

# **Tax Practice and Procedure:**

Working With (and Against) the IRS

**University of Southern California**  
Tax Research

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# **Tax Practice and Procedure-Working With (and Against) the IRS**

## **I. IRS Organization**

- A. As of 1998 IRS was divided into operating divisions**
- B. Service Centers Become Campuses**
- C. Taxpayer Advocate**
  - 1. Taxpayer Assistance Orders- TAO**
    - a) Form 911**

## **II. Types of Audits**

### **A. Power of Attorney Tips**

- 1. Fax a copy of the POA to the IRS CAF Unit**
- 2. Add additional years on both sides to the POA**
- 3. Make sure that the signatures are no older than 60 days**
- 4. Make representations rather than ask questions if you don't have a POA**

### **B. Correspondence Examinations**

- 1. Interest**
- 2. Taxes**
- 3. Medical Expenses**

### **C. Office Examinations- Generally Form 1040**

- 1. May include Schedule C, Sch. E. Casualty and Theft Losses**
- 2. Conducted by an office auditor**

### **D. Field Examinations. Reserved for most complex types of audits**

- 1. Conducted by a revenue agent**
- 2. IDR v. Summons**
  - a) All bank and financial accounts**
- 3. Generally conducted at taxpayer's place of business**
  - a) Try to move it to your office if at all possible**
  - b) If an examination is scheduled by the Service at the taxpayer's place of business and the taxpayer represents to the Service in writing that conducting the examination at the place of business would essentially require the business to close or would unduly disrupt business operations, the Service, upon verification, will change the place of examination to a Service office within the area where the taxpayer's books, records, and source documents are maintained. Treas. Reg. § 301.7605-1(d).**
- 4. Revenue Agent will wish to interview the taxpayer.**
  - a) Beginning v. End**
  - b) Can not be required in the absence of a summons. IRC Section 7521(c)**
  - c) Taxpayer may record the interview. IRC § 7521(a)(1)**

### **E. Eggshell Audits and Reverse Eggshell Audits.**

1. What is an eggshell audit.
  - a) An eggshell audit is a civil tax audit in which the taxpayer has filed a false tax return. If the falsity comes to light then there is possibility that the IRS can refer the case for criminal investigation, and ultimately criminal prosecution. Because of the sensitivity of the issues and the potential for disastrous results, anyone involved in the audit must walk on eggshells. Hence the term "eggshell audit."
  - b) What is a "reverse eggshell audit." This is a tax audit in which IRS agent is collecting information for what purports to be a civil tax audit with the intent of providing that information to the IRS' criminal investigation division for criminal tax prosecution. It is the taxpayer who is unaware of the parallel or simultaneous criminal investigation.
2. What are the stakes.
  - a) Civil Tax Fraud Penalty. IRC Section 6663.
    - (1) The civil tax fraud penalty is 75% of the underpayment which is due to tax fraud. The IRS has the burden of proving civil tax fraud by clear and convincing evidence.
      - (a) If the IRS proves that ANY portion of the underpayment is due to tax fraud then the entire amount of the underpayment is treated as being due to tax fraud, unless the taxpayer can prove by the preponderance of the evidence that some portion is not due to tax fraud.
  - b) Criminal Tax Fraud or Tax Evasion. IRC Section 7201.
    - (1) The penalty for tax evasion is a maximum fine of \$100,000, and five years in jail.
  - c) False Return Charges IRC Section 7206(1).
    - (1) The penalty for filing a false income tax return is a maximum fine of \$100,000, and three years in jail.
    - (2) A taxpayer can be convicted of filing a false tax return even though there is no tax owed.
  - d) Potential consequences of a felony tax conviction in addition to jail and monetary fines.
    - (1) Loss of voting rights.
    - (2) Loss of right to possess firearms.
    - (3) Loss of professional licenses.
    - (4) Loss of federal government contracts.
    - (5) Deportation of alien.
3. What are the options?
  - a) Pre-emptively bring the issues to the attention of the examining agent.
  - b) File an amended tax return.
  - c) Remain silent, and see if the agent discovers the problem areas.
4. Who Should Handle the Tax Audit.
  - a) Return Preparer

**(1) Advantages**

- (a) Less likely to raise the suspicions of the IRS agent; especially where the tax audit has already begun.**
- (b) Possible lower cost to Client.**

**(2) Disadvantages**

- (a) The client may have made false statements to the return preparer which need to be protected (to the extent possible) from exposure to the IRS.**
- (b) The return preparer may have a conflict of interest since one of the defenses available to the client may be reliance on the return preparer. It would generally not be in the interest of the tax return preparer to divulge that he prepared a false tax return. The return preparer may also have exposure to penalties under Internal Revenue Code Section 6694, which in turn could implicate the tax return preparer's ability to practice before the IRS.**
- (c) If the return preparer has knowledge of the sensitive areas he could be required to reveal them or invoke the federally authorized tax practitioner which would highlight the problems.**
- (d) Most return preparers will not have sufficient experience with tax fraud to be able to effectively handle an eggshell audit on their own.**

**(e) Lack of attorney client privilege**

- i) Federally authorized tax practitioner privilege. IRC Section 7525 protects confidential client communications with respect to tax advice between a client and a federally authorized tax practitioner. A federally authorized tax practitioner includes CPAs, Enrolled Agents, and enrolled actuaries.**

**a. Limitations, Problems and Tips**

- 1) The federally authorized tax practitioner privilege may only be asserted in civil administrative proceedings before the IRS or in civil tax proceedings in Federal Court brought by or against the United States.**
- 2) The federally authorized tax practitioner privilege does not apply to written communications in connection with the promotion of the direct or indirect participation of any corporation in any "tax shelter." A tax shelter is any plan or arrangement if a significant purpose of the arrangement is the avoidance or evasion of federal income tax. See Section 6662(d)(2)(C)(iii).**
- 3) If a client is ever subject to criminal prosecution the federally authorized tax practitioner privilege is not applicable. Clients should be discouraged from making "confessions," in the mistaken belief that their statements are privileged.**
- 4) The federally authorized tax practitioner privilege will not apply in non-tax matters such as divorce proceedings or SEC investigations.**
- 5) The federally authorized tax practitioner privilege does not apply to California tax proceedings.**
- 6) Because the federally authorized tax practitioner privilege is based upon the attorney client privilege an understanding of that privilege is essential. For example:**

