MLI #5 Appeals From Collection Due Process Hearings Under IRC §§ 6320 and 6330

SUMMARY

Collection Due Process (CDP) hearings were created by the IRS Restructuring and Reform Act of 1998 (RRA 98).[1] CDP hearings provide taxpayers with an independent review by the IRS Office of Appeals (Appeals) of the decision to file a Notice of Federal Tax Lien (NFTL) or the IRS's proposal to undertake a levy action. In other words, a CDP hearing gives taxpayers an opportunity for a meaningful hearing before the IRS issues its first levy or immediately after it files its first NFTL with respect to a particular tax liability. At the hearing, the taxpayer has the statutory right to raise any relevant issues related to the unpaid tax, the lien, or the proposed levy, including the appropriateness of the collection action, collection alternatives, spousal defenses, and under certain circumstances, the underlying tax liability.[2]

Taxpayers have the right to judicial review of Appeals' determinations if they timely request the CDP hearing and timely petition the United States Tax Court.[3] Generally, the IRS suspends levy actions during a levy hearing and any judicial review that may follow.[4]

Since 2003, CDP has been one of the federal tax issues most frequently litigated in the federal courts and analyzed in the National Taxpayer Advocate's Annual Reports to Congress. The trend continues this year, with our review of litigated issues finding 105 opinions on CDP cases during the review period of June 1, 2012, through May 31, 2013.[5] Taxpayers prevailed in full in eight of these cases (nearly eight percent) and in part in nine others (nearly nine percent). Of the 17 opinions where taxpayers prevailed in whole or in part, seven taxpayers appeared *pro se* and ten were represented.

The cases discussed below demonstrate that CDP hearings serve an important function by providing taxpayers with a forum to raise legitimate issues before the IRS deprives them of property. Many of these decisions provide guidance on substantive issues. The Court imposed sanctions for inappropriate use of the CDP process in three of the 105 cases reviewed.[6]

PRESENT LAW

Current law provides taxpayers an opportunity for independent review of an NFTL filed by the IRS or of a proposed levy action.[7] As noted above, the purpose of CDP rights is to give taxpayers adequate

1 RRA 98, Pub. L. No. 105-206, § 3401, 112 Stat. 685, 746 (1998).

2 Internal Revenue Code (IRC) §§ 6320(c) (lien) and 6330(c) (levy). IRC § 6320(c) generally requires Appeals to follow the levy hearing procedures under IRC § 6330 for the conduct of the lien hearing, the review requirements, and the balancing test.

3 Internal Revenue Code (IRC) § 6330(d) (setting forth the time requirements for obtaining judicial review of Appeals' determination); IRC §§ 6320(a)(3)(B) and 6330(a)(3)(B) (setting forth the time requirements for requesting a CDP hearing for lien and levy matters, respectively).

4 IRC § 6330(e)(1) provides that generally, levy actions are suspended during the CDP process (along with a corresponding suspension in the running of the limitations period for collecting the tax.). However, IRC § 6330(e)(2) allows the IRS to resume levy actions during judicial review upon a showing of "good cause," if the underlying tax liability is not at issue.

5 For a list of all cases reviewed, see Table 4 in Appendix III, *infra*.

6 The Tax Court imposed penalties for frivolous proceedings under IRC § 6673 in the following three cases: *Klingenberg v. Comm'r*, T.C. Memo. 2012-292; *Mattson v. Comm'r*, 508 F. App'x 653 (9th Cir. 2013); and *Zook v. Comm'r*, T.C. Memo. 2013-128.

7 IRC §§ 6320 and 6330. *See* RRA 98, Pub. L. No. 105-206, § 1001(a), 112 Stat. 685 (1998).

notice of IRS collection activity and a meaningful hearing before the IRS deprives them of property.[8] The hearing allows taxpayers to raise issues relating to collection of the liability, including:

- The appropriateness of collection actions;[9]
- Collection alternatives such as an installment agreement (IA), offer in compromise (OIC), posting a bond, or substitution of other assets;[10]
- Appropriate spousal defenses;[11]
- The existence or amount of the underlying tax liability, but only if the taxpayer did not receive a statutory notice of deficiency or have another opportunity to dispute the liability;[12] and
- Any other relevant issue relating to the unpaid tax, the NFTL, or the proposed levy.[13]

A taxpayer cannot raise an issue considered at a prior administrative or judicial hearing if the taxpayer participated meaningfully in that hearing or proceeding.[14]

Procedural Collection Due Process Requirements

The IRS must provide a CDP notice to the taxpayer after it has filed the first NFTL or generally before its first intended levy for the particular tax and tax period.[15] The IRS must provide the notice not more than five business days after the day of filing the NFTL, or at least 30 days before the day of the proposed levy.[16] If the IRS files a lien, the CDP lien notice must inform the taxpayer of the right to request a CDP hearing within a 30-day period, which begins on the day after the end of the five-business-day period after the filing of the NFTL.[17] In the case of a proposed levy, the CDP levy notice must inform the taxpayer of the right to request a hearing within the 30-day period beginning on the day after the date of the CDP notice.[18]

Requesting a CDP Hearing

Under both lien and levy procedures, the taxpayer must return a signed and dated written request for a CDP hearing within the applicable period.[19] The Code and regulations require taxpayers to provide their reasons for requesting a hearing. Failure to provide the basis may result in denial of a face-to-face hear-

8 Prior to RRA 98, the U.S. Supreme Court had held that a post-deprivation hearing was sufficient to satisfy due process concerns in the tax collection arena. *See U.S. v. National Bank of Commerce*, 472 U.S. 713, 719-722 (1985); *Phillips v. Comm'r*, 283 U.S. 589, 595-601 (1931).

