INTRODUCTION

This Procedure and Administration Deskbook provides broad, basic explanations of Procedure and Administration's primary subject matter areas. It is an overview, generally spanning the process from filing, through examination, collection, and litigation. This Deskbook is intended to assist P&A attorneys and paralegals to identify and analyze commonly encountered questions and issues with greater ease.

While this Deskbook is a standalone primer, it is not a replacement for the more detailed reference guides already available on the P&A website:

- the Summons Handbook: http://publish.no.irs.gov/pubsys/irm/indp25.htm
- the GL-1 Training Material: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- GL-2 Training Material: http://www.irs.gov/file_source/pub/irs-utl/GL2%202013%20Lesssons.zip
- Bankruptcy Handbook: http://publish.no.irs.gov/pubsys/irm/indp05.htm
- Counsel Bankruptcy Practice Deskbook: http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/PA/Pages/ChiefCounselBankruptcyPracticeDeskbook.aspx
- Disclosure and Privacy Law Reference Guide. http://www.irs.gov/pub/irs-pdf/p4639.pdf
- Disclosure of Official Information Handbook (IRM 11.3): http://publish.no.irs.gov/pubsys/irm/indp11.htm

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CHAPTER 1: FILING REQUIREMENTS

I. GENERAL FILING REQUIREMENTS – SECTION 6011

A. General Requirement of Return, Statement, or List

1. *Filing Tax Returns*. Every person who is subject to income tax must file a return on a form prescribed by the IRS. IRC § 6011(a), Treas. Reg. § 1.6011-1(a).
2. *Persons Required to File Returns*:
    a. Every individual residing in the United States and every United States citizen, wherever residing, must file a return when income reaches a certain level. Treas. Reg. § 1.6012-1(a).
    b. Every corporation that is subject to income tax must file a return, whether the return shows taxable income or a loss. Treas. Reg. § 6012-2(a)(2).
    c. Fiduciaries in general, and fiduciaries of estates and trusts, must also file returns. Treas. Reg. § 1.6012-3.
    d. Employers and other payors that withhold taxes also have return filing requirements. Treas. Reg. §§ 31.6011(a)-1; 31.6011(a)-3; 31.6011(a)-4.
    e. Persons subject to manufacturers' and retailers' excise taxes, environmental excise taxes, the excise tax on indoor tanning services, the excise tax on foreign insurance policies, and the excise tax on the issuance of certain obligations in registered form generally must file a quarterly excise tax return. Treas. Reg. § 40.6011(a)-1.
    f. Domestic International Sales Corporations have special return requirements. IRC § 6011(c).
    g. Taxpayers with a financial interest, or signature or other authority over foreign financial accounts, including bank or securities accounts in a foreign country, must file Treasury Department Form TD F 90-22.1, Report of Foreign Bank and Financial Accounts (FBAR).
    h. Every taxpayer that participates in a reportable transaction and is required to file a tax return must disclose the reportable transaction on Form 8886, Reportable Transaction Disclosure Statement. Treas. Reg. § 1.6011-4(a).
    i. A gift tax return must be filed by the donor of the gift, his guardian or committee, or representative of his estate unless the gift is excludible under the annual dollar amount exclusion. IRC § 6019; Treas. Reg. § 25.6019-1(a).
    j. An estate tax return must be filed for the estate of a U.S. citizen if the gross estate exceeds the "basic exclusion amount," reduced by the decedent's adjusted taxable gifts. Returns may also have to be filed for estates of nonresidents aliens with assets situated in the U.S. IRC § 6018(a).
3. *Electronic Filing IRC § 6011(e)*

a. REGULATIONS REQUIRED TO IMPOSE E-FILE REQUIREMENT. The IRS is required to issue regulations setting standards for determining which returns must be filed electronically, but may not impose e-file requirement on income tax returns of individuals, estates, or trusts (except for certain returns filed by specified tax return preparers). IRC § 6011(e)(1).

NOTE: In issuing regulations, the IRS generally may not impose e-file requirement unless the person is required to file at least 250 returns during the calendar year, and must take into account the ability to comply at reasonable cost. IRC § 6011(e)(2).

b. PERSONS REQUIRED TO FILE RETURNS ELECTRONICALLY.

   i. Filers of 250 or more information returns, including the Form 1099 series and the Form W-2 series are generally required to file electronically. Treas. Reg. § 301.6011-2(b). For information returns, the 250-return threshold applies separately to each type of return. Treas. Reg. § 301.6011-2(c)(1)(iii).
   ii. Corporations required to file a Form 1120 series of returns must file electronically if it and members of its controlled group is required to file at least 250 returns during the calendar year. Treas. Reg. § 301.6011-5.
   iii. Exempt organizations and private foundations required to file Form 990, Return of Organization Exempt from Income Tax; Form 990-PF, Return of Private Foundation or Section 4947(a)(1) Trust Treated as Private Foundation; must file electronically if the organization is required to file at least 250 returns during the calendar year. Treas. Reg. § 301.6033-4.
   iv. Partnerships with more than100 partners must file Form 1065 and Form K-1 electronically. Treas. Reg. § 301.6011-3(a).
   v. Specified tax return preparers (return preparers that reasonably expect to file 11 or more individual income tax returns during the calendar year generally must file those returns electronically. IRC § 6011(e)(3), Treas. Reg. § 301.6011-7.
   vi. Financial institution required to file a Form 1042-S, Foreign Person's U.S. Source Income Subject to Withholding, under Prop. Treas. Reg. § 1.1474-1(d) must file the information required by the applicable forms and schedules on magnetic media. Prop. Treas. Reg. § 301.1471-1(a).

4. *Joint Returns of Income Tax by Husband and Wife (IRC § 6013)*

a. WHO MAY FILE A JOINT RETURN

   i. A husband and wife married on the last day of the tax year may generally file a joint return. IRC. §§ 6013(a), 6013(d)(1).
   ii. In the event of the death of a spouse, a joint return may generally be made for the surviving and the deceased spouse if the tax year of both spouses begins on the same day. Treas. Reg. § 1.6013-6(a)(2)(v).

    iii. A United States citizen or resident alien married to a nonresident alien may elect to file a joint return, provided that both spouses agree to be taxed on their worldwide income and supply all necessary books and records and all information pertinent to the determination of tax liability. IRC § 6013(a)(2).

b. SIGNING A JOINT RETURN
    i. Joint returns must generally be made and signed by a husband and wife
    ii. A return may be made by a duly authorized agent or guardian if:
        A. one of the spouses is under a disability,
        B. is absent from the United States for a continuous period of 60 days prior to the due date of the return,
        C. or on good cause gets permission from the Service. Treas. Reg. §1.6012-1(a)(5).
    iii. MIA. The spouse of an individual missing in action in a designated combat zone may file a joint return even though the return is not signed by the missing spouse. IRC § 6013(f).
    iv. TACIT CONSENT. Where a return is signed only by one spouse, courts may deem a joint return if they believe the other spouse gave her tacit consent. *Howell v. Commissioner*, 175 F.2d 249 (6th Cir. 1948).

c. JOINT AND SEVERAL LIABILITY.
    i. Generally, a husband and wife are jointly and severally liable for the tax on a joint return. IRC § 6013(d)(3).
    ii. Liability on a joint return can be avoided on a showing that
        A. A joint return was not made (see tacit consent rule above);
        B. The return was made under conditions of duress or deception, Brown v. Commissioner, 51 T.C. 116 (1968);
        C. Taxpayer qualifies for innocent spouse relief. IRC § 6015.

d. CHANGING STATUS
    i. Amending Separate Returns to file a Joint Return. Married taxpayers who have filed separate returns may change their minds and file a joint return as long as the due date for filing the return has not passed.
    ii. A joint return may also be filed after the due date by taxpayers who filed separate returns, but only if
        A. The joint return was filed within 3 years from the due date for filing the taxpayers' return for the tax year, determined without regard to any extension granted to either spouse. IRC § 6013(b)(2)(A);
        B. Neither spouse has filed a properly executed petition with the Tax Court, IRC § 6013(b)(2)(B);
        C. Neither spouse has started a suit for the recovery of any part of the tax for the tax year. IRC § 6013(b)(2)(C);
        D. Neither spouse has entered into closing agreement for the tax year, IRC § 6013(b)(2)(D);

E. No civil or criminal case against either spouse for the tax year has been compromised under IRC § 7122, IRC § 6013(b)(2)(D).

e. AMENDING JOINT RETURN TO FILE A SEPARATE RETURN. Except under certain circumstances following the death of one of the spouses, separate returns may not be substituted after a joint return has been filed. Treas. Reg. 1.6013-1(a)(1).

5. *Place for Filing Returns*. Generally, tax and information returns must be filed with the Internal Revenue Center that serves the area in which the taxpayer's legal residence or principal place of business is located, or at the location designated in the return form and instructions.
   a. Notice 2010-53 advises taxpayers of the proper address for filing certain returns, elections, statements and other documents.
   b. Hand carried returns may be filed with any person assigned the responsibility to receive returns in the local IRS office, Treas. Reg. § 301.6091-1
6. *Time for Filing Returns*
   a. INCOME TAX RETURNS. In general, unless an extension is received, income tax returns for calendar year individuals, trusts, employee benefit plans, estates and partnerships must be filed by April 15 of the year following the reported tax year, Treas. Reg. § 1.6072-1(a)(1).
      i. Returns of nonresident alien individuals, other than those whose wages are subject to withholding, must be filed on or before the 15th day of the sixth month following the end of the tax year, except for those who elect to be treated as residents, Treas. Reg. § 1.6072-1(c).
      ii. Unless an extension is received, corporations must file their returns by the 15th day of the third month following the end of the taxable year, which is March 15 of the year following the reported tax year for calendar year corporations, IRC § 6072(b).
      iii. Unless an extension is received, charitable organizations must file their returns by the 15th day of the fifth month following the end of the taxable year, which is May 15 of the year following the reported tax year for calendar year charitable organizations, IRC § 6072(e).
      iv. Unless an extension is received, cooperative organizations must file their returns by the 15th day of the ninth month following the end of the taxable year, which is September 15 of the year following the reported tax year for calendar year cooperative organizations, IRC § 6072(d).
      v. Short Period Returns – When a return must be filed for a period less than 12 months, the filing due date is generally the same as for a taxpayer with a 12-month tax year ending on the last day of the short period, Rev. Rul. 71-129, 1971 C.B. 397.
   b. EMPLOYMENT TAX RETURNS

i. Employers generally file Form 941, Employer's Quarterly Federal Tax Return, to report amounts withheld and FICA. The return is due quarterly, on April 30, July 31, September 30 and January 31. Small employers may file Form 944, Employer's Annual Federal Tax Return, which is due on January 31. Agricultural employers may also file an annual form, Form 943. See Publication 15 (Circular E) and Publication 15-A.

ii. Taxpayers report non-payroll withholding on an annual Form 945, Annual Return of Withheld Federal Income Tax, which is due on January 31. This includes backup withholding, gambling withholding, and pension withholding.

c. INFORMATION RETURNS

i. Wage and tax statements are due to the recipient on January 31st following the end of the calendar year. Treas. Reg. § 31.6051-1(d). The Form W-2 Wage and Tax statement, Form W-2, together with The Form W-3 reconciliation statement is due to the Social Security Administration on the last day of February of the year following the calendar year for which it is made. Treas. Reg. § 31.6071(a)-1(a)(3)(i). Or if filed electronically, by March 31. IRC § 6071(b).

ii. Generally, Forms 1098 and 1099, and other information returns, must be furnished to the recipient by January 31 of the year following the calendar year for which it is made, and filed with the IRS by February 28 of the year following the calendar year for which it is made or, if filed electronically, by March 31. See underlying information return Code sections and Regulations, and Treas. Reg. § 1.6071-1(c). Form 1099-B, Proceeds From Broker and Barter Exchange Transactions, Form 1099-S, and Form 1099-MISC if reporting amounts pursuant to section 6045, are due to the recipient on February 15 of year following the calendar for which it is made. Treas. Reg. § 31.6045-1(k)(2).

iii. Returns of partnerships (Form 1065) are due by the following April 15 for calendar year partnerships, and on or before the 15th day of the fourth month after the close of the tax year for fiscal year partnerships. IRC § 6072, Treas. Reg. § 1.6031(a)-1(e)(2).

A. Each partnership required to file a tax return must, on or before the day on which the return for the tax year is required to be filed, furnish to each person who is a partner or who holds an interest in the partnership as a nominee for another person at any time during the tax year a copy of the information required to be shown on the return. Form 1065, Schedule K-1, is used to furnish to a partner or a nominee the information from the Form 1065.

B. The return of a partnership all of the partners of which are nonresident aliens must be filed on or before the 15th day

of the sixth month following the close of the partnership year.

C. An electing large partnership must furnish Form K-1 payee statements to partners on or before the first March 15 following the close of the taxable year. IRC § 6031(b).

For more information:

- Contact P&A Branches 1&2.
- For counterarguments to frivolous arguments as to who must file, *see* Notice 2010-33, IRB 2010-17 at: http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/PA/Pages/FrivolousTaxArguments.aspx
- *See also* http://www.irs.gov/Tax-Professionals/The-Truth-About-Frivolous-Tax-Arguments-Introduction

II. Disclosure of Information by Return Preparers – Section 7216

Section 7216 of the Code governs the disclosure or use of information obtained by any person who is engaged in the business of preparing tax returns, engaged in the business of providing services in connection with the preparation of tax returns, or who prepares a return for another for compensation.

A. General Rule. Section 7216 makes it a criminal offense for a tax preparer to knowingly or recklessly: (1) disclose any information furnished to him for or in connection with the preparation of any such return; or (2) use any such information for any purposes other than to prepare or assist in preparing any such return. Section 6713 provides for a parallel civil penalty. The penalty upon conviction of violating section 7216 is a fine of $1,000, imprisonment up to one year, or both, together with the costs of prosecution.

B. Exceptions to the general rule.

1. The disclosure is made pursuant to any other provision of the Code or pursuant to court order.
2. The information is used in the preparation of, or in connection with the preparation of, State and local tax returns and declarations of estimated tax.
3. Other disclosures or use of information permitted by regulations; see Treas. Reg. § 301.7216-2:
    a. disclosures to the IRS;
    b. disclosure or uses for preparation of a taxpayer's return;
    c. updating the taxpayer's tax return preparation software if the preparer provides software to the taxpayer in connection with the preparation or filing of a tax return;
    d. disclosures to other tax return preparers;
    e. disclosure or use of information in the case of related taxpayers, provided certain conditions are met;
    f. disclosure pursuant to court order or certain administrative actions;

g. disclosure or use in securing legal advice, Treasury investigations, or court proceedings;
h. certain disclosure by attorneys and accountants;
i. a corporate fiduciary that prepares a tax return for the taxpayer for whom it renders custodial or management services may disclose or use tax return information in the ordinary course of rendering services to the taxpayer or make the information available to the taxpayer's attorney, accountant, or investment advisor;
j. disclosure to taxpayer's fiduciary when the taxpayer becomes incompetent, insolvent, bankrupt, or the taxpayer's assets are placed in conservatorship or receivership;
k. disclosure or use of information in preparation or audit of state or local tax returns or assisting a taxpayer with a foreign country obligation;
l. with limitations, to obtain payment for tax return preparation services;
m. a tax return preparer may retain records, including tax return information;
n. maintenance of a list of certain tax return information to provide general business or economic information or to solicit tax return preparation services;
o. with limitations, use and disclosure of tax return information to produce statistical compilations that cannot be tied to a specific taxpayer;
p. disclosure or use of information for quality, peer, or conflict reviews;
q. disclosure to report the commission of a crime, or,
r. disclosure of tax return information due to a tax return preparer's incapacity or death.

C. Consents for Disclosure or Use.

1. Treasury Reg. § 301.7216-3 provides that a tax preparer must obtain consent from the taxpayer unless disclosure or use is expressly authorized in section 7216 or Treas. Reg. § 301.7216-2. This consent must be knowing and voluntary. Except as permitted by Treas. Reg. 301.7216-3(a)(2), a tax return preparer may not condition the provision of services on the taxpayer furnishing consent. The regulations require the following to be a valid consent:
   a. Consents must include the name of the tax return preparer and the taxpayer.
   b. The consent to disclose must describe the intended purpose of the disclosure and the recipient(s) of the disclosed information.
   c. A consent to use information must describe the use authorized.
   d. The consent must specify the tax return information to be disclosed or used.
   e. The taxpayer must sign and date the consent.

2. The Secretary may publish IRB guidance regarding consents for 1040 series filers. (See below for information on Rev. Proc. 2013-14.)

3. Consents for non1040 series filers may be in any format, including engagement letters, provided all requirements in section 301.7216-3(a)(i) are met.

4. A taxpayer may consent to a specific duration for the consent. If no duration is specified, the consent will be for one year.
5. For 1040 series filers, consents for disclosures and consents for use must be separate, although multiple disclosures or multiple uses may be in one consent.
6. Taxpayers must be provided with a copy of the consent.

D. Revenue Procedure 2013-14.

1. Revenue Procedure 2013-14 provides that consents obtained during calendar year 2013 with respect to a taxpayer filing a return in the Form 1040 series may contain either the mandatory language in section 4.04 of Rev. Proc. 2008-35 (the predecessor to Rev. Proc. 2013-14) or the mandatory language in section 5.04 of Rev. Proc. 2013-14. Any consent obtained on or after January 1, 2014, must contain the mandatory language in Rev. Proc. 2013-14.
2. The Rev Proc. also sets forth:
   a. That consent does not have to be obtained merely to engage a tax return preparer to perform tax return preparation services;
   b. formatting requirements for consents, e.g. font size, paper size, what information may appear on a single computer screen;
   c. mandatory language that must be in consents to disclose or consents to use; and,
   d. requirements for data protection safeguards and electronic signatures.

For more information:

- Contact P&A Branches 1&2
- Treasury Reg § 301.7216-1 through 301.7216-3.
- Revenue Ruling 2010-4.
- Revenue Ruling 2010-5.
- http://www.irs.gov/Tax-Professionals/Section-7216-Information-Center.

III. CIRCULAR 230/ANNUAL FILING SEASON PROGRAM/ PTINS/POAS

A. Circular 230. The regulations governing practice before the IRS under 31 CFR part 10 are compiled and reproduced as Treasury Department Circular 230. Circular 230 provides rules and regulations governing practitioners' conduct before the IRS. Practice before the IRS includes preparing and filing documents; representing taxpayers at conferences, hearings, or meetings; corresponding or communicating with the IRS; and providing written advice. Practitioners covered by Circular 230 include attorneys, CPAs, enrolled agents, enrolled retirement plan agents, and actuaries.

1. The IRS Office of Professional Responsibility (OPR) conducts investigations into practitioner activities, enforces the rules set forth in Circular 230, and applies, sanctions, which can include censure, suspension, or disbarment from practice before the IRS, as well as monetary penalties.
2. *Case Law.*

a. *Loving v. United States*, 917 F. Supp. 2d 67 (D.D.C. 2013), *aff'd* 742 F.3d 1013 (D.C. Cir. 2014) (return preparation is not practice before the agency and tax return preparers are not representatives).
b. *Ryan, LLC v. Lew*, 55 F.Supp.3d 89 (D.D.C. 2014) (holding the IRS lacks authority to promulgate or enforce restrictions on contingent fees with respect to ordinary refund claims where preparation and filing precedes examination or adjudication).

B. Annual Filing Season Program (AFSP). This program allows individuals to obtain a record of completion if they meet the following requirements (1) obtain a preparer tax identification number (PTIN), (2) complete a 6 hour federal tax filing season refresher course (if not exempt by virtue of another credential), (3) complete required continuing education, and (4) consent to be subject to the duties and restrictions of Circular 230. Rev. Proc. 2014-12, 2014-29 IRB 192. This is an annual program. Participants must meet the requirements on a yearly basis.

1. Beginning on January 1, 2016, only AFSP participants may represent taxpayers before the IRS during the examination of a return or claim for refund that the individual prepared and signed. Previously any unenrolled individual could represent a taxpayer during an examination based upon having prepared and signed the return. The individual must be an AFSP participant in the year the return was prepared and in the year of representation. This does not affect the rights of Circular 230 practitioners to represent before the IRS.
2. The IRS Return Preparer Office (RPO) administers the AFSP.

C. Preparer Tax Identification Numbers. Any return preparer who prepares "all or substantially all" of a tax return or claim for refund for compensation is required to have a PTIN. Treas. Reg. § 1.6109-2. Additionally, every enrolled agent must have a PTIN. Circular 230 §10.4. RPO is responsible for PTIN registration. PTINs must be renewed annually. RPO also conducts tax compliance and suitability checks related to PTIN renewal.

1. *Individuals not required to have a PTIN*.
   a. Tax assistance under Low Income Taxpayer Clinics or VITA;
   b. Students in a Student Tax Clinic Program; or
   c. Employees of the taxpayer.
2. *Case Law*.
   a. *Brannen v. United States*, 2011 U.S. Dist. Lexis 155732 (N.D. Georgia August 26, 2011), *aff'd*, 682 F.3d 1316 (11th Cir. 2012) (statutory authority for PTIN user fee is upheld).
   b. *Buckley v. United States*, 2013 WL 7121182 (N.D.GA., 2013) (upheld statutory authority for PTIN user fee and held user fee amount was reasonable).

D. Power of Attorney. *Form 2848, Power of Attorney and Declaration of Representative*. When signed by the taxpayer, Form 2848 grants individuals eligible to practice before the IRS the authority to represent the taxpayer before the IRS and AFSP participants. The authorized representative can receive and inspect all tax documents

and perform all acts that taxpayers can perform, (*e.g.* sign consents, agreements or waivers). The Form 2848 must specify the year and subject matter of the representation.

NOTE: Joint filers each need a separate Form 2848.

NOTE: Contrast Form 2848, Power of Attorney, with the Form 8821, Tax Information Authorization (which only authorizes an individual to receive and/or inspect taxpayer information).

For more information:

- Contact P&A Branches 1&2

Circular 230 and Return Preparer:

- Circular 230
- Rev. Proc. 2014-42, Annual Filing Season Program
- PTIN Regulations § 1.6109-2
- Notice 2011-6, Implementation of Rules Governing Tax Return Preparers (only still relevant relating to PTINs)
- Pub. 216, Conference and Practice Requirements
- Rev. Proc. 2012-12, Continuing Education Requirements for Practitioners
- IRM 20.1.2.12.1, Practice Before the IRS and 20.1.6.12.2, Sanctions for Violations
- Pub. 1345 Handbook for Authorized IRS e-file Providers

Power of Attorney:

- Instructions for Form 2848
- Pub. 216, Conference and Practice Requirements

IV. FOREIGN BANK ACCOUNT REPORT (FBAR)

A. The Bank Secrecy Act. The Bank Secrecy Act (BSA) gave the Treasury Department authority to establish recordkeeping and reporting requirements for U.S. persons with financial interests in, or signature authority over, financial accounts maintained with financial institutions in foreign countries. The FBAR statutory provisions are found in Title 31 of the U.S. Code. Relevant provisions include 31 USC § 5314 (records and reports on foreign financial agency transactions), § 5319 (availability of reports), § 5321 (civil penalties) and § 5322 (criminal penalties). The Financial Crimes Enforcement Network (FinCEN) has primary responsibility for the FBAR, but enforcement authority has been delegated to the IRS.

The regulations require that FinCEN Report 114, Report of Foreign Bank and Financial Accounts (FBAR), must be filed with the Treasury Department under certain circumstances.

1. *FBAR Filing Requirements*. Any U.S. person (which includes a U.S. citizen or resident and domestic corporations, partnerships, trusts and estates) who has financial interest in, or signature authority over, financial accounts in a foreign country, is required to file an FBAR. This applies when the aggregative value of the foreign financial accounts exceeds $10,000 at any time during the calendar year.

2. *Covered Financial Accounts.* Financial accounts include any bank accounts, mutual funds or similar pooled funds, securities derivatives, annuities or insurance policies with a cash value, and other financial instruments.
3. *Financial interest defined.* This includes accounts where the U.S. person is the owner of record or has legal title whether the account is maintained for his or her own benefit or for the benefit of others, including non-U.S. persons. This can include:
    a. Interest in a corporation if the U.S. person owns directly or indirectly more than 50% of the total value of stock.
    b. Interest in a partnership if the U.S. person owns interest in more than 50% of the profits.
    c. Interest in a trust if the U.S. person has beneficial interest in more than 50% of assets or receives more than 50% of current income.
4. A person has signature authority when he or she can control disposition of money or other property in an account by delivery of a document with his signature to the financial institution maintaining the financial account.
    a. Signature authority reporting for some individuals who have signature authority based upon their employment has repeated been delayed beginning in 2008.
5. The FBAR must be received by the Department of Treasury on or before June 30 of the year following the year being reported. Additionally, unless an exception is granted by FinCEN, the report must be filed electronically.

NOTE: The FBAR is <u>not</u> filed with the filer's federal income tax return and an extension to file the federal tax return does not extend the due date for filing the FBAR.

B. <u>Miscellaneous</u>.
1. If two or more U.S. persons have a financial interest in the same account, then each person may have to file an FBAR and report the entire value of the jointly owned accounts.
2. There are FBAR filing exceptions which include IRA owners and beneficiaries, trust beneficiaries, and U.S. military banking facilities.
3. There are civil penalties (31 USCS § 5321) and criminal penalties (31 USCS § 5322) for failing to file or filing a false FBAR.

<u>For more information:</u>
- Treasury Regulations at 31 CFR § 1010.350 (Reports of Foreign Financial Accounts) and 31 CFR Chapter X (General BSA Regulations)
- IRM 4.26.16 (FBAR) and 4.26.17 (FBAR Procedures)
- http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/sbse/Pages/OffshoreInternational.aspx?phrases=FBAR&strict=n
- Contact P&A Branch 1 & 2.

V. INFORMATION REPORTING/BACKUP WITHHOLDING

A. Relevant Code sections: generally §§ 6041-6050W, providing for information returns generally within the Form 1099 and 1098 series. Sections 6051-6053 provide for reporting by employers, and §§ 6055-6056 provide for information reporting of health insurance coverage.

1. Information reporting is required for taxpayers (filers) in a trade or business.
2. Information returns must be filed with the Service (or, in the case of Forms W-2, with SSA) and payee statements must be furnished to the payees. See due dates and electronic filing requirements in Chapter I, *supra*.
3. In general, an information return includes the name, address and TIN of the payor, the name, address and TIN of the payee, the amounts required to be reported, and any other information required to be reported. The payee statement generally contains the information shown on the information return. However, the TIN of the payee may be truncated on the payee statement (other than a Form W-2), so that only the last 4 digits are shown.
4. Payee statements may be furnished using substitute statements or composite statements. They may also be furnished electronically with the consent of the payee.

B. Common reporting provisions are:

1. Section 6041 – payments of $600 or more of rent, compensation, premiums, annuities, or other fixed or determinable gains, profits or income. (generally reported on Form 1099-MISC; wages on Form W-2; gambling winnings on Form W-2G).
2. Section 6041A - payments for services of $600 or more, or direct sales of $5,000 or more (Form 1099-MISC).
3. Section 6042 – dividends (Form 1099-DIV).
4. Section 6045 – broker reporting (Form 1099-B); also reporting of real estate transactions (Form 1099-S) and gross proceeds paid to attorneys (Form 1099-MISC).
5. Section 6049 – Interest (Form 1099-INT and 1099-OID).
6. Section 6050E – state tax refunds (Form 1099-G).
7. Section 6050H – mortgage interest received (Form 1098).
8. Section 6050P – cancellation of indebtedness (Form 1099-C).
9. Section 6050S – tuition and student loan interest received (Forms 1098-E and 1098-T).
10. Section 6050W – payment card and third party network transactions (Form 1099-K).
11. Section 6051 – receipts for employees (Forms W-2)

C. Information Reporting Penalties.

1. Section 6721 provides for a penalty for failure to file correct information returns (as defined in section 6724(d)(1)). Section 6722 provides a penalty for failure to furnish correct payee statements (as defined in section 6724(d)(2)).

2. The penalties apply to a failure to file the return or furnish the payee statement, failure to include all required information, or the inclusion of incorrect information.
    a. FAILURE TO FILE. A failure to file a return electronically is deemed to be a failure to file. Each penalty is generally $100 per return or statement, with a calendar year limitation of $1,500,000. The penalty may be reduced if the failure is corrected within a specified time.
    b. INTENTIONAL DISREGARD. In the case of intentional disregard, each provision provides for a penalty of generally $250 per return or statement or, if greater,10 percent of the amount that should have been reported, and there is no annual limitation. The intentional disregard penalties are higher with respect to certain information reporting requirements.
    c. SECTION 6723 provides a $50 penalty for failure to comply with a specified information reporting requirement, such as a failure to furnish a TIN to another person.
    d. SECTION 6724 provides for a waiver of the information reporting penalties for reasonable cause. Under Treas. Reg. § 301.6724-1, the filer must show that there were significant mitigating factors or that the failure was due to circumstances beyond the filer's control; in addition, the filer must have acted in a responsible manner both before and after the failure. The regulations provide special rules for establishing that the filer acted in a responsible manner in the case of a failure to include a payee's correct TIN on an information return.

<u>For more information:</u>

- Contact P&A Branches 1 & 2
- See the General Instructions for Certain Information Returns (Forms 1097, 1098, 1099, 3921, 3922, 5498, and W-2G)
- Publication 1586 – Reasonable Cause Regulations and Requirements for Missing and Incorrect Name/TINs.
- Publication 1179 – General Rules and Specifications for Substitute Forms 1096, 1098, 1099, 5498 and Certain Other Information Returns.

D. <u>Backup Withholding</u>. IRC § 3406 requires payers to withhold income tax on reportable payments of interest, dividends, and other payments under certain conditions.

1. IRC § 3406(a) provides for backup withholding on certain reportable payments, if:
    a. the payee fails to furnish a TIN to the payor in the manner required,
    b. the Secretary notifies the payor that the TIN furnished by the payee is incorrect,
    c. there has been a notified payee underreporting described in IRC 3406(c), or
    d. there has been a payee certification failure described in IRC 3406(d).

2. Backup withholding applies only to reportable payments as set forth in section 3406. Reportable payment means any interest or dividend payment which is required to be shown on a return required under
   a. IRC 6049(a) (interest payments),
   b. IRC 6042(a) (dividend payments), and
   c. IRC 6044 (patronage dividend but only to the extent such payment is in money).

In addition, it includes other payments required to be shown on a return required under
   a. IRC 6041 (relating to certain information at source payments),
   b. IRC 6041A (payments for remuneration of services and direct sales),
   c. IRC 6045 (returns of brokers),
   d. IRC 6050A (payments to certain fishing boat operators),
   e. IRC 6050N (royalty payments), and
   f. IRC 6050W (relating to returns for payments made in settlement of payment card transactions).

3. Payers will be held liable for the payment of any backup withholding required to be deducted and withheld under IRC § 3406 per IRC § 3403. The payer may be relieved of this liability if the payee reported the income and paid the tax. *See* section 3402(d).

4. Backup withholding adjustments are subject to the Trust Fund Recovery Penalty (section 6672).

5. Backup withholding is treated as withholding on wages per IRC § 3406(h)(10).

For more information:

- See IRM 4.23.
- Contact P&A Branches 1&2.

CHAPTER 2: INFORMATION GATHERING IN THE EXAMINATION AND COLLECTION CONTEXT[1]

I. INFORMATION DOCUMENT REQUESTS (IDRS)

Information Document Requests, or IDRs, are an informal administrative request that a taxpayer supply information. The requests are often submitted to the taxpayer on a Form 4564 accompanied with a letter notifying the taxpayer that an audit was initiated. IDRs are not judicially enforceable. The statutory authority for the IRS to make these "soft" requests for information is IRC § 7602(a)(1).

II. SUMMONS

A summons is an administrative demand seeking testimony or records from a taxpayer or a third party. The IRS has authority under sections 7602(a)-(b) to issue summonses in pursuit of information for examination, collection, or criminal tax purposes. Specifically, IRC § 7602(a)(2) authorizes the IRS to summon the taxpayer, or the taxpayer's officer or employee, or any other person to give testimony or produce books, papers, records, or other data that "may be relevant" to the inquiry.

A. Valid summons. A valid, properly issued summons is judicially enforceable. To be valid, a summons must satisfy the elements defined in *United States v. Powell*, 379 U.S. 48 (1964). These are:

1. The summons must be issued for a proper purpose;
2. the summons must seek information that "may be relevant" to the investigation;
3. the summoned information must not already be in the Service's possession; and,
4. the Service must have followed all of the requirements of the Code and the regulations.

With respect to what is an improper purpose, *see Clarke v. United States*, _ U.S. , 134 S. Ct. 2361 (2014), wherein the Supreme Court reversed the Eleventh Circuit and unanimously held that a bare allegation by a summons opponent that a summons was issued for an improper purpose is insufficient to require a district court to hold an evidentiary hearing. Instead, a summons opponent must present some credible evidence that could plausibly raise an inference of bad faith.

Under IRC § 7603(a), a summons may be served by delivering it in hand to the summoned person, or by leaving it at that person's last and usual place of abode. *See* Treas. Reg. § 301.7603-1, Summons Handbook, IRM 25.5.

Delegation Order 25-1 authorizes particular IRS officers and employees to issue a summons, administer oaths, take testimony and receive documents from the summoned individual. The authority to issue certain types of summonses, such as John

[1] Summons authority also applies to criminal investigations, which is outside the scope of this deskbook.

Doe summonses, is restricted to high ranking executives. Other restrictions apply to third-party summonses. *See* D.O. No. 25-1, IRM 1.2.52.2.

B. Referral to Justice Department Effect on Summons. If the Service has recommended that the Justice Department commence a grand jury investigation or criminal prosecution of a taxpayer, the IRS may not issue or begin to enforce any summons for the taxable period and type of tax at issue in the referral. This prohibition continues as long as the referral remains in effect. *See* Treas. Reg. § 301.7602-1(c)(1)-(4). Note that if a Justice Department referral is made for the taxpayer after the U.S. commenced its summons enforcement court proceeding, then the summons enforcement case may go forward.

C. Notice procedures for third party summons. IRC § 7609(a) requires that the Service give notice to the taxpayer of all summonses issued to third parties, other than those excepted under sections 7609(c)(2)-(3). Such notice must be given to the taxpayer named in the caption of the summons and to every person (other than the summoned witness) named in the description of summoned records. Treas. Reg. § 301.7609-2, IRM 25.5 and Summons Form 2039, Parts C - D.

   Notice can be given by any manner provided in section 7603 for serving a summons, by certified or registered mail to the noticee's last known address, or if there is no last known address, notice may be left with the summoned person. Treas. Reg. § 301.7609-2(a)(3). Notice must be given no later than 3 days after the day the summons is served. The date of production must be at least 23 days after the date on which notice was given to allow a noticee the opportunity to petition to quash the summons. IRC § 7609(a)(1), Treas. Reg. § 301.7609-2.