- 7) The privilege may be waived if the confidential information is disclosed to a third party such as a parent or child.
- 8) The federally authorized tax practitioner privilege **SHOULDN'T BE CONFUSED WITH WORK PRODUCT PRIVILEGE**. This privilege protects documents, prepared in anticipation of litigation by a party or its counsel. It is subject to different rules and restrictions.
- 9) Communications made for the purpose of preparing a tax return are generally not privileged! The communication must be confidential. It has been held by some courts that there is no expectation of confidentiality in information intended to be included on a tax return. cf. *United States v. Cote*, 456 F.2d 142 (8th Cir. 1972) (disclosure waives privilege not only as to disclosed data but also as to details underlying the information on the return) with *United States v. Abraham*, 905 F.2d 1276 (9th Cir. 1990) (Although communications made solely for tax return preparation are not privileged, communications made to acquire legal advice about what to claim on tax returns may be privileged).
- 10) It does not apply to business or financial advice.
- 11) If the IRS can establish that an otherwise privileged attorney-client communication was in furtherance of a criminal or fraudulent scheme by the taxpayer, the attorney-client privilege will not apply. In re Grand Jury Investigation (The Corporation), 87 F.3d 377, at 381 (9th Cir. 1996); In re Grand Jury Proceedings (John Doe), 867 F.2d 539, at 541 (9th Cir. 1989).

**(f) Effective Dates.** Generally communications made on or after July 22, 1998.

- b) **Return Preparer with the Assistance and Advice of a Tax Litigation Attorney.** While a much better idea than option one, if the return preparer has prior knowledge of the tax problems on the return some of the above disadvantages will still be applicable.
- c) **New accountant with no prior knowledge of the sensitive issues.** This can obviate some of the concerns listed above.
  - (1) **Kovel Accountant.** In *United States v. Kovel*, 296 F.2d 918 (2d Cir. 1961) the privilege was extended to communications made by a client to an accountant retained by the law firm representing him in order to interpret the client's financial data for his tax attorney. The court stated that "[w]hat is vital to the privilege is that the communication be made in confidence for the purpose of obtaining legal advice from the lawyer. If what is sought is not legal advice but only accounting service . . . or the advice sought is the accountant's rather than the lawyer's, no privilege exists." 296 F.2d at 922. In *In re G-1 Holdings Inc.*, 218 F.R.D. 428 (D.N.J. 2003), the court interpreted *Kovel* to limit the extension of the attorney-client privilege between an accountant and a client to when the accountant functions as a "translator" between the client and the attorney. See *U.S. v. Bell*, 95-1 USTC ¶50,006 (N.D. Cal. 1994) (court concluded that reports concerning the taxpayer's transfer pricing system prepared by an accountant at the direction of the taxpayer's outside counsel were covered by attorney-client privilege and work product doctrine). Cf. *U.S. v. Randall*, 99-1 USTC ¶ 50,596 (D. Mass. 1999) (attorney-client privilege inapplicable to taxpayers' conversations with accountant referred to them by an

attorney who was acting solely as a tax return preparer).

(a) See attached example of a "Kovel engagement letter."

d) **Tax Litigation Attorney.** The major disadvantage is possibly alerting the revenue agent that there is potential tax fraud. On the other hand if the revenue agent is already aware of the sensitive issues then it will not be a big surprise that a tax litigation attorney has been brought in. Likewise if the dollar amounts are large, or some of the issues technical in nature bringing in a tax litigation attorney should not be a tip off.

**5. Has the Tax Audit Become Criminal? Is a Criminal Tax Fraud Referral Imminent?**

a) The Internal Revenue Manual provides that when the agent has determined in conjunction with the fraud referral specialist that "firm indications of fraud exist" the civil tax audit should be suspended, and the case referred to the Criminal Investigation for possible criminal prosecution. The IRM distinguishes between "indicators" of fraud which it refers to as a sign or symptom of fraud, and "firm indications" which it refers to as "affirmative acts." IRM 25.1.2.1. Listed below are examples of fraud indicators from the IRS Fraud Handbook. IRM 25.1.2.2.

**(1) Indicators of Fraud-Income.**

(a) Omissions of specific items where similar items are included.

(b) Omissions of entire sources of income.

(c) Unexplained failure to report substantial amounts of income determined to have been received.

(d) Substantial unexplained increases in net worth, especially over a period of years.

(e) Substantial excess of personal expenditures over available resources.

(f) Bank deposits from unexplained sources substantially exceeding reported income.

(g) Concealment of bank accounts, brokerage accounts, and other property.

(h) Inadequate explanation for dealing in large sums of currency, or the unexplained expenditure of currency.

(i) Consistent concealment of unexplained currency, especially in a business not calling for large amounts of cash.

(j) Failure to deposit receipts to business account, contrary to normal practices.

(k) Failure to file a return, especially for a period of several years although substantial amounts of taxable income were received.

(l) Cashing checks representing income at check cashing services and banks other than the taxpayer's.

(m) Covering up sources of receipts by false description of source of disclosed income, and/or nontaxable receipts.

