TAX CONTROVERSIES: PRACTICE AND PROCEDURE (2nd ed.) & 2006 SUPPLEMENT

2007 Update

(through June 20, 2007)

Chapter 1

§ 1.02 (The Self-Assessment System)

IRS statistics show an increase in audit coverage during 2006 for most taxpayer segments. *See* IRS, Fiscal Year 2006 Enforcement and Service Results, *available at* http://www.irs.gov/newsroom/article/0,,id=164435,00.html. According to the IRS, the individual audit rate increased to 0.98 percent during fiscal year 2006, compared with a 0.93 percent rate in 2005. The audit rate increased as the individual taxpayer's reported income increased. A total of 1.67 percent of individuals claiming income of $100,000 or more were audited during 2006, compared with a .89 percent rate for individuals claiming incomes of less than $100,000. IRS data also show that "customer satisfaction" ratings for many taxpayer assistance efforts, including telephone assistance, increased.

§ 1.03 (The Internal Revenue Service)

Mark Everson resigned his position as IRS Commissioner in April 2006 and was replaced by Acting Commissioner Kevin M. Brown later in the year.

§ 1.06[A] (Ethical Restrictions on Tax Practice – Tax Planning)

As mentioned on page 10 of the 2006 Supplement, legislation in 2004 authorized the Treasury Department to impose monetary penalties against tax practitioners for violations of Circular 230. 31 U.S.C. § 330. The IRS has recently released guidance detailing how it intends to apply monetary sanctions. *See* Notice 2007-39, 2007-20 I.R.B. 1243. According to the Notice, monetary penalties may be imposed for a single act of prohibited conduct or for a pattern of misconduct, and may be imposed in addition to, or in lieu of, other types of punishment, including suspension, disbarment, or censure. Monetary penalties will not be used, however, as a bargaining chip that a practitioner may offer in order to avoid some other form of punishment.

The 2004 legislation limits the amount of the penalty such that it cannot exceed the gross income derived (or to be derived) from the prohibited conduct giving rise to the penalties. 31 U.S.C. § 330. Notice 2007-39 specifies that, in determining the amount of the monetary penalty, the IRS will consider the income that the practitioner could reasonably expect to realize, irrespective of whether the income has actually been realized. According to the Notice, the IRS will not impose monetary penalties in cases of minor technical violations, when there is little or no injury to a client, the public, or tax administration, and there is little likelihood of repeated similar misconduct.

Chapter 2

§ 2.03 (Examinations)

The IRS announced that it plans to begin conducting National Research Program audits on an annual, rolling basis, selecting approximately 13,000 individual returns for audit each year, starting with the 2006 tax year. *See* IR-2007-113, *available at* 2007 TNT 110-9.

Subject to some exceptions, the IRS has set a 5-year limit on audits of the same taxpayer by the same examiner or specialist in the LMSB or TE/GE division. Policy Statement P-4-5, *available at* http://www.irs.gov/pub/foia/ig/spder/p-4-5.pdf. "[A]n examiner's or specialist's assignment of 25 staff days or less is not considered part of the examination (not to include survey actions) for purposes of application of this Policy Statement." *Id.* at 1. The Policy Statement is effective as of February 9, 2006. *Id.*

§ 2.04[B][1] (Innocent Spouse Procedures)

In *Billings v. Commissioner*, 127 T.C. 7, 17 (2006) (reviewed by the court), the Tax Court overruled its holding in *Ewing v. Commissioner*, 118 T.C. 494 (2002), *rev'd*, 439 F.3d 1009 (9th Cir. 2006), in light of intervening Court of Appeals precedent. In *Billings*, the Tax Court held that it not have jurisdiction over nondeficiency stand-alone innocent spouse petitions.

In December 2006, Congress amended section 6015(f)(1) to extend it to "an individual who requests equitable relief under subsection (f)," applicable to "liability for taxes arising or remaining unpaid on or after the date of the enactment of this Act," which is December 20, 2006. Pub. L. 109-432, Div C, Title IV, § 408(c). Accordingly, in *Van Arsdalen v. United States*, T.C. Memo. 2007-48, in which unpaid taxes remained as of December 20, 2006, the Tax Court vacated its order dismissing the matter for lack of jurisdiction.

Chapter 3

§ 3.03[B] (Exceptions Under Section 6103 Permitting Disclosure)

The Treasury Department finalized the temporary regulations under section 6103(k)(6), mentioned on pages 49-50 of the 2006 Supplement. *See* T.D. 9274 (July 11, 2006). The final regulations are nearly identical to the temporary version.

§ 3.03[C] (Remedies for Unlawful Disclosure Under Section 6103)

A recent Eighth Circuit decision, *Snider v. United States*, 468 F.3d 500 (8th Cir. 2006), reflects continued disagreement over whether a single act of wrongful disclosure by an IRS agent to more than one person constitutes multiple violations of section 6103(a). The taxpayers in *Snider* were under investigation for failure to pay income and employment taxes, as well as employing illegal aliens. During the course of the investigation, the IRS Special Agent contacted approximately 20 of the taxpayers' employees and business associates and revealed to them the taxpayers' names and that they were being investigated for tax and nontax crimes. *Id.* at 505-06.

The majority in *Snider* affirmed the district court's ruling that all the disputed disclosures were unauthorized and that the government had failed to establish that the disclosures were made as a result of a good faith but erroneous interpretation of section 6103. *See* I.R.C. § 7431(b). In doing so, the majority rejected the government's contention that section 6103(k)(6) allows an IRS employee conducting a third-party interview to identify the taxpayer under investigation. The fact that the taxpayer is under investigation is return information. Moreover, according to the majority, disclosure of the taxpayers' identities was not "necessary" to the IRS investigation and thus the disclosures did not fall within the exception in section 6103(k)(6). *Snider*, 468 F.3d at 507-08.

On the issue of calculating the amount of statutory damages under section 7431, the majority affirmed the district court's conclusion that a single disclosure to multiple persons counts as multiple violations of section 6103:

> The government urges that we hold that (1) a disclosure to more than one person at a time amounts to one act of disclosure; and (2) a disclosure of more than one piece of return information in a single interview constitutes a single act of disclosure. We disagree. Increased culpability warrants increased punishment. Direct disclosures to multiple persons multiplies the harm to the taxpayer. Our sister circuit has held that one disclosure to two people counts as two separate disclosures. *Mallas v. United States*, 993 F.2d 1111, 1125 (4th Cir. 1993). As *Mallas* recognized, § 7431(c)(1)(A) imposes statutory damages for "each act of unauthorized disclosure of . . . return information," and § 6103(b)(8) defines "disclosure" as "making known to any person in any manner whatever a return or return information." *Id*. Accepting the government's position would nullify the language "in any manner whatever." *Id*. If a government official directly discloses a taxpayer's return information to two listeners at the same time, the official has informed both listeners and caused as much harm as telling them separately. *Id*. We see no reason why the government should benefit from a wider audience, especially where a wider audience means an increased injury to the taxpayer's privacy. The same reasoning applies to the quantity of information disclosed.
>
> At the same time, we recognize the concerns addressed in *Miller v. United States*, 66 F.3d 220 (9th Cir. 1995). In *Miller*, the Ninth Circuit held that the IRS's disclosure of return information to a Los Angeles Times reporter, who subsequently published 184,000 newspapers containing the information, represented a single act of disclosure rather than 184,000 acts of disclosure. . . . The court reasoned that § 7431 "punishes 'disclosure,' not subsequent disseminations" and declined to extend *Mallas* to such a situation. . . . We agree

> that the proper limitation of liability is the initial act of disclosure, not secondary disclosures made by others such as the media. . . .
>
> However, we do not agree with the Ninth Circuit's holding in *Siddiqui v. United States*, 359 F.3d 1200, 1202-03 (9th Cir. 2004), which extended *Miller* and declined to impose liability for an agent's unauthorized disclosure of return information in a speech to a party of 100 people. As discussed above, we believe that liability should track culpability and injury. A disclosure to 100 people is certainly more egregious than a disclosure to one person, and we believe that Congress drafted the statute to scale damages to injury and culpability with respect to the agent's own acts of disclosure. The method of counting performed by the district court is affirmed.