D. John Doe Summons. A John Doe summons is any summons that does not identify by name the taxpayer being investigated. John Doe summonses are highly sensitive and must be approved by a federal district court before service. Only certain authorized senior executives may issue a John Doe summons. *See* D.O. No. 25-1, IRM 1.2.52.2. A John Doe summons must be reviewed in the National Office before any request is made for the Justice Department to seek district court approval to serve the summons. CCDM 34.6.3.

   To obtain court authorization to serve a John Doe summons, the Government must not only satisfy the *Powell* requirements, but must also establish three factors:

   1. the summons relates to the investigation of a particular unknown person or an ascertainable group or class of unknown persons;
   2. there is a reasonable basis for believing that such person or group or class of persons may fail or may have failed to comply with any provision of any internal revenue law; and,
   3. the information sought to be obtained from the summoned records or testimony (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources. IRC § 7609(f)(1)-(3). *See* IRM 25.5.7.

III. Tax Accrual Workpapers

Tax accrual workpapers (TAW) are audit workpapers, whether prepared by the taxpayer or by an independent accountant, which relate to the tax reserve for current, deferred and potential or contingent liabilities, however classified or reported on audited financial statements. It also includes footnotes disclosing those tax liabilities on audited financial statements. TAW reflect an estimate of a company's tax liability.[2] Documents created prior to, or outside of, the consideration of whether reserves should be created (even though these documents may have been used in the preparation of tax accrual workpapers) are not TAW. *See* IRM 4.10.20.2.

A. Standard Policy for Requesting Tax Accrual Workpapers. The IRS follows a policy of restraint and generally does not request tax accrual workpapers for civil tax purposes, absent unusual circumstances. This policy applies to all audits that do not involve a listed transaction as defined in Treas. Reg. § 1.6011-4, and to all audits of returns filed on or before February 28, 2000 that involve a listed transaction. *See* IRM 4.10.20.3.

   Note: The Supreme Court has unanimously held that the IRS can legally require disclosure of tax accrual workpapers. *United States v. Arthur Young*, 465 U.S. 805 (1984).

   1. Unusual circumstances exist when an examiner has identified a specific issue and needs additional facts, has sought from the taxpayer and available third parties all of the facts relating to that issue, and has sought a supplementary analysis (e.g., from the taxpayer's accountant) of facts relating to the identified issue, and has reconciled the taxpayer's Schedule M-1 or M-3 to the identified issue. *See* also TAW FAQ 11.
   2. A request for tax accrual workpapers should be limited to the portion of the workpapers that is material and relevant to the examination. *See* IRM 4.10.20.3.1.

B. Modified Policy for Requesting Tax Accrual Workpapers For Returns Involving Listed Transactions. In general, the modified policy applies to returns filed by taxpayers claiming benefits from listed transactions. Announcement 2002-63, 2002-2 C.B. 72. A listed transaction is defined in Treas. Reg. § 1.6011-4. The policy governing requests for tax accrual workpapers varies according to when the tax return was filed. *See* IRM 4.10.20.3.2.

C. Procedures for Requesting Tax Accrual Workpapers. IRM 4.10.20.4 sets forth procedures for requesting tax accrual workpapers by IDR or summons.

   1. Requests made under the unusual circumstances standard must be approved by designated executives for the operating division responsible for the audit, as well as by Procedure & Administration. See IRM 4.10.20.4.
   2. Requests involving listed transactions must be reviewed by the team manager in LB&I, or by the group manager in SBSE cases. Field Counsel and

[2] Also referred to as the tax pool analysis, tax liability contingency analysis, tax cushion analysis, or tax contingency reserve analysis.

Procedure & Administration will provide pre-issuance review of any request for tax accrual workpapers. CCDM 34.6.3.6.1.

IV. Summons Enforcement

If the summoned party does not comply with a summons, the examiner, revenue officer, or special agent may refer the matter to Counsel for summons enforcement, after consulting with an appropriate manager in the operating division having authority over the case.

Suit or defense letters for summons enforcement are drafted by Field Counsel and the letters require pre-approval by P&A if the summons case involves:

1. a summons for tax accrual workpapers or other audit workpapers;
2. a John Doe summons;
3. a designated or related summons under IRC § 6503(j);
4. a summons to a third party for records located outside the U.S.;
5. a summons for a computer tax software package;
6. a summons issued pursuant to a Form 8300 investigation;
7. a summons which is opposed on federal tax practitioner privilege grounds under IRC §7525; or
8. a summons involving other significant, novel, or important issues, at the discretion of Field Counsel.

See CCDM 34.6.3.3.2.

In addition, suit or defense letters for summonses that were issued to or seek records (other than bank records) pertaining to the tax liability of a minister or person claiming to be a minister must be coordinated by Field Counsel with TEGE Division Counsel, while suit or defense letters for summonses issued by the IRS on behalf of a tax treaty partner must be coordinated by Field Counsel with Branch 7 of ACC International. CCDM 34.6.3.2 and 34.6.3.6.6.

For more information:

- Summons Handbook at IRM 25.5 http://publish.no.irs.gov/pubsys/irm/indp25.htm
- GL-1 Training, Lesson 16 (Summons) at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 6 & 7.

V. Third-Party Contacts

In general, no IRS officer or employee may contact any person other than the taxpayer with respect to the determination or collection of such taxpayer's tax liability without giving the taxpayer reasonable notice in advance that such contacts may be made. A record of persons contacted must be made and given to the taxpayer upon request. IRC § 7602(c).

A. Five Elements of a Third-Party Contact: A third-party contact is a communication which:

1. *Is initiated by an IRS employee*. This occurs whenever it is the IRS employee who first tries to communicate with a person other than the taxpayer. Returning unsolicited telephone calls or speaking with persons other than the taxpayer when attempting to speak to the taxpayer are not initiations of third-party contacts. Treas. Reg. § 301.7602-2(c)(1)(i)-(ii). For the definition of an IRS employee for purposes of the third-party contact rules, see Treas. Reg. § 301.7602-2(c)(1)(i)(B).
2. *Is made to a person other than the taxpayer.* "Person other than the taxpayer" and "third party" are used interchangeably, and do not include an IRS officer or employee, as defined in Treas. Reg. § 301.7602-2(c)(1)(i)(B), any computer database or website regardless of where located and by whom maintained, or a taxpayer's current employee, officer, or fiduciary. See Treas. Reg. § 301.7602-2(c)(2)(i)-(ii).
3. *Is made with respect to the determination or collection of the tax liability of such taxpayer*. The phrases "with respect to," "determination or collection," "tax liability," and "such taxpayer" are defined and illustrated in Treas. Reg. § 301.7602-2(c)(3)(i)-(ii), examples 1-6(a)-(b).
4. *Discloses the identity of the taxpayer being investigated*. An IRS employee discloses the taxpayer's identity whenever the employee knows or should know that the person being contacted can readily ascertain the taxpayer's identity from the information given by the employee. Treas. Reg. § 301.7602-2(c)(4)(i)-(ii), examples 1-2.
5. *Discloses the association of the IRS employee with the IRS*. An IRS employee discloses his association with the IRS whenever the employee knows or should know that the person being contacted can readily ascertain the association from the information given by the employee. Treas. Reg. § 301.7602-2(c)(5).

B. Requirement of Pre-Contact Notice. In general, an officer or employee of the IRS may not make third-party contacts without giving reasonable notice in advance to the taxpayer that contacts may be made. The pre-contact notice may be given orally or in writing. Written notice may be given in any manner that the IRS employee reasonably believes that the taxpayer will receive in advance of the third-party contact. Written notice is deemed reasonable if it is mailed to the taxpayer's last known address, given in person, left at the taxpayer's dwelling or usual place of business, or actually received by the taxpayer. Treas. Reg. § 301.7602-2(d)(1). Publication 1 is frequently used by the collection and examination functions for this purpose. In certain circumstances, Letters 3164 may also be used.

C. Exception. The IRS does not need to provide pre-contact notice to the taxpayer if the taxpayer was otherwise given advance notice under another statute, regulation, or administrative procedure. Treas. Reg. § 301.7602-2(d)(2).

D. Post-Contact Reports.

1. A taxpayer may request a record of persons contacted in any manner that the Commissioner reasonably permits. *See* Treas. Reg. § 301.7602-2(e)(1)-(2)(i)-(ii) for further guidance. Requests should be forwarded to the Area Third Party Contact Coordinator, listed on the third-party contact coordinator website. *See* IRM 4.11.57.4.6 and 5.1.17.
2. IRS officers or employees record third-party contacts on Forms 12175. If a taxpayer already received a similar record pursuant to another statute, regulation, or administrative procedure, IRS officers or employees do not need to provide a post-contact record for third-party contacts under this section. Treas. Reg. §§ 301.7602-2(e)(3)-(4), examples 1-5.

E. Exceptions to Third Party Contact Notice.

1. *Authorized by the taxpayer.* Section 7602(c) does not apply to contacts with the taxpayer's authorized representative, or in instances where the taxpayer, or the taxpayer's authorized representative, requests or approves the contact. This section does not entitle anyone to prevent or delay a contact with any third party. Treas. Reg. § 301.7602-2(f)(1)(i)-(ii).
2. *Jeopardy.* Section 7602(c) does not apply when the IRS employee making a contact has good cause to believe that providing the taxpayer with either a general pre-contact notice or a record of the specific person contacted may jeopardize the collection of any tax. *See* Treas. Reg. § 301.7602-2(f)(2)(i)-(ii).
3. *Reprisal*. Section 7602(c) does not apply when the IRS employee making a contact has good cause to believe that providing the taxpayer with either a general pre-contact notice or a specific record of the person being contacted may cause harm to any person in any way, physically, economically, emotionally or otherwise. A statement by the third party that harm may occur to any person is sufficient to constitute good cause. *See* Treas. Reg. § 301.7602-2(f)(3)(i)-(ii), examples 1-3.
4. *Pending criminal investigations*. Section 7602(c) does not apply to contacts made during a criminal investigation or an inquiry to determine whether to open a criminal investigation. *See* Treas. Reg. § 301.7602-2(f)(4)(i)-(ii).
5. *Governmental entities*. Section 7602(c) does not apply to any contact with any office of any local, state, Federal or foreign governmental entity, *except* for contacts concerning the taxpayer’s trade or business with that government office, such as the taxpayer’s contracts with or employment by the office. See Treas. Reg. § 301.7602-2(f)(5).
6. *Confidential informants.* Section 7602(c) does not apply when the employee making the contact has good cause to believe that providing either the pre-contact notice or the record of the person contacted would identify a confidential informant whose identity would be protected under section 6103(h)(4). Treas. Reg. § 301.7602-2(f)(6).
7. *Nonadministrative contacts*. Section 7602(c) does not apply to contacts made in the course of a pending court proceeding. *See* Treas. Reg. § 301.7602-2(f)(7)(i)-(ii), examples 1-3.

For more information:

- See GL-1 Training, Lesson 16 Part VII (Summons) at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 6 & 7.

CHAPTER 3: ASSESSMENT

I. IN GENERAL

An assessment under section 6201 is a bookkeeping notation that records the determination of a tax liability in the Service's records. Thus, an assessment is merely the recording of a tax liability by an authorized employee on a Form 23C (or electronic equivalent). Assessments are important because the federal tax lien arises by operation of law only after the taxpayer neglects or refuses to pay the tax following a section 6303 notice and demand. *See* section 6321. If a taxpayer fails to pay an assessed tax within ten days after notice and demand, then the Service (unlike most other creditors) may engage in administrative collection (*e.g.*, it may levy the taxpayer's property or rights to property and it may file a public notice of the federal tax lien).

The authority for making an assessment has been delegated to an assessment officer who signs a summary record on an assessment certificate listing the total tax liability of all taxpayers for each type of tax to be assessed at a service center on that day. Supporting records are used to identify the taxpayer, the type of tax and taxable period (if applicable), and the amount of the assessment relating to the summary record. Treas. Reg. § 301.6203-1.

II. SUMMARY ASSESSMENT

Assessments made without any restrictions are referred to as "summary assessments." Employment taxes and certain excise taxes may be summarily assessed. Other types of taxes, which are normally subject to deficiency procedures, may be summarily assessed as follows:

1. *Tax shown on the original return*. IRC § 6201(a)(1).
2. *Tax shown on an amended return*. Generally, an amended return doesn't constitute a return under the Code. Treas. Reg. § 301.6211-1(a) treats the amounts shown as additional tax on an amended return as an amount shown by the taxpayer upon his return for purposes of computing a deficiency, unless the amended return clearly indicates the taxpayer is protesting rather than admitting the additional tax.
3. *Mathematical or clerical errors shown on a tax return*. Such errors are defined in section 6213(g)(2). The taxpayer must be given an explanation of the asserted error and a period of sixty days to request that the Service abate the assessment, in which case the Service must thereafter follow the deficiency procedures.
4. *An amount paid after the Service has made a preliminary determination of an additional tax liability*. IRC § 6213(b)(4).
5. *Overstatement of credits for income tax withheld at the source or estimated tax payments*. IRC § 6201(a)(3). The Service may recover the amount as if the overstatement was due to a mathematical or clerical error, but the taxpayer may not trigger the deficiency procedures.

6. *The amount of a tentative allowance that had been issued under section 6411 after processing an application for a tentative carryback adjustment based on a net operating loss, a business credit, or a capital loss.* The issuing process is cursory and expedited. If the Service subsequently determines the tentative allowance was erroneous then it may recover the amount as if the allowance was due to a mathematical or clerical error, but the taxpayer may not trigger the deficiency procedures.
7. *The tax liability determined when a receiver is appointed for a taxpayer.* IRC § 6871(a). Collection efforts are generally suspended because the taxpayer's property is under the jurisdiction of a court.

For more information:

- Contact P&A branches 3 & 4
- *See* Gl-1 Training, Lesson 1 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip

III. JEOPARDY & TERMINATION ASSESSMENTS

If the Service determines that collection of an income, estate, or gift tax from a taxpayer will be jeopardized by delay, it may make immediate assessment of the tax either before the return for the year is due by terminating the year (a termination assessment under section 6851), or after the return is due (a jeopardy assessment under section 6861). Under section 7429, the jeopardy or termination assessment must be approved by Chief Counsel. Typically, jeopardy levies are made in conjunction with jeopardy and termination assessments. Within 5 days after the date of the assessment and/or levy, the Service must give the taxpayer a written statement of the information relied upon in making the jeopardy determination and notice of the right to an administrative hearing with the IRS Office of Appeals if requested within 30 days after the end of the 5-day period.

For more information:

- Contact P&A Branches 3 & 4
- *See* GL-1 Training, Lesson 1 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip

IV. CRIMINAL RESTITUTION ASSESSMENT

The amount of restitution imposed in a final order of restitution may be assessed under section 6201(a)(4) in the same manner as if the amount were a tax. The final order of restitution may not be challenged on the basis of the existence or amount of the underlying tax liability in any proceeding, including in Tax Court.

For more information:

- *See* CC Notice 2011-018, https://employeeresources.prod.irscounsel.treas.gov/Lists/CCNotices/Attachments/650/CC%202011%20018.pdf

- Contact P&A Branches 3&4

V. SFRs (Substitutes for Returns)

When a taxpayer fails to make a return, the Service can make the return, based on whatever knowledge is available or can be obtained. Such a return is commonly referred to as a "substitute" return. As a general rule, a substitute for return is good and sufficient for all legal purposes.

A. Source of IRS Authority to Prepare and Execute Substitutes for Returns. The Service's authority to prepare and execute substitutes for returns is found in IRC § 6020(b)(1). That section generally provides that if any person fails to make any return required by any internal revenue law, or applicable regulation, at the required time, the Service is authorized to make a return based on information obtained through testimony or otherwise. The authority also applies when the taxpayer makes, willfully or otherwise, a false or fraudulent return.

B. Procedures for Preparing and Executing a Return under Section 6020(b). Treas. Reg. § 301.6020-1(b)(2) provides the procedures for preparing and executing a valid substitute for return. Specifically, the regulations provide that a document (or set of documents) signed by an authorized Internal Revenue Officer or employee is a return under section 6020(b) if the document (or set of documents):

1. identifies the taxpayer by name and taxpayer identification number,
2. contains sufficient information from which to compute the taxpayer's liability, and,
3. the document (or set of documents) purports to be a return under section 6020(b).

IRM 20.1.2.2.10.1 describes the procedures for preparing the return under section 6020(b). *See* Notice CC-2007-005 and IRM 5.18.1, ASFR Program, for additional information. The procedures provided in Treas. Reg. § 301.6020-1(b)(2) are consistent with the Section 6020(b) return requirements set forth in *Cabriac v. Commissioner*, 120 T.C. 163 (2003), *aff'd in an unpub. op.*, No. 03-3157 (3rd Cir. Feb. 10, 2004), and *Spurlock v. Commissioner*, 118 T.C. 155 (2002).

C. Status of Returns Prepared under Section 6020(b). IRC § 6020(b)(2) states that "any return… made and subscribed by the Secretary shall be prima facie good and sufficient for all legal purposes." Treas. Reg. 301.6020-1(b) further states that "any return made in accordance with [Treas. Reg. 301.6020-1(b)(1)] and signed by the commissioner or other authorized Internal Revenue Officer or employee shall be good and sufficient for all legal purposes *except insofar as any Federal statute expressly provides otherwise*." (Emphasis added.)

Note: There are several exceptions to the general rule that Section 6020(b) returns are sufficient for all legal purposes:

1. For assessment purposes, the service must follow deficiency procedures in order to assess the amount shown on a section 6020(b) return. *See Spurlock v. Commissioner*, T.C. 118 T.C. 155 (2002).
2. In computing the amount of a deficiency, the section 6020(b) return is not considered to be the return of the taxpayer. IRC § 6211.
3. For purposes of making an election to file a joint return, the section 6020(b) return is not the taxpayer's return when the taxpayer makes an election on a subsequently filed return. *Millsap v. Commissioner*, 91 T.C. 926 (1988).
4. For purposes of starting the statute of limitations on assessment and collection, a section 6020(b) return does not constitute the taxpayer's return. *See* Treas. Reg. § 301.6020-1(c)(1), referring to IRC § 6501(b)(3) and Treas. Reg. § 301.6501(b)-1(e).
5. In order to obtain a discharge of tax in bankruptcy, a section 6020(b) return does not qualify as the return that a taxpayer must have filed to escape the effect of 11 USC § 523(a)(1)(B)(i), which prohibits the discharge of taxes for which a return was not filed. 11 USC § 523(a).
6. A section 6020(b) return will not constitute a return for purposes of making an election to itemize deductions under Section 63. The Tax Court has held that a taxpayer must file a return (separate from the section 6020(b) return) in order to elect to itemize deductions. *Jahn v. Commissioner*, T.C. Memo. 2008-141.

D Litigating Position for Returns Prepared under Section 6020(b).

1. Notice CC-2007-005 discusses procedures that should be followed in Tax Court cases in which the section 6651(a)(2) failure to pay addition to tax has been determined on the basis of a substitute for return. Notice CC-2007-005 also provides the Service's litigating position with respect to section 6651(a)(2) addition to tax, as stated in Treas. Reg. § 301.6020-1(b)(3).
2. Notice CC-2007-014, which updates Notice CC-2007-005, provides detailed information on obtaining documentation for section 6020(b) returns from the campuses when the documentation is not in the administrative file.

For more information:

- IRC 6651(g) Treatment of Returns Prepared by Secretary under Section 6020(b)
- Treas. Reg. § 301.6020-1(b) Execution of Returns
- CCDM 35.2.2.11, Answers in Failure to Pay (Section 6651(a)(2) Cases With a Substitute for Return Filed under Section 6020(b))
- CCDM 35.8.5.5, Failure to Pay Addition to Tax for Returns Prepared Under Section 6020(b)
- Contact P&A Branches 1&2

VI. Deficiency Process

The deficiency is an amount defined in section 6211. A deficiency and an amount due are generally different amounts, because the deficiency calculation does not take withholding into account. A deficiency can exist even when there is no balance due.

A. 30-day letter. A 30-day letter advises a taxpayer of the right to file a protest, request a conference, and/or present any additional evidence or argument during an exam. The letter is not described or required by the Code. Multiple 30-day letters may be issued as the Service continues to re-evaluate a taxpayer's case. The 30-day letter does not affect the statute of limitations on assessment.

B. 90-day letter. When the Service determines a deficiency, the Service must issue a notice of deficiency in order to validly assess that amount, unless an exception applies (*see*, e.g., math error, *infra*). The Service determines the amount of a deficiency owed by a taxpayer in the 90-day letter. Thus, the 90-day letter is the statutory notice of deficiency, which is defined and governed by IRC § 6212.

The 90-day letter must be sent to the taxpayer's last known address. Duplicate originals may be used where there is confusion. For example, spouses may have different addresses even in cases where the deficiency is based on a joint return. The 90-day period is the time during which a taxpayer may petition the Tax Court.

1. *Exceptions to 90-day limitation*:
    a. The 90-day period is extended to 150 days if either the taxpayer is outside the United States when the notice is mailed or the notice is mailed to an address outside of the United States.
    b. Other exceptions include assessments made pursuant to section 6201(a) (taxes shown on return, erroneous income tax prepayment credits, certain orders of criminal restitution) and assessments of net operating loss carrybacks and amounts paid pursuant to section 6213(b)(3) and (4).
2. *Other considerations*:
    a. If the taxpayer communicates with the Service after a 90-day letter has been issued, the Service cannot extend the time period during which the taxpayer may timely petition the Tax Court.
    b. A statutory notice of deficiency can only be rescinded with the consent of the taxpayer.
    c. If a notice of deficiency is issued and the Service then determines an additional amount is due, the Service may issue a second notice. However, if the first notice is petitioned, the second notice is invalid and the government must plead an increased deficiency in the Tax Court. See sections 6212(c) and 6214(a).
    d. Issuance of a statutory notice of deficiency, and any litigation that occurs in the Tax Court, suspends the assessment statute. *See* section 6503(a).

C. Tax Court. The Tax Court is a pre-payment forum where taxpayers may resolve disputes over the amount of a deficiency as determined by the Service. In order for the Tax Court to have jurisdiction in a deficiency case, there must be a valid notice of deficiency and a timely petition. The Tax Court also has jurisdiction to determine if there is an overpayment for the year at issue. In order to determine the correct liability for the year(s) listed on the notice of deficiency, the Tax Court may need to look at issues involving other tax periods. The Tax Court has jurisdiction to consider these issues but cannot determine the liability for years not directly before the Court. *See* section 6214(b). *See also* CCDM 35.2.1 *et seq*.

While the statutory notice of deficiency is given a presumption of correctness, the burden of proof may shift during litigation. This is controlled by section 7491.

For more information:

- Contact P&A Branches 6&7
- *See* GL-1 Training, Lesson 1 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip

D. TEFRA (TEFRA Partnership Procedures, IRC §§ 6221 – 6234)

Prior to enactment of the United Partnership Audit and Litigation Procedures of IRC §§ 6221 through 6234 by the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA Partnership Procedures")

Before the TEFRA partnership procedures were enacted in 1982, partnership items appearing on individual and corporate taxpayer returns were determined by individual audits and notices of deficiency which included both partnership and nonpartnership items. Thus, multiple partners in the same partnership would be adjusted through separate proceedings unique to each partner. Each notice of deficiency suspended the period for assessment for only one partner and began a petition period for only that partner. Alternatively, the partner could allow the notice of deficiency to default, pay the tax, and file a claim/suit for refund. Inconsistent results were possible.

After enactment of the TEFRA Partnership Procedures, one partnership audit, notice and judicial proceeding bind all partners.

One Notice of Beginning of Administrative Proceeding ("NBAP") is sent to the Tax Matters Partner (TMP) to signify the beginning of an audit (copies to Notice Partners).

One Notice of Final Partnership Administrative Adjustment ("FPAA") is sent to the Tax Matters Partner (TMP) informing him of the Service's adjustment to partnership items (copies are sent to Notice Partners).

1. *Effect of FPAA*:
    a. Only the FPAA notice to the TMP suspends the period of limitations for all partners and begins the petition period for a unified judicial proceeding.

b. Only one petition based on the FPAA to the TMP may be filed on behalf of all partners either in the Tax Court, District Court, or Court of Federal Claims; duplicate petitions are dismissed.
c. The single petition that goes forward will bind all partners regardless of whether they participate or intervene. If no petition is filed, the defaulted FPAA will bind all partners.
d. Once an FPAA is defaulted, no separate refund action is allowed. IRC § 6511(g). Thus, all adjustments that may result in a refund must be raised on a petition to the FPAA because this will be the sole opportunity to file a petition resulting in a refund.
e. The Service computes the resulting assessments and refunds following the default of the FPAA, or the final decision of the Tax Court. Petitions to the District Court, or the Court of Federal Claims, are treated as defaulted FPAAs for assessment and collection purposes in order to preserve the status of those forums as refund courts. IRC § 6225.

2. *Penalties*. Penalties are assessed using notice of deficiency procedures following the partnership proceeding. For years ending after August 5, 1997, however, they may be determined at the partnership level and directly assessed following the partnership proceeding.
3 *Unified Audit and Litigation Procedures (IRC §§ 6221-6234).* Unified in three respects:
   a. All partners are governed by one administrative proceeding and one docketed proceeding.
   b. All deficiencies <u>and refunds</u> are determined based on the single unified proceeding.
   c. Section 6229 sets forth a minimum assessment period for all partners running from the date the partnership is filed or due to be filed, whichever is later.
4. *Partnership Level Determination of "Partnership Items."*
   a. An FPAA determines the amount and allocation of partnership items as defined by IRC § 6231(a)(3). It does not redetermine a deficiency or refund. Similarly, a judicial proceeding to redetermine FPAA adjustments only redetermines partnership items. Thus, an FPAA is not a notice of deficiency in tax and should not be referred to as such.
   b. The Service computes the deficiencies or refunds resulting from partnership item adjustments (known as "Computational Adjustments") following the default or judicial redetermination of the FPAA. IRC § 6231(a)(6).
   c. Computational Adjustments are typically and immediately assessed (or refunded) following the default or judicial redetermination of the FPAA. However, certain "Affected Items" such as penalties may require notices of deficiency ("affected item notices of deficiency") before they may be assessed. For taxable years ending after August 5, 1997, penalties may be directly assessed following the partnership proceeding.

<u>For more information:</u>

- For partnership exams, see the IRS TEFRA website.
- For TEFRA basics, view this PowerPoint.
- For a discussion of the effect of bankruptcy law on the TEFRA procedures, see the Bankruptcy Handbook.
- Contact P&A Branches 6&7

E. Math error. Math error procedures are an exception to deficiency procedures. If the Service determines a deficiency that resulted from a mathematical or clerical error, as defined by section 6213(g)(2), then the Service may follow either deficiency procedures, or the math error procedures found in sections 6213(b)(1) and (2).

There are many references throughout the code to errors that may be assessed as if the amount resulted from a math error. Oftentimes these references will allow the Service to assess the amount due without providing the taxpayer the option to request a statutory notice of deficiency pursuant to section 6213(b)(2).

The definitions in section 6213(g)(2) are narrow and the list is inclusive. The definitions are generally limited to situations where it is clear the taxpayer made a mistake and the Service's correction of that mistake is almost certainly valid.

Math error procedures call for the Service to issue a notice to the taxpayer. The Service may assess that amount; however, if the taxpayer responds within 60 days of the notice and requests a statutory notice of deficiency, then the Service must abate the math error assessment and follow deficiency procedures.

For more information:
- *See* GL-1 Training Lesson 1 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- CCDM 35: Tax Court Litigation
- IRM 4.8.9 Examination; Statutory Notices of Deficiency
- IRM 8.2.2 Appeals; Processing 90 Day Cases and Defaulted Notices
- IRM 8.17.4 Appeals; Notices of Deficiency
- Contact P&A Branches 6&7

VII. PENALTIES

The Internal Revenue Service has a responsibility to collect the proper amount of tax revenue in the most efficient manner. Penalties provide the Service with an important tool to achieve that goal because they enhance voluntary compliance by taxpayers. Penalties encourage voluntary compliance by demonstrating the fairness of the tax system to compliant taxpayers and by increasing the cost of noncompliance. See Policy Statement 20-1, IRM 1.2.20.1.1.

A. Failure to File/Pay Penalties:

1. *Failure to File* (IRC § 6651(a)(1)). This penalty applies to a taxpayer who fails to timely file a return.

2. *Failure to Pay* (IRC § 6651(a)(2)). This penalty applies to a taxpayer who reports an amount of tax due on his return but fails to pay it by the payment due date. The penalty applies to 6020(b) return (substitute for return).
3. *Failure to Pay* (IRC § 6651(a)(3)). This applies to taxpayer who fails to pay any amount required to be shown on a return, which is not so shown, within 21 calendar days from the date of notice and demand therefore (10 business days if the amount for which notice and demand is made equals or exceeds $100,000).

NOTE: All three of these penalties may be excused if the failure is due to reasonable cause and not due to willful neglect.

B. Accuracy-Related Penalty on Underpayments – In General (IRC § 6662). A twenty percent (20%) penalty is applied for:

1. Negligence or disregard of rules or regulations.
2. Substantial understatement of income tax.
3. Substantial valuation misstatement.
4. Substantial overstatement of pension liabilities.
5. Substantial estate or gift tax valuation misstatement.

NOTE: A forty percent (40 %) penalty will be applied for gross valuation misstatement of (3), (4), or (5) above.

NOTE: There is no stacking of the accuracy-related penalty components. *See* Treas. Reg. § 1.6662-2(c) and *D.H.L. Corp. v. Commissioner*, T.C. Memo. 1998-461. The maximum accuracy-related penalty is 20 percent (40 percent gross valuation misstatement), even if that portion of the underpayment is attributable to more than one type of misconduct

C. Negligence or Disregard of Rules or Regulations (IRC § 6662(c)). Any failure to make a reasonable attempt to comply with the provisions of the Code, or to exercise ordinary and reasonable care in the preparation of a tax return. See IRC § 6662(c) and Treas. Reg. § 1.6662-3. Negligence also includes the failure to do what a reasonable and ordinarily prudent person would do under the same circumstances. *See Marcello v. Commissioner*, 380 F.2d 499, 506 (5th Cir. 1967). No negligence if return position has a reasonable basis. Treas. Reg. § 1.6662-3(b)(1). Disregard of rules and regulations includes any careless, reckless or intentional disregard of the provisions of the Internal Revenue code, temporary or final regulations, revenue rulings or notices. A disregard of rules or regulations is careless if the taxpayer does not exercise reasonable diligence to determine the correctnesss of a return position that is contrary to the rule or regulation. Treas. Reg. § 1.6662-3(b)(2). The penalty for disregarding rules or regulations does not apply if the return position is adequately disclosed. Treas. Reg. § 1.6662-3(a) and (c).

D. Substantial Understatement of Income Tax (IRC § 6662(d)). Penalties apply when there is a substantial understatement of income.

1. *Individuals*: Understatement exceeds the greater of 10 percent of the tax required to be shown on the return or $5,000.

2. *Corporations (Pre-AJCA)*: Understatement exceeds the greater of 10 percent of the tax required to be shown on the return for the taxable year or $10,000.
3. *Corporations (Post-AJCA)*: Understatement exceeds the lesser of (i) 10 percent of the tax required to be shown on the return (or, if greater, $10,000), or (ii) $10,000,000.

NOTE: AJCA amendment is for tax years beginning after 10/22/04.

E. Application of Gross Valuation Misstatement Penalty. In December 2013 the Supreme Court resolved a conflict among the circuits on the application of the 40% gross valuation misstatement penalty. See *United States v. Woods*, 134 S.Ct. 557 (2013) .Taxpayers had argued that the 40% penalty does not apply when the IRS totally disregards a transaction as lacking economic substance. *See e.g., Todd v. Commissioner*, 862 F.2d 540 (5th Cir. 1988), *Heasley v. Commissioner*, 902 F.2d 380 (5th Cir. 1990), *Bemont Investments, L.L.C. v. United States,* 679 F.3d 339 (5th Cir. 2012), *Gainer v. Commissioner*, 893 F.2d 225 (9th Cir. 1990), *Keller v. Commissioner*, 556 F.3d 1056 (9th Cir. 2009). *See also Klamath Strategic Investment Fund, LLC v. United States*, 472 F. Supp. 2d 885 (E.D. Tex. 2007). But most circuits besides the 5th and 9th Circuits disagreed. *See Fidelity Int'l Currency Advisor A Fund, LLC v. United States*, 661 F.3d 667 (1st Cir. 2011); *Zfass v. Commissioner*, 118 F.3d 184 (4th Cir. 1997); *Gilman v. Commissioner*, 933 F.2d 143 (2d Cir. 1991); *Merino v. Commissioner*, 196 F.3d 147 (3rd Cir. 1999); *Illes v. Commissioner*, 982 F.2d 163 (6th Cir. 1992); *Massengill v. Commissioner*, 876 F.2d 616 (8th Cir. 1989); *Alpha I, L.P. v. United States*, 682 F.3d 1009 (Fed. Cir. 2012); Treas. Reg. 1.6662-5(g). In *Woods* the Supreme Court held a penalty applies to the portion of any underpayment that is "attributable to" a "substantial" or "gross" "valuation misstatement," which exists where "the value of any property (or the adjusted basis of any property) claimed on any return of tax" exceeds by a specified percentage "the amount determined to be the correct amount of such valuation or adjusted basis (as the case may be)." The Court found that the penalty's plain language made it applicable in this case. Once the partnerships were deemed not to exist for tax purposes, no partner could legitimately claim a basis in his partnership interest greater than zero. Any underpayment resulting from use of a non-zero basis would therefore be "attributable to" the partner's having claimed an "adjusted basis" in the partnerships that exceeded "the correct amount of such . . . adjusted basis." And under the relevant Treasury Regulation, when an asset's adjusted basis is zero, a valuation misstatement is automatically deemed gross. Therefore the 40% penalty applied.

F. Fraud Penalty (IRC § 6663). This penalty is seventy-five percent (75%) on the portion of an underpayment that is attributable to fraud. The reasonable cause exception applies. Some of the badges of fraud are:

1. Understating income;
2. keeping inadequate records;
3. failing to file tax returns;
4. making implausible or inconsistent explanations for behavior;
5. concealing assets;

6. failing to cooperate with tax authorities;
7. engaging in illegal activities;
8. dealing in cash; or,
9. failing to make estimated tax payments.

NOTE: the burden of proof of fraud is on the IRS. *See* IRC § 7454(a). In addition, in the case of a joint return, this section does not apply with respect to a spouse unless some part of the underpayment is due to the fraud of that spouse. IRC § 6663(c).

G. Burden of Production (IRC § 7491(c)). The Service bears the burden of production for any penalty or addition to tax if (1) the examination began after July 22, 1998, and (2) the taxpayer is an individual.

The burden of production, or burden of going forward, is met with a prima facie showing that the penalty or addition to tax is appropriate, such as proof that the taxpayer did not file a return or substantially understated income.

If a petition fails to state a claim in respect of penalties or additions to tax, the Service incurs no obligation to produce evidence in support because the issues are deemed conceded under T.C. Rule 34(b)(4). *See Swain v. Commissioner*, 118 T.C. 358 (2002).

