SIGNIFICANT CASES

This section describes cases that generally do not involve any of the ten most litigated issues, but nonetheless highlight important issues relevant to tax administration.[1] These decisions are summarized below.

In *King v. Burwell*, the Supreme Court upheld Treasury regulations that provide a Premium Tax Credit to individuals who obtain health insurance through a federally-facilitated exchange.[2]

Virginia residents who did not want to purchase health insurance or pay a penalty (under Internal Revenue Code (IRC) § 5000A) filed suit. They challenged the validity of Treasury Regulations that grant a health insurance Premium Tax Credit, as applied to residents of states that did not set up their own exchanges.[3] If the regulations were invalid, the plaintiffs would be ineligible for the credit. Without the credit, the plaintiffs would not be required to purchase insurance because they would qualify for the exception applicable to low income taxpayers without access to affordable insurance.[4]

By statute, the Premium Tax Credit is only available to offset premiums available "through an Exchange established by the State."[5] The Commonwealth of Virginia has not established a state-run health insurance exchange and is therefore served by the federally-facilitated exchange (*i.e.*, HealthCare.gov). The plaintiffs allege that the related regulations are invalid because they authorize credits not only for people using "an Exchange established by the State," but also for people using the federally-facilitated exchange.[6]

The district court upheld the regulations and granted the government's motion to dismiss.[7] The United States Court of Appeals for the 4th Circuit affirmed, citing *Chevron*.[8] Under *Chevron*, courts generally defer to an agency's interpretation of ambiguous statutory language.[9]

The Supreme Court affirmed but did not defer to the IRS under *Chevron*. It concluded that the statutory language was ambiguous, but that Congress did not intend to delegate a decision of such deep "economic

1 When identifying the ten most litigated issues, TAS analyzed federal decisions issued during the period beginning on June 1, 2014, and ending on May 31, 2015. For purposes of this section, we generally used the same period, except that we included two Supreme Court decisions issued shortly thereafter and one circuit court decision that directly affects TAS.

2 *King v. Burwell*, 135 S. Ct. 2480 (June 25, 2015), *aff'g* 759 F.3d 358 (4th Cir. 2014), *aff'g sub. nom. King v. Sebelius*, 997 F. Supp. 2d 415 (E.D. Va. 2014).

3 *See generally* Treas. Reg. § 1.36B–2.

4 Low income individuals for whom the annual "cost of coverage" exceeds eight percent of their projected household income are not subject to a penalty for failing to purchase health insurance. IRC § 5000A(e)(1)(A). Under this rule, the cost of coverage may be reduced by the Premium Tax Credit. IRC § 5000A(e)(1)(B)(ii).

5 IRC §§ 36B(b)(2), 36B(c)(2)(A)(i).

6 Treas. Reg. § 1.36B–2 provides that credits shall be available to anyone "enrolled in one or more qualified health plans through an Exchange," and Treas. Reg. § 1.36B-1(k) adopts, by cross-reference, a Health and Human Services (HHS) definition of "Exchange" that includes any Exchange, "regardless of whether the Exchange is established and operated by a State … or by HHS." 45 C.F.R. § 155.20.

7 *King v. Burwell*, 997 F. Supp. 2d 415 (E.D. Va.2014).

8 *King v. Burwell*, 759 F.3d 358 (4th Cir. 2014).

9 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). On the same day that the 4th Circuit issued its opinion, a panel of the Court of Appeals for the District of Columbia Circuit struck down the regulations, creating a split among the circuits. *Halbig v. Burwell*, 758 F.3d 390 (D.C. Cir. 2014). The Court of Appeals for the District of Columbia later agreed to rehear the case *en banc* and vacated its original decision eliminating the split. *Halbig v. Burwell*, 114 A.F.T.R.2d (RIA) 5868 (2014).

and political significance" to the IRS.[10] Additionally, it noted that the IRS had no particular expertise in crafting health insurance policy to which courts should defer.

Instead, the Court searched for a meaning compatible with the structure and purpose of the law. It noted that the petitioner's literal interpretation could result in the failure of the legislation. It found that Congress intended the Premium Tax Credit to apply broadly, to both state and federal exchanges to maximize insurance coverage. The Court therefore held that Premium Tax Credits are available to individuals purchasing insurance through the federally-facilitated exchange.[11]

This case is significant because those purchasing health insurance through the federally-facilitated exchange will continue to receive tax credits. It is also significant because the Court suggested that Treasury Regulations may not be entitled to *Chevron* deference when they interpret the ACA or other important non-tax laws in areas where the IRS does not have substantive expertise.

In *Obergefell v. Hodges*, the Supreme Court held that states must allow same-sex couples to marry and recognize same-sex marriages performed in other states.[12]

Various district courts held that the state laws in Michigan, Tennessee, Ohio, and Kentucky, which defined marriage as between one man and one woman, violated the U.S. Constitution. The U.S. Court of Appeals for the 6th Circuit consolidated these cases and reversed, upholding the state laws. The Supreme Court reversed, holding that the states cannot "exclude same-sex couples from civil marriage on the same terms and conditions as opposite sex couples"[13] and that states must recognize same-sex marriages performed in other states.

Although same-sex married couples have been treated as married for federal income tax purposes since the Court held the Defense of Marriage Act (DOMA) unconstitutional,[14] this case is significant to federal income tax administration because it affects marital status, parentage, income, property rights, insurance coverage, and state taxes, all of which are reported on federal returns. Couples in common-law marriage states may find themselves legally married on a retroactive basis. For those in community property states, the holding may affect their taxable income for both state and federal income tax purposes, even if they file separately.[15] Determining the parentage of children for federal tax purposes may now be less complicated. These issues may prompt some to amend their federal or state returns. Even those who only amend state returns to change their filing status may also amend their federal returns for consistency (*e.g.*, to adjust their deduction for state and local taxes). While this case should generally simplify tax filing,

10 *King v. Burwell*, 135 S. Ct. 2480, 2489 (2015).

11 As the Court based its decision on its interpretation of the statute, it would be difficult for the IRS to issue regulations that would reinterpret the statue any other way. *See National Cable & Telecommunications Association v. Brand X Internet Services*, 545 U.S. 967 (2005) (suggesting agencies may not adopt a statutory interpretation rejected by the courts).

12 *Obergefell v. Hodges*, 135 S. Ct. 2584 (June 26, 2015).

13 *Id*. at 2605.

14 *U.S. v. Windsor*, 133 S. Ct. 2675 (2013); Rev. Rul. 2013-17, 2013-38 I.R.B. 201. After *Windsor*, the IRS allowed but did not require retroactive joint filing. Rev. Rul. 2013-17, 2013-38 I.R.B. 201. For a discussion of *Windsor* and related tax issues, see, *e.g.*, National Taxpayer Advocate 2013 Annual Report to Congress 326-27 (discussing *Windsor*), National Taxpayer Advocate 2013 Annual Report to Congress (Most Serious Problem: *Domestic Partners and Same-Sex Couples Need Federal Tax Guidance*), and National Taxpayer Advocate 2012 Annual Report to Congress 449 (Status Update: *Federal Tax Questions Continue to Trouble Domestic Partners and Same-Sex Spouses*).

