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DISPUTE RESOLUTION WITH THE IRS AND TAXPAYER BILL OF RIGHTS 2

by

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The notice of a tax audit strikes fear in the hearts of the strongest taxpayers—and often their tax advisers—simply because the Internal Revenue Service ("IRS") may assess additional taxes and penalties. The inconvenience of an audit often is an equally disturbing factor. The 1988 Taxpayer Bill of Rights¹ prescribes that the time and place of a civil audit be reasonable, but the IRS still has considerable latitude in determining reasonableness. Despite this standard, the audit examination may still be scheduled at a location the taxpayer and his representative consider distant and/or at a time they consider inconvenient.

This article expands on the meaning of reasonable time and place and examines numerous other rules governing audit examinations: (1) the significance of the taxpayer’s last known address; (2) the rules governing representation before the IRS; (3) established channels for resolving difficult tax problems; (4) guidelines for disputing IRS findings; (5) IRS tools for collecting assessments of additional tax; and (6) the appropriateness of litigation in resolving assessment disputes. In addition, the Taxpayer Bill of Rights 2 and the IRS initiatives to expand taxpayer rights are analyzed and explained. Tax practitioners with a working knowledge of these provisions will be better prepared to represent clients receiving that dreaded IRS audit notice.

TIME AND PLACE OF IRS AUDITS

The 1988 Taxpayer Bill of Rights², codified in I.R.C. Section 7605, provides the IRS with the authority to establish the time and place of an audit examination, provided they are reasonable.³ Final regulations, effective for examina-

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2. Id.
tions scheduled after April 2, 1993, set standards for IRS personnel to use in scheduling audits, and established criteria for taxpayers to follow in requesting changes if the taxpayer believes the time or place set by the IRS is unreasonable. These regulations, however, apply primarily to civil examinations. Except for the statutory 10-day period that must be allowed whenever an administrative summons is used, the regulations do not apply to criminal investigations. Moreover, the regulations specify that the reasonableness criteria are not applicable to international examinations.

The regulations provide that it is reasonable for the IRS to schedule appointments on a normal work day during normal working hours. In addition, the IRS may schedule examinations without considering the taxpayer’s or his representative’s seasonal business fluctuations—although the IRS is to work with these people in minimizing adverse scheduling dates.

Place for Examination

Whether the IRS conducts an office examination or a field examination depends upon the return’s complexity and the relative efficiency of the types of examinations.

The location for an office examination of an individual’s return is based initially upon the address shown on the return for the period selected for examination. The IRS office closest to this address will be used unless the office does not have an examination group or appropriate personnel to conduct the audit. Where this latter situation occurs, the IRS will conduct the examination at the closest office having the appropriate personnel. Office examinations of estates, trusts, and other entities generally will be conducted at the IRS office closest to the location where the original books, records, and source documents of the entity are kept. The IRS, however, may move any office examination to another location if the taxpayer or his representative requests such a move because of advanced age or physical infirmities that make traveling to the IRS office difficult.

4. T.D. 8469, 4-5-93.
8. Id.
Field examinations normally are required where the books and records are so voluminous that requiring the taxpayer to transport them would be burdensome. In addition, the IRS may prefer a field examination because it allows the examining agent(s) to test the taxpayer's veracity for telling the truth by observing his reaction to specific questions.

A field examination generally is conducted at the location where the taxpayer's original books, records, and source documents relevant to the examination are kept, which in most cases is the taxpayer's residence or principal place of business. However, the place of business is not a satisfactory examination site if the business is so small that the examination would either force the taxpayer to close his business or disrupt normal operations.

The taxpayer may submit a written request to change the place of an examination. In deciding this issue, the IRS considers the following factors:

1. the location of the taxpayer's current residence;
2. the location of the taxpayer's current principal place of business;
3. the location at which the taxpayer's books and records are maintained;
4. the location at which the examination can be conducted most efficiently;
5. the resources available at the office to which the taxpayer has requested a transfer;
6. other factors indicating that conducting the audit at a particular location causes undue hardship.

A transfer will not be granted merely for the convenience of the taxpayer's representative. Additionally, where the applicable statute of limitations expires within 13 months from the date of the transfer request, the IRS may require that the taxpayer agree to extend the limitations period for up to one year as a condition to granting the transfer request.
The IRS may decline to conduct an audit at any field location where it appears that its personnel will be in physical danger. To avoid physical danger, the IRS may transfer the audit to an IRS office and take other reasonable precautions to protect its personnel.

The IRS is not precluded from initiating the transfer of an examination if the transfer promotes effective and efficient conduct of the examination. However, if the taxpayer requests that the transfer not be made, the IRS must consider the six factors listed above.

### Notice Sent to Last Known Address

A number of Internal Revenue Code sections regarding audits and examinations refer to the taxpayer’s “last known address.” The phrase does not necessarily mean the taxpayer’s actual address; instead, it means the last address made known to the IRS. A notice sent to the taxpayer’s last known address is legally effective even if the taxpayer never receives it, is deceased, legally disabled, or, where the taxpayer is a corporation, has terminated its existence.

#### Notice of Deficiency

The IRS must send a notice of deficiency in income, estate, gift, or a chapter 41, 42, 43, or 44 excise tax by registered or certified mail. The notice may be mailed to the taxpayer’s last known address unless the IRS is notified that another person is acting for the taxpayer in a fiduciary capacity. Notice of a deficiency in estate tax is sufficient if addressed in the name of the decedent (or person subject to liability) and mailed to his/her last known address (unless the IRS has been notified of the existence of a fiduciary relationship).

Failure to receive a deficiency notice may devastate the taxpayer. A frequent result is that the taxpayer may not petition the Tax Court for a redetermination of the deficiency because the time to file a Tax Court petition will have expired. Thus, the amount covered by the deficiency will be assessed and must
be paid on notice and demand for its payment. In addition, the IRS may assert a further deficiency (e.g., penalties and interest).

Other Notices

The last known address rule applies not only to notices of deficiencies, but also to the following notices:

1. notice and demand for tax;
2. notice of intention to levy;
3. notice of seizure and sale;
4. notice of liability in transferee cases;
5. notice of third-party summons.

The consequences of not receiving these notices may be as disastrous to the taxpayer as the failure to receive the deficiency notice. Consider the following example:

John and Mary Doe move from Denver to Dallas without notifying the IRS of their change of address (a common occurrence). The IRS mailed a notice of deficiency to their last known address in Denver—i.e., the address shown on their last filed income tax return—by certified mail. The IRS specifically sent them a notice and demand for tax, a notice of intention to levy on their property, and a notice of seizure and sale of their property by certified mail. The Does did not file a Tax Court petition or otherwise respond to the notices because they never received them. As a consequence of the Does' failure to respond to any of the notices, the IRS can sell real and personal property owned by the Does before they are even aware of their tax debt.

Proving the IRS Failed to Properly Mail

Proving that the IRS did not mail the notice by certified mail is almost impossible. Even if the taxpayer's files have been destroyed or lost, the IRS may be able to produce computer records and a certified mailing list. However, a conflict in the evidence may lead to a question of fact.

33. Treas. Reg. § 301.6861-1(a) (1997); I.R.C. § 6303(a) (West 1997).
34. I.R.C. § 6303(a) (West 1997).
36. I.R.C. §§ 6335(a), (b) (West 1997).
37. I.R.C. § 6901(g) (West 1997).
In *Wiley v. United States*, a taxpayer argued in district court that the IRS, which had seized and sold his real property, did not send him a notice of deficiency by certified mail for the proper tax year. The IRS failed to find the taxpayer’s file but produced computer records and a certified mailing list showing that the notice was sent. However, the computer records did not contain the numeric code that normally would record that the notice of deficiency had been sent. In addition, an expert’s affidavit expressed the opinion that the omission of the numeric code indicated the notice was never sent. Based on the conflicting evidence, the Sixth Circuit concluded there was a genuine issue of material fact as to whether a notice of deficiency had been sent to the taxpayer by certified mail. Thus, the Sixth Circuit affirmed the district court’s denial of summary judgment to the taxpayer, reversed the grant of summary judgment to the IRS, and remanded the case for further proceedings.

**Correct Address**

“Last known address” connotes the address on the most recently filed and properly processed return. Revenue Procedure 90-18 provides special meanings for the terms “return,” “properly processed,” and “address on return.” Return for this purpose includes (1) a wide variety of returns filed under a social security number (including individual income tax returns, and gift, estate, and generation-skipping transfer tax returns), (2) returns filed under an employer identification number, and (3) qualifying substitute forms. However, “return” does not include applications for extensions of time to file returns. The “address on return” is the address shown in the upper portion of the return’s front page.

A return is generally considered “properly processed” only after a 45-day processing period, beginning the day after the return is received. However, the 45-day processing period for a return received before its due date does not begin until the day after the due date. In addition, the 45-day address change period for a return not filed in “processible form” does not begin until the day after the error causing the return to be unprocessable is corrected.

**Notifying the IRS of Change in Address**

A tax return with new address information that is properly processed will automatically update the address of record. But in the case of gift, estate, and gen-
eration-skipping transfer tax returns, address records are maintained separately from those for individual income tax returns. Thus, an individual taxpayer’s notification of a change of address should indicate whether any gift, estate, or generation-skipping transfer tax returns are affected by the notification.\textsuperscript{45}

A clear and concise written notification of a change of address (i.e., from the address shown on the most recently filed return) must be sent to the former IRS Service Center or to the Chief, Taxpayer Service Division in the local district office. The taxpayer may use IRS Form 8822, \textit{Change of Address}, or a signed written statement specifically stating that he wants to have the address of record changed to a new address.\textsuperscript{46} A new address in the letterhead of a taxpayer correspondence does not by itself change the taxpayer’s address of record. The information that must be contained in the notification includes:

1. the new address;
2. the taxpayer’s full name and signature (both names for taxpayers filing joint returns);
3. the old address;
4. the social security number and/or employer identification number (both social security numbers for taxpayers filing joint returns).\textsuperscript{47}

Correspondence sent to the taxpayer by the IRS that requires or solicits a taxpayer response will qualify as clear and concise written notification of a change of address if it is returned to the IRS with corrections marked on the taxpayer’s address information.\textsuperscript{48}

Taxpayers who make estimated tax payments must notify the IRS of any change of address during the year by using IRS Form 8822 or a clear and concise written statement.\textsuperscript{49} The taxpayer should send the notification to the IRS Service Center where the last return was filed. Although the taxpayer may continue to use old preprinted payment vouchers until the IRS sends the taxpayer new vouchers, the taxpayer should not change the address on the old voucher.

\textsuperscript{45} Id.
\textsuperscript{46} Id.
\textsuperscript{47} Id.
\textsuperscript{48} Id.
\textsuperscript{49} Id.
Individuals who want to represent other taxpayers before the IRS must follow special rules promulgated by the IRS. Practice before the IRS includes communicating with the IRS regarding another taxpayer’s rights, privileges, or liabilities under laws and regulations administered by the IRS; representing a taxpayer at conferences, hearings, or meetings with the IRS; and preparing and filing necessary documents with the IRS for a taxpayer. The guidelines describe who may practice before the IRS as well as the rules governing such practice. They also indicate how to authorize representation before the IRS through a power of attorney.

Who Can Represent Taxpayers?

Attorneys and certified public accountants ("CPAs") can represent taxpayers before the IRS if they are not suspended or under disbarment and file a declaration to that effect. Enrolled agents and enrolled actuaries who pass a written examination showing their competence in their areas of practice may also represent taxpayers before the IRS. The practice of enrolled actuaries, however, is limited to matters within their areas of expertise.

Because of their special relationships with taxpayers, unenrolled individuals, including unenrolled return preparers, may represent taxpayers before the IRS on certain matters. An unenrolled return preparer’s representation is limited to matters stemming from a return that he or she prepared and may only be a representation before the Examination Division of the IRS.

Enrollment is not required if representation of a taxpayer before the IRS occurs outside the United States. Additionally, the IRS Director of Practice may waive enrollment for a particular matter by issuing a “Commissioner’s Special Authorization” to a representative who requests the authorization in writing. If the Director grants a representative such authorization, the taxpayer must file IRS Form 2848, Power of Attorney and Declaration of Representative, listing “CSA”.  

51. Treas. Dept. Circ. No. 230 §§ 10.2(e), 10.3(a), 10.3(b).
55. Internal Revenue Service Pub. No. 470, Limited Practice Without Enrollment, Rev. Proc. 81-38, 1981-2 C.B. 592 (providing additional information on the limitations that apply to unenrolled return preparers); see also Treas. Dept. Circ. No. 230 § 10.7(a).
56. Treas. Dept. Circ. No. 230 § 10.7(c).
in the designation block of Part II of IRS Form 2848, and attach a copy of the letter from the Director of Practice. 57

Corporations, associations, partnerships, and other business entities are ineligible to practice before the IRS. 58 In addition, individuals who have violated laws or IRS regulations, or are under professional suspension or disbarment, and certain government employees are also generally ineligible to practice before the IRS. 59

Rules of Practice

The rules of practice before the IRS impose two critical duties on enrolled taxpayer representatives: (1) they must promptly submit records of information requested by the IRS, and (2) upon request, they must provide information concerning possible regulations violations by other parties and be prepared to testify in disbarment or suspension proceedings. 60 However, a representative may decline to follow these rules if he believes in good faith and on reasonable grounds that the information is privileged or that the request is of doubtful legality.