The Service's burden of production does not require evidence to rebut possible defenses. *See Higbee v. Commissioner*, 116 T.C. 438, 446 (2001).

H. Reportable Transaction Penalties. *See* IRC § 6662A, IRC § 6707, IRC § 6707A and "Reportable Transaction" Treas. Reg. § 1.6011-4(b)(2)-(7).

1. *Common types*:
    a. Listed transactions – determined by IRS to be a tax avoidance transaction, as identified by reg, notice or other published guidance.
    b. Confidential transactions – offered to TP under conditions of confidentiality for which minimum fees are paid to advisors.
    c. Contractual protection transactions – offered to TP with a right to a full or partial refund of fees if not sustained.
    d. Loss transactions – TP claims losses under section 165 (dollar thresholds in place).
    e. Transactions of Interest – identified by IRS as a transaction of interest by reg, notice or other published guidance (generally, the IRS doesn't have enough information to determine whether the transaction should be identified specifically as a tax avoidance transaction).
2. *§ 6662A: Accuracy Related Penalty on Reportable Transaction Understatements*. These apply to understatements attributable to Listed transactions and reportable transactions (other than listed transactions) with a significant tax-avoidance purpose.

NOTE: there is no IRC § 6662A penalty for understatements subject to the fraud penalty, and no section 6662 penalty for underpayments to the extent that IRC § 6662A penalty is imposed. But the understatement is included for purposes of determining whether there is a substantial understatement for purposes of IRC § 6662(d)(1).

3. *Failure to Furnish Reportable Transaction Information* (IRC § 6707). This is asserted for failing to file a return under section 6111(a) or for filing a false or incomplete return. IRC § 6111(a) requires material advisor to make a return disclosing reportable transaction.
4. *Failure to Include Reportable Transaction Information w/ Return* (IRC § 6707A). This is imposed when there is a failure to include information with respect to a reportable transaction on a return or statement.

EXAMPLES:

- Notice 2000-44 Inflated Partnership Basis Transaction (Son of BOSS)
- Notice 2001-16 Intermediary Transaction
- Notice 2004-8 Abusive Roth IRA Transaction
- Notice 2008-34 Distressed Asset Trust (DAT) Transaction

For more information:

- *See* Ann. 2002-2; 2004-46; and 2005-80.
- CC Notice 2004-036 on Penalty Administration
- http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/FM/Training/StreamingMedia/Streaming%20Media%20Resources/class6_slide_penaltiesAndInterest.pptx
- IRM 20.1 Penalty Handbook http://publish.no.irs.gov/pubsys/irm/indp20.htm
- Contact P&A Branches 1&2.

VIII. INTEREST

OVERPAYMENT INTEREST

A. In general. Section 6611 of the Code provides that interest is paid on any overpayment at the rate set under section 6621. Interest is allowed from the date of the overpayment to a date preceding the date of the refund check by not more than 30 days. No interest is allowed on an overpayment of income tax if an overpayment is refunded either: (1) within 45 days after the last date prescribed for filing determined without regard to extensions of time for filing, or (2) in the case of returns filed after the last date prescribed for filing, within 45 days after the date the return is filed. The due date for payment of any tax is the last day fixed by law or regulation for the payment of tax, determined without regard to extensions.

1. Overpayment interest accrues until the overpayment is refunded or credited. If an overpayment is credited, interest is allowed from the date of the overpayment to the due date of the amount against which such overpayment is credited. There can be no overpayment of tax until the entire tax liability has been satisfied (except in cases where the tax was assessed and collected after the expiration of the period of limitations).

2. The dates of overpayment of any tax are the date of payment of the first amount (when added to previous payments) is in excess of the tax liability (including any interest, addition to tax, or additional amount). *See* Treas. Reg. § 301.6611-1(b).
3. Advance payments of tax, payments of estimated tax, and credit for income tax withholding, are deemed paid on the due date of the return. IRC § 6611(d); IRC § 6513.
4. If the taxpayer has filed a late return, no interest is allowable for any time before the date on which the return was filed. IRC § 6611(b)(3).

B. Restrictions on Overpayment Interest. Common situations in which overpayment interest will not accrue on an overpayment:

1. *45 Day rules*. In general, interest is not paid on an overpayment when it is refunded within 45 days of the later of the return due date (determined without regard to any extension of time for filing), the return received date (if filed after the due date), or the date the return was filed in proper form.
2. *Net operating loss (NOL) and other carrybacks*. If any overpayment of tax results from the carryback of an NOL, such overpayment shall be deemed not to have been made prior to the filing date for the taxable year in which such loss arises.

C. Overpayment Interest and Litigation. In Tax Court, overpayment interest may be an issue presented in Rule 155 computations or Rule 261 Motions to redetermine interest, which must be filed within one year of entry of a final decision in a deficiency case.

In District Courts and the Court of Federal Claims, overpayment interest may be raised as Tucker Act claims for additional overpayment interest. Taxpayers are not required to file a claim with the Service prior to filing a complaint in court. However, in the case of interest netting, Rev. Proc. 1999-43 and Rev. Proc. 2000-26 instruct the taxpayer to file a request with the Service. These claims are subject to the limitations provisions of 28 USC §§ 2401 and 2501, and suit must be filed within six years from the time the overpayment was scheduled.

For more information:

- IRM 20.2, Interest, including
- IRM 20.2.4, Overpayment Interest
- IRM 20.2.8, Restricted Interest
- IRM 20.2.9, Interest on Carryback of Net Operating Loss
- IRM 20.2.14, Netting of Overpayment and Underpayment Interest
- P&A Subject Matter Training Slides from August 2012, http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/PA/PA%20Subject%20Matter%20Training%20Documents%20and%20Links/Interest%20%20information%20reporting%20(8-14-12).ppt
- Contact P&A Branches 1&2

UNDERPAYMENT INTEREST

A. In general. Section 6601(a) of the Code provides that if any amount of tax is not paid on or before the last date prescribed for payment, interest is paid on the amount due from that last date to the date paid. The underpayment rate is established under section 6621. Unless specifically prohibited by law, interest payment on underpayments is mandatory. The last date prescribed for payment is determined without regard for extensions; and without regard for any notice and demand for payment issued, by reason of jeopardy, prior to the last date otherwise prescribed for payment.

B. Other considerations. If the taxpayer is making payments under an installment agreement, check IRC § 6601(b)(2) to determine the last date prescribed for payment.

1. Interest is treated like a tax and will be assessed, collected, and paid in the same manner as a tax.
2. If a payment is made within 21 days of notice and demand (10 business days if the amount due is $100,000 or more), no additional interest will be imposed for the period between the date of the notice and demand and the date of payment.
3. Under IRC § 6622, interest accrues on interest, effective for interest accruing after December 31, 1982.

C. Restrictions on Underpayment Interest. The following are common situations in which underpayment interest will not accrue on an outstanding liability:

1. *IRC § 6603 Deposits*. A taxpayer may make a cash deposit for certain underpayments of tax that have not been assessed. *See* Rev. Proc. 2005-18, 2005-1 C.B. 798 as to whether a remittance should be considered a deposit. IRC § 6603 is effective for deposits made on or after October 22, 2004. For guidance on older remittances, *see Rosenman v. United States*, 323 U.S. 658 (1945), and cases applying *Rosenman*.
2. *Net operating loss (NOL) carrybacks*, *IRC § 6601(d)(1)*. When a return showing an NOL is filed, the reduction of a tax by the carryback does not affect the computation of interest for the period ending with the filing date for the taxable year in which the net operating loss arises. For example, a taxpayer files its 2004 return showing tax of $100 but does not pay this liability. The taxpayer files its 2006 return showing net operating loss of $100, which taxpayer carries back to 2004. Here, underpayment interest runs on the 2004 liability from 4/15/2005 (due date of carryback year return) to 4/25/2007 (due date of loss year return. The same principle applies to capital loss carrybacks (§ 6601(d)(1)); foreign tax credit carrybacks (§ 6601(d)(2)); and certain credit carrybacks (§ 6601(d)(3)).
3. *IRC §§ 6601(f), Satisfaction by credits*. If a portion of tax is satisfied by the crediting of an overpayment, no interest shall be imposed on that portion of tax for the period during which, had the credit not been made, interest would have

been allowable with respect to the overpayment. This is generally relevant when the Services makes an offset under IRC § 6402(a).

D. Interest Rates and Netting. Generally, to the extent for any period that interest is both payable and allowable on equivalent underpayments and overpayments by the same taxpayer, the net rate of interest imposed on such amounts shall be zero.

1. *Interest rates governed by IRC § 6621.* Generally, the underpayment rate is the Federal Short Term Rate (FSTR) plus 3 percentage points.
    a. For large corporate underpayments, the rate is FSTR plus 5 percentage points. IRC § 6621(c). A large corporate underpayment (often abbreviated LCU) is any underpayment by a C corporation that exceeds $100,000.
    b. If estate tax is paid in installments under IRC § 6166, underpayment interest is calculated at a reduced rate of 2 percent on a portion of the tax as defined in § 6601(j)(2); and at a rate that is 45% the general underpayment rate on the remaining portion of the tax.
2. *Overpayment rates*
    a. FSTR plus 3 percentage points for individuals
    b. FSTR plus 2 percentage points for corporations. The rate is FSTR plus .5 percentage points to the extent the overpayment for any taxable period exceeds $10,000. (This lower rate is known as the GATT rate).
3. *IRC § 6621(d), Issues associated with interest netting.*
    a. The underpayment and the overpayment must be "by the same taxpayer."
    b. Interest accruing prior to 10/1/1998 is subject to the "special rule" of Pub. L. No. 105-206, § 3301(c)(2), as amended by Pub. L. No. 105-277, § 4002(d).
    c. *See* Rev. Proc. 2000-26, 2000-1 C.B. 1257 (interest accruing on or after 10/1/1998); and Rev. Proc. 99-43, 1999-2 C.B. 579 (interest accruing before 10/1/1998).

E. Underpayment Interest and Litigation.

1. In Tax Court, underpayment interest may be an issue presented in:
    a. IRC § 6404(h) interest abatement cases;
    b. Rule 155 computations; or
    c. Rule 261 Motions to redetermine interest, which must be filed within one year of entry of a final decision in a deficiency case.
2. In District Courts and the Court of Federal Claims, underpayment interest may be raised:
    a. as claims for a refund of deficiency interest paid. These claims are subject to the same IRC §§ 6511 and 7422 limitations as claims for the underlying tax.
    b. These claims are often grounded in IRC § 6621(d) interest netting, or Rev. Rul. 99-40, 1999-2 C.B. 441, which provides the date from which interest will be assessed when an overpayment claimed on a return is credited to the succeeding year's estimated tax or refunded without

interest, and a deficiency for the overpayment year is subsequently determined.

For more information:

- IRM 20.2, Interest, including
- IRM 20.2.5, Interest on Underpayments
- IRM 20.2.8, Restricted Interest
- IRM 20.2.9, Interest on Carryback of Net Operating Loss
- IRM 20.2.14, Netting of Overpayment and Underpayment Interest
- P&A Subject Matter PowerPoint Training Slides at: http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/PA/PA%20Subject%20Matter%20Training%20Documents%20and%20Links/Interest%20%20information%20reporting%20(8-14-12).ppt
- Contact P&A Branches 1&2.

IX. Abatement and suspension

A. In general. The Service abates a tax when it allows a claim for credit or refund. The Service may also abate the unpaid portion of the assessment of any tax or any liability in respect thereof which is: (1) excessive in amount, (2) assessed after the expiration of the period of limitation or (3) is erroneously or illegally assessed under section 6404(a). *See H. & H. Trim & Upholstery Co. v. Commissioner*, T.C. Memo 2003–9, where the Court found that section 6404(a) applied to some of the accrued interest directly attributable to respondent's error (providing a wrong payoff amount).

B. Abatement procedure used in the interest of efficiency. A taxpayer may not file a claim for an abatement of income, estate, or gift tax under section 6404(b); nevertheless, such claims are sometimes submitted and the Service may consider a request to abate an unpaid amount instead of requiring that the taxpayer pay the tax and file a claim for credit or refund when such a claim would clearly be allowed.

C. Small tax balances. The Service may abate amounts under uniform rules used to determine when administrative and collection costs outweigh the collection of the balance. IRC § 6404(c).

D. Abatement of interest or penalties due to Service errors. Taxpayers may request the abatement of interest to the extent the accrual of interest is attributable to unreasonable errors and delays by the Service. IRC § 6404(d). Taxpayers may request the abatement of any penalty or addition to tax attributable to erroneous written advice by the Service. IRC § 6404(f).

E. Suspension of interest and penalties due to Service's failure to give notice. If the Service fails to provide to an individual who timely files his or her return notice of increased liability and the basis for the increase within the 3-year period after the later of the return filing date or due of the return (without regard to extensions), interest, certain penalties and certain additions to tax will be suspended on the

increase in liability until the Service provides such notice, plus 21 days. IRC § 6404(g).

For more information:

- *See* CC:PA Subject Matter Training PowerPoint http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/PA/PA%20Subject%20Matter%20Training%20Documents%20and%20Links/Interest%20Abatement%20Presentation.ppt
- Contact P&A Branches 3&4.

X. ASSESSMENT STATUTE OF LIMITATIONS

A. In General.

1. *Three-year rule*. Assessment statutes of limitations generally limit the time the Service has to make tax assessments to within three years after a return is due or filed, whichever is later. IRC § 6501(a). The Service cannot assess additional tax after the time for assessment has expired under any statute of limitations. An assessment is merely the recording of a tax liability by an authorized employee on a Form 23C.
    a. Early returns are deemed filed on last day prescribed by law for filing the return. IRC § 6501(b)(1).
    b. Early-filed employment tax returns are deemed filed on April 15. IRC § 6501(b)(2).
    c. Filing an excise tax return for a specified period on which an entry has been made constitutes filing a return of all amounts of excise tax which would be required to be reported on the return for such period. IRC § 6501(b)(4).
    d. A timely mailed return may be treated in certain circumstances as filed on the return's due date even if it is received after the due date if the postmark on the envelope was on or before the due date and the envelope was properly deposited in the U.S. mail (or with a designated private delivery service) on or before the due date. See IRC § 7502 and regulations thereunder.
    e. Amended returns do not extend the original three-year assessment period.
2. *Exceptions To Three-Year Rule*
    a. Consent, IRC § 6501(c)(4). The three-year rule can be extended by agreement in writing and signed by authorized representatives of taxpayer and Service.
    b. Six-Year Exception, IRC § 6501(e)(4). Underreporting of more than 25% of the gross income stated on the original return.
    c. No Limitation Period. Assessment of taxes can be made at any time in the case of a false or fraudulent return, a willful attempt to evade tax, or a failure to file a return. IRC § 6501(c)(1), (2), (3).
    d. Special limitations periods for listed transactions (IRC § 6501(c)(10)), NOLs (IRC § 6501(h)), foreign tax carrybacks (IRC § 6501(i)), certain

credit carrybacks (IRC § 6501(j)), tentative carryback adjustments (IRC § 6501(k)), chapter 42 taxes (IRC § 6501(l)), deficiencies attributable to election of certain credits (IRC § 6501(m)), and other miscellaneous circumstances (see generally IRC § 6501).

3. *Suspension of Three-Year Rule*. The following suspend the running of the statute of limitations on assessment:
    a. Timely issuance of valid notice of deficiency (IRC § 6503(a)(1)).
    b. The filing of a Tax Court petition (IRC § 6503(a)(1)).
    c. The filing of a bankruptcy petition (IRC § 6503(h)).
    d. The issuance of a designated summons by the IRS (IRC § 6503(j)).
    e. For other specific instances, see generally IRC § 6503.
4. *Collection of Tax*, IRC § 6502(a). The IRS has ten years from the assessment date to collect the tax by administrative mean (seizures, levies, offsets) or to institute a suit for collection.

B. Period of Limitations on Criminal Tax Prosecutions.
1. *General Rule*, IRC § 6531. Indictment must be instituted within three years after the commission of the offense.
2. *Exceptions*. The period of limitations is six years under IRC § 6531 for:
    a. offenses involving defrauding the U.S.,
    b. willfully attempting to evade or defeat tax,
    c. willfully aiding or assisting in connection with any false or fraudulent return or other document,
    d. willfully failing to pay tax or file any tax return, and,
    e. certain other miscellaneous offenses described in IRC § 6531.

For more information:

- *See* GL-1 Training, Lesson 1 Part V (ASED) at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 1 & 2

XI. Closing Agreements

A. In general. The statutory authority for the Secretary to enter into closing agreements is IRC § 7121. Section § 7121 authorizes the Secretary to enter into a written agreement with any person relating to the liability of such person in respect of any tax for any tax period.
1. *Signature authority to sign for the Service*. Pursuant to section 7701(a)(11)(B) the term "the Secretary" includes the Secretary of Treasury or his delegate, the Commissioner of Internal Revenue. The Commissioner has redelegated his authority to lesser officials in Delegation Order 8-3 (formerly Delegation Order 97). The Commissioner (or his delegate) always signs last, after the taxpayer
2. *Final and Conclusive*. Closing agreements are final and conclusive and resolve the issues addressed in the agreement. A closing agreement cannot be conditional or contingent. Unless a § 7121(b) statutory exception applies, *i.e.*, fraud, malfeasance, or misrepresentation of a material fact, once the

Service, enters into a closing agreement that agreement can only be set aside by the Commissioner. This authority cannot be redelegated.

B. Finality. Closing agreements are final and conclusive and any issues are resolved with finality. A closing agreement cannot be conditional or contingent. Once the closing agreement is entered into by the Service, it can only be set aside by the Commissioner and only upon a showing of fraud, malfeasance, or a misrepresentation of a material fact. IRC § 7121(b). This decision cannot be redelegated. *See, e.g.*, IRM 8.13.1.6.2(1).

For more information:

- Contact P&A Branch 5.
- *See* P&A Subject Matter Training PowerPoint at: http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/PA/PA%20Subject%20Matter%20Training%20Documents%20and%20Links/Closing%20Agreements.ppt

CHAPTER 4: PAYMENTS

I. PAYMENT

A. Due date. The time for paying the tax shown on a return is generally the time fixed for filing the return (determined without regard to any extension of time for filing the return). IRC § 6151. Other tax, once assessed, shall be paid upon notice and demand from the Service. IRC § 6151. The notice and demand procedures are in section 6303.

B. Form of payment. Payment must be made by a commercially acceptable means. IRC § 6311. Treasury created the Electronic Federal Tax Payment System (EFTPS) to accept electronically transmitted tax payments. Treasury has approved payment by credit or debit cards after providing rules for disclosure to credit and debit card companies. IRC § 6311(e).

C. Payment versus deposit. A taxpayer may make a deposit with the Service under section 6603 to stop the running of interest on a disputed tax liability and later designate that remittance to be a tax payment. *See* Rev. Proc. 2005-18 (concerning designating a remittance as a IRC 6603 deposit) and Rev. Proc. 2002-26 (explains how the Service applies undesignated partial payments and involuntary partial payments among periods and also how it applies a partial payment within a period among tax, penalty, and interest).

D. Place of payment. The place for paying tax shown on a return is generally the place fixed for filing the return. IRC § 6151.

1. The Secretary may require that payment of certain taxes be made to authorized Government depositories. IRC § 6302(c).
2. The primary depository taxes include employment taxes, certain excise taxes, corporate income and estimated taxes, and taxes withheld on nonresident aliens and foreign corporations. The frequency of the deposits is based on the volume of the deposits.
3. For deposits made on or after January 1, 2011, depository taxes must be paid by electronic funds transfer [*e.g.*, EFTPS]. Treas. Reg. § 31.6302-1 (h)(2)(iii). (Previously, deposits were made to financial institutions using paper coupons with only large depositors being required to pay by electronic funds transfer.)

II. EXTENSION OF TIME TO PAY

A. In general.

1. *Amount shown on the return*. The Service is authorized to extend the time for payment of any tax shown on a return for a reasonable period, for a period up to 6 months (12 months for estate tax); but if the taxpayer is out of the country, the extension may exceed 6 months. IRC § 6161(a)(1). The regulations require that the taxpayer show undue hardship. Treas. Reg. § 1.6161-1(b).

2. *Deficiencies.* The Service is authorized to extend the time for payment of certain deficiencies for a period up to 18 months and in exceptional cases, for an additional period up to 12 months. IRC § 6161(b)(1).
3. *Special situations*. The Service is authorized to extend the time for payment for bankruptcy and receivership situations under same procedures as that for deficiencies. IRC § 6161(c). An extension is available for corporations expecting net operating carrybacks. IRC § 6164.

B. Estate Tax attributable to a closely held business.

1. *In general*. If the value of a closely held business exceeds 35% of the value of the adjusted gross estate, the estate may elect to obtain a 5 year deferral of the estate tax attributable to that business during which time it only pays interest and then pay the tax in equal installments over a period of up to 10 years. IRC § 6166. The Service is authorized to extend the time for payment of any part of any installment (including any part of a deficiency prorated to any installment), for reasonable cause, for a reasonable period of up to 10 years but not beyond 12 months after the due date for the last installment. IRC § 6161(a)(2)(A).
2. *Security for deferral*. The Service may require a bond pursuant section 6165 to secure the tax deferred under section 6166. An estate may elect to provide a lien under section 6324A in lieu of the bond.

C. Estate Tax attributable to any property. The Service is authorized to extend the time for payment of estate tax shown on a return for reasonable cause for a reasonable period not in excess of 10 years. IRC § 6161(a)(2)(A). Similarly, the period for an estate tax deficiency may be extended for a period up to 4 years. IRC § 6161(b)(2).

III. JOINT APPLICATION

A payment made by either spouse filing a joint return is applied to the joint and several liability assessed for the account; however, the spouses have separate interests in any overpayment with the amount attributable to each depending on the amount he or she contributed to the overpaid tax.

IV. PARTIAL PAYMENTS

If a taxpayer makes a voluntary partial payment with specific written directions, the Service will apply the payment according to those directions. If a voluntary payment is made without directions or if the payment is involuntary, the Service will apply the payment as the Service determines will serve its best interests.

For more information:

- Contact P&A Branches 3&4.
- *See* Rev. Proc. 2002-26 listing the order of priority.

CHAPTER 5: COLLECTION

I. LIENS

A lien is a charge or encumbrance that one person has on the property of another as security for a debt or obligation. *See Dep't of the Army v. Blue Fox, Inc.*, 525 U.S. 255, 262-63 (1999).

A. Federal Tax Lien (FTL). The FTL is characterized as a general tax lien because of its applicability to all property of the taxpayer. The FTL is the basis of virtually all tax collection since it attaches to all of a taxpayer's property, both real and personal, as well as after-acquired property.

1. IRC § 6321 provides that if "any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person."
2. *Assessed Tax*. There must be an assessed tax and not some other federal claim. In its simplest form, assessment involves nothing more than the recordation of the acknowledged tax liability on a list at the service center. See IRC § 6203. However, assessment other than by recording a liability from a self-assessed tax return is a technical process driven by the rules found in Chapter 63 of the Code. The assessment date of a tax can be obtained by the taxpayer since he is entitled, upon request, to a copy of the record of assessment. *See* IRC § 6203.

B. Notice and demand. IRC § 6303(a) provides:
"Where it is not otherwise provided by this title, the Secretary shall, as soon as practicable, and within 60 days, after the making of an assessment of a tax pursuant to section 6203, give notice to each person liable for the unpaid tax, stating the amount and demanding payment thereof. Such notice shall be left at the dwelling or usual place of business of such person, or shall be sent by mail to such person's last known address."

1. *Form of Notice*. This notice, like the notice of deficiency under section 6212(b), must be sent to the last known address. No particular form for the notice is required as long as the contents satisfy the requirements of section 6303(a). *See Hughes v. United States*, 953 F.2d 531, 536 (9th Cir. 1992); *Planned Invs., Inc., v. United States*, 881 F.2d 340, 344 (6th Cir. 1989). The notice is usually in writing.
2. *Timely*: A substantial body of case law touches generally on the impact of "untimely" notice and demand. In most cases, the legal issue directly presented is whether a defect (often timeliness) of the notice and demand precludes the Service from collecting by instituting a judicial action. In these cases, the courts have uniformly held that improper notice and demand does not preclude the Service from instituting judicial collection action.

3. *Purpose*. The rationale is that the purpose of notice and demand is to apprise the taxpayer that he owes a tax and to provide him with a warning that the Service may be about to take action to collect the tax; when no timely notice is given, the "warning" is deemed to have been given by the filing of pleadings in the civil action. Failure to give notice at all precludes the creation of a lien. *See United States v. Coson*, 286 F.2d 453, 463 (9th Cir. 1961).

C. Effect of Federal Tax Lien. A taxpayer is not deprived of the use of his/her property when a general tax lien has come into being. The filing of a NFTL, however, publicizes his/her financial problems to creditors, which may affect the taxpayer's ability to receive credit.

D. Other Issues:

1. *Lien arises at the time of assessment*. The section 6321 lien arises on assessment. It relates back to the date of assessment from the date of notice and refusal to pay. *See* IRC § 6322; *Harris v. United States*, 764 F.2d 1126, 1128 (5th Cir. 1985).
2. *Lien Remains Until Liability Satisfied or Legally Unenforceable*. The lien continues until the tax liability (or a judgment against the taxpayer arising out of such liability) is satisfied or becomes legally unenforceable due to lapse of time. *See* IRC § 6322.
3. *Reducing liability to judgment*. This usually occurs when a tax lien is about to expire and administrative remedies have been exhausted.
   a. The tax lien does not merge into the judgment or judgment lien; they continue to exist independently. *See United States v. Overman*, 424 F.2d 1142, 1147 (9th Cir. 1970). After judgment, a tax lien lasts until the judgment is satisfied. *See* IRC §§ 6322, 6502(a).
   b. A tax may be collected administratively by levy or by a proceeding in court, but only if the levy is made or the proceeding begun within 10 years after the assessment of the tax. IRC § 6502(a)(1). The tax liability may be collected beyond the ten-year period if it is reduced to judgment. Section 6502(a) provides that, where a timely proceeding in court for the collection of a tax is commenced, the Government is permitted to collect taxes by administrative levy action until such time as the liability for the tax, or a judgment against the taxpayer arising from such liability, is satisfied or becomes unenforceable.

E. Estate and Gift Tax Liens

1. *Estate tax lien*. The estate tax lien arises on the date of death and lasts for 10 years. There are no suspensions or extensions. The estate tax lien attaches to all property in the gross estate, which includes both probate and non-probate property (property that goes directly to another by contract or operation of law).

2. *Gift tax lien*. The gift tax lien arises on the date of a taxable gift and lasts for 10 years. There are no suspensions or extensions. The gift tax lien attaches to all gifts by a donor given during the year in which the gift tax liability arises.

For more information:

- *See* GL-1 Training, Lesson 2 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 3&4

II. RELEASE, DISCHARGE AND SUBORDINATION

A. Release. When the IRS issues a certificate under section 6325 and files that certificate in the same office where the NFTL is filed, the certificate of release extinguishes the FTL in its entirety.

1. *Satisfaction of tax liability.* The tax liability is satisfied when the IRS determines that the entire liability listed on the NFTL is paid. *See* Treas. Reg. 301.6325-1(a)(4).
2. *Multiple liabilities*. If a lien secures more than one assessment, all assessments secured by the lien notice must be satisfied before the IRS will issue a certificate of release. *See* Treas. Reg. § 301.6325-1(a)(6).

Note: a certificate of discharge removes the lien from specific property. The release can be revoked while a discharge cannot be revoked.

B. Discharge. A discharge of a FTL removes the lien from a specific piece of property. A release of FTL removes the lien from all property to which the FTL was attached.

1. *Foreclosure sales*. In general, when a lien or interest senior to a FTL is being foreclosed against property, junior liens, including FTLs, are discharged under state law. Federal law provides exceptions for FTLs.
   a. Judicial. State law cannot discharge a junior FTL if a NFTL was properly filed when the foreclosure suit was commenced and the United States was not a party to the suit.
   b. Nonjudicial. State law cannot discharge a junior FTL if a FTL was properly filed more than 30 days before the date of the sale and the Service is not given written notice of the sale in accordance with section 7425(c)(1) at least 25 days before the sale.

Note: If the FTL is senior to the lien or interest being foreclosed, the sale will not discharge the FTL.

2. *Administrative discharge*.
   a. Certificate of discharge on property belonging to taxpayers: the Service may issue a certificate of discharge of any part of property subject to a tax lien if:
      i. the property remaining subject to the lien is worth at least double the amount of the tax liability secured by the lien plus the amount of all

other liens and security interests with priority over the tax lien. *See* IRC § 6325(b)(1).

    ii. an amount is paid over to the Service that is at least equal to the value of the property to be discharged. *See* IRC § 6325(b)(2)(A).
    iii. the interest of the United States in the part of the property to be discharged is valueless. *See* IRC § 6325(b)(2)(B).
    iv. the property is sold and, per agreement with the Service, the sale proceeds are held as a fund subject to the tax lien. *See* IRC § 6325(b)(3).

b. Certificate of discharge on property belonging to third parties: The Service must issue a certificate of discharge to a non-taxpayer who owns property subject to a tax lien, if that person deposts an amount equal to the value of the government's interest (as determined by the Service) or furnishes a bond in the same amount. *See* IRC § 6325(b)(4).
   - A third-party who receives a certificate of discharge under section 6325(b)(4) may challenge the Service's determination of value by bringing suit in district court within 120 days of the determination. *See* IRC § 7426(a)(4).

C. Subordination. A FTL may be subordinated to another interest by issuance of a certificate of subordination if (1) the Service is paid an amount equal to the amount of the lien or interest to which the certificate subordinates the FTL; or, (2) the Service believes that subordination will ultimately result in an increase in the amount realized by the government from the property subject to the FTL and will facilitate the ultimate collection of the liability.

For more information:

- I.R.M. 5.17.2.8.3
- *See* GL-1 Training, Lesson 7 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 3&4

III. REDEMPTION IF SALE OF REAL PROPERTY DISCHARGES LIEN

Under IRC § 7425(d), the IRS has the authority to redeem (*i.e.*, buy back) property that is subject to a federal tax lien.

A. Right to Redeem. The right arises when:

1. A judicial sale in a proceeding in which the United States was joined as a party and,
2. A nonjudicial sale in which the notice of federal tax lien was on file more than 30 days prior to the sale, and the Service is entitled to notice of the sale, and either receives adequate notice at least 25 days in advance of the sale (see section 7425(c)(1)) or consents to the sale (see section 7425(c)(2)). See Treas. Reg. § 301.7425-4(a)(1), (3).

3. *Definitions*:
   a. Judicial sales. The term "judicial sale" is narrowly defined, and only applies to sales where there is a judicial proceeding that provides a complete and formal hearing on the merits and results in an order directing the sale of the property.
   b. Nonjudicial sales. Includes, but is not limited to, the divestment of taxpayer's property by operation of law, public or private sale, by forfeiture, or by terms in a contract for sale.

B. No right to redemption if:
   1. Judicial sales in which the lien of the foreclosing lienor is junior to the federal tax lien; the United States was not named as a party, whether or not a notice of federal tax lien was on file; local law does not provide for the discharge of junior encumbrances by the sale, and,
   2. Nonjudicial sales in which the lien of the foreclosing lienor is junior to the federal tax lien; a notice of federal tax lien was not filed more than 30 days prior to the sale.

C. Time for Redemption. The statutory right of redemption arises only when a sale is conducted to satisfy a lien on real property that is prior to the federal tax lien and results in a discharge of the tax lien. State law determines whether the junior tax lien is discharged. The United States has 120 days from the date of the foreclosure sale to exercise its redemption right or longer if provided by state law.

D. Property Redeemed and Subsequent Encumbrances. A redemption reaches the entire property foreclosed even if the federal tax lien had attached only to a partial interest. Redemption is not limited to the taxpayer's interest in the property. If the holder of a second lien interest senior to the federal tax lien forecloses on the same property within the 120-day redemption period, the Service's redemption right survives the second foreclosure.

E. Amount to be Paid for a Redemption. To redeem, the United States must pay the purchaser, or his successor in interest, the "actual amount paid" for the property, plus certain additional amounts specified by the regulations.
   1. *Interest*: Interest at the rate of 6 percent per annum on the amount paid from the date of sale to the date of redemption. Treas. Reg. § 301.7425-4(b)(1)(ii). (The 6 percent rate is governed by 28 USC § 2410(d) not the flexible rates of the Internal Revenue Code.)
   2. *Excess expenses*: The amount required to redeem also includes expenses necessarily incurred by the purchaser to maintain the property after the foreclosure sale reduced by rents received (plus the reasonable rental value if purchaser-occupied or is rented at less than its reasonable rental value).
   3. *Payments to senior lienholders*: A purchaser (or successor in interest) of real property at a foreclosure sale may request reimbursement for payments of principal and interest made to senior lienholders. *See* Treas. Reg. § 301.7425-1.

For more information:

- *See* GL-1 Training, Lesson 9 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 3&4.

IV. LIEN PRIORITY – NFTL FILING AND WITHDRAWAL

The federal tax lien arises by operation of law following a neglect or refusal to pay following notice and demand of an assessed liability (an "assessment" or "secret" lien). *See* IRC §§ 6321, 6303. A federal tax lien often will be attached to property in which a competing creditor has an interest. The priority of the federal tax lien vis-à-vis the interests of competing creditors is determined by federal law.

A. Statutory Priority. The priority of a federal tax lien over a competing lien generally would be determined according to the principal of first in time, first in right. However, section 6323 provides that, with respect to four classes of competing creditors, a federal tax lien would not have priority unless and until the government files a notice of its lien. Moreover, the Code affords some competing interests superpriority status, which will prime the government's federal tax lien interest regardless of the time that either the lien arose of a notice was filed.

1. *Four Horseman*. Purchasers, holders of security interests, mechanic's lienors, and judgment lien creditors (the "four horsemen"). Section 6323(a) provides that the federal tax lien is not valid as against these four classes of competing creditors unless and until a notice of federal tax lien is filed.
2. *Superpriorities*. Regardless of whether the Service has filed a notice of federal tax lien, the government does not have priority over those interests afforded superpriority status pursuant to section 6323(b). Subsections (c) and (d) of section 6323 also provide limited priority to security interests that generally would be protected under the U.C.C.

B. Common Law Priority. Where a competing lien does not have statutory priority under section 6323, the basic rule in determining the priority of liens is often referred to as "first in time, first in right." The competing lien must be choate before the federal tax lien arises. *See United States v. City of New Britain*, 347 U.S. 81 (1954).

A state-created lien is choate when it is specific and perfected. A lien is specific when it attaches to specific property or rights to property and it is perfected when the identity of the lienholder, the amount of the lien, and the identity of the property to which it attaches are established. *See United States* v. *City of New Britain*, 347 U.S. 81 (1954).

C. Filing notice of the federal tax lien. The procedures for filing a notice of federal tax lien are in section 6323(f). The procedures are different for real and personal property.

