Clarifying Misconceptions About Extending Assessment-Periods and "Cooperating" During IRS Audits

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Hale E. Sheppard explains assessment-periods, IRS duties related to extension requests, and analyzes the critical issues related to Form 872.

I. Introduction

The IRS has a relatively short time to complete an audit and its resources are limited. Consequently, the IRS often must ask taxpayers to "voluntarily" extend the assessment-period by granting a Form 872 (*Consent to Extend the Time to Assess Tax*) or some variation thereof. Given the significant issues at stake, the Internal Revenue Code and IRS procedures mandate that IRS personnel notify taxpayers and their representatives of certain rights, including the right to reject, limit, or otherwise tailor the Form 872. A recent report by a government watchdog agency found that the IRS is not fully meeting its notification duties. Even if it were, many taxpayers and their representatives would remain completely unaware of key issues affecting the decision of whether or not to grant the IRS a Form 872.

This article explains assessment-periods, IRS duties related to extension requests, and the findings of the recent governmental report. More importantly, it analyzes the following critical issues related to Form 872: If a taxpayer declines to grant a Form 872 during an audit, is he permanently deprived of the chance to present his case to the Appeals Office? What strategic advantages are gained by "cooperating" with the IRS? What, exactly, does "cooperating" mean in different contexts? Is not granting a Form 872 tantamount to not "cooperating" with the IRS?

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II. Overview of Assessment-Periods and Extension Requests

The IRS generally has three years from the date on which a taxpayer files a return to assess taxes related to that return.[1] This three-year period may be extended in certain situations. For instance, if a taxpayer files a false or fraudulent return with intent to evade tax, then the IRS may assess tax at any time.[2] In other words, there is no time limit for assessment in such situations. Another example is when a taxpayer voluntarily grants the IRS additional time to complete its audit, generally by executing Form 872 or the appropriate version thereof.[3]

Importantly, when asking taxpayers to relinquish their right to force the IRS to finish its audit within the general three-year period, the IRS must give them critical information. Code Sec. 6501(c)(4)(A) states that the IRS "*shall* notify the taxpayer of the taxpayer's right to refuse to extend the period of limitations, or to limit such extension to particular issues or to a particular period of time, on each occasion when the taxpayer is requested to provide such consent."[4]

If one were to take IRS pronouncements at face value, the understanding would be that the IRS rarely needs to seek extensions from taxpayers being audited, such that whether the IRS is giving taxpayers proper notices is a non-issue. Indeed, more than 60 years ago, the IRS was proudly announcing the following:

> It has been a long-established policy of the [IRS] to secure a consent, extending the statutory period of limitation, only in a case involving unusual circumstances …. It is the policy and purpose of the [IRS] to keep to an absolute minimum the number of consents obtained from taxpayers. The audit program of the [IRS] is set up to obtain the completion of the examination of returns within the present statutory period of limitation whenever possible.[5]

Now, decades later, the IRS continues to make similar statements about its efficiency in conducting audits:

> It is the policy of the [IRS] to secure consents to extend the period of time to assess tax only in cases involving unusual circumstances …. Every attempt should be made to resolve cases before it is necessary to extend the statute of limitations. If it is necessary to extend the statute, the period of extension should be no longer than is necessary to complete the examination and other administrative actions.[6]

The IRS statements described above are incompatible with current reality. The norm in modern times is for the IRS to seek one or more Forms 872 from taxpayers in essentially every audit. Consequently, the question of whether the IRS is meeting its notice obligations under Code Sec. 6501(c)(4)(A) acquires importance.

III. IRS Duties Related to Extension Requests

The Internal Revenue Manual contains instructions for IRS personnel to ensure that they do not violate taxpayer rights mandated by Congress in Code Sec. 6501(c)(4)(A). For example, the Internal Revenue Manual explains that the IRS must notify taxpayers of the following rights, each time the IRS requests an extension: (i) the right to refuse to extend the assessment-period, (ii) the right to request that the extension be limited to particular issues, and (iii) the right to request that the extension be limited to a particular period of time or date.[7] IRS personnel normally meet these notification duties by providing taxpayers with Form 872, Letter 907 (*Request to Extend Assessment Statute*), Letter 967 (*Consent Extending Period of Limitation Transmittal*), and Publication 1035 (*Extending the Assessment Period*).[8]

