

**Legislative Recommendation #16****Amend IRC § 6330 to Provide That “an Opportunity to Dispute” an Underlying Liability Means an Opportunity to Dispute Such Liability in a Prepayment Judicial Forum****PRESENT LAW**

IRC §§ 6320(b) and 6330(b) provide taxpayers with the right to request an independent review of a Notice of Federal Tax Lien filed by the IRS or of a proposed levy action. The purpose of these collection due process (CDP) rights is to give taxpayers adequate notice of IRS collection activity and provide a meaningful hearing to determine whether the IRS properly filed a notice of federal tax lien or whether it may proceed to deprive the taxpayer of property through a levy. In a CDP hearing, conducted by a settlement officer with the IRS Independent Office of Appeals (Appeals), a taxpayer may raise a variety of issues, including collection alternatives and spousal defenses. Under IRC § 6330(c)(2)(B), however, a taxpayer may only dispute the existence or amount of the underlying tax liability if the taxpayer “did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability.”<sup>1</sup>

The IRS and the courts interpret IRC § 6330(c)(2)(B) and Treasury regulations under IRC §§ 6320 and 6330 to mean that an opportunity to dispute the underlying liability includes a prior opportunity for a conference with Appeals, even where the taxpayer had no prior opportunity for prepayment judicial review of the liability and no subsequent prepayment judicial review of the Appeals determination is available.<sup>2</sup> Additionally, at least one Court of Appeals has held that IRC § 6330(c)(4)(A) is an independent basis for denying a merits hearing in the CDP process if a prior merits hearing occurred.<sup>3</sup>

In a recent deficiency case applying these rules, *Lander v. Commissioner*,<sup>4</sup> the Tax Court held the taxpayer was not permitted to dispute the underlying liability in a CDP hearing where the taxpayer did not receive the notice of deficiency sent by the IRS but obtained an Appeals hearing as a part of the audit reconsideration process.<sup>5</sup> Because the underlying liability was not at issue in the CDP hearing, the taxpayer was precluded from disputing the underlying liability in the Tax Court proceeding.<sup>6</sup> Thus, by seeking to resolve his tax liability through audit reconsideration, the taxpayer forfeited his right to seek judicial review of the liability in a prepayment forum.

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- 1 IRC §§ 6320(c), 6330(c)(2)(B). The phrase “underlying tax liability” includes the tax deficiency, any penalties and additions to tax, and statutory interest. *Katz v. Comm’r*, 115 T.C. 329, 339 (2000).
  - 2 Treas. Reg. §§ 301.6320-1(e)(3), Q&A (E)(2), 301.6330-1(e)(3), Q&A (E)(2), provides that “an opportunity to dispute the underlying liability includes a prior opportunity for a conference with Appeals that was offered either before or after the assessment of the liability. An opportunity for a conference with Appeals prior to the assessment of a tax subject to deficiency procedures is not a prior opportunity for this purpose.” The Tax Court and at least three Courts of Appeal have upheld the validity of these regulations. *Lewis v. Comm’r*, 128 T.C. 48, 61 (2007); *James v. Comm’r*, 850 F.3d 160 (4th Cir. 2017); *Keller Tank Services II, Inc. v. Comm’r*, 854 F.3d 1178 (10th Cir. 2017); *Our Country Home Enterprises, Inc. v. Comm’r*, 855 F.3d 773 (7th Cir. 2017).
  - 3 *James v. Comm’r*, 850 F.3d 160 (4th Cir. 2017). IRC § 6330(c)(4)(A) provides that an issue may not be raised at a CDP hearing “(i) if the issue was raised and considered at a previous hearing under section 6320 or in any other previous administrative or judicial proceeding; and (ii) the person seeking to raise the issue participated meaningfully in such hearing or proceeding.”
  - 4 *Lander v. Comm’r*, 154 T.C. 104 (2020), holding that the conference with Appeals as part of the audit reconsideration process constituted “an opportunity to dispute the tax liability” under IRC § 6330(c)(2)(B).
  - 5 A notice of deficiency allows taxpayers to petition the Tax Court for *de novo* review of the IRS’s determination under IRC § 6213(a), but audit reconsiderations are not subject to Tax Court review.
  - 6 At the conclusion of a CDP hearing, the taxpayer, within 30 days of the Appeals settlement officer’s determination, may petition the Tax Court for review of the determination. IRC §§ 6230(c), 6330(d). If the taxpayer’s underlying liability was not at issue in the CDP hearing, the taxpayer will be precluded from disputing the underlying liability in the Tax Court proceedings. Treas. Reg. § 301.6330-1(f)(2), Q&A (F)(3).

