

March 11, 2004

Civil and Criminal Tax Procedure

Offshore Voluntary Compliance Initiative

The Internal Revenue Service's Offshore Voluntary Compliance Initiative (OVCI) has received over 1,300 applications. Over 90 percent of those applications have been accepted, and more than \$170 million in outstanding tax, penalties and interest has been collected from these applicants. Numerous amended returns have been filed by taxpayers who did not participate in the OVCI, but who did have income from offshore sources. A review of these returns may generate additional revenue. The OVCI applications have disclosed that credit cards are not the only method used to avoid or evade U.S. taxes. The applications disclose the use of foreign entities, foreign bank accounts, and foreign trusts. Applications have been received from taxpayers living in the U.S. as well as taxpayers living in some 48 countries. The OVCI applications have revealed some 500 promoters of offshore foreign arrangements, of which 230 were previously unknown to the IRS. Several promoters identified by applicants are under active investigation by the IRS.

There should be no question that the IRS is serious about pursuing taxpayers who the Service believes have evaded their U.S. income tax liability through the use of offshore financial arrangements. In *United States v. Plath*, No. 03-60439, U.S.D.C. Southern District of Florida, October 29, 2003, the IRS sought to enforce a summons against a taxpayer to provide information about foreign bank accounts. The IRS issued Information Document Requests to the taxpayer requesting information concerning a credit card account with Leadenhall Trust Company in the Bahamas. The taxpayer submitted some but not all the requested documents; in particular, there were no statements for foreign bank or credit card accounts. The IRS responded by issuing two summonses requesting that information. The summonses also required the taxpayer's appearance before the IRS. The taxpayer's counsel, on the belief that the IRS was planning to seek to enforce the summonses whether the taxpayer appeared or did not, advised the taxpayer not to respond. The court issued an order commanding the taxpayer to appear and produce the documents. The taxpayer did appear and asserted the Fifth Amendment in response to the questions posed and did not provide the requested documents. At a contempt hearing, the taxpayer testified he did not possess any of the records requested by the summons. In addition, he testified he had not made any efforts to obtain any documents relating to the foreign bank accounts. He had not made any such effort because he claimed he did not know who to contact. The taxpayer further testified that the offshore account referenced by the IRS was not his, despite evidence presented by the IRS that identified him as the user of the offshore credit card.

In the civil contempt proceeding, the IRS was required to establish by clear and convincing evidence that the taxpayer violated the court's earlier order. Once the IRS made a *prima facie* showing of a violation, the burden shifted to the taxpayer to produce detailed evidence specifically explaining why he could not comply. The taxpayer's burden of production was not satisfied by a mere assertion of inability. Rather, the taxpayer was required to demonstrate an inability to comply by showing that he had made "in good faith all reasonable efforts to comply." The court found that the taxpayer had not adequately demonstrated that he had taken all reasonable efforts to comply with the summons; indeed, he failed to use any efforts to contact Leadenhall Trust to obtain the necessary documentation. Accordingly, the court found that the taxpayer failed to meet the substantial and rigorous burden of showing that he had made "all reasonable efforts to comply." Based upon the foregoing, the court found that the taxpayer was in civil contempt for failure to comply with the court's order enforcing the summons, and gave him 30 days to purge himself of contempt. Failure to do so would result in confinement at a corrections facility until he purged himself of the contempt.

Tax Shelters

The IRS announced in IR-2004-19 that it is now sharing with 45 states, the District of Columbia, and New York City, audit leads on 20,000 individuals and entities engaged in abusive tax avoidance schemes. This is the first large transfer of information under the terms of the new IRS – State Partnership unveiled in September 2003. Under the terms of the arrangement, the IRS and the cities and states coordinate efforts to address common compliance concerns regarding abusive tax avoidance transactions, thereby avoiding duplicative efforts. The initial leads transferred to states involved scams using offshore transactions, abusive trusts, employee leasing, home-based businesses, employment taxes and other tax-avoidance schemes. The IRS, states and cities will subsequently share information on any resulting tax adjustments from the audits, allowing them to build on the results of each other's work. The process allows the agencies to leverage resources by greatly decreasing the possibility of two or even three tax agencies performing a lengthy examination of the same taxpayer. Included among the cities and states that have signed partnership agreements and that have received information are California, Connecticut, Delaware, District of Columbia, Florida, Georgia, Illinois, Maine, Maryland, Massachusetts, New York City, New York State, New Jersey and Pennsylvania.

