

Celebrating a Decade of Tax Controversy Observations and Insights

By *Claudia A. Hill*

Claudia Hill examines how tax controversy has changed over the past decade.

When the JOURNAL OF TAX PRACTICE AND PROCEDURE launched with the April–May 1998 edition, the IRS Restructuring and Reform Act (“the Act”) had just become law. It was the first major overhaul of the IRS in 45 years.

Much of the Act grew from the recommendations of the National Commission on Restructuring the Internal Revenue Service issued on June 25, 1997, relating to executive branch governance and management of the IRS, Congressional oversight of the IRS, personnel flexibilities, customer service and compliance, technology modernization, electronic filing, tax law simplification, taxpayer rights and financial accountability.

Many of the major provisions of this restructuring came from concerns vocal tax practitioners raised at that time about the frustrations taxpayers faced in working with the agency. Examples of provisions that have directly and meaningfully impacted tax practice over the last decade follow:

- The Act mandated the replacement of geographic regional divisions of the IRS with units designed to serve particular categories of taxpayers.
- The Act provided a five-year term of office for the Commissioner of Internal Revenue.
- The Act provided that the National Taxpayer Advocate will be appointed by the Secretary of the Treasury and will report directly to the Commissioner of Internal Revenue; specific authorities were granted to the office.

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- The Act created an IRS oversight board to ensure, among other things, that taxpayers are properly treated by IRS employees.
- The Act created a limited privilege for taxpayers with respect to certain communications made between a taxpayer and a “federally authorized tax practitioner” in noncriminal proceedings.
- The Act allowed for civil damages of up to \$100,000 where an IRS office or employee negligently disregards the tax statutes or regulations.
- The Act limits the use of certain financial status audit techniques by IRS employees.
- The Act provided that certain assessments and levies must have the approval of IRS legal counsel.
- The Act provides for changes in the due process rights afforded to taxpayers after the filing of a notice of federal tax lien.
- The IRS was required by the Act to follow certain guidelines in the Fair Debt Collection Practices Act.
- The Act changed certain procedures relating to taxpayers’ offers in compromise of tax liabilities and installment agreements between taxpayers and the IRS.
- The Act addressed inequities in the innocent spouse statutes by expanding the innocent spouse statutes to include separation of liability and providing equitable relief.
- The Act increased, from \$10,000 to \$50,000, the designated maximum amount that may be at issue in simplified “small tax case” actions filed in the U.S. Tax Court.
- The Act also changed certain rules regarding the burden of proof in court proceedings in connection with federal taxes.

Most of these provisions have been assimilated into our practices. Some require much clarification through regulatory actions and the courts. These topics have been the focus of many articles and columns featured in this JOURNAL. We have been pleased to not only follow the evolution of these concepts, but often lay the foundation for analysis of them. Now, with the help of our Advisory Board, we look to areas of practice that hold promise as the focus of practice over the next decade.

Probably the hottest area at this time, expected to hold much opportunity for representation professionals in the near future, is international. IRS Commissioner Doug Shulman told Senate Finance Committee members at a March 17 hearing on offshore tax evasion that the IRS will maintain its “unprecedented focus” on international compliance and enforcement efforts.

JTPP Advisor Robert McKenzie with Arnstein & Lehr LLP, Chicago, tells us:

One the biggest sea change in tax enforcement is the new emphasis by the IRS in pursuing offshore bank accounts. The IRS current efforts are creating new incentives for those who maintained secret foreign accounts to come forward and voluntarily disclose their tax omissions. In addition to going after individual taxpayers the IRS has teamed with the Department of Justice to demand information from foreign banks in tax haven countries. The United States is placing increasing pressure on tax haven countries to become less secretive and those efforts have already resulted in some relaxation of privacy rules in Switzerland and other jurisdictions. Expect tougher legislation from Congress to add momentum this process. Also expect more efforts to reach multinational corporations that choose to shelter significant income in tax haven jurisdiction. These combined efforts will create a growth area in international tax compliance over the next decade.

