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FEBRUARY 2000 *BULLETIN NO. 473*

GENERAL LITIGATION BULLETIN

Department of the Treasury **Office of Chief Counsel** **Internal Revenue Service**

SAFE HARBOR FROM DISCLOSURE LITIGATION TUMULT
Levy Disclosures Not Wrongful Despite Lack of Deficiency Notice

Answering the question of whether the Service may disclose tax return information in issuing liens and levies, even if the proper collection procedures were not followed, the Tenth Circuit in **Mann v. United States, 2000 U.S. App. LEXIS 2487 (10th Cir. Feb. 18, 2000)**, determined that I.R.C. § 6103(k)(6) provides a safe harbor for such disclosures. Because tax return information may be disclosed under section 6103(k)(6), even if procedural deficiencies render the levies defective, no cause of action exists under I.R.C. § 7431.

Taxpayers filed a joint return, but claimed no taxable income and requested a refund of taxes paid. Although the Service notified the taxpayers that they underpaid their tax liability and owed additional taxes, no notice of deficiency was sent. After the taxpayers responded to the Service's letter, denying liability, the Service issued several notices of levy. The levy notices contained the taxpayers' names, address, social security numbers, and described the tax liability. The taxpayers then filed suit against the Service under I.R.C. § 7431, seeking damages for wrongful disclosure of tax information.

The district court found for the Government on summary judgment, and the Tenth Circuit affirmed. The appellate court did not agree with the taxpayer's argument that because the Service failed to follow the correct assessment and collection procedures (by failing to issue a notice of deficiency and waiting the prescribed statutory period before initiating collection), the Service was not authorized to disclose tax information about them. The Tenth Circuit found that I.R.C. § 6103(k)(6) authorizes the Service to disclose tax return information in the issuance of liens and levies.

The court distinguished Chandler v. United States, 687 F.Supp. 1515 (D. Utah 1988), aff'd per curiam, 887 F.2d 1397 (10th Cir. 1989). In Chandler, the Service received but miscredited payment from a taxpayer, then issued a levy. The district court in Chandler held the Service negligently disclosed tax return information by issuing the notice of levy. The Tenth Circuit found that Chandler focused on the Service's conduct leading up to the levy. Unlike the conduct in Chandler, the Service in this case did not act unreasonably or negligently in pursuing taxpayers who already had paid the tax. Rather, the taxpayers here failed to pay the tax, and even though the collection procedure was technically defective, sections 6103 and 7431 address improper disclosures, not improper collection.

The Service, on appeal, also argued that the taxpayer's exclusive remedy for wrongful disclosure was under section 7433, not 7431. The appellate court, while agreeing that the question of which provision was the appropriate means of relief was important, declined to address the issue because the Government did not raise it before the district court.

DAMAGES, SUITS FOR: Against U.S.: Unauthorized Disclosure (§ 7431)

WHO BEARS THE BURDEN?
Supreme Court Looks at Burden of Proof in Bankruptcy

The Supreme Court granted certiorari to decide whether the burden of proof with respect to a tax creditor's claim in a bankruptcy case should be governed, like other substantive rights, by applicable nonbankruptcy law or whether equity requires the burden of proof in a bankruptcy case always be borne by the claimant. In a case decided by the Seventh Circuit, the State of Illinois filed a proof of claim for taxes in a Chapter 7 bankruptcy. Deciding that the former officer of a defunct corporation was liable as a responsible person for a state use tax, the Seventh Circuit ruled that the burden of proof remains the same in bankruptcy as without (that is, the burden of proof is on the debtor to show that he is not a responsible officer). **In re Stoecker 179 F.3d 546 (7th Cir. 1999)**. Two circuits support this interpretation: Resyn Corp. v. United States, 851 F.2d 660 (3d Cir. 1988) and In re Landbank Equity Corp., 973 F.2d 265 (4th Cir. 1992), while two circuits find equity requires the burden of proof to be on the claimant in all cases. In re Placid Oil, Inc., 988 F.2d 554 (5th Cir. 1993); In re MacFarlane, 83 F.3d 1041 (9th Cir. 1996); see also In re Brown, 82 F.3d 801 (8th Cir. 1996) (dicta); In re Fullmer, 962 F.2d 1463 (10th Cir. 1992) (dicta).

BANKRUPTCY CODE CASES: Determination of Tax Liability (§ 505)
PENALTIES: Failure to Collect, Withhold or Pay over: Responsible Officer

CASES

1. **BANKRUPTCY CODE CASES: Application of Payment**
In re Poydras Manor, Inc., 242 B.R. 603 (Bankr. E.D. La. 2000) - Liquidating Chapter 11 debtor may designate that payments be made first to trust fund taxes, under the rationale of In re Deer Park, Inc., 10 F.3d 1478 (9th Cir. 1993).

2. **BANKRUPTCY CODE CASES: Automatic Stay (§ 362): Commencement or Continuation of Judicial, Administrative or other Proceeding**
In re Thompson, 241 B.R. 920 (Bankr. S.D. Ga. 1999) - The debtor moved for relief from the automatic stay to allow the Tax Court to determine his tax liability. The bankruptcy court found that the intent of B.C. § 362 is that it applies only to entities trying to collect a debt or obtain property from the debtor or his estate. The debtor, not being one of those entities, cannot request relief under section 362 from the automatic stay.

