

TaxTrends

RECENT CASES AND RULINGS



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PROCEDURE & ADMINISTRATION

How IRS Inaction Stymies Abatement Requests

When a taxpayer sends the IRS a written request for an abatement of taxes, penalties, and/or interest, she expects a response. The taxpayer's expectations are rooted in notions of fair play, common courtesy, and logic. Based on these concepts, the taxpayer often assumes that when the IRS does not answer her inquiry after a reasonable period of time she is entitled to construe this silence as a rejection. A corollary to this conclusion is that if the IRS has effectively made its decision through inaction, the taxpayer can seek immediate review by the U.S. Tax Court. Unfortunately, that is not the case. This item

examines a recent case that demonstrates a taxpayer's limited ability to force the IRS's hand when it comes to abatement requests.

Claims for Refund: Unique Taxpayer Rights and Remedies

To better understand taxpayer limitations in the context of requests for abatement, it is necessary to understand that while requests for abatement of certain taxes, interest, and/or penalties are in some ways similar to claims for refund, they are distinct administrative devices. One major difference between the two is that a taxpayer files a claim for refund *after* she has already paid the amounts in question, whereas she generally submits a request for abatement *before* she has fully satisfied the alleged liability. In

both cases the amounts assessed by the IRS were too high; it is mainly a matter of timing. The common confusion about these two administrative mechanisms is further compounded by the fact that, depending on the type of items at issue, they are often filed on the same document, i.e., Form 843, Claim for Refund and Request for Abatement. Despite the conceptual similarities and the frequent use of the same form, requests for abatement and claims for refund are two entirely different procedures, with separate rights and remedies.

The IRS may allow a claim for refund if the taxpayer has overpaid (Sec. 6402(a)). The first step is for the taxpayer to file a timely claim for refund (Sec. 6511(a)). If the IRS formally denies the claim (in full or in part) by issuing a notice of disallowance, then the taxpayer can seek immediate help from the courts by initiating a suit for refund. The taxpayer can also file a refund suit if the IRS simply fails to respond to her claim within six months (Secs. 6532(a)(1), 7422(a)). Thus, the taxpayer has an immediate remedy if the IRS either outright refuses to act or delays doing so for more than six months. In the context of claims for refund, the law dictates that a taxpayer can interpret the IRS's silence as a negative, which affords the taxpayer a

large degree of control over her tax destiny.

Requests for Abatement: Effect of IRS Inaction

IRS inaction in response to an abatement request, however, is not equivalent to a denial of the request. This fact was recently confirmed by the Tax Court in *Ward*, TC Memo 2007-374. In this case, the IRS audited the Wards' income tax returns for 1994 and 1995. After concluding the audit, the IRS presented the Wards with the proposed adjustments. On June 29, 1999, the taxpayers signed Form 870-AD, Offer to Waive Restrictions on Assessment and Collection of Tax Deficiency and to Accept Over-assessment, thereby agreeing to the assessment and collection of tax deficiencies, late-filing penalties, and "interest as provided by law." Despite this concession, the Wards did not pay their liability immediately. Therefore, the IRS ultimately issued them a final prelevy notice, alerting the taxpayers to their right to request a collection due process (CDP) hearing before the Service could proceed with its intended seizure of assets. The Wards never requested a CDP hearing.

On or about June 14, 2002, the Wards sent a letter to the IRS enclosing a check for \$22,000, directing the IRS to apply the payment "to tax principal only" and requesting that the IRS accept the check as full payment of their outstanding "tax principal" for the relevant years. The letter contained the heading "Interest & Penalty Abatement Request," under which the Wards asked the IRS to abate all penalties and interest related to 1994 and 1995 because of the financial hardships they were facing. The letter further explained that the Wards were unaware when they signed the Form 870-AD back in 1999 that penalties and interest would continue to accrue until the liability had been completely satisfied.

Approximately three years later, on March 31, 2005, the IRS sent the Wards a letter addressing the late-

filing penalties for 1995. The letter explained that the IRS could not abate the penalties for that year because the Wards had failed to satisfy the legal standard; that is, they failed to demonstrate that there was reasonable cause for failing to file their tax return in a timely manner. The letter did not mention the Wards' penalty abatement request for 1994. It was also silent as to interest abatement for either year.

On July 31, 2006, the Wards filed a petition with the Tax Court seeking judicial review of the IRS's actions (or inactions) regarding their earlier letter requesting abatement of penalties and interest. The Wards raised two main arguments in support of their petition. They first argued that the letter they sent to the IRS on or about June 14, 2002, constituted a specific request for abatement of penalties and interest for both 1994 and 1995. Thus, the IRS's failure to issue a final determination letter in response to their request was the equivalent of a final determination letter not to abate. The Wards argued, alternatively, that the letter from the IRS dated March 31, 2005, was tantamount to a denial, despite the fact that it failed to address all of the penalties and interest in question.