D. Withdrawal of notice of federal tax lien. The Service has the discretion under section 6323(j) to withdraw a notice of federal tax lien when:

1. the filing of the lien notice was premature or otherwise not in accordance with administrative procedures,
2. the taxpayer has entered into an installment agreement unless the agreement provides otherwise,
3. the withdrawal will facilitate collection of the liability, or
4. with the consent of the National Taxpayer Advocate, the withdrawal is in the best interests of the taxpayer and United States.

E. The effects of release, withdrawal, and discharge on lien priority.

1. *Release*. When the government releases a lien, the effect is that the lien is extinguished (meaning there no longer is a federal tax lien interest in the property at all). *See* IRC § 6325(a).
2. *Withdrawal*. When the government withdraws a notice of federal tax lien, the lien still exists, but its priority depends on the rules for unfiled liens. See IRC § 6323(j).
3. *Discharge*. When the government discharges specific property from a federal tax lien, the federal tax lien still exists, but the lien no longer attaches to the discharged property. See IRC § 6325(b). The discharge is only valid to the extent that the taxpayer is divested of the property and, just as with other after-acquired property, the federal tax lien will reattach to any property from which the lien was divested if the property is returned to the taxpayer in any manner.

F. The effect of refiling a notice of federal tax lien on lien priority. After a lien releases, the government may refile its notice of lien (and, if the re-filing is timely, it will retain its priority). Refiling is timely if it occurs within the one-year period ending 30 days after expiration of 10 years after the date of the assessment or within the one-year period ending 10 years after the close of the preceding refilling period. IRC § 6323(g).

If the government fails to timely refile its lien, it may still refile, but the notice of refiling will be treated as a new filing. The government will thus lose whatever priority it had. IRC § 6323(g)(1).

For more information:

- *See* GL-1 Training, Lesson 4 at: http://intranet.prod.irscounsel.treas.gov/eTools/training/courses/default.asp?Course_ID=1155&tab=Course_Materials
- Contact P&A Branches 3&4 for lien priority issues.

V. LEVIES AND SEIZURES

A levy is an administrative means by which the Service seizes property to satisfy a taxpayer's liability. Levy authority only arises after the taxpayer neglects or refuses to

pay after being issued notice of assessment of tax and demand for full payment under section 6303. A levy and seizure are legally the same but for administrative convenience a levy generally refers to taking funds and a seizure refers to taking property that must be sold, such as tangible property.

A. Property subject to levy. Except for property listed in section 6334, the Service may levy on property or rights to property of the taxpayer or on which there is a tax lien for the collection of the taxpayer's liability. IRC § 6331(a).

   NOTE: *Principal residence seizure.* The Service must obtain approval of a United States district court to seize a taxpayer's principle residence.

B. Notice and opportunity for hearing before levy. Section 6331(d) requires the Service to give the taxpayer at least 30 days notice of its intent to levy on the taxpayer's property. Section 6330, with certain exceptions, requires the Service to give a taxpayer notice of the right to a pre-levy collection due process (CDP) hearing before the first levy to collect each tax/tax period.

C. Jeopardy levy. The Service may levy without giving the pre-levy notice under sections 6330 or 6331(d) (but is required to give section 6303 notice and demand) if collection of the tax will be jeopardized by delay. A jeopardy levy may be made in connection with a jeopardy or termination assessment. Under section 7429, jeopardy levy must be approved by Chief Counsel. Within 5 days after the date of the levy, the Service must give the taxpayer a written statement of the information relied upon in making the jeopardy determination and notice of the right to an administrative hearing with the IRS Office of Appeals if requested within 30 days after the end of the 5-day period.

D. Execution of levy and seizure.
   1. *Notice of levy.* A levy is executed by serving a notice of levy on any person in possession of, or obligated with respect to, property or rights to property subject to levy. Treas. Reg. § 301.6331-1(a)(1). The Service may serve a notice of levy by mailing the notice to the person on whom service is authorized. Treas. Reg. § 301.6331-1(c).
   2. *Seizure.* In the case of tangible property, levy is accomplished by physical seizure, posting, or tagging of the property to show the exercise of dominion and control over the property.
   3. *Consent or writ of entry.* The Service may execute a levy by seizing a taxpayer's property in public areas without obtaining a judicial warrant. However, if the property is on private residential or business premises, the Fourth Amendment requires the Service, except in exigent circumstances, to secure written consent to enter the premises or obtain a writ of entry from a federal district court before seizing property in a private area. *See G.M. Leasing v. United States*, 429 U.S. 338 (1977).
   4. *Surrender of property.* Except in cases involving life insurance, endowment contracts, or banks, any person in possession of, or obligated with respect to,

property or rights to property subject to the levy being made must surrender the property or rights (or discharge the obligation) upon demand. IRC § 6332(a). The IRS must follow special rules for levies on life insurance and endowment contracts (section 6332(b)) and bank deposits (section 6332(c)).

5. *Defenses*. A third party has only two defenses for refusing to surrender property levied against: (1) not being in possession of taxpayer property or (2) the property is subject to prior judicial attachment or execution. *See United States v. Nat'l Bank of Commerce*, 472 U.S. 713, 721–22 (1985).
6. *Effect of honoring levy*. If a third party in possession of the property levied upon honors the levy, that person is discharged from any obligation or liability to the delinquent taxpayer and any other person with respect to that property arising from the surrender. IRC § 6332(e).
7. *Failure to Comply with Levy*. If a person levied upon refuses to honor the levy, then such person is personally liable for the amount that he or she failed to surrender. *See* IRC § 6332(d). Additionally, there may be a 50% penalty imposed if the failure was not due to reasonable cause. Id.

E. Sale of seized property.

1. *Notice of seizure*. As soon as possible after the seizure of property, the Service must give written notice to the owner of the property (or, in the case of personal property, the possessor thereof). IRC § 6335(a).
2. *Notice of sale*. As soon as possible after the seizure of property, the Service must give written notice of the sale to the owner of the property. Notice of the sale must also be published in a newspaper generally circulated in the county where the seizure was made. IRC § 6335(b).
3. *Time of sale*. The time of the sale must be not less than 10 days nor more than 40 days after the date of the public notice of sale. IRC § 6335(d).
4. *Redemption of property*.
    a. After the Service levies on property, but before it sells the property, the person whose property was levied on has the right to pay the amount of tax due, together with the expenses of the levy to recover the property. IRC § 6337(a).
    b. After a sale, the owner or person with a lien on real property has 180 days to recover the property by paying to the purchaser the purchase price plus 20 percent annual interest. IRC § 6337(b).
5. *Sale*. Section 6331(b) authorizes the sale of seized property. The sale is conducted by the Property Appraisal and Liquidation Specialists (PALS).
6. *Property deemed purchased by United States*. Property may be deemed sold to the United States if no one offers the minimum price below which the property will not be sold, as determined by the Service, and the Service determines that purchase of the property would be in the best interest of the United States.
7. *Certificate of sale*. After the sale, the Service issues a certificate of sale to the purchaser, which transfers to the purchaser all the taxpayer's right, title and interest in the property sold. IRC §§ 6338(a), 6339.

8. *Deed to real property*. After the 180-day redemption period has expired, the Service will issue the purchaser a deed to the real property sold upon surrender of the certificate of sale. IRC § 6338(b). The deed conveys all of the taxpayer's right, title and interest in the property sold. IRC § 6339(b).

F. Application of levy proceeds

1. *In general*. Under IRC § 6342, any money realized by levy or by sale of seized property (or by sale of property redeemed by the United States based on a tax lien) shall be applied in the following order:
    a. Expenses of the seizure and sale;
    b. Unpaid Federal taxes due on specific property sold (e.g., alcohol or tobacco);
    c. The liability of the delinquent taxpayer;
2. *Surplus proceeds*. The taxpayer will be given the surplus unless a creditor, including the Service, establishes a superior claim. Any surplus is an overpayment under section 6402 subject to offset against taxes not subject to the levy.

For more information:

- *See* GL-1 Training, Lesson 10 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 3&4

VI. LEVY RELEASE AND RETURN OF LEVIED PROPERTY

A. Mandatory release. Section 6343(a) requires a release of levy for all or part of the seized property where:

1. the liability for which such levy was made is satisfied or becomes unenforceable by reason of lapse of time,
2. release will facilitate collection of the liability,
3. the taxpayer has entered into an installment agreement to satisfy the liability (unless the agreement provides otherwise),
4. the levy is creating an "economic hardship" due to the financial condition of the taxpayer, or
5. the fair market value of the property exceeds the liability and release of the levy on a part of the property could be made without hindering collection of the tax liability.

B. Return of wrongfully levied property.

1. Section 6343(b) authorizes the Service to return wrongfully levied property to a third party (person other than the taxpayer). Property is wrongfully levied when the third party owns or has an interest in the property senior to the United States.
2. Seized property may be returned at any time. The Service may return an amount equal to the amount of money levied upon or received from a sale of seized property only within the 9-month period following the date of levy.

C. Discretionary return of property.

1. Section 6343(d) authorizes the Service to return levied or seized property to the taxpayer if:
    a. the levy was premature or otherwise not in accordance with administrative procedures;
    b. the taxpayer enters into an installment agreement that includes the liability being collected by the levy, unless the agreement provides otherwise;
    c. returning the property facilitates collection; or
    d. with the consent of the taxpayer or the National Taxpayer Advocate (NTA), returning the payment is in the best interests of the taxpayer (as determined by the NTA) and the government.
2. Seized property may be returned at any time. The Service may return an amount equal to the amount of money levied upon or received from a sale of seized property only within the 9-month period following the date of levy.

For more information:

- *See* GL Training, Lesson 10 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 3&4

VII. COLLECTION STATUTE OF LIMITATIONS

A. Collection Statute Expiration Date (CSED). Section 6502 provides that a tax may be collected by levy or proceeding in court begun within ten years after assessment.

1. *Extensions.*
    a. By court proceeding. If a timely proceeding is commenced in court for collection of a tax, the period during which such tax may be collected is extended until the liability for the tax, or a judgment against the taxpayer arising from the liability, is satisfied or becomes unenforceable. IRC § 6502 (flush language).
    b. By agreement. For requests to extend made after December 31, 1999, the ten-year collection statute cannot be extended by agreement between the taxpayer and the Service, except in connection with an installment agreement or release of levy under section 6343. IRC § 6502(a)(2).
2. *Suspensions.* The ten-year collection period is suspended during the following periods (not a complete list).
    a. While all or substantially all of the taxpayer's assets are in the control or custody of a court, plus 6 months. IRC § 6503(b).
    b. During taxpayer's absence from the United States if absent for a continuous six months or more. IRC § 6503(c).
    c. From date Service seizes or receives wrongfully levied property of a third party until property is returned or section 7426 judgment becomes final, plus 30 days. IRC § 6503(f).

d. During the period the bankruptcy automatic stay (11 USC § 362) prohibits the Service from collecting, plus six months. IRC § 6503(h).
e. While an offer in compromise or request for an installment agreement is pending, plus 30 days after rejection and if the taxpayer appeals to the IRS Office of Appeals during 30-day period, then during the appeal. IRC § 6331(k).
f. While a granted installment agreement is in effect, for 30 days after the installment agreement is terminated, and if the taxpayer appeals the termination to the IRS Office of Appeals within the 30-day period, then during the appeal. IRC § 6331(k).
g. From the date a CDP hearing is requested until the determination resulting from the CDP hearing becomes final. IRC § 6330(e).
h. From the date of the taxpayer's application for a Taxpayer Assistance Order until the date of the National Taxpayer Advocate's decision about such application, plus any period specified in the Taxpayer Assistance Order. IRC § 7811(d).
i. From the date an innocent spouse relief claim is filed until (i) a waiver of restrictions on levy or proceeding in court is filed, plus 60 days, or (ii) until the innocent spouse determination is final, plus 60 days. IRC § 6015(e)(2).

For more information:

- GL-1 Training Lesson 10 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 3&4

VIII. TRUST FUND RECOVERY PENALTY AND SECTION 3505 LIABILITY

The trust fund recovery penalty (TFRP) under section 6672 and the lender/surety liability provisions of section 3505 hold certain third parties liable for "trust fund" taxes that a primarily liable taxpayer (usually an employer) failed to withhold and/or pay over to the Service. The Service uses these provisions as a "collection device" for the underlying unpaid trust fund taxes; the trust fund taxes, interest, and penalties due are ultimately collected only once from the taxpayer (employer) and/or liable third parties. While the persons potentially liable under sections 6672 and 3505 are frequently different, there are some cases where the Service may simultaneously pursue liability against a person under both sections

A. In general.

1. The trust fund recovery penalty (TFRP) is a liability imposed under section 6672 on a responsible person(s) who willfully fails to withhold or remit "trust fund taxes," which generally refer to employment taxes and certain types of excise taxes (i.e., those federal taxes that are required to be collected, withheld, accounted for, and paid over to the government). For most purposes, however, the TFRP is treated as a tax, and is not really a "penalty."

2. Under the Code, each responsible person is severally liable for the entire unpaid trust fund tax liability, plus interest and penalties; however the Service will collect against the liability, interest, and penalties only once.

B. Other Relevant Statutory Provisions.

1. *Duty of Business to Withhold and collect*: IRC sections on withholding (3102, 3202, 3402) and excise taxes collected by businesses from customers (4103, 4521, 4261, 4271).
2. *Special Fund in Trust for the US*: IRC section 7501(a) states that federal taxes required to be collected or withheld from other persons (*e.g.*, employees or customers) represent a special fund in trust for the United States," and the amount of such trust funds shall be assessed, collected, and paid in the manner applicable to the taxes (owed by the employer) from which the trust fund arose.
3. *Rules for Application of Penalties*: IRC section 6671.

C. Responsible Persons.

1. *Person*. The Code defines person broadly. It is not limited to "natural persons" but also include entities. *See* section 7701(a)(1). The courts and the Service use the shorthand phrase to describe a person required to collect, truthfully account for, or pay over trust fund taxes. It can be more than one person.
2. *Factors Showing "Responsibility*": Although no single factor is controlling, the most important factor is a person's control over a business's finances. Courts use a multi-factor test to determine control where no factor is controlling.

D. "Willfulness."

1. "Willfully" generally means a voluntary, conscious, and intentional decision not to turn over trust fund taxes to the United States. It is a civil liability, not a criminal penalty, so ill intent is not a necessary factor. Willfulness may be found if there is a "reckless disregard" of a known risk that the taxes will not be remitted.
2. "Reasonable Cause" is not a Defense to Willfulness: The Code does not contain a "reasonable cause" defense to willfulness (unlike many other Title 26 penalties). However, the Circuits have split on whether "reasonable because" may negate a responsible person's willfulness.

E. Liability of Lenders and Sureties (IRC section 3505). In certain instances, the government may impose liability on lenders or sureties for unpaid withholding and FICA taxes pursuant to section 3505. The purpose of section 3505 is to prevent the practice of "net payroll financing" (funding employers in poor financial condition only with funds sufficient to cover net payroll). There are several statutory provisions to consider:

1. Direct payment for wages: IRC section 3505.
2. Difference between IRC sections 6672 and 3505: Both cover unpaid employment taxes, but section 3505 also covers excise taxes. Section 3505 is

not an “assessable” tax. The government must commence a suit to establish section 3505 liability, unless the liable person signs a Form 4219 consent.

For more information:

- *See* GL-1 Training, Lesson 18 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 3&4.

IX. TRANSFEREE AND FIDUCIARY LIABILITY

A. Overview. A transferee or fiduciary may be made liable for the liability of another person pursuant either to state or federal law. Such liability may be either a tax or not-tax debt (e.g., an erroneous refund). When advising Collection on the handling of cases involving third-party liabilities, you must determine: (1) the facts giving rise to third-party liability or potential liability; (2) the source of the liability (e.g., a state or federal law); and (3) the procedures for assessing and/or the liability.

B. Statutory Authority.

1. With respect to the collection of taxes, if a third-party is liable as a fiduciary under the federal priority statute (31 USC § 3713(b)) or as a transferee under either federal or state law, then the liability may be litigated either in the Tax Court under section 6901 or by suit in district court under section 7402(a) or 28 USC §§ 3301-3308.
2. Section 6901(a) provides that the liability, at law or in equity, of a transferee of property or of a fiduciary under 31 USC § 3713(b) shall be assessed, paid, and collected in the same manner as the underlying tax liability of the taxpayer. Accordingly, the Service may use this procedural statute to assess against a third party. Once an assessment is made, the Service may engage in administrative collection (*e.g.*, levy).
3. If the Service obtains a judgment pursuant to a referral under section 7402, then the government may collect on the judgment and/or judgment lien.

C. Who is liable?

1. Transferees, including donees, beneficiaries of decedents’ estates, successors to corporate or partnership liquidations or corporate reorganizations, and de facto successors.
2. Fiduciaries under 31 USC § 3713(b).
3. Transferees of transferees.

D. Statutes of Liability.

1. *Transferees*: The Service may assess within one year after the expiration of the period of limitation (including suspensions or extensions) on assessment against the transferor. IRC § 6901(c)(1).
2. *Fiduciary*: The liability must be assessed not later than one year after the liability arises, or not later than the expiration of the period for collection of the

tax in respect of which the liability arises, whichever is the later. IRC § 6901(c)(3).

3. *Transferee of a Transferee*: The Service may assess within one year after the expiration of the limitations period for assessment against the preceding transferee, but not more than three years after the expiration of the period for assessment against the initial transferor. IRC § 6901(c)(2).

Note*: Period of limitation*. Because the period of limitation to assess a transferee or fiduciary keys off of the transferor's/taxpayer's period of limitation (whether for assessment or collection), any extension of the transferor's/taxpayer's period of limitation is applicable to the transferee/fiduciary.

E. District Court.

1. Section 7402(a) confers jurisdiction upon district courts to render such judgments and decrees as may be necessary or appropriate for the enforcement of the internal revenue laws. This statute, along with 28 USC §§ 1340 and 1345, grants the district courts jurisdiction over suits brought by the United States to set aside fraudulent conveyances, establish transferee liability and prove other types of third-party liability, as to tax and non-tax debts arising under the IRC.
2. There are advantages and disadvantages to using either section 6901 or section 7402 (for example, the period of limitation may have elapsed for one option but not the other); a case by case analysis will determine which is best in a given situation.

For more information:

- Contact P&A Branches 3&4.
- See GL-1 Training, Lesson 19 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip

X. OFFERS IN COMPROMISE

A. In general. An OIC is an agreement between a taxpayer and the IRS that settles a tax debt for less than the amount owed. An OIC achieves collection of what is potentially collectible at the earliest possible time and at the least cost to the IRS (Policy Statement P-5-100). Such an agreement provides eligible taxpayers with a path toward paying off their tax debt and getting a "fresh start."

B. Law. IRS may compromise any civil or criminal case arising under the internal revenue laws prior to reference to DOJ for prosecution or defense (IRC § 7122(a)). DOJ may compromise any civil or criminal case after reference to DOJ for prosecution or defense (IRC § 7122(a)). The IRS may compromise a liability on any of 3 grounds (Treas. Reg. § 301.7122-1):

1. *Doubt As To Liability (DATL)*. Doubt as to liability exists where there is a genuine dispute as to the existence or amount of the correct tax debt under the law. There is no doubt as to liability when the tax debt is established by a final court decision or judgment concerning the existence or amount of tax debt.

The taxpayer must offer more than $0. A taxpayer need not submit a user fee or partial payment to submit an OIC based on DATL.

2. *Doubt As To Collectibility (DATC)*. Doubt as to collectability exists when the taxpayer's assets and income are less than the full amount of the liability. In considering an OIC based on DATC, the IRS determines the taxpayer's ability to pay, which is based in part on the taxpayer's basic living expenses. The determination of basic living expenses is based on a taxpayer's individual facts and circumstances, guided by IRS guidelines on national and local living expense standards. Before submitting the offer, taxpayers must file all tax returns legally required to be filed, make all required estimated tax payments for the current year, and make all required federal tax deposits for the current quarter if the taxpayer is a business owner with employees.
3. *Effective Tax Administration (ETA)*. The Service is authorized to compromise with individuals when it determines that a liability could be collected in full, but to do so would cause economic hardship within the meaning of Treas. Reg. § 301.6343-1. If there are no grounds for compromise on collectibility, liability, or economic hardship grounds, the Service may compromise to promote effective tax administration where compelling public policy or equity considerations identified by the taxpayer provide a sufficient basis for compromising the liability. Treas. Reg. § 301.7122-1(b)(3)(ii). This basis is established only when exceptional circumstances exist such that collection of the full liability would undermine public confidence that the tax laws are being administered in a fair and equitable manner.

C. Additional considerations:

1. Taxpayers submitting OICs based on DATC or ETA must make a nonrefundable partial payment when submitting their offers. *See* IRC § 7122(c); Notice 2006-68. The amount of the payment depends on the nature of the offer:
   a. Lump sum (5 or fewer installments). 20% of total offer must be submitted with the offer.
   b. Periodic payment (6 or more installments). The first payment must be is submitted with the offer.

Note: The taxpayer must continue making periodic payments while the IRS considers whether to accept offer.

2. Penalties and interest continue to accrue while an OIC is pending. An offer is pending after the IRS official signs and accepts the offer as pending and before it is withdrawn by the taxpayer or rejected or accepted by the IRS. If a taxpayer defaults on an accepted OIC the taxpayer will be liable for the original tax liability, less payments made, plus all interest and penalties that have accrued.
3. An OIC can only be accepted for assessed taxes.
4. A taxpayer in an open bankruptcy proceeding is not eligible for an OIC.
5. The IRS keeps any refunds for tax periods extending through the calendar year that the IRS accepts the offer.

6. The IRS generally cannot levy the taxpayer's assets while an OIC is pending or is in effect, unless collection of the tax is in jeopardy. *See* IRC § 6331(k).

For more information:

- *See* GL-1 Training, Lesson 14 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branch 5

XI. INSTALLMENT AGREEMENTS

A. In general.

1. *Statutory authority*. The Service has the authority to enter into written installment agreements with any taxpayer providing for the payment of any tax in installment payments if doing so will facilitate full or partial collection of the taxpayer's liability. IRC § 6159(a). Congress provided the Service with the authority to enter into partial payment installment agreements in section 843 of the American Jobs Creation Act of 2004, effective for agreements entered into on or after October 22, 2004.

NOTE: The Service must review each partial payment installment agreement at least once every two years. IRC § 6159(d).

2. *OIC v. IA*. Installment agreements differ from offers in compromise in that installment agreements only provide for a means by which the taxes are to be paid. They do not finally settle either the determination of the correct amount of the tax for a period or the liability for the payment of such taxes. Interest and penalties also keep running even when an installment agreement is in place.

B. Seeking an IA.

1. A request for an installment agreement can be made orally or in writing, but the actual agreement must be in writing.
2. A request for an installment agreement should include information sufficient to identify the taxpayer and the tax liability to be covered by the agreement, along with an offer to make monthly or periodic payments of a specific amount.

For more information:

- *See* GL-1 Training, Lesson 14 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branch 5

XII. CURRENTLY NOT COLLECTIBLE (CNC)

A taxpayer's account may be placed in "currently not collectible" status for a variety of reasons. The main reasons for placing an account in CNC status are (1) neither the taxpayer nor the taxpayer's assets can be located, (2) the taxpayer has no assets subject to levy (e.g., taxpayer's only assets are exempt from levy under section 6334)

and (3) levy would prevent the taxpayer from being able to meet necessary living expenses, *i.e.*, economic hardship.

1. *Authority*. Policy Statement 5-71 provides the authority for reporting accounts currently not collectible (CNC). Accounts can be removed from active inventory after taking the necessary steps in the collection process. See IRM 1.2.14.1.14.
2. *Procedure*. The investigation required to establish a CNC condition varies with the dollar amount and type of case. Generally, a collection information statement (CIS) (Form 433-F, Form 433-A or Form 433-B) disclosing the taxpayer's financial condition will be required to report an account CNC. A taxpayer may request his or her account be placed in CNC status.
3. *Tax Lien Filing*. In general, a Notice of Federal Tax Lien will be filed listing accounts being reported CNC when the aggregate unpaid balance of assessments equals or exceeds $10,000.00.

For more information:

- Contact P&A Branches 3&4
- IRM 5.16.1

CHAPTER 6: REFUNDS

I. REFUND

Under Treasury Reg. § 301.6402-2(a), no refund or credit can be made until the Service determines that the taxpayer made an overpayment of tax for the period, which generally is a tax year.

A. Overpayment defined. The Code contains no general definition of the term "overpayment." The Supreme Court has interpreted the term in its "usual sense, as meaning any payment in excess of that which is properly due." *Jones v. Liberty Glass*, 332 U.S. 524, 531 (1947).

B. Statutory Overpayment. Section 6401 provides that the term "overpayment" includes amounts that are assessed or collected after the applicable period of limitations. Accordingly, these amounts are treated as overpayments even if the taxpayer has not paid more than the liability imposed by the Code. For example, if the Service collects money on an outstanding liability after the expiration of the section 6502 period of limitation on collection after assessment, then the amount collected is a "statutory overpayment".

C. Administrative Claim for Refund. To be eligible to receive a refund or credit, a taxpayer must file a timely claim for refund or credit before the expiration of the applicable statutory period of limitation. Treas. Reg. §§ 301.6402-2 and -3.

D. Offset. Section 6402 authorizes the IRS to credit any overpayment of tax, including the applicable interest, against any outstanding liability for any tax (or for any interest, additional amount, addition to the tax, or assessable penalty) owed by the person making the overpayment. The IRS must act within the applicable period of limitation.

The balance, if any, is then refunded, provided the taxpayer does not have other debts that are administered through the Treasury Offset Program ("TOP") at FMS. *See* IRC § 6402(c) – (f) (*e.g.*, FMS will offset debts owed to other federal agencies).

E. Informal and protective claims. Case law has recognized the validity of some informal claims, *i.e.*, claims that are otherwise defective because of some formal requirement. *U.S. v. Kales*, 314 U.S. 186 (1941). An informal claim must contain a written component. It must put the Service on notice that refund is requested and describe legal and factual basis for the refund.

Case law has also recognized protective claims. A taxpayer may have a claim that is contingent on future events (*e.g.*, a lawsuit). To preserve the statute, the taxpayer may file a protective claim that must at a minimum meet the *Kales* criteria for informal claims. A protective claim need not state a particular dollar amount.

II. REPORTS OF REFUNDS AND CREDITS TO JOINT COMMITTEE

Section 6405 provides that no refund or credit of income, estate, or gift tax, and certain other taxes in excess of $2,000,000 ($5,000,000 in the case of a C corporation), can be authorized until a report has been made to the Joint Committee on Taxation.

For more information:

- *See* IRM 4.36 *et seq.*
- Contact P&A Branches 3&4.

III. TENTATIVE CARRYBACK AND REFUND ADJUSTMENTS UNDER IRC § 6411

A taxpayer may apply for what is referred to as a quick refund based on a tentative carryback adjustment if the taxpayer is entitled to carry back a loss or credit to a prior year. Subsequent to making a tentative carryback refund, the IRS may make a full examination of the return under its regular auditing procedures.

If the IRS later determines that the amount refunded or credited as a tentative allowance was greater than the actual amount of the overassessment for the year, the IRS can:

1. immediately assess the amount of the excessive refund as if were a math error (section 6213(b)(2));
2. send a SND within the three-year period during which a deficiency may be assessed (section 6501(h)); and/or
3. commence an action for the recovery of an erroneous refund within the two-year period under section 6532(b) (5 years for fraud). (IRC § 7405).

IV. ERRONEOUS REFUND

An erroneous refund is defined as the receipt of any money from the IRS to which the recipient is not entitled. This includes all erroneous refunds, regardless of taxpayer intent or whether the error that caused the erroneous refund was made by the IRS, the taxpayer or a third party. The Service has the burden of proof regarding:

1. whether an erroneous refund was issued;
2. the amount of the erroneous refund; and,
3. that the applicable SOL has not expired.

Section 7405 authorizes the United States to bring an action in U.S. District Court to recover an erroneous refund. The statute of limitations for an erroneous refund is generally two years, unless the government can demonstrate the refund was induced by fraud or misrepresentation of a material fact. An action to recover a refund resulting from fraud or misrepresentation of a material fact is subject to a five year limitation period. *See* IRC § 6532(b).

For further information:

- IRM 21.4.5 (lists 5 Categories of erroneous refunds)
- Contact P&A Branches 3&4

V. Refund Statute of Limitations

A. <u>General Rule</u>.

1. *General Rule*, IRC § 6511(a). Claims for credit or refund must be filed within three years from the time the return was filed or two years from the time the tax was paid, whichever expires later. If no return was filed, claims must be filed within two years from the time the tax was paid.
2. *Limitations and Exceptions*
    a. "Look-back Period" Limitation, IRC § 6511(b). Limits the amount of allowable refund to the amount of tax paid within the three-year period (plus the period of any extension of time to file) preceding the filing of the claim. IRC § 6511(b)(2)(A). If the claim was not filed within three years from the time the return was filed, but instead was filed within two years of any payment of tax, the amount is limited to the tax paid within the two-year period preceding the filing of the claim. IRC § 6511(b)(2)(B). If no claim was filed, the refund is limited to the amount which would be allowable under IRC § 6511(b)(2)(A) or (B), as the case may be, if the claim was filed on the date the refund is allowed. IRC § 6511(b)(2)(C).
    b. Extension of Time By Agreement, IRC § 6511(c) – An agreement to extend the period for assessment under IRC § 6501(c)(4) extends the limitations period for filing a claim for refund until six months after the expiration of the agreement.
    c. Special limitation periods.
        i. Certain special periods apply to bad debts and worthless securities (IRC § 6511(d)(1));
        ii. NOLs and capital loss carrybacks (IRC § 6511(d)(2)); the foreign tax credit (IRC § 6511(d)(3)); certain credit carrybacks (IRC § 6511(d)(4));
        iii. self-employment taxes (IRC § 6511(d)(5), (7)); and,
        iv. income recaptured under qualified plan termination (IRC § 6511(d)(6)).
3. *Suspension*
    a. Under section 6511(h) the limitations period is suspended while the taxpayer is unable to manage financial affairs due to a financial disability, *i.e.*, medically determined physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than twelve months. This suspension does not occur if the individual has a guardian or other person authorized to act. *See* IRC §§ 6903 (Fiduciaries) and 6012(b) (returns made by fiduciaries and receivers).

b. Section 7508 and 7508A can also postpone the time for filing a claim for refund. This means that the IRS will disregard the due date until the end of the postponement period. *See infra*, Chapter 9, part VII.

For more information:

- Contact P&A Branches 1&2

VI. *LEWIS V. REYNOLDS* (JUDICIAL SET-OFF)

Under the principles established by the Supreme Court in *Lewis v. Reynolds*, 284 U.S. 281 (1932), a taxpayer's claim for refund must be reduced by the amount of the correct tax liability for the taxable year, regardless of the fact that the Commissioner can no longer assess any deficiency for the taxable year. In *Lewis v. Reynolds* the taxpayer filed a claim for refund alleging that certain deductions had been improperly disallowed by the Commissioner after the period of limitations on additional assessment had expired. The Commissioner agreed with the taxpayer that the period of limitations had expired but denied a refund on the basis that the correct computation of tax resulted in additional tax. The taxpayer argued that the Commissioner lacked the authority to redetermine the tax after the period of limitations had expired but the Supreme Court upheld the Commissioner's authority.

Under the *Lewis* doctrine of setoff, the otherwise time-barred assessment and collection of an underpayment of tax for a year may be set off against a refund due to a taxpayer for the year of the underpayment. Although the statute of limitations may have barred the assessment and collection of any additional sum, it does not obliterate the right of the United States to retain payments already received when they do not exceed the amount which might have been properly assessed and demanded.

For more information:

- Contact P&A Branches 3&4

VII. ANTI-ASSIGNMENT ACT

Section 3727 of Title 31, the Anti-assignment Act, excuses the United States from private assignments of income tax refunds prior to submission of the tax return and allowance of the refund by the IRS. The Act has a number of purposes, including preventing possible payment of multiple of claims to avoid investigation of alleged assignments and enabling the Government to deal only with the original claimant. In the absence of such a rule, the Government would be in danger of becoming embroiled in conflicting claims, with delay and embarrassment and the chance of multiple liabilities.

When an assignment does not comply with the Act, it is voidable at the government's discretion. When the government exercised its discretion to void the assignment of a potential tax refund, the claim is not valid against the United States. The government retains a property interest in the checks until they are cashed. (Contact P&A 3&4.)

CHAPTER 7: APPEALS

I. OFFICE OF APPEALS.

The Office of Appeals is the Internal Revenue Service's dispute resolution forum. Section 1001(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105–206, 112 Stat. 685 (RRA 98), required the Commissioner to ensure an independent Appeals function within the Service. The Commissioner granted Appeals authority to consider and negotiate settlements of Internal Revenue Service controversies. The mission of Appeals is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service. Appeals' jurisdiction is broad and includes the following.

A. Liability Determinations.

1. *Proposed Deficiency*. Before the Service issues a notice of deficiency to a taxpayer giving him/her a right to file a petition with the United States Tax Court, the Service in most cases gives the taxpayer a "30-day" letter, which offers the taxpayer an opportunity for a conference with Appeals to dispute the Service's asserted deficiency. The asserted deficiency results from the examination of the taxpayer's tax year during which Service determines that the taxpayer's liability is greater than reported on a tax return (or if no return is filed determines the taxpayer's liability). For income, estate, gift and excise taxes under Subtitle D, chapters 41, 42, 43, and 44, the Service must issue the taxpayer a notice of deficiency giving him/her 90 days from the date of the notice to file a petition with the Tax Court. *See* IRC §§ 6311-6216.
   a. If the taxpayer fails to file a protest within 30 days after the date of the 30-day letter, the Service will mail the taxpayer a notice of deficiency under section 6212 to his/her last known address.
   b. If the taxpayer files a timely protest within the 30-day period, and Appeals and the taxpayer cannot reach an agreement as to the amount of the deficiency, then Appeals will issue the notice of deficiency showing the amount it determined.
2. *Proposed Partnership Adjustments*. In most cases, the tax matters partner of a partnership subject to IRC §§ 6221-6234 will be issued a "60-day" letter offering a conference with Appeals, which gives the partners an opportunity to file a protest of the Service's proposed adjustments within 60 days of the letter. Unless all partners settle the adjustments, Appeals will issue a Notice of Final Partnership Administrative Adjustment (FPAA). The non-settling partners have a total of 150 days to petition the FPAA.
3. *Tax Court Docketed Deficiency Cases*. If the taxpayer did not file a protest of a proposed deficiency in a conference with Appeals, then after the taxpayer files a petition with the Tax Court, Counsel will refer the case for Appeals to consider the Service's deficiency determination. If Appeals and the taxpayer are able to reach an agreement as to the amount of deficiency, then Counsel will submit a decision document to the Court showing the amount of the

agreed-upon deficiency amount. If Appeals and the taxpayer are unable to reach an agreement, then the case is referred back to Counsel for trial.

