RECORD NO. 16-1279

In The
United States Court Of Appeals
For The Seventh Circuit

OUR COUNTRY HOME ENTERPRISES, INC.,

Petitioner – Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent – Appellee.

ON APPEAL FROM THE UNITED STATES TAX COURT
THE HONORABLE LEWIS R. CARLUZZO
CASE NO.: 7688-14L

REPLY BRIEF OF APPELLANT

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I. INTRODUCTION

The government's brief is best described as an oxymoron. It is replete with internal inconsistencies and misguided arguments. This Reply Brief explains why that is so.

II. THE GOVERNMENT'S ARGUMENTS REGARDING THE MERITS OF THE PENALTY ASSESSMENT SHOULD NOT BE CONSIDERED BY THIS COURT BECAUSE THE COURT BELOW HELD THAT IT DID NOT HAVE THE ABILITY TO DETERMINE THE MERITS OF THE PENALTY ASSESSMENT

The government first argues that the issues affecting the merits of the penalty assessment, including the issue of whether the amount of the penalty was correctly determined by the Commissioner under Internal Revenue Code ("IRC") §6707A, are either "moot" or "abandoned" in the present appeal. Given that the Commissioner successfully argued to the Tax Court below that the Court had no ability (or jurisdiction, depending your point of view) to rule on the merits of the penalty assessment, the government has no business arguing to this Court that it should resolve the present appeal by resolving the merits of the penalty assessment.

A. The Government's "Mootness" Argument

The government's "mootness" argument is nothing more than a bald-faced effort to flout basic procedural rules, in dereliction of well-established legal doctrines. Collateral estoppel is an affirmative defense, *i.e.,* part of the merits of a dispute, which must be specifically pled in federal courts. *See* Fed. Rule Civ. P.

8(c), *Blonder-Tongue Labs v. University of Illinois*, 402 U.S. 313, 350 (1971) ("[t]he purpose of such pleading is to give the opposing party notice of the plea of estoppel and a chance to argue, if he can, why the imposition of an estoppel would be inappropriate"). The government's "collateral estoppel" argument was not pled as an affirmative defense below. It was not raised in the government's motion for summary judgment below. The Tax Court below never addressed that issue. The collateral estoppel issue therefore is not part of this case at the present time. (In fact, the collateral estoppel issue may never ever come into play if the computational issue discussed *infra* is resolved in favor of Our Country Home Enterprises, Inc. ("OCHE"). *See infra,* at p. 12.) Simply put, what the government calls a "mootness" argument is an improper effort to inject a new issue into the case for the first time at the appellate level.

Appellate courts, including this Court, have repeatedly held that, when a Court lacks jurisdiction to determine the merits of a dispute, the Court should not opine on the merits of the dispute but should instead dismiss the case for lack of jurisdiction. *See, e.g., Arbaugh v. Y&H Corp.*, 546 U.S. 500, 506 (2006), Fed. R. Civ. P. 41(b). Furthermore, appellate courts, including this Court, have repeatedly held that an appellate court generally should not consider an issue for the first time on appeal. *See, e.g., Perry v. Sullivan*, 207 F.3d 379, 393 (7th Cir. 2000). The notion that the government would ask this Court to decide the present appeal by looking to the merits of the penalty assessment after convincing the Tax Court below that it lacked the ability to decide those merits is mind-boggling.

The only way any court can possibly decide the so-called "mootness" issue raised by the government in its brief is if this Court holds that the Tax Court below had the ability to determine the merits of the penalty assessment against OCHE. If this Court were to do what the government is asking the Court to do, namely, rule on the so-called "mootness" issue without addressing the question of whether the Tax Court had the ability to rule on the merits of the penalty assessment against OCHE, this Court will be improperly depriving OCHE of a meaningful opportunity to litigate the merits of the penalty assessment, including the collateral estoppel issue and the computational issue discussed *infra*. This Court would also be depriving the Tax Court (and everyone else) of much needed guidance on why it is that this Court (and the Tax Court below) has or does have the ability to decide the merits of the penalty assessment against OCHE.

This Court should not under any circumstances address the collateral estoppel argument raised by the government for the first time on appeal. Rather, this Court should do one of two things. This Court should either reverse the Tax Court's holding and remand the case to the Tax Court to consider all issues related to the merits of the penalty assessment, including the collateral estoppel issue (if the Commissioner is allowed to amend his pleadings to properly raise this issue), or this Court should merely affirm the ruling of the Tax Court that it lacked the ability to rule on the merits of the penalty assessment, without addressing any other issues.

B. The Government's Argument That OCHE Has Supposedly "Abandoned" A Key Computational Issue in the Present Appeal Is Wrong

The need for a remand, if the Court determines that the Tax Court has jurisdiction to determine the merits of the penalty assessment against OCHE, becomes even more clear in light of a proper analysis of the government's misleading and incorrect statement at footnote 6 of its Brief that OCHE has "abandoned" what the government calls a "statute of limitations" argument, but what is more appropriately labeled a challenge to the manner in which the Commissioner computed the amount of the penalty assessment.

To better understand how utterly wrong the government's argument is on this issue, it is appropriate to first discuss the nature of what the government calls the "statute of limitations" issue. The government refers to this issue as a "statute of limitations" issue at pages 13-14 of its brief. This issue was also referred to as a "statute of limitations" issue by OCHE's trial counsel below. (JA 161-163, 167-171, 203-205, 218-223)[1].