Violations of the rules of practice may result in the IRS Director of Practice reprimanding, suspending, or disbarring the attorney, CPA, or enrolled agent. 61 The following are considered examples of disreputable conduct:

1. any criminal revenue offense or offense involving dishonesty;
2. knowingly giving false or misleading information in connection with tax matters;
3. solicitation of employment by prohibited means;
4. willful failure to file a tax return;
5. misappropriation of, or failure to properly and promptly remit, funds received from clients for payment of taxes;
6. attempts to influence the official action of IRS employees by the use of threats or false accusations, or by offering special inducements;

57. Statement of Procedural Rules §§ 601.503(b), 601.504(a), 601.504(b), 601.501(b)(9).
58. Statement of Procedural Rules §§ 601.502(b), 601.502(c); see also Treas. Dept. Cir. No. 230.
7. disbarment by any state court, federal court, or federal agency;

8. knowingly aiding and abetting another person to practice before the IRS during a period of suspension, disbarment, or ineligibility;

9. contemptuous conduct including the use of abusive language, or statements known to be false;

10. giving a false opinion knowingly, recklessly, or through gross incompetence, or following a pattern of providing incompetent opinions. 62

Power of Attorney

A power of attorney is a written authorization for an individual to act for another taxpayer in tax matters. 63 Under a general power of attorney, the representative may perform all acts that the taxpayer can perform. These acts include receiving, but not endorsing or negotiating, a refund check. However, the representative cannot sign the taxpayer's personal income tax return unless the taxpayer is unable to sign it as a result of disease, injury, or other good cause, and the representative is authorized to sign the return by the power of attorney. 64 In addition, the appointed representative (under the power of attorney) cannot substitute a new representative or delegate authority unless the power of attorney specifically authorizes such action.

IRS Form 2848 may be used to appoint a representative, including an unenrolled return preparer. 65 A non-IRS power of attorney may also be used under certain circumstances (e.g., a person of advanced age has entrusted all business and financial matters to a fiduciary under a non-IRS power of attorney). 66 The person named under the non-IRS power of attorney, however, must be authorized to practice before the IRS; otherwise, another person who can practice before the IRS must be named. 67

Filing, terminating, and revoking a power of attorney. The taxpayer must file the power of attorney with every IRS office with which he expects to deal. 68

62. Id.
65. Pursuant to § 6 of Rev. Proc. 81-38, I.R.S. Form 2848 is acceptable. Any other properly executed written authorization also will be accepted.
A power of attorney is updated by writing a letter to the specific IRS office where the original is filed or by filing a new power of attorney.\(^6^9\)

If the taxpayer becomes incapacitated or incompetent, a power of attorney generally terminates. However, the power will continue if the taxpayer authorizes, on IRS Form 2428, that it should continue, or if the taxpayer's non-IRS durable (general) power of attorney meets all of the requirements for acceptance.\(^7^0\)

A power of attorney may be revoked by sending a copy of the original IRS Form 2848, signed and dated at the bottom of page 2, with the word “Revoked” at the top of page 1, to each office of the IRS where the form was originally filed, as well as to the IRS Service Center where the return covered by the power of attorney was filed.\(^7^1\) Similarly, a non-IRS power of attorney is revoked by sending a signed and dated letter requesting revocation, accompanied by a copy of the non-IRS power of attorney.\(^7^2\) In addition, a power of attorney or tax information authorization is automatically revoked, unless the taxpayer specifies otherwise, by a new power of attorney or tax information authorization, respectively.\(^7^3\)

**RESOLVING CLIENTS’ TAX PROBLEMS**

The IRS operates several programs designed to assist tax practitioners who experience difficulties in resolving their clients’ tax problems. Through these programs, practitioners with tax-related questions or grievances concerning the IRS’s treatment of a particular issue can communicate directly with IRS employees by phone, by mail, or at regional IRS Service Centers. The first step is to contact the IRS through the normal resolution channels, which include the Practitioner Hot Line and the Practitioner Priority Case Program. If these programs prove unsuccessful, the problem may qualify for the Problem Resolution Program (“PRP”) under standards established by the IRS. In urgent cases, where the manner in which the IRS is administering the situation has imposed, or is about to impose, hardship upon the taxpayer, the practitioner may bypass these programs and apply for a Taxpayer Assistance Order (“TAO”). Filing of a TAO application suspends any further enforcement actions until review is completed.

Recently, the IRS supplemented the PRP with “Operation Link,” a program designed to tackle lingering problems that have not been resolved through

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70. *Id.*
73. *Id.*
the normal channels or the PRP.\textsuperscript{74} By facilitating the flow of information between the practitioner and the IRS, Operation Link is expected to lessen the amount of time spent in pinpointing the source of the problem.

In addition to these practitioner assistance programs, the IRS has instituted several procedures intended to speed up the entire audit process: (1) early referral;\textsuperscript{75} (2) accelerated issue resolution;\textsuperscript{76} and (3) meditation.\textsuperscript{77} Each of these procedures has a different set of rules with which the practitioner must be familiar in order to ensure that his clients obtain the maximum advantage of the time savings.

\textbf{Normal Resolution Channels}

The IRS established the Practitioner Hot Line to provide practitioners with account-related tax assistance. It is available exclusively to practitioners representing clients.\textsuperscript{78} Questions of law are not addressed, and assistance is limited to inquiries on individual and business tax accounts. Examples of typical services provided include payment tracers, credit transfers, and penalty abatements. For these services, practitioners may now contact most IRS districts by toll-free Practitioner Hot Lines.

The Practitioner Priority Case Program processes complex practitioner cases at regional IRS Service Centers. A "priority case" is one that involves a complicated situation that a practitioner feels requires special handling, but that does not meet the PRP criteria discussed below.\textsuperscript{79} Information concerning priority cases should be mailed to the service center servicing the practitioner.

\textbf{Problem Resolution Program (PRP)}

If attempts to correct a tax problem through the normal resolution channels are unsuccessful, the practitioner may contact the Problem Resolution Officer ("PRO") responsible for the PRP in that district or the Service/Compliance Center Director. The PRO is responsible for making every effort to determine the source of the problem and resolve it, regardless of whether the problem was initially caused by the taxpayer, the practitioner, or the IRS.\textsuperscript{80} The PRO has direct

\begin{itemize}
  \item \textsuperscript{74} \textit{Internal Revenue Service Pub. No. 1320, Operation Link.}
  \item \textsuperscript{75} I.R.S. Announcement 94-41, 1994-12 I.R.B. 7.
  \item \textsuperscript{76} Rev. Proc. 94-67, 1994-2 C.B. 800.
  \item \textsuperscript{77} I.R.S. Announcement 95-2, 1995-2 I.R.B. 59.
  \item \textsuperscript{78} The address and phone number of the nearest Problem Resolution Office and Practitioner Hot Line are located in the white pages of any local telephone directory under "United States Government."
  \item \textsuperscript{79} \textit{Internal Revenue Service Pub. No. 1320, Operation Link.}
  \item \textsuperscript{80} I.R.M. 518(13).1 (3-29-94).
\end{itemize}
contact with various functional areas within the district or service center and with other offices that provide assistance in resolving complex problems. Requests for PRP assistance may be made by telephone, correspondence, walk-in, or referral from an IRS employee. Whether the problem is channeled through the Service/Compliance Center or a district PRO, a PRP employee will be assigned the case and will keep the taxpayer or the taxpayer’s representative informed of its status.

**PRP criteria.** Five conditions qualify a case for PRP handling:

1. Refund Problems: at least 90 days after the filing of an original or amended return, or refund claim, the taxpayer has not received the refund and has initiated a follow-up inquiry;

2. Inquiry Delay: at least 45 days after an initial inquiry for information or assistance (except refund inquiries), the taxpayer has not received an acknowledgment contract or has not received a response by the date promised in the acknowledgement contract;

3. Third Notice: the taxpayer has received a third notice from the IRS, indicating incorrect action or lack of action on the part of the IRS in resolving the prior notices;

4. Administrative Recourse: the taxpayer has not been permitted to discuss the recommendations or actions of a PRP employee with that employee’s division manager(s), or the problem has not been resolved despite such a discussion and there are no appeals procedures;

5. Other Criteria: the use of normal channels has not been successful in resolving the problem, or it is in the best interest of the IRS to include the inquiry or the complaint in the PRP program. For example, a bank informs a taxpayer of its receipt of an IRS notice of levy, and the IRS has had no prior contact on this matter.\(^\text{81}\)

**Exclusions.** In some situations, the problem meets the standards of the PRP, but access to the program is nevertheless prohibited. This type of prohibition occurs if:

1. an established administrative or formal appeal procedure is more appropriate;

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81. *Id.*
an appropriate response previously has been given to the taxpayer;

the resolution of the problem is exclusively the responsibility of another federal, state, or local agency;

the problem is a non-tax administrative matter involving the IRS (e.g., disclosure or personnel);

the case is under jurisdiction of the Criminal Investigation Division;

a tax protester issue is involved;

a resolution was achieved and the taxpayer was advised on the same day the inquiry was identified as meeting PRP criteria;

the taxpayer agrees with the IRS determination but refuses to pay. 82

Taxpayer Assistance Order (TAO)

Taxpayers with unresolved grievances may seek recourse under the Taxpayer Bill of Rights 83 in addition to the PRP. The Taxpayer Bill of Rights includes a provision allowing the taxpayer to apply for a TAO. Issuance of a TAO is authorized when the taxpayer is suffering, or about to suffer, a significant hardship as a result of the manner in which the internal revenue laws are being administered. 84 An application may be made by calling the PRO in the taxpayer’s district. Alternately, taxpayers or their representatives may write a letter to the office describing the hardship or file a IRS Form 911, Application For TAO To Relieve Hardship. 85 While the application is under review, enforcement actions against the taxpayer are suspended.

Operation Link

As a supplement to the PRP, Operation Link permits practitioners to forward documentation of a problem directly to a special post office box or mail stop number established for the district or service center Problem Resolution Office. 86 This special address should be used only when alerting the office to a potential

82. Id.
84. I.R.C. § 7811 (West 1997).
86. INTERNAL REVENUE SERVICE PUB. NO. 1320, OPERATION LINK.
systemic problem or when the case meets PRP criteria and the practitioner has been unable to resolve the problem through normal channels.

Documentation submitted should include a copy of the controversial tax return and any relevant IRS notices, legible copies of both sides of canceled checks for payments either not credited or applied to the wrong accounts, a copy of the document on which no action has been taken, a phone number, power of attorney or taxpayer information authorization, and a concise explanation of the problem. 

In “emergency cases,” such as an application for a TAO, an erroneous levy action, or an actual systemic problem supported by several examples, practitioners may call or fax documentation to the district Problem Resolution Office. By utilizing Operation Link to transmit necessary documentation quickly and efficiently, taxpayers can facilitate the identification of cases meeting the standards of the PRP earlier in the notice cycle, thereby eliminating time-consuming and frustrating multiple contacts with service centers and district offices.

**Early Referral Procedures**

The IRS’s early referral procedures allow taxpayers whose returns are being examined to request a transfer of developed, but unresolved, issues to Appeals while other issues continue to be developed in Examination. Early referral is optional, but must be requested by the taxpayer, and approved by both Appeals and the District.

The purpose of early referral is to resolve cases more quickly. The early resolution of a key issue may encourage taxpayers and the IRS to agree on other issues in the case. Early referral may also save time because Appeals and Examination are working simultaneously.

Appropriate issues for early referral include those that meet the following criteria:

1. resolution of the issues is expected to result in quicker resolution of the case;
2. both the taxpayer and Examination agree the issues should be referred to Appeals early;
3. the issues are not designated for litigation.

