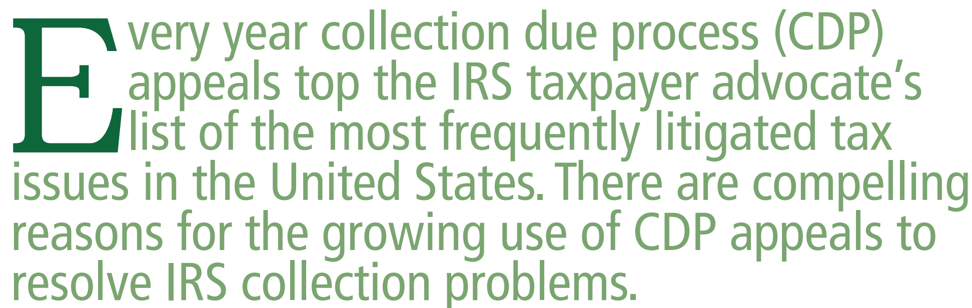
WINNING

AN IRS COLLECTION CASE IN TAX COURT

BY HOWARD LEVY, JD



Every year collection due process (CDP) appeals top the IRS taxpayer advocate's list of the most frequently litigated tax issues in the United States. There are compelling reasons for the growing use of CDP appeals to resolve IRS collection problems.

CDP appeals are the most meaningful opportunity a taxpayer has to resolve a collection problem without the IRS being able to seize or levy property. If an IRS administrative hearing provides unsatisfactory results, the Tax Court has jurisdiction to conduct a review of the IRS decision-making process. The purpose of court review is protection against IRS abuse in the collection process.

"Due process," in the context of IRS collections, is the right to a decision on IRS collection methods by an independent judge who balances the IRS's desire to enforce by levy with a taxpayer's offer of collection alternatives.

The due process rights of the Tax Court are a key component of our tax collection system. Due process puts the brakes on the IRS, preventing a government agency from reviewing and deciding how to collect back taxes on its own without any checks and balances on its power.

If your efforts to reach resolution with IRS administratively in a CDP hearing are unsuccessful, and you disagree with the IRS's final decision on enforcement and resolution, you have the right to have the Tax Court conduct an independent review of your case.

Heading to Tax Court – The Notice of Determination

At the conclusion of a CDP appeal hearing, the IRS will issue a Notice of Determination Concerning Collection Action under Sec. 6320 and/or 6330. This is usually referred to as a Notice of Determination. The IRS is required by Internal Revenue Code Sec. 6320 (for CDP hearings disputing the filing of a federal tax lien) and IRC Sec. 6330 (for CDP hearings disputing an IRS decision on alternatives to levy) to prepare this notice at the conclusion of the CDP hearing. The Notice of Determination reflects the IRS's findings and recommendations from the CDP hearing.

If judicial review of the IRS's decision is desired, a petition to the Tax Court must be filed thirty days after the date the Notice of Determination was issued. The Tax Court is generally not a court of equity, meaning it sticks by filing deadlines with few exceptions. If you want judicial review of errors made by the IRS in reviewing your settlement proposals, it is important to timely file a petition.

If the only issue is denial of innocent spouse relief, the appeal can be filed within ninety days of the Notice of Determination.

See IRC Sec. 6015(e)(1)(A). However, if the Notice of Determination involves both innocent spouse relief and other collection issues (for example, offer in compromise(OIC)), file the appeal within thirty days, otherwise consideration of the non-innocent spouse issues would be barred. (Treas. Reg. Sec. 301.6320-1(f)(2)Q&A-F2, Sec. 301.6330-1(f)(2)Q&A-F2; *Raymond v. Commissioner*, 119 T.C. 191 (2002)).

The Tax Court is a traveling court, based in Washington, D.C., with thirty-two judges. Tax Court judges travel across the country setting "dockets" in cities where they hear all the cases that are pending in that area when they visit. A Tax Court may visit a city twice in a year. Because of that, a CDP case can take at least up to a year to be resolved by the Tax Court.

