Dear Colleague:

We are pleased to enclose update materials for our casebook, TAX CONTROVERSIES: PRACTICE AND PROCEDURE (3rd ed.). We opted not to do a new supplement this summer, as the 2015 Supplement is rather lengthy and is largely up to date. Instead, we highlight in the attached materials the major developments of the past year (through June 15, 2016). Please feel free to copy the enclosure and to distribute it to students.

We are currently working on the fourth edition of the TAX CONTROVERSIES casebook. It should be in print in 2017. We expect that the new edition will have the same 20 chapters on civil tax controversies, client representation, and tax research that the current edition does. The purpose of the new edition is simply to bring the materials in the text itself up to date. However, if you have suggestions for improving the casebook, please do let us know now while we have time to consider incorporating them into the fourth edition.

We should also note that this casebook was part of the line that LexisNexis sold to Carolina Academic Press. Electronic copies of the 2015 Supplement are available from a link at http://www.cap-press.com/books/isbn/9781422422632/Tax-Contours-Third-Edition. That site also contains a link to our accompanying statutory volume, TAX CONTROVERSIES: STATUTES, REGULATIONS, AND OTHER MATERIALS (2013 ed.), including a link for faculty to request a complimentary review copy. Carolina Academic Press plans to link this letter from that website, as well.

Have a great semester!

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§ 1.02 (Structure of the IRS)

Both the Department of Justice and the Federal Bureau of Investigation investigated the IRS’s controversial use of “Be On the Lookout” (BOLO) lists to screen for excessive political activity by applicants for tax-exempt status under Code section 501(c)(4). Both found mismanagement by the IRS but no criminal activity. See Leandra Lederman, IRS Reform: Politics as Usual?, 7 COLUM. J. TAX L. 36, 54 (2016). In a March 2015 report, TIGTA found that the IRS was not using BOLO lists anymore. Id. at 40 & n.19. The IRS subsequently announced new initiatives designed to add more transparency to the tax-exempt application process and to ensure a neutral review of each application. Casey Wooten, IRS Implementing Senate Suggestions on 501(c)(4) Targeting, 208 DAILY TAX REP. G-3 (Oct. 28, 2015).

Some in Congress are not satisfied, however, and are calling for IRS Commissioner John Koskinen’s censure or impeachment. See William Hoffman & Fred Stokeld, Efforts To Oust Koskinen Advance In House, 151 TAX NOTES 1048 (2016). Mr. Koskinen did not become Commissioner until December 2013, but these Congressmen allege misconduct in connection with the government’s efforts to obtain Lois Lerner’s emails, including the failure to inform Congress of back-up tapes before they were destroyed. Id. The American College of Tax Counsel (ACTC) sent House leaders a letter praising Commissioner Koskinen and stating its “view that such actions are not commensurate with the alleged conduct and will damage the agency at a time when it needs strong leadership.” Letter from ACTC to the Hon. Paul Ryan et al. (July 13, 2016), http://www.actconline.org/wp-content/uploads/2014/05/ACTC-letter-to-Congressional-Leadership.pdf.

§ 1.05[A][1] (Voluntary Compliance Estimates)

The IRS recently released updated “tax gap” estimates, updating its 2011 estimates, which were based on the 2006 tax year. The new estimates are averages from tax years 2008 through 2010. The estimated gross tax gap for those years is $458 billion and the estimated net tax gap after enforcement activities is $406 billion per year. IRS, TAX GAP ESTIMATES FOR TAX YEARS 2008–2010, at 1 (2016), available at https://www.irs.gov/PUP/newsroom/tax%20gap%20estimates%20for%202008%20through%202010.pdf. The resulting estimated voluntary compliance rate for the years 2008–2010 is 81.7%. Id. This is lower than the IRS’s previous estimate, for tax year 2006, of 83.1%. Id. at 2. However, the IRS says that “[t]he small increase in the estimated size of the tax gap [from $450 billion] and small decrease in the voluntary compliance rate are largely attributable to improvements in the tax gap estimation methodology, and do not represent a significant change in underlying taxpayer behavior.” IRS, The Tax Gap: Tax Gap Estimates for Tax Years 2008–2010, IRS Statement on the Tax Gap Update, IRS.GOV (Apr. 28, 2016), https://www.irs.gov/uac/the-tax-gap.
The IRS Oversight Board has been suspended because it does not have enough members confirmed by the U.S. Senate to form a quorum. Thus, there is no published Taxpayer Attitude Survey for 2015. See IRS Oversight Board, US DEPT. TREASURY (accessed July 1, 2016), https://www.treasury.gov/irsob/Pages/default.aspx.

§ 1.05[A][2] (Enforcement Statistics)

For fiscal year 2016, the IRS’s budget is about $900 million below that of 2010 and its personnel has been reduced by around 17,000 full-time employees over that period. IRS, Commissioner Koskinen’s Speech to the National Press Club, March 24, 2016, (2016), available at https://www.irs.gov/uac/march-24-2016-commissioner-koskinen-speech-to-national-press-club [hereinafter Koskinen’s Speech]. The budget cuts have resulted in a steady decline in the number of audits that the IRS is able to perform. In 2015, the IRS completed the fewest audits in a decade and the audit rate was the lowest that it has been since 2004. Id.

More specifically, in fiscal year 2015, the IRS’s overall audit rate for individuals was only 0.8 percent. IRS, DATA BOOK 2015, at 23 tbl. 9a, available at https://www.irs.gov/pub/irs-soi/15databk.pdf [hereinafter DATA BOOK 2015]. That figure reflects a decrease from the 0.9 percent audit rate in 2014. IRS, DATA BOOK 2014, at 23 tbl. 9a, available at https://www.irs.gov/pub/irs-soi/14databk.pdf [hereinafter DATA BOOK 2014]. For individuals with assets over $1 million, the 2015 audit rate was 9.6 percent, DATA BOOK 2015, at 23 tbl. 9a, up from 7.5 percent in 2014, DATA BOOK 2014, at 23 tbl. 9a. Also in 2015, the audit rate of corporations other than S corporations was 1.3 percent, the same as in 2014. DATA BOOK 2015, at 23 tbl. 9a; DATA BOOK 2014, at 23 tbl. 9a. Audits of corporations with assets under $10 million decreased from 1.0 percent to 0.9 percent. DATA BOOK 2015, at 23 tbl. 9a; DATA BOOK 2014, at 23 tbl. 9a. Audits of corporations with assets over $10 million decreased to 11.1 percent from 12.2 percent. DATA BOOK 2015, at 23 tbl. 9a; DATA BOOK 2014, at 23 tbl. 9a.