In response, the IRS filed a motion to dismiss for lack of jurisdiction. The IRS argued that the reason set forth for abatement in the Wards' letter—financial hardship—is not an acceptable rationale for abatement. Accordingly, the IRS did not issue a final determination letter to the Wards under which they could seek judicial review by the Tax Court.

In framing its analysis, the court cited Sec. 6404(h)(1), which states:

The Tax Court shall have jurisdiction over any action brought by a taxpayer who meets [certain net worth requirements] to determine whether the [IRS's] failure to abate interest under this section was an abuse of discretion, and may order an abatement, if such action is brought within 180 days after the date of the mailing of the [IRS's]

final determination not to abate such interest. (Emphasis added.)

The Tax Court made short shrift of the Wards' first argument that the IRS's refusal to issue a final determination letter was, in effect, its final determination. In rejecting the Wards' contention, the court looked to one of its earlier decisions. In *Cho*, TC Memo 1998-363, the taxpayers filed a timely Form 843 requesting abatement of interest for 1992. Several months passed and they received no response; therefore, the taxpayers filed a petition with the Tax Court trying to invoke its jurisdiction under Sec. 6404(h)(1). Approximately 20 days later, the IRS sent the taxpayers a letter indicating that their abatement request was being disallowed in full. The IRS filed a motion to dismiss the taxpayers' petition for lack of jurisdiction. The crux of the Service's argument in *Cho* was that, as of the time that the taxpayers filed their petition, the IRS had not made a final determination. Drawing a parallel to the procedures for refund claims, the taxpayers argued that the court should treat the IRS's inaction as a final determination to trigger jurisdiction. Put differently, the taxpayers contended that the IRS should be required to either grant or deny an abatement request within a reasonable time and that silence on the matter should be construed as a denial.

Although the Tax Court rejected the taxpayers' theory in *Cho*, it did point out the inequities of the situation. The court noted that, although notices of deficiency (issued by the IRS under Sec. 6213(a)) and final determination letters (issued by the IRS in response to abatement requests under Sec. 6404) share many characteristics, they have one major distinction. The IRS generally must issue a notice of deficiency before assessing taxes and may collect such taxes only after assessment. Accordingly, the IRS is motivated to issue a notice of deficiency as soon as possible. By contrast, abatement requests ordinarily are filed after amounts have been assessed (and possibly collected)

by the IRS but not yet paid by the taxpayer. Under these circumstances, the IRS may be less inclined to act, particularly since it is not statutorily required to do so. This nuance did not escape the court, which, in discussing Sec. 6404(g) (which was redesignated as Sec. 6404(h) in 1998), explained that change must be accomplished at the congressional level, not the judiciary:

[The taxpayers'] argument has a certain appeal, guaranteeing a taxpayer the right of judicial review under Section 6404(g). However, in contrast to Section 6532(a) [which addresses claims for refund], Congress did not provide a remedy within Section 6404(g) where the [IRS] fails to act on a request for abatement of interest within a reasonable time. Neither the plain language of Section 6404(g) nor the legislative history suggests a basis for imposing a time limit within which the [IRS] is obliged to act with respect to a request for abatement of interest. Because the Court clearly lacks the

authority to graft such a time limit onto Section 6404(g), [the taxpayers'] remedy lies with Congress, not with this Court.

The Tax Court also rejected the Wards' alternative argument that the IRS letter dated March 31, 2005, constituted a final determination letter. The problem with this assertion, the Tax Court explained, was that the letter gave no indication that the IRS intended the letter—which addressed penalties for only one year and completely ignored the interest issue for both years—to be a final determination. Citing its earlier decision in *Bourekis*, 100 TC 20 (1998), the Tax Court stated that “a letter must be intended as a notice of final determination not to abate interest under section 6404 to be treated as such for jurisdictional purposes.”

Reflections

The lesson to be learned from *Ward* is that the Tax Court does not

have jurisdiction over interest abatement cases until the IRS issues a final determination letter, and the IRS has no statutory duty to issue such a letter within a given time period.

It is possible that this situation will change in the future. An appellate court could overrule the Tax Court's recent decision, Congress could modify the law to give taxpayers the right to judicial review after six months of IRS inaction in cases of both claims for refund and requests for abatement, or the Tax Court could hear a different case (with original legal arguments and facts more favorable to the taxpayer) that convinces it that the IRS's failure to promptly exercise its congressionally granted discretion is by itself an abuse of discretion. Until then, taxpayers and tax practitioners should be aware of *Ward's* impact and adjust their strategies accordingly.

WARD, TC MEMO 2007-374

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