4. *Certain excise taxes or employment taxes.* Subtitle D excise taxes other than those imposed by chapter 41, 42, 43 or 44 and employment and unemployment taxes are not subject to deficiency procedures. Nevertheless, when the Service conducts an examination and determines that the tax liability is greater than reported on a tax return (or if no return is filed determines the taxpayer's liability), the Service in most cases issues a 30-day letter to the taxpayer's last known address offering an opportunity to protest the determination in a conference with Appeals.
    a. If the taxpayer fails to file a protest within 30 days after the date of the 30-day letter, the Service will make the assessment.
    b. If the taxpayer files a protest within the 30-day period, and Appeals and the taxpayer cannot reach an agreement as to the amount of the additional liability, then the Service will make the assessment of the amount determined by Appeals.
5. *Trust Fund Recovery Penalty*. A trust fund recovery penalty (TFRP) under IRC § 6672 is made against any person who is responsible for and willfully fails to collect, account for, and pay over taxes held in trust. The Service must give the taxpayer a notice of proposed assessment 60 days before making the assessment. In the notice of proposed assessment, the Service offers the taxpayer an opportunity for a conference with Appeals to dispute the TFRP.
    a. If the taxpayer fails to file a protest within 60 days of the date of the notice of proposed assessment, the Service will make the assessment.
    b. If the taxpayer files a protest within 60 days of the date of the notice of proposed assessment, and Appeals and the taxpayer cannot reach an agreement as to the amount of the TFRP, then the Service will make the assessment of the amount determined by Appeals.
6. *Penalty Appeals Program*. After certain penalties are assessed (e.g., failure to file, failure to pay or deposit, information return related penalties), taxpayers may request an abatement of the penalties based on reasonable cause. If Exam denies the requested abatement in whole or in part, the taxpayer may request consideration by Appeals.

B. Relief from Liability.

1. *Relief from Joint and Several Liability*. If a taxpayer is denied full or partial relief from joint and several liability under IRC § 6015, the Service issues him/her a preliminary determination letter. The letter offers the taxpayer the opportunity to contest the denial in Appeals by requesting an Appeals conference within 30 days of the date of the letter.
    a. If the taxpayer fails to request a conference with Appeals within 30 days after the date of the preliminary letter, the Service will issue a Final Appeals Determination, which the taxpayer may petition to the Tax Court within 90 days.

   b. If, after a timely request, Appeals sustains the denial, it will issue a Final Appeals Determination, which the taxpayer may petition to the Tax Court within 90 days.

2. *Denial of Request for Interest Abatement*. If a taxpayer is denied full or partial abatement under section 6404(e)(1) for an error or delay in performing a ministerial or managerial act, the Service issues a letter offering the taxpayer the right to protest the denial in Appeals. The taxpayer will be granted a conference with Appeals if the taxpayer requests a conference within 30 days of the denial letter and meets the requirements of IRC § 7430(c)(4)(A)(ii).
   a. If the taxpayer fails to request a conference with Appeals within 30 days after the date of the denial letter, the Service will issue a Final Determination, which the taxpayer may petition to the Tax Court within 180 days.
   b. If, after a timely request, Appeals sustains the denial, it will issue a Final Determination, which the taxpayer may petition to the Tax Court within 180 days.

C. <u>Collection Determinations</u>.

1. *Collection Due Process*. IRC § 6320 gives the taxpayer a right to one hearing with Appeals the first time the Service files a Notice of Federal Tax Lien (NFTL) for a tax period. IRC § 6330 gives the taxpayer the right to one hearing before the first levy to collect an unpaid tax period, or in certain instances after the levy (e.g., jeopardy or levy on federal contractors). Taxpayers are granted a CDP hearing under IRC §§ 6320 and 6330 when they timely request a hearing after the issuance of a notice of opportunity for a hearing. At the conclusion of the hearing, Appeals issues a notice of determination, which the taxpayer may petition to the Tax Court for review of the determination.
   a. NOTICE. The taxpayer is only entitled to one IRC § 6320 notice and one IRC § 6320 notice. Treas. Reg. §§ 301.6320-1(b), 301.6330-1(a).
      i. The CDP notice must be given in person, left at the taxpayer's dwelling or usual place of business, or sent to the taxpayer's last known address by certified or registered mail.
      ii. A CDP levy notice must be delivered by one of the above methods not less than 30 days prior to the first levy. The taxpayer must request a CDP levy hearing within 30 days of the date of the notice. IRC § 6330(a)(2) and (3).
      iii. A CDP lien notice must be delivered by one of the above methods not more than five business days after the NFTL is filed. The taxpayer must request a CDP lien hearing within 30 days after this five-day period. IRC § 6320(a)(2) and (3).
      iv. If the taxpayer's CDP hearing request is untimely, the taxpayer is not entitled to a CDP hearing but may receive an Equivalent Hearing (discussed below) if requested within one year after the end of the five-business-day period after the NFTL is filed or one year after the date of the CDP levy notice. IRC §§ 301.6320-1(i), 301.6330-1(i).

v. If the CDP notice is not properly sent, the notice is not valid, and the taxpayer is entitled to a substitute notice. Treas. Reg. §§ 301.6320-1(a)(2) Q&A-A12, 301.6330-1(a)(3) Q&A-A10.

b. MATTERS CONSIDERED AT THE CDP HEARING:

i. Verification. The Appeals officer must obtain verification that all applicable legal or administrative procedural requirements necessary for the NFTL filing or levy have been satisfied. IRC §§ 6320(c), 6330(c)(1).

ii. Issues raised. The taxpayer may raise the following issues at the hearing.

1. Relevant issues relating to the unpaid tax or collection action, including appropriate spousal defenses, interest abatement, challenges to the appropriateness of collection actions, offers of collection alternatives and requests for currently not collectible status. IRC §§ 6320(c), 6330(c)(2)(A).
2. Challenges to the existence or amount of the underlying liability. IRC §§ 6320(c), 6330(c)(2)(B).

iii. Issues Precluded. The taxpayer is precluded from raising the following issues at the hearing.

1. Challenge to the existence or amount of the underlying liability if the taxpayer received any statutory notice of deficiency or otherwise had an opportunity to dispute the tax liability. IRC §§ 6320(c), 6330(c)(2)(B).
2. Issues that were raised and considered at a previous CDP hearing or in any other previous administrative or judicial proceeding if the person participated meaningfully in the hearing or proceeding. IRC §§ 6320(c), 6330(c)(4).
3. Issues that are deemed frivolous pursuant to IRC § 6702(b)(2)(A). IRC §§ 6320(c), 6330(g).

c. NOTICE OF DETERMINATION. Unless the taxpayer provides the IRS with a written withdrawal of the CDP hearing request, Appeals must issue a notice of determination if the taxpayer has timely requested a CDP hearing. Treas. Reg. §§ 301.6320-1(f)(1), 301.6330-1(f)(1). The determination must take into consideration the verification requirement, any issues raised by the taxpayer pursuant to IRC § 6330(c)(2), and whether the proposed collection action balances the need for efficient collection of taxes with the legitimate concern that any collection action be no more intrusive than necessary.

2. *Equivalent Hearing*. If a taxpayer did not timely request a CDP hearing with Appeals, the taxpayer has the right to request an "Equivalent Hearing". However, the taxpayer must specifically state he or she wants an Equivalent Hearing. The same rules apply to an Equivalent Hearing as a CDP hearing. However, the taxpayer does not have the right to seek judicial review of Appeals' decision.

3. *Collection Appeal Program*. The Collection Appeal Program (CAP) is an administrative appeal for certain collection actions. Except for installment agreements, appeals in CAP are not required by statute or regulations. See IRC §§ 6331(k)(2), 7122(e)(2), Review in CAP is for the appropriateness of the action taken or proposed based on the Code, regulations, policy and IRM procedures after considering all the relevant facts and circumstances. Taxpayers are not entitled to judicial review of Appeals' decision made in a CAP hearing. A taxpayer, or a third party whose property is subject to a collection action, may appeal the following actions under CAP:
    a. Levy or seizure action that was or will be taken.
    b. Notice of Federal Tax Lien that was or will be filed.
    c. Filing of a Notice of Federal Tax Lien against an alter-ego or nominee's property.
    d. Denials to issue lien certificates, such as subordination, withdrawal, discharge or non-attachment.
    e. Rejection, proposed for modification, modification or proposed for termination or termination of installment agreements.
    f. Disallowance of taxpayer's request to return levied property under IRC § 6343(d).
    g. Disallowance of property owner's claim to return property under IRC § 6343(b). CAP decisions by Appeals are binding on the taxpayers and the Collection functions.
4. *Offer in Compromise*. An Offer in Compromise (OIC) is an agreement between a taxpayer and the government to settle a tax liability in exchange for payment of less than the full amount owed. The taxpayer is entitled to Appeals' review of the Service's rejection of an OIC. IRC § 7122(e)2). Taxpayers are not entitled to judicial review of the Appeals' decision resulting from an OIC review hearing. A taxpayer is also permitted to submit an OIC during a CDP or equivalent hearing. Rejection of an OIC by Appeals is subject to judicial review when part of a CDP determination. Appeals has jurisdiction to make decisions on OIC cases in the following circumstances:
    a. Offers appealed after being rejected by Collection.
    b. Offers based wholly or in part on doubt as to liability after being rejected by Examination, or if the liability was previously determined by Appeals.
    c. Offers submitted directly to Appeals as a collection alternative in a CDP or equivalent hearing.
    d. Offers being evaluated by Collection when a Notice of Federal Tax Lien is filed and the taxpayer requests a CDP hearing or Equivalent hearing.
5. *Jeopardy Assessment and/or Levy*. After the Service makes a jeopardy assessment and/or a jeopardy levy, the taxpayer is entitled to a hearing under section 7429. Appeals will determine whether the jeopardy determination was reasonable under the circumstances and whether the amount assessed is appropriate under the circumstances. If only a jeopardy levy was made, then Appeals will only decide whether the jeopardy determination was reasonable. If the taxpayer disagrees with Appeals's decision or if Appeals does not make a decision within 15 days after the hearing is requested, the taxpayer may file

suit in United States district court for review of the jeopardy determination and the appropriateness of the amount assessed.

D. Restrictions on Appeals' Consideration of Certain Matters.

1. *Controlled issues*. Appeals considers certain controlled issues subject to the review and decision of Service officials assigned nationwide responsibility for specific issues. *See* IRM 8.7.3.8.
2. *CCI*. Appeals may not settle Compliance Coordinated Issues (CCI), formerly known as Industry Specialization Program (ISP), or other issues designated for litigation by the appropriate Associate Chief Counsel. *See* IRM 8.7.3.2, Coordinated and Appeals Emerging Issues and IRM 8.7.3.5, Designation of Coordinated Issue for Litigation.
3. *Technical Advice issued*. Appeals may not settle cases contrary to Technical Advice Memoranda (TAM) if the advice is favorable to the taxpayer, concerns an organization's exempt status or private foundation classification, or concerns an employee plan's qualification. *See* IRM 8.6.3, Appeals Rulings.

II. COUNSEL'S ROLE AND *EX PARTE* COMMUNICATIONS

The Chief Counsel is the legal adviser to the Commissioner and his officers and employees (including employees of Appeals) on all matters pertaining to the interpretation, administration, and enforcement of the internal revenue laws and related statutes. Appeals employees are encouraged to obtain legal advice from attorneys in the Office of Chief Counsel and are permitted to do so under Rev. Proc. 2012-18, with one limitation, described below. In general, Appeals employees are not bound by the legal advice obtained from Counsel. The legal advice provided by Counsel is just one factor to be considered by Appeals in its consideration of the case.

A. Legal Advice. Attorneys in the Office of Chief Counsel are expected to provide legal advice without bias in favor of either the Government or the taxpayer. Rev. Proc. 64-22, 1964-1 C.B. 689. Appeals' requests for legal advice will be handled by field Counsel, who may seek assistance of the appropriate Associate Chief Counsel office. See CCDM 33.1.2.2.2, Coordination of Legal Advice with Associate Chief Counsel.

B. *Ex parte* communications prohibited. RRA 98 included a prohibition of *ex parte* communications between Appeals employees and other Service employees to the extent that those communications appear to compromise the independence of Appeals.

1. *Ex parte communications*. *Ex parte* communications are communications between Appeals and other Service functions without the participation of the taxpayer or the taxpayer's representative.
   a. *Ex parte* communications between Appeals employees and employees of originating functions, *i.e.*, Examination, Collection, and Service Center (Campus) functions, are prohibited to the extent they appear to compromise the independence of Appeals. *See* Rev. Proc. 2012-18, Sec. 2.03(1).

NOTE: The restriction on communicating with Appeals *ex parte* only applies while Appeals is performing its duties of evaluating the strengths and weaknesses of the specific issues in specific cases and the overall hazards of litigation for those cases.

b. A field attorney should not communicate *ex parte* with Appeals employees regarding an issue in a case pending before Appeals if:
    i. that field attorney personally provided legal advice regarding the same issue in the same case to the originating function, or
    ii. personally served as an advocate for the originating function regarding the same issue in the same case.

c. The restriction described above generally does not apply to reviewers or national office attorneys unless they essentially function like a field docket attorney.

2. If the restriction on *ex parte* communications applies, Counsel will assign a different attorney to provide assistance to Appeals.
   a. The newly assigned (second) attorney will review the file to see what advice was previously given.

   Note: The second attorney may discuss the case with the first attorney.

   b. The second attorney and the reviewer will exercise independent judgment in rendering the advice to Appeals thereby assuring no violation of the *ex parte* communication rules.

3. The *ex parte* communication rules generally do not apply:
   a. to communications between Appeals and Service functions that are not subject to the Appeals process, such as Criminal Investigation, Competent Authority, Taxpayer Advocate Service, and IRS officials with overall supervisory responsibilities.
   b. if an Appeals employee is not functioning in the capacity of evaluating the strengths and weaknesses of a case, for example, if an Appeals employee is preparing a statutory notice of deficiency.
   c. to communications between Appeals and Counsel concerning cases docketed in the Tax Court, with the exception of remanded CDP cases.. With a docketed case, if a trial attorney who previously provided advice to Examination is assigned to the case, then that same attorney may communicate with Appeals with respect to that docketed case without giving the taxpayer or representative an opportunity to participate. *See* Rev. Proc. 2012-18, Sec. 2.06(2)(a).

   NOTE: Communications between Appeals and the originating function in docketed cases are still subject to the ex parte communication rules when the case is in Appeals' jurisdiction.

For more information:

- Rev Proc. 2012-18
- CCDM 33.1.2.2.2; IRM 8.1 *et seq*
- Chief Counsel Collection Due Process Deskbook, at http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/PA/Documents/CDP%20Deskbook%202014%207%2031%202014.doc

CHAPTER 8: LITIGATION

I. TAX COURT

The following sections describe some of the issues that P&A addresses that arise in Tax Court. **For detailed guidance on all phases of litigation in Tax Court, *see* CCDM 35.1 *et seq*.**

A. Collection Due Process (IRC §§ 6320 and 6330)

1. *Jurisdiction*. The Tax Court has jurisdiction to review Appeals' Collection Due Process (CDP) determination if the taxpayer files a petition with the Tax Court within 30 days of the determination. IRC §§ 6320(c), 6330(d)(1).
   a. TIME PERIOD. If the taxpayer seeks judicial review only of the portion of a determination relating to a section 6015 claim or a claim for interest abatement, Tax Court jurisdiction can be established under IRC §§ 6015(e) or 6404(h)(1), and the taxpayer has 90 days or 180 days, respectively, to file a petition.
   b. EXCLUSIVE JURISDICTION. For notices of determination dated on or after October 17, 2006, the Tax Court has exclusive jurisdiction to review CDP determinations, regardless of whether the Tax Court has jurisdiction over the underlying tax liability. IRC §§ 6330(c), 6330(d)(1).
2. *Standard and Scope of Review*
   a. STANDARD OF REVIEW. Where the underlying liability is at issue, the Tax Court reviews the liability de novo. Otherwise, the Tax Court reviews the determination for abuse of discretion. See Sego v. Commissioner, 114 T.C. 604, 610 (2000).
   b. ISSUES RAISED AT THE CDP HEARING. The taxpayer may only seek Tax Court review of an issue that was properly raised during the CDP hearing. Treas. Reg. § 301.6330-1(f)(2), Q&A-F3; *Giamelli v. Comm'r*, 129 T.C. 107 (2007).
   c. MOOTNESS. The Tax Court's jurisdiction under section 6330(d) is generally limited to reviewing whether the NFTL should remain filed or the proposed levy should proceed, and the court will dismiss as moot cases in which there is no unpaid tax liability upon which the lien or the proposed levy could be based. *Greene-Thapedi v. Commissioner*, 126 T.C. 1 (2006).
3. *Remand.*
   a. ABUSE OF DISCRETION. If Appeals has abused its discretion or the taxpayer was not given a proper hearing, the Tax Court will remand the matter to Appeals to hold a supplemental hearing, but only if such hearing would be necessary and productive. *See Kelby v. Commissioner*, 130 T.C. 79 (2008); *Lunsford v. Commissioner*, 117 T.C. 183 (2001).
   b. NO ABUSE OF DISCRETION. The Tax Court has also held that it has authority to remand a CDP case, where there has been a material change in a taxpayer's factual circumstances after the determination

was issued and remand would be helpful, necessary, or productive. *Churchill v. Commissioner*, T.C. Memo. 2001-82.

NOTE: *See* CC Notice 2013-002 for guidance regarding remands of collection due process cases to Appeals based on a post-determination change in circumstances.

c. EX PARTE COMMUNICATIONS. *See* Rev. Proc. 2012-18, § 2.03(10), for guidelines concerning ex parte communications and CDP cases; Chapter 6, *supra*.

4. *Effect on Statutes of Limitation*. The following statutes of limitation are suspended for the period during which the hearing and any appeals therein are pending, plus 90 days. *See* IRC § 6330(e)(1); Treas. Reg. §§ 301.6320-1(g)(2), Q&A-G1, 301.6330-1(g)(2), Q&A-G1.
   - Section 6502 (collection after assessment)
   - Section 6531 (criminal prosecution)
   - Section 6532 (suits)
5. *Levy during CDP Cases in Tax Court*.

a. GENERALLY. A timely CDP levy hearing request suspends any levy action to collect liabilities listed on the CDP levy notice for the period during which the hearing and any appeals therein are pending, plus 90 days. IRC § 6330(e)(1); Treas. Reg. § 301.6330-1(g)(2), Q&A-G3.

NOTE: The suspension of levy action does not extend to unpaid tax liabilities covered by a CDP lien notice. Treas. Reg. § 301.6320-1(g)(2), Q&A-G3. However, the Service has administratively decided that, except for jeopardy and state income tax refund levies, it will not levy to collect taxes that are the subject of a CDP lien hearing. See IRM 5.1.9.

b. MOTION TO PERMIT LEVY. Levy will not be suspended during appeal of the CDP determination if the underlying tax liability is not at issue in the appeal and the court determines the Secretary has shown good cause not to suspend the levy. IRC § 6330(e)(2).

c. SECTION 6330(F) LEVY. The suspension of levy action does not extend to levy actions listed in IRC § 6330(f).

For more information:

- *See* GL1 Training, Lesson 11 at http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/PA/Documents/CDP%20Deskbook%202014%207%2031%202014.docs
- Consult Chapter 7 of the CDP Deskbook at: http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/PA/Documents/CDP%20Deskbook%202014%207%2031%202014.doc
- Contact P&A Branches 3&4

B. Innocent Spouse Relief (IRC § 6015)

Generally, married taxpayers who file joint Federal income tax returns are jointly and severally liable for the tax. IRC § 6013(d). Under certain circumstances, a spouse

may seek relief from that joint liability. Section 6015 offers taxpayers three possible avenues for relief from joint and several liability.

1. *Section 6015(b): Innocent Spouse Relief*
    a. A requesting spouse may elect relief from joint and several liability for an understatement of tax attributable to erroneous items of the other spouse if the requesting spouse did not know or have reason to know of the understatement and taking into account all of the facts and circumstances, it would be inequitable to hold the requesting spouse liable. The requesting spouse must make this election no later than two years after the date that the Secretary has begun collection activities against the requesting spouse.
    b. If the relief is granted, the requesting spouse will be relieved of liability to the extent that the liability is attributable to the portion of the understatement of which the requesting spouse did not know or have reason to know.
    c. For an explanation of "know or have reason to know," *see* Treas. Reg. § 6015-2(c).
2. *Section 6015(c): Relief by Separation of Liability*.
    a. A requesting spouse may elect to allocate a deficiency if the requesting spouse is no longer married to, is legally separated from, is no longer living with the other spouse, or is a widow.
    b. If the request is granted, the requesting spouse will only be liable for the portion of the deficiency property allocable to him/her under section 6015(d), generally, as if separate returns had been filed. *See also* Treas. Reg. § 1.6015-3(a).
    c. The requesting spouse must make the election no later than 2 years after the date that the Secretary has begun collection activities against the requesting spouse.
    d. The requesting spouse cannot get relief if the Service establishes that he/she had actual knowledge of the item (unless there was domestic abuse). *See* § 6015(c)(3).
3. *Section 6015(f): Equitable Relief*.
    a. If a requesting spouse does not qualify for relief under subsections (b) or (c), the Commissioner may grant relief from any unpaid tax or any deficiency if it is inequitable to hold the requesting spouse liable.
    b. *See* Rev. Proc. 2013-34, 2013-41 IRB 397, for guidelines, including equitable factors.
    c. While (b) and (c) relief requires that there was an understatement or deficiency, (f) allows relief from either a deficiency or underpayment of tax.
    d. Change in position for the "2-year rule": The IRS will now consider requests for equitable relief under section 6015(f) if the period of limitation on collection of taxes under section 6502, or, if applicable, the period of limitation for credit or refund under section 6511, remains open for the years at issue. *See* Proposed Reg. § 1.6015-5(b)(2), REG-132251-11 (78 FR 49242); Rev. Proc. 2013-34; Notice 2011-70, 2011-32 IRB.

4. *Section 66: Relief from community income.*
    a. Generally, in community property states, spouses not filing a joint return each report one half of community income
    b. Section 66 provides relief from the community income splitting requirements in certain circumstances.
    c. Innocent spouse relief may be requested under section 66(c). If the requirements for traditional innocent spouse relief are not met, equitable relief may be available. *See* Rev. Proc. 2013-34.
5. *Procedures.*
    a. The Cincinnati Centralized Innocent Spouse Operation (CCISO) is responsible for making the IRS's administrative decision of whether or not to grant innocent spouse relief.
    b. Three types of Tax Court cases involving innocent spouse relief:
        i. STAND-ALONE CASE: a petition from the IRS's administrative denial of the taxpayer's request on Form 8857, or when six months have elapsed since the claim was filed without a final determination. IRC § 6015(e) provides for Tax Court jurisdiction to determine a taxpayer's entitlement to relief.

        NOTE: The court may not consider the underlying liability.
        ii. DEFICIENCY CASE: a petition from a Notice of Deficiency for a joint return, where a spouse raises the issue of innocent spouse relief. Have the requesting spouse fill out the Form 8857 if possible. Send the case to CCISO and have CCISO make a determination. In a deficiency case, CCISO should send its response to the trial attorney rather than the taxpayer. See CC Notice CC-2013-011 (June 10, 2013).
        iii. COLLECTION DUE PROCESS (CDP) CASE: a petition from a CDP Notice of Deficiency where a taxpayer requested innocent spouse relief in the CDP hearing.
    c. Notice to the non-requesting spouse is required within 60 days of the service of the petition. See IRC § 6015(e)(4), CCDM 35.2.2.12.2.
    d. The Tax Court determines de novo the taxpayer's entitlement to relief.
    e. The IRS may not pursue collection while the claim is pending. See Treas. Reg. § 1.6015-7(c)(1). The collection statute of limitations is suspended during this time, plus an additional 60 days. *See* IRC § 6015(e)(2); IRM 25.15.1.8.

For more information:

- Contact P&A Branches 1&2.
- GL-1 Training, Lesson 17 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- P&A intra-web site, under "Quick Reference" http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/PA/Pages/Innocent.aspx .
- IRM 25.15, Relief from Joint and Several Liability
- www.irs.gov/Individuals/Tax-Information-for-Innocent-Spouses

C <u>Denial of Interest abatement (6404)</u>

Although IRC §§ 6601 and 6602 impose interest on unpaid tax, penalties and interest, IRC § 6404(e) provides for the abatement of interest due to unreasonable errors and delays by the Service. IRC § 6404(h) provides for Tax Court review of the Service's denial of taxpayer requests for interest abatement.

1. *Unreasonable Error or Delay*. The Service, in its discretion, may abate the interest on a deficiency as described in IRC § 6212(a) if it is attributable to either:
    a. a failure by the Service to perform a managerial or ministerial act in a timely manner, or,
    b. an error on the part of the Service in performing a ministerial or managerial act.

   Section 6404(e) abatements are subject to the following requirements:
    a. There must have been an assessment of interest.
    b. The accrual of the interest must be attributable to an unreasonable error or delay by a Service official in performing a managerial or ministerial act.
    c. No significant aspect of the delay can have been caused by the taxpayer.
    d. The delay must have occurred after the taxpayer was contacted by the Service in writing about the deficiency.
        i. *Managerial Act*. *See* Treas. Reg. § 301.6404-2(b)(1). A managerial act is an administrative act that occurs during the processing of a taxpayer's case involving the temporary or permanent loss of records or the exercise of judgment or discretion relating to management of personnel. A managerial act does not include:
            A. A decision concerning the proper application of law.
            B. A general administrative decision, such as the IRS's decision on how to organize the processing of tax returns or its delay in implementing an improved computer system.
        ii. *Ministerial Act*. *See* Treas. Reg. § 301.6404-2(b)(2). A ministerial act is a procedural or mechanical act that does not involve the exercise of judgment or discretion. It is an act that occurs during the processing of a taxpayer's case after all prerequisites to the act, such as conferences and review by supervisors, have taken place.

        NOTE: The term ministerial act does not include decisions concerning the proper application of law.
2. *Erroneous Refunds*. The Service will abate the assessment of all interest until the date on which demand for repayment is made unless (1) the erroneous

refund exceeds $50,000 or (2) the taxpayer or a related party has caused the erroneous refund.

3. *Review of Denial of Interest Abatement Request § 6404(h)*. The Tax Court has jurisdiction to review the Service's determination not to abate interest. IRC § 6404(h). The requirements are as follows:
   a. NET WORTH REQUIREMENTS. In order to be entitled to review, taxpayers must meet the following net worth requirements, which are derived from the attorneys' fees provisions. IRC §§ 6404(h)(1), 7430(c)(4)(A)(ii); 28 USC § 2412(d)(2)(B).
      i. Individual taxpayers' net worth must not exceed $2 million.
      ii. Business taxpayers' net worth must not exceed $7 million. The business must have no more than 500 employees.
      iii. 501(c)(3) tax exempt organizations have no net worth requirements.
   b. PETITION. The taxpayer must petition the Tax Court within 180 days after the date of the mailing of the final determination not to abate interest. *See* IRC § 6404(h)(1). For purposes of determining the date of mailing of the determination, rules similar to those found in IRC § 6213 shall apply. *See* IRC § 6404(h)(2)(A).
4. *Standard of Review*. The standard of review is abuse of discretion. *See* IRC § 6404(h)(1).
5. *Relief*. The Tax Court may order an abatement of the interest. Rules similar to the overpayment jurisdiction of the Tax Court provided in IRC § 6512(b) apply. *See* IRC § 6404(h)(2)(B).

For More Information:

- P&A Subject Matter Training, Interest Abatement Presentation at: http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/PA/PA%20Subject%20Matter%20Training%20Documents%20and%20Links/Interest%20Abatement%20Presentation.ppt
- IRM 20.2.7, Interest Abatement and Suspension of Interest: IRC 6404 and 7508 at http://publish.no.irs.gov/cat12.cgi?request=CAT1&catnum=32968
- Contact P&A Branches 3&4.

D Tax Court Discovery (Branerton Rule) – Tax Court Rule 70.

Tax Court Rule 70(a) requires an attorney to use informal communications before petitioners or their counsel are served with formal discovery. T.C. Rule 70(a), 90(a); *Branerton Corp. v. Commissioner*, 61 T.C. 691 (1974).

1. A *Branerton* letter is sent to petitioners or their counsel requesting informal discovery as required pursuant to the Tax Court rules. This letter sets up a date and time for a conference (*Branerton* conference) and may have an attachment requesting informal interrogatories and production of documents. If petitioners do not respond to the *Branerton* letter, the IRS attorney can start preparing for formal discovery.
2. Formal discovery may commence after the parties have made a good faith

effort to gather information informally. Formal discovery is generally used to find unknown facts and establish uncontested matters as quickly as possible. (CCDM 35.4.3.3).

a. Interrogatories consist of clearly and concisely written questions pertaining to the issues in the case. *See* T.C. Rule 71.
b. Requests for Production of Documents seek to obtain certain documents pertaining to the issues in the case. T.C. Rule 72.
c. Depositions can be used by either party to require the other party, or a third party witness, to appear before a court reporter and answer questions by the opposing attorney. This rule cannot be used for expert witnesses. T.C. Rule 74.
d. Requests for Admissions are used to have one party admit to certain facts pertaining to the case. Although not a discovery technique, admissions may lead to formal discovery. T.C. Rule 90.

Note: Discovery of Electronically Stored Information (ESI). Pursuant to amendment to Tax Court Rule 72 in 2010, electronically stored information (e.g. emails, word documents, spreadsheets, etc.) is subject to discovery. Accordingly, the parties have an obligation to preserve the information during discovery or when litigation is reasonably anticipated. For more information, *See* Chief Counsel Notices 2012-017, 2010-008, and 2009-024.

3. *Defenses to Discovery in Tax Court.*
   a. RELEVANCE – Discovery must be relevant to the claim or a defense or the responsive document must reasonable calculated to lead to the discovery of admissible evidence.
   b. LITIGATION PRIVILEGES. There are three basic litigation privileges which government attorneys can assert:
      i. *Attorney Client*. The attorney-client privilege protects confidential communications made between clients and their attorneys when the communications are for the purpose of securing legal advice or services. It "is one of the oldest recognized privileges for confidential communications." *In re Lindsey*, 158 F.3d 1263, 1267-68 (D.C. Cir. 1998), *cert. denied sub nom., Office of the President v. Office of Indep. Counsel*, 525 U.S. 996 (1998). Its purpose is to ensure that clients' confidences to their attorneys will be protected, thereby encouraging clients to be open and honest in their communications with their attorneys. This confidentiality is deemed essential to the adversary system underlying our judicial process.
      ii. *Work Product*. The work product doctrine protects documents and other memoranda prepared in and in anticipation of litigation. *Hickman v. Taylor*, 329 U.S. 495, 510-12 (1947). Because its purpose is to protect the adversarial trial process by insulating the attorney's preparation from scrutiny, the work product doctrine does not attach until "some articulable claim, likely to lead to

litigation," has arisen. *Coastal States Gas Corp. v. Dep't of Energy*, 617 F.2d 854, 865 (D.C. Cir. 1980).

iii. *Deliberative Process.* This privilege, also known as the "governmental privilege" or "executive privilege," which protects predecisional opinions and recommendations, is intended to protect the decision-making process. The privilege also protects the public from confusion caused by premature release of agency considerations that may not reflect the final agency decision. This privilege is only available to the government, not to private parties.

c. STATUTORY PRIVILEGE. Section 6103 prohibits the disclosure of return or return information unless authorized by Title 26. Generally, the government attorney can disclose the taxpayer's own information in court or to the taxpayer's representative. There are significant limitations on disclosing third party tax data. *See also*, The Privacy and Disclosure Reference Guide.

d. UNDUE BURDEN AND EXPENSE. The Tax Court may enter a protective order to protect a party or other person for annoyance, embarrassment, oppression, or undue burden or expense. T.C. Rule 103.

e. FAILURE TO CONFORM TO THE RULES*.* This defense it asserted when party has failed to comply with informal discovery or the discovery is untimely under the court rules.

For more information:

- Chapter 10, Disclosure & Privacy Law Reference Guide (DRG) (rev. 10/2012). (Privileges) http://www.irs.gov/pub/irs-pdf/p4639.pdf
- Chapters 1-8, DRG (6103).
- Contact P&A Branches 6&7

E. Evidence (Sec. 7491 Burden of proof)

1. *In general.* The burden of proof in a Tax Court proceeding is generally on the taxpayer, except as otherwise provided by statute or determined by the court. *See* T.C. Rule 142(a).
2. *The Rule.* Section 7491(a) places the burden of proof on the Service in any court proceeding involving a factual issue if an eligible petitioner introduces credible evidence relevant to ascertaining the taxpayer's liability. To introduce credible evidence, the taxpayer must prove that he has:
   a. Complied with the substantiation requirements; and,
   b. Maintained all records and has cooperated with reasonable Service requests for witnesses, information, documents, meetings and interviews.
3. In the case of a partnership, corporation, or trust, the taxpayer's net worth falls below the specified amount. IRC § 7430(c)(4)(A)(ii).
4. *Reconstructed Income*: Section 7491(b) places the burden of proof on the Service in any court proceeding where the Service reconstructs a petitioner's income solely through the use of statistical information of unrelated taxpayers.

5. *Penalties*: Section 7491(c) provides that, with respect to an individual, the Service shall have the burden of production in any court proceeding relating to the appropriateness of applying penalties, additions to tax and additional amounts imposed by the Code. The burden of production is the burden of producing sufficient evidence on an issue to prevail assuming the other party produces no evidence.

For more information:

- Contact P&A Branches 6&7

F. Judicial Doctrines

Judicial doctrines are "theories" created by the courts to fill the void left by either the legislature or the language of the Code. These legal doctrines set the terms for future resolution of cases in a particular area. The use of judicial doctrines to prevent tax avoidance is common in the area of income taxation for a number of reasons including: (1) the legislature cannot anticipate all events and circumstances that may unfold, and (2) due to linguistic limitations, statutes do not always capture the essence of what is intended. Some examples of judicial doctrines include:

1. *Res Judicata.* Res judicata is a judicially created doctrine that bars repetitious suits on the same cause of action. Accordingly, when a cause of action was previously litigated, res judicata bars the parties from relitigating the previously litigated cause of action. Res judicata precludes the relitigation of matters which were offered in the previous litigation and matters which could have been offered in the previous litigation.
2. *Collateral Estoppel.* Collateral estoppel is also referred to as issue preclusion. The doctrine prevents the relitigation of an issue that the same parties have previously litigated. Collateral estoppel prevents the relitigation of the same issue in different cases or causes of action.

   NOTE: Generally, six conditions must be met for a court to apply collateral estoppel:

   a. There must be a final judgment by a court of competent jurisdiction.
   b. The issue in the second suit must be identical with the one decided in the first suit.
   c. Collateral estoppel may be asserted only against parties (or their privies) to the prior judgment.
   d. The parties must have actually litigated the issues, and resolution of the issues must have been essential to the prior judgment.
   e. The controlling facts and applicable legal rules remain unchanged from those in the prior litigation.
   f. No special circumstances exist that warrant an exception to its application.
3. *Equitable Recoupment.* Equitable recoupment resolves discrepancies caused by the inconsistent tax treatment of an item among two separate years—the treatment being found erroneous in a closed year but correct in an open year.