Id. at 508-09.

The dissenting judge in *Snider* believed that each statement the IRS agent made constituted a single act of disclosure, regardless of how many people heard the statement:

> I would find that § 7431(c)(1)(A) limits the statutory damages for disclosures to the number of specific acts of disclosure. When there are no actual damages, the number of violations for purposes of determining statutory damages is based on "each *act* of unauthorized inspection or disclosure of a return or return information with respect to which such defendant is found liable." 26 U.S.C. § 7431(c)(1)(A) (emphasis added). A statement by a special agent is a single "act," regardless of the number of people who hear the statement or the number of separate items of return information included in the statement. Even if one oral disclosure is heard by numerous people, it is still one "act" of disclosure. *Siddiqui v. United States*, 359 F.3d 1200, 1202-03 (9th Cir. 2004) (holding that an oral disclosure to 100 people did not equal 100 disclosures). . . .
>
> Under the Court's expansive reading of the statute, the statutory damages for a single act of disclosure could result in an unimaginable windfall to a taxpayer for a disclosure disseminated to a large number of recipients over the internet, television or radio. For instance, a single disclosure of a taxpayer's return information to one million people on national television would result in $1,000,000,000 in statutory damages. This surely was not the result Congress intended when it provided for statutory damages of $1,000 per act of improper disclosure in the absence of actual damages. The Court's concern that counting only the agent's "act" would "nullify the language 'in any manner whatever'" and not adequately "track culpability and injury" is unfounded. . . . The statute provides for actual damages where dissemination to multiple listeners or of multiple items of return information results in more substantial injury. Because a taxpayer can use evidence of widespread dissemination to prove actual damages, there is no disproportionality to culpability or injury. The taxpayer is free to prove

> that the disclosure resulted in actual damages to the extent that actual damages exceed the statutory damage amount of $1,000 for the act of improper disclosure.

Id. at 516-17. How would the majority in *Snider* calculate the damages the plaintiff in *Ward* suffered when the IRS agent disclosed her return information during a live radio talk show?

Chapter 4

§ 4.02[C] (Settlement at the IRS Appeals Division)

The IRS recently issued two policy statements detailing when Appeals Agents should raise new issues and when a previously settled case at Appeals should be reopened. IRS Policy Statement P-8-2 (Jan. 5, 2007), *available at* http://www.irs.gov/pub/foia/ig/spder/p-8-2.pdf, provides as follows:

> An issue, on which the taxpayer and the Service are in agreement, should neither be reopened by Appeals nor should a new issue be raised, unless the ground for such action is a substantial one and the potential effect upon the tax liability is material. The existence of unreported income, deductions, credits, gains, losses, etc. stemming from a tax shelter which is a listed transaction constitutes such a substantial ground with a material effect upon the tax liability.

On the issue of when the Appeals Agent should reopen a case, IRS Policy Statement P-8-3 (Jan. 5, 2007), *available at* http://www.irs.gov/pub/foia/ig/spder/p-8-3.pdf, provides:

> (1) Mutual concession cases closed by Appeals will not be reopened by Service except under certain circumstances:
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> A case closed by Appeals on the basis of concessions made by both Appeals and the taxpayer will not be reopened by actions initiated by the Service unless the disposition involved fraud, malfeasance, concealment or misrepresentation of material fact, an important mistake in mathematical calculation, or discovery that a return contains unreported income, unadjusted deductions, credits, gains, losses, etc. resulting from the taxpayer's participation in a listed transaction, and then only with the approval of the Appeals Director of Field Operations or Appeals Director of Technical Services.
>
> (2) Requirements for reopening mutual concession cases at taxpayer's request:
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> Under certain unusual circumstances favorable to the taxpayer, such as retroactive legislation, a case closed by Appeals on the basis of concessions made by both Appeals and the taxpayer may be reopened upon written application from the taxpayer, and only with the approval of the Appeals Director of Field

Operations or Appeals Director of Technical Services. . . . The Chief of Appeals may authorize, in advance, the reopening of similar classes of cases where legislative enactments or compelling administrative reasons require such advance approval.

(3) Non-mutual concession cases will not be reopened by Service except under certain circumstances:

A case closed by Appeals on a basis not involving concessions made by both Appeals and the taxpayer will not be reopened by action initiated by the Service unless the prior disposition involved fraud, malfeasance, concealment or misrepresentation of material fact, an important mistake in mathematical calculation, or such other circumstances that indicates that failure to take such action would be a serious administrative omission, and then only with the approval of the Appeals Director of Field Operations or Appeals Director of Technical Services. The discovery that a return contains unreported income, unadjusted deductions, credits, gains, losses, etc. resulting from the taxpayer's participation in a listed transaction will constitute a serious administrative omission warranting reopening.

(4) Requirements for reopening non-mutual concession cases at taxpayer's request:

A case closed by Appeals on a basis not involving concessions made by both Appeals and the taxpayer may be reopened by the taxpayer by any appropriate means, such as by the filing of a timely claim for refund.

The IRS has finalized its optional, binding arbitration process at the Appeals level. Revenue Procedure 2006-44, 2006-44 I.R.B. 800, outlines the procedures. The Revenue Procedure is largely consistent with IRS Notice 2000-4, mentioned in the text, which established the pilot arbitration program in 2000.

The IRS has again updated its guidance on requesting pre-filing agreements. Revenue Procedure 2007-17, 2007-4 I.R.B. 368, updates Revenue Procedure 2005-12, mention on page 55 of the 2006 Supplement.

Chapter 5

§ 5.03[B][2] (Six-Year Statute of Limitations for Substantial Omission of Items Under Code Section 6501(e))

The IRS ruled in internal guidance that inflated basis on a sale by a partnership was subject to the six-year limitations period of section 6501(e). The IRS distinguished *The Colony* on the ground that it involved an earlier version of the statute and the sale of a good, whereas the taxpayer-partnership involved in the ILM sold a non-inventory asset. ILM 200628021, *available at* 2006 TNT 152-17. According to the ILM, "I.R.C. section 6501 applies *Colony*'s gross receipts test only to trade or business income arising from the sale of a good or service. This partial definition implies that Congress did not intend the gross receipts test to apply to other types of income." *Id.* M. Todd Welty, et al., *Tax Shelters and the Six-Year Statute of Limitations: "Omission of Gross Income" and* The Colony *Revisited*, 8 J. TAX PRAC. & PROC. 33 (2006), though not specifically addressing this ILM, counters IRS arguments of this type, stating, "*The Colony* did not decide what constitutes 'gross income'—be that gain or gross receipts. Rather, *The Colony* stands for the proposition that, where gross receipts of a sale are fully disclosed, there is no 'omission' of income." *Id.* at 34.