15 Even if married taxpayers file separately, each is generally subject to tax on one-half of any "community income," including income earned by his or her spouse. *See Poe v. Seaborn*, 282 U.S. 101 (1930). Married taxpayers in community property states have "community income" under state law.

there is a long list of state tax issues that will need to be resolved.[16] In addition, the Solicitor General suggested that if the Court held the state laws unconstitutional, as it did, "the tax exemptions of some religious institutions would be in question if they opposed same-sex marriage."[17] Representatives in Congress are reportedly working to address this issue.[18]

In *Rothkamm v. United States*, the United States Court of Appeals for the 5th Circuit held that the period of limitations for filing a wrongful levy claim was suspended by a person's application for a Taxpayer Assistance Order (TAO).[19]

On March 6, 2012, the IRS issued a notice of levy to Mrs. Rothkamm's bank, seeking to collect her husband's tax liability from an account she claimed was her separate property. On April 18, 2012, the bank complied with the levy, transferring the proceeds of her account to the IRS. About two weeks later, on April 30, 2012, she sought assistance from the Taxpayer Advocate Service (TAS), filing a Form 911, *Application for a Taxpayer Assistance Order*. About five and a half months later, on October 11, 2012, TAS closed her case.[20] On May 15, 2013, more than nine months following the levy, Mrs. Rothkamm filed an administrative claim for wrongful levy under IRC § 6343(b).[21] The IRS denied the claim on July 1, 2013. Finally, on September 6, 2013, Mrs. Rothkamm filed a suit for wrongful levy under IRC § 7426(a). The district court held her claim was time barred, but the United States Court of Appeals for the 5th Circuit reversed and remanded.

A person generally must file any administrative claim with the IRS for wrongful levy within nine months of the levy.[22] A person may also file suit for wrongful levy in district court within the same nine-month period.[23] However, a timely filed administrative claim tolls the nine-month period for filing a suit by up to 12 months — the shorter of 12 months from the administrative filing or six months from the date the IRS mails a notice of disallowance.[24]

16 Some same-sex married couples had to file as unmarried for state tax purposes, even on returns that required figures from a federal return. To arrive at the figures needed to fill out the state returns, taxpayers sometimes had to compute "dummy" federal returns that they would not file. *See* Intuit, *Simplifying the Tax Filing Process for Same-Sex Couples* (June 19, 2015), *available at* http://intuittaxandfinancialcenter.com/article/simplifying-the-tax-filing-process-for-same-sex-couples/. These filing burdens, which were particularly severe for those with interests in flow-through entities doing business nationwide, should decrease as a result of this decision.

17 *Obergefell v. Hodges*, 135 S. Ct. 2584, 2626 (June 26, 2015) (J. Roberts, Dissenting).

18 *See, e.g.*, Kaustuv Basu, *Lee's Bill Would Protect Tax-Exempt Status for Religious Groups*, 147 Tax Notes 1138 (June 8, 2015); First Amendment Defense Act, S.1598, 114th Cong. (2015).

19 *Rothkamm v. U.S.*, 802 F.3d 699 (5th Cir. 2015) (hereinafter *Rothkamm II*), *rev'g and remanding*, 114 A.F.T.R. 2d (RIA) 5997, 2014-2 U.S. Tax Cas. (CCH) P50,441 (M.D. La. 2014) (hereinafter *Rothkamm I*).

20 The 5th Circuit Court's dissenting opinion noted that "Rothkamm has not argued that TAS did not inform her about the period of limitation for filing a wrongful levy action." *Rothkamm II* at 718 n. 22.

21 Mrs. Rothkamm filed her administrative claim more than 14 months after the March 6, 2012, notice of levy and nearly 13 months after the bank paid the levy on April 18, 2012.

22 IRC § 6343(b); Treas. Reg. § 301.6343–2(a)(2).

23 IRC §§ 7426(a) and (i) (cross referencing IRC § 6532(c)).

24 IRC § 6532(c)(2); Treas. Reg. § 301.6532–3.

The government first argued that Mrs. Rothkamm's suit was time barred because her nine–month period for filing a wrongful levy suit expired on January 18, 2013.[25] Thus, her suit, filed September 6, 2013, was over seven months late.

Mrs. Rothkamm argued that her suit was timely because the nine-month period for bringing a wrongful levy suit was suspended during the pendency of both: (1) her April 18, 2012 application for a TAO (under IRC § 7811(d)); *and* (2) her timely administrative claim to the IRS filed on May 15, 2013.[26] She reasoned that her TAO application extended the deadline for filing an administrative claim by over five months. Because of this extension, her administrative claim was timely and it extended the period for filing suit until six months after the IRS disallowed it on July 1, 2013 (*i.e.*, until January 1, 2014). Thus, Mrs. Rothkamm's September 6, 2013 suit was timely.

By its terms, IRC § 7811(d) suspends "[t]he running of any period of limitation with respect to any action described in subsection (b) [the terms of a TAO]." IRC § 7811(b) provides:

> The terms of a Taxpayer Assistance Order may require the Secretary within a specified time period — (1) to release property of the taxpayer levied upon, or (2) to cease any action, take any action as permitted by law, or refrain from taking any action, with respect to the taxpayer…

The government argued and the district court agreed that (1) the tolling provided by IRC § 7811(d) only applies to "taxpayers" and that Mrs. Rothkamm was not a "taxpayer" for that purpose, and (2) even if Mrs. Rothkamm *was* a taxpayer, she was not entitled to tolling because it only applies to IRS actions, not taxpayer actions.[27] Thus, the district court concluded it had no subject matter jurisdiction because the claim was not timely.

First, the 5th Circuit concluded that the district court erred by failing to use the definition of "taxpayer" set forth in IRC § 7701(a)(14), which includes "any person subject to any internal revenue tax." It relied on the Supreme Court decision in *Williams*, which held that Lori Williams, "who paid a tax under protest to remove a lien on her property," was a taxpayer under IRC § 7701(a)(14), and therefore, "had standing to bring a refund action under 28 USC § 1346(a)(1), even though the tax she paid was assessed against a third party."[28] The court rejected the government's argument that subsequent case law had altered the Supreme Court's interpretation of IRC § 7701(a)(14).[29]

25 *Rothkamm I*, slip op. at *2 (referencing the January 18 deadline); Govt. Motion to Dismiss, Dkt. No. 3:13-cv-00589-BAJ-RLB 2 (M.D. La., Nov. 8, 2013) (same). If the nine-month period for filing a wrongful levy claim did not begin until the bank *paid* the levy it would have expired on January 18, 2013, but if it began when the IRS *issued* the notice of levy to the bank it would have expired on December 6, 2012. In other cases cited by the court, and on appeal, the government argued that the period begins on the date the IRS *issues* the notice of levy. *See, e.g.*, Brief for the Appellees, Dkt. No. 14-31164 at 15 (Feb. 2, 2015) (referencing the December 6, 2012 deadline); *United Sand & Gravel Contractors, Inc. v. U.S.*, 624 F.2d 733, 735 (5th Cir.1980) (treating the date of the notice of levy as the date of the levy); Treas. Reg. § 301.6532–3(c)(Ex. 1) (same for notice of seizure).