For example, equitable recoupment would allow a taxpayer to recover a barred overpayment by using it to offset an unpaid deficiency.

4. *Judicial Estoppel*. As a general rule, when a party takes a particular position in a legal proceeding and succeeds in maintaining its position, the party may not take a contrary position in a subsequent legal proceeding, especially if the contrary position will prejudice a party that acquiesced to the party's former position. *See Davis v. Wakelee*, 156 U.S. 680, 689 (1895).
    a. ELEMENTS:
        i. The party against whom judicial estoppel is asserted took an inconsistent position in a prior proceeding; and
        ii. That position was adopted by the first tribunal in some manner, such as by rendering a favorable judgment.
    b. EXCEPTION: THE MISTAKE DOCTRINE. Some courts do not apply judicial estoppel if the prior position was based on a mistake, fraud, or inadvertence because if a prior position was false then application of judicial estoppel would require the court to adopt a false position.

    EXAMPLE. Judicial estoppel is particularly appropriate in the following scenario: A debtor fails to disclose assets in a bankruptcy proceeding and then subsequently initiates a legal proceeding with respect to ownership of the undisclosed assets.

5. *Duty of consistency.* The duty of consistency, also known as the completed transaction doctrine or quasi-estoppel, can be raised by the Commissioner as an affirmative defense.
    a. GENERAL RULE: A taxpayer may not take a factual position in one year and a contrary position in a later year, after the statute of limitations has run for the first year.
    b. ELEMENTS:
        i. A knowing representation of fact by the taxpayer;
        ii. Commissioner's reliance on the taxpayer's representation; and,
        iii. taxpayer's attempt after the statute of limitations has run to change its previous position to the Commissioner's detriment.

    If the above elements are met, then the Commissioner may act as if the first position, on which the Commissioner relied, is true, even if it is not. The taxpayer cannot assert a contrary position.
    c. PURPOSE: The duty of consistency ensures that taxpayers do not benefit from their prior mistreatment of an item.

6. *Equitable estoppel* precludes a party from denying his own acts or representations which induced another to act to his detriment. The Tax Court has said the four essential elements of estoppel are:
    a. a false representation or misleading silence;
    b. an error in a statement of fact and not an opinion or statement of law;
    c. person claiming the benefits of estoppel must be ignorant of the true facts; and,
    d. person claiming estoppel must be adversely affected by the acts or statements of the person against whom estoppel is claimed.

7. *Against the government*: In addition to proving the traditional elements of estoppel, a litigant is required to demonstrate affirmative misconduct and the existence of rare and extreme circumstances. *See Broz v CIR*, 137 T.C. 46, 57 (2011), *aff'd* 727 F.3d 621 (6th Cir. 2012).
   a. Misrepresentation,
   b. reliance on representation,
   c. detriment and,
   d. if against Government—affirmative misconduct by Government.

For more information:

- Contact P&A Branches 6&7

G. Declaratory Judgments in Tax Court

The Tax Court has jurisdiction, pursuant to IRC §§ 7428,7476, 7477, 7478, and 7479 to render declaratory judgments regarding the classification of organizations as exempt from taxation, qualification of retirement plans, the value of certain gifts, the status of certain governmental obligations, and section 6166 elections by decedents' estates. These suits may only be brought by affected persons and not by third parties. P&A provides guidance on section 7479 cases in Tax Court.

For more information:

- Contact P&A Branches 3&4

II DISTRICT COURT/CT FEDERAL CLAIMS LITIGATION

SUITS BY THE GOVERNMENT IN U.S. DISTRICT COURT

The following are descriptions of some common suits the United States may bring in US District Court to protect the government's interests.

A. Suits to Reduce Liabilities or Assessments to Judgment

The government generally seeks to reduce liabilities or assessments to judgment to prevent section 6502's period of limitations from running on collection after assessment, if collection cannot be accomplished administratively.

1. *Authority*. The authority to reduce to judgment is IRC §§ 7401 and 7402(a).
2. *Effect of judgment*. A judgment extends the duration of the federal tax lien. If a liability has been reduced to judgment, then any section 6321 federal tax lien will continue until the judgment is satisfied or becomes unenforceable. IRC § 6322. But, the Service must not allow any Notices of Federal Tax Lien to (self-) release or it will lose section 6323 priority over the section 6323(a) "horsemen" (and the underlying federal tax lien will be extinguished. IRC § 6325(f)(1)(A)).

   a. The tax lien does not merge into the judgment or judgment lien. IRC § 6322.
   b. The judgment may be collected by administrative levy until it is satisfied or becomes unenforceable. IRC § 6502(a).
3. *Effect of judgment on lien foreclosure action*. Where the government has reduced an assessment to judgment, it may bring a lien foreclosure action after the statutory period expires. IRC §§ 6502 and 7403.
4. *Judgment Liens*. A judgment in a civil action creates a lien on all real property of a judgment debtor on filing a certified copy of the abstract of the judgment in the manner in which a notice of tax lien would be filed under IRC § 6323(f)(1), (2). 28 USC § 3201(a).
   a. DURATION. A judgment lien is effective for a period of 20 years. 28 USC § 3201(c)(1).
   b. RENEWABLE. A judgment lien may be renewed for one additional period of 20 years. 28 USC § 3201(c)(2).

For more information:
- Contact P&A Branches 3&4

B. Lien foreclosure

The government may foreclose a federal tax lien against specific property. It may initiate a suit to foreclose a lien in several circumstances, including when title is subject to dispute, when there are competing claims, or when the government wants to sell a business as a going concern.

1. *Statutory authority (IRC § 7403)*.
   a. FILING. At the request of the Chief Counsel (delegate of the Secretary), the Assistant Attorney General of the Tax Division (delegate of the Attorney General) may file suit in district court to enforce a federal tax lien. IRC § 7403(a).
   b. PARTIES. All persons having liens upon or claiming any interest in the property involved in a lien foreclosure action must be parties to the proceeding. IRC § 7403(b).
   c. ADJUDICATION AND DECREE. The district court will determine the merits of all claims to and liens upon the property at issue, and, in cases where the United States establishes its claim or interest, may decree a sale of the property. IRC § 7403(c).
   d. RECEIVERSHIP. The court may, if the United States asks, appoint a receiver to enforce the lien, or, if the Secretary certifies that it is in the public interest, the court may appoint a receiver while the suit is pending. IRC § 7403(d).
2. *Property subject to action*. All property subject to the tax lien is subject to the action. *See U.S. v. Rodgers*, 461 U.S. 677, 690–91 (1983). *See also* 4 B. Bittker, Federal Taxation of Income, Estates, and Gifts ¶ 11.5.4, at 111–102 ("the tax collector not only steps into the taxpayer's shoes but must go barefoot if the shoes wear out.").

3. *Foreclosure sale*. The district court is not required to order a forced sale. See IRC § 7403(c) ("The court ... may decree a sale…."). The sale can be public or private. When property is sold, though, it shall be sold as a whole or in separate parcels at public sale at the courthouse of the county, parish, or city in which the greater part of the property is located. 28 USC § 2001.
4. *Notice of sale of realty*. If the property to be sold is realty, the United States must publish notice once a week for at least four weeks prior to the sale in at least one newspaper regularly issued and of general circulation in the area in which the realty is situated. 28 USC § 2002.
5. *Personal Property*. Personal property shall be sold in the same manner as real property unless the court orders otherwise. 28 USC § 2004.

For more information:

- *See* GL-1 Training, Lesson 8 (Judicial Procedures Related to Collection) at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A, Branches 3&4.

C. Suit to set aside fraudulent conveyance

Although people can generally dispose of their property as they see fit, they may not frustrate their creditors' rights and avoid obligations by transferring title. The United States, like any other creditor, may bring a fraudulent conveyance suit against a person who transfers title to an asset to avoid federal tax obligations. If the government prevails, the district court may set aside the transfer or provide whatever other remedy is appropriate. Because maintaining a lawsuit is often more difficult and costly than administrative collection (e.g., levy), a fraudulent conveyance suit would most likely be instituted if, for example, the taxpayer transferred an asset before assessment, meaning before the federal tax lien would attach.

1. *Types of Fraudulent Transfers*:
    a. ACTUAL FRAUD. Whether a transfer is actually fraudulent is a fact-intensive inquiry. Courts will look for fraudulent intent, knowledge, or notice. They will also look for certain indicia or badges of fraud.
    b. CONSTRUCTIVE FRAUD. Constructive fraud may exist independent of the intent of the transferor. A conveyance or transfer may be constructively fraudulent if made without fair consideration (under the Uniform Fraudulent Conveyance Act "UFCA") or not for a reasonably equivalent value (under the Uniform Fraudulent Transfer Act "UFTA") or the transfer affects the solvency of the debtor.
2. *Authority*. The United States can use state or federal fraudulent conveyance laws to set aside a conveyance, thus subjecting the transferred assets to collection. The federal fraudulent conveyance provisions are found in 28 USC §§ 3301–08 (the Federal Debt Collection Procedures Act ("FDCPA")).
3. *Jurisdiction*. The district courts have jurisdiction over suits brought by the United States to set aside fraudulent conveyances. IRC § 7402. See also 28 USC §§ 1340, 1345.
4. *Statute of Limitations*. Generally, the Service has 10 years from the date of

assessment in which to levy or begin an action in court. IRC § 6502. The United States may have more than 10 years to sue to set aside a fraudulent conveyance if it has reduced its tax claim to judgment against the taxpayer. *See United States v. Weintraub*, 613 F.2d 612, 619–20 (1979). Moreover, the government is not bound by state statutes of limitation (e.g., if bringing an action under a state enactment of the UFTA or UFCA). *See United States v. Summerlin*, 310 U.S. 414 (1940). An action brought under a federal statute (e.g., the FDCPA), however, must be brought within the stated period of limitations, as follows:

a. Within 6 years after the transfer was made or the obligation was incurred or, if later, within 2 years after the transfer or obligation was or could reasonably have been discovered by claimant (28 USC § 3304(b)(1)(A));
b. Within 6 years after the transfer was made or the obligation was incurred (28 USC § 3304(a)(1) or (b)(1)(b)); or,
c. Within 2 years after the transfer was made or the obligation was incurred (28 USC § 3304(a)(2)).

<u>For more information:</u>

- *See* GL-1 Training, Lesson 8 (Transferee and other Third-Party Liability and Lesson 12 (Judicial Proceedings Related to Collection) at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- SBSE State Law Guide overview of fraudulent conveyance law. http://ccintranet.prod.irscounsel.treas.gov/OrgStrat/Offices/sbse/Pages/LawGuides.aspx
- Contact P&A Branches 3&4

D. <u>Failure to honor levy suit</u>

The United States can levy on property or rights to property of a taxpayer that are in another person's possession. If that person fails or refuses to surrender the property or rights on the Service's demand, the United States can sue that person for an amount equal to the value of the property or rights not surrendered. IRC § 6332(d). The person may also be liable for a penalty equal to 50 percent of the value not surrendered if that person acted without reasonable cause. IRC § 6332(d)(2).

1. *Persons subject to suit.* Any person in possession of (or obligated with respect to) property or rights to property subject to levy upon which a levy has been made who, upon demand by the Secretary, does not surrender the property or rights to property or otherwise discharge the obligation. IRC § 6332(a).
2. *Amount of person's liability.*
   a. VALUE OF PROPERTY OR RIGHTS TO PROPERTY. A person subject to suit is personally liable for a sum equal to the value of the property or rights not surrendered. IRC § 6332(d)(1).
   b. COSTS AND INTEREST. Section 6331(d)(1) imposes liability for costs and interests as well.
   c. 50% PENALTY. The person may also be liable for a penalty equal to 50

percent of the value not surrendered unless there was reasonable cause. IRC § 6331(d)(2). A person has reasonable cause when a bona fide dispute exists concerning the amount of the property to be surrendered pursuant to a levy or concerning the legal effectiveness of the levy. Treas. Reg. § 301.6332-1(b)(2).

3. *Defenses*. There are only two defenses to a levy:
   a. the person does not possess any property or rights to property belonging to the taxpayer, and,
   b. the property or rights to property are subject to prior judicial attachment or execution. *See United States v. National Bank of Commerce*, 472 U.S. 713 (1985).
4. *Statute of Limitations*. There is no statute of limitations for a suit to enforce a levy. IRM 5.17.4.12.4 (Aug. 1, 2010). *See also United States v. Weintraub*, 613 F.2d 612 (6th Cir. 1979).

For more information:

- *See* GL-1 Training, Lesson 10 and 12 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 3&4

Suits Against the United States

The following are suits against the United States for actions by the IRS.

A. Refund Suit under IRC § 7422

Taxpayers may challenge the validity of the IRS's tax determination by paying the disputed tax and commencing a suit for a refund in a federal district court or in the Court of Federal Claims.

1. *Full Payment Rule.* A federal district court or the Court of Federal Claims does not have jurisdiction over a suit for refund unless the taxpayer has made full payment of the amount of the assessment. *See Flora v. U.S.*, 362 U.S. 145 (1960). Some circuits require the full payment of all assessed underpayment interest, additions to tax, and penalties while other circuits do not.

2. *Standing*. The district courts have jurisdiction to hear refund suits "for the recovery of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected." 28 USC § 1346(a)(1). It does not specifically limit the persons eligible to file suit. The rules regarding standing as to bringing a tax refund suit in the district court are equally applicable to the Court of Federal Claims. 28 USC § 1491(a)(1).

For more information:

- *See* CCDM 34.5.2.4, model Defense Letters in CCDM 34.5.1.
- Contact P&A Branches 3&4

B. <u>Wrongful Levy Under IRC § 7426</u>

Under section 7426(a)(1), a person other than the taxpayer who claims an interest in or lien on levied property and that the property was wrongfully levied upon may bring suit against the United States.

1. *Wrongful Levy*. A levy is wrongful in the following circumstances:
    a. It is upon property exempt under section 6334.
    b. It is upon property in which the taxpayer had no interest at the time the lien arose or thereafter.
    c. It is upon property with respect to which the third party is a "purchaser" against whom the lien is invalid.
    d. The levy or sale pursuant thereto will destroy or otherwise irreparably injure the third party's interest in the property, which interest is senior to the federal tax lien.
2. *Limitations Period*.
    a. Generally, a wrongful levy suit must be brought within nine months of the date of the levy. IRC § 6532(c).
    b. An administrative request for return of the property is not a prerequisite to suit. IRC § 7426(f). If a request for return of the property is made pursuant to section 6343(b), the 9-month period for bringing the wrongful levy suit is extended for the shorter of 12 months from the date the section 6343(b) request was filed or six months from the date the Service mails a notice of disallowance of the request. IRC § 6532(c)(2).
3. *Suspension of the 10-year statute of limitations on collection*. The statute of limitations on collection is suspended from the date the Service wrongfully seizes or receives a third party's property to 30 days after the earlier of:
    a. The date the Service returns the property under section 6343(b), or,
    b. The date on which a judgment pursuant to section 7426 becomes final. IRC § 6503(f)(1).
4. *Relief.* Relief under section 7426 includes, but is not limited to, the following remedies, plus interest in appropriate cases:
    a. An injunction to prohibit the enforcement of the levy or the sale of the property, in cases in which the court determines that the levy or sale would irreparably injure the third party's rights in the property, which the court determines to be superior to those of the government.
    b. An order that the Service return specific property.
    c. A judgment for the amount of money levied upon.
    d. A judgment for an amount not exceeding the greater of:
        i. The amount received by the government from the sale of the property, or
        ii. The fair market value of the property immediately before the levy.
5. *Damages under IRC § 7426(h)*. If the court determines that any officer or employee of the Service recklessly, intentionally, or negligently disregarded any provision of the Internal Revenue Code, the third party may recover the lesser of:
    a. $1,000,000 ($100,000 in the case of negligence), or

b. Actual, direct economic damages sustained, less the amount of any judgment obtained under section 7426(b), plus the costs of litigation.
c. The third party must first exhaust administrative remedies by filing a claim for damages with the Service. IRC § 7426(h)(2); Treas. Reg. § 301.7426-1(b), (c), and (d).
d. An action for damages must be brought within two years of the time when the third party knew or should have known sufficient facts to apprise him or her of all essential elements of a possible cause of action). IRC §§ 7426(h)(2), 7433(d)(3); Treas. Reg. § 301.7433-1(g)(1).

For more information:

- *See* GL1 Training, Lesson 12, Judicial Proceedings Related to Collection at http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 3&4.

C. Quiet Title Action (28 USC § 2410)

Generally, no one can sue the government unless the government so consents. 28 USC § 2410 contains a waiver of sovereign immunity in actions to quiet title to property, to foreclose a lien, to partition property, to condemn property, or of interpleader with respect to property on which the government has or claims a lien. There is no waiver of sovereign immunity with respect to property in which the government holds title.

1. *Most Common Actions*. Plaintiffs most often use 28 USC § 2410 to sue the United States in quiet title, foreclosure and interpleader actions in federal district court or state court.
   a. QUIET TITLE. A person claiming some interest in property that is either subject to a tax lien or claimed to be subject to a tax lien may institute a proceeding seeking to remove a cloud (the tax lien) from the title. A quiet title action may involve a question of lien priority, or of the validity of the tax lien.
   b. FORECLOSURE. A person may seek to foreclose its interest (e.g., mortgage) against property subject to a tax lien or claimed to be subject to a tax lien and to have the property sold by judicial order. The proceeds from the sale are divided among the parties with an interest in the property, including the tax lien, according to the relative priority of the interests.
   c. INTERPLEADER. A person holding funds (or personal property) subject to a tax lien or claimed to be subject to a tax lien and subject to the claim of at least one other party may deposit the property into the registry of the court and compel the claimants to litigate the right or title to the property.
2. *Rights of the United States in 28 USC § 2410 Actions*.
   a. LIEN FORECLOSURE. In any case in which a debt owing the United States is due, the government may ask to foreclose of its lien. 28 USC § 2410(c).

   b. PURCHASE OF PROPERTY. When the property is sold to satisfy a first lien held by the United States, the government may bid at the sale an amount not exceeding its claim plus the expenses of sale. 28 USC § 2410(c).
   c. REDEMPTION. When a judicial sale of real property is made to satisfy an encumbrance prior to the federal tax lien, the government has a right of redemption. 28 USC § 2410(c).
3. *Removal*. When a 28 USC § 2410 action is brought in state court, the government has the option to remove the case to the district court of the United States for the district and division in which the action is pending. 28 USC § 1444.

For more information:

- *See* GL-1 Training, Lesson 12, Judicial Proceedings Related to Collection at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 3&4.

D. Damages for Unauthorized Disclosures of Tax Information (IRC § 7431)

As a general rule, IRC § 6103(a) provides that returns and return information shall be confidential. IRC § 7431 provides taxpayers with a civil remedy when their tax return information is disclosed in an unauthorized manner.

1. *Civil remedy*. Section 7431(a)(1) authorizes a taxpayer to bring a civil cause of action for damages against the US in district court if a United States officer or employee knowingly or negligently inspects or discloses a taxpayer's return or return information in violation of section 6103.
2. *Elements of Claim* – For a taxpayer to prevail under section 7431(a)(1), the taxpayer must demonstrate that an unauthorized inspection or disclosure of the taxpayer's return or return information:
   a. was made by an officer or employee of the United States;
   b. that the inspection or disclosure was made knowingly or negligently; and,
   c. that the inspection or disclosure was made in violation of section 6103.
3. *Specificity*. A complaint filed pursuant to section 7431 must allege the following with specificity:
   a. the returns or return information inspected or disclosed;
   b. the dates of inspection or disclosure;
   c. to whom information was disclosed; and,
   d. any other facts sufficient to inform the defendant of the particulars of the alleged violation.
4. *Proper Party.* The United States is the only proper party defendant for unauthorized disclosures by federal employees. Nevertheless, the alleged unauthorized disclosure must have been made by an individual who was an officer or employee of the federal government at the time of the disclosure.
5. *Jury Trials*. The Seventh Amendment right to a jury trial in civil matters does not apply to actions against the federal government unless Congress

specifically provides for it in the statute. Section 7431 does not provide for jury trials.

6. *Exclusive Remedy*. Section 7431 is the exclusive remedy for unauthorized disclosure of returns or return information.
7. *Good Faith Defense*. Section 7431(b) provides that the United States is not liable for unauthorized inspections or unauthorized disclosures of returns or return information: (1) which result from a good faith, but erroneous, interpretation of section 6103; or (2) which is requested by the taxpayer. Similar to the qualified immunity standard of *Harlow v. Fitzgerald*, 457 U.S. 800, 807-808 (1982). "Good faith" is generally judged by an objective standard. That is, the court determines whether a Service employee reasonably would have known of rights provided and of the agency's applicable regulations and internal rules. The circuits are split over whether good faith is an affirmative defense, or whether bad faith must be pled by the plaintiff in the complaint. The Office of Chief Counsel and the Tax Division follow the *Harlow* approach that good faith is an affirmative defense pled by the government (and not negated by the taxpayer).
8. *Damages for Unauthorized Disclosure and Inspection*. Section 7431(c) provides for two damage computations. Statutory damages are limited to each act of inspection or disclosure, rather than each item of return information inspected or disclosed; the inspection or disclosure of multiple items of return information is not multiple inspections or disclosures. Moreover, the Service's position is that damages are not based upon the number of persons who eventually may read or hear the information wrongfully disclosed. Therefore, the United States should not be held responsible for redisclosures of return information, *e.g.*, to a newspaper's subscribers. A prevailing plaintiff may recover the costs of the action plus the greater of either:
    a. statutory damages of $1,000 for each act of unauthorized inspection or disclosure; or
    b. the sum of actual damages plus, in the case of a willful inspection or disclosure resulting from gross negligence, punitive damages.
9. *Attorneys Fees*. Section 7431(c)(3) allows the plaintiff to recover reasonable attorneys' fees where the plaintiff is the prevailing party (as determined under section 7430(c)(4)). Plaintiff must make the request for attorneys' fees within 30 days of the plaintiff establishing an entitlement to such fees.
10. *Period for Bringing Action.* Section 7431(d) provides that actions for alleged unauthorized inspections or disclosures of returns or return information must be brought within two years after the date of discovery by the plaintiff of the unauthorized inspection or disclosure.

For more information:

- *See* Disclosure and Privacy Reference, Chapter 1, Part II http://www.irs.gov/pub/irs-pdf/p4639.pdf .
- Contact P&A Branches 6&7

E. Damages for Failure to Release Lien (IRC § 7432)

If a Service officer or employee knowingly or negligently fails to release a lien under IRC section 6325, the taxpayer may bring a suit for damages in district court within two years after the date on which the action accrues.

1. *Exceptions*:
   a. A taxpayer may not challenge the merits of the underlying tax in a section 7432 action.
   b. Section 7432 does not apply if the Service fails to release a lien that was erroneously filed under IRC section 6326.
2. *Standing*. Only the taxpayer has standing to bring suit against the United States. IRC § 7423(a).
3. *Recoverable amount*. A taxpayer can only obtain damages based on the actual, direct economic damages sustained by the taxpayer due to the Service's failure to release the lien, plus the costs of the action. IRC § 7432(b); Treas. Reg. § 301.7432-1(c).

   NOTE: Costs of the action do not include attorney's fees and similar litigation expenses recoverable under IRC section 7430.
4. *Exhaustion of administrative remedies*. In order to recover damages, taxpayer must have exhausted any administrative remedies available within the Service before bringing suit. See Treas. Reg. § 301.7432-1(f).
5. *Mitigation*. The amounts of damages awarded under section 7432 is reduced by the amount of damages which could have reasonably mitigated by the taxpayer. IRC § 7432(d)(2).
6. *Tax Liability*. A taxpayer will not prevail in his action under section 7432 if the underlying tax liability has not been satisfied.

For more information:

- *See* GL-1 Training, Lesson 12 at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branch 5

F. Damages for Unauthorized Collection Actions (IRC § 7433)

IRC 7433 allows a taxpayer to bring an action for damages against the United States if, in connection with the collection of a federal tax, an officer or employee of the IRS recklessly or intentionally, or by reason of negligence, disregards any provision of the Code or any applicable regulation. IRC § 7433(a); Treas. Reg. § 301.7433-1.

1. *Exclusivity*. Except for damages under section 7432, civil actions under section 7433 are the exclusive remedy for a taxpayer to recover damages caused by unlawful collection actions.

   NOTE: If a taxpayer premises an IRC 7431 unauthorized disclosure action on an invalid lien or levy, the United States will argue the appropriate remedy is IRC § 7433. *See* Chapter 4, Disclosure and Privacy Law Reference Guide http://www.irs.gov/pub/irs-pdf/p4639.pdf and cases cited therein.

2. *Statute of Limitations*. A civil action under IRC section 7433 must be brought within two years after the date of the cause of action accrues.
3. *Recoverable amount*. The taxpayer may recover damages for the actual direct economic damages sustained as a proximate result of the reckless or intentional actions of the officer or employee and the costs of the action.
   i. The maximum amount of recoverable damages is $1,000,000 for damages caused by reckless or intentional disregard.
   ii. The maximum amount of recoverable damages is $100,000 for damages caused by negligent disregard.

   NOTE: Costs of the action do not include attorney's fees and similar litigation expenses recoverable under IRC section 7430.
4. *Exhaustion of administrative remedies*. In order to recover damages, taxpayer must have exhausted any administrative remedies available within the Service before bringing suit. Treas. Reg. § 301.7433-1(e).
5. *Violation of the Automatic Stay*. The taxpayer is entitled to damages if, in connection with the collection of federal tax, an officer or employee of the Service willfully violates any provision of section 362 (automatic stay) or 524 (discharge injunction) of the Bankruptcy Code. IRC § 7433(e).

   NOTE: Any administrative and litigation costs may only be awarded under IRC § 7430, which requires administrative remedies to have been exhausted. *See* Treas. Reg. §§ 301.7430-1(e).

For more information:

- *See* GL-1 Training, Lesson 12 at http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branch 5

G. Anti-Injunction Act (IRC § 7421)

Section 7421 prohibits any suit by any person to restrain the assessment or collection of any tax except as provided in the enumerated Internal Revenue Code provisions. The substance of the action, rather than its form, controls. Even though an action does not explicitly ask for an injunction, it may nevertheless be barred by the Anti-Injunction Act. In federal tax cases, the injunction usually seeks to have an assessment declared invalid or to enjoin collection activity.

The amount of the proposed tax is irrelevant. *See Bob Jones University v. Simon*, 416 U.S. 725 (1974) ("Although the congressional restriction to post enforcement review may place an organization claiming tax-exempt status in a precarious financial position, the problems presented do not rise to the level of constitutional infirmities in light of the powerful governmental interests in protecting the administration of the tax system from premature judicial interference.").

The rationale behind the rule is that when a person has an adequate remedy at law, such as paying the disputed tax and filing a refund suit, equity generally provides that

the person may not seek equitable relief, such as an injunction. There are exceptions to the general rule.

1. *Judicial Exception*. In *Enochs v. Williams Packing & Navigation*, 370 U.S. 1 (1962), the Supreme Court enunciated a two-pronged test for the issuance of an injunction:
   a. The government must be incapable of prevailing under the most favorable view of the facts (*i.e.*, the illegality of the tax must be absolutely clear on its face).
   b. Special circumstances must exist indicating that the taxpayer does not have an adequate remedy at law (*e.g.*, a refund suit), with the result that the taxpayer will suffer irreparable injury.

   See also South Carolina v. Regan, 465 U.S. 367 (1984) (Court reasoned that Congress did not mean to bar injunctive relief by parties who will suffer some actual harm but "for whom it has not provided an alternative remedy" and *Nat'l Fed'n of Indep. Bus. v. Sebelius*, 132 S.Ct. 2566 (2012) (the Act does not apply to penalties that are not also subject to the provisions of Subchapter 68B of the Code).
2. *Statutory Exceptions*. The Anti-Injunction Act does not provide a bar to injunctive relief in the following situations:
   a. Tax Court petitions for relief from joint and several liability pursuant to IRC § 6015(e).
   b. Assessments made and notices of deficiency issued in violation of the restrictions contained in IRC § 6212(a) (authorizing the Secretary to issue a notice of deficiency when a deficiency is determined), IRC § 6212(c) (restricting the issuance of further deficiency letters once the taxpayer has petitioned the Tax Court on a prior notice of deficiency), and IRC § 6213(a) (restricting the assessment of deficiencies).
   c. Adjustments of partnership items in violation of IRC § 6246.
   d. Assessments of deficiencies attributable to partnership items made in violation of IRC § 6225. IRC § 6225(b).
   e. Levies made during the IRC § 6330(e)(1) or § 6331(i) prohibition on levy.
   f. Levies and collection proceedings made or begun during the IRC § 6672(c) prohibition on collection activity during trust fund recovery penalty refund suits, or the IRC § 6694(c) prohibition on collection activity during income tax return preparer penalty refund suits.
   g. Wrongful levy and/or sale actions permitted by IRC § 7426(a) and (b)(1).
   h. Actions for judicial review of jeopardy and termination assessments and levies permitted by IRC § 7429(b).
   i. Tax Court petitions for redetermination of employment status pursuant to IRC § 7436.

For more information:

- *See* GL1, Lesson 12, Judicial Proceedings Related to Collection at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip

- Contact P&A Branches 3&4.

H. Declaratory Judgment Act (28 USC § 2201)

A declaratory judgment is a request for a court to declare the rights of parties, without ordering anything to be done. The Declaratory Judgment Act generally permits district courts to render declaratory judgments, but it generally exempts Federal tax questions from the jurisdiction of district courts to render declaratory judgments. The Act, found at 28 USC § 2201, provides as follows:

> In a case of actual controversy within its jurisdiction, *except with respect to Federal taxes other than actions brought under section 7428 of the Internal Revenue Code of 1986* … any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such. (Emphasis added.)

The Declaratory Judgment Act only describes a type of relief (declaratory judgments) that federal courts may grant in certain circumstances if federal jurisdiction exists. It does not itself confer jurisdiction on federal courts. There must be an independent basis for federal jurisdiction.

IRC § 7428 provides charitable organizations with a cause of action in district court, the Court of Federal Claims, or the Tax Court, for a declaration regarding the organization's qualification under IRC § 501(c)(3), its status as a private foundation under IRC § 509(a), *etc.* IRC §§ 7476-79 grant jurisdiction to the Tax Court to render declaratory judgments regarding the qualification of retirement plans, the value of certain gifts, status of certain governmental obligation and section 6166 elections by decedent's estates.

Despite the Declaratory Judgment Act's prohibitions, federal courts have declared the rights of parties in some tax cases where the merits of the tax liability was not in dispute. *See also Cohen v. United States*, 630 F.3d 717 (D.C. Cir. 2011)(the court stated that the AIA and DJA are to be read coterminously, and if the AIA couldn't bar the suit, then the DJA could not either).

Although the effect of a court's decision in a quiet title action is similar to a declaratory judgment, quiet title actions are not prohibited in tax cases.

For more information:

- *See* GL-1, Lesson 12, Judicial Proceedings Related to Collection at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip
- Contact P&A Branches 3&4

III. Administrative Costs and Attorney's Fees Under IRC § 7430

In an administrative or court proceeding brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty, the prevailing party may be awarded reasonable administrative and litigation costs incurred in connection with the proceeding. Most of the time, taxpayers will seek to recover litigation and/or administrative costs as part of a judicial proceeding in Tax Court, federal district court, or the Court of Federal Claims. Taxpayers may seek to recover only administrative costs by seeking Tax Court review of the IRS's denial of a claim for administrative costs. IRC § 7430(f); Tax Court Rule 270.

1. *Administrative costs*: Administrative costs are recoverable for costs incurred from the earliest of the date of the decision of Appeals, the date of the notice of deficiency, or the date of the first letter of proposed deficiency that allows the taxpayer an opportunity for review by Appeals. A court may not award administrative costs with respect to collection actions, except for damage actions under IRC § 7433.
2. *Litigation costs*: Litigation costs are recoverable for amounts incurred after a court proceeding is initiated. The filing fee and time spent preparing petition are includable.
3. *Recoverable costs*:
   a. Attorney fees, which cannot be in excess of the statutory rate in IRC § 7430(c)(1) as adjusted for cost-of-living, unless a special factor applies such as the difficulty of the issues in the case;
   b. Administrative fees or charges by the Service;
   c. Reasonable expenses of expert witnesses;
   d. Reasonable cost of necessary studies, analysis, etc.; and,
   e. Reasonable court costs
4. *Requirements to claim costs*:
   a. EXHAUST ADMINISTRATIVE REMEDIES. If the taxpayer has been given an opportunity to go to Appeals prior to filing a petition or complaint, then the taxpayer must have requested an Appeals conference prior to filing a petition in Tax Court, or initiating a district court or Court of Federal Claims proceeding, in order to have exhausted administrative remedies. IRC § 7430(b); Treas. Reg. § 301.7430-1.
   b. The party requesting costs did not protract the proceeding.
   c. "PREVAILING PARTY."
      i. Taxpayer must substantially prevail with respect to the amount in controversy or the most significant issue or set of issues.
      ii. Taxpayer must meet the net worth requirements of 28 USC § 2412(d)(2)(B).
      iii. The United States has not established that its position was "substantially justified," i.e., reasonable under the applicable law and the facts of the case. The initial position is established:
         A. Administrative proceeding: earlier of the date of the statutory notice of deficiency or date of receipt by the taxpayer of the notice of the final decision of Appeals.

B. Court proceeding: as of the date of the answer or filing of a dispositive motion.

d. REASONABLENESS. The costs requested must be reasonable.

5 *Qualified Offers*. If a taxpayer submits a valid qualified offer, the government may not avoid liability by establishing that its position was substantially justified if the taxpayer's liability pursuant to the judgment in the proceeding is equal to or less than the amount of the qualified offer. IRC § 7430(c)(4)(E); see also Chief Counsel Notice 2010-007. The requirements for a valid qualified offer are:

a. designated as a qualified offer;
b. made to the United States;
c. made during the qualified offer period;
d. remains open for acceptance from the date made until the earliest of the date the offer is rejected, the date the trial begins, or the 90th day after the date the offer is made; and
e. specifies the offered amount of the taxpayer's liability, which must be with respect to all of the adjustments in the proceeding and no other adjustments.

For more information:

- Contact P&A Branch 5
- *See* GL-1 Training, Lesson 12, Part IV at: http://www.irs.gov/file_source/pub/irs-utl/GL1%202012%20Lessons.zip

CHAPTER 9 SPECIAL TOPICS

I. BANKRUPTCY

A. Jurisdiction.

District courts have original and exclusive jurisdiction over bankruptcy cases. In addition, district courts have original, but not exclusive, jurisdiction over civil proceedings arising under the Bankruptcy Code, or arising in, or related to, bankruptcy cases. Bankruptcy cases may be commenced in the district in which the debtor had, for the longest portion of the 180 days preceding the filing, a residence, domicile, principal place of business or principal assets. With certain exceptions, civil proceedings may be removed from a non-bankruptcy forum to the district court.

All district courts refer bankruptcy cases to bankruptcy judges. The bankruptcy court is a unit of the district court. District court judges can chose to "withdraw the reference" and determine all or a part of a bankruptcy case themselves.

