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EVALUATING AND IMPROVING THE TAXPAYER RIGHTS  
PROVISIONS OF THE IRS RESTRUCTURING AND REFORM ACT  
OF 1998

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EVALUATING AND IMPROVING THE TAXPAYER RIGHTS  
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The National Commission on Restructuring the Internal Revenue Service (Restructuring Commission) was not primarily intended to focus on taxpayer rights. There was a simple reason for this. In the preceding decade, Congress had passed two substantial bills, the Taxpayer Bill of Rights in 1989 (TBOR I),<sup>1</sup> and the Taxpayer Bill of Rights II in 1995 (TBOR II),<sup>2</sup> and in 1997, additional procedural changes to the Internal Revenue Code, many of which could be characterized as taxpayer rights provisions, were already pending in tax legislation even as the Restructuring Commission completed its work.<sup>3</sup> Therefore, the Restructuring Commission concentrated its efforts on structural reforms of the IRS—the general reorganization into four customer-based divisions, personnel improvements, changes in the IRS leadership rules, etc.<sup>4</sup> Taxpayer rights provisions were relegated to an appendix, without even the same strong recommendations as the structural changes.<sup>5</sup>

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<sup>1</sup> Technical and Miscellaneous Revenue Act, Pub. L. No. 100-67, Title VI, § 6235, 100 Stat. 3342, 3737 (1988).

<sup>2</sup> Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 401, 110 Stat. 1452 (1996).

<sup>3</sup> Taxpayer Bill of Rights 3, Pub. L. No. 104-168, § 401, 110 Stat. 1452 (1996) (amended 1997).

<sup>4</sup> NAT'L COMM'N ON RESTRUCTURING THE INTERNAL REVENUE SERV., A NEW VISION FOR A NEW IRS *passim* (1997) [hereinafter NAT'L COMM'N ON RESTRUCTURING].

<sup>5</sup> *Id.*

The House version of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 98)<sup>6</sup> included a series of taxpayer rights provisions, which largely consisted of “consensus” items, such as provisions carefully drafted to correct or improve previous enactments, follow-up ideas that had been studied pursuant to TBOR I and TBOR II, and also some of the Restructuring Commission’s ideas.<sup>7</sup> But, after hearings on the bill and on perceived abuses by the IRS, a number of additional taxpayer rights provisions were introduced.<sup>8</sup> To tax procedure experts, some of the newly proposed changes (such as the Collection Due Process provisions,<sup>9</sup> which created an entirely new avenue for judicial review of tax disputes) could be considered truly revolutionary. Good ideas often lay at the core of many of these new proposals, but Treasury and the IRS raised both policy concerns and technical objections to them. Some provisions were not completely thought through and were still being hurriedly drafted as late as (literally) the evening before the House voted on the Conference Report.<sup>10</sup>

Many taxpayer rights provisions from RRA 98 have been tremendous successes; others, unfortunately, have not lived up to their promise, often for various technical reasons; still others have been a “mixed bag.” This Article will examine a number of these provisions, how they came about and were revised during the legislative process, and how they have been implemented over the past twenty-five years. One of the authors has the perspective of being both one of the principal negotiators of these provisions for the Treasury Department in 1998 and subsequently a practitioner representing numerous individual and business taxpayers dealing with the new rules. After reviewing and evaluating the efficacy of the reviewed provisions, the Article will conclude with observations regarding reform or improvement of these provisions.

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<sup>6</sup> Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685.

<sup>7</sup> H.R. 2292, 105th Cong. 1st Sess. (1997), Title III.

<sup>8</sup> H.R. 2676, 105th Cong. 1st Sess. (1997), Title III.

<sup>9</sup> § 3401, 112 Stat. at 750 (enacting I.R.C. §§ 6320, 6330, providing notice and opportunity for hearing upon notice of lien and before levy).

<sup>10</sup> *See, e.g.*, § 3411, 112 Stat. at 750 (enacting I.R.C. § 7525, including a carve out for tax shelters in I.R.C. § 7525(b)).

## I. SUCCESS STORIES

### A. “Innocent Spouse” and “Separation of Liability” Relief Under Section 6015

Section 6013 had long provided that spouses who file a joint return are jointly and severally liable for the resulting tax.<sup>11</sup> This often led to disputes regarding collection of the joint liability from the assets of one spouse or the other, especially in situations involving separation or divorce, or where one spouse had substantial non-jointly-held assets.<sup>12</sup> Before RRA 98, relief from joint and several liability in such situations was statutorily available but somewhat limited in scope. An “innocent spouse” had to establish that she did not know, and had no reason to know, that there was an understatement of tax on her joint return and that it would be inequitable to hold her liable for the deficiency.<sup>13</sup> But, in addition, the amount at stake (that is, the understatement) had to exceed a certain portion of the innocent spouse’s adjusted gross income in the pre-adjustment year in order to obtain relief.<sup>14</sup> Moreover, the understatement had to be “substantial” and attributable to a “grossly erroneous” item of the other spouse.<sup>15</sup> If the Secretary denied innocent spouse relief, then the Tax Court could review the joint status of the liability only if a notice of deficiency had been issued.<sup>16</sup>

The limited availability of innocent spouse relief especially affected vulnerable demographics. In practice, numerous divorced single mothers

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<sup>11</sup> Joint and several liability arising from a joint tax return was first codified by the Revenue Act of 1938 and is currently set forth in I.R.C. § 6013(d)(3): “if a joint return is made . . . the liability with respect to the tax shall be joint and several.”

<sup>12</sup> Taxpayer Bill of Rights 2, Pub. L. No. 104-168, § 401, 110 Stat. 1452, 1459 (1996) (TBOR II) (requiring a study of joint liability including issues related to divorce, innocent spouse status, and community income or property); U.S. DEP’T OF THE TREAS., REPORT TO THE CONGRESS ON JOINT LIABILITY AND INNOCENT SPOUSE ISSUES (1998) [hereinafter INNOCENT SPOUSE ISSUES].

<sup>13</sup> I.R.C. § 6013(e)(1) (1996).

<sup>14</sup> I.R.C. § 6013(e)(4) (1996).

<sup>15</sup> I.R.C. § 6013(e)(2), (3) (1996); e.g., *Douglas v. Comm’r*, 86 T.C. 758, 762 (1986) (“Grossly erroneous items include any item of income that is omitted from gross income, regardless of the basis for omission. A claim for deduction or credit will be treated as a grossly erroneous item only if the claim had no basis in law or fact.”).

<sup>16</sup> I.R.C. § 6213(a) (1996).

were paying their ex-husband's tax liability single-handedly.<sup>17</sup> One member of Congress later went as far as to conclude that the IRS was taking advantage of joint liability to make women the target of collection activity.<sup>18</sup>

Potential improvements to the “innocent spouse” rules were therefore considered in connection with the passage of TBOR II in 1996.<sup>19</sup> In particular, the idea of automatically separating the joint tax liability of divorcing parties, as sometimes occurs with respect to other joint liabilities during state divorce proceedings, was discussed.<sup>20</sup> At the time, courts could not determine or enforce settlements that altered the liability of either former spouse for a tax deficiency.<sup>21</sup> Due to concerns about integrating such a provision into the tax law, however, Congress in TBOR II directed Treasury and the IRS to perform a study of the issue, which was submitted to Congress in 1998 and followed by a hearing.<sup>22</sup> The Treasury Report similarly expressed concerns about the complexity and administrability of separating

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<sup>17</sup> 144 CONG. REC. 1418 (1998); INNOCENT SPOUSE ISSUES, *supra* note 12.

<sup>18</sup> 144 CONG. REC. 1418 (1998) (statement of Sen. Jon Kyl: “singling out women for abusive collection is just plain wrong.”).

<sup>19</sup> TBOR II, § 401, 110 Stat. 1452, 1459 (1996) (requiring a study of joint liability including issues related to divorce, innocent spouse status, and community income or property); H. REP. NO. 104-506 (1996) at 30 (“joint and several liability should be reexamined”).

<sup>20</sup> *See, e.g.*, 144 CONG. REC. 1418 (1998) (statement of Sen. Jon Kyl: “One solution might be simply to repeal the joint liability rules. Maybe liability ought to be proportionate to each spouse’s earnings during the marriage. I understand the Committee is looking at a range of options.”); *see, e.g.*, Richard C.E. Beck, *The Innocent Spouse Problem: Joint and Several Liability for Income Taxes Should Be Repealed*, 43 VAND. L. REV. 317, 328 (1990) (raising concerns such as that “the deficiency assessment based upon joint return liability may arrive after the couple already has settled their division of property”).

<sup>21</sup> *See, e.g.*, *Pesch v. Comm’r*, 78 T.C. 100, 130 (1982) (observing that joint liability “was enacted by Congress precisely in order to avoid the problem of allocating deficiencies between the incomes of the spouse”).

<sup>22</sup> INNOCENT SPOUSE ISSUES, *supra* note 12; *Treasury Department Report on Innocent Spouse Relief: Hearing Before the Subcomm. on Oversight of the H. Comm. on Ways & Means*, 105th Cong. (1998) [hereinafter *Innocent Spouse Relief: Hearing*]. To put the report together the IRS sought public comment “on the effects of basing the respective spouses’ tax obligations and liabilities on the terms of a divorce decree, separation agreement or other property settlement.” I.R.S. Notice 96-19, 1996-1 C.B. 371, Part B. *See, e.g.*, ABA Section Tax’n Domestic Rel. Comm., *Comments on Liability of Divorced Spouses for Tax Deficiencies on Previously Filed Joint Returns*, 50 TAX LAW. 395, 398 (1997). Also at the request of Congress, the U.S. General Accounting Office submitted a report analyzing empirical data bearing on these issues. U.S. GOV’T ACCOUNTABILITY OFF., GAO-97-34, TAX POLICY: INFORMATION ON THE JOINT AND SEVERAL LIABILITY STANDARD, at 5–6 (1997).

liabilities and did not support the idea, even for divorced spouses.<sup>23</sup> Instead, Treasury cautiously recommended a series of further incremental changes to ease some of the technical restrictions of the innocent spouse rules.<sup>24</sup>

Reform of the innocent spouse rules in RRA 98 then followed the pattern mentioned above. The House bill substantially adopted the incremental changes suggested by Treasury.<sup>25</sup> The Senate bill, by contrast, wholeheartedly adopted the notion of separating liabilities, upon the election as of right by the potential innocent spouse in situations of divorce or separation.<sup>26</sup> Faced with two starkly different competing provisions and Treasury opposition to the Senate separation-of-liability version, the conferees left the matter open until simpler differences were resolved and then, in effect, combined the two regimes and adopted a new provision, easing the innocent spouse rules but also creating a new separation of liability regime with the goal of making relief easier to obtain.<sup>27</sup>

First, Congress removed several barriers to traditional innocent spouse relief. The adjusted gross income threshold, which was arbitrary and in no way tied to the merits of the claim, was repealed.<sup>28</sup> It had in effect precluded relief for spouses that were wholly innocent; simply if the amount at stake were low enough relative to the spouse's income, the spouse was jointly liable regardless of the equities. In addition, Congress removed the requirement that the understatement be "substantial," which had again been defined as in excess of \$500.<sup>29</sup> This deletion was in keeping with the intent of removing an unnecessary, arbitrary barrier that necessarily had a

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<sup>23</sup> INNOCENT SPOUSE ISSUES, *supra* note 12, at 10; *Innocent Spouse Relief: Hearing*, *supra* note 22, at 43.

<sup>24</sup> *Innocent Spouse Relief: Hearing*, *supra* note 22, at 53, 56.

<sup>25</sup> H.R. REP. NO. 105-599, at 249–50 (1998) (Conf. Rep.).

<sup>26</sup> S. REP. NO. 105-174, at 55–60 (1998).

<sup>27</sup> H.R. REP. NO. 105-599, at 249–55 (1998); I.R.C. § 6015.

<sup>28</sup> § 3201(e)(1), 112 Stat. at 750 (repealing § 6013(e)).

<sup>29</sup> *Id.* (repealing § 6013(e), including the "substantial" understatement requirement in § 6013(e)(3) (1996)).

disproportionate impact on low-income taxpayers, an issue to which Congress was particularly sensitive.<sup>30</sup>

Similarly, the requirement that an understatement be “grossly erroneous” was also removed.<sup>31</sup> But this change had more interesting legal implications, as well as simply enabling more innocent spouse claims. “Grossly erroneous items” were previously defined as omissions or claimed items such as deductions or credits that had “no basis in fact or law.”<sup>32</sup> The Tax Court had interpreted this requirement to mean that relief was available only to those whose spouses had taken positions that were “frivolous or fraudulent positions,” quoting “phony business deductions.”<sup>33</sup> In addition to dramatically reducing the availability of relief, this requirement had also put the “innocent” spouse in the position of having to argue that her own joint tax return was frivolous or fraudulent, with no guarantee of protection.<sup>34</sup>

Second, to address the widespread protest that divorced spouses remained jointly and severally liable, Congress enacted a separation of liability procedure. It created an election whereby liability would be apportioned as if the joint-return filers had filed separate tax returns.<sup>35</sup> To qualify to make the election, a requesting spouse must be divorced, separated, or not a member of the other spouse’s household within the twelve months

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<sup>30</sup> *Innocent Spouse Relief: Hearing*, *supra* note 22, at 50 (“Finally, the dollar thresholds prevent taxpayers with smaller liabilities from obtaining relief since the minimum understatement in all cases must be more than \$500.”); H. REP. NO. 105-364, at 61 (1997) (“it is inappropriate to limit innocent spouse relief only to the most egregious cases where the understatement is large and the tax position taken is grossly erroneous”).

<sup>31</sup> § 3201(e)(1), 112 Stat. at 750 (repealing § 6013(e) including the “grossly erroneous” understatement requirement in § 6013(e)(2) (1996)).

<sup>32</sup> § 6013(e)(2) (1996).

<sup>33</sup> *See, e.g., Douglas v. Comm’r*, 86 T.C. 758, 762–63 (1986) (interpreting legislative history in denying innocent spouse relief because the taxpayer had failed to prove that the disallowed item had “no basis in fact or law”); H.R. SUP. REP. NO. 98-432, pt. 2, at 1502 (1984) (providing an example of “phony business deductions”).

<sup>34</sup> *See INNOCENT SPOUSE ISSUES*, *supra* note 12, at 15.

