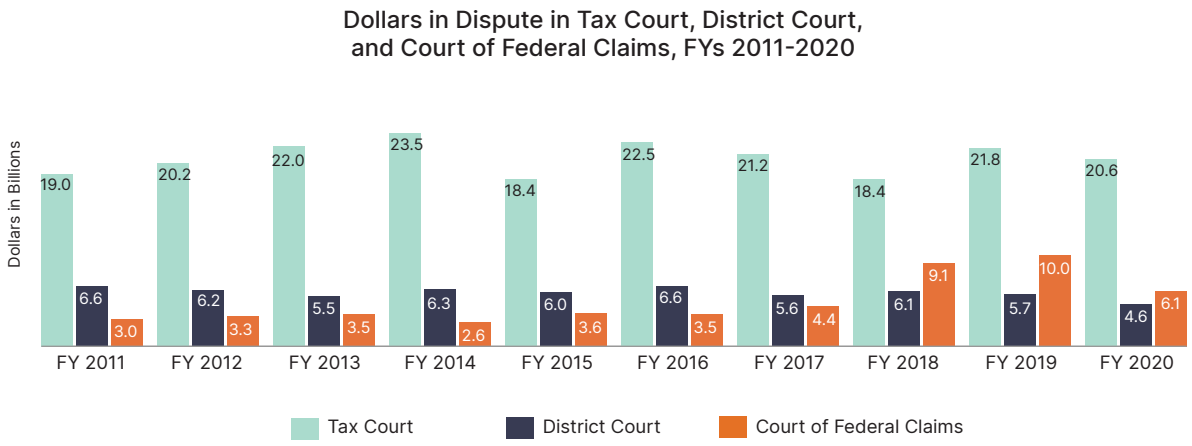
While the Tax Court dockets the lion's share of cases, there tends to be more money at stake in tax litigation in the district courts and the Court of Federal Claims. Comparing the dollars in dispute, Tax Court cases compare about 4:1 to district courts, and about 3:1 to the Court of Federal Claims. Figure 2.0.2 shows the dollars in dispute for the docketed case inventory in these courts over the past ten fiscal years.

15 IRC §§ 6214, 7476-7479, 6330(d), 6015(e), and 7436.

16 A fiscal year runs from October 1 to September 30 of the following calendar year and is different than the reporting period used for the ten MLIs in this report - June 1, 2019, through May 31, 2020.

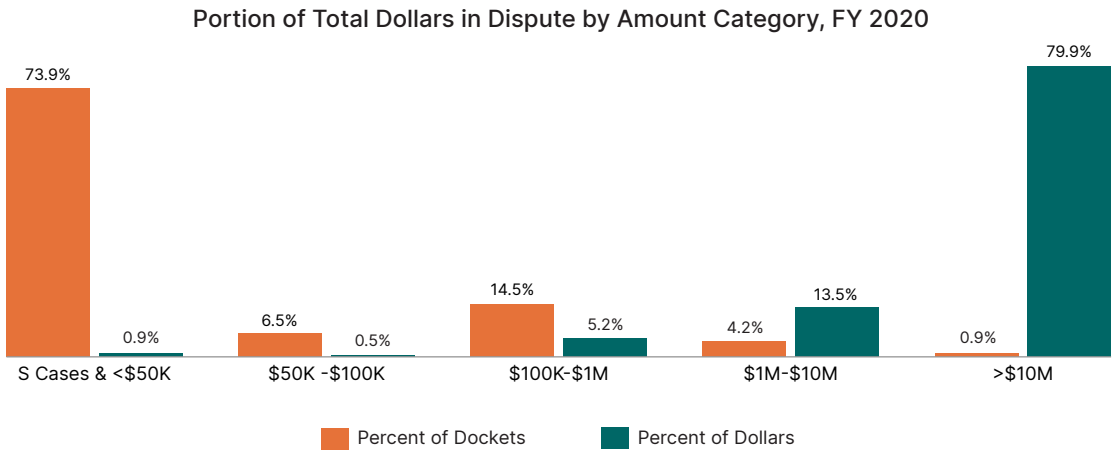
17 IRS, Counsel Automated Tracking System, TL-711 and TL-712. Does not include cases on appeal and declaratory judgments. Note that this figure covers fiscal years (October 1 – September 30), while MLI review in this report covers the period June 1 – May 31.

FIGURE 2.0.2[18]



Looking more closely at the Tax Court cases during FY 2020, we see that in nearly 74 percent of the cases, there was less than $50,000 at stake. Figure 2.0.3 shows the breakdown of FY 2020 Tax Court cases by dollars in dispute.

FIGURE 2.0.3[19]



18 IRS, Counsel Automated Tracking System, TL-711 and TL-712. Does not include cases on appeal and declaratory judgments. Note that this figure covers fiscal years (October 1 – September 30), while MLI review in this report covers the period June 1 – May 31.

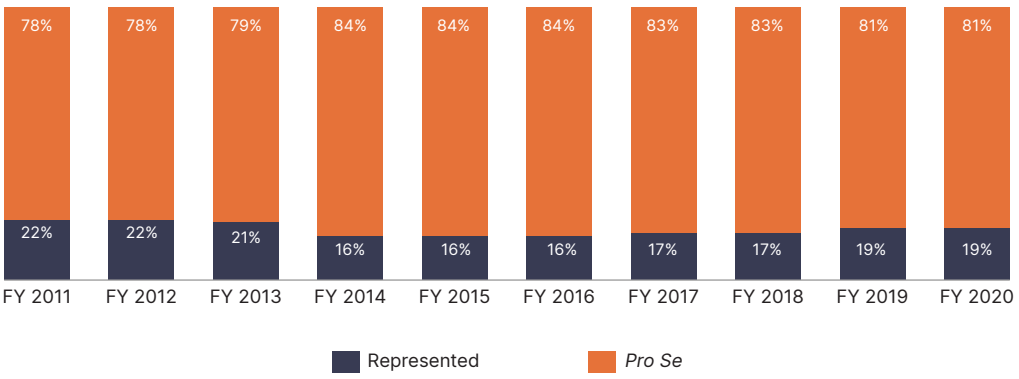
19 IRS, Counsel Automated Tracking System, TL-711. Does not include cases on appeal and declaratory judgments.

ANALYSIS OF *PRO SE* LITIGATION

Over the past ten years, an average of 82 percent of taxpayers appearing in Tax Court are not represented by counsel.[20] There is no doubt that self-represented taxpayers are disadvantaged in tax litigation as they are unfamiliar with the Court's Rules of Practice and Procedure, Rules of Evidence, and the nuances of negotiating with the IRS. The dollars at issue, along with the taxpayer's income level, are two key determinants of whether a taxpayer obtains representation to navigate the litigation process. Hiring a representative can be expensive. And even if a taxpayer has the means to do so, the amount at issue may not justify the cost. In an effort to ameliorate this difference, more than 25 years ago the Tax Court instituted Tax Clinics and Bar Sponsored Calendar Call programs which provide important advice and assistance to many low income, self-represented taxpayers.[21] The Calendar Call Program enables eligible taxpayers to seek legal advice and representation at a trial session. Low Income Taxpayer Clinics provide free or low-cost representation to qualifying taxpayers,[22] however only a fraction of eligible taxpayers avails themselves of those services. When a taxpayer appears before the court without a representative, it's called *pro se*.[23] Figure 2.0.4 compares the ratio of Tax Court cases where taxpayers proceeded *pro se* to the cases where taxpayers appeared with a representative over the past ten FYs.

FIGURE 2.0.4[24]

Proportion of Cases Petitioned to the Tax Court (Represented/*Pro Se*), FYs 2011-2020



We identify the top ten MLIs based on the number of opinions for each issue by using commercial legal research databases. This provides a high-level perspective on tax litigation, although it's important to note that the overwhelming majority of petitions filed in the Tax Court are resolved without the necessity of trial or issuance of an opinion. Figure 2.0.5 shows the number of Tax Court petitions over the past ten fiscal years, broken down by whether the taxpayers proceeded *pro se* or with a representative.

20 Counsel Automated Tracking System, TL-708A. Note that this figure covers fiscal years (October 1 – September 30), while MLI review in this report covers the period June 1 – May 31.

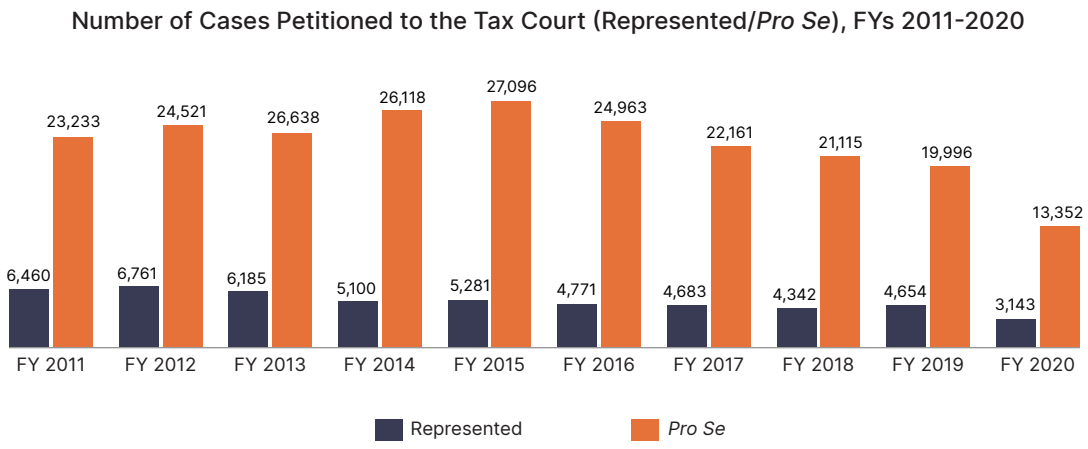
21 *See* https://www.ustaxcourt.gov/clinics.html. The Tax Court continues to invite academic and nonacademic tax clinics and bar-sponsored programs to consider participating and representing *pro se* taxpayers.

22 *See* IRC § 7526.

23 "*Pro se*" means "for oneself; on one's own behalf; without a lawyer." BLACK'S LAW DICTIONARY (11th ed. 2014).

24 IRS, Counsel Automated Tracking System, TL-708A. Does not include cases on appeal and declaratory judgments. Note that this figure covers fiscal years (October 1 – September 30), while MLI review in this report covers the period June 1 – May 31.

FIGURE 2.0.5[25]



Focusing our analysis on court opinions provides a real-time snapshot for determining any current trends and potential causes, and proposing solutions to mitigate future litigation. The opinions illustrate the IRS's successes in litigation and the parties' successes in settling a large percentage of issues thereby avoiding trial. The IRS settles about 80 percent of cases petitioned to Tax Court.[26] In litigation, the IRS consistently achieves the majority of favorable outcomes in the opinions across all issues, whether the taxpayer is represented or not. However, represented taxpayers will likely achieve a better outcome than *pro se* taxpayers.[27] Figure 2.0.6 affirms that taxpayers are more likely to prevail if they are represented. Also noteworthy is that there were 66 percent more opinions this year involving *pro se* taxpayers than represented taxpayers. Only 12 percent of *pro se* taxpayers prevailed in full or in part, compared to 23 percent of represented taxpayers in the cases we identified for this reporting period. In four of the ten categories, the only taxpayers that achieved a favorable outcome were represented. One explanation for this disparity could be that represented taxpayers may be more likely to resolve their dispute through an administrative remedy or by reaching a settlement with IRS Counsel prior to trial, obviating the need for a court opinion on the matter.

25 IRS, Counsel Automated Tracking System, TL-708A. Does not include cases on appeal and declaratory judgments. Note that this figure covers fiscal years (October 1 – September 30), while MLI review in this report covers the period June 1 – May 31.

26 IRS, Counsel Automated Tracking System, TL-711.

27 For purposes of this analysis, we considered the court's decision with respect to the issue analyzed only. A "split" decision is defined as a partial allowance on the specific issue analyzed.

FIGURE 2.0.6, Outcomes for *Pro Se* and Represented Taxpayers[28]

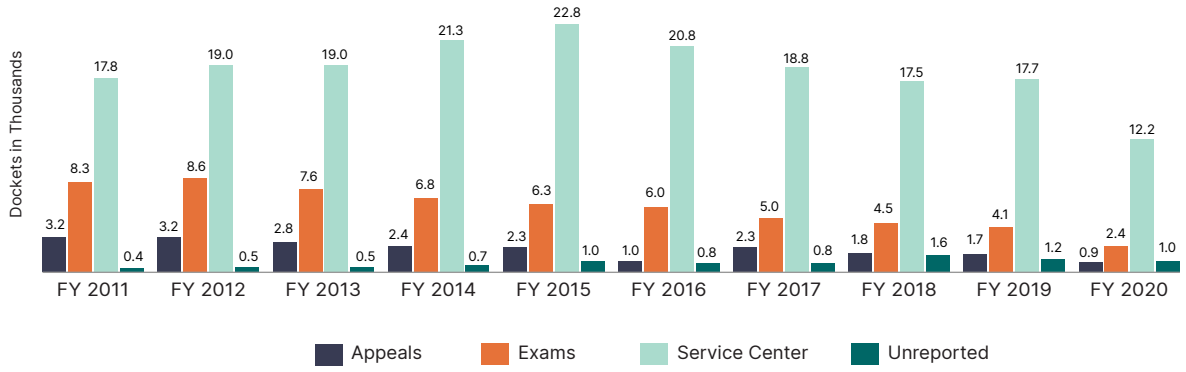
Most Litigated Issue	*Pro Se* Taxpayers			Represented Taxpayers		
	Total Cases	Taxpayer Prevailed in Full or in Part	Percent of Wins	Total Cases	Taxpayer Prevailed in Full or in Part	Percent of Wins
Collection Due Process	45	4	9%	29	6	21%
Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax	44	4	9%	27	6	22%
Accuracy-Related Penalty	37	12	32%	27	7	26%
Trade or Business Expenses	41	11	27%	23	10	43%
Gross Income	46	4	9%	16	2	13%
Summons Enforcement	22	0	0%	18	1	6%
Failure to File, Failure to Pay, and Estimated Tax Penalties	20	0	0%	11	1	9%
Schedule A Deductions	12	0	0%	9	4	44%
Charitable Deductions	3	0	0%	11	2	18%
Frivolous Issues	14	0	0%	0	0	0%
Total	284	35	12%	171	39	23%

Where appropriate, each of the MLI sections that follow include recommendations to reduce the need for litigation. However, they all share one common element: litigation only occurs when there is a failure to reach a resolution at the administrative level. Figure 2.0.7 shows Tax Court petition filing over the last ten FYs based on the IRS function that issued the notice attached to each petition. The statutory notice of deficiency is the "ticket to Tax Court" and the document which starts the procedural clock for timely filing a petition.

28 This figure covers the period June 1, 2019 – May 31, 2020. Some of the 13 percent decrease in the total number of cases from the last reporting period can be attributed to court closures related to the COVID-19 pandemic. *See, e.g.*, https://www.ustaxcourt.gov/covid.html.

FIGURE 2.0.7[29]

Source of Cases Petitioned to the Tax Court (Appeals/Exams/Service Center), FYs 2011-2020



A high percentage of petitions in the Tax Court result from a statutory notice of deficiency being issued from the IRS Service Centers (Campuses) bypassing Appeals, as shown in Figure 2.0.7. There are a variety of reasons that can trigger the issuance of the statutory notice of deficiency at the Campus: a taxpayer may not have understood the IRS correspondence or may not have provided timely or sufficient documentation; or the IRS needed to issue the statutory notice of deficiency to protect the period of limitations.

When the case originates at a Campus, a taxpayer may not have spoken with an IRS employee prior to filing a Tax Court petition.[30] Taxpayers may have had difficulty reaching an IRS employee that could assist in the process, or the IRS may not have been able to contact the taxpayer. Many of those taxpayers may miss an opportunity for achieving a resolution at the administrative level, prior to seeking Tax Court review. This is an area our office plans on reviewing this year.

29 IRS, Counsel Automated Tracking System, TL-708B. This includes declaratory judgments. The unreported category includes cases where no statutory notice was attached to the petition. Note that this figure covers fiscal years (October 1 – September 30), while MLI review in this report covers the period June 1 – May 31.

30 *See* Most Serious Problem: *Correspondence Exams: Taxpayers Encounter Unnecessary Delays and Difficulties Reaching an Accountable and Knowledgeable Contact for Correspondence Audits*, *supra*.

Significant Cases

This section describes cases that do not involve the ten most litigated issues, but highlight important issues relevant to federal tax administration.[1] Cases relevant to the National Taxpayer Advocate's recommendations are summarized immediately below, and other significant cases of interest to a broad range of stakeholders are summarized further below.

In *Myers v. Commissioner*, the U.S. Court of Appeals for the D.C. Circuit held that the deadline under IRC § 7623(b)(4) for filing a petition with the Tax Court for the review of a whistleblower award was subject to equitable tolling.[2]

Significance: The dispute in *Myers* reminds us that the Tax Court does not always have jurisdiction to determine if equitable considerations (*e.g.*, the IRS's confusing communications) extended the filing deadline under the equitable tolling doctrine. Because low-income taxpayers often miss filing deadlines for reasons beyond their control, the National Taxpayer Advocate has recommended legislation that would allow courts to consider if equitable tolling would make their filings timely.[3] Such a change would further a taxpayer's rights *to appeal an IRS decision in an independent forum* and *to a fair and just tax system*.[4] This case highlights the need for legislation because, although it addresses the problem for whistleblowers, it does not solve the problem for taxpayers in other contexts.

Summary

Mr. Myers filed Form 211, Application for Award of Original Information, with the IRS's Whistleblower Office (WBO). He sought a monetary award under IRC § 7623(b), alleging that his former employer intentionally misclassified him and other employees as independent contractors. In four letters written to Mr. Myers and sent by regular mail, the WBO declined to pay an award. The letters did not state they were determinations under the statute. Nor did they explain that to contest the determination, Mr. Myers needed to file a Tax Court petition within 30 days. Apparently confused about what to do next, he wrote to various government officials.

1 When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2019, and ending on May 31, 2020. For purposes of this section, we used the same period.

2 *Myers v. Comm'r*, 928 F.3d 1025 (D.C. Cir. 2019), *reh'g denied*, 2019 U.S. App. LEXIS 30046 (D.C. Cir. Oct. 4, 2019).

3 *See* National Taxpayer Advocate 2021 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 100-102 (*Provide That the Time Limits for Bringing Tax Litigation Are Subject to the Judicial Doctrines of Forfeiture, Waiver, Estoppel, and Equitable Tolling*). The low income taxpayer clinic at the Legal Services Center of Harvard Law School filed an *amicus* brief in this case on behalf of Mr. Myers. *See* Carlton Smith, *D.C. Circuit Denies DOJ En Banc Rehearing Petition in* Myers *Whistleblower Case*, Procedurally Taxing Blog (Oct. 9, 2019), https://proceduralltaxing.com/d-c-circuit-denies-doj-en-banc-rehearing-petition-in-myers-whistleblower-case/; Carlton Smith, *D.C. Circuit Holds Tax Court Whistleblower Award Filing Deadline Not Jurisdictional and Subject to Equitable Tolling*, Procedurally Taxing Blog (July 3, 2019), https://proceduralltaxing.com/d-c-circuit-holds-tax-court-whistleblower-award-filing-deadline-not-jurisdictional-and-subject-to-equitable-tolling/.

4 IRC § 7803(a)(3).

After receiving no satisfactory responses, Mr. Myers filed a petition *pro se* with the Tax Court. He filed after the 30-day deadline provided by IRC § 7623(b)(4). IRC § 7623(b)(4) says:

> Any determination regarding an award … may, within 30 days of such determination, be appealed to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matter).

Based on this language, the Tax Court concluded that the deadline provided by IRC § 7623(b)(4) is "jurisdictional." Thus, it had no jurisdiction to consider if the IRS's confusing communications extended the deadline under the doctrine of equitable tolling. The Tax Court dismissed the case for lack of jurisdiction.[5] The U.S. Court of Appeals for the D.C. Circuit reversed and remanded so the Tax Court could consider if the doctrine would make the filing timely.

Without a "clear statement" indicating that a deadline is jurisdictional, it is merely a claim-processing rule, and is presumed to be subject to equitable tolling, according to the Supreme Court.[6] The IRS argued before the D.C. Circuit that the statutory grant of jurisdiction in IRC § 7623(b)(4) "with respect to such matter" limited jurisdiction to matters appealed "within 30 days." Unconvinced, the court concluded that "such matter" could refer to determining the award under certain provisions (rather than on timing).[7] The court also observed the Supreme Court has not yet identified a single filing deadline that meets the "clear statement" test.[8]

Next, the court said there was no reason to believe Congress intended to exclude whistleblower claims from the equitable tolling doctrine. Two factors supported applying the doctrine: (1) the Tax Court is not an internal administrative body, and (2) Tax Court petitioners are typically *pro se* individuals who have never petitioned the Tax Court before. The only factor in the IRS's favor was "[t]hat the whistleblower award statute is not unusually protective of claimants."[9]

The Tax Court may now apply equitable tolling to review the appeal of whistleblower award determinations otherwise late. Because the D.C. Circuit is the sole appellate jurisdiction for whistleblower award appeals from the Tax Court, this is a nationwide victory for whistleblowers.