[1] "JA" refers to the joint appendix.

In fact, the so-called "statute of limitations" issue involves nothing more than whether the Commissioner improperly overstated the amount of the penalty assessment under §6707A for the year 2007. Section 6707A requires taxpayers who have engaged in transactions which the Commissioner believes to be (potentially) abusive to file an information return with their income tax return, Form 8886, to advise the Commissioner that the taxpayer has engaged in that transaction. Failure to file this information return is what gives rise to the penalty under §6707A, which was assessed against OCHE for the year 2007. With certain limitations and exceptions, that penalty amount is "75 percent of the decrease in tax shown **on the return** as a result of such transaction (or which would have resulted from such transaction if such transaction were respected for Federal tax purposes)." IRC §6707A(b)(1)(emphasis added).

But the Commissioner has to provide notice to taxpayers that the Commissioner believes that a particular transaction (or type of transaction) is (potentially) abusive in order for taxpayers to know whether they are required to include Form 8886 with their income tax return. A taxpayer cannot be penalized for failing to file Form 8886 with their income tax return unless they are provided with fair notice by the Commissioner, which is done under section 6011 of the Code, that the Commissioner considers the transaction in which the taxpayer engaged to be (potentially) abusive.

The Commissioner lets taxpayers know that he believes that certain transactions and types of transaction are (potentially) abusive by issuing Notices announcing this fact. *See* Treas. Reg. §1.6011-4. The Commissioner did not issue such a Notice regarding the type of transaction in which OCHE engaged as potentially abusive until November 5, 2007. *See* Notice 2007-83, Internal Revenue Bulletin 2007-45 (November 5, 2007), available at https://www.irs.gov/irb/2007-45_IRB/ar14.html, and (JA 31-39.). Thus, the first year for which OCHE was required to include Form 8886 with its income tax return was 2007.

But OCHE's participation in the transaction in question started in 2003, before OCHE was given notice by the Commissioner that the Commissioner considered the transaction in question (potentially) abusive. Notwithstanding the fact that OCHE was not required to include a Form 8886 with its income tax returns for the years 2003 through 2006, the Commissioner computed the §6707A penalty assessment against OCHE for 2007 by assessing 75 percent of the decrease in tax shown on the income tax returns for the years 2004 through 2007.[2] [3] (JA 227.)

[2] The Commissioner also used this improper methodology to compute the §6707A penalty assessments against the taxpayers in the two related cases, *Iames v. Commissioner*, 16-1154 (4th Cir.), *Keller v. Commissioner*, 16-9001 (10th Cir.).

[3] While OCHE initially entered into the transaction in question in tax year 2003, the facts before this Court do not indicate if OCHE took a deduction for contributions made to the plan in tax year 2003. The Commissioner assessed a penalty against OCHE based on contributions to the plan in tax years 2004 through 2007.

OCHE understandably objects to the Commissioner computing the §6707A penalty for the year 2007 by looking to OCHE's tax returns for years prior to 2007, years for which OCHE was NOT required to file Form 8886 with its income tax return. The statute, on its face appears quite clear, requiring that the penalty for a given year be calculated based on 75% of the hypothetical tax reduction for a particular "year," not for a "set of years." Thus, it appears that the penalty assessment against OCHE for the year 2007 should not exceed $33,888, which is 75% of the hypothetical tax reduction for 2007, instead of $200,000, the amount assessed against OCHE by the Commissioner, which is the maximum penalty allowed pursuant to §6707A(b)(2)(A).

This issue may have been referred to as a "statute of limitations" issue by both parties because the Commissioner based the 2007 penalty assessment on multiple tax years, 2004 through 2007. Had the Commissioner assessed multiple penalties for multiple years, the statute of limitations issue (along with other issues) may have come into play. But the Commissioner did not do that. He computed a single penalty for the year 2007 which was (from OCHE's perspective) improperly based on all of the tax returns for the years 2004 through 2007. Thus, this dispute is not about the statute of limitations but is instead about the methodology used by the Commissioner for computing the amount of the penalty assessment.

The dispute regarding the Commissioner's unusual (and from OCHE's standpoint, improper) methodology for computing the penalty assessment in these types of cases has been known to the Commissioner for a long time. IRS Appeals Officer Palminteri considered OCHE's preassessment appeal. (JA 18.) In making her decision Appeals Officer Palminteri drafted a lengthy "Appeals Case Memorandum" which discusses the arguments set forth by OCHE, and the rationale used by the Office of Appeals in sustaining the proposed penalty assessment. (JA 30-40).

Curiously, the Appeals Officer relied upon two IRS Chief Counsel Memoranda when they upheld the Commissioner's "multiple year" methodology for computing a single year's penalty under §6707A. (JA 38.) A review of these two Memoranda, IRS Chief Counsel Memorandum 201109022, available at https://www.irs.gov/pub/irs-wd/1109022.pdf, and IRS Chief Counsel Memorandum 201138039, available at https://www.irs.gov/pub/irs-wd/1138039.pdf, reveals that the reasoning contained in these Memoranda is less than impressive. While the dispute regarding the computational issue should be resolved in the first instance on remand (if this Court holds that the Tax Court has the ability to resolve that dispute), it is important to note the extreme deference given by the Appeals Officer to the poor reasoning contained in the Chief Counsel Memoranda. This extreme deference, without the Appeals Officer engaging in any independent analysis of the issue, illustrates the point that the so-called "independence" of the Office of Appeals, which is touted by the Commissioner as a reason for holding in his favor on the jurisdictional issue in his brief at pages 53-55, is often more of a myth than a reality. *See also infra* at pp. 29-30.