<sup>35</sup> § 3201(a), 112 Stat. at 734, now codified at I.R.C. §§ 6015(c)–6015(d); H.R. REP. NO. 105-599, at 53–58 (1998) (Conf. Rep.).

preceding the request.<sup>36</sup> The election must be filed within two years of the first collection activity against the filer.<sup>37</sup> These minimal, bright-line, requirements allow for apportionment of liability regardless of whether a joint filer is otherwise an “innocent spouse.” Congress anticipated that this would deliver relief to hundreds of thousands of taxpayers, as well over a million couples divorced annually in the years leading up to RRA 98, nearly 10% of whom had unpaid tax liabilities.<sup>38</sup>

Congress was concerned, however, that separation of liability provided an opportunity for joint-return filers to collude against the IRS by transferring assets to the spouse who would have the lesser liability or by knowingly signing false returns.<sup>39</sup> Therefore, the statute provides that if the IRS determines assets were transferred between joint-return filers “as part of a fraudulent scheme,” then there is no relief from joint and several liability.<sup>40</sup> In the same vein, a taxpayer may not eschew joint and several liability where she had actual knowledge of an item that gave rise to the deficiency at the time she signed the joint return.<sup>41</sup> While this knowledge requirement may sound similar, it is unlike the “innocent spouse” knowledge provision, because it requires “actual knowledge” not “knowledge or reason to know,” and because the IRS bears the burden of proof that the spouse had actual knowledge of the item.<sup>42</sup>

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<sup>36</sup> I.R.C. § 6015(c)(3)(A)(i); *see also* Treas. Reg. § 1.6015-3(b) (providing that determinations will be made as of the date the election is filed and defining “members of the same household” to presumptively include spouses who reside together).

<sup>37</sup> I.R.C. § 6015(c)(3)(B).

<sup>38</sup> U.S. GOV’T ACCOUNTABILITY OFF., *supra* note 22, at 16 (1997).

<sup>39</sup> S. REP. NO. 105-174, at 55–56 (1998) (“The Committee is concerned that taxpayers not be allowed to abuse these rules by knowingly signing false returns, or by transferring assets for the purpose of avoiding the payment of tax by the use of this election.”); H.R. REP. NO. 105-599, at 253 (1998) (Conf. Rep.) (describing “special rules . . . to prevent the inappropriate use of the election”).

<sup>40</sup> I.R.C. § 6015(c)(3)(A)(ii); Treas. Reg. § 1.6015-1(d).

<sup>41</sup> I.R.C. § 6015(c)(3)(C); Treas. Reg. § 1.6015-3(c)(2) (clarifying that such knowledge relates to an “erroneous item” or portion thereof, and that knowledge of the fact (not the tax consequence) of the item is sufficient to preclude relief).

<sup>42</sup> The subsequently promulgated Treasury Regulations provide separate definitions of the knowledge requirement for each. Treas. Reg. § 1.6015-2(c) (2002) (defining “knowledge or reason to know” for innocent spouse relief), Treas. Reg. § 1.6015-3(c)(2) (2002) (defining “actual knowledge” for election to allocate liability). *See also* King v. Comm’r, 116 T.C. 198, 204 (2001) (holding that “the burden



Moreover, in keeping with Congress's concern that women who were mistreated by their spouses not then be mistreated by the IRS, the statute disregards actual knowledge if the joint return was signed under duress.<sup>43</sup> The subsequent Treasury Regulations heeded the spirit of this exception, broadening it to allow separation of liability where the requesting individual established that she was a domestic abuse victim and therefore afraid to challenge her abuser's tax reporting, regardless of actual knowledge or specific duress.<sup>44</sup> Together with the expansion of traditional "innocent spouse" relief, the addition of the election to sever joint liability resulted in an unprecedented roll-back of joint and several liability for tax deficiencies.

Even the provision's effective date itself demonstrated the empathy of Congress's response to the inadequacy of the prior provision. The new "relief from joint and several liability" regime applied not only to any liability arising after July 22, 1998 but also to any liability that was *unpaid* as of that date.<sup>45</sup> That sort of retroactivity is unusual and was a critical component of this bill's aim to provide immediate administrative relief.<sup>46</sup>

The resulting provision has provided robust relief that focuses on the knowledge of innocent spouses, lowers the bar further for divorced spouses, and provides a "savings clause," allowing for equitable relief at the Secretary's discretion.<sup>47</sup> In January of 2001, the IRS instituted the Cincinnati Centralized Innocent Spouse Operations (CCISO) division to make all relief

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of proving the spouse's actual knowledge of the item in order to deny relief is on the Commissioner [to show] actual knowledge of the factual circumstances which made the item unallowable. . . .").

<sup>43</sup> I.R.C. § 6015(c)(3)(C).

<sup>44</sup> Treas. Reg. § 1.6015-3(c)(2)(v) (2002). I.R.S., Form 8857, Request for Innocent Spouse Relief (2021), even has a section (Part V) asking whether the requester has been "a victim of domestic violence or abuse."

<sup>45</sup> § 3201(g), 112 Stat. at 740.

<sup>46</sup> *Id.* Moreover, while it implemented a two-year deadline to make a claim, the clock only started running after the legislation was in effect, to avoid a catch-22 of claims that were newly viable yet late. § 3201(g)(2), 112 Stat. at 740. Still, the National Taxpayer Advocate (NTA) reported to Congress that the two-year deadline was another arbitrary bar and not in keeping with the intent of the changes, and the IRS has since eliminated it administratively (following conflicting rulings in various federal courts as to the deadline's scope). NAT'L TAXPAYER ADVOC., UNLIMIT INNOCENT SPOUSE EQUITABLE RELIEF (2010); Rev. Proc. 2013-34, 2013-43 I.R.B. 397.

<sup>47</sup> I.R.C. § 6015(b)–(c), (f).

determinations under § 6015.<sup>48</sup> However, the Tax Court recently held that once a case is in litigation, the IRS Office of Chief Counsel has settlement authority and need not defer to the CCISO’s recommendation.<sup>49</sup>

RRA 98 also expanded the jurisdiction of the Tax Court, providing those seeking innocent spouse relief with a basis for jurisdiction independent of any statutory notice of deficiency, thus extending it to refund claims in limited circumstances.<sup>50</sup> While RRA 98 provided for *de novo* judicial review,<sup>51</sup> the recent Taxpayer First Act of 2019 has limited it to a review of the administrative record.<sup>52</sup> That means taxpayers now have to build a robust administrative file because they can only introduce additional evidence that is newly discovered or previously unavailable. This limitation does not seem in keeping with RRA 98’s sensitivity to the possible lack of factual knowledge and abuse or duress that “innocent spouses” might face.

Overall, relief from joint liabilities has grown dramatically; tens of thousands of taxpayers apply every year.<sup>53</sup> Admittedly, the costs of administering innocent spouse relief have been substantial—in addition to processing initial claims and appeals, innocent spouse relief has been reported as one of the top ten most-litigated issues in the National Taxpayer Advocate’s (NTA) annual reports.<sup>54</sup> However, concerns about abuse of the provision<sup>55</sup> appear to have been unfounded. Rather, as anticipated, it has in

<sup>48</sup> See Innocent Spouse Relief Processing Procedures, I.R.M. 25.15.18 (Jan. 15, 2020), Innocent Spouse Shared Relief Processing Responsibilities, I.R.M. 25.15.7.1 (Sept. 1, 2006); Stephanie H. McMahon, *An Empirical Study of Innocent Spouse Relief: Do Courts Implement Congress’s Legislative Intent?*, 12 FLA. TAX REV. 629 (2012).

<sup>49</sup> *DelPonte v. Comm’r*, 158 T.C. No. 7 (2022).

<sup>50</sup> I.R.C. § 6015(e)(1)(a); see, e.g., *Deihl v. Comm’r*, 103 T.C.M. (CCH) 1935 (2012) (denying refund claim pursuant to § 6015(g)(3) because relief for that year was granted under § 6015(c)).

<sup>51</sup> I.R.C. § 6015(e)(7).

<sup>52</sup> Pub. L. No. 116-25 § 1203, 133 Stat. 981, 988.

<sup>53</sup> According to the National Taxpayer Advocate (NTA), the IRS received over 42,000 requests in 2013 and over 47,000 requests in 2015. NAT’L TAXPAYER ADVOCATE, FISCAL YEAR 2017 OBJECTIVE REPORT TO CONGRESS (2017), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/Area\\_of\\_Focus\\_13.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2020/08/Area_of_Focus_13.pdf).

<sup>54</sup> See McMahon, *supra* note 48, at 647.

<sup>55</sup> S. REP. NO. 105-174, at 55 (1998).

practice predominately protected women, especially favoring widows and divorced mothers as its precursor did.<sup>56</sup>

The revision of the innocent spouse rules must be rated a significant success of RRA 98. Despite initial concerns about the administrability of the new rules, some subsequent revisions, court interpretations, and administrative actions within the IRS have resulted in broader and more consistent relief from joint return liability in appropriate circumstances. This is particularly true for low-income taxpayers, due in part to another RRA provision—low-income taxpayer clinics, which routinely assist with innocent spouse relief requests, appeals, and litigation.

### *B. Low-Income Taxpayer Clinics Under Section 7526*

The low-income taxpayer clinic (LITC) has become such a standard feature of law schools and legal aid organizations that it may surprise readers that there were very few prior to RRA 98.<sup>57</sup> Previously, most legal aid clinics did not handle tax matters, and not-for-profit tax assistance consisted of tax return preparation clinics, such as Volunteer Income Tax Assistance. RRA 98's enactment of a grant program for LITCs was a significant step in the expansion of services to low-income taxpayers.<sup>58</sup>

Congress earmarked up to \$6 million (initially) in total annual grants to fund clinics, but beyond that, it identified this RRA provision as having no “revenue effect.”<sup>59</sup> Of course, more effective delivery of services to low-income taxpayers does not change the amount of tax properly due, but it has certainly had a substantial practical impact on getting such taxpayers into compliance, and consequently with deficiency and refund outcomes as well as collections. For example, the IRS acknowledges that in 2020 LITCs obtained “more than \$5.8 million in tax refunds and reduced or corrected

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<sup>56</sup> See McMahon, *supra* note 48, at 663–64, 667–68; *cf.* Hall v. Comm’r, 108 T.C.M. (CCH) 199 (2014) (husband denied relief on very unsympathetic facts, including that he and his wife had served prison time for a prior tax crime).

<sup>57</sup> In 1990, there were seventeen Volunteer Income Tax Administration Clinics assisting low-income taxpayers. I.R.S. Pub. No. 5066, LITCs 2021 Program Report 9 (Rev. Nov. 2011).

<sup>58</sup> § 3601, 112 Stat. at 774–76.

<sup>59</sup> H.R. REP. NO. 105-599, at 374 (1998) (Conf. Rep.).

taxpayers' liabilities by over \$116 million.”<sup>60</sup> At the same time, LITCs “brought more than 2,900 taxpayers back into payment compliance.”<sup>61</sup> Congress had hoped that LITCs would improve compliance, and they have.<sup>62</sup>

The success of this effort can be seen by the nationwide spread of LITCs.<sup>63</sup> In just over twenty years, most states now have at least one clinic, often associated with a law school, and the IRS has encouraged applications from new clinics in underserved areas, including Arizona, Florida, Idaho, North Carolina, Montana, Nevada, North Dakota, Pennsylvania, and Puerto Rico.<sup>64</sup> Now, there are about 133 clinics that in 2022 received a total of almost \$13 million in federal grants and served about 38,000 taxpayers.<sup>65</sup> The only thing limiting the program's further growth and success is that the maximum grant per clinic remains at \$100,000, the statutory amount set by RRA 98, which is the equivalent of roughly \$55,000 of today's dollars.<sup>66</sup> Clearly, though, that relatively small appropriation has been enough to jumpstart many clinics that receive funding from myriad other sources. Congress anticipated this and required that all grant recipients have matching funding.<sup>67</sup> The funding issue is severe enough, however, to warrant a “2022 Purple Book” proposal from the NTA.<sup>68</sup>

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<sup>60</sup> I.R.S., *Low Income Taxpayer Clinics Represented Nearly 20,000 Taxpayers Dealing With an IRS Tax Controversy*, <https://www.irs.gov/newsroom/low-income-taxpayer-clinics-represented-nearly-20000-taxpayers-dealing-with-an-irs-tax-controversy> (last visited Feb. 9, 2022).

<sup>61</sup> *Id.*

<sup>62</sup> S. REP. NO. 105-174, at 99 (“The Committee believes that the provision of tax services . . . to low-income individuals and those for whom English is a second language will improve compliance. . . .”); H.R. REP. NO. 105-364, at 75 (1997).

<sup>63</sup> See I.R.S. Pub. No. 3319, LITCS 2023 GRANT APPLICATION PACKAGE AND GUIDELINES 2 fig.1 (Rev. Apr. 2022).

<sup>64</sup> *Id.*

<sup>65</sup> *Id.* at 3.

<sup>66</sup> U.S. Bureau of Labor Statistics, *CPI Inflation Calculator* (bls.gov) (last visited Dec. 26, 2022) (comparing \$100,000 in January of 1999 to a value of \$55,000 in November of 2022 using the Consumer Price Index for All Urban Consumers (CPI-U)).

<sup>67</sup> I.R.C. § 7526(c)(5).

<sup>68</sup> NAT'L TAXPAYER ADVOC., 2022 PURPLE BOOK 136 (Dec. 31, 2021), [https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2022/01/ARC21\\_PurpleBook.pdf](https://www.taxpayeradvocate.irs.gov/wp-content/uploads/2022/01/ARC21_PurpleBook.pdf).

Although grant amounts have not increased, Congress was prescient enough to index for inflation the income ceiling for taxpayers to qualify to receive services from a funded clinic. Taxpayers qualify for assistance if their income does not exceed 250% of the Federal Poverty Guidelines, which currently means that a family of four with income of \$69,000 or less would qualify for assistance.<sup>69</sup>

LITCs have been in the right place at the right time repeatedly. For example, during the COVID-19 pandemic, they assisted taxpayers with novel questions, such as resolving tax issues arising from the Economic Impact Payment Program.<sup>70</sup> They have served communities during demographic shifts, and assisted a wide array of taxpayers for whom English is a second language (although the income limit applies regardless of a taxpayer's first language).<sup>71</sup> Over the years, they have alleviated the burden on low-income taxpayers from changing tax laws and tax forms, and providing educational programs attended by over 133,000 taxpayers.<sup>72</sup>

LITCs have also played a vital role in advocacy. In 2003, the NTA took over the administration of the grant program, and its mission to assist and advocate for taxpayers amplifies the work of LITCs. With no sign of income tax simplification in sight, LITCs provide crucial support for our voluntary compliance regime. The provision of funding for LITCs has thus proven to be a signal success of RRA 98.