§ 5.03[B][3] (Statute of Limitations for Fraudulent Return Under Code Section 6501(c)(1))

The Tax Court has held that the "fraudulent return" provision of section 6501 applies even if the fraud is that of the return preparer, not the taxpayer. *See* Allen v. Commissioner, 128 T.C. 4 (2007). In that case:

> Petitioner, a truck driver for UPS during 1999 and 2000, timely filed his returns for 1999 and 2000 (the years at issue). Petitioner gave his Form W-2, Wage and Tax Statement, section 401(k) statement, mortgage interest statement, and property statements to Gregory D. Goosby (Mr. Goosby), who prepared petitioner's returns for the years at issue and filed them with respondent.
>
> Mr. Goosby prepared petitioner's returns for the years at issue and claimed false and fraudulent Schedule A, Itemized Deductions, for both years. The false deductions included deductions for charitable contributions, meals and entertainment, and pager and computer expenses, as well as various other expenses. Petitioner received complete copies of petitioner's returns for the years at issue after they had been filed, but he did not file an amended tax return for either year.

Id., 2007 U.S. Tax Ct. LEXIS 7 at *2-3. In Tax Court, "[t]he parties . . . agree[d] that petitioner himself did not have the intent to evade tax, but Mr. Goosby claimed the false deductions for the years at issue on petitioner's returns with the intent to evade tax." *Id.* at *4. The court found:

> Nothing in the plain meaning of the statute suggests the limitations period is extended only in the case of the taxpayer's fraud. The statute keys the extension to the fraudulent nature of the return, not to the identity of the perpetrator of the fraud. Nor do we read the words "of the taxpayer" into the statute to require the taxpayer to have the intent to evade his or her own tax.

Id. at *7.

Chapter 6

§ 6.02[A] (Overview of the Tax Court)

The Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006) (hereinafter "Pension Act of 2006"), included a Subtitle entitled "United States Tax Court Modernization." Among other provisions, it contains sections relating to employment benefits for Tax Court judges. It also included sections allowing Special Trial Judges to hear and decide small employment status cases (those governed by section 7436(c)), *see id.* at § 857, and for retired Special Trial Judges to be recalled to judicial duties, *see id*. at § 856. Another provision allows the Tax Court bar membership fee provided for in Code section 7475 to be used "to provide services to pro se taxpayers." *Id*. at § 860. A section providing equitable recoupment jurisdiction for the Tax Court, is discussed below, in connection with Chapter 8.

§ 6.02[E] (The Tax Court's Small Tax Case Procedure)

Tax Court Chief Judge John Colvin announced in January that the Tax Court adopted a proposed amendment to its Rules. The new version of Tax Court Rule 173(b) requires the IRS to file answers in all S cases. It is effective for every S case in which the petition is filed after March 13, 2007. *See* United States Tax Court Press Release (Jan. 12, 2007), *available at* http://www.ustaxcourt.gov/press/011207.pdf; Tax Ct. R. Prac. P. 173(b). The press release notes that S cases comprise about 50 percent of the Tax Court's docket. United States Tax Court Press Release (Jan. 12, 2007), *supra*. The IRS has since released Chief Counsel Notice CC-2007-009, *available at* 2007 TNT 53-11, specifying updated procedures for filing answers in Tax Court cases that reflect the new Tax Court Rule.

Chapter 7

§ 7.01 (Introduction to the Tax Court – Tax Court Jurisdiction)

The Tax Court has held that it had no jurisdiction over the issue of whether the IRS improperly applied payments intended for a couples' 2002 tax year to the husband's 1978 tax year. Bocock v. Commissioner, 127 T.C. 178, 180-82 (2006). The court found, in part, that the payments were payments of "estimated taxes." It found that estimated tax payments are not considered in calculating the amount of a tax deficiency, under section 6211(b). *Id.* at 182. Because the Tax Court has limited jurisdiction, including jurisdiction to redetermine deficiencies. Because the court found that the payments in question were not included in the calculation of a deficiency, the court held that it lacked jurisdiction over the issue.

Chapter 8

§ 8.01 (Overview of Refund Claims; Refund Claim Relating to Tax for Which One is Not Liable)

Ten years after the *Williams* case discussed on page 380 of the text, the IRS issued Revenue Ruling 2005-50, 2005-30 I.R.B. 124. That ruling explains:

> Sections 6325(b)(4) and 7426(a)(4) were enacted as part of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, 112 Stat. 685, in response to the inadequate remedy problem identified by the Supreme Court in *United States v. Williams,* 514 U.S. 527, 115 S. Ct. 1611, 131 L. Ed. 2d 608 (1995). . . . In *Williams,* the Court held that a third party who paid another person's tax liability under protest had standing to bring a refund action under 28 U.S.C. § 1346(a)(1). The Court noted that the third party "had no realistic alternative to payment of a tax she did not owe, and we do not believe that Congress intended to leave parties in respondent's position without a remedy." 514 U.S. at 529 (footnote omitted).
>
> Sections 6325(b)(4) and 7426(a)(4) provide the remedy that was unavailable to the third party in *Williams*. Section 7426(a)(4) specifically states that "[n]o other action may be brought by such person for such a determination." Additionally, section 7426(a)(4) imposes a strict 120-day time limit for filing a substitution of value action in district court challenging the Service's determination of value. Permitting a third party to bring another action, such as a refund suit, would conflict with the 120-day limit Congress imposed on actions brought under section 7426(a)(4). *See City of Richmond* [*v. United States*]*,* 348 F. Supp. 2d [807] at 813-14 [E.D. Ky. 2004].
>
> The cause of action Congress provided in section 7426(a)(4) is limited to cases in which a third party has received a certificate of discharge from the Service under section 6325(b)(4). . . . Courts lack subject matter jurisdiction over cases brought challenging the Service's valuation determination if the certificate of discharge was sought under section 6325(b)(2), rather than section 6325(b)(4). *Wilson* [*v. United States*], 2004 WL 790220, at *2.

Id. Accordingly, the IRS concluded with respect to the person in its first hypothetical, Person A:

> Person A cannot maintain a refund action under 28 U.S.C. § 1346(a). If a discharge is obtained under section 6325(b)(4), the owner of the property has 120 days after the date the certificate of discharge was issued to bring a judicial action under section 7426(a)(4). Person A did not file a timely suit under section 7426(a)(4), and no other action may be brought.

Id.

§ 8.02[D] (Informal Claim Doctrine)

In *Kikalos v. United States*, 479 F.3d 522 (7th Cir. 2007), the Court of Appeals for the Seventh Circuit ruled that a refund claim was insufficient and failed to meet the "informal claim" standard. The court explained:

> The instructions on the tax return form stated, "Enter the line number from page 1 of the form for each item you are changing and give the reasons for each change. . . . If you do not attach the required information, your 1040X may be returned." The Kikaloses wrote, "Income was incorrectly assessed to the above named taxpayer." On December 18, 2002, the IRS rejected the refund claim by letter because the Kikaloses failed to explain or document the decrease in income. The letter stated that "if you want to sue to recover tax, penalties, or other amounts, you may file a lawsuit with the United States District court having jurisdiction or with the United States Court of Federal Claims." The letter also instructed the Kikaloses that they could send in a new claim if they had the missing information. Although the Kikaloses had until May 31, 2004 to file another claim with the necessary information, they did not do so.

Id. at 524.

