POINT TO REMEMBER

Fighting the Post-Bankruptcy Survival of Federal Tax Liens on Property That Is Excluded from the Bankruptcy Estate (Part 2)

By Michael DeBlis*

Editor’s Note: This is the second of a two-part article, which provides an overview of the federal tax system’s forced collections tools. Part 1 appeared in the NewsQuarterly, Vol. 33, No. 4, Summer 2014 issue.

Judicial Collection Actions

Although its administrative enforcement tools are at the heart of federal tax collection, the Service can seek judicial assistance to enforce a tax liability. As a practical matter, the Service seeks judicial assistance only when its administrative procedures for collecting taxes are ineffective. Because the Service employs judicial collection actions sparingly, a taxpayer is unlikely to be subject to a section 7403 action. For example, in 2010, the Service filed roughly 1.1 million NFTLs and 3.6 million notices of levy on third parties, but civil actions under section 7403 produced only 46 judicial opinions. Internal Revenue Service, Data Book 2010, Table 16 (2011), available at http://www.irs.gov/pub/irs-soi/10databk.pdf; National Taxpayer Advocate, 2010 Annual Report to Congress, Executive Summary, at 43, available at http://www.irs.gov/pub/irs-pdf/p2104c.pdf.

There are two chief reasons why the Service uses judicial collection actions as a last resort. First, as section 7421 recognizes, a federal lawsuit to enforce a lien can be a potentially long and drawn out adversarial process. Second, the Service cannot, itself, bring an action in federal court to enforce the lien through foreclosure. Instead, it must persuade the Department of Justice, which has its own priorities and demands on its resources, to commence the action on behalf of the United States. I.R.C. § 7401.

The purpose of a collection action is to reduce the federal tax assessment to judgment and to foreclose the tax liens on specific property. But the Service can also request more unusual relief. For example, it may obtain certain relief on an ex parte basis, including the authority to open, or at least be present at the opening of, a safety deposit box, and to obtain a warrant to enter property without the owner’s consent. In re Gerwig, 461 F. Supp. 449, 451 (C.D. Cal. 1978).

The Service may also attempt to set aside a conveyance as fraudulent. Such action is taken when it believes that the taxpayer transferred property prior to the federal tax lien (or levy) in order to avoid payment. I.R.C. § 6901. Generally, when a conveyance

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FROM THE CHAIR
You—Our Members—Are the Lifeblood of the Section

By Armando Gomez*

Like any volunteer organization, the Section of Taxation depends on its individual members for just about everything. While the Tax Section is the premier provider of continuing legal education for tax lawyers, educating its members through programming at our three regular meetings and numerous other CLE programs, and through thoughtful articles and commentaries published in The Tax Lawyer, the News Quarterly, and other publications, the Tax Section also provides many opportunities for its members to give back. Here are some of the ways in which you can become more engaged in the Tax Section’s work.

First, consider joining a committee, or increasing the number of committees on which you are a member. The Tax Section’s committees are where most of our work is done and are the pipeline through which Section leaders are made and leadership opportunities are filled. For example, we have over 30 committees that regularly provide programming at our three regular meetings. Whether your practice focuses on corporate transactions, planning for small businesses, cross-border matters, administrative controversy, or court practice, there is something for everyone at these meetings. You are welcome to attend any of the CLE programming at the meetings, and I encourage you to volunteer to help organize programming for our upcoming meetings. Most committees include a “current developments” session at the meetings, which can be a good place for younger or less-experienced speakers to get their feet wet. Just reach out to the committee leadership to volunteer, and I am sure they will be happy for your help. Contact information for each committee is available on the Section website. See page 11 for a current list of committees.

The committees also are the source of nearly all of the Tax Section’s government submissions. The government regularly requests our input on a wide variety of issues. Whether it is a notice of proposed rulemaking or other form of proposed guidance, or the need to address new legislation or significant judicial decisions, there are numerous opportunities for the Tax Section to provide its input into the guidance process. We also provide input to the Congressional tax-writing committees on proposed tax legislation and even on opportunities for the Congress to simplify and reform the Code. All of these projects require input from our members. As a member of a committee, you can help formulate the scope and nature of reports that the Tax Section prepares, and, if you are so inclined, you can take on a principal role in drafting the reports. There are even opportunities for less-experienced members to get involved, including with research and cite checking for the reports. Every contribution is a valuable part of the process, and we are always looking for volunteers to assist with these efforts. If you attend the three regular meetings, each committee chair usually announces the projects for which the committee is seeking help. If you cannot make it to a meeting, you can also just reach out to the committee chair to volunteer, or better yet, to suggest a project that the committee can take on (with your help, of course).

The majority of the Tax Section’s committees are focused on a particular subject or practice area, like the Partnerships and LLCs Committee or the Civil and Criminal Tax Penalties Committee. Other committees focus on the operation of the Tax Section and what we do for our members. For example, if you are interested in enhancing the quality of our meetings or want to help with organizing our periodic CLE webinars, please volunteer to join the Membership and Marketing Committee or the CLE Committee. I would also encourage you to attend one of the sessions organized by the Diversity Committee, which provides programming across a wide range of tax issues.

For the young lawyers, the Young Lawyers Forum (YLF) presents a number of opportunities to engage our younger members in the Section’s activities. For example, each year the YLF organizes the Tax Section’s Law Student Tax Challenge (LSTC), in which teams of J.D. and LL.M. students compete in drafting and presenting on assigned problems. This program, which exposes law students to a research project that a law firm associate might receive in the real world, is a great introduction to the Tax Section for the students and is a fun way for young Section members to get involved in our work. And for anyone

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Stanley Surrey was Assistant Secretary of the Treasury for Tax Policy from 1961 to 1969. He died in 1984. He was a pre-eminent tax scholar and a hands-on administrator. He was at the center of several tax issues of high profile today: the invention of “tax expenditures,” the invention of subpart F, and debates over VATs and separating the Internal Revenue Service from the Treasury.