Bankruptcy cases have various proceedings within them. Bankruptcy judges may hear and determine "core" proceedings, *i.e.* those that are core to the bankruptcy system and do not rely on nonbankruptcy law for their existence. Bankruptcy judges may not issue final orders in non-core proceedings, but rather must make proposed findings of fact and law for the district court judge. Bankruptcy judges are appointed to fourteen-year terms and are subject to removal for incompetence, misconduct, neglect of duty, or physical or mental disability. The core/noncore distinction arises from the fact that bankruptcy judges do not have life tenure and therefore cannot make a final determination when a party is entitled to have the matter heard by an Article III judge.

Appellate jurisdiction of orders, judgments and decrees of bankruptcy judges lies with the district courts or bankruptcy appellate panels ("BAP"). The courts of appeals have jurisdiction over final decisions, judgments, orders, and decrees entered by district courts and BAPs. Under some circumstances, appeals may be taken directly from the bankruptcy court to a court of appeals.

The Bankruptcy Rules are cited as the Federal Rules of Bankruptcy Procedure and are promulgated pursuant to Article I powers granted to the bankruptcy courts. These rules cannot abridge, enlarge, or modify any substantive right, or be inconsistent with legislation enacted by Congress. The rules govern which actions must be brought as adversary proceedings by filing a summons and complaint and contested matters, including objections to proofs of claim.

There is a nationwide program consisting of appointed U.S. Trustees and staffs of attorneys and clerical support. While their duties vary by jurisdiction, generally these include various duties to protect interests of both creditors and debtors.

For more information:

- *See* GL-2 Training, Overview at: http://www.irs.gov/file_source/pub/irs-utl/GL2%202013%20Lesssons.zip or
- Contact P&A Branch 5.

B. General provisions

Bankruptcy cases may be voluntary or involuntary. The bankruptcy estate is typically represented by a trustee. The debtor must provide notice of the bankruptcy to creditors. If a creditor has not received appropriate notice, it is not subject to sanctions for certain specified actions, including violation of the automatic stay.

The court closes a case after the estate is fully administered and the trustee is discharged. A case may be re-opened on motion by the debtor or other party in interest to administer assets, accord relief to the debtor, or for other cause.

For more information:

- *See* GL-2 Training, Lesson 1 at: http://www.irs.gov/file_source/pub/irs-utl/GL2%202013%20Lesssons.zip

  or

- Contact P&A Branch 5.

C. Automatic Stay. (11 USC § 362(a))

An automatic stay arises by operation of law upon filing of a bankruptcy petition and halts certain actions that were or could have been taken pre-petition. The stay:

1. Has the force of an order signed by the judge, and damages, including litigation costs, may be granted for violations.
2. Protects the debtor from harassment by creditors, protects property that may be required for a debtor's fresh start, and gives a debtor in reorganization cases time to rehabilitate.
3. Protects all creditors by preventing individual creditors from seizing assets and enables the trustee to preserve the estate and carry out his administrative duties.
4. Stays an entity from the following actions:
    a. Commencement or continuation of an action to recover a pre-petition claim, including civil actions to collect taxes.
    b. Enforcement of a pre-petition judgment.
    c. Any act to obtain possession or control over property of the estate.
    d. Any act to create, perfect, or enforce a lien against property of the estate.
    e. Any act to create, perfect, or enforce a lien against the debtor's property to the extent that the lien secures a pre-petition claim, but not an act to maintain the status quo of a perfected lien.

f. Any act to collect, assess, or recover a prepetition claim against the debtor, including serving a notice of levy or seizure of property by levy. See exception below for assessment of taxes.
g. Setoff of any pre-petition debt owed to the debtor. Section 362(b)(26) is an exception that allows for setoff of a prepetition income tax refund against a prepetition income tax liability. When the Service's prepetition right of setoff is stayed, the Service may hold the refund until the stay is lifted.
h. Commencement or continuation of certain Tax Court proceedings.

5. *Exceptions to the Automatic Stay*:
    a. Setoffs of pre-petition income tax refunds against pre-petition income tax liabilities (as explained above).
    b. Criminal actions against the debtor.
    c. Actions taken under police or regulatory powers.
    d. The Service may audit to determine tax liability, issue to the debtor a notice of tax deficiency, demand tax returns, or make an assessment of any tax.
6. *Duration of the Automatic Stay*.
    a. The stay of acts against property of the estate continues until the property is no longer property of the estate.
    b. The stay against any other act continues until the case is closed, the case is dismissed, or the debtor is either granted or denied a discharge (whichever is earlier).
    c. For individual debtors who had a prior bankruptcy case dismissed within a year, the stay on some actions will terminate on the 30th day after the filing of the second petition. These issues should be coordinated with CC:PA:05.
    d. In most circumstances, the automatic stay does not take effect in the case of an individual who has had two or more prior bankruptcy cases dismissed within one year.
    e. There is an exception from the automatic stay in certain cases arising from a prior Chapter 11 small business case.
    f. Upon request of a party in interest and after notice and a hearing, the court may terminate, modify, condition, or annul the automatic stay, provided certain requirements are met.
7. *Damages*. Subject to limitations, an individual injured by any willful violation of the automatic stay may recover actual damages, including costs and attorneys' fees.

For more information:

- See GL-2 Training, Lesson 3 at: http://www.irs.gov/file_source/pub/irs-utl/GL2%202013%20Lesssons.zip or
- Contact P&A Branch 5.

D. Case Administration

Chapter 3 of the Bankruptcy Code applies to all operating chapters, including Chapters 7, 12, 11, and 13. The first part of Chapter 3 generally introduces the players involved in most bankruptcy cases. It also describes some of the consequences of filing a bankruptcy case and what happens when the case is converted or dismissed. The most important provision of Chapter 3 is section 362, the automatic stay, discussed above.

A creditor with a security interest in the debtor's property, including a governmental entity holding a tax lien, could be harmed by a debtor's bankruptcy because the property may be dissipated, or otherwise lose value, during the bankruptcy case while at the same time the automatic stay prevents the creditor from enforcing its rights under nonbankruptcy law. The Bankruptcy Code therefore allows a creditor to have its interest in its collateral adequately protected, and if adequate protection cannot be provided the creditor is entitled to relief from the stay as to that property. Adequate protection can be provided in various forms.

1. *Adequate protection*. 11 USC § 361. The concept is to preserve the value of the property or collateral securing a creditor's claim, thereby maintaining the status quo.
   a. All creditors with a secured interest in any collateral of the debtor are entitled to adequate protection to prevent them from suffering a financial loss because of the bankruptcy. The Service is entitled to adequate protection only if its claim is secured by a tax lien and only if notice was filed before the bankruptcy.
   b. A secured creditor may obtain relief from the stay from the court if its interests are not adequately protected.
   c. Debtors are entitled to use most property of the estate in the ordinary course of business without seeking permission from creditors or the court. A debtor may not, however, use cash collateral unless all parties with an interest in the cash collateral consent, or the court authorizes its use. A secured creditor may consent if granted adequate protection.
   d. Section 361 provides three non-exclusive examples of adequate protection:
      i. Single or periodic deferred cash payments;
      ii. Additional or replacement liens; and
      iii. The "indubitable equivalent" of the value of the creditor's interest in the collateral.
   e. *Postpetition credit*. Sometimes the debtor may seek to seek postpetition credit, and may want to grant a postpetition lender a security interest in its assets (which requires court approval). Prepetition creditors with an interest in the collateral must be given adequate protection in exchange for the granting of a senior lien on collateral.
   f. *Adequate equity cushion*. The principal factor in determining whether a secured creditor's interest is adequately protected is the existence of an

adequate equity cushion (the excess of the value of the property over the debt owed to the creditor). What constitutes as adequate has been the subject of disagreement among courts. A creditor that has no equity in the debtor's property (as where the senior creditor's debt exceeds the value of the property) is not entitled to receive interest on his collateral during the period that the automatic stay is in force.

   g. *Postpetition interest*. A secured creditor, including the Service, is entitled to postpetition interest on its secure claim only if, and to the extent that, there is an equity cushion. But most courts deny the over-secured creditor's demands for period payments of accruing post-petition interest as part of its adequate protection.

2. *Use, Sale, or Lease of Property (Cash Collateral Orders)* – 11 USC § 363. If the trustee or debtor (termed the "debtor-in-possession" or "DIP" if a trustee has not been appointed) may operate its business postpetition, the trustee or DIP may use property of the estate in the ordinary course of business without court approval. Cash collateral, however, may not be used without prior consent of any creditor that has an interest in the cash, or the court. One of the "first day" motions in a typical Chapter 11 case is, therefore, the debtor's request for use of cash collateral. Creditors with an interest in other types of property must ask for adequate protection.
   a. Notice and a hearing are required if the trustee or DIP proposes to use, sell, or lease property not in the ordinary course of business.
   b. Cash collateral is defined in section 363(a). Cash collateral orders are designed to protect the value of a creditor's interest so it is not diminished as a result of the debtor's continued business operations. They typically provide the creditor, which may be the Service, with adequate protection in the form of replacement liens on post-petition accounts receivable, inventory and other property of the debtor, although monthly cash payments toward the lien claim is the preferred form of adequate protection. Typical terms include requirements for insurance coverage of the collateral and a defined budget.
3. *Obtaining credit*. Trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business. Unsecured credit sought not in the ordinary course of business must be authorized by the court after notice and a hearing.
   a. In certain circumstances, the court may, after notice and a hearing, authorize the trustee to obtain credit with priority over any and all administrative expenses, secured by a lien on property of the estate that is not otherwise subject to a lien, or secured by a junior lien on property of the estate that is subject to a lien.
   b. Priority or parity with respect to other liens may be granted only if credit is otherwise unattainable and adequate protection is provided to the subordinated lienor or creditor given equal priority.

For more information:

- *See* GL-2 Training, Lesson 4 at: http://www.irs.gov/file_source/pub/irs-utl/GL2%202013%20Lesssons.zip
  or
- Contact P&A Branch 5.

E. Creditors, Debtor and the Estate

1. *Debtor's Duties and Benefits*: 11 USC §§ 521-528. In general, section 521 sets forth a debtor's duties, such as the duty to file a list of creditors and, unless ordered otherwise, schedules and a statement of financial affairs. Several subsections of section 521 concern tax obligations:
   a. 521(e)(2)(A): debtor has to provide trustee with tax returns for most recent tax year ending before commencement of the case; copy to creditor if requested.
   b. 521(f): at the request of the court, the U.S. trustee, or any party in interest, an individual debtor in a Chapter 7, 11, or 13 case must file with the court, at the same time filed with the Service, copies of:
      i. federal income tax returns for tax years ending while the bankruptcy case is pending;
      ii. any returns filed post-petition for tax years ending in the three-year period before the commencement of the case; and
      iii. any amendments to these returns. At the election of the debtor, the debtor may file a transcript of the return rather than a copy of the return.
   c. 521(j): if the debtor fails to file a tax return that becomes due after the date of the petition, or fails to properly obtain an extension of the due date for filing such return, the taxing authority may request that the court enter an order converting or dismissing the case. The debtor has 90 days to file return or obtain extension, otherwise the court must convert or dismiss the case.
   d. 11 USC § 523(a): Provides a list of debts that are excepted from discharge in certain cases of individuals. Priority taxes (generally those due within three years of the bankruptcy case) are excepted from discharge. Taxes for which the debtor committed certain bad acts, such as failing to file a tax return or filing a fraudulent return, are also excepted from discharge.
2. *Creditors and Claims: 11 USC §§ 501 and 502*
   a. PROOF OF CLAIM. Section 501 allows a creditor to file a proof of claim, which may be paid in whole or in part from the estate. A valid proof of claim is prima facie evidence of the validity of the amount of the claim. The forms and procedures for filing proofs of claim can be found in Part III of the Bankruptcy Rules.

      NOTE: Objections are allowed to proofs of claims. 11 USC § 502; Bankruptcy Rule 3007.

b. CLASSIFICATION OF PREPETITION CLAIMS: A creditor has a secured claim to the extent of its interest in property of the estate. A creditor with the type of debt listed in section 507 has a priority claim. Prepetition claims are therefore classified as either secured, or unsecured priority, or unsecured general, claims. *See* 11 USC §§ 506, 507.
c. Bankruptcy courts have the authority to determine tax liabilities of the debtor or the estate. *See* 11 USC § 505.
d. NOTE: because of IRC § 6871, the Service does not need to follow normal deficiency procedures and may assess based on the court's determination. Post-petition taxes incurred by the bankruptcy estate are entitled to be paid as administrative expenses of the estate. *See* 11 USC § 503.

3. *The Estate* (11 USC § 541). Filing a bankruptcy petition creates an estate, which generally consists of all the debtor's interests in property on the petition date. As noted above, the estate is protected by the automatic stay of section 362(a). A debtor that is an individual can exempt certain property from the estate under section 522.
4. *Other considerations*:
   a. In chapter 13 cases, and chapter 11 cases of individuals, the debtor's postpetition property is also included in the bankruptcy estate. See sections 1115 and 1306.
   b. Section 541(b)(1) through (9) lists property excluded from the estate. The Supreme Court held that certain pension plans are excluded from the estate under 541(c).
   c. TURNOVER OF PROPERTY TO ESTATE: under section 542(a), an entity in possession of property that a trustee may use, sell or lease or that a debtor may exempt, must deliver to the trustee and account for the property. Under section 542(b), a creditor that owes a prepetition debt to the debtor must generally pay the trustee.
   d. AVOIDANCE ACTIONS. Under sections 547 and 548, a trustee can avoid certain prepetition preferential and fraudulent transfers.
   e. POST-PETITION EFFECT OF TAX LIENS: Courts have held that property acquired after the bankruptcy case was commenced is not subject to prepetition tax liens.
   f. SETOFF: section 553 preserves the creditor's prepetition right of setoff (the right to offset a prepetition debt owed to the debtor against a prepetition debt owed by the debtor).
   g. EXEMPTIONS: under section 522, individual debtors are allowed to exempt certain property from the estate. Note: exempt property remains subject to federal tax lien if a notice of federal tax lien was file prepetition, or if nondischargeable under section 523(a)(1).

For more information:

- See GL-2 Training, Lesson 5 at http://www.irs.gov/file_source/pub/irs-utl/GL2%202013%20Lesssons.zip

or

- Contact P&A Branch 5.

F. <u>Liquidation</u> (Chapter 7)

1. A Chapter 7 case begins with the filing of a voluntary petition by a "person", as defined in 11 USC § 101(41). The term "person" includes individuals, corporations, and partnerships. An estate is created when a petition is filed. 11 USC § 541.
    a. The debtor must file a list containing the name and address of each creditor. See Bankruptcy Rule 1007(a). In addition, Bankruptcy Rule 1007 lists the supporting document required to be filed by debtor after filing the petition.
    b. BAPCPA includes a requirement to provide copies of income tax returns to the trustee. 11 USC § 521(e).
2. *Administration of the Chapter 7 Estate.*
    a. TRUSTEE. 11 USC 701. A disinterested interim trustee is appointed immediately after a petition. The interim trustee's duty is to take possession of, preserve, and protect the debtor's nonexempt property until a permanent trustee is chosen. The interim trustee is usually appointed as the permanent trustee.
    b. CREDITOR'S MEETING, A.K.A "341 MEETING." *See* 11 USC § 341. This meeting is an opportunity for the trustee and creditors to examine the debtor and also is used as a forum to select the permanent trustee. For the timing requirements for holding the 341 Meeting, see Bankruptcy Rule 2003(a).
    c. 11 USC § 704: Generally, the trustee's primary duties are to
        i expeditiously liquidate the debtor's nonexempt assets to maximize the return to unsecured creditors and
        ii investigate the facts and circumstances surrounding the debtor's bankruptcy.

    The Trustee will generally only sell property that is not exempt and in which the debtor has equity that can be realized on behalf of the estate. The sale of property occurs pursuant to 11 USC § 363.

    NOTE: the 2005 amendments to the Bankruptcy Code imposed means testing for individual debtors with primarily consumer debts. Under "means testing," an individual with primarily consumer debts will be permitted to file for Chapter 7 relief only if relief is warranted based upon an analysis of whether the debtor can repay a scheduled amount or percentage to unsecured debtors. If granting a discharge would be an abuse of chapter 7, the trustee or a party in interest can move to dismiss the case. 11 USC § 707(b)(1).
3. *Property of the estate*. Generally, the estate consists of all legal and equitable interests in property held by the debtor as of the date of the petition, with a few limited exceptions. *See* 11 USC § 541(a)(1), (b), (c)(2). Most property the

debtor acquires after the petition is the debtor's to keep, as part of the fresh start approach.

4. *Conversion*. A Chapter 7 debtor has broad rights to convert a Chapter 7 case to one under Chapter 11, 12 or 13 if the debtor is an eligible debtor under the chapter to which the debtor seeks to convert. 11 USC § 706.
5. *Dismissal*. A party in interest may move for a Chapter 7 case to be dismissed for cause. 11 USC § 707(a).

NOTE: A debtor does not have an absolute right to get out of a Chapter 7 case once filed—dismissal can only be for cause. The grounds for dismissal are not limited to the grounds set out in the statute.

6. *Distribution of Property of the Estate*.
   a. CREDITORS HOLDING SECURED CLAIMS. Under 11 USC § 725, holders of valid liens or security interests will get their collateral:
      i. if the trustee abandons it pursuant to 11 USC § 554 as having no benefit to the estate, or,
      ii. if there is equity in the property and the trustee sells it, then the secured creditor will get the proceeds to the extent of its secured claim in the Chapter 7 case.
   b. SECURED CLAIMS OF THE IRS IN CHAPTER 7. In Bankruptcy Code § 724(b), Congress created a mechanism whereby the money that normally would have been paid to a secured tax claimant, including the Service, is instead used to pay higher priority claims. The provision only applies if there are no unencumbered assets with which to pay the higher priority claims.

   NOTE: this subordination procedure only applies to cases under Chapter 7.

   c. DISTRIBUTION OF PROPERTY OF THE ESTATE TO UNSECURED CREDITORS: see 11 USC § 726. Unencumbered property of the estate will be distributed first to priority creditors in order of priority.
7. *Discharge and Dischargeability*. While a debtor that is an individual may receive a discharge under 11 USC § 727 (other entities do not receive a Chapter 7 discharge), not all of the debtor's debts may be dischargeable. Certain debts are excepted from the discharge pursuant to 11 USC § 523. The grounds for denying a discharge of debt are very narrow and strictly construed against a creditor or trustee seeking the denial. 11 USC § 727.
8. *Objection*. In order to object to the debtor being granted a discharge, a party in interest must bring an adversary proceeding by filing of a complaint within 60 days of the date first set for the 341 meeting. Fed. R. Bankr. P. 4004(a). An objection may be filed by a creditor, the trustee, or the United States Trustee. 11 USC § 727(c)(1). If no objection to discharge is filed, an order discharging the individual Chapter 7 debtor will be entered by the court. Fed. R. Bankr. P. 4004(c).

For more information:

- *See* GL-2 Training, Lesson 6 at: http://www.irs.gov/file_source/pub/irs-utl/GL2%202013%20Lesssons.zip

or

- Contact P& A Branch 5.

G. Reorganization (Chapter 11)

Chapter 11 is the business organization chapter of the Bankruptcy Code that provides a means by which a financially distressed debtor may seek relief from its prepetition obligations while continuing its business operations.

For more information:

- *See* GL-2 training, Lesson 7 at: http://www.irs.gov/file_source/pub/irs-utl/GL2%202013%20Lesssons.zip

- Contact P&A Branch 5

H. The Taxable Estate

1. *Debtor and Bankruptcy Estate as Separate Entities*. The filing of a bankruptcy petition creates a bankruptcy estate, which generally consists of all assets of the person filing the petition. The bankruptcy estate of an individual is treated as a separate taxable entity for federal income tax purposes, but only in Chapter 7 and 11 cases. See IRC § 1398. In contrast, no separate taxable entity results from commencement of a bankruptcy case involving a partnership or corporation, or in Chapter 13 cases. IRC § 1399
2. *Debtor's Election to Close Taxable Year*. An individual debtor in a Chapter 7 or Chapter 11 case may elect to close the taxable years as of the day before the date on which the bankruptcy case commences; this creates two short taxable years of less than 12 months. IRC § 1398. The election is available only in cases to which section 1398 applies, and only in Chapter 7 cases when there are assets being administered by the trustee. See section 301.9100-14T(d) of the regulations concerning the time and manner of making the election.
3. *Election*. If the election is made, the federal income tax liability for the first short taxable year becomes an allowable unsecured priority claim of the bankruptcy estate that can be paid from the bankruptcy estate as a priority claim. This reduces the amount of postpetition tax the debtor will owe.
4. *Computation of Tax Liability*. The estate succeeds to specified income tax attributes of the debtor. *See* 11 USC § 1398(g)(8); see also Treas. Reg. §§ 1.1398-1, 1.1398-2, and 1.1398-3.
    a. TAX LIABILITY OF ESTATE. Gross income consists of:
        i any gross income of the individual debtor (other than any amount received or accrued as income by the debtor before commencement of the case) which under bankruptcy law constitutes property of the estate; and
        ii the gross income of the estate beginning on the date the case is commenced.

   b. TAXABLE INCOME. Except as otherwise provided, taxable income of the bankruptcy estate is computed in the same manner as in the case of an individual. Note that the BAPCPA added to the Bankruptcy Code section 1115, defining "property of the estate" in individual Chapter 11 cases as identical to that applicable in Chapter 13 cases. Notice 2006-83, 2006-2 C.B. 596 explains how section 1115 affects individual Chapter 11 cases.

5. *Abandonment of Property from the Estate.* If property of the bankruptcy estate is abandoned to the debtor under 11 USC § 554 upon "termination of the estate", the abandoned property passes to the debtor and there is no taxable event to the estate. The debtor succeeds to the estate's basis and holding period in the property.
6. *Tax Liability of Individual*:
   a. GROSS INCOME REALIZED AFTER COMMENCEMENT: Gross income of the debtor realized after commencement of the bankruptcy case to which the estate in entitled is treated under section 1398(e)(1) as gross income of the bankruptcy estate and is not included on debtor's return. See IRC § 1398(e)(2).
   b. Debtor succeeds to specified tax attributes of the estate upon termination of the bankruptcy estate. See IRC § 1398(i). Note, however, that the attributes will be reduced by the amount of cancellation of indebtedness income from the bankruptcy discharge that was excluded from income under IRC § 108.
7. *Procedural Provisions:*
   a. SUSPENSION OF RUNNING OF PERIOD OF LIMITATIONS. Under IRC § 6503(h), the statute of limitations on collection is suspended for the period of time during which the Service is prohibited by reason of the bankruptcy case from making the assessment or from collection, plus six months thereafter.
   b. COORDINATION OF DEFICIENCY PROCEDURES (IRC § 6213(f)). The 90-day or 150-day period for filing a Tax Court petition with respect to a deficiency is suspended for the period of time during which the debtor is prohibited by reason of a bankruptcy case from filing such petition, plus 60 days thereafter.
   c. See Rev. Rul. 2003-80, 2003-2 C.B. 83 for further discussion on interplay between statutory notices of deficiency and bankruptcy.
   d. INTERVENTION. Pursuant to IRC § 7464, the trustee may intervene, as a matter of right, on behalf of the estate, in any proceeding before the Tax court in which the debtor is a party.
   e. RELIEF FROM CERTAIN PENALTIES. Under IRC § 6658, the debtor or estate may be relieved from penalties imposed by IRC §§ 6651, 6654, or 6655 for failure to make timely payment of tax with respect to a period during which the bankruptcy is pending. *See* Rev. Rul. 2005-9, 2005-6 I.R.B. 470 for more on the term "pending."

For more information:

- *See* the GL-2 Training, Lesson 8 at:
  http://www.irs.gov/file_source/pub/irs-utl/GL2%202013%20Lesssons.zip

  or
- Contact P&A Branch 5.

I. Family Farmer Cases (Chapter 12)

Chapter 12 was added to the Bankruptcy Code by The Family Famer Bankruptcy Act of 1986. BAPCPA made Chapter 12 permanent and extended Chapter 12's provisions to family fishermen.

1. *Eligibility*. 11 USC § 101(18) applies to "family farmer," 11 USC § 101(19A) applies to "family fisherman."
2. *Debtor's Powers*. The debtor typically retains property as debtor-in-possession and works with standing trustee to channel payments to creditors. 11 USC §§ 1203 and 1204.
3. *Adequate Protection*. The general adequate protection provision, section 361 of the Bankruptcy Code, does not apply in Chapter 12 cases. 11 USC § 1205. The short time frame prior to confirmation reduces the importance of securing adequate protection.
4. *Sale of Property*. Farm equipment, farm land, or property used to carry out a commercial fishing operation may be sold prior to confirmation without a secured creditor's consent, but the proceeds are impressed with the creditor's lien and sale must be after notice and opportunity for a hearing. 11 USC § 1206.
5. *Filing of Plan*. The Chapter 12 plan can only be filed by debtor. The plan may be filed with the bankruptcy petitioner within 90 days unless the court grants an extension. 11 USC § 1221.
6. *Plan Contents*.
   a. The plan should provide for payments over three years, unless the court for cause approves a longer period up to five years.
   b. The debtor may modify plan at any time prior to confirmation provided that plan provision requirements are met.
   c. The plan may alter the rights of secured creditors and may provide for repayment over a period of time that will exceed the life of the plan.
   d. The plan must offer general unsecured creditors at least what they would get in a Chapter 7 liquidation proceeding.
   e. The plan needs to provide interest on secured claims and on priority claims to the extent the priority claims would have been paid in a Chapter 7 liquidation case. *See* 11 USC §§ 1222 and 1223.
7. *Confirmation.* A hearing on confirmation of the plan must be concluded within 45 days from the plan filing date, except for cause. Any party in interest may object and creditors do not vote. *See* 11 USC §§ 1224 and 1225.

8. *Discharge*. A debtor is granted a discharge after completing all payments under the plan. There is no discharge of priority taxes, and these taxes along with interest may be collected after the discharge is granted. 11 U.S.C § 1228.
9. *Special Tax Provisions*. For cases commenced on or after April 17, 2005, a plan proponent may request a determination of the tax consequences of the plan from any governmental unit. *See* 11 USC § 1231 and Revenue Procedure 2006-52.

For more information:

- *See* GL-2 Training, Lesson 9 at: http://www.irs.gov/file_source/pub/irs-utl/GL2%202013%20Lesssons.zip

  or
- Contact P&A Branch 5

J. Individual Debtor Plans (Chapter 13)

Chapter 13 provisions permit individual debtors to reorganize their debts. A trustee is in charge of every Chapter 13.

1. *Commencement of the Case*. A chapter 13 case is commenced by the filing of a petition. There are no involuntary cases. *See* 11 USC §§ 301-303.
2. Tax Return Filing Requirements. The debtor is generally required to file with the appropriate tax authorities all required tax returns for the four years ending before bankruptcy by the date for set for the section 341 meeting of creditors, if the debtor had not already done so. *See* 11 USC § 1308.

II. NON-TITLE 11 INSOLVENCIES

Section 3713 of Title 31 of the United States Code, known as the Federal Priority Statute, provides that the government is entitled to have its claims paid first when certain requirements are met. The priority given to the United States pursuant to 31 USC § 3713 is vital to federal tax collection in nonbankruptcy insolvency cases. The Supreme Court has often stated that the federal priority statute is to be construed liberally in favor of the government and has thus rejected a narrow or strict construction.

Generally, if a taxpayer is insolvent and is divested of control over the distribution of his property in a manner specified in 31 USC § 3713, the statute requires that the claims of the federal government, including taxes, be paid before the claims of other creditors. This priority is crucial in situations in which the government does not have a lien to rely on for collection. And, if the Service has a lien, section 3713 may provide a greater recovery than a federal tax lien in some situations.

1. Insolvency occurs when liabilities exceed assets. The insolvency proceedings most often encountered are receiverships, assignments for the benefit of creditors, corporate dissolutions, and insolvent decedent's estates.
2. Conditions to be met for U.S. Priority:
   a. There must be a "debt" due to the United States.

b. There is divestiture of property to a fiduciary. Examples:
   i. the debtor makes a voluntary assignment of property;
   ii. property of the debtor, if absent, is attached; or
   iii. an "act of bankruptcy" is committed.

3. The priority afforded by 31 USC § 3713 is not available to the Government when it is a creditor in a bankruptcy proceeding.

For more information:

- *See* GL-2 bankruptcy Training Lesson 11 at http://www.irs.gov/file_source/pub/irs-utl/GL2%202013%20Lesssons.zip

- Contact P&A Branch 5

III. Bank Secrecy Act

On October 26, 1970, in response to increasing reports of people bringing bags full of currency of doubtful origin into banks for deposit, Congress passed Public Law 91-508, the Bank Secrecy Act. This law is often cited as the BSA because Part I, codified mostly in Title 12 of the United States Code (USC), was intended to address a concern by Congress that U.S. citizens may have been using the bank secrecy laws of other countries to conceal illegal activities. Part II of the law is cited as the Currency and Foreign Transactions Reporting Act. It is codified now at 31 USC, Money and Finance, Chapter 53, Monetary Transactions, Part II, Records and Reports on Monetary Instruments Transactions.

After the 9/11 terrorist attack, Congress mandated anti-money laundering compliance programs for all financial institutions as defined in the BSA. Suspicious activity reporting requirements were enhanced. All nonfinancial trades and businesses were required to report receipt of coins or currency greater than $10,000 under BSA as well as under IRC 6050I. This dual Form 8300 filing requirement effectively released Form 8300 information, except for Clerk of Court reports, from the disclosure protections of the IRC. Civil and criminal penalties for money laundering were increased. The Secretary of the Treasury received expanded powers for geographical targeting orders. FinCEN was elevated to Bureau status within Treasury. Information sharing by financial institutions with Federal law enforcement agencies and voluntary information sharing among financial institutions was encouraged and protected.

A. Form 8300 Reporting Requirements. The Bank Secrecy Act requires that trades and business report case payments of more than $10,000 to the federal government by filing IRS/FinCEN Form 8300, Report of Cash Payments Over $10,000 Received in a Trade or Business.

B. Elements.

1. Trade or business receives cash;

2. The amount of cash is more than $10,000;

3. Cash received in either one lump sum of more than $10,000 or installment payments that cause the total cash received within one year of the initial payment to total more than $10,000 or previously unreported payments that cause the total cash received within a 12-month period to total more than $10,000;
4. Cash received in the ordinary course of a trade or business;
5. The same agent or buyer provides the cash; and,
6. Cash received in a single transaction or in related transactions.
7. Cash Includes:
    i. Coins and currency of the United States and a foreign country;
    ii. Cashier's checks, bank drafts, traveler's checks, and money orders with a face value of $10,000 or less, if the business receives the instrument in a designated reporting transaction or any transaction in which the business knows the customer is trying to avoid reporting the transaction.
8. A designated reporting transaction is the retail sale of a consumer durable (tangible property that is suitable for personal use, reasonably expected to last at least one year under ordinary use, and has a sales price of more than $10,000), a collectible, or for travel or entertainment if the total sales price of items sold for a trip is more than $10,000.

C. Voluntary Submissions. A business may voluntarily file a Form 8300 if the payor is engaging in suspicious transactions involving $10,000 or less.

D. Timing. Generally, a business must file Form 8300 within 15 days after the cash is received. If the fifteenth day falls on a Saturday, Sunday or holiday, the business must file the report on the next business day.

E. Written Statement for Customers. When a business files a Form 8300, the business generally must notify each person named on the Form of the filing on or before January 31 of the year after the year in which the customer made the cash payment that caused the business to make the filing.

F. Penalties for Non-Filing. Businesses may be subject to civil and criminal penalties for non-compliance. IRC §§ 6721(a)(1), 6721(e)(2)(C), 6722(a)(1), 6722(e), 7203, 7206.

For more information:

- *See* IRM 4.26 *et seq.*
- *See* IRM 25.1.12 (BSA and fraud) at http://publish.no.irs.gov/cat12.cgi?request=CAT1&catnum=50016
- *See* IRM 25.5.11 (Title 31 BSA investigations) at http://publish.no.irs.gov/cat12.cgi?request=CAT1&catnum=27540
- Contact P&A Branch 1&2

IV. DISCLOSURE

A. <u>Section 6103 (confidentiality and disclosure of returns and return nformation)</u>

Section 6103 is the primary disclosure law that governs the confidentiality of tax information. It is the result of Congress' effort to strike a balance between taxpayer's expectation of privacy and effective tax administration by the government.

The general rule, set forth in IRC § 6103(a), provides that tax returns and tax return information are confidential and cannot be disclosed except as authorized by Title 26.

1. *Definitions*.
    a. RETURN: IRC § 6103(b)(1) defines return as the actual form filed by the taxpayer, including any supporting schedules, as well as any information return filed by a third party on behalf of or with respect to the taxpayer.
    b. RETURN INFORMATION: IRC § 6103(b)(2) Defines return information to includes any information gathered by the Service with regard to a taxpayer's liability under the Code (broad definition). It includes, but is not limited to, the taxpayer's identity, the nature, source, or amount of income, whether the return was, is being, or will be examined or subject to other investigation or processing, and any other data which is received by, recorded by, prepared by, furnished to, or collected by the IRS; with respect to a return or with respect to the determination of the existence or possible existence of liability or the amount of liability under the Code.
        i. Return information does not include data in a form that is not associated, directly or indirectly, to a particular taxpayer. This is known as the Haskell Amendment.
        ii. *Not an identity test*. An item of return information that has its identifier removed is still return information. *See Church of Scientology of Ca. v IRS*, 484 U.S. 9, 14-17 (1987).
    c. TAX ADMINISTRATION: The meaning of "tax administration" is sweeping. It includes the administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws and related statutes (or equivalent laws of a state); tax conventions to which the United States is a party; and the development and formulation of federal tax policy relating to existing internal revenue laws, related statutes, and tax conventions.
2. *Common exceptions to the general confidentiality rule*. The most common exceptions to the general rule in 6103(a) appear in IRC §§ 6103(c) through (o).
    a. SECTION 6103(C) [**CONSENT**]. This provision authorizes the IRS to disclose the taxpayer's returns and return information to any person or persons the taxpayer designates.
        i. "General Purpose Consent." Treas. Reg. § 301.6103(c)-1(b) describes the requirements for valid consents authorizing the IRS to disclose returns or return information, to designated third

parties, where the consent is *not* for the purpose of assisting the taxpayer to resolve a tax matter. Such consent must be in the form of a separate written document pertaining solely to the authorized disclosure.

ii. Assistance with a tax matter. Treasury Regulation § 301.6103(c)-1 describes the circumstances that constitute consent when it is given for purposes of assisting the taxpayer with a tax matter. These may be oral or written.

b. SECTION 6103(d) [**STATES**] authorizes the IRS to disclose returns and return information to state revenue agencies, bodies, or commissions, or their legal representatives, charged under the laws of the state with tax administration responsibilities.

c. SECTION 6103(e)**[MATERIAL INTEREST]** authorizes the IRS to disclose returns and return information to specified persons who have a material interest in the information. Requests for disclosure of a return must be made in writing. Return information may only be disclosed if disclosure will not seriously impair federal tax administration.

d. SECTION 6103(f) [**CONGRESS**]. Returns and return information may be disclosed to the congressional tax writing committees (Joint Committee on Taxation (JCT), House Ways and Means Committee, and Senate Finance Committee) upon written request from the chairperson of those committees. Returns and return information may also be disclosed to the Chief of Staff of the JCT upon written request. The chairpersons of the tax writing committees and the Chief of Staff of the JCT may designate agents to receive returns and return information on their behalf. The nontax writing committees may also receive returns and return information, but under more restrictive circumstances than apply to the tax writing committees.