### *C. Electronic Filing*

While not strictly speaking a taxpayer rights provision, perhaps the biggest success of RRA 98 is the mandated increase in electronic filing of returns, which has played a critical role in supporting voluntary compliance. Taxpayers were beginning to file electronically when RRA 98 was passed: in 1997, twenty million of the 120 million total individual returns were

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<sup>69</sup> See Nat'l Taxpayer Advoc., *Low Income Tax Payer Clinics (LITC)*, <https://www.taxpayeradvocate.irs.gov/about-us/low-income-taxpayer-clinics-litc/> (last visited May 17, 2022) (providing a table of qualifying income levels).

<sup>70</sup> I.R.S. Pub. No. 5066, *LOW INCOME TAX CLINICS 2021 PROGRAM REPORT 3* (Rev. Nov. 2021).

<sup>71</sup> *Id.*

<sup>72</sup> *Id.* at 4.

electronically filed,<sup>73</sup> although those returns still required certain forms to be filed on paper.<sup>74</sup> In 2021, in contrast, the IRS received only seventeen million individual returns on paper, with the rest filed electronically.<sup>75</sup> But despite this progress, as of May 2022, the IRS had a backlog of 21.3 million unprocessed paper tax returns and refunds are delayed as a result.<sup>76</sup> This underscores both the success and the continued importance of expanding the electronic filing program.

Congress promoted electronic filing because they determined it to be more efficient and accurate, as e-filed returns are often prepared using software programs that have built-in checks.<sup>77</sup> Furthermore, under the old system, returns and other information received on paper (or magnetic media, such as computer tapes) were manually converted by IRS data-entry personnel to an electronic format before return matching, and this step can be eliminated for electronic forms.<sup>78</sup> Consequently, electronic filing is considerably more accurate than paper filing: even in 1997, it had an error rate of less than 1%, as opposed to approximately 20% for paper returns.<sup>79</sup> Half of this 20% error rate was due to taxpayer error, and half was due to IRS error,<sup>80</sup> so enhanced e-filing would likely reduce errors in both reporting and processing. Lastly, Congress believed it benefitted taxpayers to get a notice that their e-filed return was received.<sup>81</sup> Such confirmation would certainly be

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<sup>73</sup> H.R. REP. NO. 105-599, at 234 (1998) (Conf. Rep.) (“During the 1997 tax filing season, the IRS received approximately 20 million individual income tax returns electronically.”); *see* RECOMMENDATIONS OF THE NATIONAL COMM’N ON RESTRUCTURING THE IRS TO EXPAND ELECTRONIC FILING OF TAX RETURN: HEARING BEFORE THE SUBCOMM. ON OVERSIGHT OF THE COMM. ON WAYS AND MEANS, 105th Cong. Sess. 1, vol. 4, p. 5 (1997).

<sup>74</sup> *See* H.R. REP. NO. 105-599, at 236 (1998) (Conf. Rep.).

<sup>75</sup> NAT’L TAXPAYER ADVOC., 2023 OBJECTIVES REPORT TO CONGRESS 19 (2022), <https://www.taxpayeradvocate.irs.gov/reports/2023-objectives-report-to-congress/full-report/>.

<sup>76</sup> *Id.* at 29–32.

<sup>77</sup> H.R. REP. NO. 105-364, at 50 (1997); S. REP. NO. 105-174, at 39 (1998).

<sup>78</sup> H.R. REP. NO. 105-364, at 52 (1997); S. REP. NO. 105-174, at 40 (1998).

<sup>79</sup> H.R. REP. NO. 105-364, at 50 (1997); S. REP. NO. 105-174, at 39 (1998).

<sup>80</sup> S. REP. NO. 105-174, at 39 (1998).

<sup>81</sup> H.R. REP. NO. 105-364, at 50 (1997); S. REP. NO. 105-174, at 40 (1998).

beneficial to current-day taxpayers who are waiting for refunds due to COVID-19-related processing delays of their paper returns.<sup>82</sup>

Congress posited that the IRS should achieve widespread electronic filing by encouraging competition within the private sector to promote e-filing.<sup>83</sup> This was meant as an expansion of existing paperless filing programs: the conference report noted the legislators' intent for the IRS to continue and improve its telephone filing program (called "Telefile"<sup>84</sup>) and develop a similar internet-based program.<sup>85</sup> The IRS was to "eliminate barriers, provide incentives, and use competitive market forces to increase electronic filing gradually" through 2008.<sup>86</sup> Despite challenges from taxpayers, courts have ruled that the partnership between certain members of private industry and the IRS does not violate antitrust laws, because the consortium members that provide services such as electronic preparation and filing provide what are effectively private-sector services.<sup>87</sup> RRA 98 provided that the collaboration with the private sector would be monitored by a newly-created electronic commerce advisory group composed of members of industry.<sup>88</sup> This group, now called the Electronic Tax Administration Advisory Committee (ETAAC), was to report on the IRS's progress.<sup>89</sup> Lastly, the IRS was required to make filing instructions and forms available electronically, and accept other information electronically, so that

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<sup>82</sup> NAT'L TAXPAYER ADVOC., *supra* note 75.

<sup>83</sup> H.R. REP. NO. 105-599, at 235 (1998) (Conf. Rep.).

<sup>84</sup> Telefile was a program that allowed taxpayers to electronically file returns using a touch-tone telephone. It lasted from 1997 until 2005. *See* I.R.S. Announcement 2005-26, 2005-1 C.B. 969.

<sup>85</sup> H.R. REP. NO. 105-599, at 235 (1998) (Conf. Rep.).

<sup>86</sup> § 2001(b)(1), 112 Stat. at 723; *see* S. REP. NO. 105-174, at 40 (1998).

<sup>87</sup> *Byers v. Intuit, Inc.*, 600 F.3d 286 (3d Cir. 2010).

<sup>88</sup> § 2001(b)(2), 112 Stat. at 723; H.R. REP. NO. 105-599, at 235 (1998) (Conf. Rep.).

<sup>89</sup> I.R.S., *Electronic Tax Administration Advisory Committee (ETAAC)*, <https://www.irs.gov/tax-professionals/electronic-tax-administration-advisory-committee-etaac> (last visited Jan. 16, 2023). "ETAAC members represent various segments of the tax professional community including tax practitioners and preparers, tax software developers, large and small businesses, employers and payroll service providers, individual taxpayers and consumer advocates, the financial industry (payers, payment options and best practices), system integrators (technology providers), academia (marketing, sales, or technical perspectives), trusts and estates, tax exempt organizations, and state and local governments."

taxpayers who e-filed their returns would not have to file any paper documents with the IRS.<sup>90</sup>

Electronic filing has increased dramatically, though not at the pace Congress had initially targeted. In 1997, about 17% of individual returns were filed electronically.<sup>91</sup> With the passage of RRA 98, Congress set a goal of receiving at least 80% of all tax returns in electronic form by 2007.<sup>92</sup> Nonetheless, the e-file rate hovered around 60% during the years 2008 through 2011,<sup>93</sup> and the 80% goal was pushed back to 2012.<sup>94</sup> To achieve it, Congress took further steps in 2011, requiring some tax preparers that filed a substantial number of individual, trust, and estate returns to file electronically;<sup>95</sup> increases in the e-file rate after 2011 and 2012 were due in part to these changes. The electronic filing rate goal of 80% was met for individual returns in 2012,<sup>96</sup> although it was not met for all major return types until 2017.<sup>97</sup>

The importance of e-file became particularly relevant during the COVID-19 pandemic with e-file rates continuing to exceed 80%.<sup>98</sup> During

<sup>90</sup> § 2003(d) and (c), 112 Stat. at 723 (1998).

<sup>91</sup> H.R. REP. NO. 105-599, at 234 (1998) (Conf. Rep.); RECOMMENDATIONS OF THE NATIONAL COMM'N ON RESTRUCTURING THE IRS TO EXPAND ELECTRONIC FILING OF TAX RETURN: HEARING BEFORE THE SUBCOMM. OVERSIGHT OF THE COMM. ON WAYS AND MEANS, 105th Cong. Sess. 1, vol. 4, at 5 (1997).

<sup>92</sup> H.R. REP. NO. 105-599, at 234 (1998) (Conf. Rep.); § 2001(a)(2), 112 Stat. at 723.

<sup>93</sup> I.R.S., IRS ADVANCING E-FILE STUDY PHASE 1 REPORT 2 (2008), [https://www.irs.gov/pub/irs-utl/irs\\_advancing\\_e-file\\_study\\_phase\\_1\\_executive\\_summary\\_v1\\_3.pdf](https://www.irs.gov/pub/irs-utl/irs_advancing_e-file_study_phase_1_executive_summary_v1_3.pdf); I.R.S., MEDIA RELATIONS OFFICE, IRS E-FILE: A HISTORY, IRS FACT SHEET FS 2011-10 (2011), <https://www.irs.gov/pub/irs-news/fs-11-10.pdf> [hereinafter E-FILE].

<sup>94</sup> See E-FILE, *supra* note 93.

<sup>95</sup> I.R.C. § 6011(e)(3); I.R.S., IRS ADVANCING E-FILE STUDY KEY MESSAGES (2022), <https://www.irs.gov/e-file-providers/irs-advancing-e-file-study-key-messages> (last updated Aug. 19, 2022) (“Starting January 1, 2011, preparers or their firms that anticipate filing 100 or more returns must use e-file. Starting January 1, 2012, preparers or their firms that anticipate filing 11 or more returns must use e-file.”).

<sup>96</sup> I.R.S. Pub. No. 3415, ELECTRONIC TAX ADMINISTRATION ADVISORY COMMITTEE ANNUAL REPORT TO CONGRESS 1 (2012) [hereinafter I.R.S. Pub. No. 3415].

<sup>97</sup> *Id.*

<sup>98</sup> *Id.* at 68.



the early days of the pandemic in March through June 2020, the IRS could not process paper returns at its usual pace but continued to process e-filed returns efficiently.<sup>99</sup> E-file allowed many returns to be filed and processed, whereas the IRS estimated as of November 2020 that there was still a backlog of over seven million paper returns from that March–June shutdown period that had not been fully processed.<sup>100</sup> As noted above, the backlog of paper returns tripled after that.<sup>101</sup>

The existing IRS partnership with private industry for e-filing purposes was also instrumental in distributing benefits during the pandemic: Free File, which represents the private industry groups that partner with the IRS, supported the IRS’s distribution of Economic Impact Payments.<sup>102</sup> Many Americans who received these payments through the Free File system had no tax filing obligation and simply registered with the Non-Filer tool to receive these payments.<sup>103</sup> ETAAC counted these registrations as returns filed, which affected the e-filing rate: it made the number of individual

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<sup>99</sup> As of March 26, 2020, the IRS has an announcement on its website encouraging taxpayers to file electronically: “E-file recommended: To avoid delays, the IRS urges taxpayers to file electronically rather than on paper . . . The IRS emphasizes that during this period paper returns could require additional time to process; filing electronically remains the best option for taxpayers.” IRS Operations During COVID-19: Mission-critical functions continue|Internal Revenue Service (archive.org) (Mar. 26, 2020). *2020 Filing Season and COVID-19 Recovery: Hearing Before the S. Fin. Com., S. Hrg. 116-498*, 116th Cong. 44 (June 30, 2020) (statement of Charles P. Rettig, I.R.S. Comm’r) (in describing “IRS Operations During the COVID-19 Pandemic,” Commissioner Rettig stating, “[e]ven with our reduced operations, the IRS has continued to deliver the tax filing season, continuing to process electronic tax returns, issue direct deposit tax refunds and accept electronic payments”); see also *Hearing before the S. Comm. on Gov’t Operations of the Comm. on Oversight & Reform*, 116th Cong. 10 (2020) (Statement of Erin Collins, NTA).

<sup>100</sup> *Hearing before the S. Comm. on Gov’t Operations of the Comm. on Oversight & Reform*, 116th Cong. 10 (2020) (Statement of Erin Collins, NTA) at 15 (statement of Charles Rettig, IRS Commissioner). This backlog has continued to cause processing delays through 2022. I.R.S., *IRS Operations During COVID-19: Mission-critical Functions Continue* (last visited Dec. 16, 2022) (subtopic “Filed a Tax Return,” updated Dec. 16, 2022) (“As of December 9, 2022, we had 2.5 million unprocessed individual returns received this year.”).

<sup>101</sup> NAT’L TAXPAYER ADVOC., 2023 OBJECTIVES REPORT TO CONGRESS 19 (2022), <https://www.taxpayeradvocate.irs.gov/reports/2023-objectives-report-to-congress/full-report/>.

<sup>102</sup> I.R.S. Pub. No. 3415, *supra* note 96, at 58.

<sup>103</sup> I.R.S., *IRS Free File Marks Record Increase; Available Through Oct. 15*, <https://www.irs.gov/newsroom/irs-free-file-marks-record-increase-available-through-oct-15> (last visited Oct. 6, 2020).

returns e-filed during the pandemic higher than it otherwise may have been, but these taxpayers may be more disposed to e-filing in the future.<sup>104</sup>

Both ETAAC and the NTA note the importance of electronic filing and support its extension to a greater variety of forms, particularly Form 1099 (which the IRS must allow to be e-filed due to a provision in the Taxpayer First Act),<sup>105</sup> Form 1040X, Form 1040E-S, and extension forms, all of which are now able to be e-filed.<sup>106</sup> ETAAC believes the IRS should increase electronic filing goals to match what is possible due to the progress of digital communications since 1998,<sup>107</sup> and to include return types that the IRS does not currently consider “major returns.”<sup>108</sup> ETAAC acknowledges, however, that the IRS will require adequate funding to make this type of progress.<sup>109</sup> Now that Americans are routinely sharing a wealth of information and documents electronically, the success of RRA 98 is reflected in ETAAC’s admonishment that “paper filing should be the exception to the rule.”<sup>110</sup>

## II. MIXED RESULTS

### A. Collection Due Process

Prior to RRA 98, taxpayer remedies were limited in the event the taxpayer believed that collection activity undertaken by the IRS was wrongful. Administrative collection appeals were sometimes available, but judicial review of the merits of an already-assessed liability generally was not an option without first fully paying and filing a refund action preceded by a refund claim.<sup>111</sup> That simply was beyond the financial capabilities of

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<sup>104</sup> I.R.S. Pub. No. 3415, *supra* note 96, at 69.

