Tax Controversies

PRACTICE AND PROCEDURE

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2018 Letter Update

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Leandra Lederman & Stephen W. Mazza
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Tax Cuts and Jobs Act: A Brief Overview

As is well known, on December 22, 2017, Congress passed the tax law known as the Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, (the "2017 Tax Act"). By that time, the fourth edition of the casebook was already in press. The 2017 Tax Act included significant changes to the individual and corporate tax, as well as to the rules relating to U.S. corporations with overseas operations. However, the 2017 Tax Act included only minor revisions to rules relating to tax practice and procedure. Several changes worthy of note are mentioned briefly in the material below relating to Chapter 14.

In addition, several of the substantive tax law changes in the 2017 Tax Act have an indirect effect on some of the material in the casebook. For example, the 2017 Tax Act expanded the standard deduction and eliminated the personal exemption for tax years 2018 through 2025. I.R.C. §§ 63(c) (standard deduction); 151(d)(5) (personal exemption). Those revisions also affect the income threshold for individual taxpayers, mentioned on page 97 in Chapter 3. During that time period, the filing thresholds for single individuals and married couples filing jointly are slated to be based on the applicable standard deduction amount, rather than the combined amounts of the standard deduction and personal exemption. I.R.C. § 6012(f).

Congress enacted the 2017 Tax Act on a relatively tight schedule, and commentators have pointed out statutory gaps, errors, and ambiguities in the legislation. *See* Timothy J. McCormally, *Tax Reform and the IRS: Five Takeaways for Tax Practitioners*, 49 TAX ADVISER 354, 354 (June 2018). It also introduces new concepts to the Internal Revenue Code—the deduction for qualified business income in section 199A being a prime example—that are complex and in need of interpretation. Whether the task of interpreting and administering the new legislation will draw IRS resources away from compliance and collections functions remains to be seen.

Chapter 1*

Page 7:

A bipartisan group of lawmakers released several sets of draft legislation in 2018 that would overhaul some of the IRS's operations, the first major set of changes since the Internal Revenue Service Restructuring and Reform Act of 1998 ("IRS Reform Act") was enacted. *See* Taxpayer First Act, S. 3246; Protecting Taxpayers Act, S. 3278. The Protecting Taxpayers Act, for example, would codify an independent IRS Appeals Office, create procedures designed to make the Appeals process more transparent, and impose structural changes to ensure greater

* If a chapter is not referenced in this Letter Update, there were no significant updates to that chapter.

independence from the compliance and collection functions. The legislation also proposes that the IRS Commissioner be renamed the IRS Administrator, revises the responsibilities of the IRS Oversight Board, and protects some low-income taxpayers from private debt collection efforts.

Page 11:

Revenue Procedure 2018-2, 2018-1 I.R.B. 106, supersedes Revenue Procedure 2016-2, 2016-1 I.R.B. 102, cited in the casebook, without significant revision.

Chapter 2

Page 67:

Revenue Procedure 2017-1, cited and excerpted on pages 67 through 84, has been superseded by Revenue Procedure 2018-1, 2018-1 I.R.B. 1. The correct citation for Revenue Procedure 2017-1 is 2017-1 I.R.B. 1. The casebook citations to sections within the 2017 version of the Revenue Procedure remain the same as those in the 2018 version.

Page 69:

Revenue Procedure 2018-2, 2018-1 I.R.B. 106, supersedes Revenue Procedure 2017-2, 2017-1 I.R.B. 106, cited in the casebook, without significant revision.

Revenue Procedure 2018-3, 2018-1 I.R.B. 130, supersedes Revenue Procedure 2017-3, 2017-1 I.R.B. 130, cited in the casebook, without significant revision.

