

A TRIP THROUGH THE TAX COURT'S EXOTIC JURISDICTIONS

March 27, 2018

Presenters: Linda Azmon, Senior Counsel, Office of Chief Counsel
Christopher W. Jones, Attorney, Office of Chief Counsel
Robert R. Martinelli, Morgan, Lewis & Bockius LLP
Juan F. Vasquez, Jr., Chamberlain, Hrdlicka, White, Williams & Aughtry

Tax Court Jurisdiction Under Section 7436

▶ Handout Package includes:

- I.R.C. Section 7436.
- Section 530 of the Revenue Act of 1978, as amended.
- Two Tax Court opinions expanded jurisdiction under IRC § 7436:
 - SECC Corp. v. Commissioner, 142 T.C. 225 (2014)
 - American Airlines, Inc. v. Commissioner, 144 T.C. 24 (2015)
- Letter 3523 - Notice of Employment Tax Determination Under IRC § 7436.
- Sample Decision Document for Resolving a 7436 Tax Court proceeding.

Tax Court Jurisdiction Under Section 7436 (cont'd)

- ▶ Prior to August 5, 1997, Tax Court did not have jurisdiction over any employment tax issues.
- ▶ Employment Tax issues were litigated only in District Court or the Court of Federal Claims.
- ▶ Effective August 5, 1997, IRC § 7436 was added to the Code.
- ▶ IRC § 7436 allows a taxpayer to petition Tax Court to review audit determinations involving:
 - ▶ Worker classification
 - or
 - ▶ Section 530 relief.

Worker Classification

- ▶ Legislative history reflects that IRC Section 7436 was enacted to give taxpayer's a prepayment forum in Tax Court to litigate determinations made by the Service to reclassify workers from independent contractor to employee status for Federal employment tax purposes.
 - Mr. Smith was not treated as by the S-Corp as an employee (he received distributions only), and the Service believes that a portion of the distributions should have been treated as wages subject to FICA, FUTA and ITW.
 - Administrative Assistant and Bookkeeper were treated as employees by the S-Corp., but the Service believes not all wages were properly reported.

Section 530 of the Revenue Act of 1978

- ▶ Section 530 provides businesses with relief from federal employment tax obligations if certain requirements are met.
- ▶ Consistency Test - All 3 must be met.
 - ▶ reporting consistency
 - ▶ substantive consistency
- ▶ Reasonable Basis Test
 - ▶ The business must reasonably rely on one of the following:
 - ▶ prior audit safe haven
 - ▶ judicial precedent safe haven
 - ▶ industry practice safe haven
 - ▶ Other reasonable basis

Collection Due Process

- ▶ After a tax liability is assessed, the case moves to IRS Collection Division.
- ▶ The taxpayer will receive a series of notices alerting them that they must pay the balance due on their account.
- ▶ Meanwhile, section 6321 provides that a *silent* lien in favor of the Government arises for the unpaid tax liability.
- ▶ The lien, however, does not have priority over other creditors until *notice* of the lien has been filed by the Government. *See* sec. 6323.
- ▶ Eventually, the Service will want to protect its interest in the taxpayer's property against third-party creditors and will file notice of its lien in the public records.

Collection Due Process (cont'd)

- ▶ The notice is referred to as the Notice of Filing of Federal Tax Lien (“NFTL”). The Regulations provide that after the Government files the NFTL, it must send to the taxpayer “not more than five business days after the date of [such filing]” a Collection Due Process (“CDP”) notice giving the taxpayer the right to request a CDP hearing.
- ▶ To meet the requirements of the Regulation, the Government sends the taxpayer a Letter 3172, Notice of Tax Lien Filing and Right to CDP Hearing, informing the taxpayer that the Government has filed an NFTL and advising the taxpayer of the right to a hearing.
- ▶ The Service may propose to levy on the taxpayer’s property. For ease of discussion, our talk focuses on the lien-related CDP provisions. The levy-related CDP provisions, though, closely mimic the lien-related provisions