While your Tax Court petition is pending, the IRS is prohibited from taking its proposed collection action—they cannot levy or seize until the due process review is exhausted. For many, the time and collection hold can be a benefit to litigating. The flip side is that the statute of limitations on collection is also tolled—what the IRS gives up (no collection action until due process is concluded), they get back (extension of statute of limitations for the time they cannot act). As time is an essential element of being in Tax Court, it is important to carefully weigh the merits of your case and understand how the Tax Court views and decides CDP cases before entering into litigation.

Getting Ready for Tax Court

A CDP hearing is an IRS administrative process that does not have court reporters; there is no admission of evidence and no ability to testify to facts before a jury. There is no right to subpoena witnesses. (Treas. Reg. Sec. 6320-1(d)(2)Q&A-D6 and Sec. 6330-1(d)(2)Q&A-D6; *Davis v. Commissioner*, 115 T.C. 35 (2000)).

The IRS is the gatherer and recorder of facts during the administrative hearing; these are the facts that are later subject to review by the Tax Court. This is tricky as the IRS is also a party to the process (and if the case goes to Tax Court, the equivalent of a defendant). Clearly, getting ready for Tax Court during a CDP hearing is an unusual process with unique challenges.

If you tell an IRS settlement officer something during the CDP hearing, do not presume it is preserved for litigation. To the extent it is practical (and with recognition that not all CDP cases make their way to Tax Court), everything of relevance discussed in the CDP hearing should be documented and backed up by written correspondence. If there was a discussion of important issues or items that require follow-up, summarize it in writing.

In Tax Court, the IRS usually seeks to limit the evidence to its administrative record, and it will generally object to any evidence that is not in the record. The administrative record is essentially the IRS settlement officer's administrative file: the taxpayer's request for hearing; any other written communications and information from the taxpayer submitted in connection with the CDP hearing; notes made by an appeals officer or any oral communications with the taxpayer; memoranda created by the Appeals officer or employee in connection with the CDP hearing; and any other documents or material relied upon by the Appeals officer in making the determination under Sec. 6330(c)(3). (See Treas. Reg. Sec. 3016330-1(f)(2), Q&A-F4).

However, the Tax Court has held that the administrative record rule does not apply to Tax Court CDP cases and that evidence not in the IRS's file can be admitted at trial. (*Robinette v. Commissioner*: 123 TC 85 (2004), rev'd 439 F. 2d. 455 (8th Cir. 2006)).

The Tax Court's decision in *Robinette* has been overruled in the First Circuit (*Murphy v. Commissioner*, 469 F. 3d 27 (1st Cir 2006)) and Eighth Circuit, but currently is good law in all other circuits. The First Circuit covers Maine, New Hampshire, Massachusetts, and Rhode Island. The Eighth Circuit includes North Dakota, South Dakota, Nebraska, Minnesota, Iowa, Missouri, and Arkansas. In these states, the Tax Court would not hear additional evidence at trial and review is limited to the IRS's administrative file.

In the nine other circuits and thirty-nine other states, the Tax Court conducts what is known as a trial *de novo* (new trial) and has discretion to go past the IRS's administrative record to determine if there was an abuse of discretion. However, in most cases the Tax Court will not consider new issues at trial that were not previously raised in appeals. (*Giamelli v. Commissioner*, 129 TC 107 (2007); Treas. Reg. Sec. 301.6330-1(f)(2)Q&A-F3.) In all circuits and states, innocent spouse claims are reviewed by the Tax Court de novo.

Tax Court Standards of Review in CDP Litigation

During the CDP hearing and in the Notice of Determination, an IRS settlement officer is required to consider three primary issues:

1. Verification that the requirements of an applicable law or administrative procedure have been met.
2. A decision on the issues raised in the appeal (i.e., installment agreement or OIC as an alternative to levy).
3. Whether the proposed collection action (i.e., levy) balances the need for efficient collection of taxes with the taxpayer's legitimate concern that the collection action be no more intrusive than necessary. (See IRC Sec. 6330(c)(3)).

