

LITIGATION OF INDIVIDUAL INCOME TAX ISSUES AND TBOR

- Part I: Helping the Client Gather and Present Documentary and Testimonial Evidence
- Part II: The Role of The Taxpayer Bill of Rights (TBOR)

2018 United States Tax Court Judicial Conference

March 27, 2018

PART I:

- Moderator:
 - Special Trial Judge Diana Leyden
- Panelists:
 - Nancy Abramowitz, Washington College of Law, American University
 - Elizabeth Maresca, Fordham University School of Law
 - Susan Morgenstern, Local Taxpayer Advocate - Cleveland
 - Julie L. Payne, Assistant Division Counsel, IRS

PART II:

- Moderator:
 - Special Trial Judge Peter Panuthos
- Panelists:
 - Nina Olson, National Taxpayer Advocate
 - T. Keith Fogg, Harvard University Law School
 - Leslie Book, Charles Widger School of Law, Villanova University

PART I: HELPING THE CLIENT GATHER AND PRESENT DOCUMENTARY AND TESTIMONIAL EVIDENCE

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SCHEDULE C DISPUTES

EXAMPLE 1:

MS. BLAKE, THE NURSE'S AIDE

SUBSTANTIATION OF EXPENSES / SETTLEMENT

FACTUAL BACKGROUND

- In 2016, Ms. Lucy Blake worked as a nurse's aide for Apex Assisted Living in Tarrytown, New York.
- Her position included 2 types of work
 - 36 hours per week in the facility, and
 - 16 hours per week in patient's homes
- Apex issued:
 - A Form W-2 for the salary earned in the facility (\$40,000)
 - A Form 1099 for the amounts earned while working in patient's homes (\$15,000)
 - Ms. Blake reported this income on her Sch. C and claimed \$14,156 in expenses
 - An additional Form 1099 for \$32,000
 - Ms. Blake contends that this was a mistake as she did not earn this money and that when she approached Apex about it, they told her it was issued in error

IRS EXAMINATION

- The IRS sent Ms. Blake an audit letter increasing her income to match that reported to her on the second Form 1099 from Apex
- Ms. Blake responded with a letter stating that the second Form 1099 was an error
- The IRS responded by issuing a second audit letter
 - Increasing her income to include the amount reported on the second Form 1099
 - Disallowing all expenses claimed against the Schedule C income.
 - Asserting a section 6662 penalty
- A Notice of Deficiency followed 60 days later
- Ms. Blake filed a timely Petition in Tax Court

APPEALS (DOCKETED) -

- Ms. Blake provides the following documents to Appeals:
 - Substantiation for all claimed expenses
 - A letter from Apex dated around when she was hired explaining that the position included the 2 types of work she provided
 - An affidavit (as requested by the Appeals Officer) explaining that
 - she would not be reimbursed for her expenses for her work at the patient's homes.
 - she was instructed by Apex and her tax return preparer to deduct the expenses for that work
 - Apex agreed that the second Form 1099 was issued in error, and
 - Apex was under investigation for Medicare fraud

APPEALS (SETTLEMENT OFFER)

- The Appeals Officer has offered a settlement which -
 - allows 27% of the travel expenses;
 - allows 27% of the meals expenses;
 - allows 27% of the remaining expenses on the Schedule C and moves the other 73% to Schedule A as unreimbursed employee expenses;
 - allowed additional Schedule A deductions for state and local income taxes paid in 2016 of \$2,015;
 - adds \$32,000 to Ms. Blake's income and imposes self-employment income on the entire \$32,000; and
 - asserts the section 6662 substantial understatement penalty
- Ms. Blake rejects this settlement offer and case is transferred to Counsel for trial prep

KEEPING THE CHALLENGE OPEN & IDENTIFYING THE ISSUES

- The issues:
 - How can Ms. Blake prove that the expenses claimed on her Schedule C relate only to her Schedule C income and not to her Form W-2 income?
 - How can Ms. Blake prove that she did not receive an additional \$32,000 from Apex in 2016? (Corrected Form 1099?)
 - How can Ms. Blake challenge the section 6662(a) penalty? Who has the burden of proving managerial approval?

WHAT DOCUMENTS CAN YOU GET FROM THE IRS AND HOW?

- Discovery
 - Request for Documents (informal first)
- FOIA
 - Also, you can File a Freedom of Information Act Request; information on FOIA is available at <https://www.irs.gov/privacy-disclosure/freedom-of-information-act-foia-guidelines>; the page includes a sample request letter
- What to request?
 - Entire Administrative file
 - Correspondence exam? Request AMS, CEAS, and CIS documents
 - Field Exam? Request AMS and RGS documents
 - Collection Involvement? Request AMS and ICS documents
 - Appeals (non-docketed) Involvement? Request ACDS and CAR documents

FACT DEVELOPMENT

- Fact investigation for expenses (developing the narrative)
 - How were the expenses determined?
 - What other documents does Ms. Blake have relating to the expenses claimed –
 - A diary?
 - A calendar?
- How to get a corrected Form W-2.
- Managerial Approval for the section 6662(a),(b) penalty.
- Fact investigation to prove “non-receipt” of the \$32,000
 - Bank statements
 - Subpoenas
 - Investigating and developing the Medicare fraud facts
 - Thinking about getting to resolution....by litigation or by settlement