26 *Rothkamm I*, slip op. at *2. Regulations make clear that wrongful levy claims must be filed with a specific office. Treas. Reg. § 301.6343–2(b). In other cases; however, taxpayers appear to have argued that submissions to TAS were informal claims. *See, e.g.*, *John Purciello v. U.S.*, No. 2:11-cv-4181(DMC)(MF), 2013 WL 6448108 (D.N.J. Dec. 9, 2013). Even if the April 30, 2012, application for a TAO was treated as an informal claim, in the absence of additional tolling, the period for filing suit would arguably have expired 12 months later, on April 30, 2013, and the May 15, 2013 filing may still have been late.

27 *Rothkamm I,* slip op. at *2.

28 *Rothkamm II* at 704 (quoting *U.S. v. Williams*, 514 U.S. 527, 529 (1995)).

29 The government cited *EC Term of Years Trust v. U.S.*, 550 U.S. 429 (2007), which held a court had no jurisdiction to hear a claim for wrongful levy by a trust under 28 U.S.C. 1346(a)(1). The 5th Circuit explained that if the trust could bring suit under IRC § 1346(a)(1), its suit would be timely, but it would be time-barred under IRC § 7426(a)(1)'s stricter nine-month statute of limitations. Therefore, *EC Terms of Years Trust* concerned the remedy available to the trust and had no bearing on whether the trust was a taxpayer.

The 5th Circuit found no reason to conclude that the definition of taxpayer in IRC §§ 7811 or 7803 is different from the general definition of taxpayer found in IRC § 7701(a)(14), observing that at least four of the ten examples of TAOs set forth in regulations involve wrongful levies, and speculating that some of them could have been referring to third parties.[30] It held that the term "taxpayer" in IRC § 7811 includes not only the person against whom a tax is assessed, but also the person who actually pays the tax. Thus, the tolling provisions under IRC § 7811 could apply to Mrs. Rothkamm.

Next, the 5th Circuit rejected the argument that tolling only applies to actions of the IRS. IRC § 7811(d) says tolling applies to "any statute of limitations for any action described in § 7811(b)." The court suggested that tolling applied because "release[ing] property of the taxpayer levied upon," which was at issue in Mrs. Rothkamm's case, is described in IRC § 7811(b)(1).

Because the court's holding was based on the plain language of the statute under *Chevron* step-one,[31] it gave no deference to regulations which state "[A] taxpayer's right to administrative or judicial review will not be diminished or expanded in any way as a result of the taxpayer's seeking assistance from TAS."[32] It nonetheless reasoned that tolling would allow a taxpayer to pursue a TAO without fear that the process would prejudice her rights in the event she does not obtain TAO relief, claiming that its interpretation would not make the IRS or the taxpayer any worse off.[33]

Finally, the 5th Circuit concluded that neither the code nor the regulations make tolling subject to the IRS's discretion, dismissing contrary authorities.[34] It also dismissed the government's statutory arguments. The government apparently argued that Congress directly addressed the question of whether IRC § 7811(d) tolls the running of the nine-month statute of limitations in IRC § 7426(a) because neither statute references the other. According to the court, the government failed to explain how Congress may directly address something by remaining silent on it.[35] The government's other statutory argument was that tolling does not apply to the release of levies under IRC § 7811(b)(1) because that section does not contain the word "action." The court determined that this argument had no merit.[36] It noted that the government had offered no reasonable alternative construction of the plain language

30 *Rothkamm II* at 708 n.29 (citing Treas. Reg. §§ 301.7811-1(a)(Ex. 1), -1(e) (Exs. 1, 2, and 3)).

31 *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837 (1984). A court only gives deference to agency regulations under *Chevron* step-two, if it first determines the statute is ambiguous under *Chevron* step-one. *Id*.

32 Treas. Reg. § 301.7811-1(b). The court also reasoned that this regulation addresses TAOs and not tolling. *Rothkamm II* at 711.

33 *Rothkamm II* at 709-10. Whether tolling the period of limitations for taking an action makes a person better off depends on whether the person is able to take the action during the tolling period. If they are able to take the action, tolling makes them better off because they get a longer period than otherwise provided by statute. For example, if the ten-year period for the IRS to collect tax is extended during the pendency of a TAO application, the IRS is only better off if it could continue to collect during that period. Assuming it could, the IRS could collect for more than ten years otherwise allowed by law. Citing legislative history, instructions to Form 911, and case law, the dissent argues that IRC § 7811(d) tolls the limitations period only with respect to actions of the IRS on the basis that it cannot take action while an application for a TAO is pending. *Rothkamm II* at 717-18. The dissent also cited various cases for the proposition that "all suspension provisions [including § 7811(d)] are designed and intended to avoid prejudice to the IRS's ability to collect during periods of time in which collection or assessment is prohibited by law [or otherwise impeded]." *Id*. at 717 n.14.

34 *Rothkamm II* at 713 (referencing *Demes v. U.S.*, 52 Fed. Cl. 365, 373 (Fed. Cl. 2002)).

35 *Id.* at 713-14.

36 *Id.* Even if the court had accepted the government's argument that tolling under IRC § 7811(d) only covers "actions" under IRC § 7811(b) that are described using the word "action," it would have lost. IRC § 7811(b)(2)(A) specifically refers to "actions" under "chapter 64," and IRC § 6343, which covers wrongful levies, is located in chapter 64. In addition, IRC § 7811(b)(2)(D) refers to "actions" under "any other provision of law which is specifically described by the National Taxpayer Advocate in such order," which may address wrongful levies.

of IRC § 7811(d).[37] Thus, it held that Mrs. Rothkamm's filing was timely because her application for a TAO tolled the period for filing a wrongful levy claim.

This case is significant because it affirms the National Taxpayer Advocate's authority to issue TAOs to assist those who are subject to levies to collect another person's liability. However, it leaves unanswered questions about whether a "taxpayer" includes other third parties, such as whistleblowers or preparers who seek TAOs in situations where they have not been "subject to" the tax at issue in their cases.[38]

As the dissent notes, it is also significant because it creates administrative difficulties, replacing fixed periods of limitation with indefinite periods.[39] The case is likely to prompt many taxpayers who have sought TAS assistance and subsequently missed a deadline to argue that the deadline was tolled under IRC § 7811(d) by their application to TAS. It also raises a number of questions. The IRS has not implemented IRC § 7811(d) because of technical difficulties in recording and tracking the suspension period.[40] Will the IRS now feel obligated to try to implement those provisions, even in cases where they would penalize taxpayers for seeking TAS assistance?[41] Will taxpayers now seek to toll the period for taking "any" action by simply filing a Form 911 (*e.g.*, filing in tax court, requesting a collection due process hearing, claiming a refund).[42] If IRC § 7811(d) tolls the period for taxpayers to take action, can the National Taxpayer Advocate extend these periods even further?[43]

37 The government did not focus on statutory language that supports the position that only actions of the IRS are tolled: IRC § 7811(d) tolls the statute with respect to actions described in IRC § 7811(b), but the flush language of IRC § 7811(b) provides a TAO "may require the Secretary" to take or not take various actions. In other words, all of the actions described in IRC § 7811(b) must be taken by the IRS and not the taxpayer or a third party. Thus, IRC § 7811(d) can only toll the period of limitations with respect to actions of the IRS.

38 For additional discussion of these and other issues, see *Legislative Recommendation: Statute of Limitations: Repeal or Fix Statute Suspension Under IRC § 7811(d)*, *supra*.

39 *Rothkamm II* at 720.