Scholars noted in a Tax Notes symposium on “The Future of Tax Administration,” 150 TAX NOTES No. 11 (Mar. 14, 2016), that Congress’s cuts to the IRS budget have severely hampered its enforcement efforts. See, e.g., T. Keith Fogg, & Leslie Book, Problems at the IRS in Attempting to Provide Service to Taxpayers, 150 TAX NOTES 1335 (2016); Leandra Lederman, The IRS, Politics, and Income Inequality, 150 TAX NOTES 1329 (2016). The American Bar Association has sent a letter to Congress advocating for increased funding for the IRS, pointing to multiple negative consequences of inadequate IRS funding. Inadequate Funding Erodes IRS Capacity, ABA Tells Congress, 53 DAILY TAX REP. (BNA) G-2 (Mar. 18, 2016).
§ 2.02[A][1] (Procedures For Enacting Treasury Regulations)

The U.S. Tax Court’s July 2015 decision in *Altera Corporation v. Commissioner*, 145 T.C. No. 3, No. 6253-12, 2015 U.S. Tax Ct. LEXIS 31 (T.C. July 27, 2015), has been getting a lot of attention. As of this writing, it is on appeal to the Court of Appeals for the Ninth Circuit.¹

In *Altera*, the Tax Court struck down a final regulation that had been promulgated in 2003, Treas. Reg. § 1.482-7(d)(2), which requires the inclusion of stock-based compensation in operating costs under cost-sharing agreements. The court struck down the regulation because it found that the Treasury failed to comply with the “reasoned decisionmaking standard” under the Administrative Procedure Act (APA) and *Motor Vehicle Manufacturers Assoc. of the U.S. v. State Farm Mutual Auto Ins. Co.*, 463 U.S. 29 (1983). *Altera*, 2015 U.S. Tax Ct. LEXIS, at *74.

*Altera* is interesting because the IRS had provided notice to the public and an opportunity for comment, received thirteen written comments, and held a public hearing at which four people spoke. *Id.* at *23. The IRS also responded to the comments in the Preamble to the final regulation, stating in part that the “Treasury and the IRS do not agree with the comments that asserting that taking stock-based compensation into account . . . would be inconsistent with the arm’s length standard in the absence of evidence that parties at arm’s length take stock-based compensation into account in similar circumstances” and explaining that statement. *Id.* at *31. However, the Tax Court found the IRS’s response inadequate:

> Although Treasury’s failure to respond to an isolated comment or two would probably not be fatal to the final rule, Treasury’s failure to meaningfully respond to numerous relevant and significant comments certainly is. Meaningful judicial review and fair treatment of affected persons require “an exchange of views, information, and criticism between interested persons and the agency.” Treasury’s failure to adequately respond to commentators frustrates our review of the final rule and was prejudicial to affected entities.

*Id.* at *69–70.

The core of the Tax Court’s concern seems to be the fact that commentators introduced empirical evidence that unrelated parties do not share stock-based compensation costs, and Treasury did not cite contrary evidence supporting its conclusion. *See id.* at *70. The Tax Court found inadequate Treasury’s explanation that the behavior of unrelated parties might not be directly applicable to parties under common control. *See id.* at *31 (quoting regulations’ Preamble); *74 (“Because the final rule lacks a basis in fact, Treasury failed to rationally connect the choice it made with the facts found, Treasury failed to respond to significant comments when it issued the final rule, and Treasury’s conclusion that the final rule is consistent with the arm's-

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length standard is contrary to all of the evidence before it, we conclude that the final rule fails to satisfy State Farm’s reasoned decisionmaking standard and therefore is invalid.”).

In Altera, the Tax Court also seemed to conclude that all regulations promulgated under section 7805(a) carry the force of law and are subject to the APA:

Pursuant to section 7805(a) the Secretary is authorized to “prescribe all needful rules and regulations for the enforcement of” the Code. Such regulations carry the force of law, and the Code imposes penalties for failing to follow them. We therefore conclude that “Congress has delegated legislative power to” Treasury.

We further conclude that Treasury intended for the final rule to have the force of law for the following reasons: (1) the parties stipulated—and we agree … —that the adjustments to petitioner’s income can be sustained only on the basis of the final rule, and (2) in promulgating the final rule Treasury invoked its general legislative rulemaking authority under section 7805(a) . . . .

Id. at *44–45 (citations omitted). This conflicts with Treasury’s long-held position that most of its regulations are interpretive. See Michael Duffy, Altera Leaves Treasury Regulations Open to APA-Based Challenges in Tax Court, 123 J. TAX 265, 268 (2015).

§ 2.02[A][2][a] (Which Deference Standard Applies, Chevron or National Muffler?)


§ 2.04[A] (Areas in Which the IRS Will Not Issue Letter Rulings)

The IRS’s current list of no-rule areas appears in Revenue Procedure 2016-3, 2016-1 I.R.B. 126.

§ 2.04[B] (How to Request a Letter Ruling)

Rev. Proc. 2016-1, 2016-1 I.R.B. 1 updates Revenue Procedure 2015-1, but the basic instructions for requesting a ruling remain nearly the same. The most recent fee schedule can be found in Appendix A of Revenue Procedure 2016-1, 2016-1 I.R.B. 1 app. A. The fee for a traditional letter ruling remains $28,300.
§ 2.04[C] (Requesting a Conference with the IRS)

The citation on page 67 of the casebook for procedures relating to a request for a conference with the IRS should now be Rev. Proc. 2016-1, at § 10.