Perhaps even more important, the language of the whistleblower filing deadline (*i.e.*, IRC § 7623(b)(4)) mirrors the language of the collection due process filing deadline (*i.e.*, IRC § 6330(d)(1)), which the Ninth Circuit found was jurisdictional.[10] Thus, taxpayers outside the Ninth Circuit may now have an easier time arguing that the collection due process filing deadline is subject to equitable tolling. The ruling arguably creates a split with the Ninth Circuit, which could prompt the Supreme Court to review the issue.

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5 *Myers v. Comm'r*, 148 T.C. 438 (2017).

6 *See, e.g., U.S. v. Kwai Fun Wong*, 575 U.S. 402 (2015) and the cases cited therein.

7 *Myers*, 928 F.3d at 1035, n ‡. The court distinguished this grant of jurisdiction in IRC § 7623(b)(4) from the one applicable to innocent spouse cases (in IRC § 6015(e)(1)(A)), which depends on the timing of the appeal (*i.e.*, limiting the Tax Court's jurisdiction with respect to such matter "if such petition is filed — [during a certain time period]").

8 *Myers*, 928 F.3d at 1035.

9 The D.C. Circuit also dismissed the government's argument that the filing deadline for whistleblower awards in Tax Court is similar to an internal administrative filing deadline, which the Supreme Court said was not subject to equitable tolling in *Sebelius v. Auburn Reg'l Med. Ctr.*, 568 U.S. 145 (2013).

10 *Duggan v. Comm'r*, 879 F.3d 1029, 1034 (9th Cir. 2018). Some have argued that the analysis in *Duggan* is incomplete. *See, e.g.*, Bryan T. Camp, *New Thinking About Jurisdictional Time Periods in the Tax Code*, 73 The Tax Lawyer 1-60 (Fall 2019).

In *In re Shek*, the U.S. Court of Appeals for the Eleventh Circuit held that a tax debt assessed on a late-filed tax return was dischargeable in bankruptcy.[11]

> **Significance**: *In re Shek* illustrates inconsistencies faced by taxpayers in different circuits regarding whether debts arising from late-filed returns are subject to discharge.[12] Previously, the National Taxpayer Advocate recommended legislation that would remove these inconsistencies by establishing a uniform rule.[13] Such legislation would further a taxpayer's rights *to be informed* and *to a fair and just tax system*.[14] It might also reduce the need for litigation about which tax debts are discharged in bankruptcy.

Summary

Mr. Shek filed his 2008 state income tax return with the Massachusetts Department of Revenue (DOR) seven months late and did not pay the assessment. Six years later, he received a discharge in bankruptcy. After the DOR resumed collection activities, Mr. Shek moved to reopen his bankruptcy to determine if the discharge encompassed his state tax debt. The bankruptcy court held that his state tax liability had been discharged.[15] The district court affirmed,[16] and the U.S. Court of Appeals for the Eleventh Circuit also affirmed.

Under 11 U.S.C. § 523(a)(1)(B), there is an exception to discharge for tax liabilities (federal and state) with respect to which a return was (i) not filed or (ii) filed late and within two years before the bankruptcy. If something was filed, disputes center on whether the filing was a "return" under the discharge rules and when it was filed.

Whether a document is a "return" under the tax rules depends on whether it was an "honest and reasonable attempt" to satisfy the law, but does not depend on whether it was timely filed.[17] 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."[18] This paragraph defines a "return" under the discharge rules as a filing that:

> satisfies the requirements of applicable nonbankruptcy law (including *applicable filing requirements*). Such term includes a return prepared pursuant to section 6020(a) of the Internal Revenue Code of 1986, or similar State or local law…. (Emphasis added).

11 *Mass. Dep't of Revenue v. Shek (In re Shek)*, 947 F.3d 770 (11th Cir. 2020).

12 For helpful commentary, see, *e.g.*, Keith Fogg, *Is the One Day Late Interpretation of Bankruptcy Code 523 Finally Headed to the Supreme Court?*, Procedurally Taxing Blog (Jan. 28, 2020), https://proceduralltaxing.com/is-the-one-day-late-interpretation-of-bankruptcy-code-523-finally-headed-to-the-supreme-court/#comments.

13 *See* National Taxpayer Advocate 2014 Annual Report to Congress 417-422 (Legislative Recommendation: *Late-Filed Returns: Clarify the Bankruptcy Law Relating to Obtaining a Discharge*). For prior coverage of litigation involving this issue, see, *e.g.*, National Taxpayer Advocate 2017 Annual Report to Congress 351, 361-63 (*Significant Cases*).

14 IRC § 7803(a)(3).

15 *In re Shek*, 578 B.R. 918 (Bankr. M.D. Fla. 2017).

16 *In re Shek*, 2018 WL 7140300 (M.D. Fla. Nov. 13, 2018).

17 *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)).

18 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 714, 119 Stat. 23, 128-29 (2005) (modifying 11 U.S.C. § 523(a)).

Focusing on the phrase "applicable filing requirements," three circuit courts have held that liabilities regarding a late filing cannot be discharged because a late filing is not a "return" under the discharge rules.[19] Similarly, the DOR argued that Mr. Shek's liability was not discharged because his filing was not timely, and therefore, was not treated as a "return" under the discharge rules.[20]

The U.S. Court of Appeals for the Eleventh Circuit disagreed with the DOR and the circuit court decisions in *McCoy*, *Mallo*, and *Fahey*. The Eleventh Circuit reasoned that interpreting "applicable filing requirements" to mean "all" filing requirements would render the word "applicable" superfluous. It said the "applicable" requirements include only those relevant to establishing that the substance of the filing is a return, rather than tangential considerations, such as whether it is timely filed. Next, the court said that if a late filed return could not be treated as a return, then the provision (11 U.S.C. § 523(a)(1)(B)(ii)) that excludes from discharge liabilities on late returns filed within two years of the bankruptcy, would be a "near nullity." Under the DOR's interpretation, the provision would only apply to the liabilities of the small subset of taxpayers who also filed those returns under IRC § 6020(a) (*i.e.*, jointly prepared by the IRS and the delinquent taxpayer) or a similar state or local provision. An interpretation that rendered the exclusion so insignificant would violate the surplusage canon of statutory construction.[21] Had Congress intended to modify the exclusion in such a drastic, convoluted, and confusing way, the court said it would likely have clearly indicated its intent.

In *Norman v. United States*, the U.S. Court of Appeals for the Federal Circuit held regulations that capped the FBAR penalty were superseded by legislation enacted in 2004.[22]

> **Significance**: *Norman* illustrates that continuing controversy surrounds the application of the penalty for failure to file a Report of Foreign Bank and Financial Accounts (FBAR) and the conduct considered willful in this context. Previously, the National Taxpayer Advocate recommended legislation that would reduce the disproportionality of the FBAR penalty for willful violations and clarify the conduct considered willful.[23] Additional clarity in this area could reduce litigation and would further a taxpayer's rights *to be informed*, *to finality,* and *to a fair and just tax system*.[24]

Summary

Although Ms. Norman had owned a Swiss bank account since 1999, she did not indicate on her 2007 tax return she had a foreign bank account and did not file an FBAR for the year. The Bank Secrecy Act (BSA) provides:

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19 *See In re McCoy*, 666 F.3d 924 (5th Cir. 2012); *In re Mallo*, 774 F.3d 1313 (10th Cir. 2014); *In re Fahey*, 779 F.3d 1 (1st Cir. 2015). Note that attorneys at the IRS do not share the same view as those three circuit courts. *See* Chief Counsel Notice CC-2010-016 (Sept. 2, 2010) (indicating that once the IRS has made an assessment pursuant to a substitute for return, a subsequently filed Form 1040 does not qualify as a return because the filing is not an "honest and reasonable attempt" to satisfy the law, as required under *Beard*).

20 *In re Shek*, 947 F.3d at 775.

21 This canon means that an interpretation should not be favored "when that interpretation would render a 'clause, sentence, or word … superfluous, void, or insignificant.'" *In re Shek*, 947 F.3d at 777 (quotations omitted).

22 *Norman v. United States*, 942 F.3d 1111 (Fed. Cir. 2019).

23 *See* National Taxpayer Advocate 2014 Annual Report to Congress 331-345 (*Foreign Account Reporting: Legislative Recommendations to Reduce the Burden of Filing a Report of Foreign Bank and Financial Accounts (FBAR) and Improve the Civil Penalty Structure*); National Taxpayer Advocate 2021 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 73-75 (*Modify the Standard of Proof for Willful FBAR Violations and Reduce the Maximum Penalty Amounts*).

24 IRC §§ 7803(a)(3)(A), (F).

> [t]he Secretary of the Treasury *may* impose a civil money penalty on any person who violates [the FBAR rules, and] … [I]n the case of any person willfully violating [the FBAR rules] … the *maximum* penalty … *shall* be increased to the greater of — (I) $100,000, or (II) 50 percent of … the balance in the account at the time of the violation. [Emphasis added.][25]

The IRS determined that Ms. Norman willfully failed to report the account. It assessed a penalty of $803,530, which was 50 percent of the account's balance. Ms. Norman paid the penalty and requested a refund, suing in the Court of Federal Claims. The court denied the request.[26] Finding no "clear error," the U.S. Court of Appeals for the Federal Circuit affirmed.

First, Ms. Norman argued before the Federal Circuit that her FBAR violation was not willful because she did not know of the FBAR filing requirement or the contents of her 2007 return. She argued willfulness requires actual knowledge of the obligation to file an FBAR, as explained in the Internal Revenue Manual (IRM). Otherwise, every failure to file an FBAR would be willful, and such an interpretation would render superfluous the penalties for non-willful violations.

The Federal Circuit disagreed, explaining that a violation would generally not be willful if a taxpayer had no reason to know about the account. Thus, its interpretation of willfulness would not make superfluous the penalty for non-willful violations.

The Federal Circuit explained that (1) courts are not bound by the IRM, (2) Ms. Norman could be charged with constructive knowledge of the contents of her return, (3) she had been reckless in failing to learn about the filing requirements, (4) other courts had held that recklessness was enough to trigger the willful penalty,[27] and (5) IRM 4.26.16.6.5.1(5) said "the failure to learn of the filing requirements coupled with other factors, such as efforts taken to conceal the existence of the accounts and the amounts involved, may lead to a conclusion" that the taxpayer acted willfully.

The court emphasized that Ms. Norman tried to conceal the account by: (1) opening a "numbered" account that did not list her name, (2) preventing the bank from investing in U.S. securities, (3) withdrawing a significant amount in cash, and (4) inconsistently stating her knowledge of, and the circumstances surrounding, the account. Thus, the violation was willful.

Next, Ms. Norman argued that the willful FBAR penalty was capped at $100,000 by regulation.[28] From 1986 to 2004, the BSA only authorized FBAR penalties for willful violations and capped them at $100,000. A regulation issued in 1987 reiterated that the maximum FBAR penalty was $100,000.[29] In 2004, Congress increased the maximum FBAR penalty for willful violations (as quoted above) and added a $10,000 penalty

25 31 U.S.C. § 5321(a)(5)(A)-(D).

26 *Norman v. United States*, 138 Fed. Cl. 189 (Ct. Cl. 2018).

27 *See, e.g.*, *Bedrosian v. United States*, 912 F.3d 144, 152-53 (3d Cir. 2018); *United States v. Williams*, 489 F. App'x 655, 658-59 (4th Cir. 2012).

28 At least one district court agreed with this argument. *See United States v. Colliot*, 2018-1 U.S.T.C. (CCH) ¶50,259 (W.D. Tex. 2018). The Federal Circuit did not discuss *Colliot*.

29 *Amendments to Implementing Regulations Under the Bank Secrecy Act*, 52 Fed. Reg. 11436, 11445–46 (1987) (codified as 31 C.F.R. § 103.57(g)(2), and later re-codified as 31 C.F.R. § 1010.820(g)(2)) (authorizing FBAR penalties "not to exceed the greater of the amount (not to exceed $100,000) equal to the balance in the account at the time of the violation, or $25,000," an upper limit that reiterated what was then provided by 31 U.S.C. § 5321(a)(5)(C)).

for nonwillful violations.[30] However, the government did not amend the 1987 regulation, which still provides for a maximum penalty of $100,000. But the court held the 2004 amendment rendered void the 1987 regulation because the law said the maximum penalty "shall" be increased.

This case clarifies that the 2004 legislation, which increased the "maximum" penalty the government "may" impose superseded regulations that provide for a lower penalty. Although the court was persuaded that Ms. Norman knew she had to report the account and intentionally violated the law, the alternative justifications for its holding may suggest that inadvertent FBAR violations could trigger the penalties supposedly reserved for "willful" violations, unless a taxpayer can show he or she did not know about the account.[31]

In *Estate of Stauffer v. IRS*, the U.S. Court of Appeals for the First Circuit held that the limitations period for filing a refund claim was not tolled by the taxpayer's financial disability because another person could file the returns and claim the refund(s).[32]

> **Significance**: *Estate of Stauffer* illustrates how the financial disability exception to the refund statute of limitations can fail to protect those with financial disabilities. The National Taxpayer Advocate has recommended broadening the circumstances in which a disability tolls the period to file a refund claim.[33] Such legislation would further a taxpayer's rights *to appeal an IRS decision in an independent forum* and *to a fair and just tax system*.[34]

Summary

Mr. Hoff Stauffer had a durable power of attorney (POA) to file returns and otherwise act on behalf of his elderly father, Mr. Carlton Stauffer, who was mentally ill. After a falling out, Hoff told Carlton and third parties he would no longer exercise his POA. Carlton failed to file multiple tax returns before he died in 2012.

As executor of Carlton's estate, Hoff filed delinquent returns for tax years 2006 through 2012 in 2013. The 2006 return reflected an overpayment. The estate requested a portion of the overpayment be applied to the liability for 2007 and a refund of the remainder. The claim would have been late under IRC § 6511(a), unless the limitations period was extended by Carlton's financial disability.[35] Although Carlton himself was financially disabled, IRC § 6511(h)(2)(B) provides that an individual is not treated as financially disabled during any period that another person is "authorized to act" on his or her behalf in financial matters. After determining that Hoff was "authorized to act" for Carlton, the IRS denied the claim, and Hoff filed a refund suit. The U.S. district court[36] dismissed the complaint, believing that the limitations period for filing a refund claim was not tolled while Hoff held a POA, and the U.S. Court of Appeals for the First Circuit agreed.

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30 American Jobs Creation Act of 2004 (AJCA), Pub. L. No. 108–357, § 821, 118 Stat. 1418, 1586 (2004) (codified at 31 U.S.C. § 5321(a)(5)).

31 For a discussion of problems with this approach, see, *e.g.*, National Taxpayer Advocate Fiscal Year 2017 Objectives Report to Congress 164-176 (Area of Focus 12: *The IRS's Offshore Voluntary Disclosure (OVD)-Related Programs Have Improved, But Problems Remain*).

32 *Estate of Stauffer v. IRS*, 939 F.3d 1 (1st Cir. 2019).

33 *See, e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress 302-310 (*Legislative Recommendation: Broaden Relief From Timeframes for Filing a Claim for Refund for Taxpayers With Physical or Mental Impairments*).

34 IRC § 7803(a)(3).

35 Under IRC § 6511(a), taxpayers generally must file a refund claim within three years from the time the return was filed or two years from the time the tax was paid, whichever period expires later. IRC § 6511(h), however, provides an exception under which the general periods in IRC § 6511(a) are suspended if the individual is financially disabled. In a related case, the IRS lost the argument that a statement from Carlton's psychologist could not be used to establish financial disability. *See* National Taxpayer Advocate 2018 Annual Report to Congress 432, 441 (*Significant Cases*) (discussing *Estate of Stauffer v. IRS*, 285 F. Supp. 3d 474 (D. Mass. 2017)).

36 *Estate of Stauffer v. IRS*, 2018 WL 5092885 (D. Mass. Sept. 29, 2018).

The estate argued that Hoff should not be treated as "authorized to act" on behalf of Carlton because he did not have both a duty to file Carlton's tax returns, and actual or constructive knowledge that the tax returns had not been filed. The First Circuit rejected this argument because it found that Hoff was "authorized" to act on Carlton's behalf, and the plain meaning of "authorized" does not permit it to superimpose a requirement for the person to also have a duty to do so or actual or constructive knowledge that the returns need to be filed.[37]

In *CIC Services, LLC v. Commissioner*, the U.S. Court of Appeals for the Sixth Circuit denied a request to rehear a decision in which it held that the Anti-Injunction Act (AIA) barred it from enjoining enforcement of a reportable transaction notice allegedly promulgated in violation of the Administrative Procedure Act (APA).[38]

Significance: *CIC* illustrates that the AIA can sometimes block judicial review of rules backed by tax penalties unless taxpayers first: violate them, wait for the IRS to assess the penalties, pay the penalties in full, and then sue for a refund. Low-income taxpayers are unlikely to have the time, resources, or appetite for this.[39] Therefore, the AIA could discourage them from claiming benefits to which they are entitled and from challenging rules that are invalid. This case highlights the continuing importance of the National Taxpayer Advocate's legislative recommendation to allow judicial review of penalties without first requiring taxpayers to pay them in full.[40] Such legislation would further a taxpayer's rights *to appeal an IRS decision in an independent forum* and *to a fair and just tax system*.[41]

Summary

Taxpayers and their material advisors must maintain and submit records to the IRS pertaining to "reportable transactions," or face severe penalties.[42] Reportable transactions include those that the IRS has identified as "transactions of interest."[43] In November of 2016, the IRS issued Notice 2016-66, which designated certain "micro-captive" insurance transactions as "transactions of interest."[44]

CIC Services (CIC), a captive insurance company, sued the IRS, seeking to enjoin the IRS from enforcing Notice 2016-66. CIC argued that Notice 2016-66 was invalid because it was a "legislative rule," which had been promulgated without notice and comment (*i.e.,* a process in which the public is given an opportunity to comment on the proposed rule before it becomes effective, as discussed above). The IRS countered that the AIA barred CIC from suing "for the purpose of restraining the assessment or collection of any tax," and that

37 *Estate of Stauffer*, 939 F.3d at 9.

38 *CIC Servs., LLC v. IRS*, 925 F.3d 247 (6th Cir. 2019), *reh'g denied*, 936 F.3d 501 (6th Cir. 2019), *petition for cert. filed* (Jan. 24, 2020) (No. 19-930).

39 The Center for Taxpayer Rights highlights concerns in an *Amicus* brief before the Supreme Court that the executive branch could impose onerous information reporting duties on low income taxpayers that the AIA would prevent them from challenging. See *CIC Servs., LLC v. IRS*, Brief of the Center for Taxpayer Rights as *Amicus Curiae* in Support of Petitioner (No. 19-930). *Amicus* briefs were filed by many other parties not listed here.

40 *See, e.g.*, National Taxpayer Advocate 2017 Annual Report to Congress 343-386 (Legislative Recommendation: *#3 Fix the Flora Rule: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*); National Taxpayer Advocate 2021 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 94-97 (*Repeal Flora and Expand the Tax Court's Jurisdiction: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*).

41 IRC § 7803(a)(3).

42 IRC §§ 6111, 6112, and 6707A.

43 *See* Treas. Reg. § 1.6011-4(b)(6).