Q: What do you think about prospects for tax reform?
A: Tax reform requires a President to strongly get behind the effort. Even though President Carter called the tax system a “national disgrace,” he could not move tax reform in 1978 because he did not make it a high enough priority. Tax reform will come when a president gets behind it. Stanley S. Surrey, Reflections on Tax Reform in the United States, 1 CAN. TAX’N 34, 35 (1979).

Q: Do you believe that tax reform is a matter of economics or morality or what?
A: It is largely a matter of morality. “The present [1970] struggle for tax reform is essentially a moral one. It is totally immoral for us as a nation to continue the inequities of our federal income tax. It is immoral to place income tax burdens on those in poverty or close to it. It is immoral to have an efficient withholding system for wages and salaries that inexorably collects the tax liabilities of the little fellow and the moderately well-off salaried person, and then to tolerate the wholesale escape from their tax liabilities that characterizes our high-income recipients as a class.” Stanley S. Surrey, Federal Tax and Fiscal Policy, 48 TAXES 49, 51 (1970). [In later years the passive loss rules, the at risk rules, and other reforms shut down some of the schemes to which Surrey referred.]

Q: What do you think about tax provisions for macroeconomic effects?
A: “[W]e should not resort to tax devices for economic stabilization and growth that are so interwoven with the fabric of the regular tax structure … that only the keepers of the temple know which provisions owe their origins to economic stabilization or growth and which to the proper measurement of net income.” Id. at 54.

Q: What do you think about a VAT in the U.S.? Should we follow the path of Europe?
A: “Unfortunately, we are likely to enter into that subject with a large amount of confusion, rhetoric and dissembling. Partly this is due to the way the tax developed and spread in Western Europe. There the basic question was what to do about existing high level excise taxes on consumption structured in the unsatisfactory form of turnover taxes. The step to a value added tax was perhaps a natural transition, for it led to a more efficient and economically neutral tax that still had the probably necessary political strength of appearing to tax all the productive and commercial sectors as did the turnover taxes. The question in the United States is a different one. We have no general federal tax on consumption. We have, however, a national sales tax of the retail type in the cumulative geographical coverage of the various state taxes. Where do we want to go from here? If we are to have a unitary national tax on consumption, the immediate questions would seem to center around the use of the retail form in view of our state and local experiences. … Such questions do not even raise the issue of a value added tax … It would seem we would come to that issue only if one were to assert and prove that the value added method of imposing a final result sales tax on consumption by nonbusiness consumers is clearly superior to the retail sales tax … In a real sense, the Europeans … never got to that question.” Id. at 55.

Q: Don’t you believe that shifting from income taxation toward a VAT would boost the U.S. economy?
A: “[T]o say that heavy reliance on indirect taxes compared to direct taxes is a significant factor in economic growth is a naive view of a complex problem. As a matter of fact, one would be just as naive to say that the reason the United Kingdom has had a relatively slow rate of growth in recent years [as of 1968] is because it raises a high proportion of its revenues from indirect taxes … On the other hand, we have been doing pretty well in the United States as far as growth is concerned—at least for the last eight years—and we do not have a national sales tax.” Stanley S. Surrey, A Value-Added Tax for the United States—A Negative View, 21 TAX EXECUTIVE 151, 154–55 (1968–1969).

Q: What do you think about a proposal to separate the Internal Revenue Service from the Treasury Department?
A: “I first came across the proposal in the early 1940’s when it was used from time to time by former congressman Knutson as a means of plaguing the then Treasury Secretary….
Henry Morgenthau, Jr. . . . The proposal in 1952 . . . was placed . . . before the Republican Presidential candidate. . . . The proposal seeks . . . a rigid cleavage between tax administration and tax policy. . . . On one analysis, the Bureau is being separated from the thought influence, or the doctrinal influence, or the social philosophy of the Treasury Department. This seems the paramount objective. . . . [I believe] an antiseptic, sterilized tax administration, uncontaminated by the currents and needs of an ever changing society, is hardly realistic, and is clearly undesirable. . . . In brief, there are no ‘purely administrative matters’ in our federal tax system. Stated differently, there is no tax problem, certainly no significant tax problem, which should be answered on the basis of administrative considerations alone. . . . [A witness stated in congressional hearings on the proposal that] ‘I think there would be much less tendency on the part of an independent Bureau of Internal Revenue to read into the tax laws which you [the Congress] enact, interpretations which you did not intend. . . .’ I am afraid that here our witness, who

planning to attend the Midyear Meeting in Houston, please make time to drop by the LSTC competition to support the law student participants who make it to the final rounds and to see for yourself why the LSTC has been called the best tax practice writing competition for law students.

If you want to get involved but are not sure you want to present at meetings, another option is to write an article for one of the Tax Section’s publications. Our editors are always seeking new content, so please think about how you might be able to contribute. And if you have a really big idea, or an in-depth outline that you have been regularly updating, consider whether a book is the way to go. The Tax Section has published a number of books in recent years, and is always happy to help authors think through how to publish on a practical topic that will be of interest to our members.

Each year the Tax Section goes through a process of identifying new leaders, for our committees, our council, and our officers. If you have interest in getting involved in Tax Section leadership, the first step is to get active in a committee. Once you have shown interest in the committee’s work, talk with the leadership of the committee about how to join their leadership team. At our regular meetings, anyone with a red badge is a member of leadership, so feel free to ask one of us how to get more involved.