3. BANKRUPTCY CODE CASES: Chapter 7

In re Turpen, 2000 Bankr. LEXIS 96 (B.A.P. 8th Cir. Feb. 16, 2000) - Debtors filed for Chapter 13 bankruptcy, owing substantial federal taxes which they disputed. After failing to file a plan, debtors converted to Chapter 7, where they battled the trustee over liquidation of their estate. Apart from the claim of the United States, the debtors argued, the estate was solvent, and so they attempted to voluntarily dismiss their Chapter 7 filing. The trustee and the Service objected. The Bankruptcy Appellate Panel, affirming the bankruptcy court, held that a Chapter 7 debtor has no absolute right of dismissal. In this case, the debtors' failure to make a showing of good cause for dismissal, together with the ample evidence of prejudice to creditors, leads to a finding that the bankruptcy court did not abuse its discretion in refusing to grant the dismissal.

4. BANKRUPTCY CODE CASES: Determination of Tax Liability (§ 505): Amount or Legality of Any Tax Liability

In re Sawyer, 1999 Bankr. LEXIS 1747 (Bankr. E.D.N.C. Dec. 30, 1999) - Debtors filed joint tax returns for 1987-1991, but were not married until 1991. After filing for bankruptcy, the debtors attempted to file amended tax returns seeking to impose liability solely on the husband, so that their property (held in tenancy by the entireties) would not be subject to the federal tax liens. The bankruptcy court ruled the Service did not have to accept the amended returns, finding a taxpayer who benefitted from a false representation should not be allowed to withdraw that representation when it no longer benefits the taxpayer.

5. BANKRUPTCY CODE CASES: Determination of Tax Liability (§ 505): Amount or Legality of Any Tax Liability
INNOCENT SPOUSE

In re French, 242 B.R. 369 (Bankr. N.D. Ohio 1999) - Service prepared joint income tax returns for married couple, who operated a small business. After the husband died, the wife filed for Chapter 7 bankruptcy. After receiving her discharge, the widow filed an adversary action under B.C. § 505(a), arguing that as an "innocent spouse" under I.R.C. § 6015 she had no tax liability. The court found the debtor did not meet the requirements of I.R.C. § 6015(b)(2), because the Service is not asserting a deficiency (therefore, there is no understatement of tax). However, the court could not determine, for summary judgment purposes, whether the debtor qualified for relief under section 6015(f) or Notice 98-61.

6. BANKRUPTCY CODE CASES: Exceptions to Discharge (§ 523): No, Late or Fraudulent Returns

In re Krumhorn, 2000 Bankr. LEXIS 106 (Bankr. N.D. Ill. Jan. 13, 2000) - Bankruptcy court found debtor was collaterally estopped from challenging Government's claim that debtor wilfully attempted to evade or defeat his tax obligations, making the taxes nondischargeable under B.C. § 523(a)(1)(C). An earlier tax court decision gave, as an alternate holding, that the debtor's trading schemes were economic shams designed to avoid taxes. Because the issue of

wilful evasion was actually litigated and essential to the tax court's holding, the bankruptcy court barred the debtor from relitigating the issue.

7. **BANKRUPTCY CODE CASES: Exceptions to Discharge (§ 523): No, Late or Fraudulent Returns**

In re Wright, 2000 Bankr. LEXIS 64 (Bankr. N.D. Cal. Jan. 4, 2000) - Debtor's accountant prepared tax returns, but debtor never signed or filed them. In an ensuing criminal investigation, the Service obtained copies of these returns, and subsequently used information from these returns to prepare substitute returns. The debtor cooperated with the criminal investigation, pled guilty to willful failure to file tax returns, and served his sentence. He then challenged the amount of the substitute returns, agreeing to a stipulated judgment in Tax Court. The debtor next filed for Chapter 7 bankruptcy. The bankruptcy court found that the returns were not deemed filed because they never were signed by the debtor, and so the taxes were not discharged under B.C. § 523(a)(1)(B). Although the stipulated judgment in Tax Court would be considered a filed return, that was done less than two years prior to the debtor's bankruptcy, and so under B.C. § 523(a)(1)(B)(ii) the taxes were not dischargeable. Finally, the debtor's claims that the Service misled him during the criminal investigation by (according to the debtor) not telling him he needed to sign or file the returns and by promising to file the returns for him, were not sufficient to avoid discharge. The special agents had no duty to tell the debtor his duty, and the evidence did not support a finding that Service employees promised to file returns for the debtor.

8. **BANKRUPTCY CODE CASES: Exceptions to Discharge (§ 523): Pre-Petition Priority Taxes**

In re Hornick, 1999 Bankr. LEXIS 1617 (Bankr. W.D. Penn. Nov. 22, 1999) - Debtor, a clerical employee, processed payroll and paid bills using a signature stamp on checks. Following her conviction for embezzlement, the debtor filed for bankruptcy after the Service assessed taxes under the Trust Fund Recovery Penalty, I.R.C. § 6672. She sought a discharge of the taxes under B.C. § 523(a)(1)(A) and § 507(a)(8) under the rationale of In re Victor, 121 F.3d 1383 (10th Cir. 1997) (holding only allowed unsecured claims can be excepted from discharge). This court disagreed with Victor, finding section 523(a)(1)(A) focuses on the kind of tax, not the kind of claim, specified in section 507(a)(8). Any other interpretation would produce an absurd result in conflict with the plain intent of the statute.