The Internal Revenue Manual also reminds IRS personnel that such materials should be sent to both the taxpayer and the authorized representative of the taxpayer, such as the attorney, accountant, or enrolled agent.[9] This derives from the regulations, which contain the following, clear rule: "Any notice or other written communication (or copy thereof) required or permitted to be given to a taxpayer in any matter before the [IRS] *must* be given to the taxpayer and, unless restricted by the taxpayer, to the representative."[10] The downside is that the same regulation goes on to recognize that it has no teeth, acknowledging that "[f]ailure to give notice or other written communication to the recognized representative of a taxpayer will not affect the validity of any notice or other written communication delivered to a taxpayer."[11]

There are procedural safeguards, too. For instance, the Internal Revenue Manual indicates that Revenue Agents "must" get prior approval from their Group Manager in order to request an extension and they "should" document such approval in Form 9984 (*Examining Officers Activity Record*).[12] The Internal Revenue Manual further states that a Revenue Agent requesting an extension "will" maintain a copy of Letter 907 or Letter 967 in the case file and "will" document on Form 9984 or other appropriate form specifics of the request, including confirmation that the required notification of rights was made, the date of notification, the letters, consent forms, and publications provided, who was notified, and how they were notified.[13]

Group Managers also have responsibilities. The Internal Revenue Manual mandates that, before approving and signing Forms 872 obtained by Revenue Agents, they "must" review the case files and Forms 872 to confirm that the notification rights have been properly provided to the taxpayers and their representatives and Forms 9984 have been properly completed.[14]

IV. IRS Not Meeting All Obligations

Code Sec. 6501(c)(4)(A) is straightforward, as is the guidance to IRS personnel described above. Nevertheless, according to a recent report by the Treasury Inspector General for Tax Administration ("TIGTA Report"), the IRS is not always satisfying its obligations.[15]

The TIGTA Report emphasized that, while the Internal Revenue Manual instructs Revenue Agents to send taxpayers multiple documents when requesting an extension that contain valuable information about rights, Form 872 expressly states the following at the top:

> You have the right to refuse to extend the period of limitations or limit the extension to a mutually agreed-upon issue(s) or mutually agreed-upon period of time. Publication 1035, Extending the Tax Assessment Period, provides a more detailed explanation of your rights and the consequences of the choices you make.

Later, just below the taxpayer's signature block, the Form 872 then adds this declaration:

> I am aware that I have the right to refuse to sign this consent or to limit the extension to mutually agreed-upon issues and/or period of time as set forth in I.R.C. §6501(c)(4)(B).

The TIGTA Report concluded, based solely on the fact that the sample audit files it reviewed contained an executed Form 872, that the IRS was "generally compliant" with its notification duties under Code Sec. 6501(c)(4)(A).[16] It recognized, however, that some IRS personnel are not following the IRS policies and procedures set forth in the Internal Revenue Manual.[17] In particular, the TIGTA Report revealed that approximately 22 percent of the sample files lacked documentation to demonstrate compliance with the taxpayer notification requirements.[18] That means that 1,639 out of 7,572 files did not contain data to show that taxpayers were properly advised of their rights when the IRS asked for extensions.[19] The TIGTA Report further indicated that 12 percent of files lacked proof that the IRS properly notified the representatives of the taxpayers.[20] Extrapolating from the files analyzed, the IRS might have circumvented representatives in 888 out of 7,572 cases.[21]

V. Important Issues Not Revealed by the IRS

We know the following thus far: The IRS commonly seeks Forms 872 from taxpayers to extend assessment-periods despite IRS pronouncements that this only occurs in "unusual circumstances," Congress enacted Code Sec. 6501(c)(4)(A) in order to protect taxpayer rights, and the IRS is not fully meeting its duty to notify taxpayers and their representatives of various rights related to Forms 872.

Full compliance by the IRS with Code Sec. 6501(c)(4)(A) would be nice, particularly since the IRS demands full compliance by taxpayers with respect to all tax provisions. However, even if this were to occur, taxpayers would still lack critical information affecting the decision of whether or not to grant a Form 872. This is because the IRS is not required to provide it, and too many taxpayers and representatives are oblivious.

Issues abound, and they depend on the facts and circumstances of each case. However, some important considerations are as follows: If a taxpayer refuses to grant a Form 872 during an audit, will he get a chance to present his case to the Appeals Office? What advantages are gained by "cooperating" with the IRS? What does the concept of "cooperating" mean in different tax contexts? Does rejecting Form 872 violate cooperation requirements? These issues and more are examined below.