Tax Return Preparer Privilege

A significant number of cases dealing with the IRS initiative to combat perceived abusive tax shelters have dealt with defenses to enforcement actions raising the tax return preparer's privilege of Internal Revenue Code Section 7525. One of the most prominent is *United States v. BDO Seidman et al.*, No. 02-3914, 7th Cir., July 23, 2003. In this case, the Seventh Circuit determined that although identity privileges exist under the tax return preparer privilege set forth in Section 7525, certain unidentified BDO Seidman (BDO) clients who attempted to intervene in a proceeding in which the U.S. sought to discover their identity, could not intervene because they could not demonstrate a colorable claim of privilege.

The IRS had issued 20 summonses to BDO as part of its investigation of the company's compliance with the registration and list keeping requirements for organizers and sellers of potentially abusive tax shelters. Clients of BDO sought to intervene to assert a confidentiality privilege regarding certain documents that BDO intended to produce in response to those summonses. They argued that, because the documents revealed their identities as BDO clients who sought advice regarding tax shelters and who subsequently invested in those shelters, disclosure inevitably would violate the statutory privilege protecting confidential communications between a taxpayer and any federally authorized tax practitioner giving advice.

In response to the summonses, BDO refused to produce the documents sought and the IRS petitioned the District Court for enforcement. The District Court concluded that the IRS had met its burden of showing that it had issued the summonses in good faith and that BDO had failed to demonstrate that enforcement of the summonses would constitute an abuse of process. The court then directed BDO to produce all responsive documents except those that BDO previously had listed on privilege logs and submitted to the court for an *in camera* review. Among those documents were records that revealed the identities of BDO's clients who invested in at least one of the 20 types of tax shelters identified in the summonses. BDO informed these clients that it intended to produce these documents to the IRS. In response, certain of those clients filed motions to intervene in the enforcement proceeding.

The Circuit Court granted a temporary stay and remanded the case to the District Court to enter more extensive findings regarding those documents to which the clients claimed a privilege. The District Court ordered counsel to produce all confidentiality agreements, consulting agreements, and engagement letters entered into between BDO and the clients. Based upon its review, the court determined that the identities of a large number of clients were not subject to the privilege under Section 7525. The court noted that many of the confidentiality agreements established that particular clients engaged BDO's services, in part, for the purpose of preparing income tax returns. In addition, several consulting agreements contained a "no warranty" provision, which provided that "BDO's services hereunder do not include . . . any legal and/or tax opinions regarding any strategies that may be implemented." This language,

the District Court determined, suggested that the relationship between BDO and the clients was not always that of tax advisor-client, and that, in such cases, their communications would not be subject to the Section 7525 privilege. Further, the court held that other documents were generated for the purpose of preparing tax returns, another unprivileged category of communication. Accordingly, the District Court found that the clients could not intervene because they could not establish a colorable claim of privilege.

On appeal, the only factor which was at issue was whether the clients satisfied their burden of demonstrating a legally protectable interest in preventing the disclosure of the documents that would reveal their identities as individuals who sought BDO's advice regarding tax shelters. The Circuit Court stated that unless the clients could establish that the Section 7525 privilege could protect the taxpayer's identity from disclosure in the IRS enforcement action, then the clients would not prevail on appeal. The Circuit Court said that the clients sought to intervene in proceedings involving the IRS investigation of BDO for potential violations of the tax code, including the provisions requiring organizers of tax shelters to register those tax shelters with the IRS, and organizers and sellers of such shelters to keep lists of the investors. These provisions were enacted by Congress for the purpose of providing the IRS with means to better monitor tax shelters and, consequently, to deter abusive tax shelters that can adversely impact public revenues. The statutory registration and list-keeping provisions allow the IRS to identify more easily those transactions that it deems to be abusive and to quickly identify all of the participants in related tax shelter investments. These provisions also enabled the IRS to examine every purchaser of a given type of tax shelter investment and to treat those tax shelters in a more uniform manner. Congress granted the IRS the broad power to issue summonses to investigate violations of the tax code and provided the IRS with great latitude to verify compliance with those tax shelter registration and list-keeping provisions. The IRS' broad power to investigate possible violations of the tax laws is understood to be vital to the efficacy of the federal tax system, "which seeks to assure that taxpayers pay what Congress has mandated and to prevent dishonest persons from escaping taxation, thus shifting heavier burdens to honest taxpayers."

