

MURDOCK INN OF COURT

SKIT: LIABILITY PRECLUSION

SCENE 1: OFFICE OF CHIEF COUNSEL – CASE PLANNING SESSION:

MANAGER: Hello, Newbie Green. Come on in. I know you're eager to discuss that collection due process case assignment, and I'm eager to hear what headway you've made on it.

NEWBIE: Thanks, Ms. Sage. It's an interesting case. Of course, given that I've only just graduated law school, everything I'm assigned seems interesting. But this one especially so.

MANAGER: Great. Welcome to collections enforcement. There's no shortage of human drama in this area of tax law. And in terms of jurisprudential drama, there still remain a number of interesting, yet-to-be-answered questions about CDP and the proper construction of the statute. So why don't you begin by laying out some of the facts of the case you're working on, and we'll see just how interesting it is.

NEWBIE: Ok, Ms. Sage. Here goes. This case involves a company – Bobble-Heads-R-U's – that participated in an employee benefits plan called the Rock Solid Benefits Plan. Bobble-Heads didn't report its participation in the plan on its tax return for 2016. The IRS determined that the benefits plan was a reportable listed transaction that Bobble-Heads was required to report on its return, under Treas. Reg. Sec. 1.6011-4. Due to the failure to properly report the listed transaction on the return, the Service assessed a penalty under Sec. 6707A in the amount of \$87,512. And then -

MANAGER: Can I stop you there, Newbie?

NEWBIE: Sure, Ms. Sage.

MANAGER: Did Bobble-Heads file a protest with the IRS Office of Appeals with respect to the 6707A penalty?

NEWBIE: I believe so. Let me check. [Newbie rifles through papers.] Yes. Bobble-heads definitely filed a protest with the IRS Appeals Office seeking rescission of the penalty under Sec. 6707A(d). Appeals conducted a telephone conference with Bobble-Heads during which the Appeals officer entertained arguments from the company about why it wasn't liable for the penalty.

MANAGER: What sort of arguments did the company make?

NEWBIE: It argued that the Commissioner erred in calculating the penalty amount, and also that the Commissioner improperly classified participation in the Rock Solid Benefits Plan as a listed transaction. An Appeals Officer reviewed the arguments and documents submitted by the company and also held a conference call with Bobble-Heads' counsel. After considering

everything submitted, the Appeals Officer issued a memorandum explaining that the Commissioner correctly computed the penalty and properly treated participation in the benefits plan as a listed transaction. The Appeals Officer sustained the penalty in full and closed the case.

MANAGER: OK. So what happened next, Newbie?

NEWBIE: Well, the IRS assessed the section 6707A penalty and then about a month later sent Bobble-Heads a final notice of its intent to levy and notice of the company's right to a CDP hearing under section 6330. The company exercised its right to a hearing, and at the CDP hearing with Appeals, it argued again that it wasn't liable for the penalty.

MANAGER: Did the Appeals Officer allow the company to contest the underlying liability for the penalty?

NEWBIE: No, she didn't. She reviewed the transcripts from the earlier pre-assessment administrative hearing and concluded that the company had a prior opportunity to challenge its liability. And because of that, she concluded that the company was precluded by operation of section 6330(c)(2)(B) from challenging liability again. So after confirming that all other procedural steps were complied with, she issued a notice of determination sustaining the proposed levy.

MANAGER: So how is it that we're involved now?

NEWBIE: Well, the company petitioned from the notice of determination, as you might imagine, and complained about the fact that it wasn't allowed to contest underlying liability in the collection due process hearing. It seems the company thinks it's unfair – and contrary to the intent of the CDP statute – for that one pre-assessment, administrative hearing with Appeals to be its one and only bite at the apple in terms of challenging liability. The company argues that it ought to have at least one judicial opportunity to contest liability before section 6330(c)(2)(B) should operate to prevent further contest of liability.

MANAGER: And what is Counsel's preliminary position?

NEWBIE: IRS field counsel handling the case wants to file a motion for summary judgment, because if a liability challenge is precluded by 6330(c)(2)(B) and the administrative record establishes that all other procedural steps have been complied with, there are no material factual disputes, and the case is susceptible to resolution on motion for summary judgment.

MANAGER: [Nods thoughtfully before speaking.] Well, what do you think Newbie? Yes – it's field counsel's case, but we're the subject matter experts. Do you think the Commissioner should file a motion for summary judgment?

NEWBIE: Well, Ms. Sage, I've given it a lot of thought, and I have to say that I'm sympathetic to the taxpayer's argument. I mean – isn't the essence of due process a genuine opportunity to be heard before deprivation of a property interest? I understand that Congress wanted there to be some cutting off at some point of a taxpayer's opportunity to challenge liability, but surely that cutting off should occur only after a meaningful vetting of the liability question, right?

MANAGER: I suppose you're not wrong about the essence of constitutional due process, Newbie, but CDP – collection due process – isn't equivalent to constitutional due process.

NEWBIE: It isn't? Why not? Isn't there a deprivation of property that's to occur? Isn't that what the notice of intent to levy is necessarily leading toward?