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87. Id.
88. Id.
90. Id.
91. Id.
In addition, issues in the Industry Specialization Program ("ISP") and Joint Committee cases can be referred to Appeals under the early referral procedures. ISP issues are listed in Internal Revenue Manual Exhibit 8700-1. For issues in Joint Committee cases, closing agreements will not be finalized until after Joint Committee review.\textsuperscript{92}

Requests for early referral. Taxpayers may initiate early referral on an unagreed issue by making a written request. Until an IRS form is developed, the taxpayer's written request should:

1. be given to the case manager;
2. identify the taxpayer, tax period(s), and issue(s);
3. request resolution of a specific unagreed issue(s);
4. fully describe the taxpayer’s position with regard to the issue(s).\textsuperscript{93}

Upon receipt of the taxpayer’s written request, the case manager sends the request, along with a full description of the issue and Examination’s position, to the District Director or the district designee for early referral approval. The District Director may designate another district employee, such as an Examination Chief or other manager, as the approving official for the district.\textsuperscript{94}

The District Director or designee notes the district’s approval or denial on the face of the taxpayer’s request and then forwards it to the Assistant Regional Director for Appeals (Large Case) or designee. Appeals’ approval or denial also is noted on the face of the request. The Assistant Regional Director of Appeals ("ARDA") may designate another Appeals employee, such as Appeals Chief or other manager, as the approving official for the region.\textsuperscript{95}

Both the District and Appeals must approve the request for early referral. Either party may request a conference with the other to discuss conflicting approval/denial decisions. If both the District and Appeals approve the request, it will be returned by Appeals to the case manager who will inform the taxpayer and transmit the early referral issue file to Appeals. If either the District or Appeals (or both) deny the request, it will be returned to the case manager who must inform the taxpayer of the denial. No formal appeal procedure exists, but the

\textsuperscript{92.} Id.
\textsuperscript{93.} Id.
\textsuperscript{94.} Id.
\textsuperscript{95.} Id.
taxpayer may request a conference to discuss the denial of an early referral request. Generally, the taxpayer will be advised whether the request is denied or approved within 45 days of the date the case manager receives the request from the taxpayer.\textsuperscript{96}

**Transfer to Appeals.** Examination completes IRS Form 5701, *Notice of Proposed Adjustment*, to describe and explain Examination’s position on issues transferred to Appeals. This form is not treated as a letter of proposed deficiency for computing increased interest under I.R.C. Section 6621(c).\textsuperscript{97}

The taxpayer must respond in writing to the Examination’s position taken in IRS Form 5701 within 30 days, or longer if extended by the case manager. Examination then forwards the early file, which includes the following items, to Appeals:

1. applicable portions of tax returns and workpapers;
2. approved early referral request;
3. IRS Form 5701;
4. taxpayer’s written response to IRS Form 5701;
5. examination’s response to taxpayer’s position, including an estimate of the potential tax effect of the proposed adjustment.\textsuperscript{98}

**Resolving issues.** Regular Appeals procedures, including taxpayer conferences, are used to resolve early referral issues. If settlement of the early referral issue(s) is (are) reached, the taxpayer’s agreement to the issue(s) may be entered on a closing agreement for specific matters, using IRS Form 906. Examination then uses the agreement to compute the corrected tax after all of the other issues in the case are resolved. Generally, Examination will close the case. After early referral, if other issues are not agreed to in Examination, and the taxpayer requests an Appeals conference, the unresolved issues will be transferred to Appeals.\textsuperscript{99}

If settlement of the early referral issue(s) is not reached, Appeals returns the early referral file, including a copy of the Appeals Case Memo on the issue, to the case manager. If the case (as a whole) later returns to Appeals, a copy of

\textsuperscript{96} Id.
\textsuperscript{97} Id.
\textsuperscript{98} Id.
\textsuperscript{99} Id.
the Appeals Case Memo on the early referral issue(s) is included in the case file.\textsuperscript{100}

Accelerated Issue Resolution

The IRS instituted the Accelerated Issue Resolution ("AIR") process to advance the resolution of issues arising from an audit of a Coordinated Examination Program ("CEP") taxpayer from one or more tax periods to other tax periods.\textsuperscript{101} Revenue Procedure 94-67\textsuperscript{102} explains when and how a taxpayer subject to a CEP audit requests an AIR agreement from the District Director.

Scope of an AIR agreement. An AIR agreement may be entered into for:

1. issues subject to an Advance Pricing Agreement under Revenue Procedure 91-22;\textsuperscript{104}
2. issues under the jurisdiction of the Assistant Commissioner (e.g. Employee Plans and Exempt Organizations);
3. partnership issues defined in I.R.C. Section 6231, or any other issues subject to the procedures in I.R.C. Sections 6221 through 6233;
4. issues whose resolution is contrary to a private letter ruling, technical advice memorandum, or closing agreement previously issued to or entered into with the CEP taxpayer;
5. issues whose resolution is contrary to a proposed IRS position for a private letter ruling request withdrawn following notification by the IRS that it would take a position adverse to that sought by the CEP taxpayer;
6. issues of the CEP taxpayer designated for litigation by the I.R.S. Office of Chief Counsel.\textsuperscript{105}

\textsuperscript{100} Id.
\textsuperscript{102} Id.
\textsuperscript{103} Id.
\textsuperscript{105} Id.
If a request for an AIR agreement includes an issue that requires the approval of another agency, office, or IRS function, the District Director must request consent from the agency, office, or IRS function to enter into an AIR agreement for this issue.\textsuperscript{106} The other agency, office, or IRS function has discretion to grant consent or otherwise provide assistance to the District Director. Examples of situations where approval is required before the District Director may enter into an AIR agreement include:

1. issues coordinated through the Industry Specialization Program;
2. Appeals coordinated issues and Appeals Industry Specialization Program issues;
3. issues currently under Competent Authority consideration for any year, issues in which the taxpayer intends to seek relief from double taxation under a treaty, and issues for which the taxpayer has obtained Competent Authority assistance in prior years;
4. issues within the jurisdiction of the Department of Justice (e.g., refund cases);
5. issues controlled by a Regional Commissioner;
6. issues in multi-district cases.\textsuperscript{107}

Where appropriate, an AIR agreement may include related parties so the IRS will not be subject to conflicting claims of taxpayers.\textsuperscript{108} Thus, the IRS must give careful consideration to the direct or indirect impact of an AIR agreement upon other years, issues, or related cases.

Request procedures. The CEP taxpayer must submit in writing its request for an AIR agreement to the case manager in the office of the District Director having jurisdiction over the return or returns of the CEP taxpayer currently under examination. This request must: (1) state the issues and the taxable periods to which those issues relate; and (2) discuss the material facts and provide an analysis of the facts and the law as they apply to the issues in the request.\textsuperscript{109} This request also must include:

\textsuperscript{106} Id.
\textsuperscript{107} Id.
\textsuperscript{108} Id.
\textsuperscript{109} Id.
1. a statement as to whether the CEP taxpayer previously applied for Competent Authority assistance for the AIR issues;

2. true copies of all contracts, agreements, instruments, schedules, and other documents relevant to the request;

3. a statement that a later examination of the books or records (without any procedural restrictions) is permitted;

4. a perjury statement signed by the person(s) currently authorized to sign the returns;

5. the signature of the taxpayer or the taxpayer’s authorized representative.\textsuperscript{110}

Processing a request. The processing of a CEP request involves several steps.\textsuperscript{111} First, the District Director notifies the CEP taxpayer in writing of the issues accepted for consideration, the reason for rejecting certain issues, and the need for the CEP taxpayer, according to Revenue Procedure 94-69,\textsuperscript{112} to submit disclosure statements for issues being considered. Second, the District Director contacts the CEP taxpayer to discuss any questions that the IRS has or asks for additional information believed to be necessary to process the request. Third, the District Director obtains approval from, or coordinates with, all appropriate agencies, offices, and IRS functions. Fourth, the District Director evaluates the request by discussing it with the CEP taxpayer, verifies the data supplied, and requests additional data (if necessary) in a manner consistent with current auditing techniques. Fifth, the District Director submits the proposed AIR agreement for review by the District Counsel. Sixth, the District Director grants the request for an AIR agreement if: (1) there appears to be an advantage in having the issues permanently and conclusively closed; or (2) the CEP taxpayer shows good and sufficient reasons for desiring a closing agreement and the IRS finds no disadvantage to consummation.\textsuperscript{113} In any case, the law must be properly applied to the facts without taking into account the hazards of litigation, or whether the provisions of IRS Delegation Order No. 236 are applicable and are satisfied. Seventh, if the AIR agreement involves a refund or credit in excess of $1 million, the Joint Committee on Taxation reviews the proposed agreement before the IRS signs it. The taxpayer may not appeal the District Director’s rejection of all or part of a request for an AIR agreement.

\textsuperscript{110} Id.

\textsuperscript{111} Id.


Withdrawal from the process. At any time before the District Director executes the AIR agreement, either the CEP taxpayer or the District Director may withdraw all or part of the request from consideration by means of a written communication. The statement regarding additional examination and/or inspection of books and records, outside the AIR procedure, becomes effective upon the withdrawal of certain or all issues.

Form and content of AIR agreement. An AIR agreement between the CEP taxpayer and the IRS is a closing agreement under I.R.C. Section 7121. An AIR agreement must comply with the closing agreement requirements of Revenue Procedure 68-16, which includes the following items:

1. names, addresses, telephone numbers, and taxpayer identification numbers of all entities (including subsidiaries) to be included in the agreement;

2. an acknowledgment by the taxpayer that the materials and representations contained in the request for an AIR agreement were relied upon by the IRS, together with a description of other materials and representations upon which the CEP taxpayer and the IRS relied in reaching the agreement;

3. representations by the CEP taxpayer of consistent treatment of the issues subject to the AIR agreement in the years covered by the agreement;

4. the CEP taxpayer’s acknowledgment that a later examination of the books and records is permitted without any applicable procedural restrictions (e.g., providing notice under I.R.C. Section 7605(b));

5. a statement clearly identifying the resolution of the specific matters covered by the agreement;

6. computations in sufficient detail to determine the effect of the adjustments at issue;

7. a statement of any conditions for implementing the AIR agreement, including any requirements for waiving restrictions on assessment and collection, filing an amended

114. Id.
115. For further information on the form and content of a closing agreement, see Rev. Proc. 68-16, 1968-1 C.B. 770.
116. Id.
return, paying any tax, abating any overassessment, or re-funding or crediting any tax overpayment.

Miscellaneous provisions. The information received or generated by the IRS during the AIR agreement process constitutes return information as defined in I.R.C. Section 6103(b)(2) for rules of confidentiality and disclosure described in I.R.C. Section 6103(a). An AIR agreement resolves specific audit issues and is not a written determination within the meaning of I.R.C. Section 6110. The AIR procedure became effective October 31, 1994 and requires no user fee with a request.117

Mediation

Short of litigation, mediation is the last tool for settling a contentious dispute with the IRS. In Announcement 95-2, the IRS proposed the use of mediation on an experimental basis for one year.118

The mediation procedure is part of the Appeals administration process for facilitating dispute resolution. The IRS explains that mediation gives taxpayers and Appeals a chance to negotiate a settlement with the help of an objective and neutral third party.119

Mediation may be agreed upon by the taxpayer and Appeals in situations where regular good-faith settlement negotiations are unsuccessful. The proposed program is optional and available only to CEP cases in the Appeals administrative process that have been assigned to Appeals team chiefs and have not been dock- eted in any court.120 Mediation is not available for Industry Specialization Program issues, Appeals Coordinated Issues, competent authority issues, or issues designated for litigation.

The mediator has no authority to impose a decision.121 Instead, Appeals continues to have settlement authority in disputes. Thus, a decision reached under the mediation procedure is non-binding on both parties. In addition, either party may withdraw from the process at any time by written notification. If the parties reach an agreement on all or some of the issues through mediation, a final reso-lution must be obtained through established Appeals procedures. If the parties do not reach an agreement on the issues, Appeals will not reconsider them, but will continue to consider settlement of issues that were not the subject of mediation.

119. Id.
120. Id.
121. Id.
Dispute Resolution with the IRS

Mediator. A mediator, or a procedure to select one, must be agreed to by both parties. The Appeals representative from another IRS office or region or from National Office Appeals may be used as a mediator, in which case the expenses associated with the mediation process are paid by the IRS. If the taxpayer insists on an outside party and the IRS agrees, the costs, up to $5,000 per day, are split. The Federal Mediation and Conciliation Service or the U.S. Administrative Conference also may help the parties select a mediator.

The mediator must be an expert in the settlement process, have previous mediation experience, and have knowledge of tax law, industry practices, travel costs, hourly fees, and other expenses. Additionally, the mediator should have no official, financial, or personal conflict of interest with the issues in dispute, unless the conflict is fully disclosed in writing to all parties.

The agreement to mediate must be in writing and specify the issues to be discussed. A discussion summary of these issues is prepared and submitted to the mediator two weeks before the mediation is scheduled to begin. This summary also identifies the location and proposed dates for the mediation.

Mediation process. The mediation process is confidential. As part of the agreement to mediate, the taxpayer acknowledges that the mediator or any other person invited to participate may have access to all of the taxpayer’s returns connected to the issues being considered. Once the taxpayer and the Appeals Officer agree to use a mediator, they contact the appropriate assistant regional director of Appeals (for a large case) to seek approval for mediation. When the mediation request is approved, the assistant regional director schedules a conference to discuss the proposed mediation process. Besides the taxpayer and Appeals personnel assigned to the CEP case, other parties, including the taxpayer’s counsel, chief financial officer, assistant regional director, may participate in the mediation process. Although no formal appeal procedure exists for denying a mediation request, the IRS has stated that a party may request a conference to discuss the denial.