§ 2.04[D] (Taxpayer Reporting Requirements)

The citation on pages 67–68 of the casebook for procedures relating to a request for a conference with the IRS should now be Rev. Proc. 2016-1, at § 11.

§ 2.04[E] (Whether to Request a Letter Ruling and Whether to Withdraw a Ruling Request)

The citation on page 69 of the casebook for procedures relating to a request for a conference with the IRS should now be Rev. Proc. 2016-1, at § 7.02(4).

For a comparison of tax opinions and private letter rulings that discusses the benefits and limitations of each of them, see Robert W. Wood, Tax Opinion or Private Letter Ruling? A 12-Point Comparison, 149 TAX NOTES 852 (2015).

Chapter 3

§ 3.02[C] (Filing Extensions)

The Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114-41, 129 Stat. 443 (July 31, 2015), revised the original extended due dates for corporate and certain other returns. For tax years starting after December 31, 2015, the due date for most corporate returns is the same as for individual taxpayers—April 15 for calendar-year taxpayers and the fifteenth day of the fourth month following the close of the taxable year for fiscal-year returns. S Corporation returns remain due on March 15 and calendar year-end partnership returns (Form 1065) are now due on March 15 rather than April 15.

The same legislation reduces from six to five months the automatic filing extensions the IRS has the authority to grant calendar-year corporate taxpayers. I.R.C. § 6081(b). That limitation is scheduled to sunset at the end of 2025. Because partnership returns are now due a month earlier, the legislation directed the IRS to modify regulation section 1.6081-2 to allow for a six-month automatic extension rather than a five-month extension for partnerships. See Pub. L. No. 114-41 § 2006(b), 129 Stat. at 458.

§ 3.03[B][4] (Partnership Audit Procedures Under TEFRA)

For partnership returns filed in tax years beginning after December 31, 2017, Congress has repealed the partnership audit rules discussed in the text and replaced them with a new set of rules that, as a general matter, allow the IRS to assess and collect tax due on partnership adjustments at the entity level. See Bipartisan Budget Act of 2015,
In General

Determination at partnership level

Under the centralized system, the audit of a partnership takes place at the partnership level. Any adjustment to items of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year, and any partner’s distributive share thereof, generally are determined at the partnership level. Any tax attributable to these items generally is assessed and collected at the partnership level. The applicability of any penalty, addition to tax, or additional amount that relates to an adjustment of any item of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year or to any partner’s distributive share thereof is determined at the partnership level. Unlike prior law, distinctions between partnership items and affected items are no longer made. An underpayment of tax determined as a result of an examination of a taxable year is imputed to the year during which the adjustment is finally determined, and generally is assessed against and collected from the partnership with respect to that year rather than the reviewed year.

* * *

Requirement of consistency with partnership return

The centralized system imposes a consistency requirement. A partner on its return must treat each item of income, gain, loss, deduction or credit attributable to a partnership in a manner that is consistent with the treatment of such income, gain, loss, deduction, or credit on the partnership return. An underpayment that results from a failure of a partner to conform to the partnership reporting of an item is treated as a math error on the partner’s return and cannot be abated under section 6213(b)(2). The underpayment may be subject to additions to tax.

Notice of inconsistent position

If the partnership has filed a return but the partner’s treatment on the partner’s return is (or may be) inconsistent with the partnership’s return, or if the partnership has not filed a return, the math error treatment and nonabatement treatment do not apply if the partner files a statement identifying the inconsistent position. Further, a partner is treated as having complied with the obligation to file a statement identifying the inconsistent position in the circumstance in which the partner demonstrates to the satisfaction of the Secretary that the treatment of the item on the partner’s return is consistent with the treatment of the item on the statement furnished to the partner by the partnership, and the partner elects the application of this rule.
A final decision in an administrative or judicial proceeding with respect to a partnership under the centralized system is binding on the partnership and all partners of the partnership. In contrast, a final determination in an administrative or judicial proceeding with respect to a partner’s identified inconsistent position is not binding on the partnership if the partnership is not a party to the proceeding. No inference is intended that the partnership is bound by any other proceeding to which it is not a party, such as an administrative or judicial proceeding with respect to a partner’s unidentified inconsistent position.

**Partners bound by actions of partnership; designation of partnership representative**

For purposes of the centralized system, the partnership acts through its partnership representative. The partnership representative has the sole authority to act on behalf of the partnership under the centralized system. Under the centralized system, the partnership and all partners of the partnership are bound by actions taken by the partnership. Thus, for example, partners may not participate in or contest results of an examination of a partnership by the Secretary. A partnership and all partners of the partnership are also bound by any final decision in a proceeding with respect to the partnership brought under the centralized system of subchapter C. Thus, for example, a settlement agreement entered into by the partnership, a notice of final partnership adjustment with respect to the partnership that is not contested, or the final decision of the court with respect to the partnership if the notice of final partnership adjustment is contested, bind the partnership and all partners of the partnership.

Each partnership is required to designate a partner (or other person) with a substantial presence in the United States as the partnership representative. A substantial presence in the United States enables the partnership representative to meet with the Secretary in the United States as is necessary or appropriate, and facilitates communication during the audit process and during any other proceedings in which the partnership is involved. In any case in which such a designation by the partnership is not in effect, the Secretary may select any person as the partnership representative.

**Partnership Adjustments**

**Partnership adjustments by the Secretary**

The centralized system provides that any adjustment to items of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year, and any partner’s distributive share thereof, are determined at the partnership level. Any tax attributable to these items is assessed and generally is collected at the partnership level as an imputed underpayment paid by the partnership.

**Reviewed year and adjustment year**

For purposes of the centralized system, the reviewed year means the partnership taxable year to which the item being adjusted relates. For example, in
an examination by the Secretary of a partnership’s taxable year 2018, 2018 is the reviewed year.