**(2) Indicators of Fraud-Expenses or Deductions.**

- (a) Substantial overstatement of deductions.**
- (b) Substantial amounts of personal expenditures deducted as business expenses.**
- (c) Claiming fictitious deductions.**
- (d) Dependency exemption claimed for nonexistent, deceased, or self-supporting persons.**
- (e) Loans of trust funds disguised as purchases or deductions.**
- (3) Indicators of Fraud-Books and Records**
  - (a) Keeping two sets of books or no books.**
  - (b) False entries or alterations made on the books and records, backdated or post dated documents, false invoices, false applications, statements, other false documents, or applications.**
  - (c) Invoices are irregularly numbered, unnumbered or altered.**
  - (d) Checks made payable to third parties are endorsed back to the taxpayer. Checks made payable to vendors and other business payees are cashed by the taxpayer.**
  - (e) Failure to keep adequate records, concealment of records, or refusal to make certain records available.**
  - (f) Variances between treatment of questionable items on the return as compared with books.**
  - (g) Intentional under or over footing of columns in journal or ledger.**
  - (h) Amounts on return not in agreement with amounts in books.**
  - (i) Amounts posted to ledger accounts not in agreement with source books or records.**
  - (j) Journalizing of questionable items out of correct account.**
  - (k) Recording income items in suspense or asset accounts.**
  - (l) False receipts to donors by exempt organizations.**
- (4) Indicators of Fraud-Allocations of Income.**
  - (a) Distribution of profits to fictitious partners.**
  - (b) Inclusion of income or deductions in the return of a related taxpayer, when difference in tax rates is a factor.**
- (5) Indicators of Fraud-Conduct of Taxpayer**
  - (a) False statement about a material fact involved in the examination.**
  - (b) Attempts to hinder the examination. For example, failure to answer pertinent questions, repeated cancellations of appointments, refusal to provide records, threatening potential witnesses, including the examiner or assaulting the examiner.**
  - (c) Failure to follow the advice of accountant or attorney.**
  - (d) Failure to make full disclosure of relevant facts to the accountant.**
  - (e) The taxpayer's knowledge of taxes and business practices where numerous questionable items appear on the returns.**
  - (f) Testimony of employees concerning irregular business practices by the taxpayer.**

- (g) Destruction of books and records, especially if just after examination was started.
- (h) Transfer of assets for purposes of concealment, or diversion of funds and/or assets by officials or trustees.
- (i) Patterns of consistent failure over several years to report income fully.
- (j) Proof that the return was incorrect to such an extent and in respect to items of such character and magnitude as to compel the conclusion that the falsity was known and deliberate.
- (k) Payment of improper expenses by or for officials or trustees.
- (l) Willful and intentional failure to execute pension plan amendments.
- (m) Backdating of applications and related documents.
- (n) Making false statements on TEGE determination letter applications.
- (o) Use of false social security numbers.
- (p) Submission of false Form W-4.
- (q) Submitting a false affidavit.
- (r) Attempts to bribe the examiner.
- (6) Indicators of Fraud-Methods of Concealment.
  - (a) Inadequacy of consideration.
  - (b) Insolvency of transferor.
  - (c) Assets placed in other's names.
  - (d) Transfer of all or nearly all of debtors' property.
  - (e) Close relationship between parties to the transfer.
  - (f) Transfer made in anticipation of a tax assessment or while the investigation of a deficiency is pending.
  - (g) Reservation of any interest in the property transferred.
  - (h) Transaction not in the usual course of business.
  - (i) Retention of possession.
  - (j) Transactions surrounded by secrecy.
  - (k) False entries in books of transferor or transferee.
  - (l) Unusual disposition of the consideration received for the property.
  - (m) Use of secret bank accounts for income.
  - (n) Deposits into bank accounts under nominee names.
  - (o) Conduct of business transactions in false names.
- b) The IRS is under no duty to inform the taxpayer that the civil investigation may result in criminal tax charges. *United States v. Knight*, 898 F.2d 436 (5th Cir. 1990).
- c) On the other hand the IRS may not use evidence obtained through fraud, trickery or deceit. In *U.S. v. Tweel*, 550 F.2d 297 (5th Cir. 1977) the Fifth Circuit suppressed business records obtained by a revenue agent through what the court characterized as a "deliberate deception." In *Tweel*, the revenue agent called the taxpayer's accountant to request certain records.



The accountant asked if there was a special agent involved; the revenue agent responded that there was not, but failed to disclose that the examination was being conducted at the request of a criminal team at the Department of Justice.

- d) More recently the 7th Circuit refused to suppress evidence where the revenue agent failed to advise the taxpayer that she had discovered firm indications of fraud, but nevertheless continued to request records. *United States v. Greve*, 490 F. 3d 566 (7th Cir. 2007). The result might have been different if Greve had asked whether or not a fraud referral specialist had been consulted, and/or whether she was considering a referral to Criminal Investigation.
- e) Tell-Tale Signs that the agent suspects tax fraud.
  - (1) An aggressive IRS agent has stopped in the middle of the audit, and has become non-responsive or evasive when asked about when the tax audit will be completed.
  - (2) The IRS agent starts copying voluminous documents for his files.
  - (3) The IRS agent is asking a lot of "intent question." Those beginning with "Why" and "Didn't you know."
  - (4) The IRS agent insists on meeting with the client more than once.
  - (5) The IRS agent shows excessive interest in the sensitive transactions.
  - (6) The IRS agent summonses bank records directly from a financial institution, after the taxpayer has already provided, or offered to provide these records.
  - (7) Requests for sworn affidavits from the client and third parties
  - (8) A larger number of 3rd party interviews
  - (9) An IRS special agent makes a surprise visit to your client.
    - (a) A special agent will identify himself as such, and his business card has a gold shield.
- f) How do you minimize that risk.
  - (1) First understand the case.
  - (2) Client must be interviewed very carefully to ascertain the true facts.
  - (3) The preparer should be interviewed very carefully to see what defenses are available in terms of preparer reliance; or whether failure to disclose to the agent is an additional badge of fraud.
  - (4) The return must be reviewed closely to try and determine if everything the client is telling you hangs together, and makes sense.
  - (5) Don't aggravate the agent unnecessarily.
    - (a) Provide documents that you know he can get from third parties, and that are not privileged.
  - (6) Don't give the agent any additional badges of fraud. That means:
    - (a) No false documents.
    - (b) No ½ true statements.
    - (c) No misleading statements.