9 IRC § 6330(c)(2)(A)(ii).

10 IRC § 6330(c)(2)(A)(iii).

11 IRC § 6330(c)(2)(A)(i).

12 IRC § 6330(c)(2)(B).

13 IRC § 6330(c)(2)(A); Treas. Reg. §§ 301.6320-1(e) and 301.6330-1(e).

14 IRC §§ 6330(c)(4).

15 IRC § 6330(f) permits the IRS to levy without first giving a taxpayer a CDP notice in the following situations: the collection of tax is in jeopardy, a levy was served on a state to collect a state tax refund, the levy is a disqualified employment tax levy; or the levy was served on a federal contractor. A disqualified employment tax levy is any levy to collect employment taxes for any taxable period if the person subject to the levy (or any predecessor thereof) requested a CDP hearing with respect to unpaid employment taxes arising in the most recent two-year period before the beginning of the taxable period with respect to which the levy is served. IRC § 6330(h).

16 IRC § 6320(a)(2) and §§ 6330(a)(2). The CDP notice can be provided to the taxpayer in person, left at the taxpayer's residence or dwelling, or sent by certified or registered mail (return receipt requested) to the taxpayer's last known address.

17 IRC § 6320(a)(3)(B); Treas. Reg. § 301.6320-1(b)(1).

18 IRC § 6330(a)(3)(B); Treas. Reg. § 301.6320-1(b)(1).

19 IRC §§ 6330(a)(3)(B) and 6320(a)(3)(B); Treas. Reg. §§ 301.6320-1(c)(2)A-C1(ii) and 301.6330-1(c)(2)A-C1(ii).

ing.[20] Taxpayers who fail to timely request a CDP hearing will be afforded an "equivalent hearing," which is similar to a CDP hearing, but without judicial review.[21] Taxpayers must request an equivalent hearing within the one-year period beginning the day after the five-business-day period following the filing of the NFTL, or in levy cases, within the one-year period beginning the day after the date of the CDP notice.[22]

Conduct of a CDP Hearing

The IRS generally will suspend levy action throughout a CDP hearing involving a notice of intent to levy, unless it determines that:

- The collection of tax is in jeopardy;
- The collection resulted from a levy on a state tax refund;
- The IRS has served a disqualified employment tax levy; or
- The IRS has served a federal contractor levy.[23]

The IRS also suspends collection activity throughout any judicial review of Appeals' determination, except if an appeal is pending, the underlying tax liability is not at issue, and the IRS can demonstrate good cause to resume collection activity.[24]

CDP hearings are informal. When a taxpayer requests a hearing with respect to both a lien and a proposed levy, Appeals will attempt to conduct one hearing.[25] Courts have determined that a CDP hearing need not be face-to-face but can take place by telephone or correspondence,[26] and Appeals will conduct the hearing by telephone unless the taxpayer requests a face-to-face conference.[27] The CDP regula-

20 IRC §§6320(b)(1) and 6330(b)(1); Treas. Reg. §§ 301.6320-1(c)(2)A-C1, 301.6330-1(c)(2) A-C1, 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2)A-D8. The regulations require the IRS to provide the taxpayer an opportunity to "cure" any defect in a timely filed hearing request, including providing a reason for the hearing. Form 12153 includes space for the taxpayer to identify collection alternatives that he or she wants Appeals to consider, as well as examples of common reasons for requesting a hearing. *See* IRS Form 12153, *Requests for Collection Due Process or Equivalent Hearing* (Mar. 2011).

21 Treas. Reg. §§ 301.6320-1(i)(2) Q&A-I16 and 301.6330-1(2) Q&A-I16; *Business Integration Services, Inc. v. Comm'r*, T.C. Memo. 2012-342; *Moorhous v. Comm'r*, 116 T.C. 263 (2001). A taxpayer can request an Equivalent Hearing by checking a box on Form 12153, *Request for Collection Due Process or Equivalent Hearing*, by making a written request, or by confirming that he or she wants the untimely CDP hearing request to be treated as an Equivalent Hearing when notified by Collection of an untimely CDP hearing request. Internal Revenue Manual 5.19.8.4.3, *Equivalent Hearing (EH) Requests and timeliness of EH Requests* (Nov. 1, 2007).

22 Treas. Reg. §§ 301.6320-1(i)(2)A-17 and 301.6330-1(i)(2)A-17.

23 IRC § 6330(e)(1) provides the general rule for suspending collection activity. IRC § 6330(f) provides that if collection of the tax is deemed in jeopardy, the collection resulted from a levy on a state tax refund, or the IRS served a disqualified employment tax levy or a federal contractor levy, IRC § 6330 does not apply, except to provide the opportunity for a CDP hearing within a reasonable time after the levy. *See Clark v. Comm'r*, 125 T.C. 108, 110 (2005) (citing *Dora v. Comm'r*, 119 T.C. 356 (2002)).

24 IRC § 6330(e)(1) and (e)(2).

25 IRC § 6320(b)(4).

26 *Katz v. Comm'r*, 115 T.C. 329, 337-38 (2000) (finding that telephone conversations between the taxpayer and the Appeals Officer constituted a hearing as provided in IRC § 6320(b)). Treas. Reg. §§ 301.6320-1(d)(2)A-D6, A-D8 and 301.6330-1(d)(2) A-D6, A-D8.