IN TAX COURT, the IRS usually seeks to limit the evidence to its administrative record, and it will generally object to any evidence that is not in the record.

The Tax Court reviews the settlement officer's decision under an "abuse of discretion" standard. Abuse of discretion is defined as whether the settlement officer's decision sustaining IRS enforcement and rejecting a collection alternative was arbitrary, capricious, or without sound basis in fact or law. (See *Murphy v. Commissioner*, 125 T.C. 301, 320 (2005), affd. 469 F.3d 27 (1st Cir. 2006); *Sego v. Commissioner,* 114 T.C. 604, 610 (2000); *Goza v. Commissioner*, 114 T.C. 176 (2000)).

The abuse of discretion standard of review tends to favor the IRS. To begin with, latitude is inherent in it—the IRS is allowed discretion by the Tax Court in deciding how to collect taxes and will be reigned in only when the discretion is abused. That is consistent with the circumstances that led to the passage of CDP laws in 1998 because of tales before Congress of IRS revenue officers (ROs) run amok, taking taxpayers' property without notice—whether it was justified or not—sometimes to the point of harassment. These may have been isolated incidents of abuse, but Congress's goal was to stop cowboys from the Wild West and IRS ROs from operating in the same way.

Abuse of discretion has led the Tax Court away from calculating the correct value of a compromise, how much the IRS should accept in a monthly installment agreement, or whether financial hardship exists. We may not always agree with IRS's decisions on these matters, but provided the Internal Revenue Manual (IRM) and IRC are followed, they are generally not tantamount to abuse. A review of some Tax Court decisions illustrates the point of what makes a winning case.

Tucker v. Commissioner

Larry Tucker was a day trader and an IRS debtor. Mr. Tucker incurred significant losses in his day trading, and the IRS sought to include the extent of his losses in the value of his OIC, arguing that the day trading was unnecessarily risky and was the equivalent of dissipating assets. The value of his compromise was increased by the trading losses. Mr. Tucker disagreed.

The Court did not disturb IRS's analysis on the dissipated assets. The Court's decision contains a good summary on its point of view on disturbing an IRS compromise valuation.

In finding that there was no abuse of discretion, the court told Mr. Tucker:

> "The decision to entertain, accept or reject an offer in compromise is squarely within the discretion of the appeals officer and the IRS in general. In reviewing this determination, we do not decide whether in our opinion Mr. Tucker's OIC should have been accepted. (See *Woodral v. Commissioner*, 112 T.C. 19, 23 (1999); *Keller v. Commissioner,* T.C. Memo. 2006-166, affd. in part 568 F.3d 710 (9th Cir. 2009)) Instead, we review the determination for abuse of discretion." (*Tucker v. Commissioner*, T.C. Memo 2011-67).

Fernandez v. Commissioner

To the dismay of all who are frustrated by the draconian results of the IRS's application of national and local expense allowance guidelines, relief can be difficult to find in Tax Court. Luciano Fernandez found this out the hard way.

Mr. Fernandez submitted an OIC of $4,272, and the IRS countered with $205,220. IRC Sec. 7122(a) permits the IRS to prescribe national and local expense allowances to determine monthly living expenses. In most cases, this is a cap on what a taxpayer can spend. The Tax Court determined that the IRS is authorized by Sec. 7122 to cap expenses and set allowances and was unwilling to disturb how the IRS administratively interpreted Sec. 7122(a). The Court found that the IRS expense allowances are an acceptable method of determining the reasonableness of basic monthly living expenses and rejected Mr. Fernandez's arguments for the allowance of an amount that was more than the caps. (*Fernandez v. Commissioner*, T.C. Memo 2008–2010).