40 Although TAS drafted procedures for implementing statute suspension under IRC § 7811(d), due to technical difficulties, they were not implemented (*e.g.*, tracking different suspension periods for each spouse and for assessments for the same year made on different dates). *See, e.g.*, IRM 13.1.14 (Oct. 31, 2004); Memorandum from Commissioner of Internal Revenue, *Taxpayer Advocate Service Statute Suspension Provisions Under IRC Section 7811(d)* (Nov. 10, 2003). At least one legal memo concludes that if the IRS has authority not to implement IRC § 7811(d), it is because the provision can only benefit the IRS by extending the period for the IRS to take enforcement actions (*e.g.*, by extending the period for collection or assessment). *Compare* IRS Litigation Bulletin 360, 1990 WL 1086174, 1990 GLB LEXIS 12 (1990) (concluding that because IRC § 7811(d) only protects the IRS by tolling collection and assessment periods, the IRS is not legally required to implement it), *with* Memo from Acting Counsel to the National Taxpayer Advocate to Director Taxpayer Account Operations, *Suspension of the Statutes of Limitations Under Section 7811(d)* (Mar. 9, 2001) (assuming statute suspension only applies to protect the IRS's interest, but still declining to conclude its implementation is not mandatory).

41 Taxpayers would be penalized if, for example, collection statutes were tolled but collection actions were not suspended.

42 As noted above, *Rothkamm II* did not directly hold that IRC § 7811(d) extended the period for filing suit. Rather, it held that IRC § 7811(d) extended the period for filing an administrative claim, and that the IRS's denial of the timely-filed administrative claim extended the period for filing suit by operation of IRC § 6532(c)(2). A future decision could clarify that IRC § 7811(d) does not extend jurisdictional deadlines for filing in court, but this case still invites litigation in this area. *Compare Volpicelli v. U.S.*, 777 F.3d 1042 (9th Cir. 2015) (holding the limitations period for filing suit to challenge a wrongful levy was subject to equitable tolling because it was procedural and not jurisdictional, as discussed below) *with Becton Dickinson & Co. v. Wolckenhauer*, 215 F.3d 340 (3d Cir. 2000) (holding that the limitations period for filing suit to challenge a wrongful levy was jurisdictional, and thus, not subject to equitable tolling).

43 IRC § 7811(d)(2) (tolling the period of limitation with respect to "any action described in subsection (b)" by "any period specified by the National Taxpayer Advocate" in a TAO).

In *Mallo v. IRS*, the United States Court of Appeals for the 10th Circuit held that tax debt with respect to late-filed tax returns (except returns filed with IRS assistance) cannot be discharged in bankruptcy.[44]

The taxpayers did not file timely federal income tax returns for 2000 or 2001. Only after the IRS assessed a tax liability did they file returns.[45] More than two years later, the taxpayers filed for bankruptcy, seeking to discharge their tax debts. The IRS argued the tax debts were not dischargeable. In a consolidated appeal of conflicting decisions, the United States District Court for the District of Colorado agreed with the IRS, as did the United States Court of Appeals for the 10th Circuit.

A taxpayer may not discharge in bankruptcy tax liabilities "with respect to which a return … was not filed or given."[46] Tax liabilities with respect to which a late return was filed within two years of the bankruptcy petition are also exempt from discharge.[47] Before 2005, with certain exceptions, a debtor could discharge the portion of a tax debt that he or she self-assessed on a late return, as long as he or she waited two years after filing. As part of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Congress attempted to clarify the discharge rules by amending 11 U.S.C. § 523(a) to include a "hanging paragraph."[48] It defines a "return" as "a return that satisfies the requirements of applicable non-bankruptcy law (including applicable filing requirements)." It goes on to state that a late return prepared by the IRS and signed by the taxpayer under IRC § 6020(a) is treated as a return, but a return prepared by the IRS without the taxpayer's cooperation under IRC § 6020(b) is not.[49] Whether a document is a return for tax purposes depends on whether it satisfies the *Beard* test, which requires that it (1) contain sufficient data to calculate tax liability, (2) purport to be a return, (3) be an honest and reasonable attempt to satisfy the law, and (4) be executed under penalties of perjury.[50]

The IRS argued that the tax debt was not dischargeable because it arose from an IRS assessment rather than from a taxpayer's self-assessment on a return. In other words, a debt (or portion thereof) assessed by the IRS before filing was "with respect to which a return … was not filed or given,"[51] and thus, permanently nondischargeable, even if the taxpayer later filed a return. The court rejected this argument, holding that the debt arose from the tax code rather than an assessment.

Instead, the court reasoned that even if a post-assessment filing is a return under *Beard*, late returns are not "returns" for purposes of discharge because they do not satisfy "applicable filing requirements."[52] The taxpayer argued that such an interpretation would make the specific exclusion of late returns filed under IRC § 6020(b) superfluous.[53] The taxpayer also argued that the exclusion for late returns filed less than

44 *In re Mallo*, 774 F.3d 1313 (10th Cir. 2014).

45 Unlike the returns deemed meaningless in *In re Hindenlang*, 164 F.3d 1029 (6th Cir. 1999), these returns did not mirror the IRS's tax assessment.

46 11 U.S.C. § 523(a)(1)(B)(i).

47 11 U.S.C. § 523(a)(1)(B)(ii).

48 BAPCPA, Pub. L. No. 109-8, § 714, 119 Stat. 23, 128 (2005) (modifying 11 U.S.C. § 523(a)).

49 11 U.S.C. § 523(a). Under IRC § 6020(a), the IRS may prepare a late return if a taxpayer cooperates by providing "consent to disclose all information necessary for the preparation thereof" and then signs it. When taxpayers do not provide such consent or signatures, the Secretary may prepare a late return or assessment under IRC § 6020(b) "from his own knowledge and from such information as he can obtain through testimony or otherwise."

50 *Beard v. Comm'r*, 82 T.C. 766, 777 (1984), *aff'd per curiam*, 793 F.2d 139 (6th Cir. 1986) (applying a test set forth in *Zellerbach Paper Co. v. Helvering*, 293 U.S. 172 (1934)).

51 11 U.S.C. § 523(a)(1)(B)(i).

52 11 U.S.C. § 523(a) (hanging paragraph).

53 The IRS agreed with the taxpayer on this point. *In re Mallo*, 774 F.3d at 1325 (citing Chief Counsel Notice (CCN) CC-2010-016 (Sept. 2, 2010)).

two years before bankruptcy suggests that late returns should not always be excluded simply because they fail to meet the filing requirements.[54]

The court concluded that the exclusion for liabilities with respect to late IRC § 6020(b) returns was not superfluous because late returns could be discharged if they were filed under IRC § 6020(a). The taxpayer argued that allowing those offered IRS assistance in filing late returns under IRC § 6020(a) to discharge the debt, but not allowing a discharge to similarly situated taxpayers who did not receive IRS assistance in filing late would be arbitrary and inconsistent with the fresh start policy underlying bankruptcy. However, the court reasoned that any such arbitrariness would not provide a basis for it to overlook the plain language of the statute.