- (d) Counsel the client against contacting third parties to encourage them not to cooperate with the IRS. (Obstruction of justice).
  - (e) Counsel the client against destruction of documents.
  - (7) Consider whether a "voluntary disclosure" will be more or less likely to cause a CI referral.
  - (8) Consider whether you should allow the client to be interviewed?
    - (a) Generally speaking you don't want your client to be interviewed because his unconsidered statements may come back to bite him later
      - i) If you have a client and there are legitimate explanations for any problematic items on the return then you MAY wish to consider allowing the client to speak with the IRS.
        - a. At a minimum you should try and defer the interview to the end of the audit; ask for a list of questions, or areas to be covered.
      - (b) If the client is interviewed you need to make sure that the client is fully prepared for all possible areas of questioning, and that he understands that he should not guess, or speculate at answers to questions.
6. What to do about the filing of tax returns which are due during the pendency of the eggshell audit?
- a) This is a pernicious problem because even the existence a criminal tax investigation does not free the taxpayer from his obligation to file a tax return, and failure to do so may result in criminal prosecution under IRC Section 7203. On the other hand filing an honest and accurate return may reveal to the IRS the problem areas on the already filed returns. The current return may be used as an admission against the taxpayer in a criminal tax prosecution. For example:
    - (1) The current return may disclose previously undisclosed bank accounts, or foreign assets.
    - (2) If ending inventory was previously misstated correcting the problem in the current year would be an admission to the incorrect prior inventory.
    - (3) The current return correctly reporting income or deductions may confirm an agent's suspicion about prior years errors, or may lead the agent to errors of which he was previously unaware.
  - b) Fifth Amendment Solutions.
    - (1) Little support appears in the case law for the assertion that a taxpayer can fail to file any return at all because the filing of the return may incriminate him. Nevertheless this approach has been recommended by some respected commentators.
    - (2) The privilege can be asserted as to an item on a return if there is a legitimate reason why an accurate response might subject the taxpayer to a criminal prosecution. *United States v. Neff*, 615 F.2d 1235 (9th Cir. 1980).
      - (a) Of course the invocation of the privilege with regard to a specific line item will focus the IRS' attention on the sensitive areas.

**c) Other Solutions- Not Recommended**

**(1)** Send a letter to the IRS stating the taxpayer is under audit, and cannot file a return at this time, but that one will be filed as soon as the investigation is completed. Enclose a check for the approximate amount that would be do if a correct return were filed.

**(2)** Continue the error in the new return with an annotation stating that the taxpayer is currently under audit, and that the return is consistent with the method used in prior returns, but may not accurately reflect the taxpayer's income.

**F. Issuance of 30 Day letter**

**1. Manager's Conference**

**G. Extending the Statute of Limitations**

**1. Form 872**

**2. Form 872-A**

**3. Restricted Consents are a matter of right. See section 6501(c)(4)(B)**

**III. Appeals Conference**

**A. Protest. A formal written protest is required except:**

**1. If the amount for any tax period is not more than \$25,000. Instead the taxpayer should send a letter requesting Appeals consideration, indicating the changes not agreed with and the reasons for the disagreement.**

**a) A formal written protest is require in all partnership and S Corporation cases, and all employee plan and exempt organization cases without regard to the amount involved.**

**B. Required Contents of a Written Protest -- IRS Publication No. 5 (Rev. 1/99) - See Sample attached**

**1. Statement that the taxpayer wishes to appeal the examination determination;**

**2. Taxpayer's name and address, and a [daytime telephone number]**

**3. A copy of the 30 day letter, or the date and symbols on the 30-day letter;**

**4. Tax periods involved;**

**5. Itemized schedule of non-agreed adjustments;**

**6. Statement of facts supporting the Taxpayer's position;**

**7. Statement outlining the law or other authority;**

**8. Signed by the taxpayer certified as true under the penalty of perjury or signed by the representative with a declaration that:**

**a) he/she is the preparer and**

**b) the extent of knowledge as to the correctness and truthfulness of the information contained therein.**

**9. Power of Attorney (Form 2848) if not already on file.**

**C. Factors in Favor of an Appeals Conference**

**1. Opportunity for review of errors made by the revenue agent**

**2. Opportunity for settlement based on hazards of litigation**

3. Opportunity for negotiating at higher levels within the IRS
4. Opportunity for a fresh look at the situation

#### **D. Factors Against an Appeals Conference**

1. Time and expense
2. Risk of new issues being raised. Internal Revenue Manual Section 8.6.1.4 provides that a new issue should not be raised unless there are "substantial" grounds for raising the issue and the effect on tax liability is "material"
3. A new issue is not raised by Appeals to the taxpayer's detriment unless grounds for such action are substantial (strong, possessing real merit) and the potential effect on the tax liability is material (having real importance and great consequence). There must be some good, sound, substantial reason already existing in the record or known to the appeals officer to raise the issue. Mere suspicion or guess that something might be wrong with the item is not substantial. For example, if Compliance disallowed a claimed farm loss solely on the ground that it was a hobby and made no comment concerning the items making up the loss, there would not be substantial grounds for raising a new issue concerning the amount of loss, amount of any item making up the loss, or nature of any item making up the loss simply because the appeals officer merely suspected or guessed that the items had not been verified. On the other hand, if the examiner had indicated in the report that these items had not been verified, there would be good reason for the appeals officer, if he or she believed such action was necessary, to refer the case back to Compliance for such verification. If, in the discussion of reasons for disallowance of the claimed farm loss, Compliance stated that some of the items of claimed expense were personal in nature, this would constitute substantial ground for the appeals officer either raising a new issue or referring the case back to Compliance.
4. "Substantial grounds" are those which cause an appeals officer to be quite certain, at the time a new issue (other than an alternative issue) is raised, that the Government will prevail if the issue is litigated. "Quite certain" does not necessarily mean 100 percent certain, but it does mean a very high degree of certainty. If an alternative issue or position represents the real issue which should be in controversy, certainly the Government's best position should be set forth even though it does not meet the "quite certain" test. If a new issue is an alternative issue or alternative position, grounds are substantial if it strengthens the Government's position over that relied upon by Compliance because it represents the position of the Service or, if the Service has no position, the correct legal theory on the transaction involved. However, if an alternative issue or position is quite weak, even though it strengthens the Government's position, it should not be raised. Neither should an alternative issue or position be raised if the tax effect is not material or is not compatible with the Appeals' mission and objectives.