9. **BANKRUPTCY CODE CASES: Jurisdiction of the Bankruptcy Court**

In re Management Control Systems, Inc., 242 B.R. 658 (Bankr. S.D. Ind. 1999) - Officer of liquidating corporation filed petition to intervene in the corporation's Chapter 7 bankruptcy, so that the court could determine whether he was a responsible officer liable to the Government for the Trust Fund Recovery Penalty, I.R.C. § 6672. The bankruptcy court held that litigation of an individual's personal

tax liability is not "related to" the corporation's bankruptcy, and so the bankruptcy court lacks jurisdiction under 28 U.S.C. § 157(a) to hear the officer's petition.

10. BANKRUPTCY CODE CASES: Proofs of Claim (§ 501): Failure to File, Effect of

<u>I.R.S. v. Hildebrand, III, Trustee</u>, 2000 U.S. Dist. LEXIS 918 (M.D. Tenn. Jan. 11, 2000) - In this consolidated case, the Chapter 13 debtors failed to list the Service in their schedules or otherwise provide notice of bankruptcy to the Service. The bankruptcy court held the Service's untimely proofs of claim were barred under B.C. § 502(b)(9) despite the lack of notice. The district court reversed, finding that principles of fundamental fairness dictate that where the Service lacks actual or constructive notice of bankruptcy, the bar date of section 502(b)(9) is not effective.

11. BANKRUPTCY CODE CASES: Proofs of Claim (§ 501): Form

<u>In re Shaver, Jr.</u>, 1999 Bankr. LEXIS 1737 (Bankr. E.D. Tenn. Dec. 7, 1999) - The bankruptcy court overruled the debtor's objection that the Service's proof of claim lacked supporting documentation. The court held that Fed. R. Bankr. P. § 3001(c) applies to written security agreements, not tax claims based on statutory obligations, and so the Service is not required to provide any written documentation to support its claim.

12. BANKRUPTCY CODE CASES: Refunds: Bankruptcy Court Determination

<u>In re Guardian Trust Co.</u>, 242 B.R. 608 (Bankr. S.D. Miss. 1999) - The court ruled that the failure of Government's counsel to timely respond to trustee's requests for admissions, despite two prior deadline extensions, warrants a finding that the matters are deemed admitted. By deeming the matters admitted, the court granted the trustee's summary judgment motion for a claimed tax refund of $2 million, instead of having to pay the Government's claim of $6 million.

13. DAMAGES, SUITS FOR: Against U.S.: Unauthorized Collection (§ 7433)

<u>Shannahan v. United States</u>, 1999 U.S. Dist. LEXIS 20687 (S.D. Cal. Dec. 30, 1999) - Taxpayers filed amended 1993 tax return, showing a refund due, and requested the refund be applied to their 1994 estimated tax obligations. The Service instead levied against the taxpayers' retirement account. The taxpayers then filed suit under I.R.C. § 7433(a), claiming the Service's levy violated Treas. Reg. § 301.6402-3(a)(5) by not applying their 1993 overpayment to their 1994 tax liability. The court dismissed the suit, holding the Service has no obligation to accept an amended return. Although the taxpayers styled their complaint as a wrongful collection action under section 7433, the court divined the taxpayers really were challenging the Service's failure to recognize their 1993 amended return. This challenge must be brought under 28 U.S.C. § 1346(a)(1), not section 7433 (the taxpayers already had unsuccessfully brought suit under section 1346(a)(1)).

14. INTERPLEADER
LIENS: Action to Quiet Title

<u>Stackhouse v. Morgan</u>, 1999 U.S. Dist. LEXIS 20642 (E.D. Va. Dec. 15, 1999) - Decedent left her estate to her son, who disappeared fifteen years earlier after a failed attempt to murder his wife. The Service and the residual heirs both claimed the proceeds from the estate. The court determined it was premature to decide the conflicting priorities either as an interpleader or quiet title action, because there had not been a determination that the son was deemed legally dead under Virginia law. Because the administrator of the decedent's estate is therefore not in possession of the son's property (because the son cannot be a beneficiary until the presumption of death statute is resolved), the Government cannot waive its sovereign immunity and the court lacks jurisdiction to resolve the lien priorities.

15. PENALTIES: Failure to Collect, Withhold or Pay Over: Responsible Officer

<u>Larson v. United States</u>, 2000 U.S. Dist. LEXIS 960 (E.D. Wash. Jan. 7, 2000) - In 1988, taxpayer Larson formed a corporation with two other individuals, Johnson and Van Valkenberg, getting 26% of the stock . Johnson got 48% of the stock and ran the company, while Van Valkenberg got the remaining 26% and, like Larson, was a passive investor. Although Larson never was an officer or director of the corporation, nor had any involvement in its daily business, he was a signatory on the bank accounts. In 1989, Larson purchased Van Valkenberg's shares. In 1992, Larson found out employment taxes were not being paid, so he took out a loan and paid the taxes in full before confronting Johnson, who promised he would pay the taxes in the future. In 1993, the bank began notifying Larson that the corporation's accounts were overdrawn. Late in 1993, Larson learned that Johnson had been falsifying financial records. Johnson resigned in January 1994, and the business closed two months later. Larson was assessed with the Trust Fund Recovery Penalty under I.R.C. § 6672. Larson first argued that, due to procedural irregularities, he never owned Van Valkenberg's stock and therefore remained a minority shareholder. The court was not persuaded, finding that Larson held himself out as owner and, having paid consideration, had at least an equitable interest in the shares. Next, the court addressed the issue of responsible officer, finding as with the taxpayer in <u>Denbo v. United States</u>, 988 F.2d 1029 (10th Cir. 1993), Larson was the one whom the bank looked to for financial decisions. Larson effectively had the power to pay the taxes, even if he did not exercise it. Finally, the court did not accept that Larson's payment of the taxes in 1992 exonerated him. Rather, the payment should have put Larson on notice that Johnson could not be trusted, and Larson's failure to take action makes him liable.