JTPP Advisor Larry Gibbs with Miller Chevalier, Washington D.C., brings us back to a domestic focus:

Probably the hottest area at this time, expected to hold much opportunity for representation professionals in the near future, is international.

The events of last year and particularly last fall are likely to have a drastic impact on our public (and private) economic and fiscal sectors over the next 10 years. The amount of federal debt already incurred and likely to be incurred in the future is staggering. The boomers are nearing their retirement ages and the demographic shift that will result from their retirements soon

will be upon us, with all of the implications of the huge projected shortfalls in the costs of the Social Security, Medicare and Medicaid programs, based on the laws that are on the books today. Our federal government’s annual operating deficits are not sustainable, as the Obama administration openly has admitted. The politicians can lower benefits and curtail spending, raise taxes, and print money to deal with these issues. Right now, they are raising benefits, increasing spending, and printing money. The Obama administration is proposing to increase taxes on the “wealthy” individuals and “large” businesses, but in doing so, the pressure is going to be on them to ensure that, in turn, the IRS can and will take steps to ensure that everyone is paying his, her, or its fair share of taxes that are already on the books, as the Obama administration signaled recently.

But the IRS simply does not have the resources to do that much as things now stand. Some of the most prominent tax straws in today’s winds suggest that tax compliance may be continuing to decline. Some project the continued growth of the tax gap. For example, the 1099 issues underlying the prominent Geithner-Daschle-Killifer tax issues suggest that such growth among the less affluent could be accelerating, as Janet Novack pointed out in her recent article. Further, to take one small but important example, the offshore credit card problems of recent, prior years and those of UBS and its account holders of today teaches us that even more serious tax non-compliance may be growing not only at upper income levels but also among the less well-to-do.

What does all this really mean for our clients and for us as tax practitioners? Will our federal government continue to rely on an income tax for the bulk of its revenue, or will a consumption tax be added as well? Will IRS funding be increased, and if so, will any increase be real and sustained over ten years or just more of the one-shot “blue smoke and mirrors” increase of the past? Will large businesses and wealthy individuals be targeted, and if so, how? Will more of the cost and burden of tax compliance be pushed into the private sector over the next ten years as it has over the past 10 years? Will we as practitioners find ourselves caught in the middle between our legal duties to help the tax system cope and our ethical and other obligations to our clients to help them avoid paying more than they owe under an increasing complex, ever-changing tax law?

As the above scenario unfolds, these are likely to be some of the more meaty tax policy and administration challenges that will play out over the next 10 years, and they may begin to do so later this year, perhaps in ways that may surprise those of us who have spent so many years practicing in the tax area. How they play out may influence what our tax law and tax practice will look like 10 years from now.

Turning to concerns about day-to-day interactions with IRS, JTPP Advisor Carol Luttati with Law Office of Carol M. Luttati, New York, brings us back to the ever recurring topic of representing our clients as IRS pursues its compliance enforcement mission. Carol tell us:

Given the abysmal state of the economy, the many government endorsed bail-outs of various financially struggling sectors of the economy, including prominent banks and insurance companies, along with major players in the automobile industry, the IRS, of necessity, must continue to focus its efforts on closing the tax gap. Now more than ever before in recent history, the Treasury needs to be vigilant in collecting the amount of self-assessed taxes reported on all filed returns. Beyond that, the

Treasury needs to shore-up the rate of voluntary tax compliance particularly among Small Business/Self-Employed taxpayers who, as a group, roughly account for two-thirds of the tax gap.

The government desperately needs to collect every tax dollar possible to fund its ambitious bail-out and entitlement programs. The problem is that it has neither the manpower nor the luxury of time within which to do so.