In finding that the informal claim doctrine was not met, even when a series of letters to the IRS objecting to each adjustment in an examination report were considered in conjunction with the taxpayers' amended return, the court stated:

> In this case, however, the Kikaloses' failure to provide any information regarding the grounds for the refund sought was more than harmless noncompliance. The insufficient refund claim contained no facts "sufficient to apprise the Commissioner" of the claim's merits. Moreover, the IRS sent the Kikaloses a letter informing them of their claim's deficiency. The letter specifically stated that the Kikaloses could refile a new claim with the missing information. Although the Kikaloses had over a year to do so, they did not. Courts created the informal claim doctrine to provide equitable relief to taxpayers who made good faith attempts to amend harmless errors in their refund claims even though the statute of limitations would otherwise bar those amendments. Based on the facts before the Court, the informal claim doctrine cannot help the Kikaloses.
>
> However, this does not end our inquiry because the Kikaloses point out that some courts have applied the doctrine to hold that several timely-but-insufficient submissions may comprise one adequate claim even in the absence of a later-filed amendment. . . . They argue that their insufficient claim combined with Nick Kikalos's letters, and the documents gathered from the 1999 audit comply with

> the treasury regulations. The Supreme Court has not favored this argument. *See Angelus Milling Co.*, 325 U.S. [293] at 299 [(1945)].
>
> The Supreme Court held that "the protection of the revenue authorizes the Commissioner to demand information in a particular form, and he is entitled to insist that the form be observed so as to advise him expeditiously and accurately of the true nature of the claim." *Id.*
>
> Likewise, in this case, the Commissioner was entitled to require that the Kikaloses follow the treasury regulations and "focus attention on the merits of the dispute." *Martin*, 833 F.2d [655] at 660-61 [(7th Cir. 1987)]. Consequently, the district court did not err by finding that the Kikaloses did not file an informal refund claim.

Id. at 526-27.

§ 8.04[A] (Statutes of Limitations on Refund Claims)

In *Wachovia Bank, N.A. v. United States*, 455 F.3d 1261 (11th Cir. 2006), the Court of Appeals for the Eleventh Circuit started its opinion as follows:

> The Beatles' taxman told us what we'd see:
> "There's one for you, nineteen for me."
> But if we really want some funds to free, how soon does asking have to be?

Id. at 1262 (footnote omitted) (*citing* The Beatles, *Taxman*, on Revolver (EMI Records Ltd. 1966)). The question before the court was "whether the statute of limitations period set forth in 26 U.S.C. § 6511(a) applies to claims for refunds made by those who have mistakenly filed a return and paid tax when they were not actually required to file a tax return. And as the Beatles probably would have guessed, the lamentable answer is yes." *Id.* The Court of Appeals thus reversed the district court, which had held that "the three-year limitations period in § 6511 applies only to taxpayers who are required to file tax returns," *id*. at 1263, and thus not to the trust in the case at issue, which was tax-exempt.

§ 8.04[F] (Equitable Recoupment)

The Pension Act of 2006 included the following provision:

> Sec. 858. Confirmation of Authority of Tax Court to Apply Doctrine of Equitable Recoupment.
>
> (a) Confirmation of Authority of Tax Court To Apply Doctrine of Equitable Recoupment—Section 6214(b) of the Internal Revenue Code of 1986 (relating to jurisdiction over other years and quarters) is amended by adding at the end the following new sentence: "Notwithstanding the preceding sentence, the Tax Court

> may apply the doctrine of equitable recoupment to the same extent that it is available in civil tax cases before the district courts of the United States and the United States Court of Federal Claims.”.
>
> (b) Effective Date—The amendment made by this section shall apply to any action or proceeding in the United States Tax Court with respect to which a decision has not become final (as determined under section 7481 of the Internal Revenue Code of 1986) as of the date of the enactment of this Act.

Id. at § 858.

§ 8.05 (Erroneous Refunds)

An excellent article by Bryan Camp, *The Mysteries of Erroneous Refunds*, 114 TAX NOTES 231 (2007), explains the difference between rebate and nonrebate refunds and proposes legislative solutions for the collection problems erroneous refunds cause.

Chapter 9

§ 9.02[A][2] (Courts’ Deference to Treasury Regulations)

For an in-depth analysis of *Swallows Holding v. Commissioner*, 126 T.C. 96 (2006), see Steve R. Johnson, *Swallows Holding as It Is: The Distortion of National Muffler*, 112 TAX NOTES 351 (2006) and Steve R. Johnson, *Swallows as It Might Have Been: Regulations Revising Case Law*, 112 TAX NOTES 773 (2006).

§ 9.04 (Private Guidance)

Revenue Procedure 2007-3, 2007-1 I.R.B. 108, contains the IRS’s current list of no-ruling areas. It updates Revenue Procedure 2006-3, mentioned on page 132 of the 2006 Supplement.

Revenue Procedure 2007-1, 2007-1 I.R.B. 1, sets forth the IRS’s current procedures for requesting a letter ruling. It updates Revenue Procedure 2006-1, mentioned on page 132 of the 2006 Supplement.

Revenue Procedure 2007-17, 2007-4 I.R.B. 368, includes the IRS’s current procedures for requesting pre-filing agreements. It updates Revenue Procedure 2005-12, mentioned on page 132 of the 2006 Supplement.

Chapter 10

§ 10.02[C][2] (Accuracy-Related Penalties – Substantial Understatement)

Revenue Procedure 2006-48, 2006-47 I.R.B. 934, is the most recent update to Revenue Procedure 2001-11 (in the text). It identifies circumstances under which disclosure of an item on a taxpayer's return is adequate for the purpose of reducing the substantial understatement portion of the accuracy-related penalty. The changes reflected in Revenue Procedure 2006-48 are primarily editorial.

§ 10.02[C][3] (Accuracy-Related Penalties – Valuation Misstatements)

The Pension Act of 2006 reduced the thresholds for imposing the accuracy-related penalty for substantial and gross valuation misstatements. As amended, the 20 percent penalty is imposed on an income tax underpayment resulting from a substantial valuation misstatement if the value or adjusted basis of any property claimed on any federal income tax return is 150 percent (rather than 200 percent) or more of the correct valuation or adjusted basis. I.R.C. § 6662(e)(1)(A) (as amended). The 40 percent penalty for gross valuation misstatements is imposed when the property value or adjusted basis claimed on the return is 200 percent (rather than 400 percent) or more of the correct amount. I.R.C. § 6662(h)(2)(A)(i) (as amended). The Act also amended the valuation thresholds for the substantial estate and gift tax valuation understatement portion of the accuracy-related penalty. The existing 50 percent and 25 percent thresholds have been changed to 65 percent, I.R.C. § 6662(g)(1) (as amended), and 40 percent, I.R.C. § 6662(h)(2)(C) (as amended), respectively. Both sets of revised valuation thresholds apply to returns filed after August 17, 2006.

The Pension Act of 2006 also created a civil penalty applicable to appraisers who prepare a valuation appraisal if: (1) the appraiser knows, or reasonably should have known, that the appraisal would be used in connection with a federal tax return or refund claim; and (2) the claimed value of the appraised property results in a substantial valuation misstatement related to income tax under section 6662(e) or a gross valuation misstatement under section 6662(h). I.R.C. § 6695A. The provisions apply to appraisals prepared with respect to returns filed after August 17, 2006. The section 6695A penalty is the lesser of two amounts: (1) the greater of $1,000 or 10 percent of the tax underpayment attributable to the valuation misstatement; or (2) 125 percent of the gross income received by the appraiser for preparing the appraisal. I.R.C. § 6695A(b). The appraiser may avoid the penalty if he can establish that the appraised value was more likely than not the proper valuation. I.R.C. § 6695A(c).