The court then turned to the specific context of the clients' claims. The clients sought to intervene to prevent the disclosure through IRS summonses of documents that the clients contend are privileged. The clients' privilege claims rested entirely on Section 7525 which provides a confidentiality privilege for communications between a taxpayer and a tax practitioner. The Section 7525 privilege is no broader than the attorney-client privilege, and nothing in Section 7525 suggests that non-lawyer practitioners are entitled to privilege when they are doing other than lawyers' work. Because the scope of the taxpayer practitioner-client privilege depends on the scope of the common law protections of confidential attorney-client communications, the court looked to the body of common law interpreting the attorney-client privilege to interpret the Section 7525 privilege.

The attorney-client privilege protects confidential communications made by a client to his lawyer, and so, ordinarily, the identity of a client does not come within the scope of this privilege. However, over the years, a limited exception to this general rule has developed: the identity of a client may be privileged in the rare circumstance when so much of an actual confidential communication has been disclosed already that merely identifying the client will effectively disclose that communication. The Circuit Court held that the clients had not established that a confidential communication would be disclosed if their identities were revealed in response to the summonses. The disclosure of the identities of the clients would disclose to the IRS that the clients participated in one of the 20 types of tax shelters described in the summons. It was less than clear what motive or other confidential communication of tax advice could be inferred from that information alone. Unlike the situation where the government already knows much about the substance of a communication between the attorney and his unidentified client, in which case the privilege would apply to protect the identity of the client, here the IRS knows relatively little about the interactions between BDO and the clients, the nature of their relationship or the substance of their conversation. Moreover, the clients conceded that the documents which BDO intended to produce in response to the summonses were not subject to any other independent claim of privilege beyond the clients' assertion of the claim of identity. More fundamentally, the court held that the clients' participation in potentially abusive tax shelters is information ordinarily subject to full disclosure under the federal tax law. Congress had determined that tax shelters are subject to special scrutiny, and anyone who

organizes or sells an interest in tax shelters is required, pursuant to Internal Revenue Code Section 6112, to maintain a list identifying each person to whom such an interest was sold. This list-keeping precludes the clients from establishing an expectation of confidentiality in their communications with BDO, an essential element of the attorney-client privilege and, by extension, the Section 7525 privilege. At the time that the clients communicated their interest in participating in tax shelters that BDO organized or sold, the clients should have known that BDO was obligated to disclose the identity of clients engaging in such financial transactions. Because the clients could not credibly argue that they expected their participation in such transactions would not be disclosed, they could not establish that the documents responsive to the summonses, which did not contain any tax advice, revealed a confidential communication.

Other courts have reached similar conclusions. In *U.S. v. Arthur Andersen*, 2003-2 Aug. 11, 2003 USTC 50000624 No. 02-C6790 (Northern District Ill. 2003), the U.S. District Court held, in light of *U.S. v. BDO Seidman*, that interveners in an IRS enforcement action against Andersen may not assert a Code Section 7525 identity privilege.