27 *See, e.g.*, Appeals Letter 4141 (rev. Aug. 2012) (acknowledging the taxpayer's request for a CDP hearing and providing information on the availability of face-to-face conference). The National Taxpayer Advocate has repeatedly raised concerns regarding the inadequacy of Appeals' communication to taxpayers on how to request a face-to-face hearing and where this information is included in the letter. *See* National Taxpayer Advocate 2005 Annual Report to Congress 136 (Most Serious Problem: *Appeals Campus Centralization*); National Taxpayer Advocate 2009 Annual Report to Congress 70 (Most Serious Problem: *Appeals' Efficiency Initiatives Have Not Improved Customer Satisfaction or Confidence in Appeals*); National Taxpayer Advocate 2010 Annual Report to Congress 128 (Most Serious Problem: *The IRS's Failure to Provide Timely and Adequate Collection Due Process Hearings May Deprive Taxpayers of an Opportunity to Have Their Cases Fully Considered*). In response to taxpayers' and their representatives' dissatisfaction with the Appeals' CDP hearings, including the difficulty of receiving a face-to-face hearing, TAS worked with Appeals to test the use of "telepresence" or "virtual" face-to-face hearings. This test began in 2011 between two Low Income Taxpayer Clinics and two campus Appeals units and is ongoing. For a further discussion, see Status Update: *The IRS Has Made Significant Progress in Delivering Virtual Face-to-Face Service and Should Expand Its Initiatives to Meet Taxpayer Needs and Improve Compliance*, *supra*.

tions state that taxpayers who provide non-frivolous reasons for opposing the IRS collection action will generally be offered but not guaranteed face-to-face conferences.[28] Taxpayers making frivolous arguments are not entitled to face-to-face conferences.[29] A taxpayer will not be granted a face-to-face conference concerning a collection alternative, such as an installment agreement (IA) or offer in compromise (OIC), unless other taxpayers would be eligible for the alternative under similar circumstances.[30] For example, the IRS will not grant a face-to-face conference to a taxpayer who proposes an OIC as the only issue to be addressed but has failed to file all required returns and is therefore ineligible for an offer. Appeals may, however, at its discretion, grant a face-to-face conference to explain the eligibility requirements for a collection alternative.[31]

The CDP hearing is to be held by an impartial officer from Appeals, who is barred from engaging in *ex parte* communication with IRS employees about the substance of the case and who has had "no prior involvement" in the case.[32] In addition to addressing the issues raised by the taxpayer, the Appeals Officer must verify that the IRS has met the requirements of all applicable laws and administrative procedures.[33] In its determination, Appeals must weigh the issues raised by the taxpayer and decide whether the proposed collection action "balances the need for efficient collection of taxes with the legitimate concern of the taxpayer that any collection be no more intrusive than necessary."[34]

Special rules apply to the IRS's handling of hearing requests that raise frivolous issues. IRC § 6330(g) provides that the IRS may disregard any portion of a hearing request based on a position the IRS has identified as frivolous, or that reflects a desire to delay or impede the administration of tax laws.[35] Similarly, IRC § 6330(c)(4) provides that a taxpayer cannot raise an issue if it is based on a position identified as frivolous or reflects a desire to delay or impede tax administration.

IRC § 6702(b) allows the IRS to impose a penalty for a specified frivolous submission, including a frivolous CDP hearing request.[36] A request is subject to the penalty if any part of it "(i) is based on a position which the Secretary has identified as frivolous…or (ii) reflects a desire to delay or impede the administration of the Federal tax laws."[37] In *Thornberry v. Commissioner*, the Tax Court held that if Appeals determines a request for an administrative hearing is based entirely on a frivolous position under IRC § 6702(c), and issues a notice stating that Appeals will disregard the request, the Tax Court does have jurisdiction to review Appeals' decision if the taxpayer timely petitions for review. The court found

28 Treas. Reg. § 301.6320-1(d)(2) A-D8.

29 Treas. Reg. §§ 301.6320-1(d)(2) A-D7 and 301.6330-1(d)(2) A-D8.

30 Treas. Reg. §§ 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2) A-D8.

31 Treas. Reg. §§ 301.6320-1(d)(2) A-D8 and 301.6330-1(d)(2) A-D8.

32 IRC §§ 6320(b)(1), 6320(b)(3), 6330(b)(1) and 6330(b)(3). *See also* Rev. Proc. 2012-18, 2012-1 C.B. 455. *See, e.g., Industrial Investors v. Comm'r*, T.C. Memo. 2007-93; *Moore v. Comm'r*, T.C. Memo. 2006-93, *action on dec.*, 2007-2 (Feb. 27, 2007); *Cox v. Comm'r*, 514 F.3d 1119, 1124-28 (10th Cir. 2008), *action on dec.*, 2009-22 (June 1, 2009).

33 IRC § 6330(c)(1); *Hoyle v. Comm'r*, 131 T.C. 197 (2008).

34 IRC § 6330(c)(3)(C).

35 IRC § 6330(g). Section 6330(g) is effective for submissions made and issues raised after the date on which the IRS first prescribed a list of frivolous positions. Notice 2007-30, 2007-1 C.B. 883, which was published on or about April 2, 2007, provided the first published list of frivolous positions. Notice 2010-33, 2010-17 C.B. 609, contains the current list.

36 The frivolous submission penalty applies to the following submissions: CDP hearing request, OIC, IA, and application for a Taxpayer Assistance Order.

37 IRC § 6702(b)(2)(a). Before asserting the penalty, the IRS must notify the taxpayer that it has determined that the taxpayer filed a frivolous hearing request. The taxpayer then has 30 days to withdraw the submission to avoid the penalty.