#### **E. Appeals Conference v. Immediate Issuance of 90 Day Letter**

1. Interest. IRC Section 6404(g). Effective Date. Taxable years ending after July 22, 1998. The 18 month period will be shortened to 1 year for taxable years beginning after Dec. 31, 2003.

- a) In the case of an individual income tax return interest will be suspended if the IRS does not notify the taxpayer of his liability and the basis for the liability within 18 months of the filing date (or its due date without extensions, whichever is later).
  - (1) Notification includes by issuing math error notices, examination reports, and other documents listing liability and the basis thereof. In issuing these documents, the Service must include a statement of the tax liability, not merely an adjustment to the income from which that liability is computed. ILM 200130040. 2001 TNT 146075.
- b) The suspension terminates 21 days after the IRS issues the required notice.
- c) The suspension applies only if the taxpayer files a timely return (including extensions);
- d) The suspension doesn't apply if there is fraud involved;
- e) The rule is to applied separately with regard to each item or adjustment.

#### **F. Appeals Settlements.**

- 1. Types of Settlement. Settlements are issue by issue.
  - a) Mutual Concession settlements. Both parties make a concession where there is uncertainty. e.g. valuation dispute.
- 2. Split-issue settlements. Appeals may enter into settlements based on a percentage or stipulated amount of the tax in controversy.
  - a) Nuisance Value Settlements. Not permitted.
- 3. Documenting the Settlement
  - a) Form 870 - Does not prevent a taxpayer from bringing a subsequent refund suit
  - b) Form 870-AD - On its face does not permit the filing of a refund claim. But see *Joyce v. Gentsch*, 141 F.2d 891 (6th Cir 1944)
  - c) Closing Agreement – IRC Section 7121

### **IV. The Courts**

#### **A. Considerations in Choosing a Forum.**

- 1. Payment of deficiency
- 2. Precedent
  - a) "Golsen Rule" - *Golsen v. Commissioner*, 54 T.C. 70 (1970).
- 3. Availability of Jury Trial
- 4. Subpoena Power
  - a) District Court - 100 miles from the place of trial and within the district
  - b) Tax Court and Claims Court have national subpoena power. Rule 123 Ct. Cl. Rules; IRC Section 7456
- 5. Place of Trial
- 6. Costs

#### **B. Tax Court**

- 1. Statutory Notice of Deficiency ("90 day letter") - Ticket to Tax Court. See

Attached

2. Timely filed of a petition is essential
  - a) 90 days from the date of mailing
  - b) Timely mailing is timely filing
    - (1) Certified mail receipt stamped by the U.S. Post Office is proof that the letter was timely mailed. Treas. Reg. Section 301.502-1(c)(2)
      - (a) Even if not received. Treas. Reg. Section 301.7502-1(d)
    - (2) Petition must be properly addressed and proper postage affixed thereto
    - (3) Private postmeter will not establish mailing date
    - (4) Alternate delivery services pursuant to IRS Notice 2004-83 are:
      - (a) DHL Express (DHL): DHL Same Day Service; DHL Next Day 10:30 am; DHL Next Day 12:00 pm; DHL Next Day 3:00 pm; and DHL 2nd Day Service;
      - (b) Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, FedEx 2 Day, FedEx International Priority, and FedEx International First; and
      - (c) 3. United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, UPS 2nd Day Air A.M., UPS Worldwide Express Plus, and UPS Worldwide Express.
3. Small Tax Case Procedure - IRC Section 7463
  - a) Maximum amount in dispute including penalties for any one year must be \$50,000 or less.
  - b) No appeal allowed from small tax cases. IRC Section 7463(b)
  - c) Special petition form available from the Court for filing small tax cases
  - d) Trials conducted in an informal manner. Tax Court Rule 177(b)
  - e) Rules of evidence not strictly enforced. Tax Court Rule 177(b)
  - f) No briefs required. Tax Court Rule 177(c)
  - g) Small tax cases do not serve as precedent. IRC Section 7463(b)
  - h) The Court may change a case from an S case to a regular case.

### C. District Court and Court of Federal Claims

1. Prerequisites for filing suit
  - a) Tax and penalty must be paid in full. *Flora v. United States*, 362 U.S. 145 (1960).
    - (1) Exception for divisible taxes; e.g., employment taxes
  - b) Payment of interest is not required, at least in Court of Federal Claims. *Shore v. United States*, 9 F.3d 1524 (Fed. Cir. 1993).
    - (1) The IRS apparently agrees. 1996 FSA LEXIS 476 (Mar. 15, 1996), however, it may continue to attempt to collect the remaining balance due unless a refund suit is brought
  - c) Refund claim previously filed with the IRS and the IRS has denied the claim or 6 months has elapsed - IRC Section 7422
    - (1) Period of limitation on filing refund claims. IRC Section 6511(a). The

later of:

**(a) 3 years from the date tax return filed, or**

**(b) 2 years from the date the tax is paid**

**(2) Form and content of refund claim**

**(a) Income tax claims filed on 1040X or 1120X**

**(b) All other claims filed on Form 843**

**(c) Must state in detail the grounds and facts upon which the claim is based.**

**D. Suit must be brought within 2 years of the date of mailing of the "notice of claim disallowance." IRC Section 6532(a)(2).**

**E. Burden of Proof. IRC Section 7491. In any court proceeding related to income, estate, gift or generation skipping transfer taxes, if the taxpayer introduces credible evidence with respect to any factual issue the IRS will have the burden of proof with respect to that issue. Applies to court proceedings in connection with examinations began after July 22, 1998. In any case where there was no examination, it applies to court proceeding arising in connection with taxable periods or events beginning or occurring after the date of the enactment.**