Caney v. Commissioner

IRC Sec. 7122(d) does give the IRS leeway to vary from the expense allowances, but the Tax Court has made it clear it will take a special case for it to find an IRS abuse of discretion for failing to depart from the norm. Two years after Luciano Fernandez lost his attempt to have his excess expenses allowed, John and Debra Caney learned the same lesson.

THE FOCUS OF THE COURT is whether the IRS is following its own administrative procedures and the law, considering all the facts, and doing an analysis that is on point and relevant.

Debra Caney was a real estate agent, and she believed that the IRS improperly valued her future income by averaging her earnings during the halcyon days of the real estate market. The Tax Court was unwilling to disturb the IRS methodology, stating that the settlement officer faced a difficult decision on how to value income that did not amount to an abuse of discretion. In essence, it was a judgment call. Regardless of your point of view, it was not abuse.

As far as any deviation from the national and local expense allowances under Sec. 7122(d), the Court made it clear that a deviation would be appropriate only if specific facts were proven that application of the expense caps would leave Ms. Caney without resources to meet basic living expenses. Extreme and unusual circumstances—a large family requiring housing that exceeds the housing and utility expenses or medical trauma requiring the need for modifications to a home that would exceed the allowances—come to mind as the type of situation the Tax Court might be open to. (*Caney v. Commissioner*, T.C. Memo 2010-90).

The Tax Court is not necessarily any more lenient in reviewing the IRS's handling of installment agreements. IRC Sec. 6159 permits the IRS to enter into a proposed installment agreement, and Treasury Reg. Sec. 301.6159-1(c)(1)(i) gives the IRS discretion to accept or reject the agreement. As the statute gives the IRS discretion in the handling of installment agreements, it is not surprising that the Court is prone to giving the IRS deference in its decisions on installment agreements. (See *Marascalco v. Commissioner*, T.C.Memo 2010-130) The same could be said for the Tax Court's review of IRS uncollectible determinations.

As *Tucker*, *Fernandez*, and *Caney* demonstrate, the Tax Court is generally not interested in overriding IRS rules and calculations provided all relevant information was considered and the IRS was even-handed in its decision-making process and performed an analysis that properly considered all administrative and legal guidelines (like the IRM and the IRC).

What Does a Winning Tax Court Collection Case Look Like?

Abuse of discretion is an opaque standard for the Tax Court, and the best way to summarize it is possibly under the "I know it when I see it" approach. But all is not doom and gloom in CDP litigation; the Tax Court does not hesitate to stand up for taxpayers in the right circumstances and where there has been abuse of process.

With that in mind, here is a checklist of what can win a Tax Court collection case:

1. The IRS settlement officer did not *address a relevant issue*.
2. The IRS settlement officer failed *to make necessary findings of fact*.
3. The IRS settlement officer neglected *to perform an analysis that is necessary in making the determination*.
4. The IRS administrative record contains *no indication of the documents or evidence the settlement officer considered in making the determination or the reasons for the determination*.
5. The settlement officer's conduct of the hearing *deprived the taxpayer of a procedural right granted by statute or regulation, such as the right to an impartial appeals officer under Sec. 6330(b)(3)*.
6. The settlement officer did not allow *an adequate opportunity to present evidence or arguments in support of relevant issues raised during the CDP hearing process.*

(See IRS Chief Counsel Notice 2009-10.)

The focus of the court is whether the IRS is following its own administrative procedures and the law, considering all the facts, and doing an analysis that is on point and relevant.

To give you a feel for what to look for in determining if Tax Court litigation is justified, what follows are recent and noteworthy examples of cases that played out in the taxpayer's favor.

Leago v. Commissioner

Mark Leago submitted an OIC under special circumstances, arguing that the IRS should settle for less than his future collection potential. Mr. Leago needed brain surgery, had no assets, and argued that his medical

expenses and health impacted his future ability to earn were special circumstances. The IRS settlement officer did not consider the impact of the brain surgery on future collection potential, choosing to focus on the here and now, and not allowing expenses that Mr. Leago had not yet paid.

