



Effectively Representing the Taxpayer in a Substantiation and Penalty Case

US Tax Court Judicial Conference

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Substantiation of Income/gross receipts and Expenses- generally

- ▶ Self-employed individuals may receive payments in cash.
- ▶ Taxpayers may misstate their income whether received by cash or reported on a Form 1099
- ▶ Third party payers may overstate payments
- ▶ The IRS identifies apparently unreported income by various semi-automated means.
- ▶ Taxpayers face challenges about their income and/or deducted expenses.

From Exam to Tax Court: Where are You?

- ▶ Several IRS Functions Identify Issues and Issue Notices
 - ▶ Automated Substitute for Return Program (ASFR)
 - ▶ Automated Underreporter Program (AUR)
 - ▶ Correspondence Exam
 - ▶ Field Exam
 - ▶ Appeals
- ▶ How do you know what function you are dealing with, and what do the letters and notices mean?
 - ▶ Use the IRS.gov notice and letter search feature.
<https://www.irs.gov/individuals/understanding-your-irs-notice-or-letter>
 - ▶ You can find the notice (CP) or letter (LTR) number on either the top or the bottom right-hand corner of your correspondence.
 - ▶ This feature will help you better understand the notice or notice, explain steps you can take to respond and FAQs.



Want More Information?

- ▶ Call Practitioner Priority Service
- ▶ Call the examination function
- ▶ 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?
 - ▶ 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



Best Practices for Resolving Cases with the Originating Function

- Return calls and correspondence timely
 - No contact is the #1 reason for closing cases...and cases may not be returned to the originating function
- Use the phone number, address or fax number on the Letter to respond
 - This will ensure your response is received by the function that is working the case in a timely manner
- Read the entire Notice or Letter and enclosed Publications
- Do you need more time to assist your taxpayer? If so, call the number on the notice to request an additional 30 days to respond to the notice.
- Having problems? Elevate to a manager.
- Still need help? Contact TAS <https://www.irs.gov/taxpayer-advocate>
- Video Portal (<https://www.irs.gov/newsroom/videos>) contains hints and tips

What's a Notice of Deficiency?

- ▶ It's your opportunity to present your case to a judge before the tax is assessed
- ▶ Different IRS Functions use Different Forms
 - ▶ Campus functions always use Letter 3219 (CP 3219A, 3219B, 3219C, 3219N and 3219(SC/CG))
 - ▶ Any notice of deficiency that is not Letter 3219 is from field exam or Appeals (Generally, Letter 531)
- ▶ Parts of the Notice of Deficiency – Generally 4 parts
 - ▶ Cover letter explaining the notice, how to petition the Tax Court, when to do so, and how to contact TAS
 - ▶ Statement showing the adjustments being made and the calculation of the deficiency and penalties
 - ▶ Consent to assessment may be included on the Statement or as a separate document
 - ▶ Explanation of the Adjustments



How to Identify and Understand the Adjustments

- ▶ Two Types of Tax Adjustments
 - ▶ Substantive Adjustments
 - ▶ Computational Adjustments
- ▶ How can you tell the difference?
 - ▶ Look at the explanation of the adjustments
- ▶ Focus on the Substantive Adjustments and Penalties; computational adjustments follow the substantive adjustments
- ▶ Note: interest is determined once the tax is assessed, and may be disputed separately, see IRC §6404(e)

Schedules C and A: Issues and Challenges

- Deductions & Credits: Explanation of Items will tell you
 - The reason(s) for the disallowance
 - Lack of substantiation is common; also failure to meet the requirements of the code section under which it was taken
 - If any part of a credit or deduction was allowed
 - If any deductions were moved from Schedule C to A (or vice versa)
- Unreported Income: Explanation of Items will tell you
 - The reason(s) for the change and the method used to calculate the change,
 - Information Returns (Forms 1099) were unreported
 - Forms W-2 not included on the return
 - Note: unreported income may be a clue that the taxpayer is an ID theft victim
- Still unsure? Contact the IRS.
- No response? Contact TAS.