44 Notice 2016-66, 2016-47 I.R.B. 745.

the penalties that could be imposed for failure to report micro-captive transactions were treated as taxes for this purpose.[45]

Both the district court and the Sixth Circuit agreed that the AIA prohibited the suit, finding that federal district courts lacked jurisdiction over suits seeking to enjoin the assessment or collection of taxes.[46] The Sixth Circuit explained that CIC could challenge Notice 2016-66 by paying the penalty and then filing a claim for refund.[47]

In August of 2019, the Sixth Circuit denied a petition for rehearing.[48] The Sixth Circuit acknowledged that the AIA was not meant to ban all prospective relief from IRS regulations, but also recognized the importance of the IRS revenue-collection process. In May of 2020, the Supreme Court granted *certiorari*.[49]

In *Bullock v. IRS*, the U.S. District Court for the District of Montana held the IRS violated the APA when it waived the requirement for tax-exempt organizations to report their donors without following the notice and comment process.[50]

> **Significance**: *Bullock* illustrates that the IRS sometimes makes or changes rules without providing public notice of proposed changes, considering comments from stakeholders, and explaining the rationale for the rule, as required by the APA. The National Taxpayer Advocate is recommending legislation that would require the IRS to submit proposed or temporary regulations to the National Taxpayer Advocate for comment and to address any such comments in the preamble to the final rule.[51] The National Taxpayer Advocate is uniquely positioned to help the IRS consider the views of unrepresented stakeholders who might not otherwise offer comments. Such legislation would help ensure the IRS considers their perspectives. Incorporating their perspectives would further a taxpayer's *right to a fair and just tax system*.[52]

Summary

Tax-exempt organizations are required by IRC § 6033(a)(1) to file a return that includes "other information… [that] the Secretary may by forms or regulations prescribe." In 1970, after providing the public with notice and an opportunity to comment, the Secretary exercised this authority by issuing regulations that required exempt organizations to include the "names and addresses of all persons who contributed, bequeathed, or devised $5,000 or more" in money or property on their returns.[53] That information was reported on Schedule B of Form 990, Return of Organization Exempt from Income Tax. In 2018, the IRS issued Rev. Proc. 2018-38, which said that tax-exempt organizations would "no longer be required to provide the names and addresses of contributors,"[54] and updated Schedule B of Form 990 and its instructions.

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45 IRC § 7421(a).
46 *CIC Servs., LLC v. IRS*, 2017 WL 5015510 (E.D. Tenn. Nov. 2, 2017), *aff'd*, 925 F.3d at 247.
47 *CIC Servs., LLC*, 925 F.3d at 247.
48 *CIC Servs., LLC v. IRS*, 936 F.3d 501, 505 (6th Cir. 2019) (Sutton, J., concurring in denial of reh'g). The D.C. Circuit had similarly weighed in on the issue in 2015. *See Fla. Bankers Ass'n v. U.S. Dep't of the Treasury*, 799 F.3d 1065 (D.C. Cir. 2015).
49 *CIC Servs., LLC v. IRS*, 2020 WL 2105208 (May 4, 2020).
50 *Bullock v. IRS*, 401 F. Supp. 3d 1144 (D. Mont. 2019).
51 National Taxpayer Advocate 2021 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 89 (*Require the IRS to Address the National Taxpayer Advocate's Comments in Final Rules*).
52 IRC § 7803(a)(3).
53 Treas. Reg. § 1.6033-2(a)(2)(ii)(f).
54 Rev. Proc. 2018-38, 2018-31 I.R.B. 280.

Montana and New Jersey did not like Rev. Proc. 2018-38 because they were using the donor information that the IRS collected. They sued, alleging the IRS violated the APA by changing the reporting requirement without first providing public notice of the proposed change and an opportunity to comment. This notice and comment process is required when an agency issues or changes a "legislative rule."[55] It is not required when an agency issues or makes changes to

> interpretive rules, general statements of policy, or rules of agency organization, procedure, or practice . . . or when the agency for good cause finds . . . that notice and public procedure are impracticable, unnecessary, or contrary to the public interest.[56]

The IRS argued that Rev. Proc. 2018-38 was an interpretive rule because it interpreted and clarified the "other information" that IRC § 6033(a)(1) allows the IRS to require. However, the U.S. District Court for the District of Montana concluded that it was a legislative rule because it amended the previous legislative rule that required tax-exempt organizations to file substantial-contributor information annually. Thus, because Rev. Proc. 2018-38 changed a legislative rule without following the notice and comment process, the court set it aside.[57]

This case is significant because it suggests that when the IRS promulgates a legislative rule by publishing a form, it can change the form only after providing the public notice and an opportunity to comment, even if the change seems to reduce taxpayer burden.[58]

In *Silver v. IRS*, the U.S. District Court for the District of Columbia held that a taxpayer had standing to challenge the IRS's failure to carry out evaluations under the Regulatory Flexibility Act (RFA) and the Paperwork Reduction Act (PRA) when issuing regulations, and that the AIA did not bar the suit.[59]

> **Significance**: Like *Bullock* (discussed above), *Silver* illustrates that the IRS sometimes makes or changes rules without considering taxpayer burden, as required by the APA. This case is significant because it suggests that a broad range of tax regulations may be subject to challenge on the same bases (*i.e.*, a failure to conduct analysis under the RFA or PRA).[60] In 2016, the Government Accountability Office reported that only two of over 200 regulations issued by Treasury between 2013 and 2015 included an RFA analysis.[61]

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55 5 U.S.C. §§ 553(b), (c).

56 5 U.S.C. § 553(b)(3)(A)-(B). Before 2011, the Supreme Court had suggested that regulations issued pursuant to a specific legislative grant of authority were "legislative" and entitled to greater deference than regulations issued pursuant to a general grant of authority (such as IRC § 7805(a)), which were called "interpretive." *See Rowan Cos. v. United States*, 452 U.S. 247, 253 (1981). In 2011, however, the Supreme Court said the source of the authority for issuing a rule was not determinative. *See Mayo v. United States*, 562 U.S. 44 (2011). As the *Bullock* court noted, the effect of the rule (rather than the source of the authority for the rule) determines whether it is legislative or interpretive.

57 The IRS subsequently updated the regulations using the notice and comment procedure. *See Guidance Under Section 6033 Regarding the Reporting Requirements of Exempt Organizations*, 84 Fed. Reg. 47,447 (Sept. 10, 2019) (codified at Treas. Reg. § 1.6033–2 with an optional effective date for returns filed after Sept. 6, 2019).

58 This holding is generally consistent with a recently-issued policy statement, which says: "... if the intended interpretation or position would have the effect of modifying existing legislative rules or creating new legislative rules on matters not addressed in existing regulations, the interpretation or position will generally be issued through notice-and-comment rulemaking, absent exceptional circumstances." Treasury Department, *Policy Statement on the Tax Regulatory Process* (Mar. 5, 2019). *See also* Chief Counsel Notice CC-2019-006 (Sept. 17, 2019).

59 *Silver v. IRS*, 2019 U.S. Dist. LEXIS 220193 (D.D.C. Dec. 24, 2019).

60 Stuart J. Bassin, *Rethinking Validity Challenges to Tax Regulations*, 166 Tax Notes Federal 573 (Jan. 27, 2020).

61 Government Accountability Office (GAO), GAO-16-720, *Treasury and OMB Need to Reevaluate Long-standing Exemptions of Tax Regulations and Guidance* 22 (2016).

Summary

As part of the Tax Cuts and Jobs Act (TCJA), Congress enacted certain "transition tax" provisions applicable to "controlled foreign corporations" owned by "United States persons."[62] Mr. Monte Silver, an American citizen, and Monte Silver, Ltd., the controlled foreign corporation through which he practiced law in Israel (collectively, Mr. Silver), challenged the validity of regulations implementing the transition tax. Although Mr. Silver reported no transition tax liability, he alleged the IRS did not follow procedures mandated by the APA, the RFA, or the PRA — rules designed to protect small businesses from burdensome and costly regulations — when it issued the regulations.

The government moved to dismiss. It argued that Mr. Silver had no standing because he suffered no injury, and that any injury he sustained was due to the TCJA and not the regulations. It also argued that his suit was barred because invalidating the transition tax regulations would restrain "the assessment or collection of any tax," in violation of the AIA.[63]

The court found that Mr. Silver had standing because he was injured by compliance costs (recordkeeping and collection of information) that were traceable to the government's failure to follow procedural rules. Although the TCJA itself may have imposed the burden, a procedural violation that reasonably increased the risk of injury to Mr. Silver was enough to establish that the IRS's violation (and not the statute) caused the injury for purposes of standing. Finally, the AIA was not applicable because Mr. Silver was merely asking the court to compel the agency to conduct RFA and PRA analyses. The court said it would not have to analyze whether a stay of enforcement of the regulations would violate the AIA unless Mr. Smith prevailed on the merits.

In *Essner v. Commissioner*, the Tax Court held that IRC § 7605(b) does not bar the IRS from auditing a return while simultaneously using its automated document matching process (called Automated Underreporter or AUR) to address underreporting on the same return.[64]

Significance: Although IRC § 7605(a) may create an expectation that the IRS will only review and adjust a taxpayer's return once, *Essner* shows this expectation is wrong, and that the IRS's communications about different reviews can be confusing. As automated error-correction procedures increasingly replace examinations, the National Taxpayer Advocate has suggested that the procedural protections available to taxpayers under examination (*e.g.*, the rights to avoid unnecessarily repetitive inquires and to petition Appeals before issuance of a notice of deficiency) should be extended to those facing more automated procedures.[65] As this case shows, IRS procedures are inconsistent with a taxpayer's rights *to be informed* and *to finality*.[66] Some have suggested that a legislative fix may be needed.[67]

62 *See generally* Pub. L. No. 115-97 § 14103(a), 131 Stat. 2054, 2195 (2017) (codified at IRC § 965).
63 IRC § 7421(a).
64 *Essner v. Comm'r*, T.C. Memo. 2020-23.
65 *See, e.g.*, National Taxpayer Advocate Fiscal Year 2019 Objectives Report to Congress vol. 2, at 38-43 (Most Serious Problem: *Audit Rates: The IRS Is Conducting Significant Types and Amounts of Compliance Activities That It Does Not Deem to Be Traditional Audits, Thereby Underreporting the Extent of Its Compliance Activity and Return on Investment, and Circumventing Taxpayer Protections*); Nina E. Olson, "Real" vs. "Unreal" Audits and Why This Distinction Matters, National Taxpayer Advocate Blog (July 6, 2018), https://www.taxpayeradvocate.irs.gov/news/ntablog-real-vs-unreal-audits-and-why-this-distinction-matters/.
66 IRC §§ 7803(a)(3)(A), (F).
67 *See, e.g.*, Leslie Book, *Unreal and Real Audits: Surgeon Finds No Relief From IRS's "Byzantine" Exam Procedures*, Procedurally Taxing Blog (Feb. 14, 2020), https://proceduralltaxing.com/unreal-and-real-audits-surgeon-finds-no-relief-from-irss-byzantine-exam-procedures/.

Summary

Mr. Essner took distributions in 2014 and 2015 from an individual retirement account (IRA) he inherited. After reviewing material on the IRS website, he determined that the distributions were not taxable. He did not disclose them to his preparer, even though they were reported on Forms 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.

In March of 2016, Mr. Essner received a letter from the IRS's AUR unit, proposing to increase his taxable income for 2014 by the IRA distribution.[68] In October 2016, Mr. Essner's 2014 return was also selected for examination. The examination addressed his expense deductions, but not his IRA distributions. During the examination, he received a notice of deficiency from the AUR unit increasing his income for 2014 by the IRA distribution.

Mr. Essner did not establish that any portion of the IRA distributions represented a non-taxable return of his late father's original investment. He argued, however, that the IRS was barred from assessing a deficiency because it had violated IRC § 7605(b), which prohibits the IRS from conducting (1) "unnecessary examination(s) or investigations," and (2) more than one "inspection of a taxpayer's books" unless "after investigation," the IRS notifies the taxpayer that an additional inspection is necessary.

The court explained that the AUR review process involved communication with the taxpayer and a comparison of third-party records with the taxpayer's return. These activities are not an examination or an inspection of the taxpayer's books and records.[69] In addition, because both the examination and AUR process resulted in adjustments, neither was an "unnecessary" investigation. Thus, while acknowledging that a "taxpayer ought not to have been subjected to such a byzantine examination," it held that the IRS did not violate IRC § 7605(b).[70]

In *Rodriguez v. Federal Deposit Insurance Corp.*, the Supreme Court held that state law (and not federal common law) governs the ownership of a tax refund claimed on a consolidated return, potentially calling into question other federal common law doctrines and underscoring the importance of tax allocation agreements.[71]

Significance: Following *Rodriguez v. Federal Deposit Insurance Corp.,* consolidated groups are more likely to find that the "wrong" member will unexpectedly own tax refunds under state law if the tax allocation agreement is unclear. Thus, it reminds consolidated groups to ensure their tax allocation agreements are clear.[72] This case is also significant because it may suggest that longstanding federal

68 Mr. Essner's 2015 return would have been due in April 2016, after he received the letters. Perhaps this is why the IRS proposed and the court sustained an accuracy-related penalty under IRC § 6662 for that year.

69 According to the IRS, an attempt to resolve a discrepancy between a taxpayer's return and third-party data does not constitute an examination, inspection, or reopening because the IRS merely is asking the taxpayer to explain the discrepancy. *See* Rev. Proc. 2005-32, § 4.03, 2005-1 C.B. 1206.

70 *Essner*, 2020 WL 708950 at *11. For further analysis, see, *e.g.*, Bryan Camp, *Lesson From the Tax Court: IRS Automated Matching Program Not an 'Examination'*, Tax Prof Blog (Feb. 17, 2020), https://taxprof.typepad.com/taxprof_blog/2020/02/lesson-from-the-tax-court-irs-automated-matching-program-not-an-examination.html.

71 *Rodriguez v. Fed. Deposit Ins. Corp.*, 140 S. Ct. 713 (2020), *vacating and remanding* 914 F.3d 1262 (10th Cir. 2019).

72 For further analysis, see, *e.g.*, Anthony V. Sexton, *The Death of Bob Richards: Are There Broader Lessons?*, 166 Tax Notes Federal 2055 (Mar. 30, 2020).

common law doctrines, such as the substance-over-form doctrine, the sham transaction doctrine, and the step transaction doctrine are invalid because they are products of federal common law.[73]

Summary

A bank holding company filed a consolidated federal income tax return to claim a refund on behalf of itself and its federally insured subsidiary, United Western Bank. By the time the IRS paid the refund, the Federal Deposit Insurance Corporation (FDIC) had taken control of the bank subsidiary, and the holding company had filed for bankruptcy. Both the trustee for the holding company (Simon Rodriguez) and the receiver for the bank (the FDIC) claimed the refund. The parties' tax allocation agreement did not unambiguously address who owned the refund, but one clause said any ambiguity would be resolved in favor of the bank. After the case was reviewed by a bankruptcy court[74] and a district court,[75] the United States Court of Appeals for the Tenth Circuit held the refund belonged to the FDIC as receiver for the bank.

The Tenth Circuit explained that "[f]ederal common law … provides a framework for resolving this issue."[76] Pursuant to a federal common law rule (called the *Bob Richards* rule), in the absence of an unambiguous tax allocation agreement to the contrary, a refund belongs to the consolidated group member responsible for the losses.[77] Thus, the Tenth Circuit said its holding was consistent with the *Bob Richards* rule.

On appeal to the Supreme Court, the FDIC declined to defend the *Bob Richards* rule, arguing instead that it was entitled to the refund under the tax allocation agreement. However, the Supreme Court said it "took this case to decide *Bob Richards*'s fate,"[78] and held that the rule was not a legitimate exercise of federal common lawmaking. It explained that in the absence of congressional authorization, federal common lawmaking must be "necessary to protect uniquely federal interests."[79] Although this was a federal bankruptcy and a tax dispute, the Court observed that it was really about property rights, which are governed by state law.

In *Texas v. United States*, the U.S. Court of Appeals for the Fifth Circuit held the "individual mandate" to buy insurance is unconstitutional because it is no longer backed by a tax penalty, and thus, cannot be an exercise of Congress's power to tax.[80]

Significance: Holding unconstitutional the "individual mandate" to purchase insurance is significant in its own right, but the *Texas* court's analysis about why the mandate is unconstitutional is also significant. Under the court's reasoning, regulatory mandates that would otherwise be unconstitutional are valid only if backed by a tax penalty of greater than $0.

73 Although the Supreme Court's opinion does not directly reference these doctrines, as one academic has observed, federal courts apply these doctrines in tax cases to disregard transactions that state law would honor. *See* Daniel Hemel, *Opinion Analysis: In Tax Refund Case, Justices Decide a Narrow Question But Leave Much Unresolved*, SCOTUSBLOG (Feb. 26, 2020), https://www.scotusblog.com/2020/02/opinion-analysis-in-tax-refund-case-justices-decide-a-narrow-question-but-leave-much-unresolved/.

74 *In re: United Western Bancorp v. Fed. Deposit Ins. Corp.*, 558 B.R. 409 (Bankr. D. Colo. 2016).

75 *United Western Bancorp,* 574 B.R. 876 (D. Colo. 2017).

76 *Rodriguez*, 914 F.3d at 1269.

77 *See, e.g.*, *Barnes v. Harris*, 783 F.3d 1185, 1195 (10th Cir. 2015) (citing *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262, 265 (9th Cir. 1973)).

78 *Rodriguez*, 140 S. Ct. at 717.

79 *Id.*

80 *Texas v. United States*, 945 F.3d 355 (5th Cir. 2019).

Summary

Enacted as part of the Patient Protection and Affordable Care Act (ACA),[81] IRC § 5000A(a) requires certain individuals to ensure that they and their dependents have minimum essential health insurance coverage or qualify for a coverage exemption (the "individual mandate"). IRC § 5000A(b) imposes a penalty called a "shared responsibility payment" on those who do not have coverage or qualify for an exemption.

In 2012, the Supreme Court held in *NFIB* that although Congress did not have the authority to require individuals to buy insurance under the Commerce Clause or the Necessary and Proper Clause of the U.S. Constitution, the individual mandate and shared responsibility payments were a constitutional exercise of its power to lay and collect taxes.[82] In December 2017, the TCJA reduced the "shared responsibility payment" to zero, effective January 1, 2019.[83]

A collection of state attorneys general and governors and two citizens filed a lawsuit challenging the continuing constitutionality of the ACA. The District Court for the Northern District of Texas held that setting the shared responsibility payment to zero rendered the individual mandate unconstitutional, and the unconstitutional provision could not be severed from any other part of the ACA.[84] The U.S. Court of Appeals for the Fifth Circuit affirmed that the individual mandate is no longer constitutional. Instead of deciding whether the rest of the ACA must be struck down, however, it remanded the case for additional analysis.[85]

81 Pub. L. No. 111-148, 124 Stat. 119 (2010).
82 *Nat'l Fed'n of Indep. Bus. v. Sebelius (NFIB)*, 567 U.S. 519 (2012).
83 Pub. L. No. 115-97, § 11081, 131 Stat. 2054, 2092 (2017) (codified at IRC § 5000A(c)).
84 *Texas v. United States*, 340 F. Supp. 3d 579 (N.D. Tex. 2018).
85 In the meantime, another group of state attorneys general and governors, the state of California, and the U.S. House of Representatives petitioned the Supreme Court for review in support of the ACA. The Supreme Court granted certiorari. *See California v. Texas*, 140 S. Ct. 1262 (Mar. 2, 2020).

Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Quality Service*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

OVERVIEW

Collection Due Process (CDP) is a procedural safeguard created by Congress as part of the IRS Restructuring and Reform Act of 1998 (RRA 98).[2] It requires the IRS to follow a set of procedures to ensure that taxpayers have due process protections when facing IRS levy and lien actions.[3] Prior to RRA 98, taxpayers with federal tax debts did not have many protections against the government's authority to collect for those tax debts. Congress mandated CDP rights to curb potential IRS abuses.[4] Treasury issued a robust set of regulations defining CDP procedures.[5]

A CDP hearing is an opportunity for a taxpayer to have an independent and meaningful review by the IRS Independent Office of Appeals (Appeals) prior to the IRS's first levy or immediately after its first Notice of Federal Tax Lien (NFTL) filing to enforce a tax liability. Under both lien and levy procedures, the taxpayer must return a signed and dated written request for a CDP hearing, including the reasons for requesting a hearing, within the applicable period.[6] At the hearing, the taxpayer has the right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, spousal defenses, and, under certain circumstances, the underlying tax liability.[7] Some of the collection alternatives include installment agreements, requests for currently not collectible status, and

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

2 IRS Restructuring and Reform Act of 1998 (RRA 98), Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998). Prior to RRA 98, the U.S. Supreme Court had held that a post-deprivation hearing satisfied due process concerns in the tax collection arena. *See United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 726-31 (1985); *Phillips v. Comm'r*, 283 U.S. 589, 595-601 (1931).

3 IRC §§ 6320, 6330.

4 *See* S. Rep. 105-174 (1998), at 67 *et seq.* (noting that "taxpayers are entitled to protections in dealing with the IRS that are similar to those they would have in dealing with any other creditor").

5 *See* Treas. Reg. §§ 301.6330-1 (pre-levy) and 301.6320-1 (post-filing Notice of Federal Tax Lien).

6 IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B); Treas. Reg. §§ 301.6320-1(c)(2), Question and Answer (Q&A) (C1)(ii) and 301.6330-1(c)(2), Q&A (C1)(ii). The regulations require the IRS to provide the taxpayer an opportunity to "cure" any defect in a timely filed hearing request, including providing a reason for the hearing. Form 12153, Request for a Collection Due Process or Equivalent Hearing, includes space for the taxpayer to identify collection alternatives that he or she wants Appeals to consider, as well as examples of common reasons for requesting a hearing. *See* IRS, Form 12153, Request for Collection Due Process or Equivalent Hearing (Feb. 2020).