Last, I wanted to mention one program that the Tax Section has to recognize younger lawyers who are actively involved in the work of the Tax Section. Named for the late Jack Nolan, who chaired the Tax Section in 1981-82 and received the Tax Section’s first Distinguished Service Award in 1995, this program has helped propel a number of younger lawyers into leadership positions across the Tax Section. I am honored to be the first Nolan Fellow to become chair of the Section, and am pleased that a number of other Nolan Fellows are also active in leadership positions. The current chair-elect, George Howell, will be leading the effort to identify the next class of Nolan Fellows this fall. If you know of an ambitious young lawyer who is devoted to the Section’s work, please consider submitting a nomination. Details on the Nolan Fellows program and application materials can be found on the Tax Section website.
Henry was born and raised in Houston, Texas. He lives in his childhood home on Green Street, which has been in his family for generations. Henry has used the Green Street address for all personal and business purposes, including all of his tax filings.

Henry had been in the welding business since the summer following high school graduation 13 years ago. During that time he had accumulated some expensive welding equipment, which he had kept in a rented shop a few miles from the Green Street home. In 2005 a terrific storm swept through Houston and lightning struck his shop, igniting his engine drive welder. The fire department responded promptly, but not before the fire damaged his welder. Henry was unable to salvage the burned equipment and was forced to discard it. He had no insurance coverage for the welder, and he received no compensation for the damage. Henry has used the Green Street address for all personal and business purposes, including all of his tax filings.

Henry was considering what to do next when he remembered that some of his high school buddies had made some real money working in the Bakken fields in North Dakota. Anne had recently been put on a project that would require her to be in Oklahoma for an indeterminate time, so there was nothing tying Henry to Houston for the time being. Henry, never afraid of hard work, decided that he'd give it a go and try his luck in North Dakota for a little while.

Henry and Anne decided they should take a trip together, however, before they parted ways. They both wanted to go to Costa Rica and booked a trip. Before leaving for Costa Rica, Henry placed the Green Street home on the rental market. He immediately got a tenant, who was an old high school friend. Henry's friend wanted a 24 month lease and was willing to pay an upfront premium for it. Henry decided the premium could help him pay for the Costa Rica trip, so he printed a form lease and had his parents and the new tenant sign it. Henry did not forward his mail to North Dakota for a little while.

Henry asked Sam about any special equipment he'd need and Sam handed him a list of items he'd need for his work in the field. This list included: flame-resistant duck coveralls; flame-resistant rain jacket; and flame-resistant bibs. Henry ordered this equipment from a specialty retailer online and paid $1,140 for three pairs of coveralls, $400 for the jacket, and $1,050 for three pairs of bibs. Instinctively, Henry had the items mailed to the Green Street address. Henry called his friend now living in the Green Street home and asked him to mail his field clothes to him in North Dakota for a little while.
Dakota when they arrived. His friend asked if Henry would also like his other mail sent with the package. Henry declined. On April 18, 2011, Henry received his coveralls, jacket, and bibs that his friend had mailed to him.

Henry enjoyed his work in the oil fields. During breaks he talked about how lucky he was to land this job so quickly. All of his co-workers told Henry that jobs were plentiful; he also noticed that the job posting board was always full of new postings. Henry asked Sam why there are always new postings and Sam told Henry that the work in the fields was so taxing that most people simply “wore out” after six months. Sam explained that was why Henry’s contract was only seven months long—because workers could not fulfill longer contracts.

Henry was so enthralled with his work that he couldn’t understand how anyone would want to leave. After a few weeks on the job he had returned his rented truck and leased a truck instead. The leased truck was the same monthly price but had heated seats, which Henry understood to be a great benefit in the long North Dakota winter. Henry signed a 12 month lease, the shortest option available. The lease included a one month early termination penalty.

When November came, Henry had become keenly aware of the toll the job was taking on his body. Henry, tired from the field, understood Sam’s point about workers not lasting and doubted whether he’d make it. Henry talked with Sam about his misgivings, and Sam told him to buy a good winter coat to wear out in the fields to keep him warm. Sam told Henry that a warm core was the key to good spirits in North Dakota. Henry took his advice and bought a $750 extra warm goose down coat from the same online retailer he had used to purchase his coveralls, jacket, and bibs. Henry would never have purchased such a coat to wear if not for Sam’s recommendation and the overwhelmingly positive reviews the coat received online. Most people who had purchased the coat, Henry learned, enjoyed wearing it in both work and personal settings.

Sam also told Henry to take a short holiday down in Houston to refresh himself, so Henry flew to Texas for Thanksgiving. He dropped by the Green Street home to check on things for his parents and found three USPS Forms 3849, Delivery Notice/Reminder/Receipt, from the IRS. The Forms 3849 were in a pile of mail the tenant had set aside for Henry’s return. Henry went to the Post Office to retrieve the letter but found it was returned to the sender months previously. Henry asked his friend what he knew about the attempted deliveries, and his friend told him he was not home when the USPS attempted delivery. Henry had to get back to his job in North Dakota, so he left without getting the letter. He figured that if the letter was important, the sender would contact him again. Henry told the renter to forward him any further correspondence from the IRS because he wasn’t certain when he’d be back.

Feeling refreshed from his trip, Henry began to think about asking Anne to move to North Dakota with him. He emailed her from the airport and asked her to find out if her firm had any open positions near North Dakota’s Bakken fields. Anne replied that she would see what was available, but that she was apprehensive about moving to a part of the country where neither of them had family. Henry responded that he had reconnected with a bunch of his cousins who were living in Bismarck and that he already felt as though he was “part of the family.” In fact, Henry was planning to (and did) move to one cousin’s duplex at the beginning of the year. The duplex was much nicer than his hotel room and it would cost the same amount of rent.