<sup>105</sup> I.R.S. Pub. No. 3415, *supra* note 96, at 60.

<sup>106</sup> I.R.S. Pub. No. 3415, *supra* note 96, at 32–40.

<sup>107</sup> *Id.* at 9.

<sup>108</sup> *Id.* at 9, 36.

<sup>109</sup> *Id.* at 24.

<sup>110</sup> *Id.* at 36.

<sup>111</sup> I.R.C. § 7422(a); *Flora v. United States*, 357 U.S. 63 (1958).

many taxpayers confronted with large unpaid liabilities, not to mention the time and expense that would be incurred before judicial relief was obtained.

Neither the Restructuring Commission’s report nor the initial House bill contained any new avenues for relief from IRS collection activity.<sup>112</sup> But following the Senate hearings, which included discussion of several collection disputes, the Senate concluded that it was time for taxpayers to have protections “similar to those they would have in dealing with any other creditor,” even though the constitutional principles of due process do not apply to tax collection precisely because the government is not “any other creditor.”<sup>113</sup> The result was the Senate’s insertion into RRA 98 of the Collection Due Process (CDP) provisions.<sup>114</sup>

While it is not qualitatively or procedurally similar to constitutional due process,<sup>115</sup> CDP has provided substantial protection to taxpayers faced with liens or levies.<sup>116</sup> Most tax practitioners by now have a general sense of how CDP works.<sup>117</sup> Taxpayers must be given a notice—at least thirty days in advance of an IRS levy<sup>118</sup> and within five days after the filing of a notice of federal tax lien<sup>119</sup>—describing various aspects of the law applicable to collection and, most significantly, providing the opportunity to pursue a CDP appeal.<sup>120</sup> Importantly, the taxpayer must make a request for CDP review within thirty days; if a request is filed after that date, the taxpayer is foreclosed from CDP. In such late-filed cases, the IRS will generally offer an

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<sup>112</sup> H.R. 2292, 105th Cong. 1st Sess. (1997); NAT’L COMM’N ON RESTRUCTURING, *supra* note 4, *passim*.

<sup>113</sup> S. REP. NO. 105-174, at 67 (1998); *see, e.g.*, Phillips v. Comm’r, 283 U.S. 589, 593–97 (holding government tax collection activity does not require full due process).

<sup>114</sup> S. REP. NO. 105-174, at 67–69 (1998); H.R. 2676, 105th Cong. 2d Sess., § 3401, as introduced in the Senate on Apr. 22, 1998.

<sup>115</sup> *See, e.g.*, Living Care Alternatives of Utica v. United States, 411 F.3d 621, 629 (6th Cir. 2005) (“[T]he notion of due process in tax collection is not the same as in other areas of law.”).

<sup>116</sup> *See, e.g.*, I.R.C. §§ 6320, 6330.

<sup>117</sup> I.R.C. §§ 6330, 6320.

<sup>118</sup> I.R.C. § 6330.

<sup>119</sup> I.R.C. § 6320.

<sup>120</sup> I.R.C. § 6330(a)(3)(B).

administrative appeal, but only an adverse decision in the CDP procedure gives the taxpayer the opportunity for subsequent judicial review.<sup>121</sup>

In a CDP proceeding the taxpayer may raise, and the impartial IRS Independent Office of Appeals (IRS Appeals) officer must consider, any issue relevant to the unpaid tax or the proposed collection activity, including “appropriate spousal defenses,” offers of collection alternatives “such as the posting of a bond, the substitution of other assets, an installment agreement, or an offer-in-compromise,” and challenges to the “appropriateness of collection actions.”<sup>122</sup> The reference to “appropriate spousal defenses” highlights the linkage with the innocent spouse rules discussed previously: the Senate plainly envisioned CDP (and potentially subsequent judicial review) as a new avenue for relief in cases where the new innocent spouse rules might apply.<sup>123</sup> The mention of the “appropriateness” of proposed collection action is very vague, however, suggesting as it does that collection actions plainly authorized by Congress in the statute might be “inappropriate” in certain circumstances, without much guidance as to what those circumstances might be.

Similar ambiguity lies in the provision captioned “Basis for Determination.”<sup>124</sup> After instructing that the CDP hearing officer must confirm the correctness of the notifications and address all issues raised by the taxpayer, it adds that the final determination must address “whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary.”<sup>125</sup> We doubt any taxpayer ever thinks that enforced collection action is *not* “more intrusive than necessary,” and the provision validates that belief by describing it as a “legitimate concern.”<sup>126</sup>

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<sup>121</sup> Judicial review was initially available in the U.S. District Courts for certain CDP proceedings, but CDP appeals were later limited by Congress to the United States Tax Court. § 3401(b), 112 Stat. at 74; I.R.C. § 6330(d)(1), as amended by the Pension Protection Act of 2006, Pub. L. No. 109-280, § 855(a), 120 Stat. 280, 1019.

<sup>122</sup> I.R.C. § 6330(c)(2)(A).

<sup>123</sup> I.R.C. § 6330(c)(2)(A)(i); S. REP. NO. 105-174, at 67–68 (1998).

<sup>124</sup> I.R.C. § 6330(c)(3).

<sup>125</sup> I.R.C. § 6330(c)(3).

<sup>126</sup> I.R.C. § 6330(c)(3)(C).

The requirement that such concern be balanced with “the need for the efficient collection of taxes”—by means that Congress has already deliberately authorized by statute—is essentially a content-free instruction to IRS Appeals to do whatever they believe is appropriate in any collection situation.

But the most revolutionary idea in the CDP provision, which went relatively unnoticed at the time, is that it affords an entirely new avenue for redetermination of the underlying tax liability. Section 6330(c)(2)(B) provides that a taxpayer may challenge “the existence or amount of the underlying tax liability” if the person “did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such liability.”<sup>127</sup> Again, this language reflects the concern that potentially innocent spouses may effectively have been shut out of the ordinary processes that may have occurred for the redetermination of a tax liability (deficiency litigation in the Tax Court or refund litigation in the U.S. District Courts or Court of Federal Claims). But a “self-assessed” liability on a joint return that is now the subject of IRS collection activity may also theoretically qualify, thus affording an alternative avenue for litigation before the IRS has conducted any administrative examination or review of the amount of the liability.

Judicial review of the CDP determination was the final novel provision of CDP. Initially, § 6330(d) provided that CDP determinations regarding certain types of tax liabilities could be reviewed in U.S. district courts,<sup>128</sup> but after a flurry of cases in the early 2000s Congress restricted judicial review to the Tax Court.<sup>129</sup>

While it has been largely successful in facilitating review of controversial collection activities, CDP has significantly affected IRS collection activity (for better or worse) and generated a substantial administrative burden on the IRS and the Tax Court.<sup>130</sup> For example, the case

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<sup>127</sup> I.R.C. § 6330(c)(2)(B).

<sup>128</sup> I.R.C. § 6330(d)(1)(B) (1998).

<sup>129</sup> Pension Protection Act of 2006, Pub. Law No. 109-280, § 855(a) 120 Stat. at 1019.

<sup>130</sup> As of 2019, over a million CDP notices were mailed annually, resulting in tens of thousands of administrative CDP requests and over a thousand Tax Court petitions annually (although the volume reduced in 2020 and 2021, possibly related to COVID-19). *See* NAT’L TAXPAYER ADVOC., ANNUAL

load of IRS Appeals addressing collection matters more than tripled in the years following the enactment of CDP.<sup>131</sup>

CDP has also afforded considerable opportunities to contest collection actions for reasons ranging from IRS foot-faults, to overpayments in tax years not at issue,<sup>132</sup> to the merits of the underlying liability if that taxpayer did not already have an opportunity to dispute it.<sup>133</sup> Unfortunately but inevitably, frivolous claims were an immediate problem<sup>134</sup> which continues to this day, despite later legislation that permitted the IRS to disregard and penalize frivolous submissions.<sup>135</sup> However, the opposing view is that CDP did not go far enough and that the IRS continues to enforce collection without sufficient procedural safeguards due to gaps in the statutory coverage.<sup>136</sup> There have also been problems with the implementation of CDP itself that continue to pop up even twenty years later: for example, over 100,000 notices

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REPORT TO CONGRESS 488–98 (2015); NAT'L TAXPAYER ADVOC., ANNUAL REPORT TO CONGRESS 186 (2021).

<sup>131</sup> NAT'L TAXPAYER ADVOC., ANNUAL REPORT TO CONGRESS 46, 192 (2003) (“The creation of the Collection Due Process case so dramatically changed our case receipts—from 14 percent Collection cases in FY 1997, none of which were CDP, to over 50 percent Collection cases in FY 2003, most of which are CDP . . .”).

<sup>132</sup> *Weber v. Comm’r*, 138 T.C. 348 (2012) (limiting jurisdiction to the year at issue in the CDP claim but considering whether an overpayment from another year might preclude collection in the year at issue); *see also* *Greene-Thapedi v. Comm’r*, 126 T.C. 1, 13 (2006) (holding the Tax Court does not have jurisdiction to issue a refund in a CDP case).

<sup>133</sup> I.R.C. § 6330(c)(2)(B).

<sup>134</sup> The U.S. Government Accountability Office reported that about 5% of CDP claims were frivolous in 2004. U.S. GOV’T ACCOUNTABILITY OFF., GAO-07-112, TAX ADMINISTRATION: LITTLE EVIDENCE OF PROCEDURAL ERRORS IN COLLECTION DUE PROCESS APPEAL CASES, BUT OPPORTUNITIES EXIST TO IMPROVE THE PROGRAM 5 (2006), <https://www.gao.gov/assets/gao-07-112.pdf>.

<sup>135</sup> Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, § 407, 120 Stat. 2922, 2960–62 (2006) (codified as amended at I.R.C. §§ 6320, 6330, and 6702).

<sup>136</sup> The NTA has recommended expansion of CDP; for example, in its 2021 Annual Report to Congress, it suggested legislation to ensure an “opportunity to dispute the underlying liability in a prepayment judicial forum” which is currently not available if the taxpayer did not receive a statutory notice of deficiency. NAT'L TAXPAYER ADVOC., ANNUAL REPORT TO CONGRESS 8 (2021).

were issued in 2019 that did not properly apprise taxpayers of their CDP rights.<sup>137</sup>

While not every taxpayer's facts and circumstances support a CDP request, many practitioners will request a CDP hearing as a matter of course, to gain a delay if nothing else.<sup>138</sup> Delay in itself can be a protection that gives taxpayers time to investigate the propriety of collection activity, and thus zealous representation may require filing a CDP claim prior to knowing whether ultimately it is well-founded.<sup>139</sup> That is, the brief thirty-day window in which to request a CDP hearing may be approaching expiration by the time the taxpayer receives the notice in the mail and engages a representative to handle the matter. Moreover, delay has sometimes been used to allow a taxpayer time to arrange payment, for example by obtaining a loan.<sup>140</sup>

The breather provided by CDP also facilitates opportunities for alternate resolution—taxpayers can post a bond, substitute assets, negotiate installment agreements, and compromise liabilities,<sup>141</sup> actions that frequently take some time to implement. In fact, simply being aware of alternative payment options can improve voluntary reporting: the NTA found that over half of taxpayers surveyed admitted that they would be more honest if they had the option to enter an installment agreement.<sup>142</sup> Another benefit to these options is that they can include other tax years, allowing for a comprehensive

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<sup>137</sup> IRS Letter 1058 was not properly captioned; at the prompting of the NTA, the IRS revised the caption to alert taxpayers to their CDP rights. NAT'L TAXPAYER ADVOC., *supra* note 136, at 26.

<sup>138</sup> See, e.g., Bryan Camp, *Lesson from the Tax Court: The Proper Role of Delay in CDP*, TAXPROF BLOG (Sept. 30, 2019), [https://taxprof.typepad.com/taxprof\\_blog/2019/09/lesson-from-the-tax-court-the-proper-role-of-delay-in-cdp.html](https://taxprof.typepad.com/taxprof_blog/2019/09/lesson-from-the-tax-court-the-proper-role-of-delay-in-cdp.html) (comparing two Tax Court cases: *Tartt v. Comm'r*, 118 T.C.M. (CCH) 221, 2019 T.C.M. (RIA) ¶ 2019-112 (holding delay was frivolous), and *Dodd v. Comm'r*, 118 T.C.M. (CCH) 186, 2019 T.C.M. (RIA) ¶ 2019-107 (holding delay was necessary to protect taxpayer)).

<sup>139</sup> See *id.*

<sup>140</sup> In 2004, 11% of CDP cases were resolved in the taxpayer's favor because the taxpayer had made payment. U.S. GOV'T ACCOUNTABILITY OFF., GAO-07-112, TAX ADMINISTRATION: LITTLE EVIDENCE OF PROCEDURAL ERRORS IN COLLECTION DUE PROCESS APPEAL CASES, BUT OPPORTUNITIES EXIST TO IMPROVE THE PROGRAM 12 (2006), <https://www.gao.gov/assets/gao-07-112.pdf>.

<sup>141</sup> Treas. Reg. § 301.6320-1(e)(3) Q&A 1 and 6 (as amended in 2006); Treas. Reg. § 301.6330-1(e)(3) Q&A 1 and 6.

<sup>142</sup> NAT'L TAXPAYER ADVOC., *supra* note 136, at 22.

settlement.<sup>143</sup> The Government Accountability Office did a study about five years after the implementation of CDP procedures and found that nearly a third of taxpayers received an improved outcome, ranging from collection alternatives to having no liability.<sup>144</sup> Consequently, the CDP process can result in more efficient results that bring taxpayers fully into compliance.

Thus, despite some early kinks in the system, and the inevitable slowdown in enforced collection activity, CDP has eventually become a valuable procedural tool for the resolution of collection controversies.