**Grounds for Disputing IRS Findings**

New IRS guidelines make it easier for taxpayers who dispute IRS audit findings to get relief without first having to pay deficient tax. The new guidelines apply to assessments made under the Substitute for Return Program, Information Returns Program, Deferred Adverse Tax Consequences/Alternative Strategies for Tax Administration Program, EP/EO Discrepancy Adjustment

122. Id.
123. Id.
124. Id.
125. Id.
126. IRS MS 41G-154 (1-21-93).
Program, and the District Examination Program. Before the guidelines were issued, taxpayers had access to nonpayment procedures for requesting reconsideration of deficiency assessments only when they had not been afforded the opportunity to submit needed information. Otherwise, taxpayers were required to pay the tax and file a claim for refund before the IRS would reconsider an assessment.127

Correcting Tax Assessments

The IRS has discretionary authority to abate an assessment of any tax (and penalties treated as tax) if it is in excess of the taxpayer's correct tax liability.128 Before the new guidelines, the IRS limited requests for abatement to situations in which the taxpayer was prevented from submitting information that would have resulted in a lower assessment. Under the new guidelines, a taxpayer may rectify his own failures or correct IRS errors. Under their terms, abatement requests will be accepted under any of the following conditions:

1. the taxpayer submits in writing information not previously considered that would have resulted in a change to the assessment had it been timely submitted;129
2. an original delinquent return is filed by a taxpayer after an assessment was made by the IRS under the Substitute for Return Program;130 or
3. the IRS made a computational or processing error in adjusting the tax.

Unaffected Agreed Upon Assessments

Abatement requests will not be considered in any of the following circumstances:131

1. the assessment was made as a result of a closing agreement132 in which the tax liability was compromised;133
2. the assessment was made after final administrative proceedings for partnerships or S corporations;134

129. IRS MS 41G-154 (1-21-93).
130. I.R.C. § 6020(f) (West 1997).
131. IRS MS 41G-154 (1-21-93).
3. the assessment was made as a result of the taxpayer’s entering into an agreement on IRS Form 870-AD, *Offer of Waiver of Restrictions on Assessments and Collection of Deficiency in Tax and Acceptance of Overpayment*;

4. the assessment relates to a return closed on the basis of a final order of the Tax Court or other court.

The IRS will consider abatement requests made by taxpayers with a history of ignoring federal income tax statutes or by illegal tax protestors on a case-by-case basis. IRS employees in charge of making these determinations will consider the need and opportunity to bring noncompliant taxpayers into the system.

Taxpayers whose requests for abatement are not considered will be informed of this decision by letter. Taxpayers who have not entered into an agreement as to their final tax liability will be informed that they must pay the tax before filing a claim for refund.\(^\text{135}\)

**Telephone Requests**

Requests for reconsideration may be made by telephone. Taxpayers are informed of the criteria used in making a reconsideration of deficiency assessment. If a return was filed, the taxpayer is asked to file a written request or amended return identifying the prior examination issues and the reason for the abatement request. If a return was never filed, the taxpayer must file an original delinquent return. When the IRS receives this information, it will be transferred to the service center or district office that was responsible for the original assessment.

**IRS Follow-Up**

If an IRS examiner determines that additional books or records are required, the taxpayer is contacted by phone and asked to provide the relevant documents. If a formal interview or field examination is needed, the examiner schedules an appointment by phone (where appropriate), and sends a letter confirming the appointment to the taxpayer. If the taxpayer does not furnish additional information in the time requested or fails to keep the scheduled appointment without adequate reason, the examiner will deny the request.\(^\text{136}\) Taxpayers who do not agree with the examiner’s findings may request a conference with the examiner’s manager. If an agreement cannot be reached, the taxpayer must pay the tax and file a claim to pursue appeal rights.

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\(^{135}\) I.R.C. § 6511 (West 1997).

\(^{136}\) IRS MS 41G-154 (1-21-93).
Once the IRS and the taxpayer resolve the issues under consideration, the IRS has broad powers to ensure collection of additional tax assessments. The IRS may impose a levy on most of the taxpayer's assets, and the federal tax lien generally takes priority over the claims of other creditors. In order to properly advise his clients, the tax practitioner must be aware of which assets are exempt from the levy and the situations where federal tax liens do not take priority over other creditor claims. The tax practitioner also will benefit from a working knowledge of the provisions for installment settlements and offers in compromise.

**Levy on Assets**

The IRS can impose a levy for taxes on salary and wage payments, bank accounts, insurance policies, and similar assets of a delinquent taxpayer. However, the Code exempts certain property from levy to allow the taxpayer to earn a living and pay for everyday necessities.\(^\text{137}\)

**Property exempted.** The exempt amount for personal fuel, provisions, and furniture is $1,650,\(^\text{138}\) while the exempt amount for books and tools of the trade, business, or profession is $1,100.\(^\text{139}\) A taxpayer's principal residence is exempt from levy unless jeopardy exists or unless the levy is approved in writing by the district director or assistant district director.\(^\text{140}\) The 1988 Technical and Miscellaneous Revenue Act ("TAMRA")\(^\text{141}\) exempted two more types of property from levy:

1. any amount received by an individual as public assistance under the AFDC program or as supplemental security income for the aged, blind, or disabled under Titles IV and XVI of the Social Security Act or paid under state or local welfare programs for which eligibility is determined by a needs or income test;\(^\text{142}\) and

2. any amount received by a participant under the Job Training Partnership Act ("JTPA")\(^\text{143}\) from funds appropriated under the Act.\(^\text{144}\)

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137. I.R.C. § 6334 (West 1997).
Service-connected disability payments under Title 38 of the United States Code, expanded by TAMRA to include wartime death compensation, peace-time death compensation, dependency and indemnity compensation for service-connected deaths, and burial benefits, also are exempt from levy.\textsuperscript{145}

\textbf{Wages, salary, and other income.} The amount exempt from levy is determined by reference to the taxpayer’s personal exemptions and standard deduction (based on the taxpayer’s filing status), as well as any additional standard deductions due to blindness or age.\textsuperscript{146} Weekly wages exempt from levy equal the sum of the taxpayer’s standard deduction and personal exemptions for the tax year, divided by 52.\textsuperscript{147}

To obtain the full exemption, the taxpayer must submit a written and properly verified statement to the employer, who forwards it to the district director, specifying facts necessary to determine the proper amount. In the absence of this statement, the taxpayer is treated as a married individual filing a separate return with only one personal exemption. Regulations under I.R.C. Section 6334 set forth procedures the taxpayer must follow and the information that must be submitted to entitle the taxpayer to an exempt amount from levy on wages in excess of the amount to which a married individual filing a separate return with only one exemption is entitled.\textsuperscript{148}

\textbf{Exempt amount.} The regulations define the exempt amount for individuals in payment terms (e.g., daily, biweekly, weekly, semi-monthly, and monthly). For one-time payments, the exempt amount is computed as if the taxpayer had been paid for the one-week period ending on the day of payment.

For levies continuing into future years, the exempt amount is not automatically changed if the standard deduction or the amount of the personal exemption changes by operation of law (e.g., by indexing or otherwise) or for changes in the taxpayer’s filing status.\textsuperscript{149} However, if a taxpayer submits a new verified statement to his or her employer, he or she may claim a new exempt amount based on law changes effective in the year the claim is filed.

\textbf{Sources of income.} The proposed regulations also establish rules to govern the payment of exempt amounts to the taxpayer in cases where a levy on all sources is not made and where sources not levied upon are less than the exempt

\begin{itemize}
  \item I.R.C. § 6334(a)(10) (West 1997).
  \item Prop. Treas. Reg. § 301.6334-2.
  \item I.R.C. § 6334(d)(West 1997).
  \item Prop. Treas. Reg. § 301.6334-4.
  \item Prop. Treas. Reg. § 301.6334-3(e).
\end{itemize}
If a taxpayer has more than one source of wages, salary, or other income, the district director may elect to levy on one or more sources while leaving other sources of income free from levy. If the wages, salary, or other income free from levy equals or exceeds the amount to which the taxpayer is entitled as the minimum exemption from levy (and is not otherwise exempt), the district director cannot treat any of the taxpayer's wages, salary, or other income subject to levy as exempt. However, if the taxpayer's income free from levy is less than the amount to which the taxpayer is entitled as exempt from levy, then an additional amount is deemed exempt from levy and paid from the sources of wages, salary, or other income upon which levy has been made.

**Levy may not be sufficient.** The IRS can levy on most of a taxpayer's assets, including accounts receivable, to satisfy unpaid taxes. However, levied-upon accounts receivable cannot simply be “swapped” in order to satisfy an outstanding tax liability. In *Cash v. United States*, the Fifth Circuit approved the IRS's refusal to credit a corporation's accounts receivable at face value for purposes of a withholding tax lien because the IRS did not exercise dominion and control over the accounts. In addition, the IRS was not required to sell the accounts or to expend any special effort to collect the accounts because it had no independent relationship with the debtors.

The IRS had also seized a computer that contained the corporation's records of the accounts. The records were subsequently destroyed, but the court held their loss did not demonstrably affect the value of the accounts and obligate the IRS to credit the company for the assets seized. Thus, through a tax levy the taxpayer may lose not only its assets, but also its ability to track those assets.

**Relative Priority of Federal Tax Liens**

The priority of federal tax liens relative to liens of other creditors in the property of a delinquent debtor has long been a source of conflict between the IRS and the other creditors. An ancillary issue in determining the priority of a federal estate tax lien is how the statutorily limited duration of such a lien is calculated. Recent court cases have addressed these two issues.

**Lien priority.** Upon making a tax assessment, a lien is created in favor of the United States on all real and personal property belonging to the debtor, includ-

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152. Prop. Treas. § 301.6334-3.
ing after-acquired property.\textsuperscript{154} Normally, such a lien cannot become valid against any judgment lien creditor until the appropriate notice is filed.\textsuperscript{155}

Priority, for purposes of federal law, is governed by the common-law principle that “the first in time is the first in right.”\textsuperscript{156} A state lien that competes with a federal lien is deemed to be in existence for “first in time” purposes only when it has been “perfected.” Such a lien generally cannot be perfected under federal law until the identity or amount of the lien and the property subject to the lien are established.

In a 1964 case, the Supreme Court held that property subject to a lien does not have to be specifically identified in order to be established.\textsuperscript{157} A noncontingent lien on all of the property owned by the debtor is sufficient to give the creditor rights to all of the property that the debtor owns at the time the lien is filed. However in the recent case of \textit{McDermott v. Zions First Nat’l Bank}\textsuperscript{158} the Supreme Court decided that property subject to a lien does not become established until the property is actually acquired by the debtor. Thus, a lien may not be perfected as to specific property until the debtor actually acquires such property.

The Court in \textit{McDermott}\textsuperscript{159} also noted that a recorded federal tax lien does not come into existence for federal tax law purposes until the debtor acquires the property.\textsuperscript{160} The Court, however, considered this fact irrelevant, because a federal tax lien is ordinarily dated, for purposes of determining priority against competing liens under the “first in time” rule, from the time of its filing, which in this case was September 9, 1987.\textsuperscript{161} Consequently, the federal tax lien took priority over the bank’s lien with respect to the real estate acquired by the debtor on September 23, 1987.

\textbf{Significance of \textit{McDermott} decision.} If the IRS has assessed a tax against the debtor before the judgement creditor’s lien is filed, the IRS may step ahead of the creditor and take the debtor’s property when it is subsequently acquired, assuming the IRS lien has been filed prior to that time. Therefore, although the judgment creditor may not be aware of the IRS assessment, he will be affected by it.

\begin{itemize}
\item \textsuperscript{154} I.R.C. §§ 6321, 6322 (West 1997).
\item \textsuperscript{155} I.R.C. § 6323(a) (West 1997).
\item \textsuperscript{156} United States v. City of New Britain, 347 U.S. 81 (1954).
\item \textsuperscript{157} United States v. Vermont, 377 U.S. 351 (1964).
\item \textsuperscript{158} 945 F.2d 1475 (9th Cir. 1991), cert. granted, 504 U.S. 939 (1992), rev’d, 507 U.S. 447 (1993).
\item \textsuperscript{159} Id.
\item \textsuperscript{160} Id. at 450. \textit{See also} I.R.C. § 6323(a) (West 1997).
\item \textsuperscript{161} 507 U.S. at 453-54. \textit{See also} I.R.C. § 6323(b) (West 1997).
\end{itemize}
The Court’s decision in *McDermott*,\(^\text{162}\) however, does not change statutory provisions giving certain third-party interests priority over federal tax liens, even where the IRS is the first to record.\(^\text{163}\) These “super-priorities” extend to:

1. purchasers of securities and automobiles;
2. retail purchasers;
3. casual sales of less than $250;
4. certain possessory liens securing payment for repairs to personal property;
5. real property taxes and special assessment liens;
6. non-possessory liens for repairs and improvements to real property;
7. attorneys’ liens;
8. insurance contracts;
9. passbook loans;
10. certain commercial-transaction financing agreements.\(^\text{164}\)

**Duration of federal estate tax.** Internal Revenue Code Section 6324(a)(1) imposes a lien (for the amount of estate tax) on all of the property included in a decedent’s gross estate. The lien attaches at the time of death and lasts for ten years. Property that is used to pay charges against the estate and administration expenses is divested of the lien.

The Eighth Circuit in *United States v. Davis*\(^\text{165}\) recently interpreted the lien statute as durational rather than limitational. In other words, the lien lasts ten years and then expires, even if the IRS brings an action to foreclose within the ten year period.