At the beginning of March, 2012, Henry’s spirits were at an all-time high. Sam approached Henry to discuss whether he wanted to get off the month-to-month arrangement for a longer-term contract. Henry, having just heard that Anne’s project in Oklahoma had been extended, agreed and signed a one-year contract.

Henry finished out his contract in February, 2013. Finally tired of the punishing North Dakota winter, Henry moved back to the Green Street home. He has been rebuilding his welding business since he returned. On Friday, August 22, 2014, he received two letters from the IRS. The first was a Letter 1058, Notice of Intent To Levy and Notice Of Your Right To A Hearing, which informed him that the IRS was about to levy on his assets to collect unpaid taxes for 2007. The second was a notice of deficiency for tax years 2011 and 2012. The notice of deficiency was dated Monday, August 18, 2014, and the Letter 1058 was dated Wednesday, August 20, 2014.
is found under the applicable state law to have been fraudulent, it is deemed void. Therefore, the creditor can reach the property. State laws regarding fraudulent conveyances determine whether a transaction will be set aside for the benefit of the United States. Such laws typically require the government to prove that: (1) the property was transferred by an insolvent debtor, or a debtor rendered insolvent by the transfer; (2) the recipient of the property paid insufficient consideration; and (3) the debtor intended to defraud or evade his creditors.

If the Service initiates judicial action, it does so in federal district court. District courts have the power to issue orders, processes, and judgments for enforcement of the Code. Under section 7402, suits may be brought to reduce tax claims to judgment. Under section 7403, the Service may initiate an action to reduce a tax lien to judgment. Typically, this type of suit is brought when there is specific property to pay all or part of the tax.

Section 7403 is most often used when the Service needs to extend the ten-year statute of limitations for collecting assessed liabilities. A levy’s timeliness is measured with respect to the date that it is made. But an action under Section 7403 is timely so long as the action is commenced within the limitations period. I.R.C. § 6502(b); I.R.M. 5.17.4.7. And, if the Service prevails, it secures a judgment lien against the taxpayer’s property. This judgment lien has its own additional independent and lengthy statute of limitations and also extends the life of the federal tax lien, which continues its independent existence. 28 U.S.C. § 3201 (providing that the judgment lien is effective, unless satisfied, for 20 years and may be renewed for one additional period of 20 years by filing a notice of renewal).

As part of the judicial process, federal district courts can compel any person to appear, testify, and produce books and papers. I.R.C. § 7402(b). This power is particularly important because it provides an avenue of enforcement in situations where no specific enforcement provision otherwise exists. For example, if an individual is taxed under section 301 on a dividend, this provision may be used to compel disclosure of the corporation’s earnings and profits.

A federal tax lien may be foreclosed against property held by a transferee, nominee or alter-ego when the taxpayer is the equitable owner of the property. The Service may also bring suit to enforce a levy. I.R.C. § 6332.

Returning to our hypothetical, there are still some questions that remain unanswered. First, what affirmative steps may John take to extinguish or modify the tax lien? He would bring an adversary proceeding to determine the validity, priority, or extent of the lien. Essentially, he would be asking the court to issue an order releasing his home from the lien. If he is successful, the Service would no longer have a claim against his property. The release would also prevent the Service from making a new assessment at a later time. See Practical Tax Professional, § 47.225.20, Post-Bankruptcy Survival of Federal Tax Lien: Notice of Federal Tax Lien Filed.

Let’s assume that the Service uses the courts to reduce its assessment to judgment and to foreclose its federal tax lien on John’s home. It may not be too late for John to challenge the merits of the underlying tax liability in federal court. An incorrect tax assessment can be asserted as a defense to an action brought by the government to enforce its lien. I.R.C. § 7403; I.R.M. 5.17.5.17.8. When the Service (through DOJ) initiates an action to reduce a tax lien to judgment, it opens the assessment to judicial scrutiny in all respects. United States v. O’Connor, 291 F.2d 520 (2d Cir. 1961). This includes the merits of the claim. United States v. Camejo, 666 F. Supp. 1542 (S.D. Fla. 1987).

Mounting such a challenge can be a daunting feat. First, the assessment of tax upon which the lien is based is presumed to be valid. However, it is only a rebuttable presumption. Nonetheless, challenging the correctness of a tax assessment is an uphill battle.

There are also issues related to shifting of burdens of proof, production, etc. Before the court will even begin to entertain arguments challenging the underlying tax liability, John must overcome some formidable obstacles. If these obstacles prove insurmountable, then he will be barred from mounting such a challenge. The shifting of burdens is summarized below:

(1) The government has the burden of coming forward and persuading the judge that there is a tax liability. If the assessment was never challenged administratively, by filing a protest upon receipt of a 30-day letter, or judicially by filing a petition in Tax Court, the assessment establishes that liability. As you might expect, this will be easy for the government.

(2) The taxpayer has the burden of persuading the judge—by a preponderance of the evidence—that the assessment was arbitrary. Good records will go far to overcome the presumption of correctness attaching to the assessment. To the extent that good records are not available, the taxpayer will be forced to rely on the credibility of witnesses who can fill in the gaps in information. The taxpayer will no doubt be a prime witness. In the absence of any records, it becomes increasingly more challenging to persuade the judge that the Service’s assessment is not as reliable as the taxpayer’s word or recollection.

(3) The burden then shifts to the government to establish that a deficiency exists and, if so, in what amount. The government
can meet this burden even if the tax liability it asserts is different from the amount initially asserted. The government merely has to establish that there was a tax liability.