Collection Due Process (cont'd)

- ▶ Section 6320 (a)(3) provides that the CDP notice should contain the following:
 - ▶ The amount of the unpaid tax
 - ▶ The taxpayer's right to request a hearing within thirty days of the notice
 - ▶ Information about the administrative appeal available and the procedures relating to the administrative appeal
 - ▶ The provisions of the Code relating to the release of the federal tax lien
 - ▶ The provisions of the Code relating to the certification of seriously delinquent tax debt and the denial, revocation, or limitation of passports
- ▶ If the taxpayer wishes to request a CDP hearing, the taxpayer must submit a request within the thirty day period following the issuance of the CDP notice. *See sec. 6320(a)(3)(B).*

Collection Due Process (cont'd)

- ▶ The case will be sent from the Collection Division to the Office of Appeals. The taxpayer will receive the contact information for the person in Appeals (usually a settlement officer) that has received the case.
- ▶ The taxpayer can request that the case be transferred to the local Appeals Office for a face-to-face hearing.
- ▶ If the taxpayer fails to request a CDP hearing within 30 days, the taxpayer may still file the request and have the same issues considered by Appeals, however it will be considered an “equivalent hearing” rather than a CDP hearing. *See* Treas. Reg. §301.6320-1(i)(1). To obtain the equivalent hearing, the request must be made within a year of the issuance of the CDP notice. *See* Treas. Reg. § 301.6320-1(i)(2), Q&A-17. As discussed later, the taxpayer will lose certain rights by receiving an equivalent hearing rather than a CDP hearing.

Collection Due Process (cont'd)

- ▶ Section 6320 cross-references to section 6330 which provides the following items that should be considered at the hearing:
 - ▶ The settlement officer must investigate the underlying liability and verify that all “requirements of any applicable law or administrative procedures have been met.”
 - ▶ The taxpayer may raise any relevant issue relating to the unpaid tax including appropriate spousal defenses (i.e., innocent spouse relief), challenges to the appropriateness of collection actions, and offers of collection alternatives including an installment agreement or an offer in compromise.

Collection Due Process (cont'd)

- ▶ The taxpayer may challenge the existence or amount of the underlying tax liability if the taxpayer did not receive a statutory notice of deficiency or did not otherwise have a prior opportunity to dispute the tax liability.
 - The Tax Court has held that if a taxpayer does not receive a notice of determination of worker classification, the taxpayer is allowed to raise the merits of the worker classification in the CDP hearing. *See Hampton Software v. Commissioner*, T.C. Memo. 2016-38.
- ▶ Finally, the settlement officer must perform a balancing test wherein the officer must determine “whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary.”

Collection Due Process (cont'd)

- ▶ At the conclusion of the CDP hearing, the settlement officer must send the taxpayer a determination letter.
- ▶ The determination letter generally determines whether or not to uphold the Government's decision to file the NFTL.
- ▶ If the taxpayer instead had an equivalent hearing, the settlement officer will issue a decision letter.
- ▶ The taxpayer has thirty days to petition the Tax Court for review of the determination letter. If, however, the taxpayer had an equivalent hearing, the taxpayer *cannot* petition for review of the decision letter.
- ▶ The Tax Court's standard of review is generally abuse of discretion and the scope of review is generally limited to the administrative record and other items before the settlement officer when he or she made her determination.
- ▶ If, however, the settlement officer considered the taxpayer's underlying liability, the Tax Court will review the issue using a de novo standard and the Court will not be bound by the administrative record.

Tax Court Jurisdiction: Passports

- ▶ Enacted in December 2015 as part of the Fixing America's Surface Transportation Act.
- ▶ In general, section 32101(e) of the FAST Act provides that the State Department shall not issue a passport to any individual who the Internal Revenue Service certifies as having a seriously delinquent tax debt and that it may revoke a passport previously issued to such an individual.
- ▶ Exceptions
 - ▶ The State Department may issue a passport in emergency circumstances or for humanitarian reasons to an individual who has been certified.
 - ▶ If the State Department decides to revoke a passport, it may, before the revocation, limit the passport only for return travel to the United States or issue a limited passport that permits return travel to the United States.