The facts of *Davis* state that Edward McDaris died on June 30, 1984. In 1993, the IRS brought an action in the U.S. District Court to foreclose the tax lien which arose under I.R.C. Section 6324(a)(1). In May 1994, the District Court determined that a bank loan secured by the property in question had been used to

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162. 945 F.2d at 1475.
163. I.R.C. §§ 6323(a), (b) (West 1997).
164. I.R.C. §§ 6323(a), (b) (West 1997).
165. 52 F.3d 781 (8th Cir. 1995).
pay a portion of the estate's tax liability. From this determination, the court con-
cluded that the property had been divested of the tax lien and ordered the IRS not
to levy on the property. On July 6, 1994, more than ten years after Edward's
death, the IRS filed a notice of appeal with the Eighth Circuit.

The IRS argued that the ten-year-from-death limitation rewards delay,
creates an incentive for slowing resolution of the case, and encourages frivolous
appeals. The Eighth Circuit agreed that these arguments were well founded, but
it noted that there are other incentives for expeditious resolution of estate tax con-
troversies. For example, the estate may want to remove the lien to avoid title
problems, sanctions for frivolous appeals, and the continual accrual of interest on
unpaid taxes. Moreover, in Davis, the IRS was largely responsible for the delay
because it waited nine years before beginning the foreclosure proceeding.

Had the lien statute been interpreted as limitational, the IRS could have
waited until late in the tenth year before filing its claim, and then litigated the mat-
ter for years afterward. The Eighth Circuit felt that there was no basis for con-
cluding Congress intended such a result.

The running of the ten year period made the appeal moot. Thus, the
Eighth Circuit did not have to consider the substantive issue of whether the
District Court correctly concluded that the property had been divested of the lien.

On appeal, the IRS also argued that it served a notice of levy on the prop-
erty before the ten years had expired and that “such service was sufficient to sat-
isfy whatever limitations statute on collection applied, whether or not the lien
underlying the levy was thereafter allowed to lapse.” The Eighth Circuit refused
to consider this argument because it was raised for the first time in a reply brief.
Having failed to raise the argument in its opening brief, the IRS was precluded
from doing so in the reply brief.

**Installment Agreements**

The IRS has authority to enter into an agreement with a taxpayer to sat-
isfy an outstanding tax liability in installment payments if the IRS determines that
such an agreement facilitates collection of the liability. The IRS retains broad
discretion concerning when, and under what terms, it will enter into such agree-
ments.

The IRS generally requires that the taxpayer pay the difference between
allowable monthly expenses and gross monthly income each month. Much of the

166. *Id.*
give-and-take between taxpayers and the IRS in negotiating an installment agreement centers on the “proper” amount of allowable expenses. The IRS requires monthly expenses to be “verified” and “reasonable,” although currently there is no specific guidance on determining reasonableness, with decisions being left largely to the judgment of IRS field personnel. This discretion has resulted in disparate treatment of taxpayers.

The IRS has developed, but not yet released, a set of uniform national standards for determining allowable expenses when working out installment agreements. The new guidance, to be released in Internal Revenue Manual 5323, delineates two categories of taxpayer expenses: (1) necessary expenses; and (2) conditional expenses. Necessary expenses are further subdivided into three categories: (1) necessary expenses for which the IRS has promulgated national standards; (2) necessary expenses for which IRS districts must establish local standards; and (3) other necessary expenses. 169

**Necessary expenses.** To be considered necessary, an expense must either provide for a taxpayer’s (or his family’s) health and welfare or relate to the production of income. Internal Revenue Manual 5323 sets national standards for six types of necessary expenses: (1) utilities; (2) housekeeping supplies; (3) apparel and services; (4) personal care products and services; (5) food; and (6) miscellaneous. IRS tables stratified by income level and size of household indicate the amount allowable for each of these expenses. 170 For example, the tables allow a taxpayer in a one-person household grossing $3,000 per month $258 per month as a reasonable expense for food. If that same taxpayer earns $6,000 per month, the tables allow $442. In a four-person household, these amounts are $457 and $681, respectively. 171

The guidelines require IRS districts to determine and annually revise local standards for housing and transportation. In addition, districts have the option of setting a local standard for utilities higher than the national standard. The guidelines do not change the “verified and reasonable” standard for other expenses, such as taxes, health care, court-ordered payments, involuntary deductions, accounting and legal fees for representing a taxpayer before the IRS, and minimum required payments for secured or legally-perfected debts. 172

**Conditional expenses.** Conditional expenses are reasonable expenses falling outside the necessary expense categories. Under the new guidelines, these expenses generally are allowed only if the installment agreement enables the tax-

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169. I.R.M. § 5323 (8-29-95).
170. Id.
171. Id.
172. Id.
pacer to satisfy the outstanding tax liability, including accrued interest and penalties, within three years (the “three-year rule”). Otherwise, the guidelines allow the taxpayer up to one year to modify or eliminate his conditional expenses (the “one-year rule”). The one-year rule also applies to necessary expenses in excess of allowable amounts.173

Unless they are a condition of employment, the new guidelines classify charitable contributions as conditional expenses subject to both the three-year and one-year rules. Educational expenses, including college tuition, are classified as conditional expenses unless they are for a handicapped dependent or a condition of employment. As conditional expenses, they also are subject to both the three-year and one-year rules.174

Unsecured debts. Internal Revenue Manual 5323 also contains new rules for the treatment of unsecured debt. First, only minimum payments are allowed under any circumstances.175 Next, if the outstanding liability can be satisfied within 90 days, no payments are allowed in computing monthly expenses.176 Third, in limited circumstances, payments on unsecured debt qualify as necessary expenses for the production of income (e.g., payments to suppliers or payments on a line of credit). Finally, in all other situations, minimum payments on unsecured debts are considered conditional expenses subject to both the three-year and one-year rules.177

Case resolution. The new guidelines treat allowable expenses in the context of the IRS’s overall collection procedures. Internal Revenue Manual 5323 suggests that installment agreements be considered only when immediate collection, including liquidating a taxpayer’s assets, is not possible.178

Offers In Compromise

An offer in compromise is a contractual agreement between the IRS and a taxpayer whereby the taxpayer agrees to pay a reduced amount in full settlement of the tax liability assessed by the IRS.179 The compromise in essence supplants the IRS’s administrative collection devices with a contract that spells out the terms for payment of the tax liability.

173. Id.
174. Id.
175. I.R.M. 5323.435(1) (8-29-95).
176. I.R.M. 5323.435(2) (8-29-95).
177. Id.
178. Id.
In some cases, the amount of accrued interest and penalties makes the tax bill so large that monthly installment payments would never pay off the tax. The offer in compromise, while not appropriate for all taxpayers who have fallen on hard times, offers many taxpayers an effective way to resolve their outstanding tax liabilities and stop collection activities (including wage garnishment and bank account levies), without resorting to costly tax litigation.  \(^{180}\)

The offer in compromise program benefits the IRS by providing more revenue than the government otherwise would receive and by encouraging future compliance by taxpayers. Thus, increased use of the process is consistent with the IRS's collection goals and its objective of providing taxpayers with a fresh start that will enable them to comply with the tax laws in the future.

**Factors to consider before using an offer in compromise.** A taxpayer may submit, and the IRS may consider, an offer in compromise before the taxes are assessed. The IRS will not accept the offer, however, until the tax assessment takes place.

The taxpayer’s attempt to compromise assessed tax liabilities must rest on one or both of the following grounds:

1. doubt as to liability for the amount of taxes owed by the taxpayer;
2. doubt as to the collectibility of the full amount of tax, penalty, and interest owed by the taxpayers.  \(^{181}\)

Thus, the IRS does not have authority to compromise tax, interest, or penalty where the liability is clear and there is no doubt as to the taxpayer’s ability to pay. For example, a compromise is not possible where the liability has been determined by the courts.

For doubt of tax liability to exist, a bona fide dispute concerning a question of law or fact for the liability must be present. To support this doubt of liability, the taxpayer must submit a detailed statement showing why the liability is not owed.  \(^{182}\)

Doubt as to collectibility is present where the entire amount of the

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180. Treas. Reg. § 301.7122-1(d)(2) (1997). But collection activities will stop as long as the offer is not used solely for the purpose of delay and the government's interest will not be jeopardized.
182. I.R.M. 57(10)6.5(3). (9-22-94).
assessed tax liability realistically cannot be collected in full. 183 Such doubt does not simply refer to a hardship if the full amount of the tax liability is paid; instead, it refers to the taxpayer’s maximum capacity to pay the tax assessment. The taxpayer must consider that the IRS usually has ten years to collect the liability. The taxpayer also must explain why assets and income available to the taxpayer are not available to the IRS for collection and cannot be expected to be paid to the IRS if a compromise is reached. 184

An acceptable offer must reflect collection potential and be in the best interest of both the taxpayer and the IRS. 185 For example, it is not in the best interest of the IRS to accept $1 for each $100 of tax liability when it can reject the offer and wait to see what collection potential would arise in the remaining ten-year collection period. 186

Not a closing agreement. The compromise may reduce, but does not extinguish, the assessed liability. The underlying assessment is not abated, and interest accrues even if the offer in compromise is accepted by the IRS. Moreover, the original tax liability can be revived if the taxpayer defaults on the terms of the compromise agreement. 187

As a contract, the offer in compromise is subject to the rules governing general contract law. 188 The offer in compromise is simply a negotiated agreement between the taxpayer and the IRS—the end result of the taxpayer’s offer, the IRS’s counteroffer, and the eventual compromise of both parties.

An offer in compromise is not a closing agreement. A closing agreement is a determination of the taxpayer’s tax liability designed to permanently and conclusively close the taxpayer’s case by resolving issues relating to either the total tax liability or to separate items, such as the amount of gross income. 189 In contrast, an offer in compromise is an agreement between the taxpayer and the IRS as to the amount of tax liability that will be paid and how that amount will be paid.

The offer. The taxpayer’s offer must be supported by a current statement of the taxpayer’s financial condition (including data on existing assets and liabilities) and a monthly income and expense analysis. The taxpayer must certify under penalty of perjury that the information is true. The IRS verifies the infor-

183. I.R.M. 57(10)1.2(1), 5.1(1)(9-22-94).
187. I.R.M. 57(10)(21).52(1)(a)-(e). The taxpayer will be informed in a letter that the offer has been declared in default and terminated. Pattern Letters p-242, p-243, and p-244 have been developed for this purpose. See I.R.M. Exhibits 5700-101, 5700-102, and 5700-103.
188. See United States v. Lane, 303 F.2d 1 (5th Cir. 1962).
mation by reviewing prior years' tax returns and, depending upon the amount and type of taxpayer assets, by reviewing bank, courthouse, and state motor vehicle records.

The offer itself is filed on IRS Form 656, Offer in Compromise. Item 9 of the form is used to explain why the offer should be accepted. IRS Form 433-A, Collection Information Statement for Individuals, or IRS Form 433-B, Collection Information Statement for Businesses, also is submitted if the offer is based on a doubt regarding the collectibility of the debt.190 If the offer is based on a doubt regarding liability, the taxpayer must submit a detailed statement as to why such amount is not owed to the IRS. The taxpayer also must prove that he has filed accurate returns for the current and previous three tax years, as well as promise to meet the filing requirements for a period of five years after acceptance of the offer.191

The IRS cannot accept an offer regarding a debt related to employment or withholding taxes if it is less than the amount of the tax, without interest or penalties, unless the employer is: (1) no longer in the same business; (2) liquidated; (3) a tax-exempt organization; or (4) in receivership or bankruptcy. The IRS determines if other offers are reasonable by comparing the amount offered with the amount the IRS reasonably expects to receive through other collection methods. An offer generally is accepted if it is at least equal to the sum of: (1) the liquidation value of the taxpayer’s current equity; (2) the present value of the taxpayer’s future expendable income; (3) payments available from third parties; and (4) assets available to the taxpayer, but beyond the reach of the IRS. The IRS does not apply a specific percentage to the taxpayer’s present or future income to determine the amount of an offer it will accept or reject.192 Furthermore, the IRS allows the taxpayer to maintain certain reasonable lifestyle choices in deriving the amount offered.

Taxpayers can pay the amount compromised in one lump sum or can agree to make deferred payments, plus interest on the deferred amount, for up to five years. Taxpayers usually make a deposit of the amount offered when the offer is submitted, although they are not required to do so. Taxpayers also are not asked to sign IRS Form 3040, Authorization to Apply Offer in Compromise Deposit to Liability, as a condition for processing the offer.

If the IRS rejects an offer, it returns the deposit, without interest, unless the taxpayer directs that the deposit be applied to the liability. Acceptance of the

190. I.R.M. 57(10)6.5 (9-22-94).
191. I.R.S. Form 656, Offer In Compromise.
deposit by the IRS is not indicative of its acceptance of the offer.\textsuperscript{193} If the offered amount does not meet the IRS's requirements, taxpayers are given an opportunity to increase or withdraw the offer. If a final offer is rejected, the IRS notifies the taxpayer of the reason for the rejection and the taxpayer's right to an appeal. The IRS can reject the offer if the taxpayer's net realizable equity exceeds the offered amount, the taxpayer does not provide requested information, or IRS managers believe public knowledge of the accepted offer would be detrimental to voluntary compliance. Detrimental public knowledge may be triggered, for example, by accepting an offer from a suspected organized crime figure who might have hidden assets.