### *B. Notification and Disclosure of Third-Party Contacts*

RRA 98's introduction of a right to advance notice of third-party contacts is another instance of the Senate Finance Committee tackling perceived abuse by the IRS, this time of its investigative powers.<sup>145</sup> In connection with IRS examination or collection activities, § 7602 bestows broad authority on the IRS to obtain information and documentation that "may be relevant."<sup>146</sup> The Senate Finance Committee was concerned that "[s]uch contacts may have a chilling effect on the taxpayer's business and could damage the taxpayer's reputation in the community."<sup>147</sup> Advance notice would allow the taxpayer "the opportunity to resolve issues and volunteer information before the IRS contacts third parties" and avoid such intrusive inquiries.<sup>148</sup> Thus, RRA 98 provided that the IRS "may not contact

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<sup>143</sup> The Tax Court can review facts relating to non-CDP years to the extent they bear on the appropriateness of a collection alternative. *See generally* Sullivan v. Comm'r, 97 T.C.M. (CCH) 1010, 2009 T.C.M. (RIA) ¶ 2009-004 (2009) (considering facts relating to years outside CDP but within proposed installment agreement).

<sup>144</sup> U.S. GOV'T ACCOUNTABILITY OFF., *supra* note 140.

<sup>145</sup> Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3417, 112 Stat. 685, 757-58.E

<sup>146</sup> I.R.C. § 7602(a).

<sup>147</sup> S. REP. NO. 105-174, at 77 (1998).

<sup>148</sup> *Id.*



any person other than the taxpayer . . . without providing *reasonable notice in advance* . . . .”<sup>149</sup>

It seems clear that the goal of providing notice of planned third-party contacts was to give the taxpayer the opportunity to cooperate, and to inform the taxpayer that a lack of cooperation could lead to the embarrassing disclosure that the taxpayer is under examination or has a tax liability.<sup>150</sup> However, due to some concern that a specific notice like this could lead to taxpayers intervening or exerting pressure on the prospective interviewee, Congress slightly watered down the requirement in conference, stating: “[i]t is intended that in general this notice will be provided as part of an existing IRS notice provided to taxpayers.”<sup>151</sup> So, the provision ultimately allowed a general non-specific notice to be incorporated in one of the existing notifications the IRS provides at the commencement of an examination. The IRS thereafter formulated various manners of notice, one of which was merely adding some boilerplate language to IRS Publication 1, the pamphlet that is generally provided upon initiation of an audit.<sup>152</sup>

Since the initial advance notice was intended to be generic, RRA 98 also required that taxpayers be informed of specific third-party contacts “periodically” and “upon request.”<sup>153</sup> Over a decade later, Chief Counsel Advice 201330036 revealed that there was no “quality check” done internally to ensure that third-party contacts were being properly recorded and reported, and it instructed revenue agents that if they forget to record a contact to

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<sup>149</sup> § 3417, 112 Stat. at 757–58 (emphasis added) (later amended by Taxpayer First Act, Pub. L. No. 116-25, § 1206(a), 133 Stat. 981, 990 (2019) (codified and amended at I.R.C. § 7602(c)(1))).

<sup>150</sup> In most contexts, such disclosure is otherwise prohibited under § 6103(b)(2)(A), but it may be permitted under § 6103(k)(6) “to the extent that such disclosure is necessary.”

<sup>151</sup> H.R. REP. NO. 105-599, at 277 (1998) (Conf. Rep.).

<sup>152</sup> I.R.S. Pub. 1, *Your Rights as a Taxpayer*, at 2 (last rev. Sept. 2017). For more detail on the IRS’s implementation of this provision, see the Ninth Circuit’s discussion in *J.B. v. United States*, 916 F.3d 1161, 1170–71 (9th Cir. 2019); see also *supra* note 63. For various forms of notice implemented by the IRS, and for more detail on the regulatory implementation, see Hale E. Sheppard, *IRS Suffers Second Court Loss for Failing to Properly Warn Taxpayers About Third-Party Contacts During Audits*, TAXES THE TAX MAGAZINE 35 (Dec. 2021).

<sup>153</sup> § 3417, 112 Stat. at 757.

simply do it when they remember.<sup>154</sup> In practice, taxpayers often first learn of third-party contacts from the third parties directly.

Due to such unenthusiastic implementation, this provision languished, making little difference in preserving taxpayer confidentiality during examinations and collections. In 2019, the Ninth Circuit shined a spotlight on how poorly the notice requirement had been implemented.<sup>155</sup> Notice cases were rarely litigated because, as the IRS was well aware, there is no cause of action against the IRS for violating the notice requirement.<sup>156</sup> But in *J.B. v. United States*, the failure to provide notice was raised as part of a petition to quash a summons on the basis of the fourth *Powell* prong, that is, whether the IRS followed all administrative requirements.<sup>157</sup> The Ninth Circuit affirmed that the initial generic statement of intent to contact third parties was inadequate notice, considering “the congressional mandate to provide taxpayers faced with a potential third-party summons with a meaningful opportunity to respond with the relevant information themselves so as to maintain their privacy and avoid the potential embarrassment of IRS contact with third parties, such as their employers.”<sup>158</sup>

This opinion may have generated renewed impetus to protect taxpayers, as later that year the Taxpayer First Act of 2019 made the notice requirement

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<sup>154</sup> I.R.S. Chief Couns. Adv. 2013-30-036 (July 26, 2013) (“In general the employee who makes the third-party contact is responsible for ensuring that the contact is properly logged. . . . As a practical matter, if a Revenue Agent or Officer forgets to complete Form 12175, they should complete the form as soon as possible.”).

<sup>155</sup> See *J.B. v. United States*, 916 F.3d 1161 (9th Cir. 2019) (reviewing de novo), *aff’g* *Baxter v. United States*, Case No. 15-cv-04764-YGR, 2016 WL 468034 (N.D. Cal. Feb. 8, 2016), *aff’d and amended by* *Baxter v. United States*, Case No. 15-cv-04764-YGR, 2016 WL 1359413 (N.D. Cal. Apr. 6, 2016) (affirming that the IRS’s failure to give notice violated the requirements of *Powell*, and amending with respect to matters outside the court’s jurisdiction).

<sup>156</sup> I.R.S. Chief Couns. Adv. 2013-30-036 (July 26, 2013) (“There is no independent cause of action for violating third-party contact rules.”).

<sup>157</sup> *Baxter v. United States*, No. 15-cv-04764-YGR, 2016 WL 468034, at \*2 (N.D. Cal. Feb. 8, 2016) (“As to compliance with the IRC’s administrative steps (element four), the government has not met its burden under *Powell*.”).

<sup>158</sup> *J.B.*, 916 F.3d at 1172 n.15 (considering what is “reasonable” based on the “totality of the circumstances” but concluding, “we are doubtful that Publication 1 alone will ever suffice to provide reasonable notice in advance”); see also *Highland Cap. Mgmt., L.P. v. United States*, 626 F. App’x 324, 326–27 (2d Cir. 2015) (considering without deciding whether the TBOR pamphlet was sufficient notice).

more explicit and meaningful. Now, third-party contacts are prohibited “unless such contact occurs during a period (not greater than 1 year) which is specified in a notice which . . . is provided to the taxpayer not later than 45 days before the beginning of such period.”<sup>159</sup> The pro-taxpayer trend has continued with district courts quashing summonses due to inadequate notice, following the Ninth Circuit’s reasoning and congressional intent.<sup>160</sup>

The core concern about advising taxpayers in advance of particular third parties whom the IRS may contact remains a legitimate one, and to the authors’ knowledge, no one has suggested requiring it. More generic forms of notification regarding third-party contacts, whether a single time at the commencement of examination proceedings, or periodically as required by the Taxpayer First Act, appear to strike the correct balance. But the IRS’s poor history of tracking and responding to requests regarding specific lists of persons *already* contacted could merit some additional attention either by Congress or administratively.

### C. Qualified Offer

The qualified offer provision enacted in RRA 98<sup>161</sup> has its roots in conventional wisdom that litigation should be discouraged where settlement is possible. Congress was particularly concerned that the IRS would use its position as the repeat participant in tax litigation to strategically litigate cases that were long shots against taxpayers with far fewer resources.<sup>162</sup> Section 7430, originally enacted in 1982 to permit the recovery of legal fees by taxpayers,<sup>163</sup> had not resulted in much protection for taxpayers, because initial criteria for awarding fees to taxpayers required both that the taxpayer “substantially prevail” and establish that the IRS’s position was

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<sup>159</sup> Taxpayer First Act, Pub. L. No. 116-25, § 1206, 133 Stat. 981, 990 (2019).

<sup>160</sup> *See, e.g.*, United States v. Vaught, No. 18-cv-00452-DCN, 2021 WL 3639414, slip op. at 9 (D. Idaho Aug. 16, 2021).

<sup>161</sup> § 3101(e)(2), 112 Stat. at 729.

<sup>162</sup> S. REP. NO. 105-74, at 48.

<sup>163</sup> Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, § 292(a), 96 Stat. 324, 572.

“unreasonable.”<sup>164</sup> The latter requirement was softened prior to RRA 98 by an amendment that required the government (not the taxpayer) to establish that its position was “substantially justified.”<sup>165</sup> RRA 98 clarified that the IRS was not “substantially justified” in its position if it had adverse precedent in other appellate courts,<sup>166</sup> but, more importantly, Congress introduced the “qualified offer” as a new approach to short circuit that analysis.<sup>167</sup> This addition created a safety net of sorts for taxpayers, allowing them to shift some of the costs of litigation to the government if the government rejected a settlement offer that proved to be greater or equal to the judgment ultimately obtained.<sup>168</sup>

The Senate Committee on Finance added this to RRA 98 expressly to encourage settlement.<sup>169</sup> It was modeled on Rule 68 of the Federal Rules of Civil Procedure (Rule 68),<sup>170</sup> which likewise encourages settlement by allowing litigants to protect themselves from trial costs with an offer that is greater or equal to the judgment.<sup>171</sup> As with Rule 68, the qualified offer protocol thus can allow the taxpayer to obtain costs even if it “loses” a substantial portion of the case, so long as the determination against it is less than or equal to the amount previously offered. By contrast, under § 7430 *without* a qualified offer, even if a taxpayer wins, the IRS does not have to

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<sup>164</sup> I.R.C. § 7430(c)(2)(A)(i) (1985).

<sup>165</sup> I.R.C. § 7430(c)(2)(A)(i) (1986).

<sup>166</sup> § 3101(d), 112 Stat. at 728; I.R.C. § 7430(c)(4)(B)(iii). RRA 98 also expanded the timeline for cost recovery in administrative proceedings. *Id.*

<sup>167</sup> The qualified offer rules are currently codified at I.R.C. § 7430(c)(4)(E) and (g); *see also* Treas. Reg. § 301.7430-5(a).

<sup>168</sup> *See id.*

<sup>169</sup> S. REP. NO. 105-174, at 48 (1998) (“The Committee believes that settlement of tax cases should be encouraged whenever possible.”).

<sup>170</sup> *Id.* at 48 (“the Committee believes that the application of a rule similar to FRCP 68 is appropriate to provide an incentive for the IRS to settle taxpayers’ cases for appropriate amounts, by requiring reimbursement of taxpayer’s [*sic*] costs when the IRS fails to do so”).

<sup>171</sup> FED. R. CIV. P. 68(d) (“If the judgment that the offeree finally obtains is not more favorable than the unaccepted offer, the offeree must pay the costs incurred after the offer was made.”).

pay costs if it can establish that its position was substantially justified.<sup>172</sup> Moreover, unlike Rule 68,<sup>173</sup> a taxpayer can win costs under § 7430 even if the taxpayer is the petitioner (in Tax Court) or plaintiff (in a district court proceeding such as a refund suit).<sup>174</sup>

However, the qualified offer provision still has some stumbling blocks. First of all, a taxpayer who makes a qualified offer is still subject to the general limitations of § 7430: costs will be awarded only if the taxpayer exhausted administrative remedies, did not unreasonably protract the proceedings, and did not exceed the net worth thresholds.<sup>175</sup> There are also formalistic requirements: the taxpayer must make the offer after being notified of its IRS appeals rights and no later than thirty days prior to trial in a subsequent court proceeding,<sup>176</sup> must explicitly label the settlement offer as a “qualified offer,”<sup>177</sup> and must hold it open for the required period.<sup>178</sup>

Some taxpayers’ efforts to utilize the qualified offer rules may fail based on any one of these criteria. But others attempt to use a qualified offer as a type of free insurance rather than a genuine attempt to settle, with mixed results. For example, in *Gina C. Lewis v. Comm’r*, the Tax Court recently agreed with the IRS that a taxpayer who offered to settle the tax liability for the full deficiency, provided she retained the right to contest liability for it as an innocent spouse, could not obtain costs because such an offer was not a

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<sup>172</sup> I.R.C. § 7430(c)(4)(B)(i); *e.g.*, *Paz v. Comm’r*, 84 T.C.M. (CCH) 268, 2002 T.C.M. (RIA) ¶ 54860 at 3 (2002) (2002) (denying costs under I.R.C. § 7430 because the IRS’s position was “substantially justified”).

<sup>173</sup> FED. R. CIV. P. 68(a) (“a party *defending* against a claim may serve on an opposing party an offer”) (emphasis added).

<sup>174</sup> I.R.C. § 7430(a) (“In any administrative or court proceeding which is *brought by or against* the United States”) (emphasis added); *see also* Treas. Reg. § 301.7430-7(e) (example 11) (describing qualified offer in refund suit).

<sup>175</sup> I.R.C. § 7430(b)(1)-(3), & (c)(4)(A)(ii), respectively; *see* I.R.C. § 2412 (establishing net worth).

<sup>176</sup> I.R.C. § 7430(g)(2).

<sup>177</sup> I.R.C. § 7430(g)(1)(C) (“‘qualified offer’ means a written offer which . . . is designated at the time it is made as a qualified offer for purposes of this section”).

<sup>178</sup> I.R.C. § 7430(g)(1)(D) (“‘qualified offer’ means a written offer which . . . remains open during the period beginning on the date it is made and ending on 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”).

true final offer of settlement and thus did not count as a qualified offer.<sup>179</sup> While the logic is unassailable,<sup>180</sup> the result does not seem fully in keeping with Congress's intent, because the IRS forced her to litigate and lost completely, and yet she was unable to recover her costs due to the IRS's two-step approach to severing joint liability.