A. Access to the Appeals Office

Representatives who regularly defend taxpayers against IRS attacks are familiar with the reality that many Revenue Agents attempt to scare taxpayers into granting Forms 872 by telling them that refusal will deprive them of their chance to present their case to the Appeals Office. This is misleading, at best, and the documentation that must be provided to taxpayers at decision-making time fails to clarify matters. As indicated above, the Internal Revenue Manual directs Revenue Agents to give taxpayers several items, including Publication 1035. It contains the following half-truth: "[I]f you disagree with the return examination findings, we cannot provide you with an administrative appeal within the [IRS] unless sufficient time remains on the statute of limitations."[22]

What Revenue Agents conveniently do not tell taxpayers is that they nearly always have the opportunity to present their case to the Appeals Office; it is simply a matter of timing. On one hand, if a taxpayer grants a Form 872, which allows the IRS additional time to conduct its audit, identify issues, contact third-parties with relevant information, gather potentially unfavorable evidence, and fortify its legal and tax theories, then the taxpayer can approach the Appeals Office directly after the audit. Generally, the process involves the following main steps: (i) The IRS begins its audit; (ii) The IRS realizes that it lacks sufficient time to do all the probing it would like, so it seeks a Form 872 from the taxpayer; (iii) If the taxpayer grants the Form 872, the IRS continues its audit and ultimately issues an Examination Report; (iv) The taxpayer disputes the Examination Report by filing a Protest Letter; (v) The Appeals Office reviews the Protest Letter and offers a meeting/conference with the taxpayer and his representative to discuss matters, review evidence, narrow issues, make proposals, *etc.*; (vi) If the taxpayer and Appeals Office agree to a settlement, then the case ends there; and (vii) If the parties reach an impasse, then the IRS issues a Notice of Deficiency before the expiration of the extended deadline as fixed by the Form 872.

On the other hand, in situations where a taxpayer declines to grant a Form 872, the Revenue Agent must hastily complete the audit and does not prepare an Examination Report. Instead, the IRS issues a Notice of Deficiency before the expiration of the normal three-year assessment-period. The taxpayer, who has restricted the IRS from fully developing its case at the audit level, may now challenge the Notice of Deficiency by filing a timely Petition with the Tax Court. Once the case has been filed with the Tax Court, it is assigned a docket number, and thus becomes a so-called "docketed case." What many taxpayers and practitioners fail to understand, and what the IRS does not explain when seeking a Form 872, is that docketed cases are automatically routed to the Appeals Office for potential settlement before advancement of the Tax Court case. In other words, IRS procedures generally dictate that all cases get reviewed by the Appeals Office, regardless of whether the taxpayer grants a Form 872. It is simply of question of timing. This is confirmed by the following IRS pronouncements and tax provisions, about which many taxpayers and representative are unaware.

Rev. Proc. 87-24 states the following about universal review by the Appeals Office:

- "Except in unusual circumstances, a docketed case is referred by Counsel to Appeals to reach a settlement with the taxpayer."[23]
- "Appeals has exclusive jurisdiction of a docketed case involving a deficiency of more than $10,000 per period (including taxes and penalties), as long as Appeals believes there is a reasonable likelihood of settlement, or until the case appears on a trial calendar. Counsel may extend the period of Appeals consideration of the case when it appears on the trial calendar."[24]
- "Appeals will have sole settlement authority over docketed cases referred to Appeals pursuant to these procedures until the case is returned to Counsel. Upon request, a case will be returned to Counsel to allow adequate trial preparation. Whenever a docketed case is returned to Counsel, sole authority to dispose of the case by trial or settlement will revert to Counsel, unless Counsel and Appeals agree that settlement authority over some or all issues will be retained by Appeals. Thus, in some situations, Counsel will prepare a case for trial while Appeals simultaneously conducts settlement negotiations."[25]
- "In appropriate cases, such as those involving significant issues or large deficiencies, Counsel and Appeals may, as soon as the case is at issue, commence working together. During such a period of joint consultation, Appeals will retain jurisdiction over settlement, while Counsel acts in an advisory capacity, including attending settlement conferences. Joint consultation may continue until the case is settled or settlement appears likely."[26]

Rev. Proc. 2016-22 updates and clarifies Rev. Proc. 87-24, but maintains its essence. It confirms the following[27]:

- "Counsel will refer docketed cases to Appeals for settlement consideration unless (1) Appeals issued the Notice of Deficiency or made the determination that is the basis of the Tax Court's jurisdiction, or (2) the taxpayer notifies Counsel that the taxpayer wants to forego settlement consideration by Appeals."[28]
- "If Appeals issues a Notice of Deficiency, or makes a determination, without having fully considered one or more issues because of an impending expiration of the statute of limitations on assessment, Appeals may include a request in the administrative case file for Counsel to return the case to Appeals for full consideration of the issue or issues once the case is docketed in the Tax Court. If Appeals includes such a request in the administrative case file, the case will be treated as if Appeals did not issue the Notice of Deficiency or make the determination."[29]
- "When a docketed case is forwarded to Appeals for consideration, Appeals has the sole authority to resolve a docketed case through settlement until the case is returned to Counsel."[30]

The Internal Revenue Manual echoes and cross-references Rev. Proc. 87-24 and Rev. Proc. 2016-22, as follows:

- "In general, Appeals has settlement responsibility over docketed cases referred to it pursuant to [Rev. Proc. 87-24] until the case is returned to the Office of Chief Counsel."[31]
- "Appeals has settlement authority in conjunction with Counsel over docketed cases. This authority remains in Appeals, unless procedures require the case to be returned to Counsel."[32]

Universal access for taxpayers to the Appeals Office has been further strengthened recently. Congress introduced Code Sec. 7803(e) as part of the Taxpayer First Act of 2019.[33] This provision establishes the Internal Revenue Service Independent Office of Appeals ("Independent Appeals") whose function is to resolve tax disputes, without litigation, on a basis that is fair and impartial to both the IRS and the taxpayer, promote a consist application of, and voluntary compliance with, federal tax laws, and enhance public confidence in the integrity and efficiency of the IRS.[34] Importantly, Code Sec. 7803(e) expressly states that the resolution process with Independent Appeals "shall be generally available to all taxpayers."[35] It also provides that the IRS must give taxpayers answers if they are denied access to Independent Appeals. In this regard, Code Sec. 7803(e) indicates that if a taxpayer who has already received a Notice of Deficiency is prohibited from conferring with Independent Appeals, then the IRS must give the taxpayer written notice that provides a detailed description of the facts, the grounds for the decision, and the procedures for disputing it.[36] Along with creating greater access to Independent Appeals, Code Sec. 7803(e) offers taxpayers increased availability to data about the IRS's case. Certain taxpayers can request and receive, no later than 10 days before a conference with Independent Appeals, access to all non-privileged portions of the IRS's casefile.[37]

B. Reasons Why Taxpayers Might "Cooperate" During Audits

There are a number of reasons, both strategic and legal, why it is advantageous to a taxpayer to "cooperate" during the audit process. The Internal Revenue Manual specifically directs Revenue Agents to document the level of cooperation by taxpayers. It says that they should complete Form 9984 for several purposes, among them "[d]etermining whether taxpayers fully cooperated with reasonable requests for information."[38] It also says that Revenue Agents "should utilize workpapers and audit reports to support audit adjustments and document the extent of taxpayer cooperation."[39] Notwithstanding this guidance to its foot soldiers to gauge cooperation, the IRS does not notify taxpayers of these matters when seeking a Form 872, nor does it explain whether "cooperation" mandates the granting of Form 872. Examined below are just a few areas of tax where the concept of "cooperation" is important.

1. Stop the IRS from Relying Solely on Information Returns

The IRS generally is authorized to conduct audits, make determinations, and assess taxes, penalties, and interest.[40] In carrying out its job, the IRS relies on many tools, including the information returns that payors must send to both the taxpayer receiving/earning the payment and the IRS.

Here is additional context. Every person engaged in a trade or business must file an information return, such as a Form 1099-MISC (*Miscellaneous Income*), for any payments to another person in the course of such trade or business that exceed $600 in any tax year.[41] The IRS uses information returns in its automated audit program, which is the IRS's primary enforcement tool in dealing with individual taxpayers. The IRS compares the data on Forms 1099 to the figures shown on Forms 1040 filed by taxpayers. When mismatches appear, the IRS manually screens the information, and then sends the taxpayer a Notice CP 2000. It asks the taxpayer to justify the inconsistency or pay the proposed tax liability.[42]