Chapter 3

Page 114:

The Bipartisan Budget Act of 2018, Pub. L. No. 115-123, made several changes to Code section 7623 relating to whistleblower awards under section 7623(b). For example, the legislation expands the base upon which the whistleblower award will be determined to include not just tax, penalties, interest, and additions to tax, but also "any proceeds arising from laws for which the Internal Revenue Service is authorized to administer, enforce, or investigate, including—(A) criminal fines and civil forfeitures, and (B) violations of reporting requirements." I.R.C. § 7623(c)(2). The inclusion of criminal fines conflicts with guidance included in Treasury Regulation section 301.6723-2(d), cited on page 115 of the casebook. Legislative history to the 2018 Act confirms that penalties arising from violations of reporting requirements, such as the Foreign Bank and Financial Accounts requirement, should be included in the definition of proceeds that are subject to a whistleblower award. H. R. Rep. No. 115-466, at 336-339.

Page 120:

The post-TEFRA partnership audit procedures enacted in 2015 and effective for returns filed after December 31, 2017 continue to raise questions for both taxpayers and tax advisors. Congress passed a set of technical corrections in 2018, Consolidated Appropriations Act of 2018, Pub. L. No. 115-141, and the IRS has issued several sets of proposed regulations that seek to clarify the scope of the new audit regime and how items should be netted against one another to determine the total amount of the adjustment. *See, e.g.*, 82 Fed. Reg. 27334 (June 14, 2017) (creating Proposed Regulation section 301.6221(a)); 83 Fed. Reg. 4868 (Feb. 2, 2018) (creating Proposed Regulation section 301.6225). The IRS has also issued final regulations in section 301.6221(b)-(f), describing how eligible taxpayers can opt-out of the new audit regime. T.D. 9892, 83 Fed. Reg. 24 (Jan. 2, 2018). The issues raised in the technical corrections act and the new regulations are beyond the casebook's scope. For those interested in an in-depth analysis of the new regime, see Keith C. Durkin, *A Comprehensive Explanation of New Partnership Tax Audit Rule*s, 159 TAX NOTES 973 (2018); Warren P. Kean, *What to Know and Do About the New Partnership Audit Rules Now*, 156 TAX NOTES 471 (2017).

Chapter 4

Page 166:

As explained on pages 165-66 of the casebook, the U.S. Supreme Court in *United States v. Clarke*, 134 S. Ct. 2361 (2014), ruled that the taxpayer, Dynamo Holdings, had a right to an evidentiary hearing to challenge the IRS's summons if the taxpayer could identify facts that raised an inference of bad faith on the part of the IRS when it issued the summons. *Id*. at 2368. On remand, the Eleventh Circuit Court of Appeals affirmed the district court's order to enforce the summonses and deny an evidentiary hearing to the taxpayer because the taxpayer's allegations of retaliation were mere conjecture and did not support an inference of improper motive. United States v. Clarke, 816 F.3d 1310, 1318-19 (11th Cir. 2016). Dynamo Holdings petitioned the Supreme Court for a second time, claiming that on remand the lower courts unfairly denied without any explanation its efforts to amend its pleadings to provide additional facts showing bad faith on the IRS's part. *See* Matthew Beddingfield, *Supreme Court Rejects Dynamo Holdings' IRS Summons Case*, DAILY TAX REP. (BNA), Jan. 10, 2017, at K-1. The Supreme Court denied certiorari, leaving "open a legal procedure issues concerning a taxpayer's ability to provide new allegations on remand to meet a new court standard." *Id*.

Chapter 5

Page 235:

Facebook Inc.'s ongoing transfer-pricing dispute with the IRS, currently docketed before the U.S. Tax Court, has generated some interesting questions about the right to an IRS appeal and the extent to which the Taxpayer Bill of Rights, discussed in Section 1.02[B] of the casebook, creates enforceable obligations on the IRS's part.

After receiving a notice of deficiency alleging that it had undervalued intangible assets transferred to an Irish subsidiary and asserting a $1.73 million deficiency for 2010, Facebook filed a petition in Tax Court contesting the deficiency. Facebook requested a conference with the Appeals Office, which the IRS denied. The dispute over the right to an IRS Appeal went before a U.S. magistrate judge, who ruled that Facebook did not have a legally protected right to an Appeals conference in a tax deficiency case. Facebook Inc. & Subsidiaries v. IRS, No. 17-cv-06490-LB, 2018 U.S. Dist. LEXIS 81986 (N.D. Cal., May 14, 2018).