7 IRC §§ 6320(c) (lien) and 6330(c)(2) (levy). IRC § 6320(c) generally requires Appeals to follow the levy hearing procedures under IRC § 6330 for the conduct of the lien hearing, the review requirements, and the balancing test.

offers in compromise. CDP hearings also allow taxpayers to challenge the assessed liability if they received no prior opportunity to do so.[8]

Upon receiving the taxpayer's CDP hearing request, the IRS will assign the matter to a Settlement Officer (SO) within Appeals. If the taxpayer and the SO agree to a collection alternative, the parties will close the case and comply with the terms of the collection alternative. If the parties do not agree on a collection alternative, the SO will issue a Notice of Determination giving the taxpayer the right to a judicial review of that determination by the U.S. Tax Court. The taxpayer must file a petition in Tax Court within 30 days.[9] Taxpayers who fail to timely request a CDP hearing will be afforded an "equivalent hearing" that is similar to a CDP hearing, but there is no judicial review of an adverse determination.[10]

The standard of review the court applies depends on the nature of the issue it is reviewing. Where the validity of the underlying tax liability is properly at issue in the hearing, the court will review the amount of the tax liability on a *de novo*[11] basis, and the scope of its review extends to evidence introduced at the trial that was not a part of the administrative record.[12] Where the Tax Court is reviewing the appropriateness of the collection action or subsidiary factual and legal findings, the court will review these determinations under an abuse of discretion standard, a high standard which necessarily provides deference to an IRS Appeals determination unless it is "arbitrary, capricious, clearly unlawful, or without sound basis in fact or law."[13] When the review is for abuse of discretion, it is the position of the Tax Court that the scope of its review extends beyond the administrative record to include evidence adduced at trial, although in nonliability CDP cases appealable to the U.S. Courts of Appeals for the First, Eighth, and Ninth Circuits, the scope of review is limited to the administrative record.[14] However, in cases appealable to the other U.S. Courts of Appeals that have yet to address that precise issue in a precedential opinion, the court may consider new evidence not contained in the administrative record.[15] This means that taxpayers must be vigilant about developing their case fully at the administrative hearing, a requirement they may not be aware of based on the current CDP notices they receive from the IRS.

Appeals from CDP hearings have been one of the federal tax issues most frequently litigated in the federal courts since 2001. Our review of litigated issues for the period between June 1, 2019, and May 31, 2020, found 74 opinions on CDP cases. Each year, only a small fraction of taxpayers exercise their right to request an administrative hearing or petition for judicial review. Figure 2.1.1 depicts the filing trends for CDP cases.

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8 IRC § 6330(c).

9 IRC § 6330(d) (setting forth the time requirements for obtaining judicial review of Appeals' determination); IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B) (setting forth the time requirements for requesting a CDP hearing for lien and levy matters, respectively).

10 Treas. Reg. §§ 301.6320-1(i)(2), Q&A (I6) and 301.6330-1(i)(2), Q&A (I6); *Business Integration Servs., Inc. v. Comm'r*, T.C. Memo. 2012-342 at 6-7; *Moorhouse v. Comm'r*, 116 T.C. 263 (2001). A taxpayer can request an equivalent hearing by checking a box on Form 12153, by making a written request, or by confirming that he or she wants the untimely CDP hearing request to be treated as an equivalent hearing when notified by Collection of an untimely CDP hearing request. Internal Revenue Manual (IRM) 5.19.8.4.3, Equivalent Hearing (EH) Requests and Timeliness of EH Requests (Nov. 1, 2007).

11 Under a *de novo* standard of review, the Tax Court will consider all relevant evidence introduced at trial. *Jordan v. Comm'r*, 134 T.C. 1, 8 (2010).

12 The legislative history of RRA 98 addresses the standard of review courts should apply in reviewing Appeals' CDP determinations. H.R. Rep. No. 105-599, at 266. *See also* IRS Chief Counsel Notice CC-2014-002, Proper Standard of Review for Collection Due Process Determinations (May 5, 2014).

13 *See, e.g.*, *Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006); *Dalton v. Comm'r*, 682 F.3d 149 (1st Cir. 2012).

14 *See Kasper v. Comm'r*, 150 T.C. 8 at 19 n.13 (2018); *see also Keller v. Comm'r*, 568 F.3d 710, 718 (9th Cir. 2009), *aff'g* in part as to this issue T.C. Memo. 2006-166; *Murphy v. Comm'r*, 469 F.3d 27; *Robinette v. Comm'r*, 439 F.3d 455 (8th Cir. 2006), *rev'g* 123 T.C. 85 (2004).

15 *See* IRC § 7482(b)(1)(G)(i); *Rozday v. Comm'r*, 703 F. App'x. 138, 139 (3d Cir. 2017); *Tuka v. Comm'r*, 324 F. App'x 193, 195 n.2 (3d Cir. 2009); *Emery Celli Cuti Brinckerhoff & Abady, P.C. v. Comm'r*, T.C. Memo. 2018-55; *Robinette v. Comm'r*, 123 T.C. 85 at 103.

FIGURE 2.1.1[16]

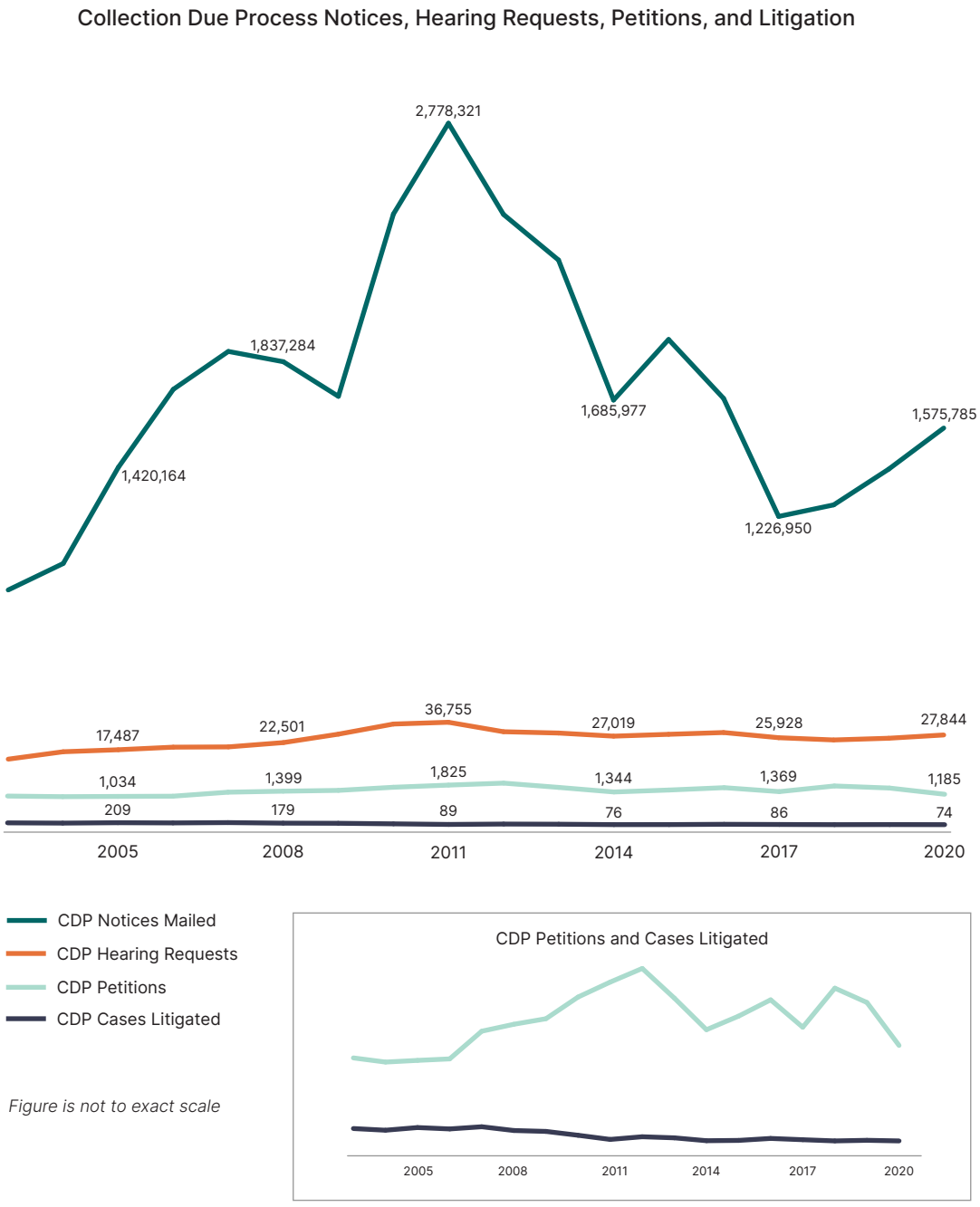


Figure is not to exact scale

16 IRS, Counsel Automated Tracking System and IRS, Compliance Data Warehouse (CDW), Individual Master File (IMF) Transaction History table for the period June 1 to May 31 for 2010 to 2020.

One of the reasons for this may be that the CDP notice format is confusing for taxpayers. For instance, Letter 1058, Final Notice, Notice of Intent to Levy and Notice of Your Right to a Hearing, is framed as a billing notice from the IRS.[17] The notice begins by informing the taxpayer about the amount due and requests payment. It is not until halfway down the first page that the taxpayer is informed about CDP hearings. The notice consists of several pages, so the key CDP paragraph may get missed. In addition, where to send the form may also be confusing to taxpayers. The hearing request must be sent (or hand delivered if permitted) to the office and address as directed on the CDP notice.[18] However, many CDP notices, such as Letter 1058, provide different addresses for responding with payment or a CDP hearing request. This is one source of confusion for taxpayers and led to missed filing deadlines.[19] The IRS recently changed its policy and will now accept as timely any CDP request received at any address on the CDP notice as long as it is postmarked before the deadline.[20] Another criticism of the CDP notices is that they do not explain to a taxpayer why CDP rights are important. The notices do not explain what a CDP hearing is, why a taxpayer would want to request one, and does not adequately explain equivalent hearings.[21]

While the CDP provisions have been in place for over 20 years, a number of questions still remain regarding the Tax Court's authority and jurisdiction in CDP cases. For example, it is not clear whether IRS administrative and mailing processes provide adequate notice to identify when the 30-day period to petition the court following receipt of a Notice of Determination begins. The IRS Office of Chief Counsel Directives Manual (CCDM) provides guidance on the settlement of docketed CDP cases. It provides that settlements through acceptance of a collection alternative such as a new offer in compromise or installment agreement where there has been no abuse of discretion by Appeals may be appropriate when it is necessary for the fair treatment of a taxpayer or when a lack of settlement could result in unfavorable legal precedent. Otherwise, the determination should be defended and the taxpayer should be encouraged to submit a collection alternative after the litigation is concluded.[22] However, the CCDM goes on to say that Counsel does not have the authority to directly accept collection alternatives from taxpayers on behalf of the IRS. If Counsel seeks to settle a docketed CDP case through a collection alternative, Counsel must request the assistance of the IRS to evaluate and accept or reject the proposed collection alternative.[23]

17 IRS, Letter 1058, Final Notice, Notice of Intent to Levy and Notice of Your Right to a Hearing (Dec. 2019).
18 Treas. Reg. § 301.6320-1(c)(2), Q & A (6). *See also* IRM 5.1.9.3.2(8), Request for CDP Hearing Rights (Aug. 30, 2018).
19 Treasury Inspector General for Tax Administration (TIGTA), Ref. No. 2020-10-054, *Review of the Independent Office of Appeals Collection Due Process Program* 6 (Aug. 21, 2020).
20 Office of Chief Counsel, Treatment of Incorrectly-Addressed CDP Hearing Requests, POSTS-113081-18 (Dec. 12, 2019); SB/SE, Interim Guidance for Collection Due Process (CDP) Requests, SBSE-05-0720-0049 (July 6, 2020).
21 National Taxpayer Advocate 2018 Annual Report to Congress 212-222 (Most Serious Problem: *Collection Due Process Notices: Despite Recent Changes to Collection Due Process Notices, Taxpayers Are Still at Risk for Not Understanding Important Procedures and Deadlines, Thereby Missing Their Right to an Independent Hearing and Tax Court Review*).
22 CCDM § 35.5.2.19 (3) (Aug. 6, 2019).
23 *Id.*

The IRS could be more selective with which taxpayers receive a CDP notice. TAS previously suggested that the IRS should adopt an algorithm that would compare its internal data on a taxpayer (assets and income) to the taxpayer's Allowable Living Expenses in order to detect if a taxpayer is at risk for economic hardship or could qualify for a collection alternative.[24] This approach could be used prior to deciding if a taxpayer should receive a CDP notice.

The low response rate will likely be complicated further by events related to the COVID-19 pandemic. On March 25, 2020, the IRS announced the People First Initiative, which provided much-needed relief to taxpayers, particularly by postponing compliance actions, which included the issuance of liens and levies.[25] In particular, the IRS directed that if the taxpayer's due date for requesting a CDP hearing fell on or after April 1, 2020, and before July 15, 2020, that due date was postponed to July 15, 2020.[26] Following the shelter-in-place order due to the COVID-19 pandemic, the IRS generated almost 20 million notices (including 47,497 CDP notices providing hearing rights for automated levies that already occurred), which were not mailed on time.[27] As a result, the notices mailed bore dates that passed, and some of the notices required taxpayers to respond by deadlines that also had passed.

TAS recommended the IRS communicate a revised deadline to request a CDP hearing that was 30 days after the IRS mailed out its backlogged CDP notices and include an insert to that effect. The IRS agreed to include Notice 1052-C, Important: You Have Additional Time to Appeal, with the backlogged CDP notices. However, 28,125 CDP notices were inadvertently sent without the insert providing the extended date, and so the IRS issued a subsequent letter to these taxpayers, providing 30 days from when the subsequent letter was sent.[28] As a result, we anticipate confusion for taxpayers who wonder whether their deadline to request a CDP hearing was based on the original CDP notice date, the date provided on the Notice 1052-C, or the date provided to some taxpayers in the subsequent letter; or if the taxpayer even understands the significance of this moving target, leaving some with the impression of a wrong date and not filing a CDP hearing request.[29]

24 National Taxpayer Advocate 2018 Annual Report to Congress 228-239 (Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*).

25 IRS, IR-2020-59, IRS Unveils New People First Initiative; COVID-19 Effort Temporarily Adjusts, Suspends Key Compliance Program (Mar. 25, 2020), https://www.irs.gov/newsroom/irs-unveils-new-people-first-initiative-covid-19-effort-temporarily-adjusts-suspends-key-compliance-program).

26 *See* IRS Notice 2020-23, 2020-18 I.R.B. 742.

27 IRS response to TAS information request (Nov. 24, 2020).

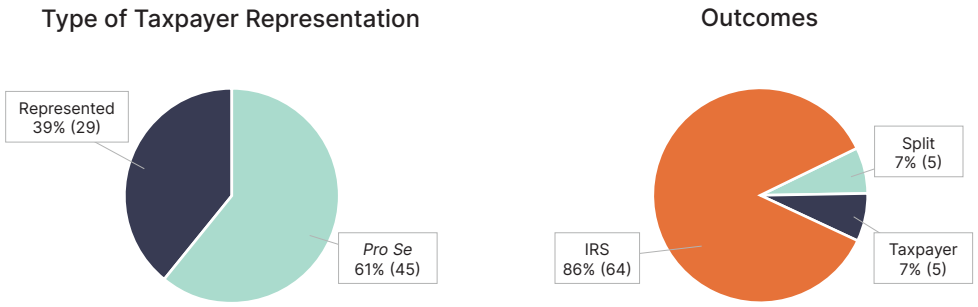
28 *Id.*

29 Some practitioners have already identified problems that could occur as a result of these backdated notices. For example, see Keith Fogg, *Sending Notices With Bad Dates*, Procedurally Taxing, https://proceduralltaxing.com/sending-notices-with-bad-dates/ (June 30, 2020).

ANALYSIS OF LITIGATED CASES

Taxpayers most often are not represented in CDP litigation, and in most cases the IRS prevails. During this reporting period there were seven cases brought by business taxpayers and 67 by individual taxpayers.

FIGURE 2.1.2[30]



We usually see a wide range of issues discussed in CDP hearings. This year's review is no different. For example, taxpayers used the CDP hearing process to contest penalties,[31] request collection alternatives,[32] and request interest abatement.[33]

CONCLUSION

CDP hearings play an important role in overall tax administration by allowing taxpayers to contest a lien or levy before (or soon after) the IRS takes the action. Petitioning the Tax Court allows for judicial review of how the IRS and Appeals are applying the law and following procedures. Oftentimes, the taxpayer does not prevail in a CDP hearing. One reason for this is because many cases are reviewed under the abuse of discretion standard,[34] or taxpayers do not fully develop their cases.[35] However, the analysis that judicial review provides is an important protection for our tax system and ensuring taxpayer rights.

Recommendations to Mitigate Disputes

The National Taxpayer Advocate recommends that:

1. The IRS should use its internal data pertaining to a taxpayer's income and assets compared to his or her Allowable Living Expenses to determine if a taxpayer is in economic hardship or qualifies for

30 Twenty-nine taxpayers appeared with representation and 45 had no representation. Of the 74 opinions issued, the taxpayers prevailed in five, the IRS prevailed in 64, and there was a split opinion in five cases, two of which were remanded.
31 *Kestin v. Comm'r*, 153 T.C. 14 (2019).
32 *See Gilmore v. Comm'r*, T.C. Memo. 2019-97.
33 *See Goldberg v. Comm'r*, T.C. Memo. 2020-38.
34 *See Brown v. Comm'r*, T.C. Memo. 2019-121.
35 *See Rockafellor v. Comm'r*, T.C. Memo. 2019-160.

a collection alternative, such as an offer in compromise, prior to issuing an intent to levy notice or NFTL.[36] Working with taxpayers ahead of time could negate the need for further collection action.

2. Revise CDP notices so that the CDP hearing aspect is a separate notice from the collection portion of the notice. Provide the taxpayer an understanding of what a CDP hearing is and why a taxpayer would want to request a CDP hearing.

36 *See* National Taxpayer Advocate 2018 Annual Report to Congress 228-239 (Most Serious Problem: *Economic Hardship: The IRS Does Not Proactively Use Internal Data to Identify Taxpayers at Risk of Economic Hardship Throughout the Collection Process*); National Taxpayer Advocate 2019 Annual Report to Congress 89-96 (Most Serious Problem: *Offer in Compromise: The IRS's Administration of the Offer in Compromise Program Falls Short of Congress's Expectations*).

Civil Actions to Enforce Federal Tax Liens or to Subject Property to Payment of Tax Under IRC § 7403

TAXPAYER RIGHTS IMPACTED[1]

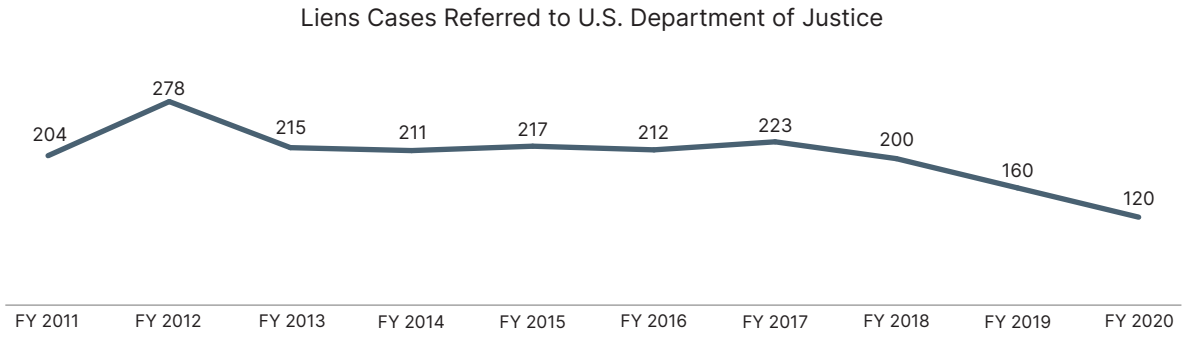
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Finality*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

OVERVIEW

IRC § 7403 authorizes the Department of Justice (DOJ) to bring a civil action to enforce a federal tax lien and to foreclose on taxpayer property, including a personal residence, to satisfy an outstanding tax liability. If the United States proves the lien is valid, the court will typically issue an order of sale that (1) authorizes the United States to foreclose on the taxpayer's subject property and (2) describes how the proceeds of sale should be distributed. In *Rodgers*, the Supreme Court held that courts have essentially no discretion to refuse to authorize a sale simply to protect the interest of the delinquent taxpayer.[2]

In fiscal year (FY) 2020, 120 federal tax lien cases were referred to the DOJ, down 25 percent from FY 2019. This continues a downward trend in referrals to the DOJ over the past four years.