The Commissioner argues in a footnote at page 14 of his Brief that OCHE has supposedly "waived" the computational issue because: (a) OCHE "has not reasserted its statute-of-limitations challenge on appeal"; and (b) OCHE supposedly did not plead this issue in its Tax Court petition. The government's first argument is both wrong and intellectually dishonest. The Commissioner, in his motion for summary judgment filed in the Tax Court, argued only that the Court lacked the ability to determine the merits of the penalty assessment. (JA 21-25). The Commissioner did not argue, in the alternative, that he was entitled to summary judgment on the merits. *Id*. Thus, the Tax Court below never addressed the computational issue, labeled the "statute of limitations" issue by the Commissioner in his Brief and by OCHE's trial counsel below.

Because the Tax Court never addressed the computational issue (or so-called "statute of limitations" issue) at all, but instead dismissed the petition on the grounds that the Court lacked the ability to determine the merits of the penalty assessment, OCHE could not possibly "waive" any issue related to the merits of the penalty assessment, including the computational issue, by not raising that issue in its Opening Brief. As noted previously at page 2, *supra*, this Court does not normally consider issues on appeal where the Court below did not rule on those issues. That is particularly true where the court below held that it lacked the ability to rule on the merits of the dispute and the issue which the party wishes to raise for the first time on appeal relates to the merits of the dispute.

OCHE notes that trial counsel below reminded the Tax Court that OCHE continued to dispute the amount of the penalty assessment for the year 2007 (JA 5-6, 72-77, 145-153, 160-163, 199-205, 218-223.), and that OCHE's Opening Brief in the present appeal also reminded this Court that OCHE continues to dispute the amount of the penalty assessment for 2007. *See* OCHE's Opening Brief at pp. 2, 3, 8. While it may not have been necessary for OCHE to do this to preserve OCHE's ability to challenge the computation of the penalty in the event there is a remand to the Tax Court to rule on the merits of the petition, the fact that OCHE has consistently flagged this issue demonstrates that, from OCHE's perspective, this issue very much remains in dispute.

With respect to the government's second argument, the government is just wrong. From OCHE's perspective, the computational issue has always been part of the case, both administratively and judicially. And the Tax Court, which deals with a large number of *pro se* litigants, has repeatedly decided issues on the merits that were not specifically raised in the pleadings, based on a "deemed consent" theory. *See LeFever v. Commissioner*, 100 F.3d 778, 784-786 (10th Cir. 1996), Rule 41(b) of the Tax Court Rules of Practice and Procedure.

Assuming, *arguendo*, that the computational issue was not properly raised in the petition, OCHE will still have the opportunity to seek leave to amend its petition to raise the computational issue if there is a remand, just as the Commissioner will have the opportunity to seek leave to amend its answer to raise collateral estoppel if there is a remand. The Commissioner never placed the merits of the penalty assessment at issue in his motion below, and the Tax Court had not yet set the case for trial as of the date the Commissioner filed his motion below.

Given that the Tax Court is quite liberal in granting leave to amend, *see* Rule 41(a) of the Tax Court Rule of Practice and Procedure, *LeFever v. Commissioner, supra*, *see also Ax v. Commissioner*, 146 T.C. No. 10 (2016), and given that the Commissioner has been aware of the computational issue for a long time, it seems likely that, in the event of a remand, OCHE's motion for leave to amend the petition to raise the computational issue would be granted.

Finally, it is worth noting that, if OCHE prevails on the computational issue on remand, the government's collateral estoppel argument will not affect the computation of the penalty in this case. The question of whether a transaction is a "listed transaction" (as opposed to a "reportable transaction"), the issue to which the government's collateral estoppel argument is addressed, affects whether the penalty under §6707A is capped at $200,000 (for a listed transaction) or $50,000 (for a reportable transaction). If OCHE prevails on the computational issue, the penalty amount will be $33,888, based on a tax benefit in 2007 of $45,184, as opposed to the amount of $200,000, which was assessed by the Commissioner.

III. THE TAX COURT BELOW HAD THE ABILITY TO DETERMINE THE MERITS OF THE PENALTY ASSESSMENT AGAINST OCHE

Having demonstrated why the government's "mootness" argument should be rejected, OCHE now explains why the government's arguments in support of its position that the Tax Court lacked the ability to determine the merits of the penalty assessment against OCHE are completely without merit

Before addressing the specifics of the government's arguments on the "jurisdictional" issue, it is worth noting that the heart of the government's argument is that the ability of the Tax Court to determine the merits of a tax liability in a Collection Due Process (CDP) case depends on when a taxpayer seeks administrative relief from a disputed liability. If the taxpayer seeks administrative relief from the liability too early, the taxpayer loses the ability to dispute the liability in court. If the taxpayer waits to seek relief from a disputed liability until the start of the CDP process, the taxpayer retains the ability to dispute the liability in court. Suffice to say that the result urged by the government makes no practical sense.