Facebook based its claim on the Administrative Procedure Act ("APA"), alleging that the "IRS acted arbitrarily, capriciously, and in violation of law, in refusing to refer its tax case to IRS Appeals." The IRS maintained that its decision not to grant an Appeals conference in a dispute over tax liability is not reviewable under the APA. *Id*. at *3-*4. The magistrate judge agreed that the IRS's decision was not reviewable, and also ruled that Facebook did not have standing to challenge the IRS's decision because "the deprivation of a nonexistent right to access IRS Appeals does not constitute an injury in fact." *Id*. at *4.

As part of her analysis, the magistrate judge noted that while the IRS Reform Act grants taxpayers an absolute right to an Appeals conference in certain collection cases, that absolute right does not exist in other contexts. *Id*. at *5. That remains true even after the IRS adopted in 2014 the Taxpayer Bill of Rights ("TBOR"), mentioned on pages 8-9 of the casebook, which includes "the right to appeal an IRS decision to an independent forum." The Taxpayer Bill of Rights was signed into law in 2015 as part of the Protecting Americans from Tax Hikes Act, Pub. L. No. 114-113, Div Q, Title IV, Subtitle A, § 401(a), 129 Stat. 3117 (2015) (adding I.R.C. § 7803(a)(3)). Relying on legislative history, the judge concluded that the statutory TBOR did not create new enforceable taxpayer rights, but merely obligated the IRS Commissioner to ensure that IRS employees are familiar with and act in accordance with preexisting taxpayer rights established by other Code provisions. *Id*. at *23. And even if TBOR did create an enforceable right to appeal a decision to an independent forum, Facebook failed to establish that the right related to the IRS Appeals Office, as opposed to the right to contest the deficiency in an independent forum such as the Tax Court. *Id*. at *25.

The magistrate judge also ruled that Facebook failed to make a case under the APA because the decision not to grant an Appeal did not represent a "final agency action for which there is no adequate remedy at law." *Id*. at *30 (citing 5 U.S.C. § 704). According to the judge:

> The IRS's decision not to refer Facebook's tax case to IRS Appeals similarly is not a final agency action because it is not an action "by which rights or obligations have been determined, or from which legal consequences will flow." Facebook retains its right to challenge the IRS's tax-deficiency determination before the Tax Court (or to try to negotiate a settlement with the IRS Counsel), and it is Facebook's and the IRS's litigation (and/or negotiation) going forward that will ultimately determine the parties' rights, obligations, and legal consequences. . . . Again, Facebook's argument to the contrary depends on its assumption that it had an enforceable right to take its tax case to IRS Appeals, and that the IRS's decision not to refer its case to IRS Appeals foreclosed that right. But as described above, Facebook does not have this right. The IRS's decision not to refer Facebook's tax

> case to IRS appeals did not alter this non-right or otherwise determine any rights, obligations, or legal consequences. It therefore is not a final agency action that is reviewable under the APA.

Id. at *31-*32.

Page 242:

In response to concerns from practitioners, an IRS official announced that the decision over whether an Appeals conference will take place in person or by telephone will be at the discretion of the taxpayer. This position reverses guidance issued in Internal Revenue Manual section 8.6.1.4.1., cited in the casebook, which places the discretion to grant an in-person conference with the Appeals Office. According to the IRS official, the right to a face-to-face conference will apply only in the case of office and field audits, not audits conducted solely by correspondence. Stephanie Cumings, *IRS Appeals Returning to In-Person Conferences*, 156 TAX NOTES 1686 (2017). As of the date of this Letter Update, the IRS has not updated Internal Revenue Manual 8.6.1.4.1. to reflect the IRS official's statements.

Chapter 11

Page 558:

The inflation-adjusted recovery amount for attorney's fees under section 7430 remains at $200 per hour for 2018. Revenue Procedure 2017-58, 2017-45 I.R.B. 489.