Appeals' letter disregarding the hearing request was a determination conferring jurisdiction under IRC § 6330(d)(1) because it authorized the IRS to proceed with the disputed collection action.[38]

Judicial Review of CDP Determination

Within 30 days of Appeals' determination, the taxpayer may petition the Tax Court for judicial review.[39] The Tax Court will only consider issues, including challenges to the underlying liability, that were properly raised during the CDP hearing.[40] An issue is not properly raised if the taxpayer fails to request Appeals consideration of the issue or the taxpayer requests consideration but fails to present any evidence regarding that issue after being given a reasonable opportunity.[41] The Tax Court, however, may remand a case back to Appeals for more fact finding when the taxpayer's factual circumstances have materially changed between the hearing and the trial.[42] When the case is remanded, the Tax Court retains jurisdiction.[43] The resulting hearing on remand provides the parties with an opportunity to complete the initial hearing while preserving the taxpayer's right to receive judicial review of the ultimate administrative determination.[44]

Where the validity of the underlying tax liability is properly at issue in the hearing, the court will review the amount of the tax liability on a *de novo* basis.[45] Where the Tax Court is reviewing the appropriateness of the collection action or subsidiary factual and legal findings, the court will review these determinations under an abuse of discretion standard.[46]

ANALYSIS OF LITIGATED CASES

We identified and reviewed 105 CDP court opinions, a nine percent decrease from the 116 cases in last year's report. As shown in the chart below, litigation of CDP cases considered by the court has been averaging about 110 cases per year over the past four years since 2010. The 105 opinions identified this year do not reflect the full number of CDP cases because the court does not issue an opinion in all cases. Some are resolved through settlements, and in other cases taxpayers do not pursue litigation after filing a petition with the court. The Tax Court also disposes of some cases by issuing unpublished orders. Table 5 in Appendix III provides a detailed list of the CDP opinions, including specific information about the issues, the types of taxpayers involved, and the outcomes of the cases.

38 *Thornberry v. Comm'r*, 136 T.C. 356 (2011). The Office of Chief Counsel disagrees with the *Thornberry* holding and will continue to file motions to dismiss for lack of jurisdiction if the taxpayer petitions for Tax Court review of a denial, under § 6330(g), of a CDP hearing request that was determined to be based on a frivolous position. See Chief Counsel Directives Manual (CCDM) 35.3.23.5.1, *Motion to Dismiss for Lack of Jurisdiction When CDP Hearing Request Denied Under Section 6330(g)* (July 25, 2012).

39 IRC § 6330(d)(1).

40 *Giamelli v. Commissioner*, 129 T.C. 107 (2007).

41 Treas. Reg. §§ 301.6320-1(f)(2) Q&A-F3, 301.6330-1(f)(2) Q&A-F3.

42 *Churchill v. Commissioner*, T.C. Memo. 2011-182; *see also* CCN-2013-002 (Nov. 30, 2012), which provides Counsel attorneys with instructions on when a remand based on changed circumstances might be appropriate.

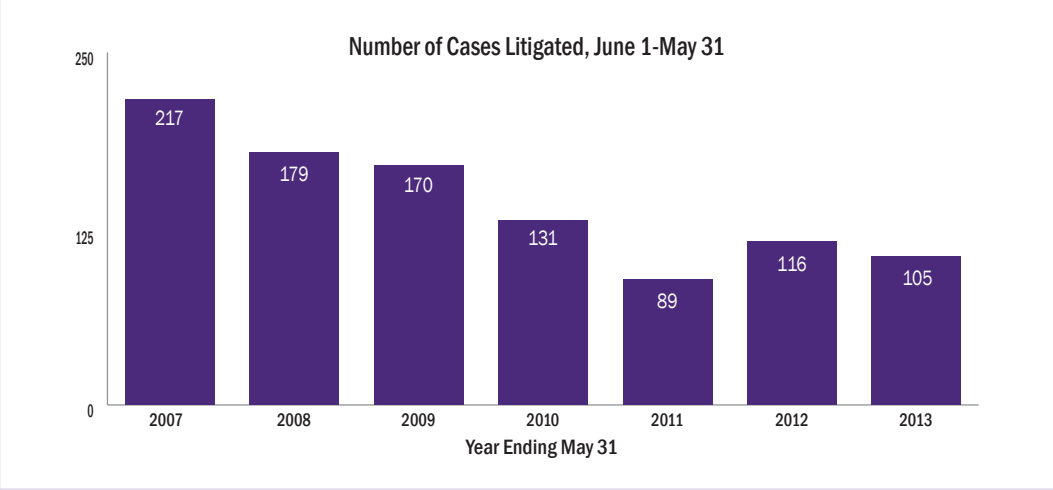
43 *Pomeroy v. Comm'r*, T.C. Memo 2013-26.

44 *Wadleigh v. Commissioner*, 134 T.C. 280, 299 (2010).

45 The legislative history of RRA 98 addresses the standard of review courts should apply in reviewing Appeals' CDP determinations. H.R. Rep. No. 1059-99, at 266 (Conf. Rep.). The term *de novo* means anew. *Black's Law Dictionary*, 447 (7th Ed. 1999).

46 *See, e.g., Murphy v. Comm'r*, 469 F.3d 27 (1st Cir. 2006); *Dalton v. Comm'r*, 682 F.3d 149 (1st Cir. 2012).

FIGURE 3.5.1, CDP Cases Litigated Between 2007 and 2013[47]



Litigation Success Rate

Taxpayers prevailed in full in eight of the 105 cases brought during the year ending May 31, 2013 (nearly eight percent).[48] Taxpayers prevailed in part in nine other cases (nearly nine percent). Of the cases in which the courts found for the taxpayer in whole or in part, the taxpayers appeared *pro se* in seven cases and were represented in ten others. The IRS prevailed fully in 84 percent of cases, the lowest percentage since 2003 when CDP first appeared as a Most Litigated Issue in the Annual Report to Congress.

FIGURE 3.5.2, Success Rates in CDP Cases[49]

Court Decision	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Decided for IRS	96%	95%	89%	90%	92%	90%	92%	89%	92%	86%	84%
Decided for Taxpayer	1%	4%	8%	8%	5%	8%	4%	10%	3%	7%	8%
Split Decision	3%	1%	3%	2%	3%	2%	4%	2%	3%	6%	9%
Neither	N/A	N/A	N/A	N/A	Less than 1%	N/A	N/A	N/A	1%	Less than 1%	N/A

47 National Taxpayer Advocate 2007 Annual Report to Congress 569; National Taxpayer Advocate 2008 Annual Report to Congress 476; National Taxpayer Advocate 2009 Annual Report to Congress 418; National Taxpayer Advocate 2010 Annual Report to Congress 436; National Taxpayer Advocate 2011 Annual Report to Congress 619; National Taxpayer Advocate 2012 Annual Report to Congress 595.