A twist on the facts will help illustrate the mechanics of the shifting of burdens. Assume that instead of filing its NFTL after John filed his bankruptcy petition, the Service filed it before. Further, assume that after learning about the NFTL, John immediately requested a CDP hearing. In other words, the request for a CDP hearing was made—and the hearing occurred—after the government filed its NFTL but before John filed for bankruptcy.

At the CDP hearing, John unsuccessfully attempted to persuade the Service to remove the notice of lien. John did not obtain judicial review of that decision in Tax Court. At that very same hearing, John disputed the merits of his tax assessment. Although the general rule is that a taxpayer may not challenge the merits of a tax assessment at a CDP hearing, there is an exception for taxpayers who have had no statutory opportunity to contest their underlying tax liability pre-assessment.

A taxpayer has no statutory opportunity to contest an underlying tax liability pre-assessment if he “did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such liability.” Recall that the notice of deficiency is a taxpayer’s ticket to Tax Court. If the taxpayer received a notice of deficiency, he had the right to contest his liability in Tax Court. Indeed, all that was required was the filing of a petition with the Tax Court for a redetermination of the deficiency.

Consequently, the failure to petition the Tax Court upon receiving a notice of deficiency is fatal to the review of a taxpayer’s underlying tax liability at a CDP hearing. Similarly, a taxpayer who waives his right to a notice of deficiency on Form 870 or Form 4549 will be deemed to have had a previous opportunity to contest his underlying tax liability. Such a taxpayer will be barred from challenging the merits of his tax liability at a CDP hearing.

Assume that the reason John was permitted to dispute his underlying tax liability at the CDP hearing was because the Service mailed his notice of deficiency to the wrong address. As a result, he never received it. At the CDP hearing, John’s challenge to his tax assessment suffered the same fate as his request to extinguish the tax lien. It was denied.

What impact does this adverse ruling have on John’s attempt to challenge the merits of the tax assessment at the foreclosure hearing? Will he be barred from mounting such a challenge in this action? The knee-jerk answer to this question might appear to be “yes” in light of the fact that John previously had an opportunity to challenge the tax assessment and lost. But that would be wrong.

Most circuits favor the rule allowing taxpayers to challenge the merits of an assessment in an action brought by the government to reduce a tax lien to judgment. Therefore, the fact that John already had “one bite at the apple” is meaningless. The case will move forward.

Of course, that will not stop the Service (through DOJ) from arguing that John should be estopped from challenging his tax liability. In so doing, it will rely on the fact that John had the opportunity to challenge his tax liability at an earlier CDP hearing and to have the merits of that liability ruled upon. The fact that that ruling was adverse to him does not mean that he should get a second bite at the apple.

John will likely fail in his attempt to rebut the presumption of correctness that attached to the $50,000 assessment. As a result, the judge will order that the federal tax lien be foreclosed and that his home be sold. She will then order that the proceeds of such sale be distributed first to the costs of the sale and other priority interests, namely the first mortgage, and then to the United States. Whatever remains will go to John. To the extent that the home is sold to satisfy the lien, the government may bid at the sale but only up to the amount of the tax lien plus selling expenses. ■

As part of the judicial process, federal district courts can compel any person to appear, testify, and produce books and papers. I.R.C. § 7402(b). This power is particularly important because it provides an avenue of enforcement in situations where no specific enforcement provision otherwise exists.
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One of the great battles in the history of tax law involved the statute of limitations in equitable relief cases. The normal statute of limitations for the collection of a tax is ten years. The IRS simply did not want the ten-year statute to apply to equitable relief cases. Relying on its regulatory powers, the IRS imposed a two-year period of limitation for claims filed under section 6015(f). This was a skilful move because an agency’s regulations are entitled to substantial deference by the courts. On the other side, a two-year limitation period would seriously impair the welfare of thousands of innocent spouses who were not able to file a claim for relief within the two-year period. The shorter statute of limitations would leave many taxpayers with a debt period. The shorter statute of limitations for filing a claim in equitable relief cases under subsection (f) would leave many taxpayers with a debt period. The shorter statute of limitations for filing a claim in equitable relief cases under subsection (f) would leave many taxpayers with a debt period.

The Executive Branch

When section 6015(f) was passed without a limitation period, the IRS faced a dilemma. The IRS had to reconcile two competing interests: (1) the legislative purpose of section 6015 to expand innocent spouse relief; and (2) the agency’s role as the nation’s tax collector with a statutory right to collect taxes due within the ten-year collection statute. To address these competing interests, the IRS used its regulatory power to create a two-year limitation period for filing a claim for equitable relief. The regulation effectively accomplished two things. First, the regulation protected the IRS’s right to pursue collection for the entire ten-year collection statute. Second, no matter how much economic hardship existed, no matter how sick the taxpayer was, no matter how inequitable the facts and circumstances were, after two years had passed from the first collection activity, the regulation barred taxpayers from filing claims for equitable relief. So taxpayers challenged the validity of the regulation in numerous court cases. The IRS began the battle from a position of strength because legislative regulations are entitled to substantial deference.

The Legislative Branch

When Congress enacted section 6015, it expressly provided a two-year limitation period for subsections (b) and (c), but Congress did not include a two-year period of limitations in equitable relief cases under subsection (f). This raised a question regarding what was the statute of limitations for filing a claim in equitable relief cases.

The Judicial Branch

The issue was first presented in Lantz v. Commissioner, 132 T.C. 131, rev’d, 607 F.3d 479 (7th Cir. 2010), where the Tax Court held that the regulation was invalid based on the court’s view that by omitting a limitation period in subsection (f), Congress manifested an intent not to impose a deadline on equitable relief claims.