The adjustment year means (1) in the case of an adjustment pursuant to the decision of a court (under the centralized system’s judicial review provisions), the partnership taxable year in which the decision becomes final; (2) in the case of an administrative adjustment request, the partnership taxable year in which the administrative adjustment request is made; or (3) in any other case, the partnership taxable year in which the notice of final partnership adjustment is mailed. For example, in the case of adjustments with respect to partnership taxable year 2018 resulting in an imputed underpayment assessed in 2020 that the partnership then litigates in Tax Court, the decision of which is not appealed and becomes final in 2021, the adjustment year is 2021.

**Payment of imputed underpayment by the partnership**

Any adjustment to items of income, gain, loss, deduction, or credit of a partnership for a partnership taxable year, and any partner’s distributive share thereof, are determined at the partnership level. In the event of any adjustment by the Secretary in the amount of any item of income, gain, loss, deduction, or credit of a partnership, or any partner’s distributive share, that results in an imputed underpayment, the partnership is required to pay the imputed underpayment in the adjustment year.

* * *

**Determination of imputed underpayment amount**

An imputed underpayment of tax with respect to a partnership adjustment for any reviewed year is determined by netting all adjustments of items of income, gain, loss, or deduction and multiplying the net amount by the highest rate of Federal income tax applicable either to individuals or to corporations that is in effect for the reviewed year. Any adjustments to items of credit are taken into account as an increase or decrease, as the case may be, in the figure resulting from this multiplication. Any net increase or decrease in loss is treated as a decrease or increase, respectively, in income. Netting is done taking into account applicable limitations, restrictions, and special rules under present law.


**Chapter 4**

§ 4.03 (Defenses to Summons Enforcement)

In March 2016, the Eleventh Circuit affirmed that District Court decision. United States v. Clarke, 816 F.3d 1310, 1318–19 (11th Cir. 2016). The Eleventh Circuit explained that, under the Supreme Court’s decision in “Clarke, a taxpayer is entitled to examine an IRS agent concerning the issuance of a summons only when he can ‘make a showing of facts that give rise to a plausible inference of improper motive.’” Id. at 1316 (quoting Clarke, 134 S. Ct. at 2367 (2014)). “Although [the Eleventh Circuit] conclude[d that] the district court erred in its conclusion that allegations of retaliation or circumvention of tax court discovery are not improper purposes to issue a summons as a matter of law,” it reached the same outcome as the District Court—enforcing the summonses—because the taxpayers allegations were merely conjecture that did not support an inference of improper motive. Id. at 1318.

§ 4.03[A][1] (The Attorney-Client Privilege)

The Second Circuit vacated and remanded the case in Schaeffler v. United States, 806 F.3d 34, 37 (2nd Cir. 2015), which is discussed in the 2015 Supplement in connection with the work-product doctrine. One issue in Schaeffler was whether the taxpayer waived attorney-client privilege protection of documents it shared with a consortium of banks that provided the taxpayer with financing for a corporate acquisition. Id. The District Court had held that “the ‘common legal interest’ or ‘joint defense privilege’ exception to the waiver by third-party disclosure rule did not apply.” Id. at 38. The Second Circuit disagreed, stating:

Parties may share a “common legal interest” even if they are not parties in ongoing litigation. . . . The common-interest rule serves to “protect the confidentiality of communications passing from one party to the attorney for another party where a joint defense effort or strategy has been decided upon an undertaken by the parties and their respective counsel.” “[I]t is therefore unnecessary that there be actual litigation in progress for the common interest rule of the attorney-client privilege to apply[.]” However, “[o]nly those communications made in the course of an ongoing common enterprise and intended to further the enterprise are protected.” The dispositive issue is, therefore, whether the Consortium's common interest with appellants was of a sufficient legal character to prevent a waiver by the sharing of those communications. We hold that it was. . . .

[T]he Schaeffler Group faced a threat of insolvency that would in turn cause a default on the Consortium’s eleven-billion Euros loan. The Group and the Consortium could avoid this mutual financial disaster by cooperating in securing a particular tax treatment of a refinancing and restructuring. Securing that treatment would likely involve a legal encounter with the IRS. Both appellants and the Consortium, therefore, had a strong common interest in the outcome of that legal encounter.

Id. at 40–41 (citations omitted). For critique of this analysis, see Lee A. Sheppard, Give Your Tax Memo to Your Bank, 149 TAX NOTES 975, 975–78 (2015).
§ 4.03[A][2] (The Work-Product Doctrine)

As mentioned above, the Second Circuit vacated and remanded the Schaeffler case discussed in the 2015 Supplement. In Schaeffler, the district court had denied the taxpayer’s motion to quash a summons for documents the taxpayer argued were protected by the work-product doctrine. Schaeffler v. United States, 22 F. Supp. 3d 319, 323 (S.D.N.Y. 2014). The taxpayer sought tax advice from Ernst and Young (EY) regarding a corporate restructuring and had received a memo EY wrote analyzing the tax issues and identifying and discussing possible challenges to that treatment by the IRS. Id. As discussed in the 2015 Supplement, the District Court found that “the EY Tax Memo, as well as the related responsive documents, would have been produced in the same form irrespective of any concern about litigation.” Id. at 340.

By contrast, the Second Circuit reasoned:

[United States v.] Adlman[, 134 F.3d 1194 (2d Cir. 1998),] held that work-product protection would be withheld only from documents that were prepared in the ordinary course of business in a form that would not vary regardless of whether litigation was expected. In the present case, such records would include the supporting records and papers that appellants’ external tax return preparers collected and created in the ordinary course of annually completing appellants’ federal tax returns.

The tax advice in the EY Tax Memo was quite different. It was specifically aimed at addressing the urgent circumstances arising from the need for a refinancing and restructuring and was necessarily geared to an anticipated audit and subsequent litigation, which was on this record highly likely.

Schaeffler v. United States, 806 F.3d 34, 43–44 (2nd Cir. 2015).