16. PENALTIES: Failure to Collect, Withhold or Pay Over: Willfulness

<u>Macagnone v. United States</u>, 2000 Bankr. LEXIS 126 (Bankr. M.D. Fla. Jan. 27, 2000) - On remand, after the district court held the bankruptcy court erred in finding the Government bore the burden of proof on the issue of wilfulness, the bankruptcy court still found the taxpayer was not liable for the Trust Fund Recovery Penalty under I.R.C. § 6672. Although the taxpayer formed the subject corporation, was its president and a shareholder, provided all of its initial capitalization, and provided 80% of the funds necessary to run the company before it filed for bankruptcy, the

bankruptcy court found the taxpayer was unaware that the employment taxes were not being paid. That the taxpayer should have known of the tax liability was irrelevant to the issue of wilfulness, the court held.

17. PENALTIES: Failure to Collect, Withhold or Pay Over: Willfulness

In re Main, Inc., 242 B.R. 574 (Bankr. E.D. Pa. 1999) - Court rejects “business judgment rule” defense (corporate directors not liable for mistakes in judgment). The rule does not excuse corporate officers from liability to pay federal taxes.

18. REFUNDS: Jurisdictional Prerequisites for Claim

Davis v. United States, 2000 U.S. App. LEXIS 2302 (Fed. Cir. Feb. 16, 2000) (*unpublished*) - Taxpayer testified that he timely mailed claim for refund, but did not use registered or certified mail. The Service denied receiving any claim for a refund. The Federal Court of Appeals affirmed the Court of Federal Claim’s dismissal for lack of jurisdiction, holding that a taxpayer’s uncorroborated testimony is not an exception to the physical delivery rule under I.R.C. § 7502. The court declined to adopt the additional, “common-law mailbox rule” exception of the 8th and 9th Circuits (although noting the taxpayer here would not have been successful even under this liberal standard).

The following material was released previously under I.R.C. § 6110
Portions may be redacted from the original advice

CHIEF COUNSEL ADVICE

Waiver of Due Process Rights

December 9, 1999
CC:EL:GL:Br1
GL-705496-99
UIL-50.00.00-00

MEMORANDUM FOR DIRECT COUNSEL, MIDWEST REGION, MILWAUKEE
CC:MSR:MWD:MIL

FROM: Alan C. Levine
Chief, Branch 1 (General Litigation) CC:EL:GL:BO1

SUBJECT: Advisory Opinion
Waiver of Due Process Rights

This is in response to your memorandum dated July 16, 1999, requesting our review and comments with respect to your proposed advisory opinion. Subsequent to that memorandum several telephone conversations took place between you, James M. Klein of your office, and Jerome Sekula of this office. Pursuant to those discussions, your office issued an advisory opinion to the Chief, Appeals Division, Midwest Region, on September 8, 1999. We have reviewed that memorandum which we received on September 27, 1999.

ISSUE

Whether the Internal Revenue Service (Service) may suggest to a taxpayer that the taxpayer waive Collection Due Process (CDP) rights allowed under the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA98)?

CONCLUSION

If the Service determines that it may be in the best interest of the taxpayer, a revenue officer may advise or suggest to the taxpayer or the taxpayer's representative, if the taxpayer is represented, that the taxpayer waive certain of the collection due process rights granted to a taxpayer under I.R.C. §§ 6320 and 6330, as added by RRA98 section 3401.

FACTS

Recently, the Service effectuated a waiver of due process rights under RRA98 to enable the filing of a Notice of Federal Tax Lien which the taxpayer desired. Although the lien filing was made at the taxpayer's request, the filing was made earlier than the Service's administrative procedures would otherwise require. To protect itself against possible claims that it had not met all administrative procedures (for the purposes of section 6330(c)(1)) prior to the filing, Collection requested the taxpayer to execute a waiver of the taxpayer's right to the Collection Due Process (CDP) hearing to which the taxpayer would otherwise be entitled to request following the filing of the lien. You have asked our office when it is appropriate for the Service to discuss and accept waivers of CDP rights.

LAW AND ANALYSIS

Section 6320 requires the Service to provide, within five business days after lien filing, CDP notification and the opportunity for an independent hearing and possible subsequent appellate court review to persons against whom a NFTL has been filed. Section 6330 requires the Service to provide, at least 30 days before the first levy, CDP notification and the opportunity for an independent hearing and possible subsequent appellate court review to persons against whose property the Service intends to levy upon for the payment of tax. The purpose of these two provisions is to permit a taxpayer who owes tax to have both an administrative and a judicial hearing to challenge the Service's determination of tax liability and/or the Service's collection actions.