48 *Antioco v. Comm'r*, T.C. Memo. 2013-35; *ENSYC Technologies v. Comm'r*, T.C. Summ. Op. 2012-55; *Fielder v. Comm'r*, T.C. Memo. 2012-284; *JAG Brokerage v. Comm'r*, T.C. Memo. 2012-315; *Jones v. Comm'r*, T.C. Memo. 2012-274; *Lane v. Comm'r*, T.C. Memo. 2013-121; *Lepore v. Comm'r*, T.C. Memo. 2013-135; *Moore v. Comm'r*, T.C. Summ. Op. 2012-116; *Pomeroy v. Comm'r* T.C. Memo. 2013-26.

49 Numbers have been rounded to nearest percentage and may not add to 100% due to rounding. A "split" decision refers to a case with multiple issues where both the IRS and the taxpayer prevail on one or more substantive issues. A "neither" decision refers to a case where the court's decision was not in favor of either party.

Issues Litigated

The cases discussed below are those the National Taxpayer Advocate considers significant or noteworthy. Their outcomes can provide important information to Congress, the IRS, and taxpayers about the rules and operation of CDP hearings. Equally important, all of the cases offer the IRS an opportunity to improve the CDP process, and collection practices in general, in both application and execution.

Dalton v. Commissioner

In *Dalton v. Commissioner*,[50] the United States Court of Appeals for the First Circuit decided the proper standard of review with respect to subsidiary legal and factual findings made by Appeals during the CDP process. In this case, the taxpayers (husband and wife) owned and operated a construction business that failed to pay its payroll taxes. The business went bankrupt, and the IRS assessed trust fund recovery penalties (TFRPs) under IRC § 6672 against the taxpayers for the unpaid taxes, which with interest exceeded $400,000. When the IRS sent the taxpayers a CDP levy notice, they requested a CDP hearing, at which they requested an OIC based on doubt as to collectibility and proposed to pay $10,000 to fully settle the liabilities.[51] The Appeals Officer (AO) rejected the offer because it did not include the value of property held by a trust. The AO included the trust property when calculating an acceptable offer amount because the AO concluded the trust was the nominee of the taxpayer. The taxpayers argued they held no legal interest in the trust property and appealed to the Tax Court.

The Tax Court initially remanded the case to Appeals with the instruction that the nominee question be reconsidered under state law principles.[52] On remand, Appeals issued a supplemental Notice of Determination (NOD) concluding again that the trust was the nominee of the taxpayers, as a Maine court would likely borrow nominee principles from federal law, and again rejected the taxpayers' OIC. The Tax Court reviewed the AO's supplemental determination to include the trust property when evaluating the OIC under a *de novo* standard. It found in analyzing the state law that the taxpayers were not the owners of the trust property and thus held that the AO's supplemental determination to proceed with the levy was an abuse of discretion.[53]

The IRS appealed the Tax Court's decision to the First Circuit, which reversed the Tax Court's decision, holding that the proper standard of review with respect to subsidiary factual and legal determinations made by Appeals during the CDP process is abuse of discretion, not *de novo*. The First Circuit reasoned that the Tax Court should not review Appeals' factual and legal determinations anew under the *de novo* standard but should instead should just analyze whether Appeals' subsidiary determinations are reasonable.

Under this more deferential standard of review, the Court found that Appeals did not abuse its discretion when it rejected the OIC based on its legal finding that the trust property was the property of the taxpayer. It found the IRS's determination that the trust was a nominee was reasonable based on the

50 682 F.3d 149 (1st Cir. 2012).

51 An OIC is an agreement between a taxpayer and the government that settles a tax liability for payment of less that the full amount the IRS believes is owed. IRC § 7122. There are several grounds for an OIC, doubt as to collectibility, doubt as to liability, and effective tax administration. Doubt as to collectibility exists when the taxpayer's assets and income are less than the liability. Treas. Reg. § 301.7122-1(b).

52 *Dalton v. Comm'r*, T.C. Memo 2008-165.

53 *Dalton v. Comm'r*, 135 T.C. 393 (2010).

facts known by Appeals at the time of the hearing. Significant facts cited by the IRS that supported the nominee finding included the following:

- The taxpayers received only one dollar at the property's sale to the grantor of the trust;
- The taxpayers continued to maintain sole possession without payments of rent;
- The trust beneficiaries were the taxpayers' children; and
- The taxpayers paid the mortgage and property taxes.

Finally, the First Circuit reiterated that Congress intended CDP hearings to be informal, including the investigation of facts. In light of the informalities of the CDP hearings, the First Circuit held that a reviewing court's objective should be to evaluate the reasonableness of Appeals' subsidiary determination. As long as Appeals has reached a reasonable conclusion on questions of fact and law during the CDP process, Appeals has not abused its discretion.[54]

Antioco v. Commissioner

In *Antioco v. Commissioner*,[55] a 71-year-old taxpayer sold her primary residence, which doubled as a bed and breakfast, to pay marital debts following a divorce. The taxpayer received her portion of the sale proceeds, which were substantial, and used these proceeds (believing the sale of the residence was exempt from tax) as a down payment to purchase a five-unit apartment building. The taxpayer lived in one unit, used a second unit to house her 96-year-old mother, and rented the three others. Learning later that she was obliged to report the income, she did so in August 2008, but without remitting payment.