Tax Court Jurisdiction: Passports (cont'd)

- ▶ Section 7345 governs the process by which the Service will certify individuals who have seriously delinquent tax debts and it provides for judicial review of the certification.
- ▶ Section 7345
 - ▶ Seriously Delinquent Tax Debt
 - ▶ In general (section 7345(b)(1))
 - ▶ Unpaid, legally enforceable tax liability;
 - ▶ That's been assessed;
 - ▶ Is greater than \$50,000 (this amount is adjusted annually for inflation - \$51,000 for 2018); and
 - ▶ With respect to which
 - ▶ A notice of federal tax lien has been filed and CDP rights under section 6320 have been exhausted or have lapsed; or
 - ▶ A levy is made under section 6331.

Tax Court Jurisdiction: Passports (cont'd)

▶ Statutory Exceptions (section 7345(b)(2))

- ▶ A debt that is being timely paid under an IRS-approved installment agreement under section 6159;
- ▶ A debt that is being timely paid under an offer in compromise accepted by the IRS under section 7122;
- ▶ A debt that is being paid under the terms of a settlement agreement with the Department of Justice under section 7122;
- ▶ A debt in connection with a levy for which collection is suspended because of a request for a due process hearing under section 6330; and
- ▶ A debt for which collection is suspended because the individual made an innocent-spouse election (section 6015(b) or (c)) or the individual requested innocent-spouse relief (section 6015(f)).

Tax Court Jurisdiction: Passports (cont'd)

- ▶ Discretionary Exclusions (Notice 2018-01 and Internal Revenue Manual)
 - ▶ Categories
 - ▶ Debt that is currently not collectible due to hardship
 - ▶ Debt that resulted from identity theft
 - ▶ Debt of a taxpayer in bankruptcy
 - ▶ Debt of a deceased taxpayer
 - ▶ Debt that is included in a pending offer in compromise
 - ▶ Debt that is included in a pending installment agreement
 - ▶ Debt with a pending adjustment that will full pay the tax
 - ▶ Taxpayers in a disaster zone
 - ▶ Caveat: The categories are subject to change

Tax Court Jurisdiction: Passports (cont'd)

- ▶ Reversal of certification
 - ▶ Reasons for reversing certification (section 7345(c)(1))
 - ▶ The certification is found to be erroneous
 - ▶ The seriously delinquent tax debt is fully satisfied (or the liability that composes it becomes unenforceable)
 - ▶ The debt ceases to be a seriously delinquent tax debt—under either the statutory exceptions or the discretionary exclusions
 - ▶ State Department notification of reversal (section 7345(c)(2))
 - ▶ Timing of notification depends on the reason for reversal
 - ▶ Generally no later than 30 days or as soon as practicable

Tax Court Jurisdiction: Passports (cont'd)

- ▶ Notification (section 7345(d))
 - ▶ Certifications will be provided to the State Department on a weekly basis
 - ▶ Each certified individual will be sent a CP 508C notice
 - ▶ Sent to the individual's last known address
 - ▶ Will list the liabilities for which the individual was satisfied
 - ▶ And will inform the individual of the right to judicial review

Tax Court Jurisdiction: Passports (cont'd)

- ▶ Judicial Review (section 7345(e))
 - ▶ Any individual who has been certified may bring a civil action to determine whether the certification was erroneous or should have been reversed.
 - ▶ Venue
 - ▶ Any federal district court
 - ▶ The Tax Court
 - ▶ Determination: If the court determines that the certification was erroneous, the court may order the Service to notify the State Department that the certification was erroneous.
 - ▶ Tax Court Rules
 - ▶ New title XXXIV for passport actions
 - ▶ Rules 350 through 354