FIGURE 2.2.1



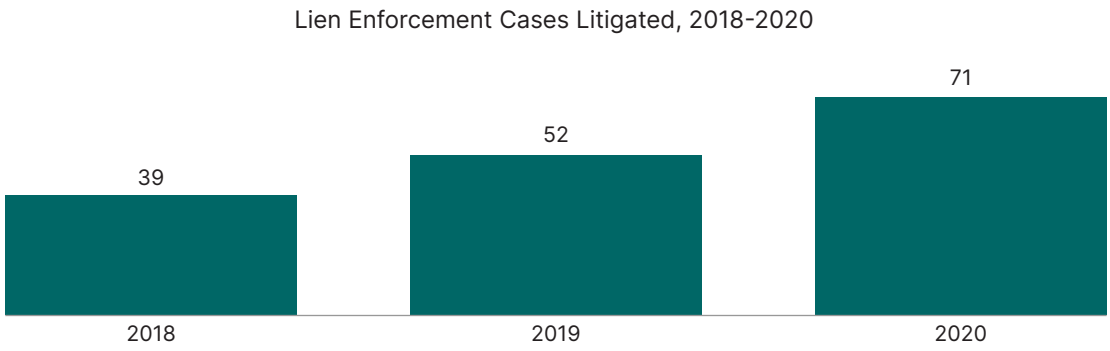
Oddly enough, the decreasing number of referrals to the DOJ have not correlated to the number of lien enforcement cases actually litigated in federal courts. During the reporting period from June 1, 2019, to May 31, 2020, we identified 71 opinions that involved civil actions to enforce liens under IRC § 7403. This represents a 37 percent increase from the 52 cases reported last year, and an 82 percent increase from the

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

2 *United States v. Rodgers*, 461 U.S. 677 (1983).

39 cases reported in the period ending May 2018. Perhaps we will see a decline in litigated cases in upcoming years, as there may be a lag due to the time it takes the DOJ to develop its lien enforcement cases. The higher percentage of lien enforcement cases referred to the DOJ that are actually litigated could also be an indication that the IRS is being more selective about referring cases to the DOJ for prosecution.

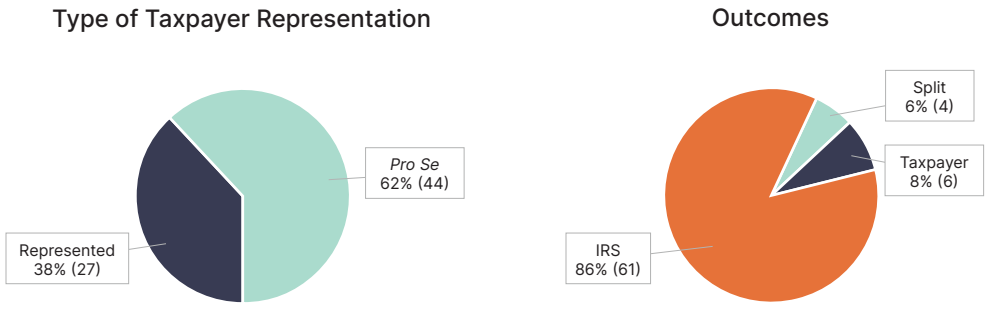
FIGURE 2.2.2



ANALYSIS OF LITIGATED CASES

Of the 71 lien enforcement cases adjudicated during the reporting period ending in May 2020, 44 (62 percent) taxpayers were unrepresented (*pro se*), while 27 (38 percent) were represented by counsel. Taxpayers prevailed in just six of the 71 lien enforcement cases. The IRS prevailed in 61 of these cases, with four cases resulting in split decisions where the IRS and taxpayers each prevailed in part.

FIGURE 2.2.3[3]



3 TAS identified seven lien enforcement cases where the taxpayer was unresponsive and there was no attorney of record as of the date of the court's opinion. Therefore, we categorized these cases as *pro se*. *See United States v. Harding*, 125 A.F.T.R.2d 1265 (E.D. Cal. 2020); *United States v. Bonadio*, 125 A.F.T.R.2d 2142 (N.D.N.Y. 2020); *United States v. Patchell*, 125 A.F.T.R.2d 642 (E.D.N.Y. 2020); *United States v. Anderson*, 2019 U.S. Dist. LEXIS 186951 (W.D. Wis. Sept. 24, 2019); *United States v. Clark*, 2019 U.S. Dist. LEXIS 127841 (D.S.C. July 9, 2019); *United States v. John*, 2020 U.S. Dist. LEXIS 30373 (E.D.N.Y. Feb. 20, 2020); *United States v. John*, 2020 U.S. Dist. LEXIS 36708 (E.D.N.Y. Mar. 2, 2020).

Ordering the sale of a taxpayer's property is a powerful collection tool and greatly impacts all parties who have an interest in the property subject to the lien. This is particularly true when the lien involves a taxpayer's personal residence. Among the 71 litigated cases this year, 32 involved the enforcement of a lien against a taxpayer's personal residence.

Lien enforcement litigation typically focuses on applying well-settled legal principles. For example, it may involve the application of the *Rodgers*[4] factors to determine whether there should be a forced sale when the property involves a third party without a federal tax debt. While such analysis may be fact-intensive, very few lien enforcement cases break new ground or add to the legal landscape under IRC § 7403 — and such was the case this year.

CONCLUSION

Lien enforcement cases are becoming an increasingly frequent source of litigation and often infringe on the rights of taxpayers and third parties. The National Taxpayer Advocate is concerned with the following aspects of the lien enforcement process:

First, seizure of a taxpayer's principal residence may have a devastating impact on the taxpayer and his or her family, especially if the taxpayer is at risk of economic hardship. Foreclosing on a home when a taxpayer is experiencing economic hardship runs contrary to a taxpayer's *right to a fair and just tax system*.[5] Congress intended that foreclosure of a principal residence should be the last resort.[6]

Second, Collection Due Process (CDP) notice and hearing procedures described in IRC §§ 6320 and 6330 are not extended to third parties who have an interest in property subject to an IRC § 7403 lien enforcement. This deprives these affected third parties of the *right to challenge the IRS's position and be heard* prior to a lien enforcement suit. Allowing affected third parties to raise defenses and propose collection alternatives in a CDP hearing could help reduce litigation by resolving these issues earlier.[7]

The National Taxpayer Advocate had included recommendations to address both of these concerns in her Purple Book.[8] At the recommendation of the Office of the Taxpayer Advocate, the IRS has written procedures into its Internal Revenue Manual (IRM) that provide substantial taxpayer protections before a case may be

4 *United States v. Rodgers*, 461 U.S. 677 (1983).

5 National Taxpayer Advocate 2020 Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 46-47 (*Provide Taxpayer Protections Before the IRS Recommends the Filing of a Lien Foreclosure Suit on a Principal Residence*).

6 The Senate Finance Committee report stated that the seizure of the taxpayer's principal residence "should only be seized to satisfy a tax liability as a last resort." S. Rep. No. 105-174, at 86-87 (1998).

7 National Taxpayer Advocate 2021 Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 47-48 (*Provide Taxpayer Protections Before the IRS Recommends the Filing of a Lien Foreclosure Suit on a Principal Residence*).

8 The National Taxpayer Advocate has submitted these recommendation in her 2020 Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 46-47 (*Provide Taxpayer Protections Before the IRS Recommends the Filing of a Lien Foreclosure Suit on a Principal Residence*) and the 2021 Purple Book: *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 47-48 (*Provide Taxpayer Protections Before the IRS Recommends the Filing of a Lien Foreclosure Suit on a Principal Residence*).

referred to the DOJ for the filing of a lien foreclosure suit.[9] However, the IRM is simply a set of instructions to IRS staff, without the force of law, and may be modified or rescinded by the IRS at any time.

Recommendations to Mitigate Disputes

The National Taxpayer Advocate recommends that:

1. Congress amend IRC § 7403 to preclude IRS employees from requesting that the DOJ file a civil action in U.S. District Court seeking to enforce a tax lien and foreclose on a taxpayer's principal residence, unless the employee has determined that (1) the taxpayer's other property or rights to property, if sold, would be insufficient to pay the amount due, including the expenses of the proceedings, and (2) the foreclosure and sale of the residence would not create an economic hardship due to the financial condition of the taxpayer.
2. Congress amend IRC §§ 6320 and 6330 to extend CDP rights to "affected third parties" who hold legal title to property subject to IRS collection actions.

9 *See, e.g.*, IRM 5.17.4.8.2.5, Lien Foreclosure on a Principal Residence (May 23, 2019); IRM 5.17.12.20.2.2.4, Additional Items for Lien Foreclosure of Taxpayer's Principal Residence (May 24, 2019); IRM 25.3.2.4.5.2(3), Actions Involving the Principal Residence of the Taxpayer (May 29, 2019).

Accuracy-Related Penalty Under IRC § 6662(b)(1) and (b)(2)

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

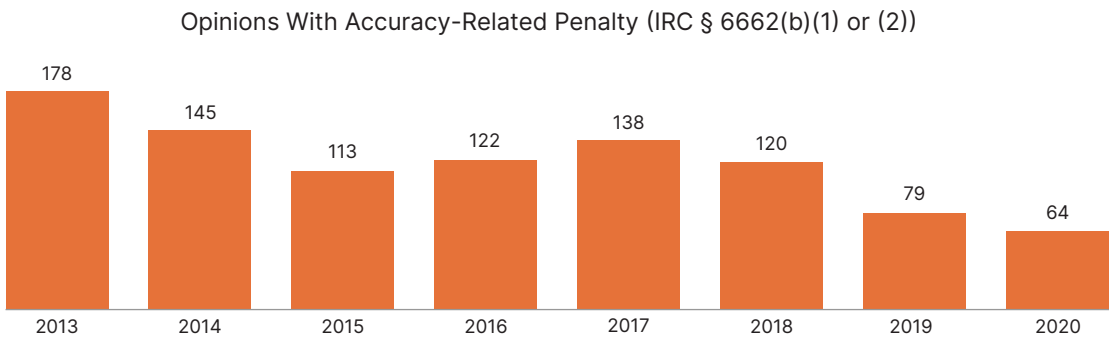
OVERVIEW

The accuracy-related penalty is frequently one of the most litigated tax issues. This penalty may be imposed if the taxpayer's negligence or disregard of rules or regulations causes an underpayment of tax required to be shown on the taxpayer's return,[2] or if an underpayment exceeds a computational threshold called a substantial understatement.[3] The accuracy-related penalty does not apply to any portion of an underpayment where the taxpayer acted with reasonable cause and in good faith.[4] Additionally, the supervisor of the employee making the penalty determination generally must provide written approval of the accuracy-related penalty before the "initial determination of such assessment."[5] There is an exception to the written supervisory approval requirement if the penalty was automatically calculated through electronic means.[6]

Much of the accuracy-related penalty litigation this year and in previous years has focused on either whether the taxpayer met the reasonable cause exception or whether the IRS failed to secure timely supervisory approval. Still, the overall number of accuracy-related penalty cases has been declining, as shown in Figure 2.3.1.[7] We identified only 64 opinions issued between June 1, 2019, and May 31, 2020, where taxpayers litigated the negligence or substantial understatement components of the accuracy-related penalty. During this same period, taxpayers petitioned Tax Court in 569 cases where the accuracy-related penalty for negligence or substantial understatement of tax was an issue during the examination.[8]

1 *See* Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the IRC. *See* IRC § 7803(a)(3).
2 IRC § 6662(b)(1).
3 IRC § 6662(b)(2).
4 IRC § 6664(c)(1).
5 IRC § 6751(b)(1).
6 IRC § 6751(b)(2).
7 The periods in the figure refer to a one-year period ending on May 31 of each year.
8 IRS Appeals response to TAS information request (Dec. 3, 2020) showing cases petitioned to Tax Court between June 1, 2019 and May 31, 2020. TAS matched this data to the cases identified by examination where the accuracy penalty was recommended as recorded in the Examination Operational Automation Database on the IRS, Compliance Data Warehouse (Dec. 2020).

FIGURE 2.3.1



Taxpayers were more successful in challenging the accuracy-related penalty in smaller dollar cases. Where taxpayers prevailed in full or in part (30 percent of all cases), the average amount of the penalty in controversy was about $61,000; whereas in cases where the IRS prevailed, the average amount was about $317,000.[9] Almost two-thirds of the accuracy-related penalty cases involved business taxpayers, including 27 sole proprietorships, eight C corporations, six partnerships, and one S corporation. In 17 cases, the penalty was asserted based on negligence, in 23 cases it was asserted due to a substantial understatement, and in 15 cases on both grounds.[10]

ANALYSIS OF LITIGATED CASES

In past reports, we have discussed the significant controversy over the IRS's compliance with the IRC § 6751(b) supervisory approval requirement.[11] Of the 19 opinions this year where taxpayers prevailed in full or in part, only five (26 percent) were due to the IRS's failure to obtain written supervisory approval as required. This is a significant decrease from last year, where 19 of the 27 opinions where taxpayers prevailed in full or in part (70 percent) were due to the IRS's failure to comply with the requirement. This decrease could be due to prior court opinions and the increased attention by the IRS to documenting supervisory approval prior to communicating the penalties to the taxpayer in writing,[12] or the IRS Office of Chief Counsel guidance advising its attorneys to concede cases where the IRS does not have sufficient evidence to show compliance with IRC § 6751(b).[13]

TAS recommended that the IRS and the Department of Treasury add a guidance project concerning the supervisory approval requirement in IRC § 6751(b) to the list of priority guidance for 2020-2021. Although guidance on IRC § 6751(b) was not included in the joint IRS and Department of Treasury Priority Guidance Plan for 2019-2020, the Office of Management and Budget (OMB) included in its unified agenda a proposal for guidance. OMB's proposal would require the supervisory approval to occur before the IRS sends a written

9 The amounts in controversy ranged from $618 to $8,313,303. Of the 64 cases, only 50 of the cases stated the amount of the accuracy-related penalty that was in controversy and the averages in the text reflect only those 50 cases.

10 In nine opinions, the basis for the accuracy-related penalty was not stated.

11 *See Chai v. Comm'r*, 851 F.3d 190 (2d Cir. 2017); *Graev v. Comm'r*, 149 T.C. 485 (2017), *supplementing and overruling in part* 147 T.C. 460 (2016).

12 *See* Internal Revenue Manual (IRM) 20.1.5.2.3.1, Documenting Supervisory Approval of Penalties (Apr. 22, 2019).

13 *See* IRS Chief Counsel Notice, Section 6751(b) Compliance Issues for Penalties in Litigation, CC-2018-006 (June 6, 2018).

communication that includes the penalty and offers appeal rights.[14] In 2020, the IRS updated the Internal Revenue Manual (IRM) to instruct employees to obtain written supervisory approval before sending a written communication that offers the taxpayer an opportunity to sign an agreement or consent to an assessment of the penalty, or request a conference with the IRS Independent Office of Appeals.[15] The IRM specifies that prior to obtaining supervisory approval, employees can share written communications with the taxpayer reflecting proposed adjustments as long as they do not offer the opportunity to sign an agreement or consent, or request an Appeals conference.

This year, we noted only one case where the court found the IRS did not have to obtain supervisory approval because the penalty was automatically calculated through electronic means.[16] However, the concern remains that the IRS continues to use electronic means to calculate negligence for the accuracy-related penalty and assert it with no human review of the computer's negligence determination.[17]

Key Decisions

The vast majority of the cases we reviewed this year mentioned the IRC § 6751(b) requirement, whether to document compliance, discuss whether the record should be reopened for the IRS to demonstrate compliance, or explain why the IRS did not have the burden to demonstrate such compliance. The key decisions we discuss below are all significant because they address novel issues related to IRC § 6751(b).

Belair Woods, LLC v. Commissioner[18]

This case is significant because the court declined to require supervisory approval before the first time the IRS communicated the penalties to the taxpayer in writing. The case draws a new line between what is deemed a mere proposal and what is a final decision to assert the penalties.

The revenue agent sent the taxpayer a summary report of proposed adjustments along with Letter 1807, TEFRA Partnership Cover Letter for Summary Report, and invited the taxpayer to a closing conference to discuss the proposed adjustments, including accuracy-related penalties. After two conferences with no agreement, the revenue agent obtained supervisory approval of the penalties and issued a 60-day letter offering appeal rights. The court found the Letter 1807 and summary report with the tentative proposed adjustments did not trigger the supervisory approval requirement, but the subsequent 60-day letter did. The court reasoned that the 60-day letter was akin to a 30-day letter in *Clay v. Commissioner*[19] in that it formally communicated the IRS's definite decision to assert the penalties and gave appeal rights.[20] In rejecting the taxpayer's argument, the court noted: "The statute requires approval for the initial determination of a penalty assessment, not for a tentative proposal or hypothesis."[21]

14 Office of Information and Regulatory Affairs, Office of Management and Budget, Rules for Supervisory Approval of Proposed Penalties, RIN 1545-BP63 (Spring 2020).
15 Memorandum from Director, Examination Field and Campus Policy, to Area Directors, Field Examination, SBSE-04-0920-0054 (Sept. 24, 2020).
16 *Purdie v. Comm'r*, T.C. Summ. Op. 2020-6.
17 *See* IRM 4.19.3.22.1.4, Accuracy-Related Penalties (Sept. 21, 2020).
18 154 T.C. No. 1, 2020 WL 58313 (Jan. 6, 2020). Although we reviewed this case, it was not included in the count of 64 opinions we reported because it was not a final decision on the merits of the accuracy-related penalty. However, because of the significance of this summary judgment opinion on the IRC § 6751(b) issue, it warrants a discussion here.
19 152 T.C. 223 (2019).
20 154 T.C. No. 1, 2020 WL 58313, at *5 (Jan. 6, 2020) (citing IRM 8.19.1.6.8.4(3) (Oct. 1, 2013)).
21 154 T.C. No. 1, 2020 WL 58313, at *5 (Jan. 6, 2020).

Frost v. Commissioner[22]

In an issue of first impression, the Tax Court established that once the IRS proves supervisory approval before a formal written communication (here the notice of deficiency), the IRS has met its initial burden of production and does not need to show there were no prior formal communications about the penalty. This holding could create difficulty for taxpayers who have misplaced or did not retain all IRS written communications and cannot prove a prior communication.[23]

The IRS disallowed the taxpayer's business expense deductions and asserted the accuracy-related penalty during an examination. The IRS provided a Civil Penalty Approval Form, which was signed over a year before the IRS issued the notice of deficiency. The court found the IRS only had to show it had supervisory approval before issuing the notice of deficiency, and it would not require the IRS to prove a negative (*i.e.*, the absence of any prior formal communications). It noted that evidence of prior formal communication would be available to the taxpayer since the taxpayer would have received it.

Wells Fargo & Company v. Commissioner[24]

The Eighth Circuit's opinion included two significant holdings: (1) taxpayers must show actual reliance on a relevant authority to show reasonable basis, and (2) written supervisory approval is not required for penalties that merely reduce a taxpayer's refund. The first holding has broad implications for attorney-client privilege as attorneys could be forced to disclose opinions given to taxpayers to show the taxpayer knew about the relevant authority. The second holding exposes a loophole in the IRC § 6751(b) supervisory approval requirement because the IRS can assert penalties without supervisory approval as long as the penalties only reduce a refund and do not result in an assessment.

The taxpayer entered into a "structured trust advantaged repackaged securities" (STARS) transaction. After the IRS disallowed the foreign tax credits and interest deduction, the taxpayer paid the deficiency and filed a refund suit. The IRS first asserted the accuracy-related penalty in litigation. The United States Court of Appeals for the Eighth Circuit affirmed the lower court's ruling that a portion of the STARS transaction was a sham. The taxpayer argued that it should not be liable for an accuracy-related penalty because it had a reasonable basis for the transaction since its return position was objectionably reasonable under the relevant authorities. However, the Eighth Circuit held that it was not enough to show the return position was reasonable when considering the authorities. The taxpayer must provide evidence that it actually knew about the relevant authorities and relied on them. Because the taxpayer could not provide such evidence, it did not establish that it had a reasonable basis for its position.

Concerning the supervisory approval requirement, the Eighth Circuit concluded that the supervisory approval requirement in IRC § 6751(b) did not apply because approval is only required if the penalties are eventually assessed. In this case, the penalty was never assessed by a revenue agent during an exam or proposed by the IRS in a notice of deficiency but was first raised by the government in litigation as an offset defense to the taxpayer's

22 154 T.C. No. 2, 2020 WL 70716 (Jan. 7, 2020).

23 The burden on taxpayers who have misplaced IRS communications would be alleviated if the IRS were to make all notices and correspondence accessible in taxpayers' online accounts. *See* Most Serious Problem: *Online Records Access: Limited Electronic Access to Taxpayer Records Through an Online Account Makes Problem Resolution Difficult for Taxpayers and Results in Inefficient Tax Administration*, *supra*.