CASEWORK / LEGAL RESEARCH

- Legal research to determine authority for Schedule C deductions
 - Proving they pertain to one portion of the income, i.e. not the wages.
 - Thinking about how to lock in legal entitlement –
 - Stipulations? Stipulated Issues?
- Legal Research regarding second Form 1099
 - Portillo v. Commissioner 932 F.2d 1128 (5th Cir. 1991)
Tax Court Rule 142
 - IRC § 7491
- Legal Research to develop reasonable cause exception to Section 6662 penalties
 - Reliance on statement of employer
 - Reliance on tax preparer
 - Lack of sophistication in tax matters

EVALUATION OF CASE

- Understand strengths and weaknesses
- Advocacy letter to counsel/appeals outlining your case
 - *“For Settlement Purposes Only”*
 - Raise burden on proof issues
 - Requesting that Counsel investigate the Medicare Fraud issue
- Consider trial value of facts developed..... Evidentiary issues?
- Thinking about litigating risks and benefits

SCHEDULE C DISPUTES

EXAMPLE 2:

MR. RAMOS, THE INDEPENDENT CARPET INSTALLER

OVERSTATED INCOME; SUBSTANTIATION

FACTUAL BACKGROUND

2014 AND 2015

- Mr. Ramos is an independent contractor. During 2014, he worked with a team of other independent installers for Government Contract Installers, Inc (“GCC”). He duly reported his Form 1099 income and associated expenses. The IRS did not audit Mr. Ramos’ 2014 tax return.
- For 2015, GCC was concerned that some installers might not be documented and feared losing their federal contracts. GCC approached Mr. Ramos and made him a “Team Captain”– he was responsible for bring a team of installers to each job, billing their time, etc. He would be paid for the completed job and would, in turn, pay the team members for their time. For 2015, Mr. Ramos received a Form 1099 for the full installation jobs and paid his team members.
- Mr. Ramos had his return for 2015 prepared showing gross receipts equal to the Form 1099 he received. He offset that by compensation paid to other contractors (to whom he furnished Forms 1099), travel expenses to various jobs, the cost of a cell phone to communicate with the team.

IRS EXAMINATION

- The IRS sent Mr. Ramos an audit letter disallowing the deduction for the compensation he paid to the members of his “team”.
- In addition, the IRS disallowed all other expenses claimed against the Schedule C income.
- Mr. Ramos called the IRS and objected.
- The next correspondence Mr. Ramos received was a Notice of Deficiency for 2015.

KEEPING THE CHALLENGE OPEN & IDENTIFYING THE ISSUES

- Mr. Ramos approaches an attorney to understand the matter and to seek help handling it.
- The attorney explains that the matter must move to US TAX COURT in order to continue challenging without having to pay the disputed liability first.
- The attorney prepares a Tax Court Petition disputing all asserted liability and penalties.
- Mr. Ramos asks, “Now what?”
- The attorney helps explain the issues Mr. Ramos confronts: (1) entitlement to a Schedule C deduction for compensation paid, (2) entitlement to travel expenses claimed, (3) entitlement to cell phone expenses claimed, and (4) avoiding the application of any penalties.

TOWARD A CASE THEORY

- Fact investigation
- Legal research to determine authority for Schedule C deductions
- Developing the narrative
- Thinking about getting to resolution....by litigation or by settlement
- Either method involves full case development in order to understand the case “value”

CASEWORK / LEGAL RESEARCH

- Legal research to understand whether there are any legal impediments to claimed deductions
 - Does it matter whether teammates actually reported income? Does their immigration status matter? Other legal barriers?
 - Can Mr. Ramos challenge the Form 1099? Who has the burden of proof under section 6201(d)? What does it take to shift the burden?
 - Thinking about how to lock in legal entitlement. Stipulations? Stipulated Issues?

FACT DEVELOPMENT

- Confirm arrangements with GCC payor
- Confirm rate for installation
- Confirm what is humanly possible to do solo
- Confirm presence of other teammates
- etc.

EVALUATION OF CASE

- Understand strengths and weaknesses
- Consider an advocacy letter to counsel/appeals outlining your case
- Consider trial value of facts developed..... Evidentiary issues?
- Thinking about litigating risks and benefits
- Penalty issues

PART II: THE ROLE OF THE TAXPAYER BILL OF RIGHTS (TBOR)

- Moderator:
 - Special Trial Judge Peter Panuthos
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TAXPAYER BILL OF RIGHTS

IRC §7803(a)(3)

- The Right to Be Informed
- The Right to Quality Service
- The Right to Pay No More than the Correct Amount of Tax
- The Right to Challenge the IRS's Position and Be Heard
- The Right to Appeal an IRS Decision in an Independent Forum
- The Right to Finality
- The Right to Privacy
- The Right to Confidentiality
- The Right to Retain Representation
- The Right to a Fair and Just Tax System