- 1. If the taxpayer complies with the statutory requirements, the Service must now assume the burden of showing to the satisfaction of the Court that the tax liability as determined was correct, and the taxpayer no longer bears the burden of proof. It is critical that examiners now document their workpapers to reflect the degree of taxpayer cooperation. In addition, the examiners must fully describe documents used to support audit conclusions and proposed tax adjustments. Examiners must also prepare documents which will fully describe the steps taken and the analysis which supports audit conclusions. IRM 8.6.1.3.5.12.**
- 2. Limitations.**
  - a) The taxpayer must have complied with all substantiation requirements. This includes, for example, Sections 274(d) and 170(a)(1).**
  - b) The taxpayer must have maintained all records required under the Internal Revenue Code;**
  - c) The taxpayer must have cooperated with reasonable requests by the IRS for witnesses, information, documents, meetings and interviews;**
  - d) If the taxpayer is a partnership, corporation or trust its net worth cannot exceed \$7 million.**
- 3. In the case of an individual taxpayer the IRS has the burden of proof with respect to any item of income which is reconstructed solely through the use of statistical information on other taxpayers.**
- 4. In a court proceeding relating to the liability of an individual for a penalty, the IRS has the burden of production. Thus the IRS must initially come forward with evidence showing the appropriateness of applying the penalty to the taxpayer. This does not require the IRS to produce evidence negating**

reasonable cause or the existence of substantial authority.

**F. Qualified Offers- Attorneys and Accountants Fees. See Sample attached.**

- 1. Generally, if the taxpayer submits a qualified offer which is not accepted, and at trial the judgment for the IRS is equal or less than the amount of the offer the taxpayer can be awarded attorneys and accountants fees. See Section 7430(g).**
  - a) Taxpayer must also meet certain income and net worth requirements, and have exhausted her administrative remedies..**
- 2. Fees may be awarded for costs and fees incurred after the earlier of the issue of the 90 day letter, the 30 day letter or the date of the receipt of a notice of written decision from the IRS Office of Appeals.**
- 3. Doesn't apply if the case is settled.**
- 4. A qualified offer is a written offer which is made during the "qualified offer period," specifies the offered amount, is designated as a qualified offer, and remains open until the earliest of**
  - a) the 90th day after it is made;**
  - b) the date the trial begins; or**
  - c) the date the offer is rejected. Section 7430(g)(1)**
  - d) The qualified offer period begins on the date of the issuance of the 30 day letter, and ends 30 days before the case is first set for trial. Section 7430 (g)(2).**





A Professional Corporation

Tax Controversy Law  
Tax Controversy Law  
Tax Controversy Law  
Tax Controversy Law

Tel: 310.208.6200

Fax: 310.478.8030

[www.bragertaxlaw.com](http://www.bragertaxlaw.com)

April 5, 2010

Re:

Dear

This is a "qualified offer" pursuant to IRC §7430. The taxpayers offer to pay a total of \$10 to settle their liability for the years 1993, 1994 and 1995. This offer shall remain open until the earliest of (a) the 90th day after it is made; (b) the date the trial begins; or (c) the date the offer is rejected.

Sincerely,

Dennis Brager

DB:db

cc:

X:\ACTIVE\OFFICE ADMIN\FORM\TAXCOURT\QUALIFIED OFFER.WPD



Department of the Treasury  
Internal Revenue Service  
OGDEN, UT 84201-0021

Letter Number: 3219(SC/CG)

Letter Date:

December 21, 2009  
Taxpayer Identification Number:

Tax Form: 1040

Tax Year Ended and Deficiency

December 31, 2007 \$ 6,391

Contact Person: office of Mrs Price  
1-800-829-8310 TOLL FREE

Contact Telephone Number:

1-877-477-9640 LOCAL FAX

Hours to Call:

7:00 AM to 8:00 PM

Last Date to Petition Tax Court:

March 22, 2010

Penalties/Additions to Tax  
IRC Section 6662(a) \$1,278

RECEIVED

DEC 24 2009

Brager Tax Law Group

BARRY P & GAIL L   
C/O DENNIS N BRAGER  
10960 WILSHIRE BLVD FL 11  
LOS ANGELES CA 90024-3702995



000002

Dear Taxpayer:

We have determined that there is a deficiency (increase) in your income tax as shown above. This letter is your NOTICE OF DEFICIENCY, as required by law. The enclosed statement shows how we figured the deficiency.

If you want to contest this determination in court before making any payment, you have until the **Last Date to Petition Tax Court** (90 days from the date of this letter or 150 days if the letter is addressed to you outside the United States) to file a petition with the United States Tax Court for a redetermination of the amount of your tax. You can get a petition form and the rules for filing a petition from the Tax Court. You should file the petition with the **United States Tax Court, 400 Second Street NW, Washington D.C. 20217**. Attach a copy of this letter to the petition.

The time in which you must file a petition with the court (90 days or 150 days as the case may be) is fixed by law and the Court cannot consider your case if the petition is filed late. As required by law, separate notices are sent to spouses. If this letter is addressed to both a husband and wife, and both want to petition the Tax Court, both must sign the petition or each must file a separate, signed petition.

The Tax Court has a simplified procedure for small tax cases when the amount in dispute is \$50,000 or less for any one tax year. You can also get information about this procedure, as well as a petition form you can use, by writing to the Clerk of the United States Tax Court at 400 Second Street NW, Washington, D.C. 20217. You should write promptly if you intend to file a petition with the Tax Court.

If you decide *not* to file a petition with the Tax Court, please sign and return the enclosed waiver form to us. This will permit us to assess the deficiency quickly and will limit the accumulation of interest. We've enclosed an envelope you can use. If you decide not to sign and return the waiver and you do not petition the Tax Court, the law requires us to assess and bill you for the deficiency after 90 days from the date of this letter (150 days if this letter is addressed to you outside the United States).