Chapter 12

Page 629:

Revenue Procedure 2018-11, 2018-5 I.R.B. 334, updates Revenue Procedure 2016-13, 2016-4 I.R.B. 290, cited in the casebook, without significant revisions to the material discussed in the casebook.

Page 649:

A long-overlooked Code provision has taken on new significance after a recent decision by the U.S. Tax Court. The Tax Court's holding in *Graev v. Commissioner*, 149 T.C. No. 23, 2017 U.S. Tax Ct. LEXIS 58 (Dec. 20, 2017), involves Code section 6751(b), enacted as part of the IRS Reform Act. Section 6751(b) mandates that "no penalty . . . shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination." I.R.C. § 6751(b)(1). The requirement of written supervisory approval does not apply to the delinquency penalties in section 6651 or the penalty for failure to pay estimated tax in section 6654.

The taxpayers in *Graev* received a notice of deficiency asserting a 40-percent gross valuation misstatement penalty relating to noncash charitable contribution deductions. After the IRS filed an answer to the taxpayers' Tax Court petition, the IRS amended its answer to concede the 40-percent penalty and instead impose a 20-percent accuracy-related penalty arising from different contributions made by the taxpayers. In an earlier opinion involving the same set of facts, a divided Tax Court had sustained the 20-percent penalty, ruling that the taxpayers' argument that the IRS failed to comply with section 6751 was premature in a pre-assessment deficiency proceeding. Graev v. Comm'r, 147 T.C. No. 16, 2016 U.S. Tax Ct. LEXIS 33 (Nov. 30, 2016) (referred to by the Tax Court as "*Graev II*"). However, in *Chai v. Commissioner*, the Court of Appeals for the Second Circuit agreed with the dissent in *Graev II* and ruled that the section 6751(b) written approval requirement is an element of the penalty claim and that written approval of an initial penalty determination must occur "before the issuance of the notice of deficiency, or the date of the filing of the answer by the IRS, or the date of the filing of an amended answer by the IRS." Chai v. Comm'r, 851 F.3d 190, 221-22 (2d Cir. 2017).

In response to the Second Circuit's decision, a divided Tax Court vacated its ruling in *Graev II* and reversed its prior holding that consideration of whether the IRS complied with section 6751(b) was premature in a deficiency case. *Graev*, 2017 U.S. Tax Ct. LEXIS, at *3, *9. Writing for the majority, Judge Thornton ruled as follows:

> Under section 7491(c) the Commissioner bears the burden of production with respect to the liability of an individual for any penalty. To satisfy this burden the Commissioner must present sufficient evidence to show that it is appropriate to impose the penalty in the absence of available defenses. *See* Higbee v. Commissioner, 116 T.C. 438, 446 (2001). In light of our holding that compliance with section 6751(b) is properly at issue in this deficiency case, we also hold that such compliance is part of respondent's burden of production under section 7491(c).

Id. at *10. Based on the unique facts of the case, the majority ultimately found that the IRS had satisfied the approval requirement and sustained the 20-percent penalty, *id*. at *16.

Judge Holmes, who concurred in the result, disagreed with his colleagues over the issue of whether compliance with the written approval requirement should be considered in deficiency cases. According to Judge Holmes:

> Section 6751 has been in the Code for nearly twenty years. Adopting [the Second Circuit's] reading as our own, and rolling it out nationwide, amounts to saying that we have been imposing penalties unlawfully on the tens of thousands—perhaps hundreds of thousands—of taxpayers who have appeared before us in that time. It is quite a counterintuitive result to those with a working knowledge of tax vocabulary and procedure; it will have unintended and irrational consequences unless corrected by additional appellate review or clarifying legislation; it is contrary to the text of the Code, whether viewed by itself or in light of a seemingly applicable canon of construction—and I predict it will even end up harming taxpayers unintentionally.

Id. at *23-24.