A. The Government's Argument That the Limitations in Section 6330(c)(4) Prohibit the Tax Court From Determining the Merits of the Penalty Assessment Is Contradicted by the Government's Own Regulations and Public Pronouncements Regarding the Meaning of Section 6330(c)(4)

The government offers two key arguments in support of its position that the Tax Court lacked jurisdiction (or the ability) to determine the merits of the penalty assessment. First the government argues that the language in §6330(c)(4) precluded the Tax Court from ruling on the merits of the underlying penalty assessment. This language provides that an issue may not be raised during a CDP hearing if: (1) the issue was raised and considered at a previous CDP hearing or in any other previous administrative or judicial proceeding; and (2) the person seeking to raise the issue participated meaningfully in such hearing or proceeding. Notably, the government did not make this argument in its initial motion for summary judgment below, and the Tax Court did not rely on or discuss §6330(c)(4) in granting the government's motion below. Thus, Appellant did not discuss §6330(c)(4) in its Opening Brief.

It is truly audacious that the Commissioner would rely on §6330(c)(4) in support of his position. In 2003, the IRS Office of Chief Counsel issued an Office of Chief Counsel Notice, CC-2003-16 (May 29, 2003). This Notice discussed the Commissioner's interpretation of §6330(c)(4) and stated in part as follows:

> Sections 6320(c) and 6330(c)(4) provides that an issue may not be raised during a CDP hearing if: (1) the issue was raised and

> considered at a previous CDP hearing or in any other previous administrative or judicial proceeding; and (2) the person seeking to raise the issue participated meaningfully in such hearing or proceeding. *See also* Treas. Reg. §§ 301.6320-1(e)(1), 301.6330-1(e)(1). The requirements of section 6330(c)(4) also applies to CDP judicial review proceedings. *Magana v. Commissioner,* 118 T.C. 488 (2002). Because section 6330(c)(2)(B) explicitly applies to challenges to tax liability, section 6330(c)(4) with its more stringent requirement of meaningful participation applies to non-liability issues.[4]

In *Lewis v. Commissioner*, 128 T.C. 48 (2007), the Tax Court upheld the Commissioner's regulation, Treas. Reg. §301.6330-1(e)(3), Q&A – E2, which was issued under subsection 6330(c)(2)(B) [not under subsection (c)(4)], discussed in OCHE's Opening Brief at pp. 13-14, 45-47, 49-51. This regulation purports to limit the ability (or jurisdiction) of the Tax Court to determine the merits of the underlying liability in a CDP case. The Court in *Lewis* noted at footnote 4 of its opinion the 2003 Chief Counsel Memorandum discussed above and further noted that the Commissioner was not arguing that §6330(c)(4) prevented the Court from determining the merits of the underlying tax liability. 128 T.C. at 52.

Thus, it is clear that, as early as 2003, the Commissioner took the position that the restrictions contained in §6330(c)(4) apply only to non-liability issues. The Commissioner clearly was of the same view at the time the Commissioner

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[4] This Chief Counsel Notice was updated and replaced by Office of Chief Counsel Notice CC-2006-019 (Aug. 18, 2006), which replaced the above discussion with a recitation of the statutory language.

prevailed in *Lewis*. It appears that the Commissioner has only recently "changed his mind" regarding the meaning of the language in §6330(c)(4).

The fact that the Commissioner has recently "changed his mind" on a subject as important as the scope of the Tax Court's ability to determine the merits of a tax liability, after taking a different position for over 15 years, is unsettling to say the least.

If the Commissioner were conceding that the statutory limitations on the ability of the Tax Court to determine the merits of the underlying tax liability in a CDP case were "jurisdictional," this change in position would be less problematic. That is because it is clear that only the courts, and not the Commissioner, have any say, beyond advocating a particular position, regarding the scope of a court's "jurisdiction." The Commissioner's views on the jurisdiction of the Tax Court, whether set forth in regulations or anywhere else, are not entitled to any deference. *See* OCHE's Opening Brief at 45-47.

But the Commissioner argues on appeal that these limitations on the Tax Court's ability to determine the merits of the underlying liability are NOT jurisdictional and argues further that this Court should defer to the Commissioner's interpretation of §6330(c)(2)(B), as set forth in the Treasury Regulation upheld by the Tax Court in *Lewis*. Notably, that regulation takes the position that a pre-assessment administrative hearing with the Office of Appeals in an income tax case does not count as a disqualifying "opportunity" which prevents a taxpayer from later challenging the merits of the underlying liability in a CDP case. Thus, the Commissioner's own regulation takes a position that is inconsistent with the Commissioner's argument that §6330(c)(4) deprives the Tax Court of the ability to decide the merits of the penalty assessment against OCHE.

The validity of the government's argument that §6330(c)(4) prevents the Tax Court from considering the merits of the penalty assessment is completely undercut by the government's argument that the Court should defer to the regulations issued under §6330(c)(2)(B). Similarly, the validity of the government's argument that this Court should defer to regulations issued under §6330(c)(2)(B) is completely undercut by the government's argument that §6330(c)(4) prevents the Tax Court from considering the merits of the penalty assessment. The government is arguing on one hand that this Court should defer to the IRS regulations, while simultaneously arguing that these regulations do not properly interpret the statute.