This case is significant because taxpayers who are even one day late in filing a return will generally not be able to discharge the liability in bankruptcy unless they can convince the IRS to assist them in filing a return under IRC § 6020(a) and it does so at least two years before the bankruptcy filing. Although IRC § 6020(a) filings may have been more common when BAPCPA was adopted,[55] by 2010 they comprised only a "minute number of cases," according to the IRS Office of Chief Counsel.[56] As this may make the availability of discharge arbitrary, the National Taxpayer Advocate recommended legislation to reverse this rule.[57]

In *Hawkins v. Franchise Tax Board of CA,* the United States Court of Appeals for the 9th Circuit held that a debtor's continued spending in excess of earnings is not by itself sufficient to establish the specific willful intent to evade taxes necessary to avoid their discharge in bankruptcy.[58]

Mr. Hawkins's accountants advised him to invest in tax shelters to offset capital gains he had realized on stock he sold to fund a new venture. That venture ultimately failed. In 2002, the IRS disallowed the losses from the tax shelter, and in 2005, assessed a deficiency. Mr. Hawkins and his wife filed for bankruptcy in 2006.

A debtor may not discharge a debt with respect to which he or she "willfully attempted in any manner to evade or defeat," under 11 U.S.C. § 523(a)(1)(C). The IRS argued that the Hawkins' continued maintenance of a rich lifestyle — spending tens of thousands of dollars more than their income each month — even after learning about their tax debts, constituted a willful attempt to evade taxes. The bankruptcy court agreed, finding they did very little to alter their lavish lifestyle after it became apparent they were insolvent. It concluded that the tax debts were nondischargeable. The district court affirmed.

The United States Court of Appeals for the 9th Circuit reversed and remanded, holding that the discharge exception in 11 U.S.C. § 523(a)(1)(C) did not apply without proof of specific intent. First, the court noted that the term "willful" has different meanings in different contexts. Based on statutory

54 11 U.S.C. § 523(a)(1)(B)(ii).

55 Although *Beard* was decided in 1984, when BAPCPA legislation was enacted in 2005 some authorities suggested that Form 870, *Waiver of Restrictions on Assessment and Collection of Deficiency and Acceptance of Overassessment*, and Form 4549, *Income Tax Examination Changes*, would be treated as IRC § 6020(a) returns, even if signed in response to an IRS substitute for return. *See, e.g.*, Rev. Rul. 74-203, 1974-1 C.B. 330 (treating these forms as IRC § 6020(a) returns). It was not until September 12, 2005, that the IRS in Rev. Rul. 2005-59, 2005-37 I.R.B. 505, revoked Rev. Rul. 74-203 and clarified that waivers of assessment do not constitute returns because they do not purport to be returns and are not signed under penalties of perjury, as required under the *Beard* test.

56 CCN CC-2010-016 (Sept. 2, 2010).

57 *See* National Taxpayer Advocate 2014 Annual Report to Congress 417-22 (Legislative Recommendation: *Clarify the Bankruptcy Law Relating to Obtaining a Discharge*).

58 *Hawkins v. Franchise Tax Board of CA*, 769 F.3d 662 (9th Cir. 2014), *rev'g and remanding*, 447 B.R. 291 (N.D. CA 2011), *aff'g* 430 B.R. 225 (Bankr. N.D. CA 2010).

construction, precedent, and policy underlying the bankruptcy code, the term must be construed narrowly in the context of exceptions to discharge.

Next, the court reasoned that the language in 11 U.S.C. § 523(a)(1)(C) almost exactly matches language in IRC § 7201, a criminal statute, which penalizes anyone who "willfully attempts to evade or defeat any tax." According to the Supreme Court, the term "willfully" in IRC § 7201 requires proof of specific intent that the defendant voluntarily and intentionally violated a known legal duty.[59]

The 9th Circuit suggested that evidence of willful intent might include keeping two sets of books, making false bookkeeping entries, destroying records, and concealing assets. Simply spending beyond one's income would not qualify. The court observed that if such spending were enough, there would be few personal bankruptcies in which taxes would be dischargeable.

Finally, the court noted that other cases applying the exception from discharge under 11 U.S.C. § 523(a)(1)(C) involved intentional acts or omissions designed to evade tax, such as criminally structuring transactions to avoid currency reporting requirements, concealing assets through nominee accounts, and similar activities. In contrast, the Hawkins' spending practices after they learned of their tax debts were consistent with their historic spending practices. They invested in property that would be subject to tax liens. They did not transfer assets into nominee accounts or conceal them.[60] Further, the court observed that no other circuit has held that living beyond one's means or failing to pay taxes, by itself, constitutes willful tax evasion within the meaning of 11 U.S.C. § 523(a)(1)(C).

This case is significant because it can be construed as creating a circuit split over the conduct that will render tax debts nondischargeable in bankruptcy (*e.g.*, whether evidence of evasion and concealment is required). The case is also significant because it highlights the need for guidance concerning the meaning of willfulness in different contexts.[61]

In *Estate of Elkins v. Commissioner*, the United States Court of Appeals for the 5th Circuit held that if a taxpayer meets its burden to establish that a valuation discount applies, the court cannot apply a different discount if the IRS does not offer evidence of a more appropriate discount.[62]

When James A. Elkins, Jr. (decedent) died in 2006, his estate claimed a "fractional-ownership discount" on the value of jointly-owned art for purposes of computing the estate tax. The art was subject to a lease agreement governing its use and transferability. On the estate tax return, the estate reported decedent's 73 percent interest in various pieces of art, and based on an appraisal, claimed a 44.75 percent combined fractional interest discount for lack of control and marketability.[63] Although the parties agreed on the undiscounted value of the art, the IRS argued in the Tax Court that the contractual restrictions on alienation should be disregarded under IRC § 2703(a), the discounts used in calculating the fair market value of the

59 *Hawkins*, 769 F.3d at 668 (citing *Spies v. U.S.*, 317 U.S. 492 (1943) and other Supreme Court decisions).

60 The government claimed that a transfer of funds into a trust, which was ordered by the family court, was done with the intent to evade tax. Additionally, Hawkins' bankruptcy attorney testified that Hawkins' intent was not to pay the tax debt, but to discharge it in bankruptcy. This evidence may become more important on remand.

61 The National Taxpayer Advocate recommended legislation to clarify the meaning of willful Foreign Bank and Financial Account Reporting (FBAR) violations. See, *e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 331, 339-40.

62 *Est. of Elkins v. Comm'r*, 767 F.3d 443 (5th Cir. 2014), *rev'g* 140 T.C. 86 (2013).

63 *Id.* at 445-46.

decedent's fractional interests were overstated, and no discount was appropriate.[64] Thus, the IRS did not produce any evidence as to an appropriate fractional interest discount.

The Tax Court found that IRC § 2703(a) was applicable to the restrictions in the agreement, and disallowed any discount in the valuation of the art. However, as to the IRS's argument that no discounts should apply to decedent's fractional interest, the court rejected both the IRS's zero-discount position and the 44.75 percent discount applied by the estate.[65] Instead, the Tax Court applied a ten percent discount based on a "preponderance of the evidence," seemingly weighing the analysis of the estate's experts against the IRS's rebuttal witnesses.[66] However, the court had concluded that the testimony of one of the IRS's witnesses was not relevant, and the other merely testified that there was no established or recognized market for fractional interests in the type of art at issue.[67]

The United States Court of Appeals for the 5th Circuit agreed with the Tax Court's conclusion that a fractional-interest discount should apply.[68] It noted that the IRS had apparently overlooked "the venerable lesson of Judge Learned Hand's opinion in *Cohan*: In essence, make as close an approximation as you can, but never use a zero."[69] It concluded; however, that the Tax Court had misapplied the preponderance standard because the IRS had offered no evidence that any specific discount (other than zero) should apply.[70] The Tax Court could not reject the estate's fractional-ownership discounts and apply one of its own without any supporting evidence. Once the estate had met its burden to support a particular discount, the burden shifted to the IRS to introduce evidence to refute those facts with its own estimate.[71] Thus, the 5th Circuit upheld the fractional interest discount applied by the estate.[72]

The 5th Circuit's analysis is significant because it discourages courts (and possibly the IRS's appeals function) from applying a split-the-baby approach to valuation discounts where the IRS presents no evidence as to an appropriate discount. It is also significant because it could prompt the IRS to issue guidance about how to compute valuation discounts.