24 957 F.3d 840 (8th Cir. 2020), *aff'g* 260 F.Supp.3d 1140 (D. Minn. 2017).

claim for refund. As a result, the penalty would never be assessed or collected by the IRS. The court noted that procedural requirements are generally relaxed when a penalty is asserted as a refund offset defense.

CONCLUSION

This year, we saw a continued decrease in accuracy-related penalty cases. Although the requirement for written supervisory approval continues to be a hotly-contested issue, there was a noticeable drop in the percentage of taxpayers who prevailed. Nonetheless, legislative changes and regulatory guidance could mitigate future disputes by clarifying exactly when the supervisory approval is required. Additionally, legislation could protect taxpayers' rights by requiring supervisory approval not only in cases where a penalty is assessed, but also where it is included in a final judicial decision. Legislation could also ensure that where the IRS proposes the accuracy-related penalty for negligence based on a computer calculation, a supervisor has reviewed to ensure the penalty is appropriate. The IRS could also accomplish this last objective administratively by ending its practice of relying solely on a computer program to determine negligence.

Recommendations to Mitigate Disputes

The National Taxpayer Advocate recommends that Congress:[25]

1. Amend IRC § 6751(b)(1) to clarify that no penalty under Title 26 shall be assessed or entered in a final judicial decision unless the penalty is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate *prior to the first time the IRS sends a written communication to the taxpayer proposing the penalty as an adjustment*.
2. Amend IRC § 6751(b)(2)(B) to clarify that the exception for "other penalties automatically calculated through electronic means" does not apply to the negligence penalty under IRC § 6662(b)(1).

The National Taxpayer Advocate recommends that the IRS:

1. Issue regulatory guidance to clarify that the supervisory approval under IRC § 6751(b) must occur prior to the first time the IRS sends a written communication to the taxpayer proposing the penalty as an adjustment.
2. Update its IRM to clarify that where the IRS uses a computer program to determine the accuracy-related penalty based on negligence, an IRS employee must first contact the taxpayer and review the facts and circumstances prior to determining the applicability of the negligence penalty and the IRS must obtain supervisory approval to ensure the penalty is appropriate prior to assertion of the penalty, consistent with the Memorandum from Director, Examination Field and Campus Policy, to Area Directors, Field Examination, SBSE-04-0920-0054 (Sept. 24, 2020).

25 The National Taxpayer Advocate has submitted these recommendations in her 2021 Purple Book, *Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration* 68-70 (*Clarify That Supervisory Approval Is Required Under IRC § 6751(b) Before Proposing Penalties*) and 71-72 (*Require an Employee to Determine Require an Employee to Determine and a Supervisor to Approve All Negligence Penalties Under IRC § 6662(b)(1)*).

Trade or Business Expenses Under IRC § 162

TAXPAYER RIGHTS IMPACTED[1]

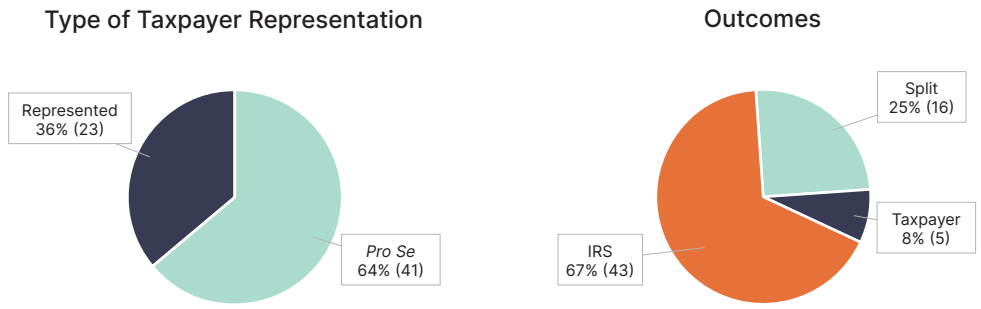
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

OVERVIEW

Trade or business deductions have been among the most litigated issues ever since TAS started tracking such activity. This litigation typically focuses on the application of well-settled legal principles and exhaustively articulated statutes and regulations to taxpayers' particular facts and circumstances. In most years, very few cases break new ground or add to the legal landscape regarding deductibility of trade or business expenses under IRC § 162. Such was the case again this year.[2]

By and large, the 64 opinions we reviewed involved unrepresented taxpayers (*pro se*) and the IRS prevailed in the overwhelming number of cases. During this same period, taxpayers petitioned Tax Court in 6,956 cases where trade or business expenses were an issue during the examination.[3]

FIGURE 2.4.1[4]



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

2 TAS analyzed cases decided during the period beginning on June 1, 2019, and ending on May 31, 2020.

3 IRS Appeals response to TAS information request (Dec. 3, 2020) showing cases petitioned to Tax Court between June 1, 2019 and May 31, 2020. TAS matched this data to the cases identified by examination where an adjustment to trade or business expenses was recommended as recorded in the Examination Operational Automation Database on the IRS Compliance Data Warehouse (Dec. 2020).

4 Of the cases analyzed by TAS, 41 involved unrepresented taxpayers, while 23 involved taxpayers with representation. The IRS fully prevailed in 43 cases, while taxpayers fully prevailed in five. The remaining 16 opinions were split between the two litigants based upon their specific facts.

ANALYSIS OF LITIGATED CASES

IRC § 162 and related Code sections give rise to litigation in a variety of areas. This year, the cases present the following issues.

FIGURE 2.4.2, Trade or Business Expense Issues[5]

Issue	Type of Taxpayer	
	Individual	Business
Substantiation of Expenses Under IRC § 162, Including Application of the *Cohan* Rule	3	27
Deductibility of IRC § 162 Expenses	1	7
Substantiation of Expenses Under IRC § 274(d)	1	20
Schedule A Unreimbursed Employee Expenses Requiring Proof Employer Did Not Reimburse Taxpayer Under IRC § 162	4	6
Hobby Losses, Nondeductible Under Either IRC §§ 183 or 162	0	7
Home Office Under IRC § 280A	0	4
Net Operating Losses Under IRC § 172	1	5
Personal Expenditures Disallowed Under IRC § 262	0	4
Capitalization and Cost Recovery Under IRC §§ 263, 263A, 195, 179, and 167	2	8
Illegal Activities Under IRC §§ 280E, 162(c), 162(f), and 162(g)	0	1
Economic Substance Doctrine	0	2
Business Bad Debt Deduction Under IRC § 166	0	7
Not Engaged in a Trade or Business Under IRC § 162	0	4
Interest Deduction Under IRC § 163	0	0

Generally, the case law in this area is based upon the taxpayer's specific facts and supporting evidence. Although this is a well-settled area of the law, cases are litigated on a reoccurring basis and span many different fact patterns. Key opinions providing new insights or revised precedents rarely are handed down. This year is no exception. However, controversy and confusion continue to arise regarding the deductibility of expenses incurred by medical marijuana dispensaries. Such dispensaries are prohibited by federal law, but legal under the laws of many states. Moreover, IRC § 280E specifies that no trade or business deductions are allowed for any business engaged in trafficking in substances that are illegal under federal law.[6]

In *N. Cal. Small Bus. Assistants, Inc. v. Commissioner*,[7] the Taxpayer contended that, even if IRC § 280E bars IRC § 162 deductions, that prohibition does not extend to other deductions from related Code sections,

5 Multiple issues may appear within one case; therefore, these figures exceed the total case count.

6 IRC § 280E states: "No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted."

7 *N. Cal. Small Bus. Assistants, Inc. v. Comm'r*, 153 T.C. 65 (2019).

such as IRC § 167 depreciation.[8] The Tax Court, however, consistent with other recent opinions, held that the IRC § 280E language was extremely broad and operated to deny deductions attributable to all marijuana dispensary operations.[9]

CONCLUSION

As witnessed by the IRS's success in litigating controversies regarding IRC § 162 trade or business deductions, most opinions in this area resulted either from taxpayer confusion regarding the applicable legal requirements or from taxpayers' occasional attempts to push the envelope. The case law, however, is well established and the statutory and regulatory guidance is exhaustive, if occasionally unduly complex.

As long as marijuana falls within schedules I or II of the Controlled Substances Act,[10] while being legal within many states, the deductibility of dispensary expenses will continue to generate controversy. Congress could consider minimizing future litigation by removing marijuana from schedule I so that businesses legally selling marijuana would not face the challenges and complexities that currently lead to most of the federal income tax litigation in this area.[11]

8 The taxpayer also raised constitutional and statutory arguments that the Tax Court found unpersuasive.
9 *See, e.g., Patients Mut. Assistance Collective Corp. v. Comm'r*, 151 T.C. 176 (2018).
10 *See* 21 U.S.C. Chapter 13. The schedules of controlled substances are located at 21 U.S.C. § 812(b).
11 Specifically, marijuana would need to be listed on neither schedule I nor schedule II for deductions in this area to be permissible.

Gross Income Under IRC § 61

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

OVERVIEW

Section 61(a) of the IRC defines gross income as "all income from whatever source derived." The income covered by IRC § 61 includes, but is not limited to, compensation for services, income from business activities, and income from dealings in property.

TAS has monitored the most litigated issues for the last 20 years, and controversies involving what constitutes gross income have always been at or near the top of this list.[2] Litigation is often attributable to disagreements regarding what constitutes accessions to wealth, taxable as income under IRC § 61. Likewise, controversies arise regarding the scope of specific statutory exclusions from gross income. In most years, very few cases break new ground or add to the legal landscape under IRC § 61. Such was the case again this year.[3]

By and large, the 62 opinions we reviewed involved unrepresented taxpayers (*pro se*) and the IRS prevailed in an overwhelming majority of cases. During this same period, taxpayers petitioned Tax Court in 3,771 cases where gross income was an issue during the examination.[4]

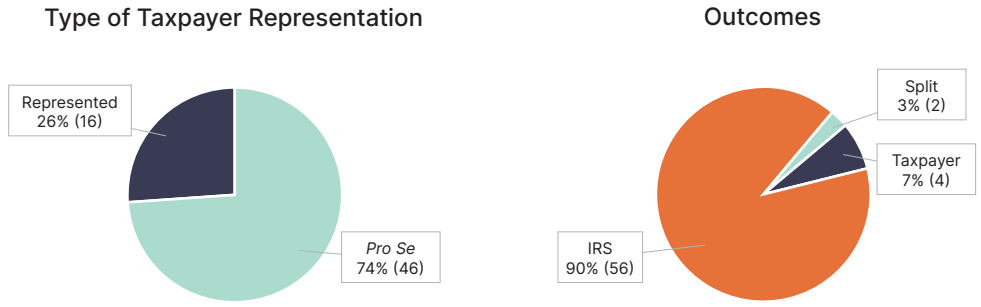
1 *See* Taxpayer Bill of Rights (TBOR), www.TaxpayerAdvocate.irs.gov/taxpayer-rights. The rights contained in the TBOR are also codified in the IRC. *See* IRC § 7803(a)(3).

2 National Taxpayer Advocate 2000 Annual Report to Congress 70.

3 TAS analyzed cases handed down during the period beginning on June 1, 2019, and ending on May 31, 2020.

4 IRS Appeals response to TAS information request (Dec. 3, 2020) showing cases petitioned to Tax Court between June 1, 2019, and May 31, 2020. TAS matched this data to the cases identified by examination where an adjustment to gross income was recommended as recorded in the Examination Operational Automation Database on the IRS Compliance Data Warehouse (CDW) (Dec. 2020). TAS also matched this data to the Individual Master File (IMF) transaction history table on CDW which showed an additional 4,350 taxpayers petitioned Tax Court as a result of changes recommended during the Automated Under Reporter process.

FIGURE 2.5.1[5]



ANALYSIS OF LITIGATED CASES

IRC § 61 and related sections give rise to litigation in a variety of areas. Figure 2.5.2 shows the issues from this year's cases.

FIGURE 2.5.2, Gross Income Issues[6]

Issue	Type of Taxpayer	
	Individual	Business
Unreported income	10	20
Income includible/excludible	5	6
Income from retirement sources	9	0
Frivolous arguments outside of IRC § 6702	4	2
Foreign earned income exclusion under IRC § 911	4	0
Settlement proceeds/damages under IRC § 104(a)(2)	1	1
Parsonage exclusion under IRC § 107(2)	0	1
Tax benefit rule under IRC § 111	1	0
Cancellation of debt under IRC § 108	2	1
Cost of goods sold	0	2

5 In this year's gross income cases identified by TAS, 46 involved unrepresented taxpayers, while 16 involved taxpayers with representation. The IRS fully prevailed in 56 cases, while taxpayers fully prevailed in four. The remaining two opinions resulted in split opinions. TAS has increased the percentage of cases where the taxpayer prevailed from 6.45 percent to seven percent for Figure 2.5.1 so that the pie chart shows 100 percent.

6 Multiple issues may appear within one case; therefore, these figures exceed the total case count. For purposes of categorizing issues, we look to the specific contentions raised by taxpayers and analyzed by the courts. If, for example, a taxpayer's basis for exclusion is a particular code section, then we would reflect the issue accordingly. By contrast, if the discussion primarily involved conceptual or infrequently occurring legal arguments, these contentions would fall into the "income includible/excludible" category. Finally, if taxpayers failed to report gross income in the first instance and then did not articulate a legal position to support that failure, such cases would be grouped as "unreported income."

As shown in Figure 2.5.2, many issues arise on a reoccurring basis. The case law is sufficiently well-settled and spans so many different fact patterns, however, that key opinions providing new insights or revised precedents are rarely decided. Such was the case this year and, although a number of the opinions make for fascinating reading, we have not identified any that call for separate analysis here.

CONCLUSION

As witnessed by the IRS's success, most opinions in this area resulted either from taxpayer confusion regarding the applicable legal requirements or from taxpayers' occasional attempts to push the envelope. As a result, the National Taxpayer Advocate has no specific recommendations in this area.

Summons Enforcement Under IRC §§ 7602, 7604, and 7609

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to Privacy*
- *The Right to a Fair and Just Tax System*

OVERVIEW

Pursuant to IRC § 7602, the IRS may examine any books, records, or other data relevant to an investigation of a civil or criminal tax liability.[2] To obtain this information, the IRS may serve a summons directly on the subject of the investigation or any third party who may possess relevant information.[3] If a person summoned under IRC § 7602 neglects or refuses to obey the summons; to produce books, papers, records, or other data; or to give testimony as required by the summons, the IRS may seek enforcement of the summons in a U.S. district court.[4] A person who has a summons served upon him or her may contest the legality of the summons in a U.S. district court if the government petitions the court to enforce it.[5] Also, if the summons is served upon a third party, any person entitled to notice may petition to quash the summons in the appropriate district court, and may intervene in any proceeding regarding the enforceability of the summons.[6]

TAS used commercial legal research databases to identify 40 federal opinions issued between June 1, 2019, and May 31, 2020, involving IRS summons enforcement and related issues. For the purposes of this section of the National Taxpayer Advocate's Annual Report to Congress, the term "litigated" means cases in which the court issued an opinion.[7] The summons enforcement cases reviewed involved requesting taxpayer records directly from a taxpayer or a third party, such as a financial institution. Of these 40 opinions reviewed, seven cases applied the standards for summons enforcement set forth in *United States v. Powell,*[8] five cases involved the assertion of a privilege by the taxpayer, and two cases involved the issuance of a John Doe summons

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

2 IRC § 7602(a)(1); Treas. Reg. § 301.7602-1.

3 IRC § 7602(a).

4 IRC § 7604(b) (providing that if any taxpayer or third party is summoned to appear, testify or produce records, the United States District Court for the district in which the taxpayer resides or is found has jurisdiction to compel the taxpayer or third party to appear, testify or produce the records). Summons enforcement cases are different from many other cases described in other Most Litigated Issues because often the government, rather than the taxpayer, initiates the litigation. However, regardless of whether the taxpayer initiates the litigation via a motion to quash a summons that was served upon him or her or in response to the United States' petition to enforce a summons, the legal standard is the same. *Villarreal v. U.S.*, 111 A.F.T.R.2d (RIA) 778 (D. Nev. 2013), *aff'g* 110 A.F.T.R.2d (RIA) 6777 (D. Colo. 2012).

5 IRC § 7604(b). *See also U.S. v. Powell*, 379 U.S. 48, 58 (1964).

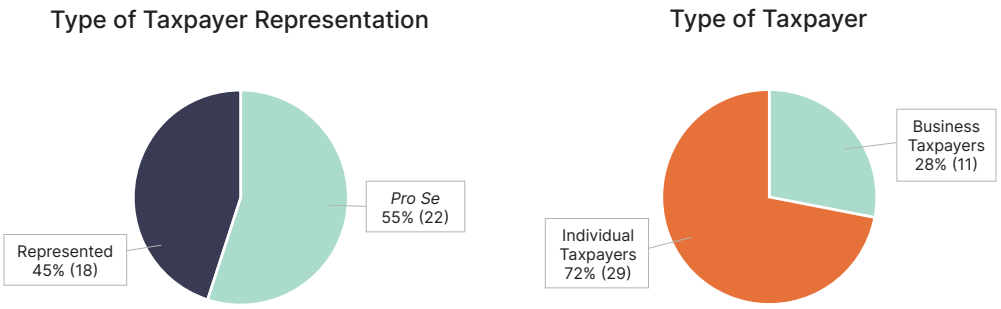
6 IRC § 7609(b).

7 We recognize that many cases are resolved before the court issues an opinion. Some taxpayers reach a settlement with the IRS before trial, while the courts dismiss other taxpayers' cases for a variety of reasons, including lack of jurisdiction and lack of prosecution. Additionally, courts can issue less formal "bench opinions," which are not published or precedential.

8 *United States v. Powell*, 379 U.S. 48 (1964). To be enforceable, the IRS must show: 1) that the investigation was conducted pursuant to a legitimate purpose; 2) that the inquiry is relevant to the purpose; 3) that the information sought is not in possession of the IRS; 4) that all administrative steps required have been followed; and 5) that the summons was not issued for an improper purpose such as harassment, pressuring a taxpayer to settle a collateral dispute or other purpose adversely reflecting on good faith. *Id.* at 57-58.

under IRC § 7609(f) (where the taxpayer(s) under investigation is not specifically identified or is unknown).[9] Furthermore, six of the 40 cases were appeals decided by a United States Court of Appeals. Twenty-nine of the opinions involved individual taxpayers, while 11 involved business taxpayers as demonstrated in Figure 2.6.1. Furthermore, most taxpayers were not represented by counsel (*i.e.*, they were *pro se*), also shown in Figure 2.6.1. The government filed a petition to enforce the summons in 19 cases, while the taxpayer initiated by filing a petition to quash the summons in 21 cases. Overall, no taxpayers fully prevailed, but one case resulted in a partial taxpayer win with a split decision.[10]

FIGURE 2.6.1[11]



In fiscal year (FY) 2020, at least 433 summons cases were in the Office of Chief Counsel's inventory.[12] In general, the Department of Justice (DOJ) handles motions to quash summons (the U.S. is listed as a defendant), and the U.S. Attorneys' Offices handle suits to enforce the summons (the U.S. is listed as a plaintiff). A total of 34 cases were referred to DOJ in FY 2020.[13] Subtracting those 34 from the total inventory, that means 399 cases were handled by U.S. Attorneys' Offices. Many summons are complied with and do not require court enforcement (as demonstrated by the relatively small number of summons enforcement court cases TAS identified for the period June 1, 2019, through May 31, 2020).

9 Under IRC § 7609(f), as amended, the IRS may issue a John Doe summons if it can establish: 1) that the summons relates to the investigation of a particular person or ascertainable group or class of persons; 2) there is a reasonable basis for believing such person or group or class may fail or may have failed to comply with the internal revenue laws; and, 3) that the name(s) of the unidentified taxpayer(s) is not readily available from other sources. IRC § 7609(f). *See also United States v. Bisceglia*, 420 U.S. 141 (1975) (often referred to as the "case of the moldy money").

10 *See Williams Dev. & Constr., Inc. v. United States*, 124 A.F.T.R.2d (RIA) 6976 (D.S.D. 2019) (limiting the scope of one of the thirteen third-party summonses to certain limited documents while enforcing the rest of the summonses in full).

11 In the forty opinions analyzed by TAS, taxpayers were unrepresented in 22 of the cases. Due to rounding issues, the percentage of business taxpayers was rounded from 27.5 percent to 28 percent while the number of individual taxpayers was rounded from 72.5 percent to 72 percent.