In *U.S. v. John Does*, Civil No. 03-C-4090 (Northern Dist. Ill. 2003), the IRS received approval from a U.S. district court to serve a John Doe summons on Jenkins & Gilchrist PC to identify taxpayers who invested in listed transactions sold by the firm's Chicago office. The Department of Justice also filed a petition to enforce five promoter's summonses and a John Doe summons. According to the IRS, the law firm's clients claimed at least \$2.4 billion in losses from investments primarily in a listed transaction. The Department of Justice alleges that the IRS is investigating the role of the law firm in organizing and selling tax shelters to determine the law firm's compliance with the registration and list maintenance requirements and its potential liability for penalties under Sections 6707 and 6708. The IRS is also investigating the returns of U.S. taxpayers who participated in this type of transaction.

In *U.S. v. KPMG LLP*, 237 F. Supp 2d 35 (D.D.C. 2002), the court dealt with the summons enforcement action initiated by the government against KPMG with respect to the service of 25 summonses as part of the examination of KPMG's promotion of and participation in tax shelters. KPMG resisted on the grounds of privilege. The District Court analyzed Section 7525 and the attorney-client privilege and found that much of the communications fell under the category of tax return preparation, which is not privileged.

In *Doe v. Wachovia Corp.*, 268 F.2d 627 (W.D.N.C. 2003), the District Court dealt with a summons served on Wachovia National Bank. Wachovia had been sued by investors with respect to certain tax shelters which were based upon legal advice provided by a law firm and based upon accounting advice provided by KPMG. The bank determined that it would comply with the summons which prompted a group of investors to bring suit against Wachovia claiming breach of contract and fiduciary duty, as well as asserting other theories, and to seek a temporary restraining order against it. The group of investors alleged actual or imminent violation of attorney-client privilege and Section 7525. The court rejected the privilege of claims.

Outside of the tax shelter enforcement arena, the assertion of privilege has also met with little success. In *Black & Decker Corp. v. United States*, 291 FRD 87 (Dist. M.D. 2003), the court provided guidance on when an accountant's advice to a lawyer for the benefit of the client would be covered by the attorney-client privilege. The court held that Black & Decker's in-house counsel did not use the accounting firm as a "translator," that is, to understand what the client was saying. The accountant's advice was not sought primarily to assist the company's attorneys in providing legal advice. Accordingly, the *Kovel* theory protecting communications between a client and an accountant who is engaged to assist the attorney in providing advice to the accountant did not apply.

In *In Re GI Holdings, Inc.*, 218 FRD 428 (Dist. N.Y. 2003), the government sought discovery of communications between the taxpayers and their advisors. The taxpayers resisted disclosure on the grounds of attorney-client privilege despite the fact that, in defending against certain penalties, they had asserted the defense of reasonable reliance on the advice of their attorney tax advisors. The District Court held for the IRS, stating that, by asserting the reliance defense, the taxpayers put the contents of the communications at issue effecting subject matter waiver of all communications on the same subject.

Tenancy by the Entireties after *United States v. Craft*

In Notice 2003-60, the IRS provides guidance on collection for property held in a tenancy by the entirety where only one spouse is liable for the outstanding taxes in light of the Supreme Court decision in *United States v. Craft*, 535 U.S. 274, 202. Tenancy by the entireties (TBE) is a form of property ownership which can only exist between a husband and wife, and only in jurisdictions which recognize it. In those jurisdictions which recognize TBE in its traditional form, creditors of the husband or creditors of the wife cannot reach TBE assets. *Craft* held that the federal tax lien, which arises under Section 6321 on “all property and rights to property” of a delinquent taxpayer, attaches to rights the taxpayer has in property held as a TBE, even though local law insulates entireties’ property from the claims of creditors of only one spouse.

Purchasers. As a matter of administrative policy, the IRS will, under certain circumstances, not apply *Craft*, with respect to certain interests created before the *Craft* decision, to the detriment of third parties who may have reasonably relied on the belief that state law prevents the attachment of the federal tax lien. For instance, if a purchaser acquired an entirety’s property before *Craft* was decided, and meets the definition of a purchaser under Section 6323(h)(6), the Service will not assert lien priority even though a notice of federal tax lien had been filed prior to the purchase. For purchases occurring after *Craft*, as a general rule, the value of the taxpayer’s interest in an entirety’s property will be deemed to be one-half. Where there has been a sale or other transfer of an entirety’s property subject to the federal tax lien that does not provide for the discharge of the lien, whether the transfer is to the non-liable spouse or a third party, the lien thereafter encumbers a one-half interest in the property held by the transferee.