The Tax Court recently rejected the Commissioner's "new" interpretation of §6330(c)(4), pointing out that this "new" interpretation is completely at odds with the very regulation to which the Tax Court deferred to in *Lewis* and to which the Commissioner would have this Court defer. *Hampton Software Development, LLC* *v. Commissioner*, T.C. Memo 2016-38; 111 T.C.M. (CCH) 1165 (2016). In footnote nine of its opinion, the Tax Court stated in part:

> Even though sec. 6330(c)(2)(B) specifically addresses when a taxpayer may challenge the underlying liability at a CDP hearing, respondent also argues that sec. 6330(c)(4) precluded petitioner from challenging the underlying tax liability at its CDP hearing. By making this argument, respondent is essentially stating that the IRS' own regulations, sec. 301.6330-1(e)(3), Q&A-E2, Proced. & Admin. Regs., addressing what constitutes a "prior opportunity" to dispute the underlying liability under sec. 6330(c)(2)(B) are irrelevant. * * *

The Court then went on to reject the Commissioner's argument that the limitations in §6330(c)(4) apply to the determination of the merits of the tax liability in a CDP case. *Id*.

B. The Purpose and Text of Section 6330(c)(4) Support the Conclusion That Section 6330(c)(4) Only Applies to "Issues" That Directly Affect the Collection of the Tax, Not to "Issues" That Affect the Amount of the Tax

Both the purpose and the text of the statute support the Commissioner's conclusion in Chief Counsel Notice CC-2003-16, *supra*, that the restrictions in §6330(c)(4) do not limit the Tax Court's ability to determine the merits of the underlying tax liability but instead apply only to the Tax Court's ability to consider collection-related issues. First, the position advanced by the Commissioner here would turn the normal rules of tax administration on their head. Normally, taxpayers are encouraged, if not required, to seek relief administratively before going to Court. For example, a taxpayer must file a claim for refund and then wait until the earlier of the denial of that claim or six months from the date of the filing of the claim before filing a refund suit in District Court. *See* IRC §§7422(a) and 6532.

The rule requiring the pursuit of administrative remedies before proceeding to court is a wise one. It leads to settlement of cases, and lowers the number of court cases. Thus, it makes sense to encourage taxpayers to pursue administrative remedies and to do so at the earliest possible opportunity.

The rule advocated by the Commissioner, however, would punish taxpayers for pursuing administrative remedies at the earliest possible time by preventing them from going to court merely by virtue of the fact that they exercised their available administrative remedies prior to pursuing a CDP administrative appeal. Such a rule makes no practical sense and is completely inconsistent with the remedial purpose of the CDP provisions.

Consider how the Commissioner's suggested interpretation of the law would play out in real life. Impecunious or cash-poor taxpayers, faced with a large proposed tax or penalty liability that could be assessed against them without the IRS issuing a notice of deficiency, would face a difficult dilemma. Should they pursue a pre-assessment administrative appeal, in the hope that they succeed in persuading the IRS that the proposed liability should not be assessed, knowing that if the appeal fails that they will never be able to litigate the merits of the liabilities after they are assessed because (a) they lack the funds to pay the liabilities in full and then sue for a refund and (b) pursuit of the pre-assessment administrative appeal would bar them from litigating the merits of the liability in a CDP case? Or do they instead forgo pursuing the pre-assessment administrative appeal, subjecting themselves to the collection process, including the filing of lien notices against them which will ruin their credit, to preserve their ability to litigate the merits of the liability in a CDP case?

The notion that Congress intended to place taxpayers in that kind of dilemma is completely absurd. The whole point of enacting the CDP procedures was to stop collection action by the IRS that was abusive and that created undue hardship and to give taxpayers the ability to dispute the underlying liability in court in situations where taxpayers previously never had such an ability. It makes far more sense to construe the statute in a manner that allows most taxpayers who dispute their liability in a CDP case to challenge the liability in Tax Court than it does to say that taxpayers can only dispute the underlying liability in court in a CDP case when they do not act diligently in pursuing their administrative remedies.

Curiously, the government, near the end of its brief, argues Congress could not have possibly intended to allow most taxpayers to challenge disputed tax liabilities in a CDP case because Congress "does not, one might say, hide elephants in mouseholes," citing to *Whitman v. American Trucking Assocs.*, 531 U.S. 457, 468 (2001). This argument gets things backwards.

As the Roman soldiers who fought Hannibal more than two thousand years ago could attest if they were alive today, if you are facing a herd of elephants, the elephants certainly did not come from a mousehole. The enactment of the CDP procedures, including §§6330(c)(2)(B) and (c)(4), was no mousehole. It was a monumental, revolutionary change in the way the Commissioner must go about collecting taxes, the equivalent of Hannibal's herd of elephants that took the Roman troops by surprise and forced them to completely change the way they did business.

As the result of the enactment of the CDP procedures, no longer can the Commissioner issue lien notices and levies with impunity, depriving taxpayers of basic living necessities and needlessly causing hardship. The CDP procedures were described by commentators as revolutionary in nature, and rightfully so.[5]

The reason why Congress unleashed a herd of elephants on the IRS is because the hearings conducted by Senator Roth revealed significant abuses by the

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[5] *See*, *The National Taxpayer Advocate's Fiscal Year 2004 Objectives Report to Congress*, Taxpayer Advoc. Serv. at 12 (2003); *see also*, Danshera Cords, *How Much Process is Due? I.R.C. Sections 6320 and 6330 Collection Due Process Hearings*, 29 Vt. L. Rev. 51 (2004); Leslie Book, *The Collection Due Process Rights: A Misstep or Step in the Right Direction?*, 41 Houston L. Rev. 1145 (2004).