The accuracy-related penalty in section 6662 is usually calculated based on the amount of the tax underpayment attributable to the types of conduct listed in section 6662. As a result, if a taxpayer files an erroneous claim for refund, no penalty applies if there was no additional tax liability attributable to the erroneous refund claim. In order to deter taxpayers from filing wrongful claims for refund, Congress enacted new section 6676 as part of the Small Business and Work Opportunity Act of 2007, Pub. L. No. 110-28, 121 Stat. 112. Section 6676(a) provides, "If a claim for refund or credit with respect to income tax (other than a claim for a refund or credit relating to the earned income credit under section 32) is made for an excessive amount, unless it is shown that the claim for such excessive amount has a reasonable basis, the person making such claim shall be liable for a penalty in an amount equal to 20 percent of the excessive amount." An "excessive amount" is the amount by which the taxpayer's claim for refund or credit exceeds the allowable amount of the claim. I.R.C. § 6676(b). The erroneous refund penalty does not apply to any portion of the excessive amount that is also subject to either the accuracy-related penalty in section 6662 or the civil fraud penalty in section 6663. The new penalty may apply to any refund claim filed or submitted after May 25, 2007.

§ 10.02[G] (Preparer Penalties – Code Section 6694)

Legislation enacted in May 2007 increased the reporting standards relating to the return preparer penalty in section 6694. *See* Small Business and Work Opportunity Act of 2007, Pub. L. No. 110-28. Subsections (a) and (b) of section 6694, as amended, reads as follows:

> § 6694. Understatement of taxpayer's liability by tax return preparer.
>
> (a) Understatement due to unreasonable positions.
>
> (1) In general. Any tax return preparer who prepares any return or claim for refund with respect to which any part of an understatement of liability is due to a position described in paragraph (2) shall pay a penalty with respect to each such return or claim in an amount equal to the greater of –
>
> (A) $1,000, or
>
> (B) 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.
>
> (2) Unreasonable position. A position is described in this paragraph if –
>
> (A) the tax return preparer knew (or reasonably should have known) of the position,
>
> (B) there was not a reasonable belief that the position would more likely than not be sustained on its merits, and
>
> (C)(i) the position was not disclosed as provided in section 6662(d)(2)(B)(ii), or
>
> (ii) there was no reasonable basis for the position.
>
> (3) Reasonable cause exception. No penalty shall be imposed under this subsection if it is shown that there is reasonable cause for the understatement and the tax return preparer acted in good faith.
>
> (b) Understatement due to willful or reckless conduct.
>
> (1) In general. Any tax return preparer who prepares any return or claim for refund with respect to which any part of an understatement of liability is due to a conduct described in paragraph (2) shall pay a penalty with respect to each such return or claim in an amount equal to the greater of –
>
> (A) $5,000, or
>
> (B) 50 percent of the income derived (or to be derived) by the tax return preparer with respect to the return or claim.

(2) Willful or reckless conduct. Conduct described in this paragraph is conduct by the tax return preparer which is –

(A) a willful attempt in any manner to understate the liability for tax on the return or claim, or

(B) a reckless or intentional disregard of rules or regulations.

(3) Reduction in penalty. The amount of any penalty payable by any person by reason of this subsection for any return or claim for refund shall be reduced by the amount of the penalty paid by such person by reason of subsection (a).

Amended section 6694 makes three important changes. First, the amendments extend the scope of the income tax return preparer penalties to preparers of *all* tax returns, amended returns and claims for refund, including estate and gift tax returns, employment tax returns, and excise tax returns. Second, the standards of conduct under section 6694(a) are altered in two ways. For undisclosed positions, revised section 6694(a) replaces the realistic possibility standard with a requirement that the preparer reasonably believe that the tax treatment of the position would more likely than not be sustained on its merits. For disclosed positions, subsection (a) replaces the not-frivolous standard with the requirement that the preparer have a reasonable basis for the tax treatment of the position. Finally, the 2007 amendments increased the amount of the penalties in both subsections (a) and (b). The first-tier section 6694(a) penalty for understatements is increased from $250 to the greater of $1000 or 50% of the income derived (or to be derived) by the tax return preparer from the preparation of a return or claim with respect to which the penalty was imposed. The second-tier section 6694(b) penalty for willful or reckless conduct is increased from $1000 to the greater of $5,000 or 50% of the income derived (or to be derived) by the tax return preparer.

The IRS announced that the pre-amendment version of section 6694(a), and the associated preparer penalty regulations, will apply to income tax returns and refund claims due on or before December 31, 2007. No transitional relief applies to the second-tier penalty for willful or reckless conduct in section 6694(b). *See* Notice 2007-54, 2007-27 I.R.B., *available at* http://www.irs.gov/irb/2007-27_irb/ar10.html. The IRS plans to revise the existing section 6694 regulations in light of the newly revised statute as soon as practicable. For a discussion of the revised penalty and how the new standards relating to existing restrictions under Circular 230, see Lee A. Sheppard, *How Much Trouble Can You Get Into?*, 115 TAX NOTES 1101 (2007).

§ 10.02[H] (Penalties Targeting Tax Shelter Transactions – in 2006 Supplement)

The Tax Relief and Health Care Act of 2006, Pub. L. No. 109-432, 120 Stat. 2922, increased the penalty for filing frivolous tax returns from $500 to $5,000. It now applies to all federal taxes, not just income taxes. I.R.C. § 6702(a) (as amended). The 2006 Act expanded application of the penalty to all "persons" who file a frivolous return (including trusts, estates, partnerships, and corporations), not just individuals. *Id.*

The 2006 Act also added Code section 6702(b), which imposes a $5,000 penalty on any person who submits a "specified frivolous submission." I.R.C. § 6702(b)(1). A submission is a "specified frivolous submission" if it is a "specified submission" (defined in section 6702(b)(2)(B) to include a request for a collection due process hearing and an application for an offer in compromise or installment agreement), and any portion of the specified submission: (1) is based on a position identified by the Secretary as frivolous; or (2) reflects a desire to delay or impede administration of the Federal tax laws. Section 6702(c) requires the Treasury Secretary to prescribe a list of frivolous positions. *See* Notice 2007-30, 2007-14 I.R.B. 883 (listing positions the IRS considers to be frivolous). The penalty for submitting a specified frivolous submission is further discussed in section 12.05[A] of this Letter Update.

The Treasury Department also released new proposed regulations under Code section 6011, which is discussed generally on pages 140-41 of the 2006 Supplement. *See* REG 103038-5 (Nov. 2, 2006). Section 6011 imposes a penalty on a taxpayer who fails to disclose his or her participation in a reportable (tax shelter-type) transaction. As a general matter, the proposed regulations are designed to clarify existing disclosure standards and discourage incomplete disclosures by making the guidelines more specific. *See* Allison Bennett & Stephen Joyce, *Sweeping Shelter Rules Tighten Disclosure*, *Make "Transaction of Interest" Reportable*, 212 DAILY TAX REPORT GG-1 (Nov. 2, 2006). The proposed regulations remove one category of reportable transactions (transactions with significant book-tax differences) and replace it with a new category, "transactions of interest." Prop. Treas. Reg. § 1.6011-4(b)(6). Transactions of interest include transactions that the IRS and Treasury believe have the potential for tax avoidance or evasion but insufficient information exists for the IRS and Treasury to determine if the transactions should be designated as tax avoidance transactions. The IRS intends to issue guidance identifying lists of transactions of interest in the near future. Bennett & Joyce, *supra*.