The Court also noted that the IRS erred as the Notice of Determination did not reflect any consideration of the applicable IRM provisions on special circumstances. The administrative record contained no evidence that the settlement officer considered how the taxpayer's age, health, medical condition—the special circumstances—affected Mr. Leago's future ability to pay. (*Leago v. Commissioner*, T.C Memo 2012-39).

Salahuddin v. Commissioner

Salahuddin v. Commissioner, T.C. Memo 2012-141, demonstrates how poor communication by IRS Appeals and errors in a Notice of Determination can impact the IRS in CDP litigation.

In advance of the scheduling of their CDP hearing, Bilal and Monique Salahuddin provided a Form 433A (Collection Information Statement for Wage Earners and Self-Employed Individuals) financial statement to the IRS's Automated Collection Service, indicating an ability to pay over $5,000/month. When their appeal was scheduled for hearing, the settlement officer requested supporting documentation for the 433A, including proof of income and living expenses.

The Salahuddins requested additional time to provide the documentation and were allowed an additional two weeks. (A denial of this one-time request for more time, after a 433A was already provided, likely would have been an abuse of discretion.) During that time period, the Salahuddins contacted the settlement officer's manager who told them that the information in the file was satisfactory, no additional documentation was required, and that appeals would grant an installment agreement of $900 to $1,000/month.

The conversation with the team manger was confirmed by a follow-up letter the Salahuddins sent to the settlement officer. The settlement officer ignored the letter and closed out the case file with a Notice of Determination stating: (1) the requested financial information was never provided, and (2) the Salahuddins did not participate in the CDP hearing.

The Court found that the IRS was not entitled to judgment without trial based on the failure to provide documents because the team manager told the Salahuddins that the information they had provided was "sufficient," and that an installment agreement would be granted. Additionally, the Notice of Determination contained factual errors, including the setting of a hearing date that apparently was confused with another taxpayer's case.

Clearly, the IRS wanted $5,000/month, not $1,000, from the Salahuddins, but the settlement officer had made procedural errors in conducting the CDP hearing that upheld the taxpayers' arguments that there was an abuse of discretion.

Blair v. Commissioner

The IRS made a calculation error in Kenneth Blair's OIC that was significant enough for an abuse of discretion finding.

Mr. Blair submitted a $24,000 offer in compromise. The IRS analyzed income and expenses and arrived at an offer value of $58,988, more than twice that offered. Mr. Blair argued that the IRS abused its discretion in using a multiplier of 109 to determine the future value of his cash flow instead of the forty-eight-month timeframe prescribed in the former IRM Sec. 5.8.5.5. As the IRS analysis was incorrect and failed to follow guidelines, Judge Wells found that the IRS abused its discretion. (*Blair v. Commissioner,* T.C. Memo 2009-232).

Industrial Investors v. Commissioner

An IRS RO was called to task for advocating his position to an IRS settlement officer in *Industrial Investors v. Commissioner*, T.C. Memo 2007-93. IRS settlement officers are required to make independent decisions, and *ex parte* communications are not permitted.

The RO sent a letter to the IRS settlement officer telling him the terms under which an OIC would be accepted, that he should not give Individual Investors a CDP hearing on a tax lien, and that the IRS should not delay collection and force any assets with equity to be used to pay the liability.

The settlement officer apparently followed the RO's direction. The settlement officer worked the case quickly, giving Industrial twelve business days to provide five years of tax returns, financial statements, and supporting documents. A request for more time was denied, and the settlement officer sent a letter to Industrial setting a hearing date.

The hearing date was at a time that posed a conflict for Industrial's counsel. The settlement officer was notified but conducted the hearing anyway, calling counsel at 8:00 a.m. and leaving a voice message, knowing he was unavailable. The IRS administrative file reflected that a draft of the Notice of Determination was made a week before the hearing, and it was sent out a few days after the ersatz hearing.