Discussions with a taxpayer or the taxpayer's representative concerning a waiver of the taxpayer's CDP rights do implicate, at least tangentially, the provisions of RRA98 section 3468. That section prohibits Service employees from requesting a taxpayer to waive the taxpayer's right to bring a civil action against the United States or any Service employee for any action taken in connection with the internal revenue laws unless the taxpayer waives that right knowingly and voluntarily, or that request is made in person and the taxpayer's attorney or representative is present, or the request is made in writing to the taxpayer's attorney or representative. Taxpayers who waive their right to a CDP hearing do not receive a CDP hearing or a Notice of Determination by Appeals from which they could otherwise seek court review. Accordingly, the consequences of a waiver of the taxpayer's right to a CDP hearing should be

discussed with the taxpayer or the taxpayer's representative, if the taxpayer is represented.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

Discussions concerning waivers of CDP rights will not be appropriate in all cases and should be engaged in only when the facts and circumstances of a particular case indicate they may be warranted. The Service must attempt to avoid circumstances that might be construed as being under duress when a waiver of CDP rights is executed by a taxpayer. The Service should agree to permit a taxpayer to execute a waiver of the taxpayer's CDP rights only when the taxpayer desires that the Service take some further administrative action that the Service would not be able to do because of section 6320 or section 6330: for example, a third-party levy that is otherwise delayed because of the notice provision requirements of either of the two sections.

The filing of a Notice of Federal Tax Lien (NFTL) does not require pre-notification to the taxpayer of CDP rights. Accordingly, any waiver concerning lien filings should normally be secured, as was done here, prior to such a filing. Pursuant to I.R.C. §§ 6331(d) and 6330(a)(2), in levy situations, notification must be given at least 30 days prior to the day of the first levy. To prevent any misunderstandings in levy situations, the taxpayer must first be given a CDP notice. Only after that CDP notice has been given should the taxpayer be allowed to waive the taxpayer's CDP rights.

We agree that a revenue officer can advise or suggest to a taxpayer or the taxpayer's representative to consider such waivers whenever the facts and circumstances indicate it may be beneficial to the taxpayer and the Service to have the taxpayer waive his or her rights to enable the Service to act quickly in performing some administrative function it could not otherwise take. Since, currently, there is no written prescribed waiver form, revenue officers should contact district counsel to draft or review a waiver on an as-needed basis.

Offers in Compromise - Agreements with States

October 7, 1999
CC:EL:GL:Br2
GL-605604-99
UILC: 17.31.00-00

MEMORANDUM FOR DISTRICT COUNSEL, VIRGINIA-WEST VIRGINIA DISTRICT

FROM: Mitchel S. Hyman
Senior Technician Reviewer, Branch 2 (General Litigation)

SUBJECT: Offers in Compromise - Agreements with States

This responds to your request for assistance dated July 19, 1999. This document is not to be cited as precedent.

ISSUE

Whether the district could enter into agreements with the states of Virginia and West Virginia for the acceptance of joint or simultaneous offers to compromise both Federal and state tax liabilities.

CONCLUSION

We conclude that there are no legal impediments to entering into such agreements. However, such an agreement may be inconsistent with IRS policy with respect to the acceptance of offers. Therefore, we advise the district to consult with the Office of Special Procedures to insure that any agreements reached with the states are consistent with Service-wide policy for the acceptance of offers in compromise.

BACKGROUND

By memorandum dated June 14, 1999, the district director for the Virginia-West Virginia District asked whether the district could enter into agreements with the states of Virginia and West Virginia for the acceptance of joint or simultaneous offers to compromise both Federal and state tax liabilities. On July 19, 1999, you requested our assistance in this matter.

The request from the district contains no details on how such an agreement would be structured. For purposes of this memorandum, we have assumed that the agreement would be similar to those Fed-State agreements which the Service has typically entered into for the collection of liabilities through installment agreements. Pursuant to these arrangements with various states, the Federal and state governments receive an agreed upon percentage of the income available to fund the agreements, computed after allowing for necessary and reasonable living expenses. Because the standards for determining whether an offer in compromise is acceptable require the Service to include equity in assets as an element of collectibility, we also assume that there would be some agreed-upon division of net realizable equity.

DISCUSSION

Installment agreements and offers in compromise are fundamentally different. One product of these differences is seen in the way the Service's collection financial standards are applied within each program.

The collection financial standards were developed as a result of a 1995 IRS initiative designed to ensure uniform treatment of similarly situated taxpayers. The IRS had always permitted taxpayers to retain the funds necessary to pay for reasonable living expenses. In response to claims that the standards applied varied widely across districts, the Service published national and local standards for necessary expenses. National standards apply to categories such as food, clothing, personal care items, and housekeeping supplies. Local standards, which are published by county, apply to housing, utilities, and transportation. The IRM also contains rules for the allowance of "conditional" expenses, defined as expenses which may be allowed if certain requirements are met. See generally IRM 105.1, Collecting Contact Handbook, Section 3.3. Since the adoption of these procedures by the IRS, Congress has enacted legislation requiring the development and maintenance of these standards to insure that taxpayers who compromise their tax liabilities are left with adequate means to pay basic living expenses. See I.R.C. § 7122(c).