The scope of the latest *Graev* opinion remains unclear. According to Carlton Smith, former Tax Clinic director at Cardozo:

> [I]t's still unclear , , , if the IRS has the burden of production if the taxpayer doesn't raise the issue under section 6751(b). . . . In meeting the burden of production, . . . the IRS will now have to produce the penalty approval form that examiners must get signed and approved by their immediate supervisors, something the IRS isn't accustomed to doing. . . . [T]he IRS may even need to provide testimony about the forms because they don't indicate that the signature is that of the "immediate supervisor." Many of the forms are being electronically stamped with signatures, which the Tax Court may not find sufficient, and many contain defects, including no signature. Such issues would likely need to be addressed in future cases.

Stephanie Cumings, *Tax Court: IRS Must Produce More Evidence in Deficiency Cases*, 158 TAX NOTES 72, 73 (2018).

As a result of the decision, tax practitioners are reportedly taking a closer look at penalty assessments and arguing that penalties should be dismissed if the IRS did not follow the requirements of section 6751(b). Caroline Vargas & Courtney Rozen, *Jump in 'Graev' References Pressures IRS on Penalty Assessment*, DAILY TAX REP. (BNA), July 9, 2018, at 6. As evidence of the increasing importance of the issue, the same article reports that the Tax Court cited *Graev* in 28 decisions during the second quarter of 2018, compared with only 10 decisions in the first quarter of the same year. *Id*.

Recent guidance from the IRS's Chief Counsel's Office advises IRS attorneys to submit evidence of compliance with section 6751(b) even if the taxpayer does not raise the issue. Chief Counsel Advice, CC-2018-006 (June 6, 2018), https://www.irs.gov/pub/irs-ccdm/cc%202018%20006.pdf. "Attorneys should not argue that approval of a penalty appearing in a statutory notice of deficiency may be obtained from the Internal Revenue Service after the statutory notice is mailed." *Id*. at 2.

Chapter 14

Page 720:

As noted in the casebook, Code section 6334(a) list classes of property exempt from levy. One of those levy exemptions includes a minimum amount of wage income, the amount of which is based upon the taxpayer's standard deduction and the taxpayer's personal and dependency exemptions. *See* I.R.C. § 6334(b) (before repeal). During those years in which the personal and dependency exemptions are repealed (2018-2025), the amount of the levy exemption for wage income is based upon the sum of the taxpayer's standard deduction plus the total of $4,150 (adjusted for inflation after 2018) multiplied by the number of the taxpayer's dependents for the tax year in which the levy takes place. I.R.C. § 6334(d)(4).

Page 722:

Among the few revisions included in the 2017 Tax Act that relate to tax procedure are changes to the levy and sale procedures. As noted in the casebook, a person other than the delinquent taxpayer whose property was seized by the IRS may bring a civil action in district court for wrongful levy and in the suit seek return of the property or, if the property has already been sold, payment of an amount equal to the value of the property or the sale proceeds, whichever is greater. I.R.C. §§ 7426, 6343(b). The 2017 Tax Act extends the time period by which the wrongly levy action may be filed from 9 months after the date of levy to two years. I.R.C. § 6532(c). Correspondingly, the period of time the IRS has to return proceeds from the sale of wrongfully levied property is also extended from 9 months to two years. I.R.C. § 6343(b).

Chapter 15

Page 766:

Under recently revised guidance, the IRS will now return to the taxpayer the application fee the taxpayer submitted with the offer in compromise request if the IRS determines that the application is not processable. I.R.M. 5.8.2.4.1.1. (revised May 25, 2018). As a general rule, the IRS will also return any down payment the taxpayer submitted with the offer request if the IRS cannot process the application. I.R.M. 5.8.2.6.5. (revised February 9, 2018). However, if the offer is not processable because the taxpayer failed to file previous years' returns, the IRS will retain the down payment and apply it to any outstanding assessed liabilities. I.R.M. 5.8.2.4.1.2 (revised May 25, 2018).

Chapter 16

Page 811:

The citation to Revenue Procedure 2012-14, 2012-1 C.B. 455, should be to Revenue Procedure 2012-18, 2012-1 C.B. 455.

Chapter 20

Page 991:

Revenue Procedure 2018-2, 2018-1 I.R.B. 106, supersedes Revenue Procedure 2017-2, 2017-1 I.R.B. 106, cited in the casebook, without significant revision.