The IRS appealed Lantz to the Seventh Circuit Court of Appeals and argued that where Congress did not include a period of limitations in a statute, the agency could “borrow” a limitations period from another statute. The Seventh Circuit agreed with the IRS and reversed the Tax Court, ruling that the regulation was valid. The Court of Appeals primarily relied on a line of cases that allowed an agency to borrow a statute of limitations where Congress had not provided one in the statute. The Court of Appeals did not address the taxpayer’s argument based upon the Russello case in which the Supreme Court held that where Congress includes a statute of limitations in one part of a statute and omits a statute of limitations in another part of the statute, the failure to include a limitations period is presumed to be intentional.

The Third Circuit Court of Appeals was the second circuit to consider the validity of the statute. In Mannella v. Commissioner, 631 F.3d, 115 (3d Cir. 2011), rev’g 132 T.C. 196 (2009), the Court of Appeals applied the Chevron test to the language in section 6015(f). Under the first Chevron test, which requires a court to determine whether Congress has directly spoken to the question at issue, the court found that the failure to include the statute of limitations left an ambiguity that the agency could fill. Then the court applied Chevron’s second test and held that the regulation was reasonable. Importantly, one judge wrote a vigorous dissent, spending considerable time refuting the reasoning in the Lantz opinion.

The IRS won the third battle in the Fourth Circuit Court of Appeals in Jones v. Commissioner, 642 F.3d 459 (4th Cir. 2011). The Fourth Circuit joined the two other Circuit Courts of Appeals holding that the regulation was valid.

* Legal Aid Society of Middle Tennessee and the Cumberlands and Tennessee Tax Project, Nashville, TN.
With three Courts of Appeals upholding the regulation as valid, most practitioners believed that the likelihood of achieving a win in one of the other circuits was remote. And without a split in the circuits, there would be no opportunity for Supreme Court review.

**Congress Weighs In**

When defeat appeared almost certain, an unexpected development occurred. On April 18, 2011, 49 members of Congress sent a letter to IRS Commissioner Shulman. In the letter, the members pointed out that of the 50,000 taxpayers annually filing claims for innocent spouse relief, 2,000 were time barred by the regulation’s two-year limitation period. The members pointed out that in enacting section 6015(f) Congress did not include a statute of limitations. Then the letter noted that the IRS “improperly ‘borrowed’ the two-year statute of limitations in 6015(b) and 6015(c)” and applied it to section 6015(f). The letter further indicated that the lack of a statute of limitations was intentional, pointing to *Russello v. United States*, a Supreme Court case which held that when language included in one part of a statute is omitted in another part of the statute, it is presumed that Congress acted intentionally. Finally, the letter stressed that a court may weigh all the facts and circumstances in considering appropriate relief. But by limiting the statute to two years, the facts and circumstances in a given case would not be considered after the two-year period had expired, leaving innocent spouses without a defense to collection action for the years three through ten in the collection statute. At the end of the letter, the members asked the Commissioner to reconsider the two-year statute of limitations.

On April 18, 2011, Senators Max Baucus, Sherrod Brown, and Tom Harkin sent a letter to the Commissioner requesting him to conduct a thorough review of the regulation. The letter underscored that in many cases the two-year limitation period denied equitable relief to the very taxpayers Congress intended to help. The letter concluded that the two-year rule ran counter to the spirit of equitable relief.

Two letters from Congress changed everything and the opportunity for a just result had now shifted in favor of innocent spouses.

**The IRS Responds**

Facing almost certain legislative action, the IRS undertook a comprehensive review of the regulation. On July 25, 2011, the IRS issued new guidance that it would no longer use the two-year limitation in equitable relief cases. IRS Notice 2011-70, 2011-32 I.R.B. 135. In the future, the IRS would allow claims for the entire ten-year period in the collection statute. Importantly, all cases pending on the effective date, July 25, 2011, would be subject to the longer statute. And all claims that had been denied for untimeliness and were not litigated could reapply for relief under section 6015(f).

**Conclusion**

The regulation creating the two-year limitation period affected thousands of taxpayers. Although the IRS position was not based upon a compelling policy, the regulation had great strength under a *Chevron* analysis and was upheld in three Circuit Courts of Appeals. When the IRS victory seemed almost certain, members of Congress wrote letters to the Commissioner recommending that the IRS had erred in adopting a two-year limitation period and asked him to review the regulation. Faced with few or no choices, the IRS accepted defeat and abandoned the two-year period in favor the ten-year collection period. The long battle over the statute of limitations in equitable relief cases was finally over and it was a great victory for taxpayer rights.

**A Practitioner’s Guide to Innocent Spouse Relief, Second Edition**

Several major developments have occurred since the initial publication of *A Practitioner’s Guide to Innocent Spouse Relief*. Notable developments included the IRS abandoning its two-year statute of limitations position on taxpayer equitable relief claims. The IRS also published Rev. Proc. 2013-34, which provided new guidance in equitable relief cases.

In this newly revised edition, the author explains:

- How to recover your client’s tax refund when the IRS grants relief under section 6015(c).
- Even though the IRS has eliminated abuse as an independent factor in Rev. Proc. 2013-34, why abuse is still a major element of an equitable relief claim.
- What to do when the IRS sends a collection notice for a joint tax assessment, and your client says “I did not file” a joint return.
- What steps to take to protect the client’s innocent spouse claim while the client is going through a divorce.
- Why it may be necessary to file a protective refund claim in some innocent spouse cases.
- Why the first meeting with the client can dictate the success or failure of recovering your client’s tax payments.