For a positive view of this outcome, see Clint Massengill, Schaeffler: Order Restored to the Work Product Doctrine, 150 TAX NOTES 563 (2016). For a critical view, see Sheppard, supra, 149 TAX NOTES at 975–78. For an argument that the Second Circuit’s decision suggests that United States v. Textron, Inc., 577 F.3d 21 (1st Cir. 2009), which is reproduced in the casebook, is confined to the First Circuit, see J. Walker Johnson & Cameron Arterton, The Work Product Doctrine Is Alive and Well, 247 DAILY TAX REP. (BNA) J-1 (Dec. 28, 2015).

Chapter 5

§ 5.02[C][3] (Docketed Versus Nondocketed Appeals)

The IRS has issued updated guidance on procedures for returning cases to Appeals after the taxpayer has filed a Tax Court petition. Revenue Procedure 2016-22, 2016-15 I.R.B. 1, updates Revenue Procedure 87-24, 1987-1 C.B.720, mentioned in the text. As a general matter, the administrative procedures listed in Revenue Procedure 2016-22 are largely the same as those in the earlier revenue procedure. The new guidance is effective for all docketed Tax Court cases.

**Chapter 6**

§ 6.02[A][1] (Categories of Information Subject to Disclosure)


The IRS has also drawn some fire in several recent FOIA lawsuits related to the exempt-organizations controversy of 2013, which is discussed in Section 1.02 of both this Update and the 2015 Supplement. See United States v. Norcal Tea Party Patriots, 817 F.3d 953, 964 (6th Cir. 2016) (holding that the IRS couldn’t refuse to produce the names of organizations that had applied for tax-exempt status); Cause of Action v. IRS, 125 F. Supp. 3d 145 (Dist. D.C. 2015) (requiring the IRS to conduct additional searches for records showing impermissible disclosures of confidential return information of Koch Industries); Citizens for a Strong New Hampshire v. IRS, No. 14-CV-487-LM, 2015 U.S. Dist. LEXIS 115596, at *4 (D.N.H. Aug. 31, 2015) (exempt organization survived summary judgment on the issue of the adequacy of the IRS’s search for information relating to its FOIA request for correspondence between two New Hampshire legislators and three IRS officials, including Lois Lerner).

**Chapter 7**

§ 7.03[C][2] (Substantial Omission of Items)

In *United States v. Home Concrete & Supply LLC*, 132 S. Ct. 1836, 1837–38 (2012), which is discussed in the 2015 Supplement, the U.S. Supreme Court determined that the six-year statute of limitation for substantial omission of items did not apply in the context of that case, which involved overstatement of basis. In June 2015, Congress amended section 6501(e)(1)(B) to specify that “An understatement of gross income by reason of an overstatement of unrecovered cost or other basis is an omission from gross income.” See Surface Transportation and Veterans Health Care Choice Improvement Act of 2015, Pub. L. No. 114–27, tit. IV, § 407(e), 129 Stat. 382 (June 29, 2015). The new statute may not put a stop to litigation of this issue, however. “David Click, tax director at McGladrey LLP in Denver . . . [said that] [b]ecause the bill refers specifically to gross income, and not net income, there could be an interpretive question of how this provision squares with the Supreme Court’s decision in *Colony, Inc. v. Commissioner*, 357 U.S. 28 (1958).” Erin McManus, *IRS Gets Six-Year Statute of Limitations for Tax Shelter Ploy*, 150 Daily Tax Rep. (BNA) G-2 (Aug. 4, 2015). In addition, Click was quoted
as stating that “the effective date of the statute may be a trap for the unwary” because taxpayers’ 2011 returns filed in 2012 will now be subject to assessment until 2018, not 2015. *Id.*

§ 7.03[C][3] (False or Fraudulent Return)

In July of 2015, the Court of Appeals for the Federal Circuit affirmed the Court of Federal Claims’s grant of summary judgment to the taxpayer on the ground that a third-party’s fraudulent intent could not be imputed to the taxpayer so as to make the statute of limitations on assessment unlimited. In *BASR Partnership v. United States*, 795 F.3d 1338, 1340 (Fed. Cir. 2015), a lawyer from Jenkins & Gilchrist (which is now defunct) contacted a family who were selling a business that would give rise to a large capital gain and proposed a tax strategy that included creation of a partnership. That lawyer later pled “guilty to conspiracy and tax evasion charges relating to his design and implementation of numerous fraudulent tax shelters.” *BASR Partnership v. United States*, 795 F.3d 1338, 1340, 1341 n.2 (Fed. Cir. 2015). An unrelated accounting firm prepared the family’s and the partnership’s tax returns, *id.* at 1340, and “There are no allegations that BASR, or even its accountant, knew or should have known that the tax return was false or incorrect, much less that it was ‘obviously’ false or incorrect.” *Id.* at 1347. The Court of Appeals stated, “Based on the statutory scheme and the absence of persuasive case law, we cannot agree with the Government that § 6501(c)(1) unambiguously permits the suspension of the limitations period when the taxpayer lacked fraudulent intent. The statutory scheme actually seems to point in the opposite direction.” *Id.* at 1347–48.

The *BASR Partnership* decision contrasts with *Allen v. Commissioner*, 128 T.C. 37 (2008), which is discussed on page 277 of the casebook. In *Allen*, the Tax Court held that the unlimited statute of limitations for fraud exception could apply where the tax return preparer committed the fraud. *Id.* at 40. Professor Bryan Camp, who filed an amicus brief supporting the taxpayer in *BASR Partnership*, has reportedly stated that “the decision is contrary to the decision in *Allen*.” See Matthew R. Madara, *Split Appeals Court Upholds Statute of Limitations Decision*, 148 TAX NOTES 503 (2015). The Federal Circuit noted a factual distinction between the two cases, however, stating, “the Tax Court's reasoning in *Allen* does not persuade us that § 6501(c)(1) necessarily encompasses situations where an attorney advising on financial transactions, but not involved with the preparation of the taxpayer's return, acts with intent to evade tax.” *BASR Partnership*, 795 F.3d at 1347.