Forms 1099 and other information returns often contain errors, and they are sometimes filed by nefarious persons for purposes of causing another taxpayer angst, think former business partner, competitor, ex-spouse, *etc*. The Internal Revenue Code has a provision designed to protect taxpayers from problems caused by inaccurate or malicious information returns, Code Sec. 6201(d). It states the following:

> In any court proceeding, if a taxpayer asserts a reasonable dispute with respect to any item of income reported on an information return filed … by a third party *and the taxpayer has fully cooperated with the [IRS] (including providing, within a reasonable period of time, access to and inspection of all witnesses, information, and documents within the control of the taxpayer as reasonably requested by the [IRS])*, the [IRS] shall have the burden of producing reasonable and probative information concerning such deficiency in addition to such information return.[43]

In short, if the taxpayer presents a "reasonable dispute" during any court proceeding about any income that he allegedly received based solely on an information return filed with the IRS, and if the taxpayer can show that he "fully cooperated" with the IRS during the audit process, then the responsibility shifts to the IRS to offer evidence, aside from the information return, that the taxpayer received the income. This concept has been addressed in various cases, including the two described below.

a. Portillo.[44] Navarro, a contractor, issued a Form 1099 for 1984 reporting the payments that he supposedly made to Portillo, a painting subcontractor who conducted his affairs primarily in cash. Portillo filed his 1984 Form 1040 reporting, among other things, the amount he believed that he had received from Portillo. The figures presented by Navarro and Portillo did not match. The IRS began an audit at some point and concluded that Portillo had omitted certain income on his 1984 Form 1040. Portillo denied this allegation.

At trial, Navarro stated that Portillo performed work for him in 1984. Navarro said that he computed the amount reported on Form 1099 from his records, which were later discarded. Navarro also testified that he paid Portillo both in cash and by check. Evidence was introduced at trial that the Examination Report reflected the auditor's belief that Portillo was paid *less* than the amount shown on the Form 1099.

The Tax Court found Navarro's testimony reliable and credible, and Portillo's contention that he received no additional cash payments from Navarro unpersuasive. Thus, the Tax Court upheld the Notice of Deficiency issued by the IRS.

The taxpayer sought review by the Fifth Circuit Court of Appeals. It stated that the IRS merely matched Form 1099 with Form 1040, and arbitrarily decided to attribute veracity to Navarro and falsity to Portillo. It also stated that, in this situation, the IRS had a duty to investigate Navarro's "bald" assertion of payment and determine if its position was supported by books, receipts, or other records. It found that the IRS's determination that Portillo had received unreported income was, in effect, "naked" because it lacked factual foundation.

Because the IRS failed to substantiate the supposed income by any other means, such as analyzing Portillo's cash expenditures, the Court of Appeals held that the presumption of correctness did not apply to the Notice of Deficiency.[45] Concluding that the Notice of Deficiency was arbitrary and erroneous, the Court of Appeals reversed the earlier judgment of the Tax Court regarding unreported income.

b. Perez.[46] In issuing its Notice of Deficiency, the IRS relied solely on a Form 1099-R (*Distributions from Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*) sent by an insurance company to the taxpayer and the IRS. The taxpayer disputed the accuracy of the Form 1099-R. In ruling in favor of the taxpayer, the Tax Court looked to *Portillo* and Code Sec. 6201(d). With regard to the "naked" Form 1099 issue, the Tax Court stated the following:

> [T]he point of section 6201(d) is that when a taxpayer raises a reasonable dispute with respect to an information return, *and when the taxpayer has fully cooperated*, then the [IRS] must produce evidence to establish the fundamental correctness of the deficiency arising from the information return, not merely that the information return existed or that the [IRS] accurately transcribed the information return into the [IRS's] own internal records. See Portillo v. Commissioner … holding that as far back as 1935 courts have followed the principle that the [IRS's] "naked assertion" that a taxpayer received unreported income without a proper foundation is not sufficient support for a notice of deficiency and is therefore not entitled to a presumption of correctness).
>
> The February 11, 1988, life insurance application is the only evidence [the IRS] produced to show the foundational accuracy of the Form 1099R. Without the actual February policy in the record or a Northwestern representative testifying as to how the provisions in the policy applied when a lapse in premium payments occurred, the record is silent as to how Northwestern determined the amounts reflected on the Form 1099-R. Moreover, we also do not know whether the February policy changed over the years or whether [the taxpayer's] subsequent bankruptcy allowed his creditors to receive the cash value of his life insurance policies in effect at the time.
>
> In summary, businesses can make mistakes in reporting data on information returns, and, decisive here, respondent offered no evidence showing that the amounts on the 2004 Form 1099-R are correct. We conclude [the IRS] has not met his burden of producing reasonable and probative information concerning the deficiency.