In *Volpicelli v. United States*, the United States Court of Appeals for the 9th Circuit held that the limitations period for challenging a wrongful levy was subject to equitable tolling.[73]

The IRS levied Logan Volpicelli's account when he was ten years old and applied the money (a $13,000 inheritance) to his father's tax debt. When Mr. Volpicelli was 18, he discovered the levy and promptly filed a wrongful levy suit.[74] The government argued his suit was time barred. Acknowledging that he

64 *Est. of Elkins*, 140 T.C. at 92. *See* IRC § 2703(a) (subject to exceptions for certain bona fide business arrangements, "the value of any property shall be determined without regard to — (1) any option, agreement, or other right to acquire or use the property at a price less than the fair market value of the property (without regard to such option, agreement, or right), or (2) any restriction on the right to sell or use such property.").

65 *Id.* at 116.

66 *Id.* at 135.

67 *Est. of Elkins*, 767 F.3d at 448-449.

68 *Id.* at 449.

69 *Id.* at 449 n.7 (citing *Cohan v. Comm'r*, 39 F.2d 540, 543-44 (2d Cir. 1930)).

70 *Id.* at 450.

71 *Id.* *See* IRC § 7491(a)(1) ("If, in any court proceeding, a taxpayer introduces credible evidence with respect to any factual issue relevant to ascertaining the liability of the taxpayer for any tax imposed by subtitle A or B, the Secretary shall have the burden of proof with respect to such issue.").

72 *Est. of Elkins*, 767 F.3d at 453.

73 *Volpicelli v. U.S.*, 777 F.3d 1042 (9th Cir. 2015), *rev'g* 108 A.F.T.R.2d (RIA) 5166 (D. Nev. 2011), *reh'g denied*, No. 12-15029 (9th Cir. Apr. 8, 2015).

74 IRC § 7426(a)(1).

failed to meet the nine-month filing deadline under IRC § 6532(c), he argued that the limitations period was equitably tolled because he was a minor at the time of the levy.

The district court agreed with the government, but the United States Court of Appeals for the 9th Circuit reversed and remanded. The court concluded it was bound by precedent, which held that IRC § 6532(c) was subject to equitable tolling.[75] With certain exceptions that the 9th Circuit found inapplicable, there is a rebuttable presumption that filing deadlines may be equitably tolled unless Congress provides otherwise, according to the Supreme Court's decision in *Irwin*.[76] As the court found no evidence to rebut that presumption, it held that equitable tolling applies to the deadline provided under IRC § 6532(c).

This case is significant because it is inconsistent with decisions in other circuits, presenting the potential for the Supreme Court to resolve the split.[77] It may also be significant to the extent it suggests that tax statutes, like other statutes of limitation, are generally presumed to be subject to equitable tolling.[78]

In *Ridgely v. Lew*, the United States District Court for the District of Columbia held that the IRS exceeded its statutory authority when it prohibited certified public accountants from charging contingent fees for the preparation of refund claims.[79]

Mr. Ridgely, a certified public accountant (CPA), filed suit under the Administrative Procedure Act (APA),[80] challenging a Treasury regulation that prohibits CPAs from charging contingent fees for preparing and filing refund claims.[81] The parties moved for summary judgment. Concluding that the IRS lacks statutory authority to regulate the preparation and filing of ordinary refund claims (*i.e.*, claims filed before adversarial proceedings have begun and before the taxpayer has formally engaged the CPA to represent him), the court granted Mr. Ridgely's motion and issued a permanent injunction barring the IRS from enforcing the regulation.

Congress has authorized the IRS to "regulate the practice of representatives of persons before the Department of the Treasury."[82] In *Loving v. IRS,* the U.S. Court of Appeals for the District of Columbia Circuit held that this statute did not authorize the IRS to regulate tax return preparers because they do not "practice… before the Department" or "represent" taxpayers when preparing a return.[83] Citing *Loving*, the U.S. District Court for the District of Columbia found that CPAs also do not "practice… before the Department" or "represent" taxpayers, prior to adversarial proceedings. Accordingly, the statute does not authorize the IRS to regulate the mere filing of ordinary refund claims by CPAs.

75 *Supermail Cargo, Inc. v. U.S.*, 68 F.3d 1204, 1206–07 (9th Cir. 1995); *Capital Tracing, Inc. v. U.S.*, 63 F.3d 859, 861–62 (9th Cir. 1995).

76 *Irwin v. Department of Veterans Affairs*, 498 U.S. 89 (1990).

77 *See, e.g.*, *Becton Dickinson & Co. v. Wolckenhauer*, 215 F.3d 340 (3d Cir. 2000).

78 For example, at least one commentator has speculated that future litigation could establish that the time periods under IRC § 7433 (giving taxpayers two years to file a suit for civil damages for certain unauthorized collection actions) and § 6532(a) (giving taxpayers two years from the claim disallowance to file a refund lawsuit) are also subject to equitable tolling. See Marie Sapirie, *Ninth Circuit Holds Firm on Equitable Tolling*, 2015 TNT 22-9 (Feb. 2, 2015).

79 *Ridgely v. Lew*, 114 A.F.T.R.2d (RIA) 5249 (D.D.C. 2014).

80 5 U.S.C. § 551 *et seq*.

81 31 C.F.R. §§ 10.27(a)-(b) (prohibiting contingent fees except in limited circumstances). This regulation is part of Treasury Department Circular No. 230, *Regulations Governing Practice before the Internal Revenue Service* (2014) (called Circular 230).

82 31 U.S.C § 330(a)(1).

83 *Loving v. Comm'r*, 742 F.3d 1013 (D.C. Cir. 2014), *aff'g* 917 F.Supp.2d 67 (D.D.C. 2013). For a detailed discussion of *Loving*, see National Taxpayer Advocate 2014 Annual Report to Congress 432. *See also* Nina E. Olson, *More Than a "Mere" Preparer: Loving and Return Preparation*, 139 Tax Notes 767 (May 13, 2013).

The court also rejected the IRS's argument that it had authority to regulate all actions of CPAs who at some point "practice" before it, regardless of whether they were acting in a "representational" capacity. First, the statute authorizes regulation of practice, not practitioners. Second, the statute only applies to individuals when they represent taxpayers, not to the actions of every person who may at some point become a representative. Finally, it would lead to absurd results if the IRS could broadly regulate the actions of CPAs, no matter what they were doing, but not regulate other individuals who could assist taxpayers in filing refund claims. The court found no support for this dichotomy in the statute's text, history or structural context.