In response to the CDP levy notice, the taxpayer requested a CDP hearing and offered to pay $1,000 a month until she could refinance the building to satisfy the tax. The taxpayer was experiencing difficulty in securing an agreement to refinance because her income was too low. Since her elderly mother was suffering from health issues and the taxpayer relied on rental income to survive, she argued that the levy would create an "economic hardship" for them both. Nevertheless, Appeals issued an NOD sustaining the proposed levy action and rejecting the taxpayer's proposal for an installment agreement due to failure to submit a new financial information statement. The taxpayer sought Tax Court review of the NOD.

Prior to trial, the Commissioner requested, and was granted, a motion to remand the case. At that time, the Commissioner conceded the AO had abused her discretion by not asking for revised financial forms and by not addressing the taxpayer's "economic hardship" argument.[56]

On remand, a new AO issued a supplemental NOD sustaining the proposed levy on the basis that the taxpayer could afford to pay her tax liabilities. The AO alleged the taxpayer committed fraud when she subsequently put her mother's name on the apartment building's deed to meet the terms of a refinancing agreement. The AO also alleged the taxpayer had deliberately transferred all her equity in the building to

54 As of the writing of this report, *Dalton* has been cited in ten decisions as well as two amicus briefs. Reactions to the *Dalton* decision are mixed. *See* Susan Simmons, *First Circuit Uses New Standard in CDP Case*, 136 Tax Notes 159 (July 9, 2012) ("The First Circuit appears to have broken new ground in applying a reasonableness standard to findings of law in CDP determinations. Whether that's helpful or reasonable remains to be seen."). *See also* Adam Cole, *Student Case Note: A Preference for Deference: The Benefits of the First Circuit's Customized Standard of Review for Collection Due Process Appeals in Dalton v. Commissioner*, 58 Vill. L. Rev. 239 (2013) (arguing that the First Circuit reached the correct result because the Dalton standard of review increases efficiency and fairness, and is consistent with the purpose of CDP).

55 T.C. Memo. 2013-35.

56 T.C. Memo. 2013-35 at 3.

her ailing mother by including her on the deed. Additionally, the AO refused to consider the taxpayer's "economic hardship" argument, labeling the issue of her 96-year-old mother a "diversionary argument."[57]

The Tax Court could not uphold the supplemental NOD on any of the stated grounds and found the AO had abused his discretion in sustaining the proposed levy. The court found the AO's determination was not supported by the administrative record and the AO drew conclusions of fraud without performing an insolvency analysis. The Tax Court found an abuse of discretion in that the AO failed to consider the economic hardship argument and failed to ask the taxpayer to submit revised financial forms, which the court had ordered. The court remanded the case for a second time and instructed the AO to consider the taxpayer's revised financial information, proposed installment agreement, special circumstances, and "economic hardship" claims.

Pomeroy v. Commissioner

In *Pomeroy v. Commissioner*,[58] the taxpayers (husband and wife) timely requested a CDP hearing in response to the CDP lien notice. In their hearing request, the taxpayers stated they planned to submit an offer in compromise to settle their tax liabilities. The taxpayers then submitted an OIC based on doubt as to collectibility offering to settle the debt for $25,000. After the OIC was sent to the centralized offer unit (COIC), the taxpayers notified the offer examiner that the husband had suffered a severe stroke and was on his deathbed. The examiner responded by asking the taxpayers to provide more information, including a doctor's written prognosis, if they wanted the medical condition to be considered in the OIC review. The taxpayers submitted additional documentation stating a doctor's prognosis was forthcoming. However, because the examiner did not receive the documentation within ten days of the request, she determined that the taxpayers could fully pay and returned the case to Appeals. Upon receiving the new documentation, Appeals assigned a Settlement Officer (SO) to review the OIC. The SO issued a NOD approving the examiner's calculations, rejecting the OIC, and sustaining the NFTL filing.

The taxpayers appealed to the Tax Court and argued, among other things, that the husband's medical condition qualified them for an OIC based on effective tax administration (ETA) even though the taxpayers had submitted the OIC based on doubt as to collectibility.[59] In particular, the taxpayers argued that Appeals did not properly consider Mr. Pomeroy's stroke when determining whether the taxpayers could full pay. The court found that because the administrative record was incomplete with regard to the husband's medical condition, it could not determine whether Appeals abused its discretion when it rejected the OIC and remanded the case so the record could be supplemented. The Tax Court also noted that the SO did not make adequate efforts to ascertain the current status of the taxpayer husband's health or his prognosis. The case was remanded to the Appeals Office to supplement the record accordingly.

Brombach v. Commissioner

In *Brombach v. Commissioner*,[60] the IRS filed an NFTL and sent the taxpayer a CDP lien notice. The taxpayer timely requested a CDP hearing and proposed an OIC in which he would pay $28,000 in full

57 T.C. Memo. 2013-35 at 4.

58 T.C. Memo. 2013-26.

59 An ETA offer may be entered into when the IRS determines that although collection in full is possible, it would cause the taxpayer economic hardship or where public policy or equity considerations support compromise. Treas. Reg. § 301.7122-1(b).

60 T.C. Memo. 2012-265.

settlement of his tax liabilities, which exceeded $150,000. The taxpayer explained in a letter submitted with the OIC that his monthly expenses exceeded the national standards the IRS adopted, pointing to a number of "special circumstances." The AO rejected this offer, finding no special circumstances making the offer acceptable.

The Tax Court, in determining whether the IRS abused its discretion in rejecting the taxpayer's OIC, considered the IRS's "reasonable collection potential" (RCP) calculations. The court held that the IRS did not abuse its discretion in determining that taxpayer's interest in motorcycles, which he jointly owned with his wife, was half the motorcycles' realizable value; in allowing housing expenses less than the taxpayer claimed; or in determining that no special circumstances existed to require acceptance of the OIC. The Tax Court agreed in part that the IRS abused its discretion in estimating the taxpayer's monthly tax expenses, using an unusually short payout period. Despite this mistake, the Tax Court held the proposed offer of $28,000 was still lower than the taxpayer's RCP and therefore Appeals did not abuse its discretion in rejecting the OIC.