Chapter 11

§ 11.02[B] (Accrual and Suspension Periods)

The Small Business and Work Opportunity Tax Act of 2007, Pub. L. No. 110-28, extended the current 18-month period within which the IRS must contact the taxpayer regarding possible adjustments to the taxpayer's liability to 36 months. The extended period applies to notices issued after November 25, 2007. The Treasury Department has also issued proposed guidance updating the interest suspension rules under section 6404(g). *See* REG 149036-04 (June 21, 2007). The guidance incorporates changes made to section 6404(g) by legislation in 2004, 2005, and 2007. *Id.*

§ 11.02[D] (Interest Abatement)

The Supreme Court has resolved the split among the circuits on the issue of whether the Tax Court has exclusive jurisdiction to review taxpayers' interest abatement claims under section 6404. Hinck v. United States, 2007 U.S. LEXIS 6081. In a unanimous opinion, the Court ruled that although Congress did not explicitly say so, the plain terms of section 6404(h) (which states, "[t]he Tax Court shall have jurisdiction over any action brought by a taxpayer . . . to determine whether the Secretary's failure to abate interest under this section was an abuse of discretion") reveal that Congress's intent was to vest jurisdiction exclusively in the Tax Court. The decision, which overrules *Beall v. United States*, 336 F.3d 419 (5th Cir. 2003), discussed in the 2006 Supplement, means that taxpayers can no longer bring interest abatement claims as part of a tax refund suit in U.S. District Court or the Court of Federal Claims.

Chapter 12

§ 12.02[A] (Collection Operations)

The IRS's private debt collection program began in September 2006 with cases assigned to three private collection agencies. *See* Diane Freda, *Union President Disputes Administration Claims About IRS Private Collection Program*, 124 DAILY TAX REPORT G-6 (June 28, 2007). The IRS expects the program, should it continue, to collect over $1 billion in unpaid taxes over a 10-year period. *Id.* Critics of the program, including the National Taxpayer Advocate, the National Treasury Employee's Union, and several lawmakers, continue to express concerns about the potential for taxpayer abuse by private agencies and privacy risks. *See* Diane Freda, *Service Issues Publication Telling Taxpayers What to Expect from Private Debt Collection*, 159 DAILY TAX REPORT G-5 (Aug. 17, 2006).

§ 12.03 (Statutes of Limitations on Collections)

Proposed regulations under section 6502, relating to the 10-year statute of limitations on collection, have been finalized. *See* T.D. 9284 (Sept. 5, 2006). The regulations conform to statutory changes made to section 6502 by the 1998 IRS Restructuring Act.

§ 12.04[B][3] (Seizure of Property Subject to Levy)

The Supreme Court ruled in *EC Term of Years Trust v. United States*, 127 S. Ct. 1763 (2007), that a third party whose property has been levied upon in order to satisfy a claim against the taxpayer must seek relief under the wrongful levy procedures in Code section 7426. The third party may not challenge the levy under the general refund procedures of 28 U.S.C. section 1346. As a result, claimants are subject to the nine-month statute of limitations in section 7426, I.R.C. § 6532(c), rather than the longer limitations periods associated with actions brought under the general refund statute. *See* I.R.C. § 6532(a). The Supreme Court's ruling is consistent with the IRS's position announced in Revenue Ruling 2005-49, 2005-30 I.R.B. 125, mentioned in the 2006 Supplement.

§ 12.05[A] (Collection Due Process Hearings)

In August of 2006, the IRS replaced the version of the Collection Due Process (CDP) Handbook it had issued in 2003. An excerpt of the 2003 CDP Handbook is included on pages 161-62 of the 2006 Supplement. The newly revised version of the CDP Handbook is available on the IRS's website at http://www.irs.gov/pub/irs-ccdm/cc-2006-019.pdf and runs 110 pages.

See CC-2006-019 (Aug. 18, 2006). The notice covers administrative CDP procedures, including the following topics:

(1) When a taxpayer has the opportunity for a CDP hearing;
(2) The role of face-to-face conferences;
(3) Conditions under which CDP hearings may be recorded;
(4) Prohibitions against *ex parte* communications; and
(5) Matters that may be considered at a CDP hearing.

The newly revised guidance also includes practices regarding CDP litigation in Tax Court.

The Pension Act of 2006 amended Code section 6330(d) to grant the Tax Court exclusive jurisdiction to review of collection due process (CDP) determinations under sections 6320 and 6330. The provision is effective for all CDP determinations issued on or after October 17, 2006, regardless of the type of underlying tax liability at issue. As a result, CDP cases involving employment taxes, trust fund recovery penalties, and the frivolous return penalty will now be reviewed by the Tax Court, rather than U.S. District Courts. *See* Chief Counsel Notice CC-2007-001 (Oct. 13, 2006) (containing transitional guidance).

The Treasury Department finalized proposed regulations issued in September 2005 under sections 6320 and 6330. T.D. 9290, 9291 (Oct. 16, 2006). The proposed regulations are briefly discussed on page 163 of the 2006 Supplement. The most significant change from the proposed rules is the provision in the final regulations that allows taxpayers to dispute self-reported tax liabilities as part of the CDP hearing. Treas. Reg. § 301.6320-1(e)(1). The regulation is consistent with the IRS's acquiescence in the *Montgomery* case, A.O.D. 2005-03 (Dec. 19, 2005), which is mentioned in the 2006 Supplement on page 167.

As discussed in section 10.02[H] of this Letter Update, legislation in 2006 amended Code section 6702(b), which now imposes a $5,000 penalty on any person who submits a "specified frivolous submission." I.R.C. § 6702(b)(1). A submission is a "specified frivolous submission" if it is a "specified submission"and any portion of the specified submission is based on a position identified by the Secretary as frivolous or reflects a desire to delay or impede administration of the Federal tax laws. *See* Notice 2007-30, 2007-14 I.R.B. 883 (listing positions the IRS considers to be frivolous). Submissions that may trigger the new section 6702(b) penalty include requests for CDP hearings under sections 6320 and 6330, as well as applications for installment agreements and offers in compromise. *See* I.R.C. § 6702(b)(2)(B).

The same 2006 legislation also amended sections 6330 and 6320, both of which now require that CDP hearing requests be in writing and state the grounds for the requested hearing. I.R.C. §§ 6330(b)(1), 6320(b)(1) (as amended). A request for a CDP hearing that includes a specified frivolous submission will be treated as if it were never submitted and will not be subject to further administrative or judicial review. I.R.C. §§ 6330(g), 6320(c) (as amended). Moreover, the taxpayer may not raise an issue as part of a CDP hearing if the issue involves a frivolous position. I.R.C. §§ 6330(c)(4), 6320(c) (as amended).

§ 12.05[B] (Installment Agreements)

The Treasury Department has withdrawn and reproposed regulations under section 6159 relating to procedures for requesting installment agreements. REG 100841-97 (Mar. 5, 2007). The 1997 version of the proposed regulations were never finalized. The new regulations largely mirror the 1997 version, with revisions that reflect interim statutory changes. In general, the regulations describe the procedures for requesting, processing, accepting, and rejecting installment agreements; the termination and modification of existing agreements; and administrative appeal procedures. Reflecting amendments to section 6159 made in 2004, the proposed regulations allow the IRS to enter into installment agreements for full or partial payment of tax liabilities. Prop. Treas. Reg. § 301.6159-1(a).

The IRS has created an on-line process for approving installment agreement applications through its website. The program is available to taxpayers setting up installment agreements with terms of up to five years and that involve $25,000 or less in combined tax, penalty, and interest liability. The Online Payment Agreement application is available on the IRS's website at http://www.irs.gov/individuals/article/0,,id=149373,00.html. The IRS has also recently announced increased user fees for processing installment agreements. *See* T.D. 9306 (Feb. 5, 2007). The charge is $105 for a basic agreement ($43 for taxpayers whose income falls at or below 250 percent of the poverty rate) and $45 for restructuring an existing agreement.