This case is significant to the extent it suggests that none of the provisions of Circular 230 are valid as to those who merely assist in filing a return or claim for refund (even if they are CPAs or attorneys), at least before the commencement of any adversarial proceedings with the IRS or formal engagement for legal representation. The proliferation of litigation regarding the IRS's regulation of tax return preparers is an indication that Congress should clarify the IRS's authority in this area, as the National Taxpayer Advocate has recommended.[84]

In *Sexton v. Hawkins*, the United States District Court for the District of Nevada enjoined the IRS Office of Professional Responsibility from requesting information from a suspended practitioner or revoking his ability to e-file on behalf of clients.[85]

Mr. Sexton, a tax lawyer, pled guilty to mail fraud and money laundering. As a result, the IRS Office of Professional Responsibility (OPR) suspended him from practice before the IRS for an indefinite period. During his suspension, he provided tax advice and return preparation services. After receiving a demand for information from OPR, including a request for client records and returns, he filed a complaint seeking declaratory relief that he was not subject to OPR's jurisdiction and asked the court to enjoin OPR's request.

According to *Loving*, a person who does not actively represent taxpayers in proceedings with the IRS and only prepares returns is *not* engaged in "practice before the IRS" and is not subject to regulation by OPR under Circular 230.[86] Mr. Sexton argued that because OPR had already suspended him from practice, he was no longer a practitioner covered by Circular 230 and his status as a mere tax return preparer left OPR with no jurisdiction over him. The Justice Department moved to dismiss for lack of jurisdiction and failure to state a claim. The court denied the government's motion and issued a preliminary injunction.

First, the court held that it had jurisdiction to review OPR's information request under the APA because OPR's request for information constituted a "final agency action" that would not otherwise be subject to review.[87] According to the court, OPR's assertion of jurisdiction over Mr. Sexton had immediate consequences, such as his obligation under Circular 230 to respond to its inquiry and the possibility of additional sanctions. If he provided the requested information to OPR, he would have to inform clients that he had turned over their confidential records and doing so would irreparably damage his reputation and business. According to Mr. Sexton, OPR had also threatened to withdraw his ability to e-file returns on behalf of clients if he failed to respond.

84 The National Taxpayer Advocate has long championed the regulation of return preparers. *See, e.g.*, National Taxpayer Advocate 2008 Annual Report to Congress 423 (Legislative Recommendation: *The Time Has Come to Regulate Federal Tax Return Preparers*); National Taxpayer Advocate 2004 Annual Report to Congress 67 (Most Serious Problem: *Oversight of Unenrolled Return Preparers*); National Taxpayer Advocate 2003 Annual Report to Congress 270 (Legislative Recommendation: *Federal Tax Return Preparers Oversight and Compliance*); National Taxpayer Advocate 2002 Annual Report to Congress 216 (Legislative Recommendation: *Regulation of Federal Tax Return Preparers*).

85 *Sexton v. Hawkins*, 114 A.F.T.R.2d (RIA) 6482 (D. Nev. 2014), *appeal docketed*, No. 14-17454 (9th Cir. Dec. 16, 2014).

86 *Loving v. Comm'r*, 742 F.3d 1013 (D.C. Cir. 2014), *aff'g* 917 F. Supp. 2d 67 (D.D.C. 2013).

87 5 U.S.C. § 702.

Second, the court found that Mr. Sexton had adequately pleaded facts to raise questions concerning (1) whether Mr. Sexton is a practitioner subject to OPR's jurisdiction, (2) whether OPR had authority to regulate a former practitioner, and (3) whether regulation of tax advice is beyond the scope of OPR's authority. The court entered a preliminary injunction barring the IRS from requesting documents from Mr. Sexton or suspending his ability to e-file. It reasoned that once Mr. Sexton produced the information it could not be "unproduced," and would cause irreparable injury to him and his business. By contrast, waiting would not be a hardship for the IRS or the public interest. The court explained that even if a permanent injunction were granted, the government could continue its investigation by issuing a subpoena.

This case is significant because it illustrates the difficulty OPR now faces in regulating previously-suspended practitioners and the need for Congress to authorize IRS regulation of tax return preparers.[88] It is also significant because it suggests an administrative request for information can be a final agency action, which is subject to judicial review under the APA.

In *Moore v. United States*, the District Court for the Western District of Washington held that the taxpayer did not have reasonable cause for not filing Foreign Bank and Financial Account Reports (FBARs), but found IRS procedures inconsistent with the Administrative Procedure Act (APA).[89]

Mr. Moore owned a foreign corporation that held a foreign bank account containing between $300,000 and $550,000, which he failed to report on Foreign Bank and Financial Account Reports (FBARs).[90] In 2009, he learned about the FBAR filing requirement, applied to the IRS's Offshore Voluntary Disclosure Program (OVD), and then opted out.[91] After interviewing Mr. Moore for five minutes, the Revenue Agent prepared an eight-page memo recommending that the IRS impose a non-willful penalty of $40,000 pursuant to 31 U.S.C. § 5321(a)(5) (the maximum of $10,000 for each of the four years from 2005 through 2008), but did not provide this memo to Mr. Moore.

The IRS sent Mr. Moore a brief letter proposing a penalty of $40,000 for years 2005 through 2008, and then assessed a $10,000 penalty for 2005 before his deadline to appeal had expired. When Mr. Moore appealed, his request for abatement was denied, also without explanation. Mr. Moore filed suit in the District Court for the Western District of Washington. The government counterclaimed and filed a motion for summary judgment.

Applying a *de novo* standard of review, the court held that Mr. Moore's failure to file FBARs was subject to non-willful penalties and was not due to reasonable cause. It declined to review the amount of the penalty under an "abuse of discretion" standard, as urged by the government.

Because "reasonable cause" is not defined in the Bank Secrecy Act (BSA) or in regulations interpreting the BSA, the court drew upon the IRC to define reasonable cause as the exercise of "ordinary business care and prudence" in the context of FBAR. It found Mr. Moore lacked ordinary business care and prudence because he (1) self-prepared his 2005 return without responding to the question on Schedule B about

88 The IRS has conceded that some suspended practitioners may obtain preparer tax identification numbers (PTINs) and prepare returns. *See* IRS, *Some Suspended or Disbarred Tax Practitioners Are Now Permitted to Obtain PTINs and Prepare Tax Returns* (May 23, 2014), *available at* http://www.irs.gov/file_source/pub/irs-utl/OPR%20statement%20052314.pdf. *See also* Rev. Proc. 2014-42, 2014-29 I.R.B. 192 (citing *Loving* and acknowledging the registered tax return preparer program is no longer in effect).

89 *Moore v. U.S.*, 115 A.F.T.R.2d (RIA) 1375 (W.D. Wash. 2015), *dismissed by* 2015 U.S. Dist. LEXIS 99804 (W.D. Wash. 2015).

90 *See* FinCEN Report 114, *Report of Foreign Bank and Financial Accounts* (which superseded TD F 90-22.1).