**IRS authority to compromise.** The IRS may compromise any civil or criminal case arising under the internal revenue laws, including cases involving taxes as well as penalties and interest.\textsuperscript{194} However, the IRS may only compromise criminal cases before referring them to the Department of Justice for prosecution and only if the criminal tax liability involved does not arise out of the illegal trafficking of narcotics or the smoking of opium or marijuana.\textsuperscript{195} Once the IRS refers a criminal tax case to the Justice Department, the authority to compromise the case rests entirely with the Department of Justice.\textsuperscript{196} Accordingly, different procedural rules and considerations apply in making such offers. The IRS also has no authority to entertain offers to compromise tax liabilities asserted under the alcohol, tobacco and firearms laws.

The IRS official involved in the offer in the compromise process must obtain a legal opinion for any offer where the unpaid liability being compromised is $500 or more before accepting the offer. Typically, the opinion is supplied by District Counsels as delegates of the General Counsel for the Department of the Treasury.\textsuperscript{197} The General Counsel’s primary role in reviewing offers in compromise is to determine whether the offer is legally sufficient to meet the standard of doubt regarding liability or collectibility. For offers predicated on doubt as to liability, an offer is legally sufficient if it is “within a reasonable range of the predicted results in litigation.”\textsuperscript{198} An offer based upon doubt as to collectibility is legally sufficient if it “closely approximates” what would be legally and practically obtainable through available enforcement procedures. The Counsel generally will not question factual determinations or asset valuations that have been

\begin{footnotes}
\footnote{193. I.R.C. § 7809(b) (West 1997); I.R.S. Form 656, Offer in Compromise; I.R.M. 57(10)5.1 (9-22-94).}
\footnote{194. I.R.C. 7122(a) (West 1997); Treas. Reg. § 301.7122-1(b) (1997).}
\footnote{195. Treas. Reg. § 301.7122-1(a) (1997).}
\footnote{196. I.R.C. § 7122(a) (West 1997); I.R.M. 57(10)1.(13) (9-22-94); United States Attorney Manual 6-6.110.}
\footnote{197. I.R.C. § 7122(b) (West 1997); I.R.M. 57(10)(16).24 (9-22-94).}
\footnote{198. I.R.M. 57(10)(16) (9-26-92).}
\end{footnotes}
made by the IRS personnel involved in the compromise process unless they are patently erroneous.

IRS review of offer. The IRS’s review of an offer takes into account the taxpayer’s age and health in determining the taxpayer’s future earning capacity. Thus, the taxpayer should take these factors into account when determining the amount of the offer and also should include any documentation supporting poor health and/or advanced age with the offer in compromise.\footnote{I.R.M. 57(10)(10).1 (5) (9-22-94). }

Processability. Upon receipt of the taxpayer’s offer, the IRS will make an initial determination of whether the offer is “processable” (i.e., whether it warrants consideration upon the merits). An offer is rejected immediately if it is frivolous or submitted solely for the purpose of delayed collection.\footnote{I.R.S. Form 656 Instructions.} A number of reasons can cause the IRS to determine that an offer is not processable. Generally, the taxpayer can avoid having the offer returned as not processable by carefully and fully completing IRS Form 656 and the appropriate IRS Form 433 in cases of doubt as to collectibility.

The IRS considers an offer unprocessable if the taxpayer or the liabilities sought to be compromised are not identified, the appropriate signatures are not present, an obsolete version of IRS Form 656 is used, the financial statement (IRS Form 433) is not provided, or the amount offered is less than the amount shown as total equity in assets (Item 27, column (d), of IRS Form 433-B or line 30 of IRS Form 433-A).\footnote{I.R.M. 57(10)9.1(3)(a)-(g) (9-22-94).} However, an offer cannot be returned solely because the cost of the investigation does not justify consideration of the offer.\footnote{I.R.M. 57(10)9.1(4) (9-22-94).}

If the IRS determines an offer to be unprocessable, it will return the offer to the taxpayer and specify the information that must be added or corrected to make it processable. Depending on the problem with the first submission, the taxpayer may remedy the situation by either entering and initialing the changes on the previously submitted IRS Form 656 or by filing a new IRS Form 656.

If the IRS determines the offer processable, an authorized IRS official will execute a waiver acceptance at the earliest possible time after receipt of the offer. This signals the running of the statute of limitations. An offer is considered pending from the time the authorized IRS official signs the waiver acceptance until the offer is accepted, rejected, or withdrawn.\footnote{I.R.M. 57(10)7.1(4) (2-26-92).} At this point, collection activity is withheld, unless there is an indication that the offer was filed as a delay
Within 30 days of receiving the offer, the examining officer contacts the taxpayer to request any additional information needed to make a decision. If personal contact cannot be made, the IRS sends the taxpayer a letter detailing the information needed. The taxpayer is given a specified date by which to comply with the request. If the taxpayer fails to comply, the IRS generally rejects the offer.

**Collection tool.** Currently, it is IRS policy to use an offer in compromise as a legitimate alternative to either declaring a case uncollectible or using a pro-rated installment agreement as a collection tool. If no criminal proceedings are contemplated against the taxpayer and an analysis of the taxpayer’s financial condition shows that the liability cannot realistically be collected in full, the IRS advises the taxpayer of the offer in compromise provisions and the taxpayer’s right to submit an offer in compromise. The IRS also discusses sources of offer funds with the taxpayer. Potential sources include:

1. a nonviable spouse who has property that he or she may be interested in utilizing to secure a compromise for the spouse’s tax debt;
2. relatives or friends;
3. lending institutions;
4. employers;
5. suppliers;
6. customers.

However, note that the IRS employee only informs the taxpayer of the compromise provisions and the taxpayer’s right to submit an offer in compromise. The IRS employee cannot specifically request that the taxpayer submit an offer or suggest the specific terms or amount of the offer itself. The taxpayer is responsible for submitting the initial offer to the IRS, although if necessary, IRS personnel may assist the taxpayer in preparing the required forms.

An offer to compromise a legally due tax liability must be based on col-

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204. I.R.M. 57(10)9.2 (9-22-94).
205. I.R.M. 57(10)9.3 (9-22-94).
207. I.R.M. 57(10)5.2 (2-26-92).
208. I.R.M. 57(10)5.1(2), (4) (9-22-94).
The investigation of offers based on inability to pay requires the examining officer to conduct a comprehensive financial analysis of the taxpayer’s status. Specifically, the examining officer must ascertain the amount that may be collected from the taxpayer’s assets and income and from third parties. The examining officer uses information from previously completed investigations, such as financial statements, previous record checks, and future collectible accounts. The officer also reviews the information on the taxpayer’s financial statement, as updated with information from the taxpayer’s last filed return. If a taxpayer claims an inability to pay as the basis for compromising a tax liability, but does not submit the required financial statement, the offer is returned immediately to the taxpayer. In this situation, the offer is treated as insufficient for processing.

**Assets.** In determining whether an offer is adequate, the IRS confirms the values assigned to the taxpayer’s assets, using the financial statements as a starting point. The method used to value the taxpayer’s assets depends on the nature of the assets involved (see Exhibit 1 for a listing of the IRS methods). Ordinarily, the IRS uses the liquidating or quick sale value to arrive at a fixed value. The IRS considers the quick sale or liquidating value the amount that would be realized from a “sale of an asset in a situation where financial pressures cause the taxpayer to sell in a short period of time.” However, in recognition that the acceptance of an offer is in the best interest of the IRS, the use of a “forced sale value” is not considered “unreasonable.” Further, the IRS exercises care “to avoid inflexible, non-negotiable values” and “rejection of an offer solely based on narrow asset and income evaluations should be avoided.” Assets of substantial artistic or intrinsic value, such as jewelry, paintings, coin, or gun collections, are not to be overlooked. The statutory exemption from levy applicable to personal and household effects is to be taken into account, as is any joint ownership interest.

**Income.** In evaluating an offer, the IRS looks at the assets of the taxpayer, as well as the taxpayer’s income stream realistically expected to be available to pay delinquent taxes. There is no fixed percentage of the taxpayer’s present or future income that must be reflected in the present offer. The taxpayer’s prospective income stream is evaluated to determine if the taxpayer is prone to large or fluctuating earnings. The IRS evaluates various other factors, including the taxpayer’s education, profession or trade, age and experience, health, and past and present employment.

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present income, to determine any future increase in real income that may be avail-
able to pay taxes. Increases in income based solely on cost of living increases are
not considered. If a substantial increase in income is expected, the IRS seeks
a collateral agreement that entitles it to a fixed percentage of the taxpayer’s
income over and above living expenses and federal taxes for a five year period.

A taxpayer with income may pay off the compromised tax liability by
making installment payments. Believing that installment payments extending
beyond five years substantially increase the probability that the agreement will
not be fulfilled, the IRS will seriously consider an offer to pay the present value
of five years of installment payments. The IRS determines the present value by
using the chart at Exhibit 5700-19 of the Internal Revenue Manual.

Public policy. An accepted taxpayer offer becomes part of the public
record. In light of this disclosure, the IRS can reject an offer if it believes public
knowledge of the agreement will be detrimental to voluntary compliance. The
rejection of an offer on public policy grounds is rare. Rejection must be support-
ed by clear and convincing evidence that acceptance of the offer will be detri-
mental.

Fraud. If IRS personnel examining an offer discover any indication of
fraud in conjunction with an offer in compromise, they refer the matter to the
Criminal Investigation Division in the same manner as any other fraud referral.
Any further action on the offer in compromise or contact with the taxpayer is held
in obeyance pending the outcome of the fraud investigation. If Criminal
Investigation rejects the fraud referral, consideration of the offer resumes.
However, if the case is accepted, the IRS officer working on the offer may not
make any further contact with the taxpayer until he has been informed of the fraud
investigation. In these cases, either the offer is rejected on the grounds that other
investigations are pending that may affect the taxpayer’s liability or consideration
of the offer is suspended until the investigation concludes. In the latter case, the
taxpayer must be informed of his right to withdraw the offer so that the statute of
limitations may resume running.

Death. As with any other contract, the death of the offeror prior to the
IRS’s acceptance invalidates the offer, and the tax liability remains uncompro-
mised. Under these circumstances, the IRS issues a rejection letter to the taxpay-
er’s estate or surviving spouse. If the offer covers the joint liability of a husband

218. I.R.M. 57(10)1.3 (2-29-92).
and wife, it is the practice of the IRS to advise the surviving spouse that the offer may be resubmitted for consideration.\textsuperscript{220}

\textbf{Appealing a rejected offer.} When an offer is rejected or has been withdrawn by the taxpayer, the taxpayer is sent a letter confirming this fact. In the case of a rejection, the reasons for the rejection will be specified. Further, the rejection letter explains the written appeal procedure. The taxpayer has 30 days from the date of the rejection letter to perfect an appeal.\textsuperscript{221} If the total liability is $2,500 or less for any tax year or tax period, the taxpayer may appeal the rejection either orally or in writing. However, if the total liability exceeds $2,500 for any tax year or period, the taxpayer must file a written protest to receive consideration by the Appeals Officer.\textsuperscript{222}

\textbf{LITIGATION: THE LAST RESORT}

After all administrative appeals with the IRS have been exhausted and the controversy has not been satisfied to the taxpayer’s satisfaction, the taxpayer must decide whether to litigate. Well-researched tax issues provide some clue as to the probability of prevailing in court. But the burdens of litigation, primarily time and expense, often overwhelm the taxpayer.