Cantrell v. Commissioner

In *Cantrell v. Commissioner*,[61] the taxpayer requested a CDP hearing after receiving a CDP lien and levy notice relating to tax year 2001. After requesting the hearing, the taxpayer filed an amended 2001 tax return. The AO provided the taxpayer with a payoff amount to settle his tax liabilities based on the amended return. The taxpayer provided the AO with a check for that amount, but the AO forwarded the amended return to a Revenue Agent who then informed the taxpayer that the return was under examination. Ultimately, the Revenue Agent sent the amended return back to the AO with the recommendation that it be rejected. The AO then issued a notice of determination sustaining the NFTL filing and the proposed levy. In response, the taxpayer filed a petition with the Tax Court, arguing that his prior payment by check, which he presented to the AO, should have settled his entire liabilities for 2001.

The Tax Court noted that only authorized agents or officials representing the Commissioner are empowered to enter into settlement agreements, and AOs are not authorized agents for these purposes. Thus, the court determined the AO's acceptance of the check did not settle the taxpayer's liability. The court reviewed the underlying liability *de novo*, since the taxpayer did not receive a notice of deficiency or otherwise have an opportunity to contest the liability. The court found the petitioner failed to provide documentation to support the deductions claimed on the amended return. Thus, the IRS did not abuse its discretion in deciding to proceed with the proposed collection actions.

Hinerfeld v. Commissioner

In *Hinerfeld v. Commissioner*,[62] the taxpayer sought Tax Court review of Appeals' determination to sustain a proposed levy. The taxpayer, a corporate officer, owed TFRPs stemming from various unpaid quarterly employment tax periods for Thermacon Industries, Inc. (Thermacon).[63] During the CDP hearing, the SO indicated she would accept the taxpayer's amended OIC, because it proposed to pay the amount that the SO calculated as the taxpayer's RCP. However, the OIC was subject to review by Area Counsel as

61 T.C. Memo. 2012-257.

62 139 T.C. 277 (2012).

63 The taxpayer did not dispute the liability. The quarterly periods owed were for the quarters ending September 30 and December 31, 2002; March 31, September 30, and December 31, 2003; and June 30, 2004.

prescribed in IRC § 7122(b) for OICs made in cases with tax assessments of $50,000 or more.[64] Area Counsel's review discovered the taxpayer was involved in pending litigation over asset transfers from Thermacon to corporations owned by the taxpayer's immediate family. The complaint filed in this litigation alleged the taxpayer and his wife made fraudulent conveyances that left Thermacon unable to pay its creditors.[65] Since the assets transferred were valued at $2.2 million, the taxpayer made conflicting statements, and since the wife was suspected of serving as the taxpayer's nominee, Area Counsel recommended the SO reject the taxpayer's amended OIC. The SO's manager agreed and notified the taxpayer that his account could be placed in "currently not collectible" (CNC) status until the litigation was resolved. The taxpayer disagreed with Appeals' determination to reject the OIC and petitioned the Tax Court.

The taxpayer argued that Appeals participated in prohibited *ex parte* communications with Area Counsel. The court analyzed administrative guidelines prohibiting certain *ex parte* communications and found in favor of the IRS. First, the court determined that the *ex parte* communications did not fall within the limitations prescribed in Rev. Proc. 2000-43,[66] because there was some evidence the Appeals manager had exercised independent judgment in rejecting the offer. Second, the court found the Area Counsel's *ex parte* communications were mandated by statute under IRC § 7122(b). The court reviewed original legislative intent to reconcile IRC § 1001(a)(4)[67] and IRC § 7122(b). It concluded the *ex parte* communications in this instance fulfilled supervisory responsibilities and were therefore not prohibited. Finally, the court found no abuse of discretion because it concluded no undue influence was exerted by Area Counsel over Appeals during its independent review of the case and found all procedures were properly followed.

Imposition of Sanctions

IRC § 6673(a)(1) authorizes the Tax Court to impose sanctions when it appears the taxpayer instituted or maintained proceedings primarily for delay or when the taxpayer's position is frivolous or groundless.[68] As we found in last year's analysis, the court imposed these penalties in only a few CDP cases. Of the 105 cases reviewed this year, the court imposed sanctions in only three, or approximately three percent.[69] Last year, with 116 CDP cases decided, the court imposed sanctions in eight cases, or seven percent.[70] This low number may be attributable to IRC § 6330(g), which allows the IRS to disregard a frivolous hearing request.

64 Section 7122(b) provides that if the Secretary makes a compromise in a civil case in which the unpaid amount of the tax assessed is $50,000 or more, an opinion of the General Counsel for the Department of the Treasury, or his delegate, shall be placed on file in the office of the Secretary. *See also* Treas. Reg. 301.7122-1(e)(6); CCDM 33.3.2.1(2), *Authority to Compromise* (Nov. 4, 2010).

65 Area Counsel discovered that the taxpayer and his wife were named as codefendants in a lawsuit filed in the U.S. District Court for the District of New Jersey on Oct. 2, 2007. The pending lawsuit, *Multi-Glass Atlantic, Inc. v. Alnor Assocs., LLC*, No. 1:07-cv-04760 (D.N.J. filed Oct. 2, 2007), concerned the sale of substantially all of Thermacon's assets pursuant to an asset purchase agreement the taxpayer signed on Thermacon's behalf on September 13, 2004, to Reelan Industries, Inc., a corporation wholly owned by the taxpayer's children and RJTL, Inc., a corporation wholly owned by Ruth Hinerfeld and the taxpayer's children.