2. Shifting the Burden of Proof to the IRS

Generally, there is a presumption in federal tax disputes that determinations made by the IRS during an audit are correct.[47] This confuses many taxpayers, who, applying basic concepts of criminal law (not tax law), logically think that people are innocent until proven guilty.

There are exceptions to this the-IRS-is-always-right principle. For instance, Code Sec. 7491(a)(1) generally provides that if a taxpayer introduces "credible evidence" in a court proceeding with respect to any factual issue relevant to ascertaining certain tax liabilities, then the burden of proving such issue switches to the IRS.[48] Importantly, the preceding general rule only applies where (i) the taxpayer has complied with all applicable substantiation and record-keeping requirements, (ii) the taxpayer has "cooperated with reasonable requests by the [IRS] for witnesses, information, documents, meetings, and interviews," and (iii) taxpayers, other than individuals, must have a net worth below a certain threshold.[49]

The legislative history to Code Sec. 7491 clarifies a few points pertinent to this article. First, it explains the rationale for allowing taxpayers to shake the-IRS-is-always-right principle:

> The Committee is concerned that individual and small business taxpayers frequently are at a disadvantage when forced to litigate with the [IRS]. The Committee believes that the present burden of proof rules contribute to that disadvantage. The Committee believes that, all other things being equal, facts asserted by individual and small business *taxpayers who fully cooperate with the IRS* and satisfy all relevant substantiation requirements should be accepted. The Committee believes that shifting the burden of proof to the [IRS] in such circumstances will create a better balance between the IRS and such taxpayers, without encouraging tax avoidance.[50]

Second, it illuminates the significance of "cooperation" in this context. The congressional reports contain slightly different language in this regard, and it is critical to have a complete picture when advancing taxpayer rights. The earlier report by the U.S. House of Representatives is set forth first below[51]:

> [T]he taxpayer must fully cooperate at all times with the Secretary (including providing, within a reasonable period of time, access to and inspection of all witnesses, information, and documents within the control of the taxpayer, as reasonably requested by the Secretary).
>
> Full cooperation also includes providing reasonable assistance to the Secretary in obtaining access to and inspection of witnesses, information, or documents not within the control of the taxpayer (including any witnesses, information, or documents located in foreign countries).
>
> A necessary element of fully cooperating with the Secretary is that the taxpayer must exhaust his or her administrative remedies (including any appeal rights provided by the IRS).
>
> *The taxpayer is not required to agree to extend the statute of limitations to be considered to have fully cooperated with the [IRS].*

The later Senate Report was similar, but it added some important details:[52]

> [T]he taxpayer must cooperate with reasonable requests by the [IRS] for meetings, interviews, witnesses, information, and documents (including providing, within a reasonable period of time, access to and inspection of witnesses, information, and documents within the control of the taxpayer, as reasonably requested by the [IRS]).
>
> Cooperation also includes providing reasonable assistance to the [IRS] in obtaining access to and inspection of witnesses, information, or documents not within the control of the taxpayer (including any witnesses, information, or documents located in foreign countries).
>
> A necessary element of cooperating with the [IRS] is that the taxpayer must exhaust his or her administrative remedies (including any appeal rights provided by the IRS).
>
> *The taxpayer is not required to agree to extend the statute of limitations to be considered to have cooperated with the [IRS].*
>
> Cooperating also means that the taxpayer must establish the applicability of any privilege. Cooperation also includes providing English translations, as reasonably required by the [IRS].

Third, the legislative history provides more detail on what Congress had in mind when it mandated that taxpayers present "credible evidence" to the court. It states that "credible evidence" is the quality and amount of evidence which, after critical analysis, the court would find sufficient on which to base its decision, if the IRS were not to submit any contrary evidence.[53] The legislative history clarifies, though, that "credible evidence" does not consist of implausible allegations of fact, frivolous claims, or tax-protestor type arguments.[54]