When you send information we requested or if you write to us about this letter, please provide a telephone number and the best time to call you if we need more information. Please attach this letter to your correspondence to help us identify your case. Keep the copy for your records.

The person whose name and telephone number are shown in the heading of this letter can access your tax information and help get you answers. You also have the right to contact the Taxpayer Advocate. You can call 1-877-777-4778 and ask for Taxpayer Advocate Assistance. Or you can contact the Taxpayer Advocate for the IRS Office that issued this Notice of Deficiency by calling 1-801-620-7168 or writing to:

OGDEN IRS CENTER  
TAXPAYER ADVOCATE  
1973 N RULON WHITE BLVD  
STOP 1005  
OGDEN, UT 84404

Taxpayer Advocate assistance is not a substitute for established IRS procedures such as the formal appeals process. The Taxpayer Advocate is not able to reverse legally correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

Thank you for your cooperation.

Sincerely yours,

Commissioner  
By



Henry Slaughter  
Field Director  
Compliance Services, Ogden

Enclosures:  
Copy of this letter  
Statement  
Waiver  
Envelope  
Publication 3498  
Form 9465

# Your Appeal Rights and How To Prepare a Protest If You Don't Agree



Department of the Treasury  
Internal Revenue Service

[www.irs.ustreas.gov](http://www.irs.ustreas.gov)

Publication 5 (Rev. 01-1999)  
Catalog Number 460741

## Introduction

This Publication tells you how to appeal your tax case if you don't agree with the Internal Revenue Service (IRS) findings.

## If You Don't Agree

If you don't agree with any or all of the IRS findings given you, you may request a meeting or a telephone conference with the supervisor of the person who issued the findings. If you still don't agree, you may appeal your case to the Appeals Office of IRS.

**If you decide to do nothing** and your case involves an examination of your income, estate, gift, and certain excise taxes or penalties, you will receive a formal Notice of Deficiency. The Notice of Deficiency allows you to go to the Tax Court and tells you the procedure to follow. If you do not go to the Tax Court, we will send you a bill for the amount due.

**If you decide to do nothing** and your case involves a trust fund recovery penalty, or certain employment tax liabilities, the IRS will send you a bill for the penalty. If you do not appeal a denial of an offer in compromise or a denial of a penalty abatement, the IRS will continue collection action.

If you don't agree, we urge you to appeal your case to the Appeals Office of IRS. The Office of Appeals can settle most differences without expensive and time-consuming court trials. [Note: Appeals can not consider your reasons for not agreeing if they don't come within the scope of the tax laws (for example, if you disagree solely on moral, religious, political, constitutional, conscientious, or similar grounds.)]

The following general rules tell you how to appeal your case.

## Appeals Within the IRS

Appeals is the administrative appeals office for the IRS. You may appeal most IRS decisions with your local Appeals Office. The Appeals Office is separate from - and independent of - the IRS Office taking the action you disagree with. The Appeals Office is the only level of administrative appeal within the IRS.

Conferences with Appeals Office personnel are held in an informal manner by correspondence, by telephone or at a personal conference. There is no need for you to have representation for an Appeals conference, but if you choose to have a representative, see the requirements under **Representation**.

If you want an Appeals conference, follow the instructions in our letter to you. Your request will be sent to the Appeals Office to arrange a conference at a convenient time and place. You or your representative should prepare to discuss all issues you don't agree with at the conference. Most differences are settled at this level.

**In most instances, you may be eligible to take your case to court if you don't reach an agreement at your Appeals conference, or if you don't want to appeal your case to the IRS Office of Appeals. See the later section *Appeals To The Courts*.**

## Protests

When you request an appeals conference, you may also need to file a formal written protest or a small case request with the office named in our letter to you. Also, see the special appeal request procedures in Publication 1660, Collection Appeal Rights, if you disagree with lien, levy, seizure, or denial or termination of an installment agreement.

## You need to file a written protest:

- In all employee plan and exempt organization cases without regard to the dollar amount at issue.
- In all partnership and S corporation cases without regard to the dollar amount at issue.
- In all other cases, unless you qualify for the small case request procedure, or other special appeal procedures such as requesting Appeals consideration of liens, levies, seizures, or installment agreements. See Publication 1660.

## How to prepare a protest:

When a protest is required, **send it within the time limit specified in the letter you received.** Include in your protest:

- 1) Your name and address, and a daytime telephone number,
- 2) A statement that you want to appeal the IRS findings to the Appeals Office,
- 3) A copy of the letter showing the proposed changes and findings you don't agree with (or the date and symbols from the letter),
- 4) The tax periods or years involved,
- 5) A list of the changes that you don't agree with, and why you don't agree.

- 6) The facts supporting your position on any issue that you don't agree with,
- 7) The law or authority, if any, on which you are relying.
- 8) You must sign the written protest, stating that it is true, under the penalties of perjury as follows:

**"Under the penalties of perjury, I declare that I examined the facts stated in this protest, including any accompanying documents, and, to the best of my knowledge and belief, they are true, correct, and complete."**

**If your representative prepares and signs the protest for you, he or she must substitute a declaration stating:**

- 1) That he or she submitted the protest and accompanying documents and
- 2) Whether he or she knows personally that the facts stated in the protest and accompanying documents are true and correct.

We urge you to provide as much information as you can, as this will help us speed up your appeal. This will save you both time and money.

## Small Case Request:

If the total amount for any tax period is not more than \$25,000, you may make a small case request instead of filing a formal written protest. In computing the total amount, include a proposed increase or decrease in tax (including penalties), or claimed refund. For an offer in compromise, in calculating the total amount, include total unpaid tax, penalty and interest due. For a small case request, follow the instructions in our letter to you by: sending a letter requesting Appeals consideration, indicating the changes you don't agree with, and the reasons why you don't agree.