Additions to Tax and Penalties

- ▶ Frequently Asserted Additions and Penalties on the Notice of Deficiency
 - ▶ Addition to tax for late filing
 - ▶ Addition to tax for late payment
 - ▶ Underpayment of estimated tax
 - ▶ Accuracy related penalty
- ▶ Reasonable Cause Exception
 - ▶ Facts and circumstances Test; Taxpayer must act in good faith
 - ▶ Generally, delegation of duty to file return to a third party or lack of funds are not reasonable cause.
 - ▶ For more information, review IRM 20.1 <https://www.irs.gov/irm/part20>, and see the resources on irs.gov:

<https://www.irs.gov/businesses/small-businesses-self-employed/penalty-relief-due-to-reasonable-cause>



Can the Taxpayer Advocate Help?

- ▶ TAS Can/Cannot...
- ▶ What's a Taxpayer Assistance Order?
- ▶ Under IRC § 7811, TAS can issue orders to operating divisions ordering them to comply with the code, regulations, IRM
- ▶ And, significantly, Taxpayer Bill of Rights
- ▶ The TAOs are like a brief from the Local Taxpayer Advocate to the operating division
- ▶ TAOs can be a legal roadmap for a case. They discuss:
 - ▶ The facts
 - ▶ The legal authorities
 - ▶ The analysis of law and facts
- ▶ TAS Maintains Documents
 - ▶ Case history
 - ▶ Correspondence and documents from the taxpayer
 - ▶ Correspondence to the operating divisions
 - ▶ Taxpayer Assistance Orders

No Resolution? File a Petition.

- ▶ File Timely!
 - ▶ The time for filing a Petition cannot be extended by anyone, including the Tax Court
 - ▶ Last day to timely file is stated on the Notice of Deficiency in top right corner, See generally IRC §6213(a) but note that there are lots of rules and exceptions!
- ▶ USTaxCourt.gov has useful information:
 - ▶ Forms <https://www.ustaxcourt.gov/forms.htm>
 - ▶ Rules <https://www.ustaxcourt.gov/rules.htm>
 - ▶ Electronic Filing (other than Petition) https://www.ustaxcourt.gov/electronic_access.htm
 - ▶ Taxpayer Information - Contains FAQs about each step in the process, a glossary and videos https://www.ustaxcourt.gov/taxpayer_info_intro.htm
- ▶ Best Practices for Drafting an Effective Petition
 - ▶ Provide clear and concise statement of facts and statements of error
 - ▶ Attach a complete copy of the notice of deficiency (redact taxpayer identification number)
 - ▶ Remember the fee waiver, if applicable https://www.ustaxcourt.gov/forms/Application_for_Waiver_of_Filing_Fee.pdf



What happens to your Petition?

- At the Tax Court
 - The Petition and Request for Place of Trial will be filed, and assigned a docket number.
 - The Court transmits the Petition (and the attached Notice of Deficiency), the Request for Place of Trial, and the Statement of Taxpayer Identification Number to the Office of Chief Counsel
 - The Tax Court may issue an order to address an issue with the petition
 - Examples:
 - Failure to pay the filing fee or file a waiver for the fee
 - No original signature on the petition
- Respond timely to the Court's orders!



What happens at Chief Counsel?