An installment agreement is a payment arrangement through which the Service achieves full payment of the tax liability at issue. See Treas. Reg. §301.6159-1(a). The agreement is not a final determination of the tax at issue. McIntyre v. United States, 1987 U.S. Dist. LEXIS 16151 (D. Colorado July 1, 1987). Rather, it is a mechanism through which the Service allows the taxpayer to take an extended period of time to meet his or her past-due obligations.

The standards used to determine allowable expenses when a taxpayer requests an installment agreement reflect the fact that the Service expects full payment of the liability. If the taxpayer qualifies for a "streamlined" installment agreement ($25,000 or less owed and achieving full payment within five years), then no financial analysis is necessary. IRM 105.1.2.4.4. Even if the taxpayer does not fall within this criteria, the procedures provide a great deal of flexibility in applying the allowable expense standards. Many expenses which would not be classified as necessary under the financial standards are permitted as conditional expenses, provided the taxes will be fully paid within a reasonable period of time. See IRM 105.1.3.3(3)-(5).

Thus, in order for the taxpayer to be granted an installment agreement, full payment of the taxes must be achieved, even if a set percentage of monthly disposable income is going to fund an agreement with the state government. The interests of Federal-state comity and cooperation are served by such an agreement, and the taxpayer is given a workable solution to his or her tax difficulties. Furthermore, these agreements with the states can be honored within the existing standards for the evaluation and acceptance of proposed installment agreements.

Offers in compromise differ from installment agreements in that, by definition, a compromise means payment of some amount less than the full tax liability. The Service has promulgated a policy statement to inform taxpayers and Service employees of the goals of the offer in compromise program and to guide them in the submission and acceptance of offers. See Policy Statement P-5-100. That policy

states that the goal of the offer in compromise program is "to achieve collection of what is potentially collectible at the earliest possible time and at the least cost to the government." Id. To that end, offers are accepted "when it is unlikely that the tax liability can be collected in full and the amount offered reasonably reflects collection potential." Id.

Because the Government will not achieve full collection of the liability through the compromise, the Service's procedures take a much more restrictive view with respect to what expenses will be permitted. The financial analysis in offer cases allows only "necessary" expenses. IRM 5.8, Offer in Compromise Handbook, Section 5.7(4). Additional expenses may only be permitted if they meet the necessary expense test. That is, they must be necessary for the health or welfare of the family or for the production of income. IRM 105.1.3.3(2). No "conditional" expenses are permitted, since the standard for allowing them is full payment within a reasonable period of time.

As for state and local taxes, the IRM handbook contains guidance on how they should be classified for expense purposes. Current state and local taxes are necessary expenses, while delinquent taxes are considered necessary only to the extent they have lien priority over the delinquent Federal taxes. See IRM 105.1, Exhibit 3-2. The agreement suggested by the district would apparently disregard this standard, allowing payment of delinquent state taxes in a set percentage, regardless of their priority vis-a-vis the Federal taxes. Such an offer is unlikely to meet the "reasonable collection potential" standard for acceptance, since the Service has agreed to forego funds which it has determined to be collectible. Additionally, allowing payment of delinquent state taxes only in states with agreements appears counter to the Service's long-term efforts to bring a sense of uniformity and fairness to the offer in compromise program.

The statute governing the evaluation of offers allows the Service to deviate from the standards adopted, but only after a case-by-case determination as to whether the allowable expense standards should be applied in the particular taxpayer's case. The standards will not be applied where they would result in the taxpayer being left without adequate means to provide for basic living expenses. See I.R.C. § 7122(c)(2)(B). The agreement suggested here would apply different standards to a group of taxpayers within a specific district based upon owing money to particular creditor–the state–and without examining the particular taxpayer's circumstances. Deviation from the standards for this reason does not appear to be considered anywhere in the Service's current policies or procedures.

CONCLUSION

The proposed agreements with the states of Virginia and West Virginia would represent a departure from the Internal Revenue Service's established policies with regard to offers in compromise and could be viewed as counter to the Service's long-term efforts to achieve uniformity and fairness in the offer in compromise program. For these reasons we recommend that such agreements only be considered after a

decision is reached, at the Service-wide level, that they can be structured in a manner that is consistence with the Service's policies with regard to the evaluation and acceptance of offers in compromise.

Designation of Federal Tax Deposits

June 9, 1999
CC:EL:GL:Br2
GL-603029-99
UILN: 6101.00-00

MEMORANDUM FOR DISTRICT COUNSEL, KENTUCKY-TENNESSEE DISTRICT

FROM: Kathryn A. Zuba
Chief, Branch 2 (General Litigation)

SUBJECT: Designation of Federal Tax Deposits

This responds to your request for assistance, dated April 5, 1999. This document is not to be cited as precedent.

ISSUE:

Can a taxpayer designate the application of a Federal Tax Deposit?

CONCLUSION:

Yes. A taxpayer can designate the application of a Federal Tax Deposit (FTD). To be effective, a designation must accompany the payment, be in writing, and clearly provide the period and type of tax to which it is to be applied.

BACKGROUND:

The Internal Revenue Service received a letter from a taxpayer's representative inquiring about the designation of Federal Tax Deposits. In the letter, the writer questions the adequacy of published guidance advising taxpayers about their right to designate partial voluntary payments, including FTDs. The writer believes that taxpayer's should be advised of this right and instructed how to designate their Federal Tax Deposits.

This letter was forwarded to your office to assist in answering the taxpayer's representative's inquiry. After thorough research, you concluded that the Service's published guidance provides taxpayers with adequate instructions regarding

designation of voluntary payments, including Federal Tax Deposits. We agree with this conclusion.