IRS.[6] The result urged by OCHE here is completely consistent with the revolutionary nature of the legislation enacted by Congress in 1998.

The language used in §6330(c)(4) likewise supports a conclusion that this subsection applies only to collection related matters. First, this subsection states that "an **issue** may not be raised at [a CDP] hearing if the issue was raised and considered at a previous hearing under section 6320 or in any other previous administrative or judicial proceeding," provided that "the person seeking to raise the **issue** participated meaningfully in such hearing or proceeding… ." (emphasis added).

The use of the word "issue" strongly suggests that this subsection was not intended to apply to determinations of liability. Typically, a dispute regarding a tax liability involves more than one issue. The present case is no exception. If §6330(c)(4) applied to liability determinations, courts in CDP cases could end up in a situation where they only have the ability to decide two issues out of five issues affecting a single liability because, for whatever reason, the taxpayer only raised three of the five issues involved in the liability determination in a prior administrative proceeding. Interpreting §6330(c)(4) to apply only to matters not relating to the underlying liability avoids such an absurd result.

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[6] *See*, William V. Roth, Jr. & William H. Nixon, *The Power to Destroy* 3-8 (1999); *The New Collection Due Process Taxpayer Rights*, 86 Tax Notes 1127 (2000); *see also*, Thomas H. Moore, *IRS Nightmares Get Senate Hearing*, CNN, (Sept. 24, 1997) http://www.cnn.com/ALLPOLITICS/1997/09/24/irs.hearing/.

The fact that the exception to the rule in §6330(c)(4) is "changed circumstances," *see* §6330(d)(3)(B), [7] likewise supports the conclusion that §6330(c)(4) applies to collection-related issues and not to determinations of liability. So-called "changed circumstances" affect collection alternatives. For example, if a taxpayer who is on an installment agreement with the IRS loses their job, that is a "changed circumstance" which warrants relief from the previously agreed upon installment agreement. These changed circumstances, however, do not affect the underlying tax liability, which normally can only be affected by events occurring before the end of a particular tax year. *See generally* IRC §441(a).

For all of these reasons, the government's argument that §6330(c)(4) precludes the Tax Court from deciding the merits of the penalty assessment against OCHE is without merit.

C. The Regulation Issued by the Treasury Department Improperly Attempts to Limit the Ability (Jurisdiction) of the Courts to Review the Commissioner's Actions and Thus Is Not Entitled to Deference

The government next argues that §6330(c)(2)(B), and the regulations issued thereunder, bar the Tax Court from considering the merits of the penalty assessment against OCHE. OCHE has already pointed out above, and in its

[7] When Congress renumbered §6330(d)(2)(B) as §6330(d)(3)(B) in 2006, Congress forgot to change the reference in §6330(c)(4).

Opening Brief, why the government's interpretation of the statute is completely inconsistent with the purposes of the statute.

According to the government, this Court should defer to the government's regulation because the regulation supposedly "does not directly regulate jurisdiction" and instead "interprets the scope of *agency* jurisdiction." Government's Brief at p 39. The government's assertion that the IRS's regulation deserves deference because it does not directly regulate the jurisdiction of the Tax Court is wrong.

The regulation does not purport to merely address the circumstances under which the Office of Appeals will consider the merits of the liability in a CDP administrative appeal. If the regulation merely addressed the circumstances under which the Office of Appeals will consider the merits of the underlying liability during the course of the administrative CDP proceeding, without seeking to limit what issues the Tax Court may decide, it would be a different matter entirely.

Thus, if a taxpayer challenged the merits of the underlying liability in an administrative proceeding which preceded the CDP administrative hearing, the Commissioner may very well have the discretion to decide that the Office of Appeals should not devote time in the CDP hearing to consider an argument by the taxpayer that was previously rejected by the IRS. Under those circumstances, it could make sense to permit the prior administrative proceeding to serve as an exhaustion of administrative remedies before the taxpayer goes to court to litigate the merits of the liability in the CDP case.

In such a situation, the Commissioner's decision on whether to reconsider the merits of the liability in the administrative CDP hearing would have no direct effect on the consideration of the merits of the liability in any subsequent court proceedings. That is because a liability determination conducted by the Tax Court in a CDP case is a *de novo* proceeding. *See Goza v. Commissioner*, 114 T.C. 176 at 181-182 (2000). Thus, what did or did not happen at the administrative level would normally be irrelevant to the Tax Court's determination of the liability. (The fact that the Tax Court's liability determination is conducted *de novo* makes clear that the government's argument at page 59 of its Brief is meritless. The government argues that the CDP procedures are a "poor vehicle" for resolving the merits of a liability because the procedures are informal in nature, with no ability to conduct formal discovery. This argument is specious. The same thing can be said about all administrative efforts to resolve a disputed tax or other liability.)

But merely because the Commissioner may be free at the administrative level in a CDP appeal to consider, or to not consider, the taxpayer's arguments that they do not owe the amount of tax asserted by the IRS does not give the Commissioner the ability to limit, through regulations or otherwise, the Tax Court's ability to determine the underlying tax liability once the taxpayer goes to court. The question of when courts have the jurisdiction to tell the Executive Branch that the Executive Branch has violated the law cannot be limited through regulations issued by the Executive Branch. *See* OCHE's Opening Brief at pp. 45-47. Accordingly, the government's assertion that the regulation in question does not seek to limit the jurisdiction of the Tax Court, and thus is entitled to deference, is completely without merit.