66 The taxpayer cited Rev. Proc. 2000-43, 2000-2 C.B. 404 (superseded by Rev. Proc. 2012-12, 2012-10 I.R.B. 455, effective after May 15, 2012.) Rev. Proc. 2000-43, Q&A-11, 2000-2 C.B. at 406, specifically addresses communications between Appeals and the Office of Chief Counsel, A-11 provides three limitations on communications between Appeals employees and Office of Chief Counsel attorneys: (1) Appeals employees must not communicate with Chief Counsel attorneys who have previously provided advice to the IRS employees who made the determination Appeals is reviewing; (2) requests for legal advice where the answer is uncertain should be referred to the Chief Counsel's National Office and handled as requests for field service advice or technical advice; and (3) although Appeals employees may obtain legal advice from the Office of Chief Counsel, they remain responsible for making independent evaluations and judgments concerning the cases appealed to them, and Counsel attorneys are prohibited from offering advice that includes settlement ranges for any issues in an appealed case.

67 RRA 98, Pub. L. No. 105-206, § 1001(a)(4), 112 Stat. 685, 689 (1998). RRA 98 § 1001(a)(4) states, "ensure an independent appeals function within the Internal Revenue Service, including the prohibition in the plan of ex parte communications between appeals officers and other Internal Revenue Service employees to the extent that such communications appear to compromise the independence of the appeals officers."

68 *See* Most Litigated Issue: *Frivolous Issues Penalty Under IRC § 6673 and Related Appellate Level Sanctions*, *infra*

69 *Klingberg v. Comm'r*, T.C. Memo. 2012-292; *Mattson v. Comm'r*, 508 F. App'x 653 (9th Cir. 2013); *Zook v. Comm'r*, T.C. Memo. 2013-128.

70 National Taxpayer Advocate 2012 Annual Report to Congress 608.

Pro Se *Analysis*

Pro se taxpayers (those without the benefit of counsel) litigated 70 (or 67 percent) of the 105 cases brought before the Tax Court, a decrease from the previous year. Table 3.5.3 shows the breakdown of *pro se* and represented cases and the decisions rendered by the court indicating that 17 taxpayers, represented or unrepresented (or about 16 percent of the 105 cases), received some relief on judicial review.

FIGURE 3.5.3, *Pro Se* and Represented Taxpayer Cases and Decisions[71]

	Pro Se Taxpayers		Represented Taxpayers	
Court Decisions	Volume	Percentage of Total	Volume	Percentage of Total
Decided for IRS	63	90%	25	71%
Decided for Taxpayer	2	3%	6	17%
Split Decisions	5	7%	4	11%
Totals	**70**		**35**	

CONCLUSION

CDP hearings provide an invaluable opportunity for taxpayers to meaningfully address the appropriateness of IRS collection actions. Given the important protection that CDP hearings offer, it is unsurprising that CDP remains one of the most frequently litigated issues.

The opinions reviewed this year suggest the communication process between the taxpayer and the Appeals Officers occasionally breaks down. For example, in one case, the taxpayer did not provide the requested documentation.[72] In another, the taxpayer provided the documentation but it was not timely, and once associated with the case was not fully considered.[73] In a third case, the AO did not request the documentation needed, including revised financial documentation.[74] As illustrated by these cases, when the facts of the case are not sufficiently developed, the taxpayer may not obtain the collection alternative or liability determination that he or she would be eligible for if all the facts were known.

The First Circuit set forth a new standard for Tax Court review of Hearing Officers' determinations of law, ruling that they can only be reversed for abuse of discretion.[75] In *Dalton v. Commissioner*, the court found no abuse of discretion where the Hearing Officer made a "reasonable" conclusion based on the facts known, regardless of whether that conclusion was legally correct.

As discussed in the Most Serious Problem on Collection Due Process, communication improvements need to be made in the collection process from its inception.[76] Taxpayers should have an opportunity to work with Collection employees and provide documentation to support their ability to pay before the IRS sends a CDP lien or levy notice, because it is better for both the taxpayer and the government to resolve

71 Due to rounding, the percentages may not add up to exactly 100 percent.

72 *See, e.g., Cantrell v. Comm'r*, T.C. Memo 2012-257.

73 *See, e.g., Pomeroy v. Comm'r*, T.C. Memo. 2013-26.

74 *See, e.g., Antioco v. Comm'r*, T.C. Memo 2013-35.

75 682 F.3d 149 (1st Cir. 2012).

76 See Most Serious Problem: *Collection Due Process Hearings: Current Procedures Allow Undue Deference to Collection Decisions and Fail to Give the Taxpayer a Fair and Impartial Hearing*, *supra*.

the tax debt as early as possible. Some cases, however, will not be resolved before CDP rights are provided. Thus, to make CDP hearings more valuable for taxpayers, Appeals Officers and Settlement Officers may need to make special efforts to ensure that taxpayers know what documentation to provide, are given an opportunity to provide the documentation, and are encouraged to do so.

Virtual CDP hearings might also improve the process. Appeals conducts CDP hearings by telephone as a default if the taxpayer does not request a face-to-face meeting. However, a single telephone conversation may not be the best way for Appeals employees to communicate to taxpayers what documentation they need and to ensure taxpayers understand what the IRS is asking of them. The use of virtual face-to-face (VFTF) service should be explored in greater depth. Expansion of VFTF service could give taxpayers visual interaction with an AO in CDP hearings and break down some of the current communication barriers, so taxpayers fully understand what Appeals has asked for and can provide all applicable information. In addition, the increased interaction between the taxpayer and Appeals employee during a virtual meeting could encourage the employee to ask for further information based on the issues raised and documents viewed during the conversation. In several cases this year, Appeals denied a collection alternative because the taxpayer did not provide the information requested. Virtual hearings may enable Appeals to gather more relevant information that would not otherwise be presented if the hearing was conducted by telephone.

In sum, changes are needed both before the IRS sends a CDP notice and while a case is open. If taxpayers provide the full documentation to prove their cases, the IRS can make determinations on collection cases that better take into account the taxpayer's facts and circumstances.