12 Data compiled by the IRS Office of Chief Counsel (Dec. 2, 2020).

13 Data provided by DOJ to the IRS Office of Chief Counsel (Nov. 9, 2020).

ANALYSIS OF LITIGATED CASES

In a summons enforcement action, the IRS bears the initial burden of establishing that the requirements for issuing a summons have been satisfied.[14] The IRS meets its burden by providing a sworn affidavit of the IRS agent who issued the summons.[15] The burden then shifts to the person contesting the summons to demonstrate that the IRS did not meet the requirements, or that enforcement of the summons would be an abuse of process.[16] This year's opinions simply applied the rules to new fact patterns.

The number of summons enforcement opinions have been declining as mirrored by the decrease in total IRS tax law enforcement and litigated cases.[17] Another contributing factor to this decline may be related to the gradual reduction in IRS examinations since 2010.[18] As noted above, TAS identified 40 opinions this year, down from 60 last year, and 85 the year before.[19] In addition, the additional taxpayer protections to the summons rules added by the Taxpayer First Act (TFA), coupled with the COVID-19 pandemic, may have had an impact on the decline of summons enforcement cases as well.[20] Under the TFA, the IRS must narrowly tailor the information sought in a John Doe summons, take additional steps before issuing a designated summons, and give taxpayers 45 days advance notice if it intends to contact third parties.[21]

CONCLUSION

The IRS may issue a summons to obtain information needed to determine the correctness of a tax return, determine if a return should have been filed, determine a taxpayer's tax liability, or collect a liability.[22] Taxpayers and third parties continue to contest IRS summonses, but rarely succeed due to the broad statutory language in favor of the government,[23] the significant burden of proof for taxpayers, and the strict procedural requirements. Further, in the past, courts have generally justified broad readings of the summons enforcement statutes to ensure IRS investigatory powers are not unduly restricted.[24] As the IRS employs a more aggressive enforcement policy, it will continue to rely heavily on the summons enforcement tool. We expect the courts will continue to see these cases litigated.

14 *Fortney v. U.S.*, 59 F.3d 117, 119-20 (9th Cir. 1995).
15 *U.S. v. Dynavac, Inc.*, 6 F.3d 1407, 1414 (9th Cir. 1993) (citations omitted).
16 *Id.*
17 As reflected in the most recent IRS Databook, IRS tax law enforcement and litigation cases decreased in FY 2019 as compared to FY 2018. Compare IRS Pub. 55B, IRS Databook 2019, table 28 (June 2020) (showing 60,108 cases received and 58,307 cases closed by the IRS Office of Chief Counsel in FY 2019) and IRS Pub. 55B-2019, IRS Databook 2018, table 26 (May 2019) (showing 66,531 cases received and 66,886 cases closed by the IRS Office of Chief Counsel in FY 2018).
18 *See* IRS Pub. 55B, IRS Databook 2019, Table 17b (June 2020) (showing a decline in the total number of tax returns examined, by examination type, in fiscal years 2010–2019).
19 National Taxpayer Advocate 2019 Annual Report to Congress 168 (Most Litigated Issue: *Summons Enforcement Under IRC §§ 7602, 7604, and 7609*).
20 *Id.*
21 Taxpayer First Act (TFA), Pub. L. No. 116-25, §§ 1204, 1206, and 1207, 133 Stat. 981, 988, 990-91 (2019). Under the revisions added by the TFA, general third-party contact notices issued by the IRS are no longer acceptable. IRC § 7602(c) as amended also forbids the IRS from issuing a notice unless it intends at that time to make third-party contacts (*i.e.*, thereby creating a present-intent requirement).
22 IRC § 7602(a).
23 *See* IRC § 7602(b). The government may examine, summon, and take testimony for the purpose of *inquiring into any offense* connected with the administration or enforcement of the internal revenue laws of the United States (emphasis added). Whatever may shine a light on the accuracy of a tax return can be summoned. Within this broad boundary, very few things would be considered an "unreasonable search."
24 *Flight Vehicles Consulting, Inc. v. U.S.*, 110 A.F.T.R.2d (RIA) 5487 (N.D. Cal. 2012), *adopting* 110 A.F.T.R.2d (RIA) 5484 (N.D. Cal. 2012).

Recommendations to Mitigate Disputes

To reduce summons enforcement challenges, it could be helpful for the government to do more to avoid the need for third-party summonses. Allowing taxpayers with an opportunity, where appropriate, to provide the information the IRS needs before contacting third parties protects taxpayer rights.[25] Under the *right to privacy*, taxpayers have the right to expect that any IRS inquiry, examination, or enforcement action will be no more intrusive than necessary.

The National Taxpayer Advocate recommends that Congress:

1. Amend IRC § 7602(c)(1) to require the IRS to tell the taxpayer in third-party contact notices what information it needs (if any) and give the taxpayer a reasonable opportunity to provide the information before contacting a third-party, unless an exception applies.[26]

The National Taxpayer Advocate recommends that the IRS:

1. Revise its third-party contact letters and internal guidance, including updated Letter 3164-A,[27] to inform the taxpayer of what the IRS needs and to give the taxpayer a reasonable opportunity to provide the information before contacting third parties.

25 There are, however, certain categories of IRS summonses which do not require the IRS to give notice to a taxpayer, as detailed in IRC § 7609(c)(2).

26 National Taxpayer Advocate 2021 Purple Book, Compilation of Legislative Recommendations to Strengthen Taxpayer Rights and Improve Tax Administration 137-138 (*Require the IRS to Specify the Information Needed in Third-Party Contact Notices*).

27 The IRS will send IRS Letter 3164-A, Third Party Contact (Jan. 1999), to notify taxpayers that the IRS may contact third parties to obtain information during the audit process. An IRS employee who issues Letter 3164 must wait ten days before contacting a third party under the Internal Revenue Manual 25.27.1.3.1.7, TPC Notification Procedures (Oct. 19, 2017).

Failure to File Penalty Under IRC § 6651(a)(1), Failure to Pay an Amount Shown as Tax on Return Under IRC § 6651(a)(2), and Failure to Pay Estimated Tax Penalty Under IRC § 6654

TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

OVERVIEW

Under IRC §§ 6651(a)(1), (a)(2), and 6654, the IRS may impose penalties on taxpayers when they fail to timely file a tax return, fail to pay an amount shown as tax on a return, or underpay installments of estimated taxes, respectively.[2] When these penalties should be imposed and how they are calculated is relatively straightforward. Historically, in the majority of litigated cases that we have reviewed, taxpayers were unrepresented (*pro se*) and the IRS has prevailed in most of them. This trend continued once again in our review of litigated cases where a written opinion was issued between June 1, 2019, and May 31, 2020.

Of the 31 cases we reviewed, taxpayers appeared *pro se* in 20, and in these cases, the outcomes almost always favored the IRS. Taxpayers were represented in the only case in which the court ruled in their favor.

During our reporting period, between June 1, 2019, and May 31, 2020, there were a total of 24,064,628 taxpayers who had penalties imposed due to the failure to timely file a tax return, failure to pay an amount shown as tax on a return, or underpayment of installments of estimated taxes.[3] Figure 2.7.1 breaks down the total for individual and business taxpayers and also shows the number of reasonable cause assistant abatements for the relevant penalties. The largest total category of abatements was for individual taxpayers with 176,308 abatements for taxpayers who had failed to pay an amount on a tax return due to a reasonable cause.[4] During this same period, taxpayers petitioned Tax Court in 127 cases where the falure to timely file a tax return penalty (delinquency penalty) and/or the estimated tax penalty was an issue during the examination.[5]

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

2 The failure to file (referred to as "FTF") penalty, failure to pay (referred to as "FTP") penalty, and the failure to pay estimated taxes (referred to as "FTE") penalties have appeared on our top ten Most Litigated Issues list since 2003.

3 Obtained from the FTF, FTP, and FTE Assessment and Reasonable Cause Assistant Abatement and Abatement Transactions dated files between June 1, 2019, and May 31, 2020, posted as of cycle 202019 on Individual Master File (IMF) and Business Master File (BMF).

4 *Id.*

5 IRS Appeals response to TAS information request (Dec. 3, 2020) showing cases petitioned to Tax Court between June 1, 2019, and May 31, 2020. TAS matched this data to the cases identified by examination where the falure to timely file a tax return penalty (delinquency penalty) and/or the estimated tax penalty was recommended as recorded in the Examination Operational Automation Database on the IRS Compliance Data Warehouse (CDW) (Dec. 2020).

FIGURE 2.7.1, Total Number of FTF, FTP, and FTE Penalties Imposed and Total Abatements Between June 1, 2019, and May 31, 2020[6]

Penalty Type	Distinct Number of Taxpayers	Reasonable Cause Assistant Abatements[7]
Individual Master File		
FTF	2,272,265	63,994
FTP	12,253,704	176,308
FTE	6,352,322	N/A
Business Master File		
FTF	1,161,542	1,568
FTP	1,715,744	4,819
FTE	309,051	N/A

ANALYSIS OF LITIGATED CASES

In all but two of the 31 cases reviewed, taxpayers raised reasonable cause as their reason for failing to file a tax return by the due date or failing to timely pay an amount shown or required to be shown as tax on a return.[8] In only one of the 29 cases where reasonable cause was raised did the taxpayer prevail.[9] In regard to the six cases where penalties were imposed for underpayment of an estimated tax under IRC § 6654, the IRS was able to show in five of those cases that the taxpayer had a required annual payment,[10] and no evidence was presented to show that the taxpayers qualified for any of the statutory exceptions to the penalty.[11] Thus, the penalty was imposed in all five of these cases. In the sixth case, the taxpayer prevailed because the IRS

6 Obtained from the FTF, FTP, and FTE Assessment and Reasonable Cause Assistant Abatement and Abatement Transactions dated files between June 1, 2019, and May 31, 2020, posted as of cycle 202019 on the IRS, CDW Individual Master File and Business Master File database tables.

7 The penalty may be abated in certain circumstances where the taxpayer can show that one of several exceptions set out in IRC § 6654(e)(1), (2) or (3) apply. Internal Revenue Manual 20.1.3.2.7.1, Estimated Tax Penalty and Reasonable Cause (Dec. 10, 2013), provides guidance as to when the penalty under IRC § 6654 can be abated, noting that underpayment of estimated tax cannot be removed or waived for reasonable cause alone. The penalty for underpayment of estimated tax generally is not waived as a result of disaster. However, in the case of a federally declared disaster area, "the Secretary may specify a period of up to one year that may be disregarded" in determining whether estimated tax payments were paid on time.

8 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 reasonable cause. *Id.* A failure to pay penalty will be abated due to reasonable cause to the extent that the taxpayer has made a satisfactory showing that he or she exercised ordinary business care and prudence in providing for payment of the tax liability and was nevertheless either unable to pay the tax or would suffer an undue hardship if he or she paid on the due date. *Id.*

9 *Estate of Skeba v. U.S.*, 432 F.Supp.3d 461 (D.N.J. 2000).

10 *See Collins v. Comm'r*, T.C. Memo. 2020-50; *Hayes v. Commissioner*, T.C. Memo. 2019-147, *appeal docketed* (9th Cir. Apr. 15, 2020); *U.S. v. Beckwith*, 124 A.F.T.R 2d (RIA) 6896 (D. Maine 2019); *Williams v. Comm'r*, 795 F. App'x 920 (5th Cir. 2019).

11 To avoid an IRC § 6654 penalty, the taxpayer has the burden of proving that one of the following exceptions applies: The tax due (after taking into account any federal income tax withheld) is less than $1,000; the preceding tax year was a full 12 months, the taxpayer had no liability for the preceding tax year, and the taxpayer was a U.S. citizen or resident throughout the preceding tax year; it is determined that because of casualty, disaster, or other unusual circumstances, the imposition of the penalty would be against equity and good conscience; or taxpayer retired after reaching age 62, or became disabled in the tax year for which estimated payments were required, or in the tax year preceding that year, and the underpayment was due to reasonable cause and not willful neglect. IRC § 6654(e)(1), (2), (3).

failed to meet its burden of production to show the taxpayer had a required annual payment payable in installments.[12]

Benton v. Commissioner illustrates the types of reasonable cause arguments that are most commonly raised by taxpayers. Taxpayers argued they had reasonable cause for failing to timely file their tax return due to a confluence of personal and financial difficulties, including a family member's serious illness and the loss of Mrs. Benton's job. However, the court held that the taxpayers did not act with ordinary business care and prudence, because despite these personal challenges, the taxpayers were able to continue operation of a family picture framing business, and the taxpayer's wife held down a temporary job.[13] *Willett v. U.S.* provides another example of a typical reasonable cause defense.[14] Here, taxpayers argued they had reasonable cause for failing to file and failing to pay because their certified public accountant (CPA), who possessed the original copies of their tax documents, became seriously ill and was unable to complete their 2014 tax return on time. However, the court determined that reliance on a CPA was not "reasonable cause" under *Boyle*.[15] These court opinions show what facts and circumstances typically establish reasonable cause.

A less conventional argument was raised in *Estate of Skeba v. U.S.* where the taxpayer was assessed a penalty in the amount of $450,959.50 for failing to timely file the estate's tax return, despite timely paying the taxes due.[16] The taxpayer's primary argument in this case was that the failure to file penalty could not be calculated when reading IRC § 6651(a)(1) together with IRC § 6651(b)(1). In other words, the late filing penalty calculated by using the formula in subsection (a)(1) should be based on the net amount due on the date prescribed for payment as set forth in subsection (b)(1).[17] Because the taxpayer had already paid the taxes due prior to filing the estate tax return, the return showed no amount due for which the failure to file penalty could be based.[18] The court agreed with the taxpayer, and held that no failure to file penalty could be calculated because there was no tax due.

CONCLUSION

The nearly unanimous rulings in favor of the IRS illustrate the case law is well established, and the statutory and regulatory guidance is exhaustive. Despite this clarity in the law, year after year, several taxpayers continue to challenge the imposition of these penalties, and most of them are unsuccessful. To ensure taxpayers are fully aware of the types of situations rise to the level of reasonable cause, the IRS should consider better communicating with taxpayers as to what constitutes "reasonable cause." For example, IRS Notice 746, Information About Your Notice, Penalty and Interest, merely informs taxpayers to submit a written statement as to why the penalty should be removed, and the IRS will consider if it is an "acceptable reason."[19] The IRS could improve this notice by providing taxpayers with a more in-depth description of what is "reasonable

12 *Frost v. Comm'r*, 2020 WL 70716 (T.C. Jan. 7, 2020).
13 *Benton v. Comm'r*, T.C. Summ. Op. 2020-12.
14 *Willett v. U.S.*, 2020 U.S. Dist. LEXIS 32126 (N.D. Cal. Feb. 25, 2020).
15 *U.S. v. Boyle*, 469 U.S. 241, 245 (1985). The Supreme Court held in *Boyle* that a taxpayer's reliance on an agent to file a return did not constitute reasonable cause for late filing, but reasonable cause may exist when a taxpayer relies on the erroneous advice of counsel concerning a question of law. 469 U.S. 241, 245, 250 (1985).
16 *Estate of Skeba v. U.S.*, 432 F. Supp. 3d 461 (D.N.J. 2020).
17 *Id.* The taxpayer also raised a reasonable cause argument in this case for failing to timely file its estate tax return. The taxpayer prevailed in this argument as well.
18 The failure to file penalty would be based on the net amount due shown on the return minus any credits and any amount paid on or before the date prescribed for payment.
19 IRS Notice 746, Information About Your Notice, Penalty and Interest (June 2020).

cause," along with several examples that illustrate what types of situations do and do not rise to the level of reasonable cause.

Recommendation to Mitigate Disputes

The National Taxpayer Advocate recommends that the IRS:

1. Review and revise notices and publications where appropriate to provide more examples of circumstances that constitute reasonable cause to better educate taxpayers.

Itemized Deductions Reported on Schedule A (Form 1040)

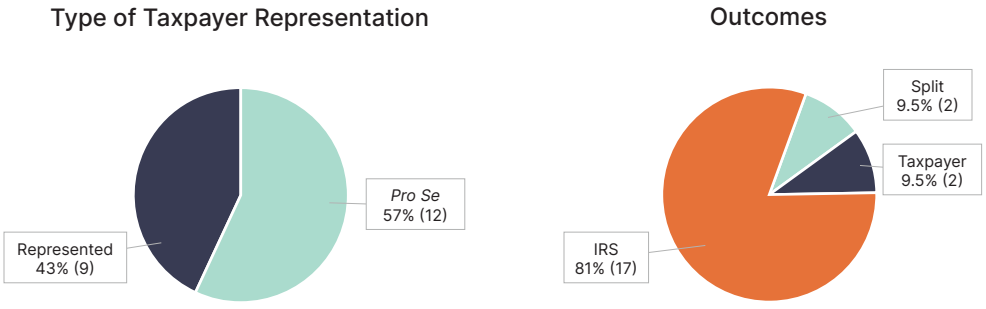
TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Be Informed*
- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Challenge the IRS's Position and Be Heard*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

OVERVIEW

Itemized deductions reported on Schedule A, Itemized Deductions, of IRS Form 1040, U.S. Individual Income Tax Return, were among the ten Most Litigated Issues for the fourth time since the National Taxpayer Advocate's 2000 Annual Report to Congress.[2] During this reporting period between June 1, 2019, and May 31, 2020, we identified 21 decisions, in which itemized deductions were litigated in federal courts.[3] All but four of these cases were litigated in the U.S. Tax Court. Figure 2.8.1 illustrates the outcome of the litigation by type of taxpayer representation. As shown, the courts affirmed the IRS position in 17 of these cases, or about 81 percent, while taxpayers fully prevailed in two cases, or about ten percent of the cases. The remaining two cases, or about ten percent, resulted in split decisions. Taxpayers were represented in 9 of the 21 (or 43%) while 12 of 21 cases (or 57%) had *pro se* (without counsel) taxpayers. During this same period, taxpayers petitioned Tax Court in 1,120 cases where itemized deductions were an issue during the examination.[4]

FIGURE 2.8.1



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

2 This year and in previous years, charitable contribution deductions have been considered separately as a Most Litigated Issue.

3 We excluded cases involving unreimbursed employee expenses and charitable deductions as they are discussed elsewhere in the National Taxpayer Advocate's Annual Report to Congress. Unreimbursed employee expenses are discussed in detail in the Most Litigated Issue: *Trade or Business Expenses Under IRC § 162, supra.* Cases involving charitable deductions are discussed in the Most Litigated Issue: *Charitable Contribution Deductions Under IRC § 170, infra.*

4 IRS Appeals response to TAS information request (Dec. 3, 2020) showing cases petitioned to Tax Court between June 1, 2019, and May 31, 2020. TAS matched this data to the cases identified by examination where an adjustment to itemized deductions was recommended as recorded in the Examination Operational Automation Database on the IRS Compliance Data Warehouse (CDW) (Dec. 2020).

ANALYSIS OF LITIGATED CASES

With the exception of *New York v. Mnuchin,* detailed below,[5] the litigation on itemized deductions focused on the application of well-settled legal principles and applied the relevant statutes, regulations, and case law to the taxpayers' particular facts and circumstances. The largest portion of this year's 21 cases involved taxpayers claiming deductions for casualty and theft losses,[6] mortgage and investment interest expenses,[7] and gambling losses.[8] Figure 2.8.2 categorizes the main issues raised by taxpayers in the 21 cases we identified. As the figure demonstrates, the largest category of deductions was casualty and theft loss deductions.

FIGURE 2.8.2, Itemized Deduction Issues[9]

Itemized Deduction	Number of Cases	Percentage of Cases
Casualty/Theft Loss	7	33%
Mortgage Interest and Investment Interest	6	29%
Gambling	3	14%
State and Local Taxes	2	10%
Medical and Dental Expenses	2	10%
Tax Preparation Fees	1	5%
Other	3	14%

One hurdle faced by taxpayers across the various itemized deduction categories is substantiation. The Code requires taxpayers to substantiate expenses underlying each claimed deduction by maintaining records sufficient to establish the amount of the deduction to enable the Commissioner to determine the correct tax liability.[10] In these cases, taxpayers were unable to or had difficulty substantiating their itemized deduction claims in nine of the 21 cases we identified, or nearly 43 percent of the cases.