§ 12.05[C] (Offers in Compromise)

The IRS recently issued a revised Form 656, *Offer in Compromise*, which reflects amendments to section 7122 made by the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222. IRS New Release 2007-50 (Mar. 5, 2007). The new form includes updated payment terms, new submission rules, and a revised checklist to determine whether the taxpayer is eligible to file an offer in compromise. The revised form may be used by taxpayers to request relief based on doubt as to collectibility and effective tax administration. Taxpayers wishing to strike a compromise based on doubt as to liability must use a separate form, 656-L. Fact Sheet 2007-16 (Mar. 2007).

In *Oman v. Commissioner*, T.C. Memo 2006-231, the Tax Court remanded to the Appeals Office a case in which the Appeals agent rejected the taxpayer's offer in compromise based on doubt as to collectibility. The agent rejected the offer because, according to the agent, the taxpayer had an "egregious history of past noncompliance" and, as a result, the it would not have been in the best interests of the government to accept the offer. *Id.* The Tax Court, relying upon policy statements in the *Internal Revenue Manual*, found the agent's reasoning "unclear" and inconsistent with the IRS's own internal guidance. The court remanded the case to the Appeals Office for further consideration.

Chapter 13

§ 13.06[B] (Sentencing Guidelines: Base Offense Level – Tax Loss)

In *United States v. Phelps*, 478 F.3d 680 (5th Cir. 2007) (per curiam), the defendant/appellant "caused corporate monies to be falsely reported as wages paid to his family members." *Id.* at 680-81. After his sentence to 42 months imprisonment resulting from his plea of guilty to a charge under 18 U.S.C. § 371 (conspiracy to defraud the government), the Court of Appeals remanded the case in light of *United States v. Booker*, 543 U.S. 220 (2005). On remand, the defendant's tax expert "presented a calculation of the tax loss . . . as $80,463.64; however, she also testified that the excess social security taxes paid through Appellant's family members' fraudulent tax filings should be credited against that figure." *Id.* at 681. Awarding such a credit would lower the defendant's base offense level. The Court of Appeals refused to apply such a credit, finding that the amount of tax loss was the amount the defendant intended to cause. It concluded:

> We are not persuaded that the amount of tax loss Appellant intended to cause should be reduced simply because his scheme to defraud apparently inadvertently caused payment of excess social security taxes. More importantly, Appellant has not shown that the district court clearly erred in finding that he had the intent to cause more than $80,000 in tax loss.

Id. at 682. The Fifth Circuit thus aligned itself with the Seventh and Tenth Circuits, which had refused to apply unclaimed deductions in calculating tax loss, unlike the Second Circuit, which had done so. *See id.* A petition for certiorari has been filed. *See* 75 U.S.L.W. 3696 (Jun. 13, 2007).

In *United States v. Kosinski*, 480 F.3d 769 (6th Cir. 2007), the defendant had been convicted of various crimes.

> The district court calculated the amount of Defendant's tax loss by a preponderance of the evidence. . . . The district court found that the offense level corresponding to Defendant's tax loss amount was nineteen and that the applicable sentencing guideline range was an imprisonment term of thirty to thirty-seven months. The district court awarded Defendant a downward departure resulting in an offense level of eighteen and an imprisonment range of twenty-seven to thirty-three months. . . .
>
> Defendant appealed his conviction to this Court on numerous grounds. . . . On March 22, 2005, this Court affirmed Defendant's conviction, but vacated the sentence because the district court used the sentencing guidelines as mandatory and "erroneously sentenced him based on facts not found by the jury, in contravention of *United States v. Booker*, 543 U.S. 220, 125 S. Ct. 738, 160 L. Ed. 2d 621 (2005)." *Kosinski*, 127 F. App'x. [742] at 750 [(6th Cir. 2005)]. The Court

> held that Defendant's sentence violated *Booker* because Defendant "was sentenced based on the amount of tax loss determined by the district court," rather than an amount found by the jury. *Id*. at 751. The Court found that "[w]ithout the district court's factual determinations of tax loss, the offense level would be 10, corresponding to a sentence of 6 to 12 months." *Id*. This Court remanded the case to the district court for resentencing.

Id. at 772-73.

The Court of Appeals explained that, on remand, "[t]he district court declined to calculate or consider Defendant's tax loss amount. The district court concluded that it did not have authority to depart from the sentencing guidelines and took offense level ten, 'as [a] starting point and [found] that anything within [the sentencing guideline range of] six to 12 months would be reasonable.'" *Id*. at 773 (*quoting* the Joint Appendix). The Court of Appeals held "that the district court erred in concluding that it could not calculate or consider Defendant's tax loss amount." *Id*. at 776. The Court of Appeals further explained:

> "*Booker* did not eliminate judicial fact-finding." *United States v. Coffee*, 434 F.3d 887, 898 (6th Cir. 2005). "It is clear under the law of this Circuit that a district court may make its own factual findings regarding relevant sentencing factors, and consider those factors in determining a defendant's sentence[.]" *United States v. Gardiner*, 463 F.3d 445, 461 (6th Cir. 2006). In the instant case, the district court erred in believing that considering Defendant's tax loss amount would violate the Sixth Amendment. . . . *Booker* does not bar the district court from calculating and considering the tax loss amount provided that the sentencing guidelines are used as advisory and not mandatory. More specifically, post-*Booker*, a district court may enhance a defendant's sentence "based upon facts not found by a jury, provided they do not consider themselves required to do so." *Davis*, 397 F.3d [340] at 352 [(6th Cir. 2005)] (Cook, J., concurring) . . . . Defendant's sentence is, therefore, erroneous insofar as the district court calculated Defendant's sentence "while harboring the misapprehension that, under *Booker*, [it] could not enhance [Defendant's] sentence based upon factors that were not determined by the jury beyond a reasonable doubt." *Gardiner*, 463 F.2d at 461. . . .
>
> Reversal here is required, not because the district court failed to calculate or consider the tax loss amount, but because the district court was under the misapprehension that it simply could not do so. In light of the district court's discretion, nothing in this opinion should be construed as an endorsement of tax loss calculation or consideration. At resentencing, the district court should recognize and exercise its discretion to consider—or to not consider—Defendant's tax loss.

Id. at 776-77.

In *United States v. Robbins*, 99 A.F.T.R.2d (RIA) 1950 (10th Cir. 2007) (unpublished):

> The tax loss proved at trial amounted to $376,000. At the sentencing hearing, the government produced two tax-filer witnesses, whose false returns were not included in the indictment, and an IRS agent. Partially crediting the witnesses' testimony, the district court found that Mr. Robbins was responsible for an additional loss in the amount of $90,675. Under the guidelines, this additional amount increased Mr. Robbins' base offense level by two points.

Id. at *8-*9. The Court of Appeals disagreed with the defendant's "contention . . . that the teachings of *United States v. Booker*, 543 U.S. 220 . . . (2005) prohibit the inclusion of tax loss arising from uncharged conduct that was not proven beyond a reasonable doubt." *Id*. at *10. The court explained:

> It is now well-settled that *Booker* does not preclude "judicial fact-finding by a preponderance of the evidence standard" at the sentencing stage unless the factual findings "operate[] to increase a defendant's sentence mandatorily." *United States v. Hall* 473 F.3d 1295, 1312 (10th Cir. 2007). Here, the district court explicitly "recognize[d] that the guidelines are advisory and not mandatory." . . . . The district court committed no clear error in determining that Mr. Robbins caused a tax loss in excess of $400,000 and sentencing him based on that amount.

Id. at *10.