The court may relieve some of the expense burden. If the court determines that the IRS’s position was not substantially justified and the taxpayer has exhausted all available IRS administrative remedies, it may award a judgment of reasonable litigation costs to the taxpayer who prevails in a suit brought against the IRS.\textsuperscript{223}

\textit{Reasonable Administrative Costs}

Reasonable costs incurred in IRS administrative proceedings include: (1) administrative fees or similar charges imposed by the IRS; (2) expenses of expert witnesses; (3) costs of any study, analysis, engineering report, test, or project for the preparation of the taxpayer’s case; and (4) fees for the services of a representative in the administrative proceeding.\textsuperscript{224} Administrative costs do not include litigation expenses or other costs incurred in connection with a proceeding that was not an administrative proceeding.\textsuperscript{225}

The courts will award a taxpayer reasonable administrative costs if: (1) the underlying substantive issues are not or never have been, before a court (i.e.,

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{220} I.R.M. 57(10)(17).7(2) (9-22-94).
\item \textsuperscript{221} I.R.M. 57(10)(17).6(4) (9-22-94).
\item \textsuperscript{222} I.R.M. 57(10)(17).8(2) (9-22-94).
\item \textsuperscript{223} I.R.C. § 7430.
\item \textsuperscript{224} Treas. Reg. § 301.7430-4 (1997).
\item \textsuperscript{225} Treas. Reg. § 301.7430-4(c) (1997).
\end{itemize}
\end{footnotesize}
because the court has the ability to award reasonable administrative costs in its disposition of the case); (2) the taxpayer is a prevailing party; (3) the taxpayer has not unreasonably protracted the administrative proceeding; and (4) the taxpayer has followed specific application procedures.\(^{226}\)

**Prevailing Party**

A prevailing party is one who: (1) establishes that the position of the IRS was not substantially justified; 2) substantially prevails as to the amount in controversy or with respect to the most significant issue or set of issues presented; and (3) satisfies the net worth and size limitations.\(^ {227}\) The IRS’s view that the taxpayer has the burden of establishing the IRS’s position is not substantially justified, is included in the notice establishing the administrative proceeding date or any date thereafter.\(^ {228}\)

Whether an IRS position is substantially justified depends in part on whether the taxpayer provides the IRS with all relevant information and arguments available to the taxpayer. The position of the IRS is reviewed for substantial justification as of each date a cost is incurred, but not earlier than the administrative proceeding date.\(^ {229}\)

To be a “prevailing party”, a taxpayer must substantially prevail with respect to the amount in controversy or with respect to the most significant issue or set of issues presented those that objectively represent the most significant issues for the taxpayer or the IRS.\(^ {230}\) Significance may exist because of the effect of the issue on other transactions not in issue. Not all cases, however, contain a most significant issue or set of issues. In such cases, the amount in controversy controls.

**Application Procedures**

To recover reasonable administrative costs, the taxpayer must file a written request with the IRS within 90 days following the mailing of the final IRS decision to the taxpayer.\(^ {231}\) If the IRS denies the taxpayer’s request for reasonable administrative costs in whole or in part, the taxpayer may appeal that denial to the Tax Court. If the IRS does not respond to the taxpayer’s request within six months of its filing, its failure to respond may be considered by the taxpayer as a denial of the request, and the taxpayer may appeal to the Tax Court.

\(^{228}\) Treas. Reg. § 301.7430-5(b) (1997).
\(^{229}\) Treas. Reg. § 301.7430-5(c) (1997).
\(^{231}\) Treas. Reg. § 301.7430-2(c) (1997).
Exhaustion of Administrative Remedies

A taxpayer’s administrative remedies are considered exhausted if the taxpayer requests and participates in an IRS Appeals Office conference on the tax matter prior to filing a court action. The taxpayer is considered to have participated in an Appeals Office conference if all relevant information regarding the tax matter has been disclosed to the Appeals Office.

If a determination that an organization is tax exempt is revoked, the affected organization must comply with special procedures to exhaust administrative remedies. Where no administrative procedure covering a taxpayer’s tax matter allows the taxpayer to request an Appeals Office conference, the taxpayer’s administrative remedies will not be considered exhausted unless the taxpayer files a written claim for relief with the district director having jurisdiction over the tax matter and allows the district director a reasonable period of time to act on the claim.

A taxpayer, however, is not required to pursue administrative remedies if the IRS notifies the taxpayer in writing that the pursuit is unnecessary, does not give the taxpayer an opportunity to request an Appeals Office conference before sending a statutory notice of deficiency, or fails to grant the taxpayer an Appeals Office conference for a claim for refund within six months of the filing of the claim for refund. A taxpayer must participate in an Appeals Office conference during either the deficiency procedures or the refund procedures for the tax matter, but is not required to participate during both procedures. Thus, if a taxpayer participates in an Appeals Office conference for a tax matter before the issuance of the statutory notice of deficiency, he does not have to request an Appeals Office conference after filing a claim for refund for the same tax matter.

CONGRESS ENACTS TAXPAYER BILL OF RIGHTS 2

The first attempt to enact Taxpayer Bill of Rights 2 (“TBOR2”) ended when the President vetoed the Revenue Reconciliation Bill of 1995. However, the Senate passed the bill on the second attempt on July 9, 1996, and it was signed by the President on July 30, 1996. TBOR2 provides over forty pro-taxpayer

239. IRS Announcement 96-5, 1996-4 I.R.B. 99. See also Taxpayer Bill of Rights 2, Pub. L.
procedural rights that will enhance taxpayers' stature when dealing with the IRS. TBOR2 represents a significant expansion of taxpayer rights from the 1988 Taxpayer Bill of Rights.

New Taxpayer Advocate

The Taxpayer Advocate ("TA") replaces the Taxpayer Ombudsman in helping individual "expeditiously resolve problems" with the IRS. The TA position carries more stature (higher salary) and power (reports directly to the IRS Commissioner) than that of the Taxpayer Ombudsman. Furthermore, the TA is empowered with broad authority to affirmatively take any action permitted by law to help taxpayers who would otherwise suffer a significant hardship as a result of the manner in which the IRS is administering the tax laws. The TA's job description also includes reporting to Congress on areas in which taxpayers are having problems in dealing with the IRS, including drafting an annual top twenty list of the most serious problems as well as recommending administrative legislative solutions where appropriate.

The new TA, rather than the defunct Taxpayer Ombudsman, will have the power to issue a Taxpayer Assistance Order ("TAO") to release levied property or require the IRS to refrain from any action which may cause the taxpayer significant and unnecessary hardship (including help with refunds). To give TAOs more clout, a TAO can give the IRS a deadline for compliance. In addition, only the TA, the Commissioner, or the Deputy Commissioner may modify or rescind a TAO.

In Announcement 96-5 released in January, 1996, the IRS tried to anticipate the TA position by beefing up the status and the authority of the Taxpayer Ombudsman. It also proposed regulations that would limit authority to rescind or modify a TAO. Some commentators speculated that the IRS's actions were an attempt to stave off inclusion of the TA provision in the final bill. The Taxpayer Ombudsman was perceived by many as not fully independent. This provision does not eliminate the Problem Resolutions Officer (PRO) program which operates on the regional and local levels. Nevertheless, Congress recommends, but does not mandate, that PROs take their direction from the TA.

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240. IRC § 7802 (d) (West 1997).


Installment Agreements

TBOR2 requires the IRS to notify taxpayers 30 days before altering, modifying, or terminating any installment agreement for any reason, except when tax collection is in jeopardy. Thus, if the IRS revokes an installment agreement based on faulty information, the affected taxpayer will have time to challenge this action. This provision became effective six months after enactment (i.e., six months after the President signed the Bill).

Under TBOR2, the IRS must establish procedures for an independent administrative review of termination of installment agreements for taxpayers who request a review. The effective date of this provision is January 1, 1997.

Authority to Abate Interest

Before TBOR2, the IRS had specific statutory power to abate an assessment of interest on a deficiency attributable to any error or delay by an IRS employee only in the case of an error or delay resulting from a ministerial act. Federal courts generally do not have the jurisdiction to review the IRS’s failure to abate interest. TBOR2 expands the IRS’s authority to include any unreasonable error or delay resulting from managerial as well as ministerial acts. These new circumstances include extensive delays caused by IRS ministerial acts such as loss of records, personnel transfers and extended illnesses, personnel training, or leave. However, interest will not be abated for delays resulting from general administrative decisions (e.g., a delay in implementing an improved computer system or how to organize the processing of tax returns). Furthermore, TBOR2 gives the Tax Court jurisdiction to determine whether the IRS’s failure to abate interest for a taxpayer, who meets the net worth and size requirements in effect for awards of attorney’s fees, is an abuse of discretion, and to order an abatement of interest. The taxpayer must petition the Tax Court within 180 days after the date of mailing of the final determination not to abate interest. The Tax Court’s jurisdiction to make the abuse-of-discretion determination applies to requests for interest abatement after the date of enactment. An order of abatement by the Tax Court is subject to review in the same manner as a Tax Court decision is subject to review.

Longer Interest-Free Period to Pay Tax

Under current law, taxpayers have an interest-free period of ten calendar days to pay tax after notice and demand. The interest-free payment deadline

244. I.R.C. § 6672 (West 1997).
for taxpayers to pay tax after receiving notice and demand will be ten business days (21 calendar days if the total tax liability shown on the notice of deficiency is less than $100,000), increased from ten calendar days. This extension of the interest-free period applies to the payment of taxes, penalties, additional amounts, or additions to tax for which interest is imposed.

**Relief From Payroll Tax Deposit Penalties**

TBOR2 allows the IRS to waive the I.R.C. Section 6656 penalty for an inadvertent failure to deposit employment taxes if: (1) the depositing entity meets the net worth requirement for attorney’s fee awards (i.e., is a small business); (2) the failure to deposit occurs during the first quarter that the depositing entity was required to deposit any employment tax; and (3) the return for the employment tax was filed on or before the due date.\(^{246}\) The penalty also can be abated if a first-time depositor inadvertently sends the deposit to the Treasury instead of to the required government depository.

**Timely Filing Rule**

The timely filing rule has always made reference to proof of mailing by means of the U.S. Postal Service.\(^ {247}\) TBOR2 reflects current practices by allowing taxpayers to use private delivery services such as Federal Express to prove timely filing of returns under the timely-mailing-as-timely-filing rule. An approved list of private delivery services will be published.

**Switch From Separate Returns to Joint Return**

Currently, taxpayers who file separate returns and later determine that they would have owed less tax had they filed jointly cannot amend their returns to file jointly if they were unable to pay the entire amount of the joint return tax liability before the expiration of the three-year period for making the election to file jointly. TBOR2 repeals the requirement of full payment of tax liability as a precondition to switching to joint filing status.\(^ {248}\) In addition, both the Treasury and General Accounting Office must conduct separate studies analyzing joint return issues and joint liability relating to divorce and innocent-spouse qualification.

**Disclosure of Collection Activities for Joint Filers\(^ {249}\)**

The IRS has not been required in the past to disclose collection informa-

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246. I.R.C. § 6656(c)(West 1997).
tion to a former spouse relating to tax liabilities from a joint return that was filed when the couple was married. If a tax deficiency with respect to a joint return is assessed and the joint filers are either divorced or not living together in the same household, TBOR2 requires the IRS to disclose in writing, in response to a written request by one of the individuals, whether the IRS has tried to collect from the other individual, the general nature of the collection activities and the amount (if any) collected. The IRS may omit the current home address and business location of the former spouse.

**Liens and Levies Changes**

If the IRS files a notice of tax lien under current law, it can withdraw it only if the notice (and the underlying lien) is erroneously filed, or if the underlying lien was paid, bonded, or becomes unenforceable. TBOR2 allows the IRS to withdraw a public notice of tax lien before payment in full by the taxpayer, if it finds any of the following:

1. the filing of the notice was premature or not in accord with administrative procedures;
2. the taxpayer has entered into an installment agreement to satisfy the tax liability;
3. the withdrawal of the lien will facilitate collection of the tax liability;
4. the withdrawal of the lien would be in the best interest of the taxpayer, as determined by the Taxpayer Advocate, and the U.S.

TBOR2 also requires the IRS to give a copy of the notice of withdrawal to the taxpayer, and to make a reasonable effort, upon the taxpayer's written request, to give notice of the withdrawal of the lien to creditors, credit reporting agencies, and financial institutions specified by the taxpayer.

In addition, the IRS can return property if a levy has taken place under TBOR2. Currently, the IRS may return levied property to a taxpayer only when the taxpayer has fully paid the tax, interest, and penalty for which the property was levied. TBOR2 allows the IRS to return property (including money deposited in the Treasury) that has been levied upon in the same four situations listed above for release of the notice of lien. Under the new provisions, if the IRS levies

on a taxpayer’s property in violation of the terms of an installment agreement, it now can return the levied property to the taxpayer.

**Levy Exemption**\(^\text{251}\)

TBOR2 increases the amounts that are exempt from levy from $1,650 to $2,500 for personal property, and from $1,100 to $1,250 for books and tools of a trade. These amounts, effective for levies issued after December 31, 1996, will be indexed for inflation after 1997. The personal property exemption no longer depends on the taxpayer being the head of a family.

**Offer-In-Compromise Simplified**\(^\text{252}\)

Under current law, amounts over $500 can only be accepted if the reasons for the acceptance are documented in detail and supported by an opinion of the IRS’s Chief Counsel. The threshold is increased to $50,000. TBOR2 allows the IRS to more easily expedite an offer-in-compromise if the taxpayer is unable to pay the full tax and there is doubt as to collectibility, or as to the tax liability itself.

**Attorney’s Fees and Costs**

Under I.R.C. Section 7430, a taxpayer who successfully challenges a deficiency may recover attorney’s fees and other administrative and litigation costs if, among other requirements, the taxpayer establishes that the position of the United States was not substantially justified.\(^\text{253}\) In addition, a taxpayer must exhaust administrative remedies to be eligible to receive an award of attorney’s fees.\(^\text{254}\) However, a taxpayer’s failure to agree to an extension of the statute of limitations, under TBOR2, cannot be taken into account for purposes of determining whether a taxpayer has exhausted administrative remedies. In addition, failure to exhaust all administrative remedies in a suit for damages for unauthorized collection activities is no longer an absolute bar to an award of litigation costs if the court determines that going through IRS channels would have been pointless. Courts may (but are not required to) reduce an award if the taxpayer has not exhausted administrative remedies. TBOR2 switches the burden of proof to the IRS to show its position was substantially justified in an action by a taxpayer for attorney’s fees and litigation costs. It also establishes a rebuttable presumption that the IRS was not substantially justified if it did not follow in the administrative proceeding its published regulations, revenue rulings, revenue procedures, information releases, notices or announcements, private letter ruling, determination letter, or Technical Advice Memorandum (“TAM”) issued to the taxpayer.