Transfers. Transfers to donees that occurred before *Craft* will be evaluated on a case-by-case basis to determine whether the equities favor or disfavor the IRS asserting the federal tax lien against property held by a donee. There may be circumstances where, although the donee gave nothing of value in exchange for the property, it would be inequitable for the IRS to assert the federal tax lien because of the donee’s reliance on the mistaken view that the property was unencumbered. For example, if the transfer was of real property to which the donee has made substantial improvements, the equities may favor not asserting the federal tax lien (or agreeing to limit its reach by carving out the value of the improvements).

The identity of the donee is also a factor that will be considered by the Service. The federal tax lien is more appropriately not asserted where the donee is a disinterested person having no relation to the taxpayer than where the donee and the taxpayer are closely related. For example, the Service may decide to assert the federal tax lien where the taxpayer transferred an entirety’s property to a family trust, but may decide not to assert the lien where the taxpayer transferred entity properties to a charitable organization.

A conveyance of an entirety’s property terminates the entirety’s estate with respect to that property. Accordingly, after *Craft*, unless the Service discharges the property from the federal tax lien, the lien will encumber a one-half interest in the hands of the transferee, regardless of whether the transferee is a donee or gives value.

Death. If the taxpayer’s interest in an entirety’s property is extinguished by operation of law at the death of the taxpayer, then there is no longer an interest of the taxpayer to which the federal tax lien attaches. When a taxpayer dies, the surviving non-liable spouse takes the property unencumbered by the federal tax lien. When a non-liable spouse predeceases the liable taxpayer, the property ceases to be held in a tenancy by the entirety, the taxpayer takes the entire property in fee simple, and the federal tax lien attaches. The rule that the federal tax lien does not survive the death of the taxpayer does not apply if the entirety’s estate previously has been terminated. For example, if the property has been conveyed to a third party, the federal tax lien would be deemed to encumber a one-half interest in the hands of the transferee, and will not be affected by the subsequent death of either spouse.

Divorce. As a general rule, if the transfer of property pursuant to a divorce occurred before *Craft*, the Service will treat the transfer as one for value, and will not assert its lien priority against the property in the hands of the ex-spouse of the taxpayer. This will not apply if the Service determines that, notwithstanding the divorce, the transfer was

fraudulent. Entirety's property subject to the federal tax lien and then transferred after Craft to a non-liable spouse, pursuant to a divorce, remains encumbered in the hands of the ex-spouse.

Mortgages. After a notice of federal tax lien is filed, the taxpayer and spouse jointly mortgage an entirety's property to a bank. If the taxpayer survives the spouse, the federal tax lien will be a senior lien against the whole property. The taxpayer's interest in the entirety's property to which the federal tax lien attaches includes the taxpayer's right of survivorship. With the death of the taxpayer's spouse, the taxpayer becomes the fee simple owner of the property, and the federal tax lien attaches to that interest in the property which is senior to the bank's interest. If the taxpayer predeceases the spouse and his or her interest is extinguished by operation of law, the federal tax lien will be extinguished; the mortgage lien then becomes the first lien on the property.

Seizure of property. The administrative sale of an entirety's property subject to a federal tax lien presents practical problems that limit the usefulness of the seizure and sale for seizure. Levying on cash and cash equivalents held as entirety's property is considerably less problematic and will be used by the Service in appropriate cases.

The Service can administratively seize and sell a taxpayer's interest in real and personal property held in a TBE. Because of the nature of the entirety's property, it would be very difficult to gauge what market there would be for the taxpayer's interest in the property. The amount of any bid would, in all likelihood, be depressed to the extent that the prospective purchaser, given the rights of survivorship, would take the risk that the taxpayer may not outlive his or her spouse. In addition, a prospective purchaser would not know with any certainty if, how and the extent to which the rights acquired in an administrative sale could be enforced. For example, rights acquired would include the right to use the property and the right to exclude others from the property. It is not clear how the rights of a prospective purchaser ultimately would be balanced with the coexisting rights of the spouse of the taxpayer. Therefore, the Service has determined that an administrative sale is not a preferable method of collection with respect to an entirety's property.