- The Petition package (Petition, Notice of Deficiency, and Request for Place of Trial) will be forwarded to a field office, generally based on the Request for Place of Trial, for Answer
- Counsel has 60 days from the date the Tax Court serves the Petition on Counsel to file its Answer. See Tax Court Rule 36(a) https://www.ustaxcourt.gov/rules/Title_IV.pdf but see Tax Court Rule 40 regarding motion practice
- The case will generally be forwarded to the Office of Appeals for consideration of the merits (See Rev. Proc. 2016-22 <https://www.irs.gov/pub/irs-drop/rp-16-22.pdf>)



Early Opportunities for Resolution

- ▶ New Initiative! Counsel is reaching out to resolve the case before filing an Answer (each office may have its own practice)
 - ▶ This initiative is most common in “S” cases and “S”-like cases
 - ▶ Parties will file a decision document in lieu of an Answer
- ▶ Development of Pro Bono Clinics
 - ▶ LITCs host early resolution conferences with pro se petitioners and Counsel and/or Appeals to facilitate resolution of the case
 - ▶ No early resolution conference program in your area? LITCs should contact the Associate Area Counsel who signs the Answers to explore establishing this program



No Resolution? Work with Appeals...

- ▶ Working with Appeals
 - ▶ After filing the Petition and the Answer, Appeals will acknowledge receipt of the case from counsel with a letter to Petitioner/Petitioner's counsel
 - ▶ The assigned Appeals Officer will subsequently correspond with Petitioner/Petitioner's Counsel to identify and endeavor to resolve the issues in the case
- ▶ What Appeals Can/Cannot do
 - ▶ Appeals mission is to resolve disputes – must resolve entire case; partial resolutions are not possible
 - ▶ Unresolved cases return to Counsel for trial preparation
 - ▶ Appeals may prepare the decision documents
- ▶ Know the Appeals rules! See IRM Chapter 8



Working with Appeals ...

- ▶ Appeals prefers to conduct its conferences by phone.
- ▶ Do you want an in-person conference?
 - ▶ Review IRM 8.6.1.4.1 which outlines Appeals practice as it pertains to different conference formats
- ▶ Rev. Proc. 2016-22
- ▶ Best Practices for Appeals Conferences:
 - ▶ Know your facts
 - ▶ Know your witnesses
 - ▶ Know the controlling law
- ▶ For more information, see <https://www.irs.gov/compliance/appeals>



No Resolution? Work with Counsel.

- ▶ First Contact (But Don't Wait -- You Can Reach Out Too!)
- ▶ *Branerton* Conferences and Informal Requests
 - ▶ Ask about the facts (what's available and what's missing), the law relied upon, and Counsel's theory of the case
 - ▶ Formal discovery should **not** be necessary in small tax cases
- ▶ Stipulations
 - ▶ Be accurate, be thorough, be well-organized
 - ▶ Refuse to stipulate or just reserve an objection?
 - ▶ Stipulations of facts vs. stipulations of settled issues
 - ▶ Limit the facts and issues for trial
 - ▶ Getting nowhere?
 - ▶ Talk with the Associate Area Counsel (AAC)
 - ▶ Request a conference with Counsel and the assigned Judge
- ▶ Keep working toward resolution!



No Resolution? Go to Trial.

- Presumption of Correctness
- Burdens of Production and Proof
- Standing Pretrial Notice and Pretrial Order
 - Require document exchange – no surprises!
- Documentary Evidence
 - Should have been included in stipulation
 - Bring copies for yourself, the Court, Counsel and any witness
 - Best practice: exchange with Counsel prior to trial
- Testimony
- Briefs?
- Not too late to resolve!



You do have Resolution!

(Understanding the Stipulated Decision)

Two parts to every Decision

- ▶ “Above the Line”
 - ▶ Clearly states the amount(s) due from petitioner for all deficiencies in tax and penalties asserted in the Notice of Deficiency
 - ▶ States the amount of overpayment or lack thereof; if there is an overpayment, an addition document titled “Stipulation” will be required showing the calculation of the overpayment
- ▶ “Below the Line”
 - ▶ Stipulation about waiver of the restrictions contained in I.R.C. § 6213(a) prohibiting assessment and collection of the deficiency and penalty (plus statutory interest) until the decision of the Tax Court becomes final
 - ▶ Stipulation about interest
 - ▶ Stipulation(s) about payments and/or withholding credits
 - ▶ Other stipulations as may be necessary to ensure the correct resolution



Questions?