However, a taxpayer can occasionally obtain a surprising win. In *BASR Partnership v. United States*, the Court of Federal Claims found that a \$1 settlement offer was a bona fide qualified offer, rather than a “sham” offer, as the IRS argued.<sup>181</sup> On the basis of that timely written offer of \$1, the court awarded over \$300,000 of legal fees.<sup>182</sup> Whether this reading of the statute ultimately serves the purpose of encouraging settlement seems debatable. It could be argued that this result condones settlement offers that do not merit serious consideration; but alternatively, the procedure followed in *BASR* should have compelled the IRS to evaluate its position seriously well before forcing the taxpayer to trial.

In *Gina C. Lewis v. Comm’r*, the taxpayer's offer was not a true offer—she reserved the right to contest liability—yet her offer was not without risk, for if the IRS had accepted her offer and she had not qualified for innocent spouse status, she would bear full liability.<sup>183</sup> In *BASR Partnership*, there was no significant risk in making an offer of \$1, and the taxpayer had clearly decided to litigate rather than reach a settlement. Of course, it is entirely possible that the court awarded costs in *BASR Partnership* because it believed the IRS had been too aggressive in litigating the statute of limitations, and

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<sup>179</sup> *Gina C. Lewis v. Comm’r*, 158 T.C. No. 3, at 7 (2022).

<sup>180</sup> For a compelling analysis of the Tax Court's reasoning and additional discussion of qualified offer jurisprudence, see Bryan Camp, *Lesson from the Tax Court: The Finality Rule for § 7430 Qualified Offers*, TAX PROF. BLOG (Mar. 14, 2022), [https://taxprof.typepad.com/taxprof\\_blog/2022/03/lesson-from-the-tax-court-the-finality-rule-for-7430-qualified-offers-.html](https://taxprof.typepad.com/taxprof_blog/2022/03/lesson-from-the-tax-court-the-finality-rule-for-7430-qualified-offers-.html).

<sup>181</sup> *BASR P'ship v. United States*, 130 Fed. Cl. 286, 305–06 (2017), *aff'd*, 915 F.3d 771, 783 (Fed. Cir. 2019) (holding that the lower court's determination to award fees on the basis of a one dollar settlement offer was not an abuse of discretion).

<sup>182</sup> 130 Fed. Cl. at 313–14.

<sup>183</sup> *Gina C. Lewis v. Comm’r*, 158 T.C. 3, at 5–6 (2022).

that the taxpayer deserved the award of what was only a portion of the true expenses inflicted upon it by the IRS.<sup>184</sup>

Whether or not the courts are allowing the qualified offer to fulfill its intended role in encouraging settlement, the qualified offer is certainly a strategy worth considering between the taxpayer's receipt of a notice of proposed adjustment (or if that is not applicable, after the notice of deficiency),<sup>185</sup> and shortly before trial, especially if extensive and expensive trial preparation can be avoided. The offer must be made no later than thirty days prior to trial,<sup>186</sup> but only costs incurred on or after the offer date are potentially covered,<sup>187</sup> so making an offer at the last minute covers fewer costs (and even then, "reasonable" attorneys' fees are capped at \$125/hour<sup>188</sup>). Superseding offers are permitted, but they reset that clock because only the last-in-time offer is compared to the judgment.<sup>189</sup> This technicality could impede settlement: once a taxpayer has made a qualified offer, it has an incentive to avoid engaging in a series of counter-offers or even renewing an expired offer,<sup>190</sup> but at least the provision gives a taxpayer a push to make a formal offer.

While the qualified offer has not aided taxpayers nor encouraged settlement to the extent Congress anticipated, it has, on a micro-level, bolstered the negotiating position of taxpayers and broken some logjams at the IRS. On a macro-level, it has probably affected the IRS Chief Counsel's litigation strategy and has trickled down to IRS Appeals. For example, for

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<sup>184</sup> In *BASR Partnership*, the IRS took a position contrary to its own Field Service Memorandum 200104006 (Jan. 26, 2001) regarding the nature of the intent to evade tax required to trigger an unlimited statute of limitations and bore the burden of proof on the nature of intent with a single questionable case, *City Wide Transit, Inc. v. Commissioner*, 709 F.3d 102 (2d Cir. 2013), as precedent. *BASR P'ship v. United States*, 795 F.3d 1338, 1347–48 (Fed. Cir. 2015); *see also* *BASR P'ship v. United States*, 915 F.3d 771, 783 (Fed. Cir. 2015).

<sup>185</sup> I.R.C. § 7430(g)(2)(A); Treas. Reg. § 301.7430-7(e) (example 14).

<sup>186</sup> I.R.C. § 7430(g)(2)(B).

<sup>187</sup> I.R.C. § 7430(c)(4)(E)(iii)(II).

<sup>188</sup> I.R.C. § 7430(c)(1)(B)(iii) (providing \$125 hourly rate with an exception where "a special factor . . . justifies a higher rate"). This current fee rate of \$125 dates back to RRA 98. *See* § 3101(a)(1), 112 Stat. at 727 (increasing hourly fee rate from \$110 to \$125).

<sup>189</sup> I.R.C. § 7430(c)(4)(E)(iii)(I); Treas. Reg. § 301.7430-7(a).

<sup>190</sup> A qualified offer can be extended, however, prior to expiration. Treas. Reg. § 301.7430-7(c)(5).

qualified offers, IRS Appeals is instructed to expedite review of substantive issues due to the ninety-day offer clock<sup>191</sup> and admonished that “[w]hen considering the issues for settlement, remember if issues raised in the qualified offer are not settled [and lost at trial], the government is liable for IRC 7430 costs.”<sup>192</sup> Further, IRS Appeals is reminded that “the position taken must be a position the government can defend if the case is litigated, otherwise the government is liable for IRC 7430 costs . . . .”<sup>193</sup> Arguably, IRS Appeals should always take the threat of costs into consideration, but at least in the qualified offer situation that instruction is overt. Thus, while qualified offers are not easy to make properly, and likely do not cover taxpayers’ actual costs, taxpayers can opt into several layers of (modest) protection with a qualified offer, and could even walk away with a settlement.

#### *D. Interest Netting*

Prior to RRA 98, and despite it afterwards as well, corporate taxpayers might owe interest on an underpayment despite having a credit for an overpayment for the same period.<sup>194</sup> That is because since 1986, the interest rate charged on corporate underpayments generally exceeds the interest rate paid on corporate overpayments, there may be an interest differential on periods of mutual indebtedness.<sup>195</sup> While the interest rates are statutory, and it has been generally accepted that for corporations the rate charged by the IRS on amounts due (the underpayment rate) exceeds the rate paid by the IRS on refunds (the overpayment rate), it seemed patently unfair that a taxpayer

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<sup>191</sup> Pre-90-Day Cases with a Qualified Offer, I.R.M. § 8.7.15.1.4(2) (Oct. 1, 2012).

<sup>192</sup> I.R.M. § 8.7.15.1.4(10) (Oct. 1, 2012).

<sup>193</sup> I.R.M. § 8.7.15.1.4(11) (Oct. 1, 2012).

<sup>194</sup> Previously, taxpayers were entitled to “annual interest netting” where an overpayment and underpayment existed for the same type of tax with respect to one annual tax return. *See, e.g., Avon Products, Inc. v. United States*, 588 F.2d 342 (2d Cir. 1978); *see also* Rev. Proc. 94-60, 1994-2 C.B. 774 and Rev. Proc. 99-40, 1999-2 C.B. 565.

<sup>195</sup> The Tax Reform Act of 1986 first set a corporate underpayment interest rate that exceeded the overpayment rate, and Congress specifically requested at that time that the IRS administratively prevent it from resulting in interest on periods of mutual indebtedness. Pub. L. No. 99-514, 100 Stat. 2085, § 1511 (Oct. 22, 1986). Currently, the interest rate for corporate overpayments is one percentage point lower than the interest rate for corporate underpayments and three percentage points lower than the interest rate for large corporate underpayments, a differential sometimes ameliorated by interest netting. I.R.C. § 6621.



could still owe net interest even during a period where a credit and an underpayment coincided. RRA 98's "interest netting" provision addressed that problem in some, but by no means all, such scenarios.

Interest netting is limited to "equivalent underpayments and overpayments by the *same taxpayer*."<sup>196</sup> For corporate taxpayers, the definition of "the same taxpayer" has been a battleground in the context of corporate mergers, acquisitions and spin-offs, consolidated returns, and other potential considerations such as common control.<sup>197</sup> Despite compelling arguments from taxpayers regarding the attribution of liabilities and overpayments and the legal consequences of various metaphysical corporate transformations, courts initially took a rigid view that the "identity" of the payor and the recipient entity had to be one and the same.<sup>198</sup> So much so, that it was considered an expansion to allow interest netting where the same taxpayer *identification number* was associated with the underpayment entity and the overpayment entity.<sup>199</sup>

In the "same taxpayer" analysis, courts focus on the identity of the taxpayer on the *dates* of the overpayment and underpayment,<sup>200</sup> rather than the identity of the taxpayer during the *period* for which the two overlapped. As an underpayment can become an overpayment, and *vice versa*, due to subsequent events, the laser-like focus on dates of under- or overpayment

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<sup>196</sup> § 3301(a) 112 Stat. at 741 (specifying "underpayments and overpayments by the same taxpayer"); I.R.C. § 6621(d) (continuing to specify "underpayments and overpayments by the same taxpayer").

<sup>197</sup> See I.R.S. Field Serv. Adv. 200212028 (Mar. 22, 2002); see, e.g., *Energy East Corp. v. United States*, 645 F.3d 1358 (Fed. Cir. 2011) (addressing acquisition with consolidated return); *Wells Fargo & Co. v. United States*, 827 F.3d 1026 (Fed. Cir. 2016) (addressing statutory mergers); *Magma Power Co. v. United States*, 101 Fed. Cl. 4 (2011) (addressing consolidated return); *Ford Motor Company v. United States*, 908 F.3d 805 (Fed. Cir. 2018) (addressing control).

<sup>198</sup> *Energy East Corp.*, 645 F.3d 1358.

<sup>199</sup> *Magma Power Co.*, 101 Fed. Cl. 562.

<sup>200</sup> See, e.g., *Energy East Corp.*, 645 F.3d 1358, 1361; *Wells Fargo & Co.*, 827 F.3d 1026. While the courts base this on the syntax of the statutory phrase "underpayments and overpayments by the same taxpayer," the statute makes no reference to dates and in fact references the "period" for which interest is due or payable twice. I.R.C. § 6621(d).

may be illogical,<sup>201</sup> especially considering the congressional intent of preventing an interest charge “on *periods* of mutual indebtedness.”<sup>202</sup>

With a more general nod to congressional intent, the Federal Circuit finally gave some ground to taxpayers on the basis that § 6621(d) is a “remedial statute”—one enacted to rectify the interest differential—and therefore warrants a broad interpretation under that canon of statutory interpretation.<sup>203</sup> Thus, the court was able to award interest netting to the survivor of a merger despite the fact that the extinguished corporation was the overpayer, and the surviving corporation was the underpayer; the entities were neither identical nor had the same taxpayer identification number.<sup>204</sup> While the premise that Congress intended relief in such a scenario is probably correct, to some practitioners and scholars logic recommends still broader outcomes.<sup>205</sup>

As with RRA 98’s innocent spouse provision, Congress’s focus on fundamental fairness is evident in the implementation of interest netting. The effective date was similarly retroactive in that, upon request, interest netting applied to taxpayers with open statutes of limitations.<sup>206</sup> On a going forward basis, Congress anticipated that “the Secretary will take all reasonable efforts to offset the liabilities, rather than process them separately using the net interest rate of zero.”<sup>207</sup> Thus, the IRS again shouldered an extensive administrative burden in implementing this, as they had to both field requests

<sup>201</sup> Bob Probasco, *A Question of Identity—Interest Netting, Part*, PROCEDURALLY TAXING 2 (Jan. 9, 2019), <https://procedurallytaxing.com/a-question-of-identity-interest-netting-part-2/>.

<sup>202</sup> H.R. REP. NO. 105-364, at 64 (1997). The statute itself also refers to “overlapping *periods*” as having an interest rate of “zero for such *period*.” I.R.C. § 6621(d).

<sup>203</sup> *Wells Fargo & Co.*, 827 F.3d 1026; *cf. Ford Motor Co.*, 908 F.3d 805 (finding this canon of interpretation did not apply because congressional intent to remediate was limited to “same” taxpayers); *see also* David Berke, *More of the Same*, 72 TAX LAW. 202, at 212, 215, 218, 220 (2018) (critiquing this canon as unsound and vulnerable to manipulation).

<sup>204</sup> *Wells Fargo & Co.*, 827 F.3d 1026.

<sup>205</sup> Berke, *supra* note 203.

<sup>206</sup> § 3301(c)(2), 112 Stat. at 741; I.R.C. § 6621(d); *see also, e.g.*, *Exxon Mobil Corp. & Affiliates v. Comm’r*, 689 F.3d 191 (2d Cir. 2012).

<sup>207</sup> H.R. REP. NO. 105-599, at 257 (1998) (Conf. Rep.).

for retroactive application of the statute via refund claims,<sup>208</sup> and set up systems to match credits to underpayments efficiently.<sup>209</sup> The burden also falls heavily on taxpayers, though. One of the problems with the implementation of this provision is that the IRS has not succeeded in automating the netting process, and instead puts the onus on taxpayers to identify periods of mutual indebtedness, run their own interest computations, and submit refund claims.<sup>210</sup>

The application of interest netting will probably continue to be heavily litigated at the appellate level due to the refund procedure, ambiguity of the statute, tentative judicial holdings, and high dollar amounts that are often at stake. And as a result, the burden of this provision on the IRS, taxpayers, and the court system is certainly much higher than Congress envisioned. After all, the concept looked pretty simple to Congress: if someone does not owe money on a net basis, then do not charge them interest. In practice it has proven difficult to apply, however.

### III. MISSES

#### A. *Burden of Proof*

RRA 98 addressed congressional unease that the system was stacked against the taxpayer in the most literal (legal) sense: the burden of proof generally lies on the taxpayer in litigation with the IRS.<sup>211</sup> That is, once the IRS determined a deficiency, it received the benefit of a rebuttable presumption that it was correct, unless and until the taxpayer produced *prima facie* evidence to the contrary.<sup>212</sup> Congress recognized that, even then, “the taxpayer must still carry the ultimate burden of proof or persuasion on the

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<sup>208</sup> See Rev. Proc. 99-43, 1999-2 C.B. 506.

<sup>209</sup> *Magma Power Co. v. United States*, 101 Fed. Cl. 562, 573–74 (2011) (regarding the administrative burden of interest netting on the IRS).