LAW & ANALYSIS:

Revenue rulings and procedures are an authoritative instrument of the Commissioner of the Internal Revenue for announcing the official rulings and procedures of the Internal Revenue Service. Revenue Ruling 73-305, 1973-2 C.B. 43, sets forth the Internal Revenue Service's policy to apply a partial voluntary designated payments in accordance with the taxpayer's directions.[1] Revenue Ruling 79-284, 1979-2 C.B. 83, extends the application of Revenue Ruling 73-305 to "withheld employment taxes and collected excise taxes where the taxpayer provides specific written instructions" regarding the application. See also Rev. Proc. 99-10, 1992-1 I.R.B. 11 (effective for FTDs required to be made after January 18, 1999). Revenue Procedure 84-58, 1984-2 C.B. 501, provides that when no assessment has been made, the Service will honor the taxpayer's designation of a payment. In turn, "[i]f no designation is made by the taxpayer, the Internal Revenue Service will allocate partial payments of withheld employment taxes and collected excise taxes to tax, penalty, or interest in a manner serving its best interest. Rev. Rul. 79-284,1979-2 C.B. 83; Policy Statement P-5-60 (February 29, 1993). See also Davis v. United States, 961 F.2d 867, 878 (9th Cir. 1992), cert. denied, 506 U.S. 1050 (1993); Wood v. United States, 808 F.2d 411, 416 (5th Cir. 1987).

Generally, designations will be accorded their ordinary meaning unless they are too ambiguous and uncertain to serve as directions to the Internal Revenue Service. See, e.g., White v. United States, 99-1 U.S.T.C. (CCH) ¶ 50,496 (Fed. Cl., April 19, 1999) (Notation "Fed. Deposit Thru 11/16/92" found too ambiguous to constitute "specific written instructions"); Hammon v. United States, 21 Cl. Ct. 14, 29 (checks sent to the Internal Revenue Service contained "ambiguous markings;" the Service was allowed to apply the funds to preexisting delinquencies). To be effective, a designation must accompany the payment, contain the taxpayer's Employer Identification Number (EIN), the period and type of tax for which the payment is intended and, if desired, a detailed description of how the payment is to be allocated between the tax, interest, and penalty. See, e.g., Kinnie v. United States, 994 F.2d 279, (6th Cir. 1993) (oral designation not binding upon Internal Revenue Service); Teets v. United States, 29 Fed. Cl. 697, 703 (1993) (allocation must be in writing). Thus, in a case of a voluntary payment sent directly to the Service, the designation should be made on the check itself. In a case of a Federal Tax Deposit, on the other hand, the designation should accompany the FTD coupon. See Wood v. United States, 808 F.2d 411, 417 (5th Cir. 1987) (holding that designation on checks sent to a depository bank were ineffective

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[1] See also In re Technical Knockout Graphics, Inc., 833 F.2d 797 (9th Cir. 1987); Muntwyler v. United States, 703 F.2d 1030, 1032 (7th Cir. 1983); O'Dell v. United States, 326 F.2d 451, 456 (10th Cir. 1964).

because such direction never reach the Internal Revenue Service). Finally, the taxpayer should retain all evidence of the designation in the event the payment is misapplied.

On the basis of the foregoing, we conclude that the applicable case law and published revenue rulings and procedures provide sufficient guidance to taxpayers wishing to designate their Federal Tax Deposits.

Accountant Privilege - Criminal Tax

CC:EL:GL:Br3
DL-108541-99
October 19, 1999
UILC:23.07.03-00

MEMORANDUM FOR LOS ANGELES DISTRICT COUNSEL

FROM: Lawrence H. Schattner
Chief, Branch 3 (General Litigation)

SUBJECT: Request for Advice on Tax Advice Privilege in I.R.C. § 7525

This Chief Counsel Advice is in response to your June 1, 1999 memorandum received by the Office of Chief Counsel (General Litigation) on July 22, 1999. Chief Counsel Advice is not binding on Examination or Appeals and is not a final case determination. Chief Counsel Advice issued to Examination or Appeals is advisory only and does not resolve the Service's position on an issue or provide the final basis for closing a case. This document is not to be relied on or otherwise cited as precedent.

ISSUE:

Whether the tax advice privilege, which under the plain terms of I.R.C. § 7525(a)(2) is not applicable in criminal tax matters or proceedings, effectively applies in such criminal matters or proceedings where the subject communications occurred during, or with respect to, earlier civil matters or proceedings.

CONCLUSION:

The plain terms of I.R.C. § 7525 provide that the tax advice privilege is not applicable in criminal tax matters or proceedings. This statutory exception contains no limitations or conditions and the legislative history further indicates that none should apply. Therefore, the tax advice privilege is not applicable in criminal tax matters or

proceedings even if a subject communication originated in the context of a civil matter or proceeding.

FACTS:

Although I.R.C. § 7525 clearly states on its face that the tax advice privilege is not applicable to criminal tax matters or proceedings, tax practitioners are beginning to argue that there are situations where the privilege applies in the criminal context. Specifically, some tax practitioners are arguing that communications between them and their clients during, or with respect to, a civil investigation are protected communications. They argue that such communications are privileged from disclosure in any later criminal tax matter or proceeding. In effect, these tax practitioners are attempting to "boot-strap" the privilege into criminal tax matters or proceedings.