There is so much wrong here it is hard to know where to start, but the ex parte communication should serve as a good lead-off hitter. As background, actual influence is not required in ex parte communications, just a

reasonable possibility that the communication may have compromised the appeals settlement process. The court held that the settlement process was compromised and remanded the case to the IRS for a fresh hearing with a different settlement officer.

The handling of the day and time of the hearing was also found to be an abuse of discretion. Judge Holmes believed that the timeframe allowed to provide the amount of documentation requested did not appear to be enough time to comply, and conducting a hearing when counsel was known to be unavailable was, to quote, "inexplicable."

A take-away lesson from *Industrial* is to always get and review a copy of the IRS settlement officer's administrative file. For other ex parte rulings that favored taxpayers in CDP cases, see *Drake v. Commissioner*, 125 T.C. 201 (2005) and *Moore v. Commissioner*, T.C. Memo 2006-171.

What Happens If the Tax Court Says the IRS Was Wrong?

A taxpayer who is on the winning side of a Tax Court CDP decision may understand how Geraldo Rivera felt when he opened Al Capone's vault.

In most cases, the Tax Court's decision is accompanied by a remand of the case to the IRS settlement officer to reconsider and correct his or her errors. Remember, the Tax Court tends to stay out of making a final determination of how much the IRS should collect. The Tax Court protects taxpayers' rights against abuse—an item of true significance and value—and instructs the IRS to start again and get it right.

The new remanded hearing is considered to be a continuation of the initial hearing. After the remanded hearing is concluded, the settlement officer will issue a Supplemental Notice of Determination with new findings. A new Tax Court petition is not filed in response; the supplemental notice is a continuation of the original Notice of Determination. The Tax Court retains jurisdiction over the supplemental notice, and if the case cannot be administratively resolved on remand, the supplemental notice is reviewed by the Tax Court for abuse of discretion. (Mark Leago knows this. His reported Tax Court case was from a supplemental notice.)

The IRS can be sensitive to cases that may be factually troubling or may cause an adverse decision. In these cases, it is not surprising for IRS counsel to file a motion to remand the case to its settlement officer before the case is tried and decided by the Tax Court. The Motion for Remand can also be made by a taxpayer, and best practice is to have the IRS consent to the motion. Remands before a Tax Court conducts a trial are a practical solution to protracted litigation.

Chief Counsel Notice 2009-10 provides clear direction to IRS counsel to seek remand on CDP cases.

> "If counsel determines that the appeals officer's exercise of discretion in conducting the hearing or making a determination on a nonliability issue cannot be defended, and reconsideration of the case by appeals is required because the error is not harmless, counsel should file a Motion for Remand to require Appeals to hold a supplemental hearing and issue a Supplemental Notice of Determination (Letter 3978)."

Not every case results in a remand to appeals, and there are exceptions. For example, in *Marlow v. Commissioner*, T.C. Memo 2010-113, James and Kathy Marlows' 2004 and 2005 tax returns were audited, and a report of the proposed changes was sent to the Marlows upon conclusion of the audit.

The auditor closed the case file out consistent with the Marlows signing and returning the proposed changes and closing the audit as agreed. No notice of deficiency was sent, the tax was assessed, and collection ensued. A Final Notice of Intent to Levy was issued, and the Marlows filed a CDP appeal, alleging that they never signed off on the audit, and the tax was erroneously assessed without a notice of deficiency.

The Marlows had lost their records in a fire and requested that the IRS settlement officer produce the signed audit agreement and proof that a Notice of Deficiency was sent. The settlement officer only was able to verify that the IRS made an assessment and produced a transcript to that extent. The IRS never found the administrative files from the audit.

The Tax Court ruled that the IRS had to go past the account transcripts under the circumstances to verify that there was a proper assessment. The IRS abused its discretion as it could not verify the assessment which formed the basis of the Final Notice of Intent to Levy. As the IRS had no record to prove the assessment was valid, the Tax Court did not have a reason for a settlement officer to conduct further deliberations and simply ruled in the Marlows' favor. **EA**

About the Author:

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