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As a consequence, practitioners should never lose sight of the

fact that every dark cloud has a silver lining. This economic turn of events could bode well for taxpayers indebted to the IRS by affording them a measure of leverage with collections. Practitioners may be able to use these troubled times to negotiate more favorable repayment terms for their clients than might otherwise be the case. As a creditor, the IRS might well decide to entertain accepting collection alternatives, other than full payment, in order to collect as much as possible as soon as possible. Such a cost-benefit analysis, on the part of the government, would present practitioners with the ability to negotiate better deals for their clients, whether at a Collection Due Process Hearing or through the Collection Appeals Program of their client’s request for an Installment Agreement, an Offer-in-Compromise or penalty abatement relief.

Advisor Kathy Petronchak, Director Tax Controversy, Deloitte Tax LLP considered ways IRS has reached out to larger business taxpayers over the last decade to offer pre-filing services intended to give assurance that issues or returns are substantially compliant with applicable law when the returns are filed. The concept was intended to eliminate costs on both sides of the table when questionable issues are raised later in the process:

The Pre-Filing Agreement (PFA) program was initially launched as a pilot program in 2000 and recently made permanent in December 2008 (Rev. Proc. 2009-14). The Compliance Assurance Process (CAP) was launched as a pilot program in December 2005 (Announcement 2005-87).

The PFA program has not taken hold as well as the CAP program. The number of successful PFAs is impacted by several factors. Applications are rejected by the IRS if the taxpayer's facts are not fully developed or if the issue does not involve the application of "settled legal principles." Such issues are debated and at times although the examiners are willing to work on the issue, the Chief Counsel's office may not be as willing. The IRS is taking a longer time to resolve PFA issues. For example, in 2000 the average number of days to process the PFA was 281. By 2008, the average number of days increased to 406, which is significantly longer than the time allotted to file a return (including extensions). Therefore, the IRS must work to decrease the processing time in order for the PFA program to be viable in the future.

While the PFA program is focused on the resolution of an issue before the time for filing the tax return, the CAP is focused on the contemporaneous review of information about completed transactions and events as they transpire over the year to resolve the whole return. Upon filing of the return the IRS and taxpayer should have a high level of certainty that the returns are substantially compliant. The IRS had 17 participants in the initial program in 2005 and the latest statistics indicate that around 100 taxpayers are in the program. This seems to imply that the participants are satisfied with the pre-filing audit experience and that the collaborative relationship needed to conduct a review in this manner is working.

Another program initiated by the IRS during the past decade is the Fast Track Settlement (FTS) Program, which seeks to expedite case resolution and expand the range of dispute resolution options available to taxpayers. FTS was launched as a pilot program in 2001 and made permanent in 2003 (Rev. Proc. 2003-40). The program was

first launched to LMSB taxpayers but was later expanded to Small Business/Self-Employed (SB/SE) and Tax Exempt/Government Entities (TE/GE) taxpayers. The program is optional and is available during the examination process unlike the other appeals processes.

An important feature of FTS is that it provides an Appeals review of the dispute in an environment where all the parties have a voice in the resolution process. The goal of FTS is to resolve cases within 120 days after acceptance into the program for LMSB taxpayers and within 30 to 40 days for other taxpayers. Normally it takes longer for cases to be settled (or otherwise concluded) at Appeals. However, when the Examination and Appeals functions of the IRS get involved to resolve cases early, it provides an opportunity to more efficiently resolve issues and to have the Appeals Officer consider settlement positions that are beyond the authority of the examination function. The taxpayer retains its traditional appeals rights if the parties do not come to an agreement at FTS.

Moving Forward

Whether we look to expanding controversy issues in the international arena or at home, whether as representation specialists in collection matters or examination, whether our niche is litigation or compliance, there will be opportunities ahead. Practitioners will be challenged with our dual responsibilities to our clients and the tax system. We will continue the integral role we play in keeping the tax system balanced. Our regulators and professional organizations will continue pressure for enhanced ethical standards, and we will continue rebuilding the public image of tax professionals. The JOURNAL OF TAX PRACTICE AND PROCEDURE looks forward to following these developments and leading us into another decade of tax controversy observations and insights.

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