Chapter 8

§ 8.01[A] (Structure)

(citing Kuretski, 755 F.3d at 940). In Kuretski, the court had held “that the Tax Court exercises its authority as part of the Executive Branch.” Kuretski, 755 F.3d at 943. The Senate Report states:

The Committee is concerned that statements in Kuretski v. Commissioner may lead the public to question the independence of the Tax Court, especially in relation to the Department of Treasury or the Internal Revenue Service. The Committee wishes to remove any uncertainty caused by Kuretski v. Commissioner, and to ensure that there is no appearance of institutional bias.


Thus far, it is unclear what effect the amendment will have, in part because it does not state where in government the Tax Court is located. For earlier discussions of the possibilities, see Brant J. Hellwig, The Constitutional Nature of the United States Tax Court, 35 VA. TAX REV. 269 (2016); Leandra Lederman, When the Bough Breaks: The U.S. Tax Court’s Branch Difficulties, 34 ABA TAX SEC. NEWSQ. 10 (Winter 2015). Several blog posts offer analyses of the statutory amendment, see, e.g., Bryan Camp, Initial Take on the Kuretski Language in the PATH Law, PROCEDURALLY TAXING (Dec. 19, 2015), http://procedurallytaxing.com/initial-take-on-the-kuretski-language-in-the-path-law/; Hoffer & Walker: The Tax Court And The Administrative State—Congress Responds To The D.C. Circuit, TAXPROF BLOG (Dec. 28, 2015) (also linking to blog posts by Daniel Hemel, Kristin Hickman, and Leandra Lederman).

§ 8.01[B] (Procedures)

The PATH Act also included a subtitle on the U.S. Tax Court. See Pub. L. 114-113, supra, tit. IV, subtit. B. The new provisions generally bring the Tax Court more in line with other federal courts. For example, the Act expressly authorizes the Tax Court to hold annual judicial conferences. See id. § 432(a) (enacting I.R.C. § 7470A). It also allows the Tax Court to “exercise, for purposes of management, administration, and expenditure of funds of the Court,” the authorities applicable to Article III courts. Id. (enacting I.R.C. § 7470). And it authorizes the Tax Court to prescribe procedures for the filing and resolution of complaints with respect to the conduct of Tax Court judges and special trial judges. Id. at § 431 (enacting I.R.C. § 7466). However, the PATH Act not only stopped short of declaring in which branch Congress has determined the Tax Court is located, it did not make the Tax Court subject to all of the provisions applicable to Article III courts, such as the Administrative Office of U.S. Courts.

§ 8.06 (The Tax Court’s Small Tax Case Procedure)

The PATH Act also amended Code section 7463 to extend small tax case jurisdiction to an additional category of cases, interest abatement cases “in which the amount of the abatement sought does not exceed $50,000.” See Pub. L. 114-113, supra, Tit. IV, Subtit. B. § 422.
Chapter 9

§ 9.02[B] (General Requirements of the Notice)

Taxpayers have begun to argue—in the wake of Mayo Foundation for Medical Education and Research v. United States, 562 U.S. 44 (2011), and a recent focus on the applicability of APA requirements to tax issues—that the APA imposes requirements on notices of deficiency. In Ax v. Commissioner, 146 T.C. No. 10, 2016 U.S. Tax Ct. LEXIS 11, at *12 (Apr. 11, 2016), the Tax Court held that the agency provisions of the APA do not pose a barrier to the IRS raising new issues in its amended answer in a deficiency case. The court noted that “the U.S. Court of Appeals for the Fourth Circuit had previously held in a deficiency case that ‘the Tax Court is not subject to the Administrative Procedure Act,’” which includes the provisions the taxpayer asserted would invalidate the Notice of Deficiency. Id. at *16–17 (citing O’Dwyer v. Commissioner, 266 F.2d 575, 580 (4th Cir. 1959), aff’g 28 T.C. 698 (1957)).

The court further found that its holding was not at odds with Mayo, 562 U.S. at 56, which had held that Chevron deference extends to tax regulations. Ax, 146 T.C. No. 10 at *19–20. The Mayo Court had stated, “In the absence of . . . justification, we are not inclined to carve out an approach to administrative review good for tax law only.” Mayo, 562 U.S. at 55. Although the taxpayers in Ax argued that Mayo had broadly rejected “tax exceptionalism,” the Tax Court found that Mayo had considered a different issue and thus was not on point. Ax, 146 T.C. No. 10 at *20. Instead, the Tax Court found that deficiency litigation had included the possibility of “new matter” from the early days of the Board of Tax Appeals, id. at *17, and that had survived the enactment of the APA undisturbed, id. at *18–19.

A similar issue is pending before the Fourth Circuit in QinetiQ U.S. Holdings, Inc. v. Commissioner, T.C. Memo. 2015-123, 2015 Tax Ct. Memo LEXIS 132, at *20 (July 2, 2015). See Marie Saiprie, How Detailed Should Deficiency Notices Be?, 150 TAX NOTES 744, 744 (2016) (citing an order from the Tax Court rejecting QinetiQ’s argument that the notice of deficiency was insufficient, stating that “it is ‘well settled’ that the APA does not apply to notices in Tax Court.”). In QinetiQ, the taxpayer had claimed a salary deduction for stock that it claimed it had transferred in compensation for services. QinetiQ, 2015 Tax Ct. Memo LEXIS, at *1. The notice of deficiency stated “It is determined that the deduction you claimed for Salaries and Wages in the amount of $117,777,501 under the provisions of IRC section 83 is disallowed in full as you have not established that you are entitled to such a deduction. Accordingly, taxable income is increased $117,777,501.” Saiprie, supra, at 744. The taxpayer is arguing that that explanation is insufficient because it does not state why the IRS disallowed the deduction. Id.