## Representation

You may represent yourself at your appeals conference, or you may have an attorney, certified public accountant, or an individual enrolled to practice before the IRS represent you. Your representative must be qualified to practice before the IRS. If you want your representative to appear without you, you must provide a properly completed power of attorney to the IRS before the representative can receive or inspect confidential information. Form 2848, Power of Attorney and Declaration of Representative, or any other properly written power of attorney or authorization may be used for this

purpose. You can get copies of Form 2848 from an IRS office, or by calling 1-800-TAX-FORM (1-800-829-3676).

You may also bring another person(s) with you to support your position.

## Appeals To The Courts

If you and Appeals don't agree on some or all of the issues after your Appeals conference, or if you skipped our appeals system, you may take your case to the United States Tax Court, the United States Court of Federal Claims, or your United States District Court, after satisfying certain procedural and jurisdictional requirements as described below under each court. (However, if you are a nonresident alien, you cannot take your case to a United States District Court.) These courts are independent judicial bodies and have no connection with the IRS.

## Tax Court

If your disagreement with the IRS is over whether you owe additional income tax, estate tax, gift tax, certain excise taxes or penalties related to these proposed liabilities, you can go to the United States Tax Court. (Other types of tax controversies, such as those involving some employment tax issues or manufacturers' excise taxes, cannot be heard by the Tax Court.) You can do this after the IRS issues a formal letter, stating the amounts that the IRS believes you owe. This letter is called a notice of deficiency. You have 90 days from the date this notice is mailed to you to file a petition with the Tax Court (or 150 days if the notice is addressed to you outside the United States). The last date to file your petition will be entered on the notice of deficiency issued to you by the IRS. If you don't file the petition within the 90-day period (or 150 days, as the case may be), we will assess the proposed liability and send you a bill. You may also have the right to take your case to the Tax Court in some other situations, for example, following collection action by the IRS in certain cases. See Publication 1660.

If you discuss your case with the IRS during the 90-day period (150-day period), the discussion will not extend the period in which you may file a petition with the Tax Court.

The court will schedule your case for trial at a location convenient to you. You may represent yourself before the Tax Court, or you may be represented by anyone permitted to practice before that court.

**Note:** If you don't choose to go to the IRS Appeals Office before going to court, normally you will have an opportunity to attempt settlement with Appeals before your trial date.

If you dispute not more than \$50,000 for any one tax year, there are simplified procedures. You can get information about these procedures and

other matters from the Clerk of the Tax Court, 400 Second St. NW, Washington, DC 20217.

## Frivolous Filing Penalty

**Caution:** If the Tax Court determines that your case is intended primarily to cause a delay, or that your position is frivolous or groundless, the Tax Court may award a penalty of up to \$25,000 to the United States in its decision.

## District Court and Court of Federal Claims

If your claim is for a refund of any type of tax, you may take your case to your United States District Court or to the United States Court of Federal Claims. Certain types of cases, such as those involving some employment tax issues or manufacturers' excise taxes, can be heard only by these courts.

Generally, your District Court and the Court of Federal Claims hear tax cases only after you have paid the tax and filed a claim for refund with the IRS. You can get information about procedures for filing suit in either court by contacting the Clerk of your District Court or the Clerk of the Court of Federal Claims.

If you file a formal refund claim with the IRS, and we haven't responded to you on your claim within 6 months from the date you filed it, you may file suit for a refund immediately in your District Court or the Court of Federal Claims. If we send you a letter that proposes disallowing or disallows your claim, you may request Appeals review of the disallowance. If you wish to file a refund suit, you must file your suit no later than 2 years from the date of our notice of claim disallowance letter.

**Note:** Appeals review of a disallowed claim doesn't extend the 2 year period for filing suit. However, it may be extended by mutual agreement.

## Recovering Administrative and Litigation Costs

You may be able to recover your reasonable litigation and administrative costs if you are the prevailing party, and if you meet the other requirements. You must exhaust your administrative remedies within the IRS to receive reasonable litigation costs. You must not unreasonably delay the administrative or court proceedings.

Administrative costs include costs incurred on or after the date you receive the Appeals decision letter, the date of the first letter of proposed deficiency, or the date of the notice of deficiency, whichever is earliest.

## Recoverable litigation or administrative costs may include:

- Attorney fees that generally do not exceed \$125 per hour. This amount will be indexed for a cost of living adjustment.

- Reasonable amounts for court costs or any administrative fees or similar charges by the IRS.

- Reasonable expenses of expert witnesses.
- Reasonable costs of studies, analyses, tests, or engineering reports that are necessary to prepare your case.

## You are the prevailing party if you meet all the following requirements:

- You substantially prevailed on the amount in controversy, or on the most significant tax issue or issues in question.
- You meet the net worth requirement. For individuals or estates, the net worth cannot exceed \$2,000,000 on the date from which costs are recoverable. Charities and certain cooperatives must not have more than 500 employees on the date from which costs are recoverable. And taxpayers other than the two categories listed above must not have net worth exceeding \$7,000,000 and cannot have more than 500 employees on the date from which costs are recoverable.

## You are not the prevailing party if:

- The United States establishes that its position was substantially justified. If the IRS does not follow applicable published guidance, the United States is presumed to not be substantially justified. This presumption is rebuttable. Applicable published guidance means regulations, revenue rulings, revenue procedures, information releases, notices, announcements, and, if they are issued to you, private letter rulings, technical advice memoranda and determination letters. The court will also take into account whether the Government has won or lost in the courts of appeals for other circuits on substantially similar issues, in determining if the United States is substantially justified.

## You are also the prevailing party if:

- The final judgment on your case is less than or equal to a "qualified offer" which the IRS rejected, and if you meet the net worth requirements referred to above.

A court will generally decide who is the prevailing party, but the IRS makes a final determination of liability at the administrative level. This means you may receive administrative costs from the IRS without going to court. You must file your claim for administrative costs no later than the 90th day after the final determination of tax, penalty or interest is mailed to you. The Appeals Office makes determinations for the IRS on administrative costs. A denial of administrative costs may be appealed to the Tax Court no later than the 90th day after the denial.