Foreclosure. The Service will foreclose the federal tax lien against an entirety's property in appropriate cases. While in an administrative sale the IRS can sell only the taxpayers' interest in an entirety's property (*i.e.*, not the entire property itself), in a foreclosure action, pursuant to Section 7403, the District Court has discretion to order the sale of the entire property, even where a non-liable spouse has a protected interest in the property, according to *U.S. v. Rodgers*, 461 U.S. 677 (1983). If the court orders the sale of the property, then the non-liable spouse must be compensated for his or her interest: Section 7403 requires "a distribution of the proceeds of such sale according to the finding of the court in respect to the interest of the parties and the United States."

Discharge and subordination. Under Section 6325(b)(2)(A), the Service may issue a certificate of discharge of property subject to a federal tax lien upon payment of an amount not less than the value of the government's interest in the property to be discharged. If a taxpayer applies for a certificate of discharge when an entirety's property is to be sold by the taxpayer and the taxpayer's spouse, then the taxpayer generally must pay the Service one-half the proceeds of the sale in partial satisfaction of the liability secured by the federal tax lien.

Deductibility of Contingent Legal Fees

The Second Circuit has joined the majority of courts in holding that the portion of a judgment received by a plaintiff in a contingent fee case, which is paid to the attorney as fees, is included in the client's gross income, according to *Raymond v. United States*, No. 03-6037(2nd Cir., January 13, 2004). In *Raymond*, the taxpayer received an award of \$900,000 in a wrongful employment termination suit. The plaintiff had a contingent fee agreement with his counsel that provided that one-third of the net recovery would be paid to the lawyer as legal fees. The taxpayer included in gross income the full amount of the judgment and sought to deduct the amount paid as contingent fees. However, because legal fees are among the itemized deductions that trigger the alternative minimum tax, the taxpayer was unable to deduct the full amount of the legal fees. The taxpayer filed an amended return excluding from his gross income the amount paid to the attorney as a contingent fee. The Second Circuit joined the majority of courts in

holding that a contingent fee is income to the client, even though state law may give the attorney an interest in the fee. The minority view holds that, when state law provides for an attorney's interest in the award that is equivalent to a property interest, the fee is not income to the client but belongs to the attorney. The IRS is currently seeking U.S. Supreme Court review of the cases from the circuits adopting the minority view. See *Banaigis v. Commissioner*, 340 F.3d 1074 (9th Cir. 2003) and *Banks v. Commissioner*, 345 F.3d 373 (6th Cir. 2003).

Innocent Spouse Relief

In *Ewing v. Commissioner*, 122 T.C. No. 2 (Jan. 28, 2004), the U.S. Tax Court rejected the IRS' assertion that the court could not consider evidence introduced at trial regarding the petitioner's claim for innocent spouse status that was not developed during the administrative process preceding the trial. The court found that its determinations under the deficiency provisions of the Internal Revenue Code are *de novo* and that the court's determination of liability would be based on the merits of the case and not upon an administrative record. The IRS further argued, and the Tax Court rejected, the notion that the petitioner was entitled to equitable innocent spouse relief only if the court found that (1) the IRS' determination was an abuse of discretion and that (2) in making that decision, the court could only consider the administrative record developed below. Finally, the court held that the petitioner was entitled to innocent spouse relief because she presented evidence that many of the factors set forth in Rev. Proc. 2000-15, 2000-1 C.B. 447 supported her claim for relief.

In *Johnson v. Commissioner*, 2003 US App. Lexis 26443 (10th Cir. 2003), the Tenth Circuit held that the estate of a person does not qualify for innocent spouse treatment, as the person is now a decedent and, as such, does not qualify as an "individual" under Section 6015(c). The court found that, when Section 6015(c) speaks of an "individual" in terms of being married, legally separated or living in the same household, the statute refers to a living person.