Chapter 10

The Court of Federal Claims dismissed for lack of jurisdiction a complaint seeking a refund of a partial payment of over $42 million in penalties imposed under Code section 6707 for failure to register a tax shelter, as required by section 6111. Diversified Group, Inc., v. United States, 123 Fed. Cl. 442, 443, 445 (2015). The taxpayers argued that the penalty was divisible by the 193 clients who invested in the shelter. Id. at 449. However, the court found that the Code
imposes the penalty on a single act (failure to register the shelter); individual client transactions are not required to be registered. Id. at 451, 455. “Although it is true that the IRS calculated the amount of the penalty based upon each client’s aggregate investment in the tax shelter, neither the number of clients that participated in the tax shelter nor the number of commercial steps necessary to accomplish that participation triggers liability under § 6707.” Id. at 451–52.

Chapter 11

§ 11.06 (Awards of Administrative and Litigation Costs and Fees to Taxpayers)

Early in 2016, the Treasury Department finalized regulations relating to the recovery of administrative and litigation costs under section 7430. See T.D. 9756 (Mar. 21, 2016), https://www.irs.gov/irb/2016-12_IRB/ar07.html. The regulations are substantially similar to the proposed regulations, which are discussed in the 2015 Supplement. The regulations have varying effective dates but a number of the amendments “apply to costs incurred and services performed in cases in which the petition was filed on or after March 1, 2016.” Treas. Reg. § 301.7430-6.

§ 11.08 (IRS Use of Summonses in Discovery)

The 2015 Supplement discusses United States v. Clarke, 134 U.S. 2361, 2367 (2014), an important case on defenses to summonses, which held that bare allegations of an improper IRS motive are insufficient to justify an evidentiary hearing in which the taxpayers could question the IRS agents involved, but that if the taxpayer could identify specific facts supporting an inference of improper motive, that would justify such a hearing. At the time the Supplement was published, the District Court for the Southern District of Florida had held that the taxpayers’ “submissions [did] not show facts giving rise to a plausible inference of improper motive regarding issuance of the summons” so as to justify a hearing. United States v. Clarke, 2015 U.S. Dist. LEXIS 33312, at *7 (S.D. Fla. 2015). On appeal, the Court of Appeals for the Eleventh Circuit affirmed, holding that the taxpayers did not meet their burden under the Supreme Court’s decision. United States v. Clarke, 816 F. 3d 1310, 1318 (11th Cir. 2016).

Chapter 12

§ 12.02[A][1] (The Failure to File Penalty)

As part of the Trade Facilitation and Trade Enforcement Act of 2015, Pub. L. No. 114-125, 130 Stat. 122 (Feb. 24, 2016), Congress increased the minimum failure-to-file penalty from $135 to $205 (applicable to returns required to be filed after 2015). Id. § 921.

§ 12.02[E] (Information Reporting Penalties)

In 2015, Congress increased the penalties in sections 6721 and 6722 for failure to provide timely and accurate information returns and payee statements. Trade Preferences Extension Act of 2015, Pub. L. 114-27 § 806, 129 Stat. 416 (June 29, 2015). In both cases, the general penalty
amount is $250 per return up to a maximum of $3 million per year. *Id.* § 806(a). For corrections within 30 days of the due date, the penalty amounts drop to $50 per return or statement, up to a maximum of $500,000. For corrections after 30 days but before August 1, the penalty is $100 per return or statement, up to a maximum of $1.5 million. *Id.* § 806(b). The increased penalty amounts are effective with respect to returns/statements due after January 1, 2016. *Id.* § 806(f).

**Chapter 13**

§ 13.03[A] (Applicable Interest Rates)

A recent decision from the U.S. Court of Federal Claims declined to follow the Tax Court’s interpretation of Code section 6621(a)(1) in the case of an S Corporation. As mentioned on page 530 of the text, the Tax Court in *Garwood Irrigation Co. v. Commissioner*, 126 T.C. 233 (2006), ruled that S corporations are not subject to the relatively lower interest rate on large corporate overpayments. In *Eaglehawk Carbon, Inc. v. United States*, 122 Fed. Cl. 209 (2015), the Court of Federal Claims disagreed with the Tax Court’s interpretation of the statute, finding that “S corporations are corporations, as both a common sense interpretation of this designation” and the Code indicate. *Id.* at 212. As a result, the refund of the taxpayer’s excise taxes were subject to the lower corporate interest rate that applies to large corporate overpayments.

**Chapter 14**

§ 14.02[A] (The IRS’s Collection Operation)

As noted in the 2015 Supplement, the IRS discontinued the private debt collection program authorized by Code section 6306. As part of the Fixing America’s Surface Transportation Act, Congress revived the program to mandate that the IRS hire private debt collecting agencies to collect “inactive tax receivables.” Pub. L. No. 114-94, § 32102, 129 Stat. 1312 (Dec. 4, 2015) (codified as amended at I.R.C. § 6306(c)). These include outstanding assessments that have been removed from the active inventory of collection cases because the IRS has been unable to locate the taxpayer and cases that have been assigned to an agent but more than a year has passed without any interaction with the taxpayer. Cases involving offers-in-compromise, installment agreements, and innocent spouse issues are not included in the inventory of available cases that may be assigned to private debt collectors. I.R.C. § 6306(d). IRS representatives have expressed the same concerns about the potential for abuse and lack of protections for taxpayers that they expressed the last time the private debt collection program was in place. See William Hoffman, *New Private Tax Debt Law Raises More Questions Than It Answers*, 149 TAX NOTES 1456, 1458–59 (2015).

**Chapter 15**

[No updates.]
Chapter 16

§ 16.03 (Court Review in CDP Cases)

In December 2015, as part of the PATH Act, Congress amended Code section 6330(d) (on petitioning the Tax Court after a CDP determination), adding a paragraph that reads as follows:

(2) Suspension of running of period for filing petition in title 11 cases.—In the case of a person who is prohibited by reason of a case under title 11, United States Code, from filing a petition under paragraph (1) with respect to a determination under this section, the running of the period prescribed by such subsection for filing such a petition with respect to such determination shall be suspended for the period during which the person is so prohibited from filing such a petition, and for 30 days thereafter, . . . .