<sup>210</sup> Rev. Proc. 2000-26, 2000-41 C.B. 1257.

<sup>211</sup> See generally *Welch v. Helvering*, 290 U.S. 111, 115 (1933) (stating Commissioner’s determination is presumptively correct).

<sup>212</sup> See, e.g., *United States v. Janis*, 428 U.S. 433, 440 (1976) (analyzing jurisprudence that the burden of proof is on the taxpayer generally).

merits.”<sup>213</sup> The rule placing the burden of proof on the taxpayer had been challenged on constitutional grounds with no success.<sup>214</sup>

Congress thought this left taxpayers at a “disadvantage when forced to litigate with the IRS,” and believed that “shifting the burden of proof to the Secretary . . . will create a better balance between the IRS and . . . taxpayers.”<sup>215</sup> Therefore, in RRA 98, Congress attempted to shift the burden of proof on certain matters from the taxpayer to the IRS by adding § 7491 to the Code.<sup>216</sup>

While § 7491(a) provides that “if . . . a taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the liability . . . the Secretary shall have the burden of proof,” limitations inherent within the statute have impeded its practical effect.<sup>217</sup> First, the “credible evidence” requirement, which according to Congress means “the quality of evidence which, after critical analysis, the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted,” itself places a burden equivalent to that of the traditional

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<sup>213</sup> H.R. REP. NO. 105-599, at 238 (1998) (Conf. Rep.); *see, e.g.*, *United States v. Rexach*, 482 F.2d 10, 16 (1st Cir. 1973) (“We therefore hold that in tax collection suits or . . . refund suits, the burdens of both going forward and ultimate persuasion are on the taxpayer.”). For an in-depth discussion of the burden of proof jurisprudence, *see* Nathan E. Clukey, *Examining the Limited Benefits of the Burden of Proof Shift*, 82 TAX NOTES 683, 688 (1999) (explaining that the burden of proof had historically rested on the taxpayer because “the taxpayer controls the evidence and information necessary [such that] more intrusive audit procedures . . . and more aggressive use of the summons power and discovery by the government” would be required otherwise).

<sup>214</sup> *See, e.g.*, *Rockwell v. Comm’r*, 512 F.2d 882, 887 (9th Cir. 1975) (rejecting the taxpayer’s argument that imposing the burden of proof was a violation of due process, concluding, “Congress can condition the taxpayer’s right to contest the validity of a tax assessment pretty much as it sees fit.”).

<sup>215</sup> H.R. REP. NO. 105-364, at 56 (1997); *see also* S. REP. NO. 105-174, at 45 (1998) (explaining that “the IRS should not be able to rest on its presumption of correctness if it does not provide any evidence whatsoever relating to penalties”).

<sup>216</sup> § 7491, 112 Stat. at 726. While not discussed herein, § 7491(b) automatically places the burden of proof on the IRS when it reconstructs a taxpayer’s income using statistical data: “[i]n the case of an individual taxpayer, the Secretary shall have the burden of proof in any court proceeding with respect to any item of income which was reconstructed by the Secretary solely through the use of statistical information on unrelated taxpayers.” *Cf. Pollard v. Comm’r*, 786 F.2d 1063, 1066 (11th Cir. 1986) (placing the burden on the taxpayer to prove that the IRS’s statistical data is incorrect).

<sup>217</sup> I.R.C. § 7491(a).

burden of production on the taxpayer.<sup>218</sup> Second, the statute imposes the related conditions that the taxpayer comply with the requirements to substantiate any item, maintain all required records, and “cooperate . . . with reasonable requests by the Secretary for witnesses, information, documents, meetings, and interviews.”<sup>219</sup> Most importantly, the burden of proof shift is limited primarily to individual taxpayers and estates, for it applies to corporations, partnerships, and trusts only if their net worth is below the thresholds set by the Equal Access to Justice Act in Title 28 (28 U.S.C. § 2412).<sup>220</sup>

One weakness of § 7491(a) lies in the substantiation and “credible evidence” requirements.<sup>221</sup> In practitioners’ experience, this level of substantiation in effect requires a taxpayer to demonstrate that its factual foundation is more likely than not true, thereby adding the burden of persuasion on top of the burden of production.<sup>222</sup> Thus, both logically and pragmatically the burden of proof is returned to the taxpayer (or it never really shifted).

Furthermore, § 7491(a) does not relieve the taxpayer of its responsibility to make its case, as Congress had hoped.<sup>223</sup> In an effort to present credible evidence, a taxpayer does not have the option of holding anything back if it

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<sup>218</sup> H.R. REP. NO. 105-599, at 240 (1998) (Conf. Rep.); *see, e.g.*, *Higbee v. Comm’r*, 116 T.C. 438, 442 (2001) (adopting the definition from the legislative history).

<sup>219</sup> I.R.C. § 7491(a)(2)(A)–(B). Section 7491(a)(2)(C) sets a third requirement of meeting the description in § 7430(c)(4)(A)(ii) if a partnership, corporation, or trust. That section in turn references the first sentence of 28 U.S.C. § 2412(d)(1)(B) which states: “A party seeking an award of fees and other expenses shall, within thirty days of final judgement in the action, submit to the court an application for fees and other expenses which shows that the party is a prevailing party and is eligible to receive an award under this subsection, and the amount sought, including an itemized statement from an attorney or expert witness representing or appearing in behalf of the party stating the actual time expended and the rate at which fees and other expenses were computed.”

<sup>220</sup> I.R.C. § 7491(a)(2)(C) (First referencing I.R.C. § 7430(c)(4)(A)(ii), which in turn references 28 U.S.C. § 2412(d)(2)(B)).

<sup>221</sup> Nathan Clukey argues that the substantiation requirement is even more robust because it is reiterated, and this heightens the taxpayer’s burden, contributing to the ineffectiveness of this provision. Clukey, *supra* note 213, at 689.

<sup>222</sup> *See, e.g., id.* at 689.

<sup>223</sup> H.R. REP. NO. 105-364, at 54-55 (1997).

wants to shift the burden of proof but must present a robust case.<sup>224</sup> In practice, Steve R. Johnson concludes in *The Dangers of Symbolic Legislation: Perceptions and Realities of the New Burden of Proof Rules*, “what was required of the taxpayer before the enactment of Section 7491 remains required.”<sup>225</sup>

Additionally, the reward for success is minimal: actually shifting the burden rarely helps the taxpayer win its case, though the Tax Court has occasionally ruled for the taxpayer on this basis.<sup>226</sup> Even in such a case, the Tax Court nonetheless observed that while “shifting the burden may . . . affect the way we view possible gaps in the evidence,” it “usually doesn’t matter very much—most cases will be decided on a preponderance of the evidence.”<sup>227</sup> Generally, as the Eight Circuit reasoned, “the party supported by the weight of the evidence will prevail regardless of which party bore the burden of persuasion, proof or preponderance.”<sup>228</sup> Most importantly, it is practically discretionary for the Tax Court to address the burden of proof issue, even if it is raised by one of the parties, precisely because “the shifting

<sup>224</sup> See Steve R. Johnson, *The Dangers of Symbolic Legislation: Perceptions and Realities of the New Burden of Proof Rules*, 84 IOWA L. REV. 413, 442 (1999) (arguing that because the taxpayer must present believable and substantial evidence in order to shift the burden, “the taxpayer’s prudent course is to fully develop and present her case. Thus, even if the burden of proof is potentially shifted, the conditions compel the taxpayer to put on as complete a case as before the introduction of § 7491 into the Code.”).

<sup>225</sup> *Id.* at 443.

<sup>226</sup> See, e.g., *Kohler v. Comm’r*, 92 T.C.M. (CCH) 48, 2006 T.C.M. (RIA) ¶ 2006,152 (2006) (“Respondent failed to introduce any evidence or present any arguments to persuade us that the value reported on the estate’s tax return was incorrect, and accordingly respondent has failed to meet his burden of proof.”); *Forste v. Comm’r*, 85 T.C.M. (CCH) 1146, T.C.M.(RIA) ¶ 55111 (2003) (“However, if the burden of proof has shifted to respondent, as we hold that it has, [the testimony presented by respondent] clearly fails to satisfy respondent’s burden . . .”).

<sup>227</sup> *Murphy v. Comm’r*, 92 T.C.M. (CCH) 422 at \*6–11 (2006) (placing the burden of proof on the IRS with respect to an interest deduction and ruling for the taxpayer based on his credible testimony and the IRS’s failure to produce direct evidence).

<sup>228</sup> See *Blodgett v. Comm’r*, 394 F.3d 1030, 1039 (8th Cir. 2005) (first, resolving a conflict in the Eighth Circuit, supporting *Polack v. Comm’r*, 366 F.3d 608, 613 (8th Cir. 2004) and then declining to follow *Griffin v. Comm’r*, 315 F.3d 1017 (8th Cir. 2003)); *Geiger v. Comm’r*, 279 Fed. App’x 834, 835 (11th Cir. 2008) (“[T]he burden of proof is of practical consequence only in the rare event of an evidentiary tie.”); *FRGC Inv. LLC v. Comm’r*, 89 Fed. App’x 656, 656 (9th Cir. 2004) (“[T]he preponderance of the evidence favored the Commissioner. That being so, the burden of proof did not come into play . . .”).

of the evidentiary burden of preponderance is of practical consequence only in the rare event of an evidentiary tie.”<sup>229</sup>

As for penalties, § 7491(c) puts the burden of production on the IRS automatically for individual taxpayers.<sup>230</sup> Relying on the legislative history, the Tax Court interpreted the “burden of production” to mean that the Commissioner “must come forward with sufficient evidence indicating that it is appropriate to impose the relevant penalty.”<sup>231</sup> However, the Tax Court has concluded that the burden remains on the taxpayer with respect to affirmative penalty defenses such as “reasonable cause” and “substantial authority,” because the legislative history specifies that the Secretary need not introduce evidence relating to those defenses.<sup>232</sup>

Like § 7491(a), § 7491(c) has had little impact. First, courts require very little from the IRS to meet the burden of production on a penalty, and it often meets this burden in presenting its case on the merits of the deficiency.<sup>233</sup> Second, notwithstanding § 7491(c), the Tax Court rules have been interpreted to require that taxpayers assign error to a penalty in their initial

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<sup>229</sup> Blodgett, 394 F.3d at 1039; *see also* Knudsen v. Comm’r, 131 T.C. 185 (2008) (supplementing T.C. 2007-340); Taylor v. Comm’r, 118 T.C.M (CCH) 156, 2019 T.C.M. (RIA) ¶ 2019-102, at \*23 (2019) (“The Court decides this case on a preponderance of the evidence without regard to which party bears the burden of proof.”).

<sup>230</sup> I.R.C. § 7491(c) (stating that the “Secretary shall have the burden of production in any court proceeding with respect to the liability of any individual for any penalty, addition to tax, or additional amount imposed by this title”). Again, entities are generally unable to take advantage of this rule. *See, e.g.,* Estate of Jackson v. Comm’r, 121 T.C.M. (CCH) 1320, 2021 T.C.M. (RIA) ¶ 2021-048, at \*83 (2021) (holding § 7491(c) inapplicable because “an estate is not an individual”); NT, Inc. v. Comm’r, 126 T.C. 191, \*195 (2006) (holding that it does not apply because “Petitioner is not an individual; it is a corporation”).

<sup>231</sup> Higbee v. Comm’r, 116 T.C. 438, 446 (2001).

<sup>232</sup> *Id.* (“[T]he legislative history indicates that it is the taxpayer’s responsibility to raise [and] bear the burden of proof with regard to those issues.”). *See also* H.R. REP. NO. 105-599 at 241 (1998) (Conf. Rep.).

<sup>233</sup> *See, e.g.,* Long Term Cap. Holdings v. United States, 330 F. Supp. 2d 122, 199 (D. Conn. 2004) (finding that “the Government has met any burden of production it may have in this case, even under petitioners’ view of § 7491(c), by coming forward with evidence demonstrating the appropriateness of penalties . . .”). However, another provision enacted in RRA 98 requiring that penalties be approved by supervisor in writing (codified at § 6751(b)(1)) has been held to be part of the IRS’s burden of production under § 7491(c). Graev v. Comm’r, 149 T.C. 485, 493 (2017).

pleading, otherwise it will be deemed to be conceded.<sup>234</sup> Third, because penalties are usually calculated as a percentage of the deficiency, a taxpayer generally will have to fight penalties only if the deficiency is sustained. Thus, to avoid penalties the best defense is a good offense, mooting the burden of production rule and reducing the impact of § 7491(c).

Thus, while § 7491 was intended to help taxpayers by shifting the burden of proof to the IRS, the conditions that must be satisfied in order to successfully shift it as to liability create nearly as much of a burden on the taxpayer as the prior burden of proof jurisprudence. Furthermore, even though § 7491 automatically shifts the burden of production as to penalties to the IRS, it still falls on the taxpayer to raise meaningful defenses to the penalty, so the provision does similarly little to alleviate the taxpayer's burden. The nature of these failures suggests that at least some of the fault lies not with the drafting of this statute but rather that the burden falls on the taxpayer for logical and practical reasons that cannot be wished away.

#### *B. The “Federally Authorized Tax Practitioner” or “FATP” Privilege*

It has long been accepted, albeit with some frustration by many parties, that non-legal tax advice is not privileged to the same extent as legal advice.<sup>235</sup> With RRA 98's addition of § 7525, Congress sought to “allow [] taxpayers to consult with other qualified tax advisors in the same manner” as with attorneys by creating a statutory privilege to protect communications between taxpayers and tax advisors authorized to practice before the IRS (e.g., accountants and enrolled agents).<sup>236</sup> This privilege was to “appl[y] in

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<sup>234</sup> Swain v. Comm’r, 118 T.C. 358, 363 (2002); TAX CT. R. 34(b)(4) (“The assignments of error shall include issues in respect of which the burden of proof is on the Commissioner. Any issue not raised in the assignments of error shall be deemed to be conceded.”). See also Del Wright Jr., *Improperly Burdened: The Uncertain and Sometimes Unfair Application of Tax Penalties*, 35 VA. TAX REV. 1, 27–29 (2015) (arguing that this line of caselaw was wrongly decided due to antipathy to tax protester arguments).

<sup>235</sup> See *Couch v. United States*, 409 U.S. 322, 335 (1973); *United States v. Arthur Young & Co.*, 465 U.S. 805, 817 (1984).