Collection Procedure

In Revenue Ruling 2003-108, the IRS stated that in cases when no notice of a federal tax lien has been filed, actual knowledge of the statutory tax lien is irrelevant for purposes of Section 6323. That Section provides that the statutory tax lien is not valid against a purchaser, holder of a security interest, mechanic's lien holder or judgment lien creditor until notice has been filed. Where before becoming a purchaser, security interest holder, mechanic's lien holder or judgment lien creditor, a third party has knowledge of a statutory tax lien but no notice of a federal taxing filing, the knowledge is irrelevant and the statutory lien is inferior to the secured party's lien.

The IRS has issued proposed regulations to implement new restrictions on the IRS' ability to levy a taxpayer's principal residence and property used in a taxpayer's business. Previously, the IRS could levy on a principal residence if there was jeopardy or if the district director approved the levy. Under the new provisions, only a U.S. District Court can approve a levy on the taxpayer's principal residence. In addition, the new provision generally exempts tangible personal property and real property (other than rental property) used in the taxpayer's business from levy. The IRS may levy on business assets if an area director determines that other assets available for collection are insufficient to pay the tax liability and personally approves the levy in writing.

Collection Due Process - *Montgomery*

In *Montgomery v. Commissioner*, 122 T.C. No. 1 (2004), the court considered whether the taxpayer should be permitted to challenge the existence or amount of the tax liability reported in the original return in a collection due process hearing. Here, the taxpayers filed their original return showing an unpaid liability of almost \$200,000. The taxpayers had exercised stock options in 2000, but when the time came to pay the tax liability, the value of the stock acquired through the options had become essentially worthless. The IRS issued a Notice of Intent to Levy, and the

taxpayers requested a collection due process hearing. The taxpayers advised the Appeals Office that they intended to submit an amended return that would show a refund. When the amended return was not filed, the Appeals Office issued a Notice of Determination concerning collection action under Section 6320 and Section 6330 concluding that the levy should be permitted to proceed. The petitioners shortly thereafter submitted an amended income tax return reflecting a large refund. In response to the Notice of Determination, the taxpayers filed a petition for lien or levy action under Section 6320 and 6330 with the Tax Court, challenging the underlying tax liability as set forth on the 2000 return based upon their amended return. The IRS moved for summary judgment claiming that the taxpayers were barred from challenging the existence or amount of their underlying tax liability for 2000 in a collection review proceeding on the grounds that the tax liability was self-assessed on the petitioner's original return. In rejecting this argument, the court looked to the plain language of Section 6330(c)(2)(B) which in part states that a person may raise, at a collection due process hearing, challenges to the existence or amount of the underlying tax liability for any tax period if the person (1) did not receive a statutory notice of deficiency for such tax liability or (2) did not otherwise have an opportunity to dispute such tax liability. Inasmuch as the IRS had not issued a notice of deficiency with respect to this liability, the court relied upon the plain, clear and unambiguous language of the statute to hold that the taxpayers were permitted to challenge the existence or amount of the tax liability reported on their original income tax return because they (1) had not received a Notice of Deficiency for the year 2000 and (2) had not had an opportunity to dispute the tax liability in question.

Collection Due Process - *Keene*

In *Keene v. Commissioner*, 121 T.C. 21 (2003), the U.S. Tax Court held that an individual is entitled under Code Section 7521(a)(1) to make an audio recording of his collection due process (CDP) hearing with an appeals officer. After the IRS denied a taxpayer's request to record a CDP hearing, the appeals officer denied the taxpayer's request for a hearing and issued an adverse determination notice. The taxpayer petitioned the Tax Court arguing that the appeals officer's decision to prevent him from recording the session was an illegal action that denied him due process. The court noted that Section 7521(a)(1) states that a taxpayer may make an audio recording of any in-person interview concerning tax, but it does not define "in-person interview." The court rejected the IRS' attempt to distinguish "interview" from "hearing" and decided that the CDP hearing is an "in-person interview." The court held that a taxpayer who seeks to record a CDP hearing may do so under Section 7521 and remanded the case with directions to offer a hearing that may be recorded.

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