NOTE: Returns and return information that can directly or indirectly identify a specific taxpayer may only be furnished to the committee when sitting in closed executive session (unless the taxpayer consents in writing).

e. SECTION 6103(h) authorizes disclosures to certain federal officers and employees for purposes of tax administration.

i. Section 6103(h)(1) [**NEED TO KNOW**] authorizes inspection by or disclosure to officers and employees of the Department of Treasury whose official duties require such for purposes of tax administration. A written request is not required.

ii. Section 6103(h)(2) [**JUSTICE**] authorizes disclosure of return and return information to officers and employees of the U.S. Department of Justice in a referred tax administration case for use in an investigation or proceeding if:

A the taxpayer is or may be a party to the proceeding;

B an item reflected on the return of a non-party taxpayer affects or may affect the resolution of an issue in the proceeding; or

C there is or may be a transactional relationship between the non-party taxpayer and a party, and the non-party's return or return information is or may be related to resolving an issue in the proceeding. See also Treas. Reg. § 301.6103(h)(2)-1 *et seq*. See § 6103(h)(3) for referral authority.

iii. Section 6103(h)(4) **[COURTS]** authorizes disclosure of return or return information in a federal or state judicial proceeding pertaining to tax administration if:

A. the taxpayer is a party to the proceeding;

B. an item reflected on the return of a non-party taxpayer directly affects the resolution of an issue in the proceeding; or

C. there is a transactional relationship between the non-party taxpayer and a party, and the non-party's return or return information is directly related to resolving an issue in the proceeding.

f. SECTION 6103(k)(6) [**INVESTIGATIVE DISCLOSURES**] authorizes disclosures made for investigative purposes. IRS, Chief Counsel, and Office of the Inspector General for Tax Administration (TIGTA) officers and employees are specifically authorized by section 6103(k)(6) and Treas. Reg. § 301.6103(k)(6)-1 to disclose return information (but not an actual return) to the extent that disclosure is necessary to obtain information which is not otherwise reasonably available. These officers and employees use this information to determine the correct tax, liability for tax, or the amount to be collected, or to enforce any other provision of the Code.

g. SECTION 6103(n**)[CONTRACTORS]** authorizes the IRS to disclose returns and return information to any person to the extent necessary to contract for services for tax administration purposes. *See* Treas. Reg. § 301.6103(n)-1.

3. *Unauthorized Access and Disclosure.* The general confidentiality rule is supported by both criminal penalties against the individual who makes a knowing unauthorized disclosure, or civil damages against the United States. See IRC 7213; IRC 7213A and IRC 7431.

For more information:

- *See* Disclosure and Privacy Law Reference Guide at http://www.irs.gov/pub/irs-pdf/p4639.pdf
- Contact P&A Branches 6&7

B. Freedom of Information Act.

The Freedom of Information Act (FOIA) is codified at 5 USC § 552, e*t seq*. The FOIA is an access statute that requires a federal agency to disclose records based on the

category of the record. The basic concept of FOIA is that the public has a right to know how the government operates.

Subsection (a)(1) of the FOIA requires automatic disclosure of information such as descriptions of agency organizations, functions, and procedures; substantive agency rules; and statements of general agency policy through publication in the Federal Register.

Subsection (a)(2), also known as the "reading room" provision, requires that certain types of records, such as final agency opinions and orders, specific policy statements, administrative staff manuals, and records previously processed for disclosure under the FOIA be routinely available for public inspection and copying.

Subsection (a)(3), which is by far the most commonly understood part of FOIA, provides that any person may have access to a specified record without demonstrating a "need to know."

Note: Do not suggest that a taxpayer submit a FOIA request for records the taxpayer is entitled to under 6103(e) during an examination or other enforcement activity.

Note: Do not suggest that a person submit a FOIA request for documents made available for public inspection under either section 6104 or section 6110. These statutes and implementing regulations have specific procedures for release of the covered documents to the public.

1. A request submitted under section (a)(3) of the FOIA must meet the following criteria in order to be considered a valid and proper request.
   a. in writing;
   b. signed by the requester;
   c. state that the request is made pursuant to FOIA;
   d. be addressed to the IRS official responsible for control of the records;
   e. establish the right of the person to receive the records where disclosure is limited by statute (e.g., § 6103 or Privacy Act);
   f. reasonably describe the records being requested;
   g. provide an address where the response is to be sent;
   h. agree to pay fees or seek a waiver of fees; and,
   i. attest to the fee category of the requester (or person on whose behalf the request is made).
2. *Responding to a FOIA Request.* IRS Disclosure Offices respond to FOIA requests for IRS and Field Counsel records. Records are disclosed unless a FOIA exemption or exclusion applies.
   a. RESPONSE TIME. The IRS must respond or ask for a voluntary extension of time within 20 working days of receipt of a valid request. If unusual circumstances exist, the agency has 10 additional days to respond.
   b. UNUSUAL CIRCUMSTANCES. Unusual circumstances exist when the number of records responsive to the FOIA request is voluminous, or the records are located at multiple locations, or there is a need to consult with one or more other agencies.

c. NATIONAL OFFICE RECORDS. The Disclosure and Litigation Support Branch of P&A's Legal Processing Division processes FOIA requests submitted for national office Counsel records. *See* CCDM 30.11. Attorneys should be mindful of the statutory response times when providing disclosure personnel with recommendations as to the appropriate exemptions from disclosure.

3. *FOIA Exemptions*. There are nine FOIA exemptions that protect records from release to the requester. For IRS and Chief Counsel records, the exemptions cited most often are 3, 5, 6, and 7. (5 USC § 552(b)(3), (5), (6), and (7)).

   a. EXEMPTION 3: This provision protects information specifically exempted from disclosure by statute. Common statutes asserted by the IRS are:
      - i IRC § 6103(a)
      - ii IRC § 6103(e)(7)
      - i Fed. R. Crim. P. 6(e) (grand jury)
      - i. 31 USC § 5319(Bank Secrecy Act)

      NOTE: Agencies cannot use the Privacy Act to withhold records that must be disclosed under FOIA. 5 USC § 552a(t).

   b. EXEMPTION 5. This exemption generally protects information that would not be available to a party in litigation. It encompasses the Deliberative Process Privilege, the Attorney Work Product Doctrine, and the Attorney-Client Privilege.

   c. EXEMPTION 6. This exemption protects personnel, medical, and similar files, the disclosure of which would constitute a clearly unwarranted invasion of personal privacy. This exemption requires a balancing of the individual's right to privacy against the public's right to be informed about how the agency conducts its activities.

   d. EXEMPTION 7. This exemption protects a variety of records compiled for law enforcement purposes, but only to the extent that the production of such law enforcement records or information:
      - i. could reasonably be expected to interfere with enforcement proceedings (exemption 7(A)).
      - ii. would deprive a person of a right to a fair trial or an impartial adjudication (exemption 7(B)).
      - iii. could reasonably be expected to constitute an unwarranted invasion of personal privacy (exemption 7(C)).
      - iv. could reasonably be expected to disclose the identity of a confidential source (exemption 7(D)).
      - v. would disclose techniques, procedures, or guidelines for law enforcement investigations or prosecutions (exemption 7(E)).
      - vi. could reasonably be expected to endanger the life or physical safety of any individual (exemption 7(F)).

4. *Administrative Appeals and Judicial Remedies*. A requester can administratively appeal if he disagrees with the IRS response. An appeal to the Office of Appeals must be filed within 35 days after the date of denial. There is no requirement to appeal if the IRS misses the time for a response. The Appeals Office must respond within 20 business days after receipt of the

appeal letter. If the appeal is denied, in whole or in part, or if the agency fails to timely respond to the appeal, the requester can file a FOIA complaint in U.S. District Court. The IRS is the proper party defendant, and must answer (through DOJ) within 30 days or any longer time the summons provides. The Associate Chief Counsel (P&A) has unique jurisdiction over all aspects of litigation arising under the FOIA. CCDM 37.2.2.1.

5. *Affirmative Defenses*. The following are some of the more common affirmative defenses that the IRS asserts in a FOIA litigation:
    a. Plaintiff failed to exhaust administrative remedies (lack of subject matter jurisdiction).
    b. All located responsive, non-exempt, records have been provided, and plaintiff's complaint is therefore moot.
    c. Withheld records are exempt from access under 5 USC § 552(b).
    d. The IRS is not required to create new documents in response to a FOIA request. **Note** that under the EFOIA, copying or sorting electronic records is not creating a new record.
    e. The IRS is not required to answer questions or conduct legal research.
    f. Lack of proper service.
    g. The defendant named is not the proper party.
    h. Plaintiffs are not entitled to a jury trial.
    i. Plaintiffs are not entitled to monetary damages.
6. *Attorney's Fees.* Under 5 USC § 552(a)(4)(E) a requester that substantially prevails is eligible for attorney's fees and costs. Court cases have refined the eligibility. Accordingly, for FOIA purposes, we do not recommend that you rely on IRC § 7430.
    a. *Pro se* plaintiffs are not eligible for attorney's fees, but are eligible for costs. *Kay v. Erhler*, 499 U.S. 432 (1991).
    b. Generally, an attorney representing himself is not eligible for attorney's fees. *Benavides v. BOP*, 993 F.2d 257, 259 (D.C. Cir. 1993).
    c. Although a litigant is eligible, the district court has the discretion to deny the fees if the court determines the litigant is not entitled to the fees. This discretion ordinarily is guided by four traditional criteria that derive from the FOIA's legislative history. These factors are: (1) the public benefit derived from the case; (2) the commercial benefit to the complainant; (3) the nature of the complainant's interest in the records sought; and (4) whether the government's withholding had a reasonable basis in law. *See Long v. IRS*, 932 F.2d 1309, 1313 (9th Cir. 1991). *See also Davy v. CIA*, 550 F.3d 1155, 1159 (D.C. Cir. 2008); *Detroit Free Press, Inc. v. DOJ*, 73 F.3d 93, 98 (6th Cir. 1996); and *Tax Analysts v. DOJ*, 965 F.2d 1092, 1093 (D.C. Cir. 1992).
    d. **Note**: attorney fees and costs in FOIA cases are no longer paid by the Claims and Judgment Fund of the United States Treasury. Pursuant to Section 4 of the OPEN Government Act of 2007, FOIA attorney fees and costs are now paid directly by the agency, using funds "annually appropriated for any authorized purpose." 5 U.S.C. § 552(a)(4)(E)(ii)).

For more information:

- *See* Disclosure and Privacy Law Handbook, Chapter 9 at http://www.irs.gov/pub/irs-pdf/p4639.pdf
- DOJ Guide at http://www.justice.gov/oip/doj-guide-freedom-information-act-0
- Contact P&A Branches 6&7

C. Privacy Act

The Privacy Act of 1974, 5 USC § 552a, applies to “records” pertaining to “individuals” maintained in a “system of records.” The Privacy Act has three primary aspects: (1) collection and maintenance of agency records; (2) access to the records by the individual; and, (3) disclosure by agency.

1. *Individual*. The term is defined under 5 USC § 552a(a)(2) as meaning a U.S. citizen or a legal permanent resident alien. Permanent resident alien status does not apply to entities (corporations, partnerships, trusts, and etc), tourists, and temporary, illegal, or undocumented residents.
2. *Records*. The term is defined in 5 USC § 552a(a)(4) to mean any item, collection, or grouping of information about an individual that is maintained by a Federal agency, including but not limited to education, financial transactions, medical history, criminal or employment history that contains the individual’s name or other identifying particular assigned to the individual, such as SSN, TIN, fingerprint, photograph, voice prints, eye scan, *etc*.
3. *System of Records*. The term is defined in 5 USC § 552a(a)(5) to mean a group of records under the control of any Federal agency from which information is retrieved by reference to individual’s name or other identifying particular.
4. *System of Records Notices*. Published in the federal register, these notices describe the records maintained in the Systems of Records, including individuals covered by those records and the agency’s uses of the records (5 USC § 552a(e)(4). Each System of Records Notice (SORN) must be reviewed whenever the IRS or the Office of Chief Counsel:
    a. Develops new programs or procedures affecting individuals
    b. Uses existing records in a new way
    c. Collects records not previously collected
    d. Discloses records to a new recipient or for a new purpose.

    NOTE: It may be necessary to revise an existing SORN, or publish a new SORN, to cover such changes/additions to the records or their usage.
5. *Collection and Maintenance*. The Act places certain restrictions and mandates certain actions by every agency that maintains records in a system of records. The agency requirements listed under 5 USC § 552a(e) include:
    a. Maintain only records that are relevant and necessary to accomplish purpose required by statute or Executive Order.
    b. Collect information to the greatest extent practicable from the individual.
    c. Inform each individual asked to supply information about himself on a form (Privacy Act Notices):
        i. Authority (statute or Executive Order) to collect

   ii. Whether providing is mandatory or voluntary
   iii. Principle purpose(s) for which the information will be used
   iv. Routine uses (as published in Federal Register)
   v. Effects on the individual of not providing the requested information.
  d. Publish System of Records Notices (SORNs) in the Federal Register.
  e. Maintain all records used in making a determination about an individual with such accuracy, relevance, timeliness, and completeness as is reasonably necessary to assure fairness to the individual in any determination.
  f. Maintain no record describing how any individual exercises First Amendment rights (unless authorized by explicit statute or by the individual, or pertinent to and within scope of authorized law enforcement activity).

6. *Access by Individual*. Generally, an individual can have access to records about himself maintained in a system of records and can request that the agency amend a record about himself. The Department of the Treasury regulations, which establish procedures for individuals to request access to, or amendment of, their records (including procedures for review and administrative appeal) and fees for copies are published at 31 C.F.R., Subtitle A, Part 1, Subpart C.
   a. ACCESS TO RECORDS. Upon request, an agency must provide the individual an opportunity to review (and to copy all or any portion of) records pertaining to himself, unless an exemption (published as part of the SORN) applies. 5 USC § 552a(d)(1). The agency cannot use a FOIA exemption to withhold records if the Privacy Act requires disclosure. Neither can it use the Privacy Act exemption to withhold records if FOIA requires disclosure. 5 USC § 552a(t).
   b. EXCEPTIONS. Note that a requester is forestalled from obtaining access to any information compiled in reasonable anticipation of a civil action or proceeding. 5 USC § 552a(d)(5). Furthermore, special procedures may apply to disclosures of medical records, including psychological records. 5 USC § 552a(f)(3).
7. *Amendment of records*, 5 USC § 552a(d)(2) and (3). An agency must permit the individual to request amendment of a record.
   a. The agency has 10 working days to acknowledge receipt of the request. The agency must either promptly correct whatever material the individual believes is not accurate, relevant, timely, or complete; or, inform the individual of the agency's refusal to amend. The response must include the reason for refusal and describe the procedure for the individual to request an administrative appeal of the decision.
   b. The agency must respond to any administrative review request within 30 working days and, if amendment is still refused, permit the individual to file with the agency a concise statement of his reasons for disagreement with the agency refusal and inform the individual of his judicial review rights under 5 USC § 552a(g)(1)(A).

c. Whenever the record is disclosed, the agency must note the disputed portion(s) of the record, include a copy of the individual's statement, and (if the agency deems it appropriate) a statement of the agency's reason(s) for refusing to amend.

NOTE: IRC 7852(e) provides that tax records **cannot** be amended.

8. *Disclosure by Agency* Section 552a(b) prohibits disclosure absent the individual's consent **except**:
    a. to officers and employees of the agency that maintains the record who need the record for official duties;
    b. as required under 5 USC § 552 (FOIA);
    c. for a routine use as published in the applicable SORN (see 77 Fed. Reg. 47930, et seq. (August 10, 2012));
    d. to the Bureau of the Census;
    e. for statistical research, without individual identifiers;
    f. to National Archives and Records Administration;
    g. to another agency or instrumentality of any governmental jurisdiction within or under the control of the U.S. for a civil or criminal law enforcement activity – requires written request from head of another agency;
    h. to a person pursuant to a showing of compelling circumstances affecting the health or safety of an individual – requires notification to individual's last known address;
    i. to either House of Congress or, to the extent of matter within its jurisdiction, any committee, subcommittee, or joint committee;
    j. to GAO;
    k. pursuant to an order of a court of competent jurisdiction (signed by a judge); or,
    l. to a consumer reporting agency pursuant to 31 USC 3711(e).

    NOTE: Field employees most commonly encounter items 1, 3, 7, and 11. Proposed disclosures other than pursuant to items 1 and 3 must be coordinated with the Disclosure Office or CC:PA.[3]
9. *Civil Remedies*. An individual may bring a civil action against the agency in Federal District Court to get amendment, access, or (only as to items 3 and 4 below) actual damages of at least $1,000 for each misbehavior. The statute of limitations is two years. The Department of the Treasury is the proper party defendant. The Associate Chief Counsel (P&A) has unique jurisdiction over all aspects of litigation arising under the Privacy Act. CCDM 37.2.1. Section§ 552a(g) grants an individual a remedy if the agency:
    a. refuses to amend a record at the individual's request; (*but see* IRC § 7852(e);
    b. refuses to comply with an access request;
    c. fails to maintain a record with appropriate accuracy, relevance, timeliness and completeness and that record is used to made a determination adverse to the individual;

[3] Accounting of disclosure is required for items 3 - 12. Accounting must be made available to the individual upon request for items 3 – 4 and 8 – 12. 5 USC § 552a(c).

   d. fails to comply with any other provision of the Privacy Act in such a way as to have an adverse effect on an individual.

10. *Criminal penalties*. 5 USC § 552a(i) provides that it is a misdemeanor and fine up to $5,000, if any agency officer or employee knowingly and willfully discloses covered information in a manner not authorized, or willfully maintains a system of records without publishing a SORN. It is also a criminal violation if any person knowingly and willfully requests or obtains any record under false pretenses.
11. *Computer Matching Agreements.* Under certain circumstances, an agency can operate a computerized match between two or more Systems of Records (maintained by that agency or another agency) or with non-Federal records. 5 USC § 552a(a)(8). Such "matching programs" require a written agreement. 5 USC § 552a(o). All matching programs must be coordinated with CC:PA.
12. *Government Contractors*, 5 USC § 552a(m). If an agency contracts out the operation or maintenance of a System of Records, all rules and requirements still apply to such SOR. Proposals to contract out the operation or maintenance of any SOR must be coordinated with CC:PA.

For more information:

- IRM 11.3.13 (FOIA)
- IRM 11.3.14-19 (Privacy Act)
- See DRG Chapter 11, Part II (Privacy Act) at http://www.irs.gov/pub/irs-pdf/p4639.pdf
- Contact P&A Branches 6&7

D. Section 6104 (public inspection of certain Information about exempt organizations and pension plans)

With the passage of the Revenue Act of 1950, Congress required that certain tax exempt educational and charitable organizations annually file information to be made available to the public. *See* Pub. L. No 81-814, ch. 994, 64 Stat. 906 (1950) (amended by 65 Stat. 124 and 66 Stat 820). In 1958, Congress amended section 6104 to include these organizations' applications for tax exempt status, as well as annual returns reflecting the organizations' gross income, expenses, disbursements for charitable purpose, accumulations of income and a balance sheet. *See* Technical Amendments Act of 1958, Pub. L. No. 85-866, § 75(a), 72 Stat. 1606, 1660-61. In 2000, Congress amended section 6104 to require publicity of certain information filed by political organizations granted exempt status under section 527. *See* Pub. L. No. 106-230, § 1(b)(1)(A)(i)-(vi), 114 Stat. 477, 78.

1. *Exempt organizations*. The application filed by any organization exempt from taxation under section 501(a) or a political organization exempt from taxation under section 527, for any taxable year, or any papers submitted in support of an application for exempt status, and any letter or other document issued by the Service granting the qualified or exempt status are open to public inspection. IRC § 6104(a)(1)(A).

a. FORM 4506-A TO THE IRS. Individuals may also make a request to inspect copies of annual returns, reports, and exempt status application materials, or materials will be provided to the requester without charge other than a reasonable fee for any reproduction and mailing costs. The request for either the application or the returns may be made by submitting a Form 4506-A.

b. FROM THE ORGANIZATION. A person may also request to see the material at the *organization*'s principal, regional or district office, or in writing. IRC § 6104(d)(1)(B).

2. *Pension Plans.* Section 6104(a)(1)(B), which addresses exempt pension plans, was added to the Code in 1974 as part of the Employee Retirement Income Security Act (ERISA), Pub. L. 93-406. ERISA is a comprehensive statutory scheme that sets minimum standards for most voluntarily established pension and health plans in private industry to provide protection for the individuals in these plans. ERISA is enforced by the Department of Labor, the Pension Benefit Guarantee Corporation as well as the IRS. The IRS's role is to ensure that plans meet, and continue to meet, requirements for tax exempt status.

   a. APPLICATIONS AVAILABLE FOR PUBLIC INSPECTION FOR PLANS WITH 26 OR MORE PARTICIPANTS. Section 6104(a)(1)(B) provides that the "application filed with respect to the qualification of a pension, profit-sharing, or stock bonus plan", "any papers submitted in support of an application", and "any letter or other document issued by the Internal Revenue Service and dealing with the qualification" shall be open to public inspection in the time and manner as the Secretary prescribes. The regulations elaborate on what documents issued by the IRS relating to plan qualification will be open to public inspection under section 6104(a)(1)(B)(iv).

   b. OTHER DOCUMENTS AVAILABLE. These documents include but are not limited to, "determination letters relating to the qualification of a plan, technical advice relating to the issuance of such determination letters, technical advice relating to the continuing qualification of a plan and letters or other documents revoking or modifying any previous favorable determination or denying the qualification of the plan." Treas. Reg. 301.6104(a)-3(c).

For more information:

- *See* chapter 14, http://www.irs.gov/pub/irs-pdf/p4639.pdf
- Treas. Reg. § 301.6104-1 et seq.
- *See* IRM 11.3.9 (exempt organizations) and IRM 11.3.10 (employee plans)
- Contact P&A Branch 6&7

E. Section 6110 (public inspection of written determinations).

1. *General Rule.* Rulings, Determination Letters, Technical Advice Memoranda, and Chief Counsel Advice, along with any related background file, are open to public inspection. A written determination is a ruling, determination letter, technical advice memorandum or Chief Counsel advice.

2. Section 6110(i)(1) defines “Chief Counsel Advice” as written advice or instruction prepared by any national office component of the Office of Chief Counsel which interprets a revenue provision.
3. Subsection 6110(l) provides that section 6110 does not apply to any matter to which either of the following sections apply:
    a. section 6104, Publicity of Information Required from Certain Exempt Organizations and Trusts; or,
    b. section 6105, Confidentiality of Information Arising Under Treaty Obligations.
    c. Likewise, section 6110(b)(1) provides that documents pertaining to an advanced pricing agreement or pertaining to a section 7121 closing agreement are not open to public inspection under section 6110.
4. *Exemptions From Disclosure*. Section 6110(c) provides various exemptions from disclosure that are akin to the exemptions under the Freedom of Information Act. Taxpayer identifying information is not made available for public inspection.
5. Section 6110(i)(3) provides special rules regarding exemptions from disclosure for Chief Counsel Advice by incorporating the FOIA exemptions listed in 5 U.S.C § 552(b) and (c).
6. *Time For Disclosure*. Section 6110(g) provides that, generally, written determinations are available for public inspection between 75 and 90 days after the written determination was issued to the recipient.
7. *Disputes Relating To Disclosure*. Section 6110(f) provides the procedures for certain persons to seek additional redactions or additional disclosure. *See also*, Treas. Reg. § 301.6110-5.
8. *Remedies For Violations of Section 6110*: Section 6110(j) provides the procedures for certain persons to seek enforcement of the provisions of section 6110.
9. *Precedent*. Section 6110(k)(3) provides that documents made available for public inspection under section 6110 are not to be used or cited as precedent.
10. *Exclusive remedy*. Section 6110(m) provides that 6110 is the exclusive remedy for releasing written determinations and background file documents. *See also Church or Scientology of CA. v. IRS*, 792 F.2d 146, 149 (D.C. Cir. 1986)

For more information:

- Treas. Reg. §§ 301.6110-1 – 6110-7.
- *See* DRG Chapter 13, Part 1 at http://www.irs.gov/pub/irs-pdf/p4639.pdf
- *See* IRM 11.3.8
- Contact P&A Branch 6&7.

V. WHISTLEBLOWERS

A. Statutory Authority – IRC section 7623. Section 406 of the Tax Relief and Health Care Act of 2006, Public Law 109-432 (120 Stat. 2922), enacted on December 20, 2006, amended section 7623 of the Internal Revenue Code on the payment of awards

to certain persons who provide information to the Internal Revenue Service relating to the detection of underpayments of tax and violations of the internal revenue laws. Section 406 redesignated the existing statutory authority to pay awards at the discretion of the Secretary of the Treasury as section 7623(a), and added a new provision at section 7623(b), requiring payment of an award when certain conditions are met.

1. *General Rules*. Section 7623(b)(1) provides that qualifying individuals will receive an award of at least 15 percent, but not more than 30 percent, of the collected proceeds resulting from the action with which the Secretary proceeded based on the information provided to the IRS by the individual. Section 7623(b)(2) provides for awards of 10 percent or less in cases involving disclosures of specific allegations resulting from certain public sources. Section 7623(b)(3) provides for reduced awards in cases in which the claim for award is brought by an individual who planned and initiated the actions that led to a tax underpayment or a violation of the tax laws. Section 7623(b) applies only when the amount in dispute in an action against a taxpayer exceeds $2,000,000 (and in the case of an individual taxpayer, when the individual's gross income exceeds $200,000 for any taxable year subject to the action).
2. *Other Rules*. Section 406 also addressed several award program administrative issues and established a Whistleblower Office within the IRS, which operates at the direction of the Commissioner, analyzes information received under section 7623, as amended, and either investigates the information itself or assigns the investigation to the appropriate IRS office.

For more information:

- Treas. Reg. §§301.7623-1 through 301.7623-4, inclusive, provide comprehensive guidance for the section 7623 award program, addressing the submission of information, definitions of key terms in the statute, whistleblower administrative proceedings, and the determination and payment of awards.
- Treas. Reg. § 301.6103(h)(4)-1 confirms that the Whistleblower Office is authorized to disclose return information during whistleblower administrative proceedings.
- Treas. Reg. §301.6103(n)-2 provides rules on disclosures of return information in connection with written contracts with whistleblowers.
- IRM Part 25.2.2 provides instructions on handling whistleblower information, processing claims for awards, and making payment under section 7623.
- IRS Whistleblower Office homepage (http://www.irs.gov/uac/Whistleblower-Informant-Award) has current information, including a link to Form 211, Application for Award for Original Information.

VI. COMBAT ZONE AND DISASTER RELIEF, AND MILITARY DEFERMENT

A. Combat zone.

IRC § 7508 postpones the deadlines for certain acts performed by taxpayers and the Service. As long as the taxpayer remains in a combat zone, the taxpayer does not have to perform the acts listed in IRC § 7508(a). The acts covered by IRC § 7508 include

filing any return for income, estate, or gift tax; paying any income, estate or gift tax; filing a claim for credit or refund of any tax; assessing or collecting a tax; claiming a refund or litigating a suit.

1. The postponement primarily applies to individuals who served in the Armed Forces in a combat zone or qualified hazardous duty area (and to persons performing qualifying services outside such area) or who participated in a contingency operation.
    a. COMBAT ZONE. A Combat Zone is an area designated in an Executive Order by the President of the United States. The current tax year Publication 3 lists the areas designated as combat zones by Executive Order.
    b. CONTINGENCY OPERATION. The rules in IRC § 7508 have been extended for a contingency operation designated by the Department of Defense for an individual deployed outside the United States away from the individual's permanent duty station while participating in an operation. This new rule is effective for any period for performing an act which has not expired before 11/11/2003.
    c. QUALIFIED HAZARDOUS DUTY AREA. Congress has extended some of the same tax relief provided for those in a combat zone to those in a qualified hazardous duty area. Congress has also extended the relief to persons performing qualifying service outside such area.
    d. AREA CERTIFIED BY THE DEPARTMENT OF DEFENSE. The Department of Defense may certify an area as being in direct support of military operations in a combat zone and a person serving in such an area who receives hostile fire/ imminent danger pay under 37 USC § 310 (a) (13) is treated as serving in a combat zone pursuant to Treas. Reg. § 1.112-1(e).
2. Members serving in an area designated or treated as a combat zone are granted special tax benefits. Service in a combat zone includes any periods the service member is absent from duty because of sickness, wounds, or leave. If, as a result of serving in a combat zone, a person becomes a prisoner of war or is missing in action, that person is considered to be serving in the combat zone so long as he or she keeps that status for military pay purposes.
    a. A deadline may be postponed 180 days after the last day of service in the combat zone (or hazardous duty area) or participating in a contingency operation or hospitalization from such service or participation.
    b. In addition to the 180 days mentioned in IRC 7508 itself, a deadline that includes a filing period is postponed by the number of days that were left in any period for taking action when the taxpayer entered the combat zone or the contingency operation.
    c. For example, if the taxpayer entered the combat zone or was hospitalized in December preceding the filing season, and remained there into January, the entire 105 day period from January 1 to April 15 for filing an individual income tax return (106 days in a leap year) will be added to the last day of service in the combat zone (along with the 180 day period) to determine the extended deadline for filing the tax return.

For more information:

- Treas. Reg. § 1.112-1
- Pub. 3
- IRM 25.16.6.1 http://publish.no.irs.gov/cat12.cgi?request=CAT1&catnum=36901

B. Disaster relief.

When a disaster occurs (*e.g.*, large-scale flood, hurricane, tornado, etc.), the impacted State's governor may request that the President declare the State a federally declared disaster area under the Stafford Act (42 USC §§ 5121-5207). In response to the governor's request, the President may issue a disaster declaration. FEMA, the Federal Emergency Management Agency, is charged with administering the Stafford Act, which provides various forms of disaster and emergency relief. FEMA will respond to the disaster declaration, make a determination as to scope of disaster area and recommend appropriate relief. FEMA may grant public assistance only, which provides funds to assist state and local first responders, or public and individual assistance, or it may grant assistance to individuals, as well.

When FEMA grants individual assistance to persons located in the impacted area, the IRS provides tax relief under IRC § 7508A. Section 7508A authorizes the IRS to postpone for a period of up to one year certain taxpayer filing and payment deadlines, as well as certain IRS compliance activities, in response to a federally declared disaster or terroristic or military actions. When the IRS provides section 7508A relief it determines an appropriate postponement period commensurate with the damage caused by the disaster. Filing and payment obligations, as well as the acts listed in section 7508(a), with a due date falling within the postponement period are postponed until the last day of that period. During the postponement period, the affected taxpayer is eligible for relief from interest, penalties, additional amounts, or additions to tax for filing and payment due dates (original or extended) falling due during the period.

1. Section 7508A authorizes the IRS to postpone the acts described in IRC § 7508(a) and those filing and payment obligations identified in Treas. Reg. § 301.7508A-1(c). The acts that may be postponed include:
    a. Filing any return of income, estate, gift, employment, or excise tax;
    b. Payment of any income, estate, gift, employment, or excise or any installment thereof or of any other liability to the United States in respect thereof;
    c. Filing a petition with the Tax Court for redetermination of a deficiency, or for review of a decision rendered by the Tax Court;
    d. Allowance of a credit or refund of any tax;
    e. Filing a claim for credit or refund of any claim;
    f. Bringing suit upon any such claim for credit or refund;
    g. Assessment of any tax;
    h. Giving or making any notice or demand for the payment of any tax, or with respect to any liability to the United States in respect of any tax;

i. Collection, by levy or otherwise, of the amount of any liability in respect to any tax;
j. Bringing suit by the United States in respect of an liability in respect of any tax; and,
k. Any other act required or permitted under the internal revenue laws.

NOTE: When the disaster is of an historic proportion (*e.g.*, Hurricane Katrina), the IRS *may* postpone compliance activities during the postponement period.

NOTE: Generally the IRS does **not** postpone the time to perform the acts listed in g. – j. above (all acts to be performed by the government) unless the disaster is of historic proportion.

2. *Definitions*.
   a. COVERED DISASTER AREA. The IRS's determination of the impacted area is made in coordination with FEMA. Generally, only certain counties within a state may be impacted and these areas are specified in the IRS's news release granting relief.
   b. AFFECTED TAXPAYER. As defined in Treas. Reg. § 301.7508A-1(c), it includes:
      i. taxpayers whose principal residence or principal place of business is located in a covered disaster area;
      ii. relief workers affiliated with a recognized government or philanthropic organization assisting in a covered disaster area; and
      iii. taxpayers whose records necessary to meet a deadline for a specified act are located in the covered disaster area.
3. *Postponement period*. Section 7508A postpones the time for performing an act. It does not serve as an extension. The postponement period allows the IRS to disregard a time period of up to one year for performance of the act. To the extent that other statutes may rely on the date a return is due to be filed, the postponement period will not change the due date of the return. When the original due date of a return or payment occurs prior to the start of the postponement period, but the extended due date falls within the postponement period, the affected taxpayer's return will be timely if filed on or before the last day of the postponement period. If the taxpayer files an extension and the postponement period ends prior to the extended due date, the affected taxpayer's return will be timely if filed on or before the extended due date.

For more information:

- All disaster relief and combat zone questions are coordinated with attorneys designated in the subject matter index.
- Treas. Reg. 301.7508A-1 *et seq*.
- Rev. Proc. 2007-56 (or its successor).
- IRM 25.16.1 at http://publish.no.irs.gov/cat12.cgi?request=CAT1&catnum=36901

C. Military Deferment.

Under the Servicemembers Civil Relief Act, 50 USC app. Section 501, the collection of any income tax due from any person in the military service, whether falling due before or during military service, may be deferred if his/her ability to pay the tax is "materially affected" because of that person's military service. "Materially affected" means, if the taxpayer's current monthly income (military income) is less than the monthly income immediately prior to active duty, their ability to pay the balance due has been "materially affected" by reason of active military status. Upon application by the taxpayer, collection may be deferred during the taxpayer's period of military service and up to 180 days afterward. Interest and penalties do not accrue during this period. The running of a statute of limitations against the collection of tax is suspended for the period of military service plus 270 days thereafter.

> **Note**: If the taxpayer is not eligible for deferment, he/she is entitled to a reduction in the interest rate to 6% (unless the applicable interest rate is below 6%) on the tax liabilities arising before he/she entered military service.

For more information:

- *See* IRM 5.1.7.12 and 5.19.1.4.
- Contact P&A Branches 3&4.