In some non-deficiency cases, mere notification of the right to request an Appeals conference is treated as a “prior opportunity” to dispute the liability. For example, the IRS assesses certain penalties without issuing a notice of deficiency.<sup>7</sup> Some “summary” penalty assessments are made systemically (*i.e.*, they are automatically imposed by a computer rather than manually imposed during an audit).<sup>8</sup> When the IRS makes these summary assessments, it notifies the taxpayer of the proposed penalty by sending a letter or notice that makes mention of the taxpayer’s right to seek a conference with Appeals.<sup>9</sup> For purposes of the Trust Fund Recovery Penalty, for example, this correspondence constitutes “an opportunity to dispute such liability,” even when the taxpayer does not request a conference in response to the letter and no conference takes place.<sup>10</sup> Whether or not the taxpayer requests or receives a conference with Appeals in response to the letter, the taxpayer will not be permitted to dispute the merits of the liability at a CDP hearing or in Tax Court, even if the liability resulted from an automated system rather than any human intervention. To obtain judicial review of the underlying liability, the taxpayer must pay the tax – generally the full amount due – and seek a refund.<sup>11</sup>

One exception to the full payment rule applies to “divisible” taxes. When an assessment may be divisible into a tax on each transaction or event, the taxpayer need only pay enough to cover a single transaction or event before filing suit.<sup>12</sup>

Additional provisions in IRC § 6330 preserve the integrity of CDP hearings. Appeals Officers may disregard requests for CDP hearings that are made to delay collection.<sup>13</sup> Among the matters that cannot be raised at a CDP hearing are “specified frivolous submissions” as defined in IRC § 6702(b)(2)(A).<sup>14</sup>

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- 7 Assessable penalties are primarily found in IRC §§ 6671 through 6720C. The IRS also treats the penalties found in IRC §§ 6038 and 6038A as assessable penalties, a practice the National Taxpayer Advocate believes is not supported by statute. See National Taxpayer Advocate 2020 Annual Report to Congress 119-131 (Most Serious Problem: *International: The IRS’s Assessment of International Penalties Under IRC §§ 6038 and 6038A Is Not Supported by Statute, and Systemic Assessments Burden Both Taxpayers and the IRS*). See also Legislative Recommendation: Amend IRC § 6212 to Provide That the Assessment of Foreign Information Reporting Penalties Under IRC §§ 6038, 6038A, 6038B, 6038C, and 6038D Is Subject to Deficiency Procedures, *supra*.
- 8 IRM 21.8.2.20.2(1), Form 5471 Penalties Systemically Assessed From Late-Filed Form 1120 Series or Form 1065 (Mar. 26, 2018); IRM 21.8.2.21, Form 5472 - Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business (Oct. 1, 2016); IRM 21.8.2.21.2(1), Form 5472 Penalties Systemically Assessed From Late-Filed Form 1120 Series (Mar. 18, 2020).
- 9 In some notices, a description of the right to seek a conference with Appeals is brief and does not appear until the end of the notice. For example, the IRS issues Notice CP 15, Notice of Penalty Charge, to advise taxpayers of a proposed assessable penalty under IRC § 6038. On the second page of the notice, near the end, the notice advises: “If you wish to appeal this penalty, send the IRS at the address shown on page 1 of this notice a written request to appeal within 30 days from the date of this notice. Your request should include any explanation and documents that will support your position. Your explanation should reflect all facts that you contend are reasonable cause for not asserting this penalty.”
- 10 Treas. Reg. §§ 301.6320-1(e)(4), Example 3, 301.6330-1(e)(4), Example 3, relating to the trust fund recovery penalty (TFRP) under IRC § 6672. The IRS sends Letter 1153, Proposed Trust Fund Recovery Penalty Notification, to inform taxpayers it is asserting the TFRP and courts have held Letter 1153 is an “opportunity to dispute such liability.” *Bletsas v. Comm’r*, T.C. Memo. 2018-128, *aff’d* 784 F. App’x 835 (2d Cir. 2019); *Smith v. Comm’r*, T.C. Memo. 2015-60; *Thompson v. Comm’r*, T.C. Memo. 2012-87.
- 11 See 28 U.S.C. § 1346(a)(1) (providing that once a taxpayer pays the tax, the taxpayer may file suit in a U.S. district court or the U.S. Court of Federal Claims to recover any tax the taxpayer believes has been erroneously assessed or collected). In *Flora v. United States*, 362 U.S. 145 (1960), the U.S. Supreme Court held that, with limited exceptions, a taxpayer must have “fully paid” the assessment (called the “full payment rule”) before filing suit in these courts.
- 12 The TFRP, for example, is a divisible tax. After the IRS assesses the penalty, the responsible person need only pay the amount due with respect to a single employee for a single quarter before filing suit. Other exceptions to the full payment rule include IRC § 6694(c) (applicable to those who have paid 15 percent of certain assessable preparer penalties) and IRC § 6703(c) (applicable to those who have paid 15 percent of the assessable penalties under IRC §§ 6700 and 6701 relating to promoting abusive tax shelters and aiding and abetting understatements).
- 13 IRC § 6330(g) provides: “Notwithstanding any other provision of this section, if the Secretary determines that any portion of a request for a hearing under this section or section 6320 meets the requirement of clause (i) or (ii) of section 6702(b)(2)(A), then the Secretary may treat such portion as if it were never submitted and such portion shall not be subject to any further administrative or judicial review.”
- 14 IRC § 6330(c)(4)(B). IRC § 6702 allows for the imposition of a penalty of up to \$5,000 where a request for a CDP hearing is “either based on a position the IRS has identified as frivolous or reflects a desire to delay or impede the administration of federal tax laws.” IRC § 6702(b)(2)(A)(i) & (ii), (B)(i), (c).

