

Legislative Recommendation #15**Provide That “an Opportunity to Dispute” an Underlying Liability Means an Opportunity to Dispute Such Liability in the U.S. Tax Court****SUMMARY**

- *Problem:* The IRS takes collection actions against some taxpayers who had their tax liability determined by the IRS but did not have an opportunity to challenge the existence or amount of that liability in the U.S. Tax Court. As a result, some taxpayers have no alternative but to pay the tax the IRS says they owe and then seek a refund in a different federal court, an option that many taxpayers cannot afford and that imposes additional burden.
- *Solution:* Allow taxpayers to challenge the existence or amount of an IRS-determined tax liability at a Collection Due Process (CDP) hearing in cases where they did not have a prior opportunity to dispute the liability in Tax Court.

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 a proposed levy action. The review is provided through a CDP hearing conducted by the IRS Independent Office of Appeals (Appeals) and is subject to review by the Tax Court, generally the only prepayment judicial forum in which taxpayers may resolve their disputes with the IRS. Commonly, the existence and amount of a tax liability has already been conclusively determined by this point under procedures that gave the taxpayer an opportunity to seek Tax Court review of the IRS’s determination. Thus, the purpose of the CDP hearing is typically to determine whether the taxpayer qualifies for collection alternatives (*e.g.*, an offer in compromise or an installment agreement) based on the taxpayer’s ability to pay.

However, IRC § 6330(c)(2)(B) also provides that a taxpayer may dispute the existence or amount of the underlying tax liability at a CDP hearing 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.”¹

The IRS and the courts interpret IRC § 6330(c)(2)(B) and the Treasury regulations under IRC §§ 6320 and 6330 restrictively. They take the position that a taxpayer does not have a right to dispute the existence or amount of a liability if the taxpayer had a prior opportunity for a conference with Appeals, even if the taxpayer had no prior opportunity for Tax Court review of the liability and even if no subsequent Tax Court review of the Appeals determination is available.² For example, one court has held that a taxpayer who did not receive a notice of deficiency was not permitted to dispute his underlying liability in a CDP hearing because the taxpayer previously sought to resolve the tax liability through audit reconsideration.³ 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.⁴

1 IRC §§ 6320(c), 6330(c)(2)(B). The phrase “underlying tax liability” includes the tax deficiency, any penalties, additions to tax, and statutory interest. *Katz v. Comm’r*, 115 T.C. 329, 339 (2000).

2 See Treas. Reg. §§ 301.6320-1(e)(3), Q&A-E2, 301.6330-1(e)(3), Q&A-E2; *Lewis v. Comm’r*, 128 T.C. 48, 61 (2007); *James v. Comm’r*, 850 F.3d 160 (4th Cir. 2017); *Keller Tank Servs. II, Inc. v. Comm’r*, 854 F.3d 1178 (10th Cir. 2017); *Our Country Home Enters., Inc. v. Comm’r*, 855 F.3d 773 (7th Cir. 2017). Additionally, at least one Court of Appeals has held that IRC § 6330(c)(4)(A) provides an independent basis for denying a merits hearing in the CDP process if a prior merits hearing occurred. *James*, 850 F.3d 160.

3 *Lander v. Comm’r*, 154 T.C. 104 (2020). Audit reconsiderations are not subject to Tax Court review.

4 See Treas. Reg. § 301.6330-1(f)(2), Q&A-F3.

IRC § 6330(c)(4)(A) provides, in part, that a taxpayer is precluded from raising an issue during a CDP hearing if the issue was raised in a previous administrative hearing. This restriction has been interpreted to mean that if a taxpayer had a prior hearing at Appeals with respect to the liability, the issue of the liability cannot be raised at the CDP hearing, even if the taxpayer had no prior opportunity for Tax Court review of the liability.⁵

Mere notification of the right to request an Appeals conference may prevent the taxpayer from disputing the tax liability in a CDP hearing. For example, the IRS assesses some penalties without issuing a notice of deficiency.⁶ The IRS notifies the taxpayer of the proposed penalty by sending a letter or notice. 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 the Tax Court. To obtain judicial review of the underlying liability, the taxpayer must pay the tax – generally the full amount due – and seek a refund in a federal district court or the U.S. Court of Federal Claims.⁷

REASONS FOR CHANGE

The value of CDP proceedings is undermined when taxpayers who have never had an opportunity to dispute their underlying liability in the Tax Court are precluded from doing so during their CDP hearing, and these taxpayers have no alternative but to pay the tax and then seek a refund, an option that not all taxpayers can afford. 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, allowing more taxpayers to dispute their tax liabilities in CDP hearings will better protect taxpayer rights without imposing 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 a non-deficiency case, the taxpayer did not have an opportunity to dispute the liability in the U.S. Tax Court.
- 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).

5 *Our Country Home Enters., Inc. v. Comm'r*, 855 F.3d 773, 792-793 (7th Cir. 2017); *Keller Tank Servs. II, Inc. v. Comm'r*, 854 F.3d 1178, 1199-1200 (10th Cir. 2017) (both cases holding that a taxpayer who challenged an IRC § 6707A penalty at an Appeals hearing prior to assessment was precluded from raising the issue in a CDP hearing); Treas. Reg. §§ 301.6320-1(e)(3) Q&A-E2, 301.6330-1(e)(3) Q&A-E2.

6 These “assessable” penalties are primarily found in IRC §§ 6671 through 6720C. The IRS sometimes assesses these penalties systemically (i.e., automatically by computer rather than manually during an audit). See, e.g., Internal Revenue Manual 21.8.2.20.2(1), Form 5471 Penalties Systemically Assessed From Late-Filed Form 1120 Series or Form 1065 (Oct. 1, 2023), https://www.irs.gov/irm/part21/irm_21-008-002r. But see *Farhy v. Comm'r*, 160 T.C. No. 6 (Apr. 3, 2023), where the Tax Court recently held that the IRS does not have authority to assess Form 5471 penalties. The government is currently appealing this decision to the U.S. Court of Appeals for the District of Columbia Circuit.

7 Under *Flora v. United States*, 362 U.S. 145 (1960), a taxpayer must have “fully paid” the assessment before filing a refund suit. One exception to the full payment rule applies to “divisible” taxes.