91 For a discussion of problems with the OVD and recommendations to improve it and the FBAR rules, see, *e.g.*, National Taxpayer Advocate 2014 Annual Report to Congress 79-93, 331-45.

whether he had foreign accounts[92] and (2) responded "no" to a similar question on an organizer he provided to his preparer for his 2007 return. Citing *Williams*, a case that relied on similar facts to hold that an FBAR violation was *willful*, the court concluded that Mr. Moore did not have reasonable cause.[93]

The APA generally requires that an agency's denial of an appeal be accompanied by the "grounds for denial."[94] The court concluded that the government did not sufficiently explain why it denied Mr. Moore's appeal, imposed the maximum penalty for each of the four years, and assessed the 2005 penalty before the agreed date. The court noted that the available evidence, such as the Revenue Agent's internal memo, also failed to explain the IRS's reasons for imposing the maximum penalty.[95] Nor did it explain why the IRS assessed the 2005 penalty before expiration of the period allowed for Mr. Moore's appeal. The court stated that if the government did not supplement the record to explain itself on these issues, it would hold that the IRS's actions were arbitrary and capricious. After the IRS supplemented the record, the court denied the IRS's claim for interest because of its failure to disclose its reasoning but concluded that its actions to assess the penalty were not arbitrary.[96]

Finally, the court concluded the penalty did not violate the *Excessive Fines Clause of the Eighth Amendment*.[97] In *Bajakajian*, the Supreme Court held that a punitive forfeiture of $357,144 in currency (or 100 percent of it) for failure to report it violated the *Excessive Fines Clause* because the penalty was "grossly disproportional" to the gravity of the offense.[98] Although the government provided no evidence as to the harm caused by the offense, the court concluded the $40,000 penalty, which was only about 10 percent of the account balance, was not disproportionate. The court analyzed the proportionality of the FBAR penalties in aggregate, rather than separately for each year or violation.

This case is significant because it suggests that the FBAR penalty (including reasonable cause defenses) is subject to *de novo* review, though the IRS will seek greater judicial deference to its determination of the penalty amount.[99] It also illustrates that a court may rely on the APA in reviewing FBAR penalties and may require the IRS to document and disclose to taxpayers more detailed information concerning the basis for its decisions. Moreover, the court's analysis suggests that it is appropriate to compare the *aggregate* amount of FBAR penalties to the value of the unreported account in determining whether they violate the *Excessive Fines Clause*. Finally, the decision confirms the difficulty taxpayers face in claiming reasonable cause for failure to report an account on an FBAR, if they have not disclosed it to a preparer and have no

92 Mr. Moore admitted he saw the question but did not read the instructions regarding accounts owned by a corporation. Based on those instructions, he should have responded "yes" if he owned more than 50 percent of the stock of a corporation that owned any such accounts.

93 *Williams v. Comm'r*, 489 Fed. App'x. 655 (4th Cir. 2012) (*Williams II*); *Moore v. U.S.*, 115 A.F.T.R.2d (RIA) 1375 (W.D. Wash. 2015) (internal citations omitted) ("the only evidence materially distinguishing the defendant in *Williams II* from Mr. Moore is that defendant pleaded guilty to criminal tax evasion for failing to report the income from the foreign account he had not disclosed.").

94 5 U.S.C. § 555(e).

95 The court did not consider an Appeals memo that was in the IRS's files because the IRS successfully claimed it was privileged.

96 *Moore v. U.S.*, 2015 U.S. Dist. LEXIS 99804 (W.D. Wash. 2015).

97 After applying a balancing test, the court also concluded that the IRS's procedures did not violate the *Due Process Clause*. This analysis confirms that the IRS's procedures must comply with mainstream due process jurisprudence. For commentary on this issue, see Leslie Book, *Procedural Due Process and FBAR*, Procedurally Taxing (May 4, 2015), *available at* http://www.proceduralltaxing.com/procedural-due-process-and-fbar/.

98 *U.S. v. Bajakajian*, 524 U.S. 321 (1998).

99 For further commentary about the significance of this case, see, *e.g.*, Leslie Book, *District Court FBAR Penalty Opinion Raises Important Administrative and Constitutional Law Issues*, Procedurally Taxing (Apr. 6, 2015), *available at* http://www.proceduralltaxing.com/district-court-fbar-penalty-opinion-raises-important-administrative-and-constitutional-law-issues/; Andrew Velarde, *Moore Answers Novel FBAR Questions*, 2015 TNT 71-1 (Apr. 14, 2015).

good explanation for why the question about foreign accounts on Schedule B did not prompt them to read the instructions on the form.

In *Dynamo Holdings Limited Partnership v. Commissioner*, the Tax Court, for the first time, allowed a taxpayer to use predictive coding to limit "e-discovery" to relevant documents.[100]

In consolidated Tax Court proceedings, the IRS moved to compel production of electronically stored information (ESI) on two backup tapes.[101] The taxpayers argued that the IRS's request was excessively burdensome because to avoid producing irrelevant, confidential, and privileged material they would have to review between 3.5 and 7 million documents manually at a cost of $450,000 or more. The taxpayers asked the court to allow them to use predictive coding to limit their response. Predictive coding is a document review tool that uses computer algorithms that learn from a small number of human reviews to predict which documents are likely to be the most relevant. The taxpayers' expert testified that predictive coding could limit the manual document review to 200,000-400,000 documents at a cost of $80,000–$85,000.

The IRS opposed the use of predictive coding, arguing that it is an unproven technology. It also asserted the taxpayers could avoid the cost and expense of reviewing the documents by providing the IRS with access to all data on the tapes, while reserving the right (through a "clawback agreement") to later claim that some or all of the data that the IRS actually tries to introduce is privileged.

Although the court granted the IRS motion to compel production, it found the IRS's proposal of a clawback agreement unreasonable. The court remarked that it is not normally in the position of deciding or imposing a particular *method* of discovery upon the parties, but would make a ruling on the matter as an issue of first impression. Tax Court rules regarding discovery had not yet addressed the issue.[102]

The court relied upon the expert testimony and an article by Magistrate Judge Andrew Peck reviewing the technology.[103] It reasoned that studies have indicated predictive coding is more accurate than keyword searches or even a traditional manual review, as it can reduce human error. The court rejected the IRS's argument that predictive coding is an unproven technology, cited several federal cases that had allowed its use, and granted the taxpayers' request to use it in responding to the IRS request.[104] It concluded that an electronic discovery expert could design an effective search. Finally, the court noted that if the taxpayers did not address all of the IRS's concerns about incomplete discovery, the IRS could file another motion to compel.

This case is significant because it establishes that the Tax Court will allow the use of predictive coding in response to electronic discovery requests. Predictive coding can lessen the significant burden of responding to costly discovery requests by the IRS.

100 *Dynamo Holdings Ltd. Partnership v. Comm'r*, 143 T.C. No. 9 (2014).

101 The IRS did not want paper copies because it wanted to review the metadata to determine when the ESI was created.

102 *See generally* Tax Court Rule 70(a). However, the court could have relied upon Tax Court Rule 103(a), issuing an order to protect a party from undue burden or expense from a discovery request. Guidance on e-discovery, which the IRS issued in 2012, did not incorporate predictive coding. CCN CC-2012-017 (Sept. 13, 2012).

103 Andrew Peck, Search, *Forward: Will Manual Document Review and Keyboard Searches Be Replaced by Computer-Assisted Coding?*, L. Tech. News (Oct. 2011).

104 *See, e.g.*, *Hinterberger v. Catholic Health Sys., Inc.*, 2013 WL 2250603 (W.D.N.Y. 2013); *Moore v. Publicis Groupe*, 287 F.R.D. 182 (S.D.N.Y 2012); *In Re Actos*, 2012 WL 7861249 (W.D. La. 2012).