DISCUSSION:

I.R.C. § 7525 establishes a limited tax advice privilege. I.R.C. § 7525 was added by section 3411(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105-206, and is applicable to communications made on or after July 22, 1998. I.R.C. § 7525(a)(1) establishes the general rule as follows:

> With respect to tax advice, the same common law protections of confidentiality which apply to a communication between a taxpayer and an attorney shall also apply to a communication between a taxpayer and any federally authorized tax practitioner to the extent the communication would be considered a privileged communication if it were between a taxpayer and an attorney.

I.R.C. § 7525(a)(2) plainly limits the context in which the privilege can be asserted to noncriminal tax matters or proceedings. The statute provides as follows:

> Paragraph (1) [§ 7525(a)(1)] may only be asserted in–
>
> > (A) any noncriminal tax matter before the Internal Revenue Service; and
> >
> > (B) any noncriminal tax proceeding in Federal court brought by or against the United States.

To date, there are no reported cases interpreting I.R.C. § 7525 or addressing the specific issue presented. Likewise, the legislative history does not directly address the specific issue presented.

The text of the various legislative reports closely follow the language of the statute. The Senate Committee Report, S. Rep. No. 105-174, reprinted in Standard Federal Tax Reporter (CCH) para. 42,816 (1999), states:

> The privilege of confidentiality may be asserted in any noncriminal tax proceeding before the IRS, as well as in noncriminal tax proceedings in the Federal Courts where the IRS is a party to the proceeding.

The Senate Committee Report also reiterates this point:

> The privilege granted by the provision may only be asserted in noncriminal tax proceedings before the IRS and in the Federal Courts with regard to such noncriminal tax matters in proceedings where the IRS is a party.

Id.

The Conference Committee Report, H.R. Conf. Rep. No. 105-599, reprinted in Standard Federal Tax Reporter (CCH) para. 42,816 (1999), contains similar language:

> The conference agreement also clarifies that the privilege created by this provision may be asserted in non-criminal tax proceedings before the IRS and in the Federal courts with regard to a noncriminal tax proceeding where the United States is a party.

In sum, both the plain language of the statute and the legislative history are clear: the tax advice privilege may not be asserted in criminal proceedings.

Moreover, the law does not support tax practitioners' creative efforts to fashion an exception to the plain statutory rule that the tax advice privilege does not apply in criminal tax matters or proceedings.

It is well established that under the common law, no privilege attaches to transactions between a client and a federally authorized tax practitioner, including an accountant, and such person is competent to testify to communications between himself and his client in both civil and criminal proceedings. United States v. Arthur Young & Co., 465 U.S. 805 (1984); Couch v. United States, 409 U.S. 322 (1973); see "Privileged Communications between Accountant and Client," 33 ALR4th 539 § 2 (1984 & Supp. 1999); see generally 1 Am. Jur. 2d "Accountants," § 15 (1994 & Supp. 1999). It is also well established that statutes in derogation of common law must be strictly construed. American Casualty Co. v. M.S.L. Division, 406 F.2d 1219 (7th Cir. 1969); see Charney v. Thomas, 372 F.2d 97 (6th Cir. 1967) (statutes in derogation of common law must be construed narrowly). The courts have repeatedly held that changes in common law effected by statute must be clearly evidenced therein. See, e.g., United States v. Tilleraas, 709 F.2d 1088 (6th Cir. 1983); United States v. Mead, 426 F.2d 118 (9th Cir. 1970); United States v. Bowman, 358 F.2d 421 (3d Cir. 1966). No statute is to be construed as altering common law further than its words clearly import. United States v. Mead, supra. Even where a statute clearly expresses the intention to abrogate

common law, the scope of common law will be altered no further than is necessary to give effect to the language of the statute. United States v. Tilleraas, supra.

In the instant case, I.R.C. § 7525(a)(2) clearly indicates that the tax advice privilege may not be asserted in criminal tax matters or proceedings. Neither the statute nor the legislative history indicates in any way that exceptions to this rule should be permitted, or that the privilege could effectively apply in a criminal proceeding if it stemmed from communications in the context of civil actions. Given that I.R.C. § 7525 is in derogation of the common law, it must be strictly and narrowly construed based upon its plain terms. The scope of the common law rule should not be altered any more than is necessary to implement the statute. Here, it is not necessary to extend the privilege to criminal proceedings when the communications originated in the context of civil actions to implement the statute. Although the statute extends the common law protections inherent in the attorney client privilege to tax advice communications between a taxpayer and a federally authorized tax practitioner, it is clear that this extension is not absolute. The limitations in subparagraph two are clear and should be upheld without qualification to effectuate the intent of the statute. In the absence of clear legislative intent to allow the “bootstrapping” of the privilege, the privilege should not be assertable in a criminal tax matter or proceeding regardless of where or in what context the tax advice communication originated.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS:

We believe the argument of tax petitioners that the tax advice privilege may be “bootstrapped” in some criminal tax matters or proceedings has no support in the statute or the legislative history. The plain language of the I.R.C. § 7525 and the accompanying legislative history clearly state that the privilege is not applicable in criminal proceedings. Well established principles of statutory construction support the Service’s position that the privilege should not be extended beyond the plain language of the statute in the absence of clear and explicit legislative intent.