## REASONS FOR CHANGE

The value of CDP proceedings is undermined when taxpayers who have never had an opportunity to dispute the underlying liability in a prepayment judicial forum are precluded from doing so during their CDP hearing. Taxpayers who wish to dispute their underlying liability in a judicial forum but cannot raise the issue in a CDP hearing due to the application of IRC § 6330(c)(2)(B) have no alternative but to pay the tax and then seek a refund, an option that not all taxpayers can afford, particularly when the liability consists of high-dollar assessable, non-divisible penalties.<sup>15</sup> In addition, in deficiency cases where the taxpayer did not receive a notice of deficiency, the decision whether to request a conference with Appeals has ramifications that most taxpayers will not anticipate and that reward taxpayers who have skilled representation. Specifically, savvy taxpayers may refrain from seeking to resolve their liabilities through, for example, the audit reconsideration process in order to preserve their ability to adjudicate their underlying liabilities in a later CDP hearing, while taxpayers without sophisticated knowledge of these rules may request audit reconsideration without recognizing that doing so will cause them to lose their ability to later adjudicate their underlying liabilities in a CDP hearing.

The National Taxpayer Advocate believes that judicial and administrative interpretations limiting a taxpayer's ability to challenge the IRS's liability determination in a CDP hearing are inconsistent with Congress's intent when it enacted CDP procedures. Compared to the burden the current rules place on taxpayers, and in view of the statutory safeguards already in place to prevent frivolous or meritless CDP proceedings, allowing more taxpayers to dispute their tax liabilities in CDP hearings will better protect taxpayer rights without imposing an undue administrative burden on the IRS or the Tax Court.

## RECOMMENDATIONS

- Amend IRC § 6330(c)(2)(B) to allow taxpayers to raise challenges to the existence or amount of the underlying tax liability at a CDP hearing for any tax period if the taxpayer did not receive a valid notice of deficiency for such liability or, in non-deficiency cases, the taxpayer did not have an opportunity to dispute the liability in a prepayment judicial forum.
- Clarify that IRC § 6330(c)(4)(A) applies only to collection issues and not to liability issues, which are addressed exclusively in IRC § 6330(c)(2)(B).

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<sup>15</sup> For legislative recommendations to address the issue of “pay to play” judicial review, see Legislative Recommendation: *Repeal Flora: Give Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can*, *infra*, and Legislative Recommendation: *Expand the Tax Court's Jurisdiction to Hear Refund Cases and Assessable Penalties*, *infra*. See also 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, Giving Taxpayers Who Cannot Pay the Same Access to Judicial Review as Those Who Can)*.