MANAGER: Yes – there will be a deprivation of property when levy by the government occurs. That's true. But long ago in Phillips v. Commissioner, the Supreme Court held that the Government's effort to summarily collect tax revenue by administrative means doesn't implicate constitutional due process, because due process – and the required opportunity to be heard – is provided afterward, principally through the refund suit mechanism in which a taxpayer can challenge the tax and seek refund of any amount wrongly collected. The Court held that in the case of tax collections, a post-deprivation hearing was appropriate (rather than a pre-deprivation hearing) because of the exceptional importance of prompt collection of taxes by the Government. So when we think about what CDP requires, we should be looking to the statute that Congress gave us, to sections 6230 and 6330, and not to the larger body of constitutional due process jurisprudence.

NEWBIE: Ok. I think I follow you, Ms. Sage, and I'll have a read of that case. Phillips v. Commissioner, right?

MANAGER: That's right. So let's turn then then to the requisites of the statute. What does the statute say about the opportunity to contest liability in a CDP hearing?

NEWBIE: [Looking at Code for reference.] Well, section 6330(c)(2)(B) says that a person may raise a challenge to the existence or amount of the underlying tax liability if the person didn't receive a statutory notice of deficiency for the tax liability or did not otherwise have an opportunity to dispute such tax liability.

MANAGER: And you said the liability at issue was an assessable penalty, right? So no statutory notice of deficiency was required in the case before assessment.

NEWBIE: That's right.

MANAGER: So the real question, then, is whether the taxpayer otherwise had an opportunity to dispute the tax liability before the CDP hearing. The statute doesn't really tell us what is an opportunity to dispute liability, does it? How about the regulations interpreting that statute? What do they provide?

NEWBIE: I know there are pretty extensive regulations under section 6330. Let me see. [Looking over CFR.] Ok – I think I found the right part. It looks like section 301.6330-1(e)(3) addresses this at Q&A E2. It says, “An opportunity to dispute the underlying liability includes a prior opportunity for a conference with Appeals that was offered either before or after the assessment of the liability.”

MANAGER: And that’s what occurred here – taxpayers were afforded an opportunity to dispute the liability through a conference before Appeals, right? So it seems to me that the liability preclusion rule kicks in. The taxpayer had a bite at the apple – so to speak – in terms of liability challenge, and therefore can’t persist in challenging liability in the CDP hearing by operation of section 6330(c)(2)(B). And that includes this proceeding before the Tax Court. So summary judgment is definitely looking like a promising way to go in this case.

NEWBIE: Hmm. But that conference with Appeals doesn’t seem like the equivalent of a judicial opportunity to contest liability such as a taxpayer would have on receipt of a statutory notice. The Appeals hearing doesn’t involve any findings of fact in any real sense, there’s no discovery, no evidentiary rules, no witnesses, no opportunity for cross-examination, no transcript of the proceeding. It just doesn’t seem reasonable that an IRS Appeals conference, such as it is, should serve to preclude a taxpayer from seeking judicial review in the same way that deficiency proceedings do.

MANAGER: Well, Newbie. If you’re saying that that you think operation of the liability preclusion rule sort of infringes on taxpayer’s constitutional rights, go have a look at Phillips v. Commissioner, which we discussed earlier. Again, that case really drives home that, at least in the tax collections area, due process is fulfilled by the opportunity for a taxpayer to sue for refund once the tax (or a portion of it in the case of divisible taxes) is paid. So whatever complaints a taxpayer wishes to make about the administrative process and CDP, infringement of constitutional due process shouldn’t be among the arguments made.

Now if what you’re saying is that you think the Commissioner didn’t reasonably construe the language of section 6330(c)(2)(B) when it wrote the rule that a prior opportunity would include an administrative opportunity before Appeals, then I recommend you read a trio of recent appellate cases that looked at that very question. The cases are Keller Tank Services II, Inc. in the 10th Circuit, Our Country Home Enterprises, Inc. in the 7th Circuit, and James in the 4th Circuit. And for sure have a look at the Judge Goeke’s opinion in Lewis v. Commissioner. These cases take a close look at the statute, its purpose, and the way in which the IRS interpreted the statute when writing the regulation at issue. All affirm the reasonableness of the IRS rule providing for liability preclusion in CDP following a prior Appeals conference in which the taxpayers contested liability for an assessable penalty.

NEWBIE: [Sighs heavily.] Ok, Ms. Sage.

MANAGER: Still not convinced?

NEWBIE: Well I understand that Congress gets to define the body of CDP rights and can decide where to draw the line in terms of cutting off challenges to liability, and it sounds like the courts are satisfied that the IRS drafted a regulation based on a permissible construction of the statute. What I'm still wondering about is the due process – the constitutional due process – of the folks who can't afford to pay the tax and therefore don't have the opportunity to sue for refund. What of their due process?

MANAGER: Good point, Newbie. I guess I'd say that delivering on due process is foremost about providing the opportunity to be heard, not necessarily guaranteeing that such a hearing occur in all instances. And keep in mind that those who cannot afford to pay the tax in order to sue for refund will still have a chance to raise certain issues if the Government files a suit to reduce the tax assessment to judgment and to foreclose the tax liens on specific property.

NEWBIE: I suppose that counts for something. Thanks for the guidance on this assignment and the case references. I'll touch base with you again after I digest them, but I'm definitely thinking summary judgment makes sense here.

MANAGER: Ok. Sounds good, Newbie. Let me know if you have any more questions going forward.

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