\(^{252}\) I.R.C. § 7122(b)(West 1997).
\(^{253}\) I.R.C. § 7430(c)(4)(West 1997).
The successful taxpayer will receive an award of attorney's fees unless the IRS satisfies its burden of proof. Attorney's fees may be awarded in all declaratory judgment proceedings after the date of enactment of TBOR2.\textsuperscript{255} TBOR2 increases the amount that a taxpayer can sue the U.S. for damages caused by an officer or employee of the IRS who recklessly or intentionally disregards Code provisions or regulations in collecting tax from the taxpayer from $100,000 to $1 million.

\textbf{Hourly limit on attorney's fees.}\textsuperscript{256} TBOR2 increases recoverable attorney's fees for prevailing taxpayers from $75 per hour to $110 per hour, indexed for inflation and rounded to the nearest $10 after 1996. Special circumstances still may justify higher hourly rates.

\textbf{Responsible Person Penalty Rules}

Under TBOR2, the IRS is required to issue a notice to an individual it believes is a responsible person under the I.R.C. Section 6672 one-hundred percent trust penalty rules at least 60 days prior to issuing a notice and demand for the penalty, unless collection is in jeopardy.\textsuperscript{257} The statute of limitations will not expire sooner than 90 days after the notice was mailed. TBOR2 also requires the IRS to disclose to a responsible person who requests the information in writing the name of any other person it has determined to be a responsible person for the same tax liability. The IRS also must disclose whether it has attempted to collect the penalty from other responsible persons, the general nature of those collection activities, and the amount, if any, collected.

\textbf{Contribution from other responsible persons.} Responsible persons who pay more than their proportionate share of I.R.C. Section 6672 liability now must pursue claims for contribution against other responsible persons for contribution under state law, to the extent state law permits them.\textsuperscript{258} Since the IRS may collect the penalty from the responsible person it can collect from most easily, rather than from the most culpable person, TBOR2 provides a federal cause of action for contribution from other responsible persons for penalties assessed after the date of enactment. If more than one person is liable for this penalty, each person who paid the penalty is entitled to recover any amount over his proportionate share from other responsible persons. This proceeding is a federal cause of action and is entirely separate from any proceeding involving the IRS's collection of the penalty.

\textsuperscript{255} I.R.C. § 7430(b)(1)(West 1997).
\textsuperscript{256} I.R.C. § 7430(b)(3)(West 1997).
\textsuperscript{257} I.R.C. §§ 6672(b)(1)-(b)(3) (West 1997).
\textsuperscript{258} I.R.C. § 6103(e)(9) (West 1997).
Dispute Resolution with the IRS

Tax-exempt organization board members. TBOR2 provides that the I.R.C. Section 6672 responsible person penalty will not be imposed on volunteer, unpaid members of any board of trustees or directors of a tax-exempt organization to the extent those members: (1) are solely serving in an honorary capacity; (2) do not participate in the day-to-day or financial activities of the organization; and (3) do not have actual knowledge of the failure.\textsuperscript{259} The IRS must develop materials to inform honorary and volunteer tax-exempt board members of whether they may be treated as responsible persons.

\textit{Summons Rules}

The IRS must follow special procedures before it issues a summons requiring a third-party recordkeeper to provide information concerning a taxpayer. If a third-party summons is served on a third-party recordkeeper listed in I.R.C. Section 7609(a)(3), then the taxpayer must receive notice of the summons and have an opportunity to challenge it in court. TBOR2 has added enrolled agents to the list of third party recordkeepers.\textsuperscript{260} The taxpayer has no statutory right to receive notice of the summons and does not have the opportunity to challenge it in court. Taxpayers will now get like protections accorded to attorneys and accountants for summonses issued to enrolled agents.

\textit{Designated summonses.} Designated summonses are limited to corporations that are being examined as part of the Coordinated Examination Program. TBOR2 provides that the running of the assessment period for a “designated summons” (as clearly stated) for a corporate return may be suspended while the parties are in court to obtain or avoid judicial enforcement of an administrative summons if the summons is issued at least 60 days before the assessment period is scheduled to expire.\textsuperscript{261} The limitations period is suspended during the judicial enforcement period of the designated summons and of any other summons relating to the same tax return that is issued within 30 days after the designated summons is issued. TBOR2 also requires that issuance of any designated summons regarding a corporation’s tax return must be reviewed by the Regional Counsel, Office of the Chief Counsel to the IRS, for the region in which the examination of the corporation’s return is being conducted.

\textit{Retroactive Regulations}

TBOR2 provides that final, temporary and proposed regulations relating to statutory provisions must have an effective date no earlier than the date of publication in the Federal Register or the date on which any notice substantially

\begin{footnotesize}
\begin{itemize}
\item 259. I.R.C. \S\ 6672(e)(West 1997).
\item 260. I.R.C. \S\ 7609(a)(3)(West 1997).
\item 261. I.R.C. \S\ 6503(j)(West 1997).
\end{itemize}
\end{footnotesize}
Exceptions to this rule include:

1. any regulations filed or issued within 18 months of the enactment of the statutory provision to which the regulation relates may be issued retroactively;

2. Congress may give the Treasury authority to prescribe a regulation’s effective date;

3. Treasury may issue retroactive temporary or proposed regulations to prevent abus;

4. Treasury may issue retroactive temporary, proposed, or final regulations to correct a procedural defect in the issuance of a regulation;

5. taxpayers may be permitted to elect to apply a temporary or proposed regulation retroactively from the date of its publication;

6. final regulations may take effect from the date of publication of the temporary or proposed regulation to which they relate.

Annual Delinquency Reminders

Due to limited staff and resources, the IRS may wait for years to collect on small deficiencies. TBOR2 provides that the IRS must send taxpayers annual reminders of their outstanding tax liabilities beginning in 1997. However, a taxpayer’s failure to receive a timely, annual reminder notice does not excuse the tax liability. Congress was concerned that taxpayers often believe after a number of years that the IRS has abandoned its claim for small deficiencies and, thus, are surprised when it acts to collect years later when the ten-year limitations period on collection is close to expiring.

Phone Numbers on Information Returns

Information returns will have to list the telephone number of the information contact of the person required to make the information return- (i.e., the phone number of the information contact for the payor). For example, the
phone number of the department with the relevant information may be provided. TBOR2 makes phone numbers a requirement starting in 1997.

**Unidentified Payments Requirements**

Under TBOR2, the IRS will be required to notify within 60 days taxpayers who have submitted payments that the IRS cannot associate with the taxpayer.\(^{265}\)

**Suit for Improper Disclosure from Tax Professional**

If an IRS employer entices a tax professional to disclose information (intentionally compromising the determination or collection of any tax due) about clients in exchange for the favorable treatment of the taxes of the professional, the taxpayer has an absolute right to bring a civil action for damages and costs for the lesser of $500,000 or actual damages, plus costs.\(^{266}\) The tax professional must have acquired the taxpayer’s information while advising the taxpayer in connection with his tax liability. This remedy does not apply to information conveyed by a taxpayer to an attorney, CPA, or enrolled agent for the purpose of perpetrating a fraud or crime. Damages for these purposes (litigation limits) do not include the taxpayer’s liability for any civil or criminal penalties or other losses attributable to criminal sanctions.

**Additional Disclosure Designation**

The IRS may disclose a taxpayer’s return or return information only to someone designated by the taxpayer in a written request.\(^{267}\) However, TBOR2 eases this “formal written” restriction by allowing the IRS to disclose taxpayer information to a designated third party through alternatives means using electronic communications systems.

**Netting of Interest**

The Treasury must conduct a study of the manner in which the IRS has implemented the netting of interest on overpayments and underpayments and the policy and administrative implications of global netting.\(^{268}\) The Treasury must hold a public hearing to receive comments from any interested party before submitting the report of its study to the tax writing committees. The report was due

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6050B(b)(1), 6050H(d)(1), 6050I(e)(1), 6050J(e), 6050K(b)(1), 6050N(b)(1) (West 1997).
266. I.R.C. §§ 7435, 7536 (West 1997).
six months after the enactment of TBOR2, and the IRS initially announced an expected completion date of October 1, 1996. Now, however, the report is expected to be part of a package containing legislative language relating to the Treasury's tax simplification proposal.

Rewards for Civil Violations

Rewards may be paid for information relating to civil violations, as well as criminal violations. The rewards are to be paid out of proceeds collected (other than interest) from the information collected.

Disclosure of Cash Transaction Returns

TBOR2 gives the IRS permanent authority to disclose Form 8300 (cash-reporting information returns) to other Federal agencies and to state, local, and foreign agencies to administer Federal criminal statutes, and for civil and regulatory purposes. However, disclosure is not permitted to any agency for purposes of tax administration.

CONCLUSION

Resolving taxpayers' problems with the IRS is not a pleasant task. The challenges associated with an IRS examination (e.g., time and place, representative, proper channel for resolving problems, means of settling additional tax liability, when to litigate, disputing IRS's findings) often are considered by practitioners at the least opportune time. Expanded rights through IRS initiatives and TBOR2 are certainly welcome relief to taxpayers who seek to resolve disputes with the IRS. A working knowledge of these rules beforehand allows the tax practitioner to better represent his tax clients in the event of a tax controversy.

**EXHIBIT 1**

**IRS VALUATION METHODS**

<table>
<thead>
<tr>
<th>Type of Asset</th>
<th>IRS Valuation Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Cash on hand</td>
<td>Full value.</td>
</tr>
<tr>
<td>2. Checking and savings accounts</td>
<td>Average balance over reasonable savings account period (generally three months).</td>
</tr>
<tr>
<td>3. Furniture, fixtures, and personal effects</td>
<td>The taxpayer’s financial and personal effects statement amount is usually regarded as sufficient. I.R.M. 57 (10)(13).5.</td>
</tr>
<tr>
<td>5. Listed stock</td>
<td>Quick sale value (generally market value minus the cost of sale). I.R.M. 57(10)(13).2(1).</td>
</tr>
<tr>
<td>6. Unlisted stock</td>
<td>Average of bona fide bid and ask prices over reasonable period less the cost of sale.</td>
</tr>
<tr>
<td>7. Life insurance</td>
<td>The unsecured interest in the policy (including the cash surrender value), provided the insured has the right to change the beneficiary or to borrow against the policy without the beneficiary’s consent. The cash loan value, plus all accumulated dividends and interest left with the company, also is an asset to be considered. I.R.M. 57(10)(13).3.</td>
</tr>
<tr>
<td>Type of Asset</td>
<td>IRS Valuation Method</td>
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<td>-------------------------------------</td>
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<tr>
<td>8. Pension and profit-sharing</td>
<td>Required contributions to an employer’s plan that cannot be withdrawn prior to separation from service or death are not considered an asset with any equity. However, where the taxpayer contributed the amounts voluntarily, the equity is considered the gross amount in the taxpayer’s plan minus any employer contributions. Amounts that the taxpayer is permitted to borrow are considered an asset. The cash deposits in an IRA 401(k) or Keogh plan are included at full value; other investments are considered at current value; and the penalty for early withdrawal and additional tax is subtracted to determine the assets’ value. I.R.M. 57(10)(13).4.</td>
</tr>
<tr>
<td>9. Real estate (general rule)</td>
<td>Valued at highest and best use, determined by evidence of recent sale of property or similar property in the vicinity, by appraisal or by assessed valuation when it reasonably reflects the quick or forced sale value or when it can be adjusted to reflect those values. I.R.M. 57 (10)(13).91.</td>
</tr>
<tr>
<td>10. Real estate (jointly owned)</td>
<td>Taxpayer’s proportionate share (determined under state law) of the net equity in the property based on its quick sale value.</td>
</tr>
<tr>
<td>Type of Asset</td>
<td>IRS Valuation Method</td>
</tr>
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<td>----------------------</td>
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<tr>
<td>11. Closely held corporation</td>
<td>Property held with the taxpayer’s spouse in tenancy by the entirety is valued at not less than 20% of the net equity in the property based on its quick sale value. I.R.M. 57 (10)(13).92.</td>
</tr>
<tr>
<td>12. Accounts receivable</td>
<td>Facts and circumstances will dictate value. However, the stock value must reflect the net worth of its assets, earning condition, dividend policy, current financial condition, anticipated future prospects, and going concern value of the corporation. I.R.M. 57 (10)(13)2.3.</td>
</tr>
<tr>
<td>13. Machinery and equipment</td>
<td>Valued on a case-by-case basis, taking into account the existence of a market for the equipment, the difficulty of moving and dismantling the equipment, and the cost, approximate age, and condition of each item in arriving at its value. I.R.M. 57 (10)(13).6.</td>
</tr>
</tbody>
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