The most notable case litigated on the topic of itemized deductions involved the deduction for state and local taxes paid. Specifically, in *New York v. Mnuchin*, the states of New York, Connecticut, Maryland, and New Jersey filed an action against the United States, the IRS, the Acting Commissioner of the Internal Revenue, the United States Department of the Treasury, and the Secretary of the Treasury.[11] The states alleged that the new Tax Cuts and Jobs Act (TCJA) limit on the amount of state and local taxes paid that taxpayers can claim on Schedule A (the "SALT cap") violated constitutional guarantees of federalism and exceeded

5 *New York v. Mnuchin*, 408 F. Supp. 3d 399 (S.D.N.Y. 2019), *appeal docketed*, No. 19-3962 (2d Cir. Nov. 26, 2019).
6 IRC § 165.
7 IRC § 163.
8 IRC § 165(d).
9 Several cases we identified had more than one of the issues listed in Figure 2.8.2. In addition to the top three deductions listed above, IRC § 164(b)(6) provides the deduction for state and local taxes paid; IRC § 213(a) provides the deduction for medical and dental expenses; and IRC § 67 provides the miscellaneous itemized deductions, including tax preparation fees and other professional fees.
10 IRC § 6001; *Welch v. Helvering*, 290 U.S. 111, 115 (1933); *Cohan v. Comm'r*, 39 F.2d 540, 543-44 (2d Cir. 1930) (providing an exception to strict substantiation and allowing the taxpayer to estimate expenses under certain circumstances); Temp. Treas. Reg. § 1.274-5T(b). For detailed recordkeeping guidance for taxpayers, see also IRS, Publication 17, Your Federal Income Tax for Individuals: Tax Guide 2019 for Individuals (July 2020).
11 *New York v. Mnuchin*, 408 F. Supp. 3d 399 (S.D.N.Y. 2019), *appeal docketed*, No. 19-3962 (2d Cir. Nov. 26, 2019).

Congress's taxation powers.[12] The U.S. District Court for the Southern District of New York granted the defendants' motion to dismiss for failure to state a valid legal claim. It concluded that the states failed to cite a constitutional principle that would bar Congress from exercising its otherwise plenary power to impose an income tax with a limited SALT deduction. The court held that there is no basis to conclude that the SALT cap is unconstitutionally coercive. The SALT cap, like any federal tax provision, will affect some states more than others. However, the states still have the ability to make their decisions as to how they will exercise their own sovereign tax powers. Thus, the states failed to plausibly allege that the SALT cap meaningfully constrained their decision-making process.

CONCLUSION

The number of itemizers significantly decreased, by about 66 percent from tax year (TY) 2017 to TY 2019, likely due to the tax changes brought about by the TCJA.[13] A reduction in the number of itemizers may eventually lead to a decrease in litigation in the coming years. In addition, a further decrease in litigation over the issue could occur through increased taxpayer awareness of substantiation requirements. If taxpayers carefully maintain detailed records related to any itemized deductions they claim, they will be in a better position to verify such deductions with the IRS before disputes result in litigation. Accordingly, the IRS must continue to increase awareness of taxpayer recordkeeping requirements, which will protect taxpayers' *rights to be informed* and *to pay no more than the correct amount of tax*. By doing so, the IRS will encourage taxpayers to comply with their tax obligations and minimize the risk of litigation.

Recommendation to Mitigate Disputes

The National Taxpayer Advocate recommends that the IRS:

1. Evaluate the IRS's existing communication strategy, including the IRS website, guidance, and publications, to taxpayers, preparers, and practitioners to determine how to increase awareness about itemized deductions, including recordkeeping requirements. Then based on the findings, conduct outreach within the next two fiscal years to better educate taxpayers.

12 Section 11042 of the TCJA, Pub. L. No. 115-97, 131 Stat. 2054, 2085 (2017), amended IRC § 164(b)(6) to limit the aggregate amount of the itemized deduction taxpayers can claim for state and local income, general sales, real property, or personal property taxes up to $10,000 per year ($5,000 in the case of a married individual filing a separate return) for Tax Years (TYs) 2018 to 2025.

13 In TY 2017, about 43.4 million taxpayers claimed itemized deductions (30.3 percent). In TY 2019, about 14.6 million taxpayers claimed itemized deductions (9.9 percent). Individual Returns Transaction File on the IRS CDW (comparing tax returns filed between January 1 and October 1 in both TYs 2017 and 2019). The Joint Committee on Taxation staff estimated the number of taxpayers who itemize would decrease as a result of TCJA. Joint Comm. on Taxation, *Tables Related to the Federal Tax System as in Effect 2017 Through 2026* (JCX-32-18), Table 5 (Apr. 23, 2018). TAS has a website, available in both English and Spanish, to educate individual taxpayers about items that were changed and not changed as a result of TCJA. For a detailed list of these changes, see TAS, Tax Changes by Topic, https://www.taxchanges.us/ (last visited Aug. 9, 2020).

Charitable Contribution Deductions Under IRC § 170

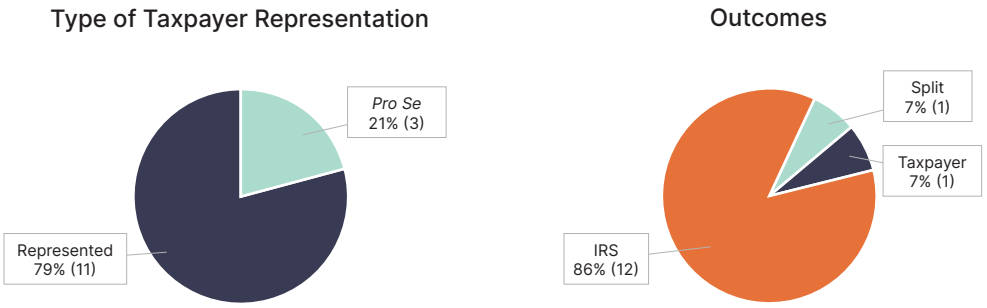
TAXPAYER RIGHTS IMPACTED[1]

- *The Right to Pay No More Than the Correct Amount of Tax*
- *The Right to Appeal an IRS Decision in an Independent Forum*
- *The Right to a Fair and Just Tax System*

OVERVIEW

We identified 14 opinions issued between June 1, 2019, and May 31, 2020, on the issue of the deductibility of charitable contributions under IRC § 170, which is three fewer cases than in last year's report. Of the 14 cases, the most common issues were whether a donation constituted a qualified conservation easement (eight cases) and whether a claimed deduction was adequately substantiated (six cases). An additional case involved both issues. Taxpayers were usually represented, and the IRS usually prevailed. During this same period, taxpayers petitioned the Tax Court in 401 cases where charitable contributions were an issue during the examination.[2]

FIGURE 2.9.1[3]



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

2 IRS Appeals response to TAS information request (Dec. 3, 2020) showing cases petitioned to Tax Court between June 1, 2019, and May 31, 2020. TAS matched this data to the cases identified by examination where an adjustment to charitable contributions was recommended as recorded in the Examination Operational Automation Database on the IRS, Compliance Data Warehouse (Dec. 2020).

3 Of the 14 cases, three taxpayers appeared without representation and 11 had representation. Of the 14 cases, the taxpayer prevailed in one case, the IRS prevailed in 12 cases, and there was a split opinion in one case.

ANALYSIS OF LITIGATED CASES

The most significant cases centered on syndicated conservation easements, an arrangement in which an investor purchases an interest in a pass-through entity that holds real property. The pass-through entity contributes a conservation easement encumbering the property to a tax-exempt entity and allocates a charitable contribution deduction to the investor.[4] Promotional materials for these transactions offer prospective investors the possibility of a charitable contribution deduction of more than two and a half times the amount of the investor's investment.[5] The IRS contends that promoters obtain an appraisal that greatly inflates the value of the conservation easement by using the highest and best use of the property before it was encumbered with the easement to create a fictional and unrealistic valuation of the property. The IRS also contends that investors in the pass-through entity typically claim charitable contribution deductions that grossly multiply their actual investment in the transaction and defy common sense.

Although the IRS recognizes the important role of conservation easement deductions in incentivizing land preservation for future generations, abusive syndicated conservation easement transactions have been of concern to the IRS for several years. For several years, the IRS has focused on curtailing abuse in this area by designating syndicated conservation easements as a listed transaction and aggressively auditing taxpayers who participate in these transactions.[6]

Nevertheless, between 2017 and 2018, the number of individual participants in these transactions increased from 14,000 to 16,900, with many participating in multiple deals; the total amount of deductions claimed through these tax shelters increased from $6.8 billion in 2017 to $9.2 billion in 2018.[7] In June 2020, the IRS offered to settle docketed Tax Court cases with this issue.[8] It does not appear that many taxpayers have accepted the offer to date.[9]

4 Although taxpayers generally are not permitted to deduct gifts of property consisting of less than the taxpayer's entire interest in that property, they may deduct the value of a contribution of a partial interest in property that constitutes a "qualified conservation contribution." IRC § 170(f)(3)(B)(iii), (h).

5 IRS Notice 2017-10, 2017-4 I.R.B. 544 at 3, Syndicated Conservation Easement Transactions. See also S. Comm. on Finance, S. Prt. 116-44 at 11, 116th Cong., 2d Sess., *Committee Print on Syndicated Conservation-Easement Transactions* (Aug. 2020), describing transactions in which the real property held by the pass-through entity was sold in an arm's length transaction, followed shortly thereafter by an appraisal asserting a value multiple times higher than the value established in that prior arm's length transaction, which calls into question the accuracy of the appraisal.

6 *See* IRS Notice 2017-10, 2017-4 I.R.B. 544, Syndicated Conservation Easement Transactions. Promoters and participants in these transactions must disclose them to the IRS pursuant to IRC §§ 6011, 6111, 6112, and the regulations thereunder. See also S. Comm. on Finance, S. Prt. 116-44 at 3, 116th Cong., 2d Sess., *Committee Print on Syndicated Conservation-Easement Transactions* (Aug. 2020), noting that as of Feb. 2020 the IRS is auditing or plans to audit 84 percent of the partnerships that participated in syndicated conservation easements from 2015-2017.

7 Letter from Charles P. Rettig, Commissioner, IRS, to Sen. Charles Grassley, Chairman, Committee on Finance (Sept. 17, 2020). See also, *e.g.*, Kristen A. Parillo, *Deluge of Tax Court Easement Petitions Continues*, 2020 TNTF 205-9 (Oct. 23, 2020), noting that "In the last few weeks, 27 easement-related petitions were filed, with $481,505,985 in claimed deductions on the line."

8 IRS, IR-2020-130, IRS Offers Settlement for Syndicated Conservation Easements; Letters Being Mailed to Certain Taxpayers With Pending Litigation; IRS, IR-2020-152, IRS Urges Taxpayers to Accept Easement Settlement Offers. Among other things, the settlement requires a concession of the tax benefits claimed by the taxpayers and imposes penalties: all partners in an electing partnership must agree to settle to receive these terms, and the partnership must make a lump-sum payment representing the aggregate tax, penalties and interest for all of the partners before settlement is accepted by the IRS; the IRS Office of Chief Counsel will allow investors to deduct the cost of acquiring their partnership interests, but it will require a penalty of at least ten percent; partners who are promoters of conservation easement schemes are not allowed any deductions and must pay the maximum penalty asserted by IRS (typically 40 percent); if less than all the partners agree to settle, the IRS may settle with those partners but will normally impose less favorable terms on the settling partners. As of Nov. 2019, there were 80 such docketed Tax Court cases. *See* IRS, IR-2019-192, IRS Increases Enforcement Action on Syndicated Conservation Easements (Nov. 12, 2019).

9 See, however, IR-2020-196, Settlements Begin in Syndicated Conservation Easement Transaction Initiative (Aug. 31, 2020), announcing the completion of the first settlement under the initiative.

In this year's reporting cycle, the IRS prevailed in seven of the eight cases in which the deductibility of a donation of a conservation easement was at issue (including the case in which adequate substantiation was also at issue).[10] As the Tax Court noted in one of this year's opinions:

> [i]n recent years the Commissioner has attacked a popular form of charitable contribution — the donation of conservation easements. Many of these attacks are surgical strikes on what he believes are gross exaggerations of the value of particular easements. But he has also launched three sorties — all predicated on the requirement that such easements be "perpetual" — that he hopes will cause more widespread casualties.[11]

The perpetuity requirement of IRC § 170(h)(5)(A) was primarily at issue in the conservation easement cases included in this year's analysis, rather than the value of the easement.[12] For example, in three Tax Court cases, the taxpayers lost because the deeds they used to convey the easements provided that in the event of a sale of the property following judicial extinguishment of the easement, the donee would receive a fixed amount, rather than a proportion, of the sale proceeds.[13] This provision did not satisfy the requirement that the conservation purpose of the easement must be protected in perpetuity.[14] The court in one of the cases acknowledged that many other conservation easement deeds contain the same inadequate language.[15]

The IRS could help avoid litigation by providing model language taxpayers could use in deeds conveying conservation easements, and the National Taxpayer Advocate has recommended that the IRS provide such guidance.[16] As the IRS explained in response to that recommendation, it has provided sample language for a "constructive denial clause" in conservation easement deeds that is consistent with the perpetuity requirements of IRC § 170(h).[17] This is an encouraging development that may avert unnecessary litigation. Additional guidance and sample language, particularly with respect to other aspects of the perpetuity requirements, may also help taxpayers navigate these complex issues and help prevent unnecessary litigation.

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10 In addition, the IRS prevailed in at least seven conservation easement cases that were decided outside of this year's reporting period. The opinions in three such cases were published on June 23, 2020: *Plateau Holdings, LLC v. Comm'r*, T.C. Memo. 2020-93; *Lumpkin One Five Six LLC v. Comm'r*, T.C. Memo. 2020-94; and *Lumpkin HC v. Comm'r*, T.C. Memo. 2020-95. The opinions in four such cases were published on July 9, 2020: *Effingham, LLC v. Comm'r*, T.C. Memo. 2020-102; *Englewood Place LLC v. Comm'r*, T.C. Memo. 2020-105; *Riverside Place LLC v. Comm'r*, T.C. Memo. 2020-103; and *Maple Landing, LLC v. Comm'r*, T.C. Memo. 2020-104.

11 *Oakbrook Land Holdings, LLC v. Comm'r*, T.C. Memo. 2020-54 at *1 (fn. refs. omitted).

12 In contrast, last year's report included a discussion of several cases in which the value of the easement was at issue. *See, e.g., Pine Mountain Preserve LLLP v. Comm'r*, 51 T.C. 247 (2018), *aff'd in part*, *rev'd in part*, *vacated in part and remanded*, No. 19-11795, 2020 WL 6193897 (11th Cir. Oct. 22, 2020). The Tax Court determined the value of the conservation easement in a concurrently filed separate opinion, T.C. Memo. 2018-214.

13 *R.R. Holdings, LLC v. Comm'r*, T.C. Memo. 2020-22; *Oakbrook Land Holdings, LLC v. Comm'r*, T.C. Memo. 2020-54; and *Woodland Properties Holdings, LLC v. Comm'r*, T.C. Memo. 2020-55.

14 IRC § 170(h)(5)(A); Treas. Reg. § 1.170A-14(g)(6).

15 *Oakbrook Land Holdings, LLC v. Comm'r*, T.C. Memo. 2020-54.

16 National Taxpayer Advocate 2019 Annual Report to Congress 203 (Most Litigated Issue: *Charitable Contribution Deductions Under IRC § 170*).

17 National Taxpayer Advocate Fiscal Year 2021 Objectives Report to Congress vol. 2, at 194, Counsel Narrative Response, citing IRS Chief Counsel Advice 2020-02011 (Jan. 10, 2020). A constructive denial clause provides that if an easement holder does not respond within a specified period to a request by the property owner regarding a proposed use, then the request is considered denied. *See also* IRS Chief Counsel Generic Legal Advice 2020-001 (Mar. 27, 2020) (providing language to amend a conservation easement that complies with the perpetuity requirements of § 170(h)).

CONCLUSION

For several years, the IRS has focused on curtailing abuse in the area of syndicated conservation easements. However, designating these transactions as potentially abusive tax shelters does not appear to have deterred taxpayers from participating in them, and IRS court victories in this area do not appear to have deterred taxpayers from litigating their cases. Some taxpayers may accept the IRS's offer to settle their cases with this issue, but litigation in this area may very well continue for years.

Recommendation to Mitigate Disputes

The National Taxpayer Advocate recommends that the IRS:

1. Develop and publish additional guidance that contains sample easement provisions to assist taxpayers in drafting deeds that satisfy the statutory requirements for qualified conservation contributions, particularly the perpetuity requirement for those conservation easements that incentivize land preservation for future generations.

Frivolous Issues Penalty Under IRC § 6673 and Related Appellate-Level Sanctions

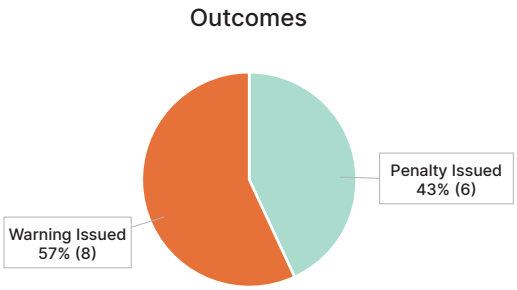
TAXPAYER RIGHT IMPACTED[1]

- *The Right to Appeal an IRS Decision in an Independent Forum*

OVERVIEW

From June 1, 2019, through May 31, 2020, the federal courts issued decisions in at least 14 cases involving the IRC § 6673 "frivolous issues" penalty, with two cases involving an analogous penalty at the appellate level. This litigation focuses on penalties for maintaining a case primarily for delay, raising arguments deemed frivolous by the courts, unreasonably failing to pursue administrative remedies, or filing a frivolous appeal.[2] In all 14 of the cases analyzed by TAS, taxpayers were unrepresented. Although none of them prevailed, in most (57 percent) of the decisions we analyzed, taxpayers escaped liability for the penalty with only a warning they could face sanctions for similar conduct in the future.[3] This year, no cases presented novel legal questions under IRC § 6673 and related appellate-level sanctions.

FIGURE 2.10.1[4]



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

2 The Tax Court generally imposes the penalty under IRC § 6673(a)(1). Other courts may impose the penalty under IRC § 6673(b)(1). U.S. Courts of Appeals are authorized to impose sanctions under IRC § 7482(c)(4), or Rule 38 of the Federal Rules of Appellate Procedure, although some appellate-level penalties may be imposed under other authorities.

3 *See, e.g., Tartt v. Comm'r*, T.C. Memo. 2019-112 (concluding that the taxpayer's positions were "frivolous" but recognizing it was his first appearance before the court and therefore letting him off with just a warning).

4 The IRS fully prevailed in all 14 cases. In six cases, a penalty was issued. In eight cases, taxpayers were warned.

ANALYSIS OF LITIGATED CASES

Case law in this area is considered well-settled, and the numerous arguments presented by taxpayers have been universally deemed frivolous and rejected by the courts. Taxpayers challenge the legality of tax laws, claim exemption from tax liabilities, and argue creative variations on these themes.[5] Upon encountering these arguments, the courts almost invariably cite the language set forth in *Crain v. Commissioner:*

> We perceive no need to refute these arguments with somber reasoning and copious citation of precedent; to do so might suggest that these arguments have some colorable merit. The constitutionality of our income tax system — including the role played within that system by the Internal Revenue Service and the Tax Court — has long been established.[6]

Upon deciding to issue a penalty, the amount varied, regardless of the type of frivolous argument being raised.[7] The Tax Court has indicated, however, that it can be lenient when it is the taxpayer's first court appearance.[8] Instead, taxpayers were warned in these cases not to bring similar arguments in the future, demonstrating the willingness of the courts to penalize taxpayers if taxpayers persisted in raising frivolous arguments. Taxpayers were always warned in previous proceedings before a penalty was issued. Where the IRS has not requested the penalty, and the facts are appropriate, the court has nonetheless raised the issue *sua sponte.*[9]

CONCLUSION

Taxpayers in the cases analyzed this year presented the same arguments raised and repeated year after year, which the courts routinely and universally reject.[10] Considering that all taxpayers in the examined cases were unrepresented, Congress and the IRS may consider increasing the visibility and availability of Low Income Taxpayer Clinics to provide assistance to eligible taxpayers who may otherwise make frivolous arguments. Congress may consider increasing funding for publicity and require the IRS to increase publicity efforts.

5 *See, e.g., Staples v. Comm'r,* T.C. Memo. 2019-75 (rejecting the taxpayer's argument that the law did not require him to file a federal income tax return or pay federal income tax).

6 *Crain v. Comm'r,* 737 F.2d 1417-18 (5th Cir. 1984). *See, e.g., Wells v. Comm'r,* T.C. Memo. 2019-134.

7 Penalties assessed during this review period ranged from $1,000 to $10,000.

8 *See, e.g., Hayes v. Comm'r,* T.C. Memo. 2019-147. Taxpayers avoided the IRC § 6673 penalty in six cases where the IRS requested it.

9 "*Sua sponte*" means without prompting or suggestion; on its own motion. Black's Law Dictionary (10th ed. 2014). For conduct that it finds particularly offensive, the Tax Court can choose to impose a penalty under IRC § 6673 even if the IRS has not requested the penalty. *See, e.g., Wells v. Comm'r,* T.C. Memo. 2019-134.

10 *See, e.g.,* National Taxpayer Advocate 2019 Annual Report to Congress 204-207 (Most Litigated Issue: *Frivolous Issues Penalty Under § 6673 and Related Appellate-Level Sanctions*).