§ 13.06[B][2] (Upward and Downward Departures – Upward Departure from Sentencing Guidelines Range)

United States v. Rajwani, 476 F.3d 243, *modified & reh'g den.*, 479 F.3d 904, (5th Cir. 2007), the defendant "was convicted on three counts of aiding and abetting wire fraud in violation of 18 U.S.C. §§ 1343 and 1342." *Id.* at 244. The conviction was based on the defendant's actions in inducing elderly women to wire large amounts of money to her bank account.

The district court determined that the defendant's base offense level was 7 and applied several enhancements, including a 2-level vulnerable victim enhancement because the victims were elderly. The resulting total offense level of 21 resulted in a sentencing range of 37-46 months. However, "the court found that an upward departure was warranted because the Guidelines range did not adequately address the seriousness of the offense (U.S.S.G. § 2B1.1, Comment 19) and because the circumstances in the case were present to a degree substantially in excess of that which ordinarily would be involved in a typical offense of this kind (U.S.S.G. § 5K2.0(a)(3)). The judge sentenced the defendant to a term of 120 months on each count, to be served concurrently." *Id.* at 246.

On appeal, the Court of Appeals for the Fifth Circuit noted that the 120-month sentence corresponded to an additional 9 or 10-level increase in offense level (to 30 or 31). *Id.* at 258 & n.7. Although the Court of Appeals found that making an upward departure was not an abuse of discretion under the circumstances of the case, exceeding twice the top of the Sentencing Guidelines range (which would be 92 months) was excessive. The court therefore vacated the sentence and remanded the case. *Id.* at 252.

Chapter 14

§ 14.03 (Representing a Taxpayer During a Criminal Investigation)

In December 2006, U.S. Deputy Attorney General Paul J. McNulty issued new guidance on the federal prosecution of business organizations. *See* Memorandum to Heads of Department Components, United States Attorneys from Paul J. McNulty, Deputy Attorney General (Dec. 12, 2006), *available at* 2006 TNT 239-45. The memo, known as the McNulty memo, supersedes the 2003 Thompson memo. Like the Thompson memo, it contains nine factors relating to the determination of whether to bring charges against a business entity and the negotiation of plea agreements with companies. *See id*. However, the McNulty memo provides, in part, that:

> Waiver of attorney-client and work product protections is not a prerequisite to a finding that a company has cooperated in the government's investigation. . . .
>
> Prosecutors may only request waiver of attorney-client or work product protections when there is a legitimate need for the privileged information to fulfill their law enforcement obligations. A legitimate need for the information is not established by concluding it is merely desirable or convenient to obtain privileged information. The test requires a careful balancing of important policy considerations underlying the attorney-client privilege and work product doctrine and the law enforcement needs of the government's investigation. . . .

Id.

With respect to whether a business's payment of its employees' legal fees constitutes "protect[ion] [of] its culpable employees and agents," the McNulty memo provides:

> Prosecutors generally should not take into account whether a corporation is advancing attorneys' fees to employees or agents under investigation and indictment. Many state indemnification statutes grant corporations the power to advance the legal fees of officers under investigation prior to a formal determination of guilt. As a consequence, many corporations enter into contractual obligations to advance attorneys' fees through provisions contained in their corporate charters, bylaws or employment agreements. Therefore, a corporation's compliance with governing state law and its contractual obligations cannot be considered a failure to cooperate. . . .

Id.

§ 14.07 (Grand Jury Proceedings)

United States v. Ponds, 290 F. Supp. 2d 71 (D.D.C. 2003), discussed in the 2006 Supplement on pages 200-201, was reversed and remanded. *See United States v. Ponds*, 454 F.3d 313, 316 (D.C. Cir. 2006). The Court of Appeals explained:

> The central question on appeal is whether the district court's reliance on "a sharp distinction" between the testimonial aspect of producing documents and the contents of the documents, *see Ponds*, 290 F. Supp. 2d at 79, is contrary to an essential holding of the Supreme Court in *Hubbell* that the use of the contents of documents may be a barred derivative use of the testimony inherent in the immunized act of producing those documents. Throughout its opinion, the district court emphasizes its understanding that § 6002 immunity is limited to the act of production and does not extend to the contents of documents. *See id.* at 80-81, 83, 84, 85, 86, 88, 91. Ponds contends that the district court has returned to the repudiated manna-from-heaven rationale by seeming to think that nothing is amiss if the prosecution uses the contents of the documents without reference to the testimony inherent in the act of production.

Id. at 322-23. The Court of Appeals further found that "[a]lthough the contents of the documents are irrelevant to determining whether the act of production was testimonial, the government's use of the contents of the documents is critical in determining whether there was a derivative use of the compelled testimony that violates § 6002." *Id.* at 324.

The court found that the circumstances of the *Ponds* case fell between those of *Fisher v. United States*, 425 U.S. 391 (1976), and *United States v. Hubbell*, 530 U.S. 27 (2000):

> Unlike *Fisher*, the prosecutors here did not ask for "retained copies" of workpapers, tax returns, and correspondence about which they were sure of both the existence and location. *Compare Fisher*, 425 U.S. at 394, *with Ponds*, 290 F. Supp. 2d at 74. Unlike *Hubbell*, the set of topics for which the Maryland prosecutors sought "any and all documents" "refer[ring] or relat[ing]" to is somewhat defined. *Compare Hubbell*, 530 U.S. at 46-49, *with Ponds*, 290 F. Supp. 2d at 74. For most of the subpoena categories, however, the government has failed to establish its previous knowledge of the existence or location of the documents.

Id. at 324-25. The court concluded on this point that

> The Supreme Court has not defined the precise amount of cognition on the part of an immunized party necessary to render a subpoena response "testimonial," but it

> is clear here that, as in *Hubbell*, the government "needed [Ponds'] assistance both to identify potential sources of information and to produce those sources," *Hubbell*, 530 U.S. at 41, and "it is undeniable that providing a catalog of existing documents," *id.* at 42, rendered this subpoena response "testimony" rather than mere "surrender."

Id. at 327.

The government's impermissible use of the documents nonetheless would not require reversal of the defendant's conviction if the use constituted harmless error beyond a reasonable doubt. *Id.* at 328. The court explained the application of this standard as follows:

> In this determination, "[t]he government cannot escape its error simply by showing the availability of 'wholly independent' evidence from which it *might* have procured indictment or conviction had it not used the immunized testimony," *United States v. Pelletier*, 898 F.2d 297, 303 (2d Cir. 1990) (emphasis added), but must demonstrate beyond a reasonable doubt that the tax evasion case *would* have been vigorously pursued, and the search warrant sought and obtained, had the government not relied on the documents revealed by Ponds' act of production. Unless the government's use of *Kastigar* evidence, in light of evidence from independent sources, was "'so unimportant and insignificant' and ha[s] so 'little, if any, likelihood of having changed the result of the proceeding' that [it] 'may be deemed harmless,'" *United States v. Gallo*, 859 F.2d 1078, 1082 (2d Cir. 1988) (quoting *Chapman*, 386 U.S. at 22) (alterations omitted), the violation of Ponds' right not to be a witness against himself cannot be excused as harmless beyond a reasonable doubt.

Id. at 328-29. Accordingly, the court remanded the case to the district court to determine the extent of the government's impermissible use and whether that use constituted harmless error.

Chapter 15

§ 15.02[D] (Declining Representation of a Tax Client)

For a good recent article on identifying clients who present suspect financial data, see Damon M. Fleming et al., *The Problem Tax Client: Opinions from the Field*, 9 TAX PRAC. & PROC. 33 (April-May 2007).

Chapter 16

No updates.