D. The Regulation Is Not Entitled to Deference Under the Chevron Standard

Even under the test set forth in *Chevron U.S.A. v. NRDC, Inc.*, 467 U.S.837 (1984), the Commissioner's regulation does not pass muster. That is because the regulation is not a reasonable interpretation of the statute.

1. The Statute Is Not "Ambiguous"

The government argues that the statute is "ambiguous" because it does not directly define the term "opportunity to dispute." The government is wrong. The meaning of an "opportunity to dispute" becomes quite clear upon consideration of the statutory scheme.

OCHE pointed out in its opening brief at pp. 24-26 that receipt of a notice of deficiency is but one of at least five different ways in which taxpayers are provided with an opportunity to dispute a tax liability judicially before the Tax Court. The existence of these other types of opportunities to judicially dispute the merits of a tax liability is important. It is these other types of judicial opportunities to dispute a liability with which the example listed in §6330(c)(2)(B), the issuance of a notice of deficiency to a taxpayer, "hangs out" for purposes of the doctrine of *noscitur a sociis*.

Equally important is that there is only one other "type" of way to challenge a disputed tax liability, namely, administratively, and that the statutory scheme makes clear that Congress could not have possibly intended to prevent taxpayers from judicially challenging the merits of the underlying liability in a Tax Court CDP case merely because a taxpayer had a prior administrative opportunity to dispute the underlying liability.

OCHE's Opening Brief explains that every single taxpayer who is being billed by the IRS for unpaid taxes or penalties has an administrative "opportunity" to dispute that liability within the IRS, unless the liability is already *res judicata*. OCHE Opening Brief at 26-35. (The existence of the *res judicata* exception is why OCHE stated in its Opening Brief at page 12 that administrative opportunities can be pursued in "*almost* every collection case" (emphasis added). The government's nonsensical effort to attribute any additional significance to OCHE's use of that phrase, *see* Government's Brief at pp. 43-44, is completely misguided.)

Taxpayers who dispute an unpaid liability can submit an offer in compromise based on doubt as to liability. If that offer in compromise is rejected, the taxpayer can seek an administrative appeal with the Office of Appeals.

Taxpayers who have been audited can submit a request for audit reconsideration. If that request is initially denied, the taxpayer can request a hearing with the Office of Appeals. All of these are administrative "opportunities" to dispute the merits of the underlying tax liability. And these administrative "opportunities" are available to all taxpayers who owe the IRS money, except for those taxpayers whose liabilities have become *res judicata*.

Because all taxpayers whose unpaid tax liabilities are not *res judicata* have these administrative "opportunities" to dispute a tax liability prior to the start of a CDP administrative appeal, the exception in §6330(c)(2)(B) necessarily must refer to judicial opportunities only, not to administrative opportunities. Otherwise the exception would swallow the rule permitting taxpayers to challenge the underlying liability in CDP cases.

2. The Distinctions Drawn by the Regulations Are Not (And Cannot Be) Justified by the Government

The government argues at page 52 of its Brief that it should be allowed to issue a regulation that draws distinctions between certain types of administrative opportunities for purposes of §6330(c)(2)(B). Neither the statutory scheme nor the purpose of the statute supports drawing any such distinctions or drawing the types of distinctions drawn in the regulations.

The existence of an "opportunity" to administratively challenge a tax liability does not depend on whether the taxpayer takes advantage of such an opportunity. That is made clear by the fact that, under the statute, a taxpayer who receives a notice of deficiency and who fails to challenge the liability in Tax Court has had a prior "opportunity" to challenge the liability.

Why is it that the "opportunity" to submit an offer in compromise based on doubt as to liability does not count as a "prior opportunity" under the regulation? Why is it that the opportunity to request audit reconsideration does not count as a "prior opportunity" under the regulation? The government offers no answers to these questions.

The government also fails to explain why the regulation treats similarly situated taxpayers differently. Why is it that a pre-assessment conference with the Office of Appeals in an income tax case does not count as a "prior opportunity" but a pre-assessment conference with the Office of Appeals regarding a proposed penalty assessment under section 6672 does count as a "prior opportunity?" The government does not, and cannot, adequately answer these questions in its Brief. The regulation on which the government relies draws irrational distinctions and should be struck down, even under the standard set forth in *Chevron*.

E. The Government's Cheerleading About the Supposed "Independence" of the Office of Appeals Is Undercut by the Numerous National Taxpayer Advocate's Reports Which Describe the Serious Problems Which Exist in the Office of Appeals

The government, at pages 53-55 of its Brief, also touts the so-called "independence" of the Office of Appeals as a reason to limit the Tax Court's jurisdiction to determine the merits of a tax liability in CDP cases. To the extent this cheerleading has any relevance to this case, it is undercut by the contents of a series of annual reports issued by the National Taxpayer Advocate's Office. This office was established statutorily by the same legislation that enacted the CDP provisions. Each year, the Advocate's Office is required to issue a report to Congress. These annual reports discuss, *inter alia*, the most serious problems being faced by the IRS.