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Tax Bites Autumn Serenade

By Robert S. Steinberg

October Song
(To the tune of “September Song,” by Kurt Weill and Maxwell Anderson—considered by many the best song ever written)

It seemed a long, long while
From December to April
When there was still time
To use the tax escape mill.

Cunning shelter peddlers
Hatching schemes for those
Disinclined to recall
Former tax scam woes.

January drew nigh
February rolled by
March felt hurried
You feel worried.

Your CPA will file
An extension, relax
Until October
No mention of tax.

Love Song to IRC
(To the tune of “Once I Loved,” by Antonio Carlos Jobim, Ray Gilbert, and Vinicius DeMoraes)

IRC,
Tell me just what exactly are you trying
to say to me?
I'm unsure.
You're implacably dense and your
meanings are vague and obscure.

Once I know,
The complexities of your intentions, you
are amended so.
There and then,
I'm resigned to confusion of not knowing
you once again.

With your changing ways,
IRC,
Never say what you mean, or mean
what you say to me.
Yet in my life, you are the world to me.

Why Can’t They Lose My File?
(To the tune of “Teenager in Love,” by Doc Pomus and Mort Shuman, for the hit recording by Dion and the Belmonts)

They can't find Lerner's e-mails.
Wonder how can that be?
If they have lost that female's,
Why can't they misplace me?
Each night I ask the Gods with a smile—
If they’re so flummoxed, why can’t they lose my file?

Shopping for Tax Rates
(To the tune of “April in Paris,” by Vernon Duke and E.Y. Harburg)

I'd pay no taxes.
Not dread this fear.
My brain relaxes,
Just to think I'd disappear.

I dream through all my slumber,
They’ll lose my SSN.
Then I would have no number,
And they’re just number men.
Each night I ask the Gods with a smile—
If they’re so flummoxed, why can’t they lose my file?

Shopping for tax rates.
Corporate inversions.
Foreign conversions.
Now all the rave.

Shopping for tax rates.
Mergers to measure.
Profits for pleasure.
We crave.

Who cares about morality?
Shareholders who'll bear the tax?
Morality’s banality.
Numbers motivate our acts.

We're shopping for tax rates.
Don't call it treason.
We know the reason.
Pure greed.

* Law Offices of Robert S. Steinberg, Palmetto Bay, FL.
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Newly updated in 2014, this guide takes you step-by-step through the Innocent Spouse claim process, from information gathering to refund relief. The new edition addresses several notable developments, including the IRS abandoning its two-year statute of limitations position on taxpayer equitable relief claims, and also publishing Rev. Proc. 2013-34, which provides new guidance.
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GOVERNMENT SUBMISSIONS

Comments on Summary of Staff Discussion Draft on Reforming Tax Administration

Introduction: As part of its commitment to support a simple and equitable tax system, the Section, through the collective effort of its Committees, has produced both a series of white papers that address broad tax policy principles and comments that provide detailed options for tax reform. The latest such effort answers then-Chairman of the Senate Finance Committee Max Baucus’s request for comments on his tax reform staff discussion draft concerning tax administration. Many topical issues, such as return preparer regulation, a statutory right to review by the Office of Appeals, the Taxpayer Bill of Rights, and the current tax penalty structure, are addressed. Following is the Executive Summary of the report. As with all of the Section’s government submissions, these comments, dated June 25, 2014, are available on the website at http://www.americanbar.org/groups/taxation/policy.html. –Jesse Tsai, Staff Counsel

On November 20, 2013, then-Chairman Max Baucus of the U.S. Senate Committee on Finance released a staff discussion draft of proposed reforms to the administration of the tax laws (the “Discussion Draft”). These Comments address certain aspects of the Discussion Draft and respond to the request for comment on certain issues affecting tax administration practice and procedure.

The Discussion Draft includes provisions intended to simplify the tax filing process and expand electronic filing, address tax-related identify theft, and reduce the tax gap through enhancements to information reporting. The Section of Taxation of the American Bar Association (the “Section”) supports the goals underlying these proposals. We also note, however, that addressing those goals requires an adjustment to the funding provided to the Internal Revenue Service (the “Service”) through the annual appropriations process. As we recently wrote to Congress, the Section is gravely concerned that the recent trend of funding reductions for the Service have the authority to regulate all paid tax return preparers. In light of the recent decision to the contrary in Loving v. I.R.S., 742 F.3d 1013 (D.C. Cir. 2014), the Section strongly supports this proposal, with clarifications discussed below to ensure that the legislation adequately remedies the issues raised in the Loving decision.

The Discussion Draft requested comments on whether Congress should create a statutory right to review by the Office of Appeals (“Appeals”) prior to the issuance of a notice of deficiency. The Section supports this proposal because it would increase fairness for taxpayers, resolve cases more quickly and economically for both taxpayers and the government, and help ensure the independence of Appeals. In addition, the Section respectfully recommends that Congress provide a pre-assessment statutory right to review by Appeals of all penalties.

The Discussion Draft also requested comment on reforming the current tax penalty structure to ensure that penalties are used appropriately to effectively promote taxpayer compliance. We applaud Congress for its consideration of reform of the penalty regime. In a 2009 white paper, the Section encouraged Congress to address civil tax penalty reform. With the benefit of five years’ experience since that white paper was issued, we believe that the principles and recommendations set out in the white paper are still timely, and that penalty reform is more important than ever. We also recommend that:

- The Internal Revenue Code of 1986, as amended (the “Code”) be revised to allow taxpayers to assert a uniform reasonable cause and good faith defense with respect to most, if not all, penalties.
- In TEFRA partnership proceedings, courts be permitted to take ancillary jurisdiction over the “reasonable cause and good faith” defense of partners, rather than requiring those partners to litigate their penalty defenses in subsequent proceedings.
- Congress apply strict liability penalties in only the most narrow circumstances.
- Congress repeal the “disqualified tax adviser” provisions that effectively require taxpayers to obtain “second opinions” with respect to certain transactions in order to assert penalty defenses based on reasonable cause.
- Congress clarify the codified economic substance doctrine.
- Congress provide taxpayers with an opportunity for pre-assessment judicial review of most penalties.