IRC § 6330(d)(2).

Congress also made a conforming change in the cross-reference in Code sections 6320(c). PATH Act of 2015, Pub. L. 114-113, tit. IV, subtit. B. § 424. Congress also made a similar change in Code section 6015(e), as discussed in Section 17.02[A](3) of the Chapter 17 updates, below. Id. The Joint Committee on Taxation explains:

Neither section 6015 or 6330 includes a rule similar to the coordination rule found in the general provisions regarding filing a petition with the Tax Court for taxpayers in bankruptcy. Under that rule, the period of the automatic stay in bankruptcy is disregarded, and the taxpayer may file its petition with the Tax Court within 60 days after the stay is lifted.


Chapter 17

§ 17.02[A] (Substance)

In November 2015, the Treasury promulgated proposed regulations on relief from joint and several liability under Code section 6015. See REG-134219-08, Relief From Joint and Several Liability, 80 FR 72649; Prop. Treas. Reg. §§ 1.6015-1 to 1.6015-8, 80 Fed. Reg. 72649 (Nov. 30, 2015) (corrected Jan. 13, 2016). In part, the proposed regulations clarify that interest and tax penalties are not separately available for relief in underpayment cases any more than they are in understatement cases. See Prop. Treas. Reg. § 1.6015-1(m) (also moving discussion from Treas. Reg. § 1.6015-1(h)(4)).
§ 17.02[A][3] (Section 6015(f))

With respect to equitable relief under Code section 6015(f) “for any unpaid tax or any deficiency,” the proposed regulations that Treasury promulgated in November 2015 would make both “unpaid tax” and “underpayment” mean “the balance due shown on the joint return, reduced by the tax paid with the joint return.” See REG-134219-08, supra; Prop. Treas. Reg. § 1.6015-1(h)(6).

§ 17.02[B][2] (Court Jurisdiction Over Innocent Spouse Claims)

In the PATH Act of 2015, Congress added a new provision to § 6015(e), clarifying the tolling of statute of limitations in Chapter 11 cases. The change is similar to the tolling provision Congress added to the CDP statutes in the same section of the bill; the CDP changes are discussed in Section 16.03 of this Update Letter. The new provision states:

In the case of a person who is prohibited by reason of a case under title 11, United States Code, from filing a petition under paragraph (1)(A) with respect to a final determination of relief under this section, the running of the period prescribed by such paragraph for filing such a petition with respect to such final determination shall be suspended for the period during which the person is so prohibited from filing such a petition, and for 60 days thereafter.


§ 17.02[B][5] (Res Judicata)

The proposed regulations that Treasury promulgated in November 2015, which are mentioned above, also provide guidance on the exception to res judicata under Code section 6015(g)(2), when the requesting spouse “did not meaningfully participate in a prior court decision.” REG-134219-08, supra; Prop. Treas. Reg. § 1.6015-1(e)(3). The proposed regulation provides in part:

Meaningful participation is a facts and circumstances determination. Absent abuse as set forth in paragraph (i) of this section, the following is a nonexclusive list of acts to be considered in making the facts and circumstances determination:

whether the requesting spouse participated in the IRS Appeals process while the prior proceeding was docketed; whether the requesting spouse participated in pretrial meetings; whether the requesting spouse participated in discovery; whether the requesting spouse participated in settlement negotiations; whether the
requesting spouse signed court documents, such as a petition, a stipulation of facts, motions, briefs, or any other documents; whether the requesting spouse participated at trial (for example, the requesting spouse was present or testified at the prior proceeding); and whether the requesting spouse was represented by counsel in the prior proceeding. No one act necessarily determines the outcome.

*Id.*

The ABA Section of Taxation has made a number of recommendations for changes before the proposed regulations are finalized. See Joseph DiSciullo, *ABA Tax Section Suggests Changes to Proposed Spousal Relief Regs*, 151 TAX NOTES 331, 331 (2016). Among other things, the Tax Section suggested clarification that Code section 6015(g)(2) would not pose a barrier to a request under section 6015(c) by a spouse who was not eligible for relief at the time the petition was filed but became eligible at a later point. *Id.* The Tax Section also noted that the proposed regulations did not address whether a collection suit under Code sections 7402 or 7403 can provide the grounds for res judicata, and argued that those suits should not have a res judicata effect because of court decisions holding that no section 6015 defense is available in those collection actions. *Id.*

**Chapter 18**

§ 18.03[B][1] (Background and Scope)

As noted in the 2015 Supplement, the American Institute of Certified Public Accountants (AICPA) filed suit against the IRS challenging the IRS’s voluntary Annual Filing Season Program, which provides education and testing of return preparers and lists the names of those preparers in an online public directory. AICPA v. IRS, 2014 U.S. Dist. LEXIS 157723 (D.D.C. 2014). The U.S. District Court for the District of Columbia’s 2014 ruling that the AICPA lacked standing to challenge the program was reversed in 2015 by the U.S. Court of Appeals for the District of Columbia. AICPA v. IRS, 804 F.3d 1193 (D.C. Cir. 2015) (finding that the AICPA had standing because its members would face intensified competition as a result of the program). The case is now pending at the district court. See AICPA v. IRS, D.D.C., No. 1:14-cv-01190 (reversal by Court of Appeals noted Dec. 23, 2015).

The 2015 Supplement discusses *Loving v. I.R.S.*, 742 F.3d 1013, 1022 (D.C. Cir. 2014), in which the Court of Appeals for the D.C. Circuit ruled that the IRS did not have the authority to mandate testing for all return preparers. The IRS has announced that it will refund fees that return preparers paid to take a mandatory competency test. Diane Freda, *IRS Refunds Fees for Tax Preparer Tests Held by Courts to Be Invalid*, 99 DAILY TAX REP. (BNA) G-2 (May 22, 2015).

**Chapters 19 and 20**

[No updates.]