The National Taxpayer Advocate's 2015 Annual Report, at pages 82-90, available at http://taxpayeradvocate.irs.gov/reports/2015-annual-report-to-congress, includes in its discussion of the most serious problems facing the IRS a section titled "The Appeals Judicial Approach and Culture Project is Reducing the Quality and Extent of Substantive Administrative Appeals Available to Taxpayers." The National Taxpayer Advocate's 2014 Annual Report, at pages 185-196, available at http://taxpayeradvocate.irs.gov/2014AnnualReport, includes in its discussion of the most serious problems facing the IRS a section criticizing the Office of Appeals for not properly performing the "balancing test" in CDP cases, to the detriment of taxpayers' rights. The National Taxpayer Advocate's 2013 Annual Report, at pages 155-164, available at http://www.taxpayeradvocate.irs.gov/2013-Annual-Report/, contains a section titled "Collection Due Process Hearings: Current Procedures Allow Undue Deference to the Collection Function and Do Not Provide the Taxpayer a Fair and Impartial Hearing."

These Annual Reports, and the Annual Reports that preceded them, are also replete with sections noting how the IRS overall is providing inadequate services to taxpayers. Thus, to the extent the manner in which the Office of Appeals is currently doing its job is relevant to the outcome of this appeal, it is clear that judicial review of the IRS's administrative rulings by the Office of Appeals is more necessary than ever.

Finally, consider the following hypotheticals, which are loosely based on real life situations.

> #1. A taxpayer files a "balance due" income tax return for year X, reporting $2 million of cancellation of debt ("COD") income and reporting $700,000 of unpaid taxes. The taxpayer, not long after getting the first bill from the IRS, consults with a tax attorney. The attorney reviews the tax return and determines that the taxpayer was not required to include the COD income in taxable income because the taxpayer was insolvent, *see* IRC §108(a), and that the taxpayer owes about $1,000 to the IRS once the COD

income is excluded from taxable income. The taxpayer cannot pay the $700,000 in full. The attorney promptly submits an offer in compromise based on doubt as to liability.

Under the Commissioner's view of the law, because the taxpayer promptly files an offer in compromise based on doubt as to liability, the taxpayer will later be precluded from challenging the merits of the liability in a CDP case if the IRS rejects the offer in compromise. Because the taxpayer cannot pay the liability in full, the taxpayer will not be able to judicially challenge the liability. According to the Commissioner, the taxpayer would have had the opportunity to judicially challenge the liability in a CDP case only if the taxpayer did not administratively challenge the liability until the IRS either filed a notice of federal tax lien or sent a final notice of intent to levy, both of which trigger CDP rights.

By comparison, under OCHE's view of the law, the taxpayer could judicially challenge the liability in a CDP case even though the prior offer in compromise was rejected. Given that Congress clearly intended to expand the ability of taxpayers to challenge the merits of disputed tax liabilities in CDP cases, only OCHE's interpretation of the statute makes practical sense.

#2. A taxpayer is driving to the post office on April 15 to mail her "balance due" personal income tax return to the IRS. On the way to the post office the taxpayer is injured in a car accident. The taxpayer is discharged

> from the hospital three days later, at which time she mails her personal income tax return to the IRS. The IRS assesses and bills her for a late filing penalty pursuant to IRC §6651(a)(1). This section provides that, if a return is filed less than one month late, a penalty of 5% of the tax due shall be assessed unless the failure to file is due to reasonable cause. The taxpayer submits a letter asking the IRS to abate the penalty assessment on the grounds that the taxpayer has reasonable cause for the late filing of the return. The IRS denies the taxpayer's abatement request. In its denial letter the IRS offers an appeal of the penalty abatement denial if such appeal is requested within 60 days.

Under the Commissioner's view of the law, if the taxpayer appeals the penalty abatement denial prior to filing a CDP administrative appeal, the taxpayer cannot judicially challenge the penalty assessment in a CDP proceeding, because the taxpayer allegedly had a prior opportunity to dispute the underlying liability. *See* Internal Revenue Manual §8.22.8.12-1. If the taxpayer received the final notice of intent to levy prior to the IRS denying the penalty abatement request, the taxpayer could administratively and judicially challenge the penalty assessment in a CDP. *Id.* If the taxpayer were to receive a final notice of intent to levy during the 60 day appeal window, whether the taxpayer could challenge the liability judicially in a CDP case turns on whether the taxpayer requests a CDP hearing prior to the expiration of the 60 day appeal window. *Id*.

By way of contrast, under OCHE's view of the law, the taxpayer can challenge the late filing penalty in court in a CDP case regardless of what happened previously.

The ability of taxpayers to challenge a liability in court in a CDP case should not depend on when they sought administrative relief from the liability. Nor should it depend on the whims and fancies of the Commissioner, who can change his administrative procedures and his "interpretations" of the law at his pleasure. Accordingly, the Tax Court erred when it concluded that it did not have the ability to determine the merits of the penalty assessment against OCHE.

CONCLUSION

For the reasons set forth above and in OCHE's Opening Brief, this Court should reverse the ruling of the Tax Court that it lacked the ability to determine the penalty assessment against OCHE and remand the case to the Tax Court for consideration of the merits of the dispute.

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Dated: August 25, 2016

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CERTIFICATE OF FILING AND SERVICE

The undersigned, counsel for Petitioner-Appellant, Our Country Home Enterprises, Inc., hereby certifies that on August 25, 2016, the foregoing Reply Brief of Appellant was filed via the Court's CM/ECF System, which will send notice of such filing to all registered users.

The necessary filing and service were performed in accordance with instructions given to me by counsel in this case.

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