Follow-up on Funding for the Internal Revenue Service

Introduction: In response to H.R. 5016, which proposes to decrease funding to the Internal Revenue Service to its lowest level in a decade, the Section reiterated its support of adequate funding for the Service. This was initially expressed in the Section’s February 10, 2014, letter to the House and Senate Appropriations Subcommittees on Financial Services and General Government. While the Section appreciates the tremendous difficulty Congress faces, such a dramatic reduction in funding impairs the Service’s ability to maintain sufficient personnel that is properly trained. This will inevitably harm taxpayers and inhibit the Service’s ability to administer tax laws and collect tax revenues. As with all of its government submissions, the Section’s July 21, 2014, follow-up letter regarding Service funding in light of H.R. 5016 is available on the website at http://www.americanbar.org/groups/taxation/policy.html.

--Jesse Tsai, Staff Counsel

Dear Chairmen Udall and Crenshaw, and Ranking Members Johanns and Serrano:

In light of the U.S. House of Representatives’ passage of H.R. 5016, The Financial Services and General Government Appropriations Act, which would fund the Internal Revenue Service (the “Service”) at significantly reduced levels compared to the government’s fiscal year 2014, I respectfully reiterate, on behalf of the American Bar Association, our support for ensuring that the Service receives adequate funding for fiscal year 2015. As indicated in our letter to you on February 10 of this year, the American Bar Association has consistently supported adequate funding for the Service to carry out its missions of taxpayer service and enforcement of federal tax laws.

We recognize the intense challenges that the Congress faces regarding the federal budget. While we appreciate the difficult task at hand, we would like to reiterate the importance of providing the Service with sufficient resources to perform its critical functions of providing taxpayer service and collecting taxes properly due. The proposed funding reduction in H.R. 5016 would reduce the Service’s funding to its lowest level in ten years. While the Service has made great strides in reducing costs, such as increasingly automating systems, we believe that reduced funding will negatively impact the Service’s ability to serve taxpayers and enforce the tax laws that Congress enacts. We worry that by not adequately funding the Service, we are at risk that the following consequences might occur:

• A decrease in federal revenue. Every dollar devoted to tax enforcement yields a substantial increase in tax collections, and reducing funding in the Service’s tax enforcement efforts results in significantly lower tax collections. Moreover, failure to collect taxes properly due undermines confidence in our voluntary compliance system, especially when honest and diligent taxpayers believe that other taxpayers are not paying their proper share.

• A lack of necessary Service personnel. In order to perform the Service’s critical functions, in the face of complex and constantly changing tax laws, a sufficient staff must be recruited and properly

1 National Taxpayer Advocate, 2013 Annual report to Congress – Executive Summary, p. 21 (December 31, 2013).
trained. With many senior Service personnel opting for retirement, and funding limits preventing many vacancies from being filled, we are concerned that the Service will not have sufficient personnel to adequately address taxpayer needs. Additionally, the Service’s training budget has already been reduced by 85% since fiscal year 2009, and we are concerned about the adverse effects this reduction may have on tax administration.

- A negative effect on the Service’s ability to administer the laws Congress enacts. The Service is required by law to implement the Foreign Account Tax Compliance Act (“FATCA”) and the Affordable Care Act (“ACA”). While the Service faithfully tries to carry out its responsibilities, and assist taxpayers in complying with their legal obligations under FATCA and ACA, the reductions may compromise the Service’s ability to carry out these duties.
- A decrease in the quality of taxpayer service. Last year, the Service was able to answer only 61% of the calls it received from taxpayers. Additionally, the Service had approximately 690,000 cases of identity theft open. The ability of taxpayers to meet with the Office of Appeals to resolve cases administratively has also been negatively affected by decreased funding. We fear that because most of the Service’s budget is devoted to personnel costs, the reductions necessarily reduce the staff available to deal with these issues.
- Elimination of volunteer service programs that aid elderly and low income taxpayers. Last year, nearly 92,000 volunteers assisted with 3.3 million returns through volunteer programs administered by the Service. If the Service does not have the resources to support these programs, many elderly and low income taxpayers will be unable to access important tax services.

While we appreciate the difficult challenge that the Congress faces, we nonetheless urge Congress to provide the Service the necessary funding so that it can fulfill its core functions of providing taxpayer service and collecting taxes properly due. We believe that adequate funding to the Service is vital because taxpayers will inevitably suffer without a fully functioning Service. We do not believe that the Service can appropriately fulfill its obligations without adequate funding.

Thank you for your consideration.

Sincerely,

Michael Hirschfeld
Chair, Section of Taxation

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1 Written Statement of Nina E. Olson, National Taxpayer Advocate, pg. 11, Hearing on Internal Revenue Service FY 2015 Budget Request Before the Comm. on Appropriations, Subcomm. on Financial Services and General Government, U.S. Senate, 113th Cong. (Apr. 30, 2014).
Boxscore

Since July 11, 2014, the Section has coordinated the following government submissions, which can be viewed and downloaded free of charge from the Section’s website at http://www.americanbar.org/groups/taxation/policy.html.

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<td><strong>Executive Compensation, 29th Annual National Institute</strong>&lt;br&gt;American Bar Association – Chicago, IL</td>
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