<sup>236</sup> H.R. REP. NO. 105-599, at 267–69 (1998) (Conf. Rep.).



the same manner and with the same limitations as the attorney-client privilege of present law.”<sup>237</sup>

There are several apparent logical flaws in this privilege *ab initio*. Basing a statutory privilege on a common law privilege was probably destined to fail, as the statute carefully restricted the privilege without creating a logical foundation for it. That foundational flaw is revealed by a throw-away line in the legislative history which states that “aspects of federal tax practice covered by the new privilege” do not thereby constitute the unauthorized practice of law.<sup>238</sup> This recognizes that tax advice from tax lawyers is only covered by attorney-client privilege if the advice is *legal* advice in the first place,<sup>239</sup> from which it follows that tax advice from non-lawyer tax practitioners would likewise only be covered if it were qualitatively similar advice.<sup>240</sup>

The drafters of this provision attempted to finesse these issues. They defined “Federally Authorized Tax Practitioner” (which has come to be inelegantly abbreviated as FATP) as “any individual who is authorized under federal law to practice before the Internal Revenue Service if such practice is subject to federal regulation under § 330 of title 31, United States Code.”<sup>241</sup> Attorneys and Certified Public Accountants (CPAs) are statutorily “authorized” to practice before the IRS.<sup>242</sup> In regulations (commonly referred to as Circular 230), the IRS has authorized other categories of persons to

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<sup>237</sup> *Id.* at 268.

<sup>238</sup> *Id.* at 269 (“No inference is intended as to whether aspects of federal tax practice covered by the new privilege constitute the authorized or unauthorized practice of law under various State laws.”).

<sup>239</sup> *E.g.*, *United States v. Microsoft Corp.* 125 A.F.T.R.2d 2020-547, 2020 U.S. Dist. LEXIS 8781 (W.D. Wash. Jan. 17, 2020); *see also* *Shaeffler v. United States*, 806 F.3d 34, 40 (2d Cir. 2015).

<sup>240</sup> Alternatively, the statute could cover work that *would be* legal work had a lawyer performed it. *But see* *United States v. Frederick*, 182 F.3d 499, 502 (7th Cir. 1999) (stating in *dicta*, “Nothing in the new statute suggests that these nonlawyer practitioners are entitled to privilege when they are doing other than lawyers’ work; and so the statute would not change our analysis even if it were applicable to this case . . .”). But of course, persons not admitted to the bar cannot technically do “lawyers’ work” without potentially running afoul of state unauthorized practice of law statutes.

<sup>241</sup> I.R.C. § 7525(a)(3)(A).

<sup>242</sup> 5 U.S.C. § 500(c), added by District of Columbia Appropriations Act, Pub. L. No. 106-113, § 1000(a)(9), 113 Stat. 1501, 1535–36.

practice before the IRS: “enrolled agents,”<sup>243</sup> “enrolled actuaries,”<sup>244</sup> and “enrolled retirement plan agents.”<sup>245</sup> The IRS tried to add “registered return preparers” and bring them within the scope of Circular 230’s regulatory regime, but that action was held to exceed the IRS’s regulatory authority in *Loving v. IRS*.<sup>246</sup> That return preparers are not subject to such regulation leads to the conclusion that return preparers are not Federally Authorized Tax Practitioners within the meaning of § 7525, and thus that communications with them are not privileged. Of course, there is caselaw to the effect that return preparation is not even covered by the attorney-client privilege, again meaning that the FATP privilege would not apply either.<sup>247</sup>

The definition of “tax advice” in § 7525 reinforces this point. “Tax advice means advice given by an individual with respect to a matter which is *within the scope of the individual’s authority to practice* described in Subparagraph (A).”<sup>248</sup> The nature of the advice is not further defined. The holding in *Ridgely v. Lew*,<sup>249</sup> that even acknowledged practitioners (in that case, a CPA) may not be subject to Circular 230 with respect to certain pre-representational activities (there, preparation of refund claims), throws even further doubt as to when the FATP privilege would apply. The “scope of an individual’s authority to practice” under 5 U.S.C. § 500 and the statute authorizing Circular 230 regulation (31 U.S.C. § 330) has thus been limited by *Loving* and *Ridgely* only to active representation of taxpayers before the IRS.

Beyond the ambiguities created by these original definitions and subsequent cases, Congress expressly carved certain exceptions to the FATP

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<sup>243</sup> 31 C.F.R. § 10.3(c).

<sup>244</sup> 31 C.F.R. § 10.3(d) (although their practice is limited to specified subject areas).

<sup>245</sup> 31 C.F.R. § 10.3(e) (whose practice is also limited in scope).

<sup>246</sup> *Loving v. IRS*, 742 F.3d 1021 (D.C. Cir. 2014).

<sup>247</sup> *See, e.g., United States v. Richey*, 632 F.3d 566 (9th Cir. 2011) (“The attorney-client privilege may extend to communications with third parties who have been engaged to assist the attorney in providing legal advice. If the advice sought is not legal advice, but, for example, accounting advice from an accountant, then the privilege does not exist.”).

<sup>248</sup> I.R.C. § 7525(a)(3)(B).

<sup>249</sup> *Ridgely v. Lew*, 55 F. Supp. 3d 89, 94 (2014).

privilege that potentially encompass much tax advice, far more than any limitations on the attorney-client privilege. Specifically, the FATP privilege does not cover written advice related to the direct or indirect participation of any person in a tax shelter,<sup>250</sup> nor may it be asserted in any criminal matter.<sup>251</sup> Both of these exceptions are potentially severe limitations on the scope of the § 7525 privilege.

First, § 7525(b)(2) references the very broad definition of “tax shelter” set forth in § 6662(d)(2)(C)(ii), which encompasses any transaction or structure “a significant purpose” of which is “avoidance or evasion.” Although the Seventh Circuit compared this exception to the crime-fraud exception under the attorney-client privilege,<sup>252</sup> the tax shelter exception also applies in non-criminal matters, and practitioners have complained that it logically includes a broad swath of innocuous advice, such as taking advantage of congressionally-approved tax deferral vehicles (*e.g.*, retirement plans).<sup>253</sup>

Although this provision was apparently intended to prevent tax shelter “marketing materials” from being hidden behind a claim of privilege, the broad definition of “tax shelter” necessarily inhibits taxpayers from seeking advice regarding precisely the sort of transactions where good advice is necessary. It also allows the IRS to issue guidance, or even make a taxpayer-specific determination, that a structure involves tax avoidance long after advice is rendered,<sup>254</sup> and thereby potentially to obtain communications that might previously have been thought to be privileged. Congress anticipated that the tax-shelter exception would not encroach on the FATP privilege where advice is provided in the course of a “routine relationship.”<sup>255</sup> But the Seventh Circuit reduced this to a tautology: if a transaction appears to be

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<sup>250</sup> I.R.C. § 7525(b).

<sup>251</sup> I.R.C. § 7525(a)(2).

<sup>252</sup> *See, e.g.*, *United States v. BDO Seidman LLP*, 492 F.3d 806, 822 (7th Cir. 2007) (comparing the tax shelter exception to the crime-fraud exception).

<sup>253</sup> *See, e.g.*, James Plecnik, *Tax Sheltering and the Federally Authorized Tax Practitioner Privilege*, 134 J. TAX’N 06 (2021).

<sup>254</sup> *See, e.g.*, *Valero Energy Corp. v. United States*, 569 F.3d 630 (7th Cir. 2009) (holding that “promotion” of a tax shelter can include individualized advice provided by a longstanding advisor).

<sup>255</sup> H.R. REP. NO. 105-599, at 269 (1998) (Conf. Rep.).

driven by tax avoidance, it is a shelter, and therefore not routine, even if such advice was provided in the regular course of a longstanding relationship.<sup>256</sup> What the Seventh Circuit missed is Congress's intention that the tax-shelter exception not "adversely affect such routine relationships,"<sup>257</sup> but it clearly has done so, as taxpayers can place no anticipatory reliance on the FATP privilege.

The second exception, that the FATP privilege may not be raised in criminal matters at all, is broader than the crime-fraud exception to the attorney-client privilege because it does not even protect communications about *past* criminal conduct.<sup>258</sup> This may discourage a previously non-compliant taxpayer from seeking advice from a non-lawyer FATP regarding coming into compliance. Arguably, a more expansive FATP privilege would serve the public interest in compliance, which courts often consider in delineating the boundaries of the FATP privilege.<sup>259</sup>

The net effect of these ambiguities and exceptions is that the FATP privilege is likely to be respected only in a post-return, representational context, where there is only civil tax liability at issue and no realistic chance of criminal exposure. In contrast, tax planning communications with lawyers can be privileged as legal advice, and likely would not be subject to the crime-fraud exception or other waivers. As a practical matter, however, CPAs can be brought into such discussions, and privilege retained, through *Kovel* agreements<sup>260</sup> rather than by reliance on the FATP privilege. In

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<sup>256</sup> See *Valero*, 569 F.3d at 634.

<sup>257</sup> H.R. REP. NO. 105-599, at 269 (1998) (Conf. Rep.) ("The Conferees do not understand the promotion of tax shelters to be part of the routine relationship between a tax practitioner and a client. Accordingly, the Conferees do not anticipate that the tax shelter limitations will adversely affect such routine relationships.").

<sup>258</sup> I.R.C. § 7525(a)(2). Interestingly, courts seem prone to combining the analysis of whether the attorney-client and federally authorized tax practitioner privileges apply in light of criminal activity, missing this nuance. See, e.g., *United States v. Trenk*, 103 A.F.T.R.2d 2009-1071 (2009 WL 485375) (Feb. 26, 2009); *United States v. BDO Seidman, LLP*, 492 F.3d 806 (7th Cir. 2007) with additional discussion of this issue in the district court, 2005 WL 742642 (N.D. Ill. 2005) (affirmed in part and vacated in part).

<sup>259</sup> See, e.g., *United States v. Microsoft Corp.*, 125 A.F.T.R.2d 2020-547, 2020 U.S. Dist. LEXIS 8781 (W.D. Wash. Jan. 17, 2020) (giving weight to the public interest in a privilege determination).

<sup>260</sup> *United States v. Kovel*, 296 F.2d 918, 920 (1961).

addition, the IRS has adopted a “policy of restraint” providing, subject to certain exceptions, that

[i]f a document is otherwise privileged under the attorney-client privilege, the tax advice privilege in section 7525 of the Code, or the work product doctrine and the document was provided to an independent auditor as part of an audit of the taxpayer’s financial statements, the Service will not assert during an examination that privilege has been waived by such disclosure.<sup>261</sup>

This policy was necessary because courts repeatedly have held that disclosing privileged documents to outside independent auditors waived attorney-client privilege (though it would not necessarily waive the protection of the work product doctrine).<sup>262</sup>

Thus, the FATP privilege has not come close to carrying out the idea of protecting taxpayer communications with non-lawyer advisors. Indeed, not only has it proved to be a weak and ineffective protection, but it has also probably contributed to the erosion of attorney-client privilege throughout the tax world as well. Attorney-client privilege with respect to tax advice has long been plagued by the fear that taxpayers will hire attorneys to do non-legal work like tax return preparation in order to attempt to claim the privilege. This has led to much hair-splitting as to what constitutes *legal* advice on tax matters. Recently, the Ninth Circuit had to check itself, after initially noting, in an opinion on the scope of attorney-client privilege, that “*normal tax advice*—even coming from lawyers—is generally not privileged.”<sup>263</sup> The Ninth Circuit, fortunately, reconsidered the broad implications of this casual language and amended the footnote to replace that phrase with “*normal tax return preparation assistance*” which is more in keeping with cases limiting attorney-client privilege based on the disclosure of tax returns.<sup>264</sup> While the scope of the FATP privilege technically has no bearing on the application of attorney-client privilege, its gaps arguably

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<sup>261</sup> I.R.S. Announcement 2010-76, Policy of Restraint.

<sup>262</sup> See, e.g., *United States v. Textron Inc. and Subsidiaries*, 577 F.3d 21 (1st Cir. 2009) (holding disclosure waived attorney-client privilege and the federally authorized tax practitioner privilege); *United States v. Deloitte, LLP*, 610 F.3d 129 (D.C. Cir. 2010) (holding disclosure waived attorney-client privilege).

<sup>263</sup> *In re Grand Jury*, 13 F.4th 716 n.5 (9th Cir. 2021).

<sup>264</sup> *In re Grand Jury*, 23 F.4th 1088 n.5 (9th Cir. 2021), *cert. granted*, 143 S. Ct. 80 (2022), *cert. dismissed as improvidently granted*, 143 S. Ct. 543 (2023).

further the perception that there is precious little tax advice that deserves protection.

Is the FATP privilege, or some similar privilege directed at non-lawyers in the tax system, worth saving? Certainly not until the courts clarify the extent of the attorney-client privilege in situations involving tax advice and/or return preparation.<sup>265</sup> Then, policy-makers must give some thought to the core concept of § 7525, *i.e.*, whether it makes sense to define a privilege for communications with non-lawyers as co-extensive with, or at least by reference to, the privilege for such communications with lawyers. Similarly, so long as the exceptions to the two privileges potentially differ, there will always be pressure on their relative scope, which presently inhibits reliance on § 7525. In short, in the authors' view, more thought needs to be given to the underlying rationale for the privilege for any communications regarding tax advice other than traditional attorney-client communications.

#### IV. CONCLUDING OBSERVATIONS

The discussion above shows that, as is probably the case with any significant legislation, there are some provisions in RRA 98 that have proven to be hits, some complete misses, and some that have shown mixed results in the past twenty-five years. Some of the mixed bag provisions could probably be improved with renewed focus on them, while some of the least successful provisions (such as the burden of proof shift and the FATP privilege) likely require fundamental re-thinking to be useful and viable. Those that are already successes, however, by definition require the least amount of future tweaking: perhaps just changing the funding levels or criteria for LITCs, for instance, or returning separation of liability and “innocent spouse” relief to *de novo* review in the Tax Court. The twenty-fifth anniversary of RRA 98 is a good time for such legislative improvements.

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<sup>265</sup> While it was hoped that the Supreme Court would clarify the scope of the FATP privilege, having granted certiorari in *In re Grand Jury*, the Supreme Court subsequently dismissed the grant of certiorari as improvidently granted. 143 S. Ct. 543 (2023).