3. Recouping Fees from the IRS

Generally, Code Sec. 7430 provides that the "prevailing party" in any administrative proceeding before the IRS, or in any litigation that is brought by or against the government in connection with the determination, collection, or refund of any tax, penalty, or interest may be awarded reasonable administrative and/or litigation costs.[55] Recoverable administrative costs may include legal fees, reasonable expenses for expert witnesses, and costs for any study, analysis, report, test, or project necessary for the preparation of the taxpayer's case.[56] Litigation costs for which the taxpayer may seek reimbursement follow similar guidelines.[57] Various aspects about recovery pursuant to Code Sec. 7430 are explained below.

a. Prevailing Party Standards. The term "prevailing party" generally means a party in any tax-related administrative proceeding or litigation that (i) has substantially prevailed with respect to either the amount in controversy or the most significant issues presented, and (ii) has a net worth that does not exceed the statutory thresholds.[58]

b. Exhausting Administrative Remedies. Even if a taxpayer substantially prevails and meets the net worth requirement, the taxpayer still cannot recover costs from the government, unless other hurdles are overcome. For example, the taxpayer must have exhausted all administrative remedies available within the IRS.[59] What this means in the context of Code Sec. 7430 is found in a Chief Counsel Advice, which states the following:

> If appeal rights are given prior to the [Notice of Deficiency] then the [taxpayer] must request a conference with Appeals prior to filing a petition with the tax court to exhaust administrative remedies. If for varying reasons the [taxpayer] is not given appeal rights prior to the [Notice of Deficiency] then the [taxpayer] is excused from exhausting administrative remedies prior to petitioning the tax court. However, if after filing a petition with the tax court counsel refers the case to Appeals or gives the [taxpayer] the opportunity to go to Appeals then the [taxpayer] must participate in an Appeals conference to exhaust administrative remedies.[60]

Importantly, the Internal Revenue Code specifically provides that the duty to exhaust all administrative avenues does not obligate the taxpayer to grant the IRS extensions of the assessment-period.[61]

c. No Unreasonable Delays by Taxpayer. To preserve eligibility for fee recoupment, the taxpayer cannot "unreasonably protract" the proceedings with the government.[62]

d. Substantial Justification for Government Positions. The taxpayer will not be deemed the "prevailing party" if the government establishes that its position was "substantially justified."[63] In other words, if the government manages to prove that the position it took during the administrative dispute or litigation was substantially justified, then the taxpayer is precluded from recovering costs.

There is a rebuttable presumption that the government's position is *not* substantially justified, if it failed to follow its "applicable published guidance" during a proceeding.[64] Such guidance includes regulations (final or temporary), revenue rulings, information releases, notices, and announcements.[65] It also encompasses various items issued to the particular taxpayer involved in a dispute, such as private letter rulings, technical advice memoranda, and determination letters.[66] In deciding whether the position taken by the government was substantially justified, the courts are instructed to consider whether the government lost on similar issues in federal appeals courts.[67]

The regulations provide additional clarity regarding what constitutes a substantial justification. For instance, they explain that the government's position is substantially justified only if it has a reasonable basis in both fact and law.[68] A significant factor in making this determination is whether the taxpayer presented all the relevant information under his control to the appropriate IRS personnel.[69] The regulations do not specifically use the term "cooperation" here, but requiring taxpayers to exhaust administrative remedies, not cause unnecessary delays, and present all relevant information to the IRS is akin to cooperation.

4. Acquiring Worker-Classification Relief

The IRS commonly audits companies and claims that certain workers, treated as independent contractors, should really be characterized as employees and subjected to all employment taxes and filing obligations. When this occurs, knowledgeable companies rely on so-called "Section 530." It is not found in the Internal Revenue Code; rather, it is a reference to Section 530 of the Revenue Act of 1978.[70]

The company that satisfies all the criteria necessary to warrant Section 530 relief obtains two major benefits. First, the IRS may not assess any back employment taxes, penalties, or interest charges against the company.[71] Second, and perhaps more importantly, the IRS cannot obligate the company to reclassify the workers as employees going forward, regardless of the fact that applicable law supports reclassification. The company gets a free pass, if you will, for past *and* future behavior, if it can prove that Section 530 applies.[72]

Congress introduced Section 530 over 40 years ago in an effort to counter aggressive IRS worker-classification audits on small businesses.[73] According to the legislative history, the congressional relief provided to companies by Section 530 was appropriate because the IRS had dramatically increased enforcement of employment tax laws, many of the positions that the IRS began taking were contrary to those followed in earlier years, and mandatory reclassification of workers often resulted in double payment of the same taxes because companies were obligated to pay federal income tax liabilities and FICA taxes for workers, even though such workers may have already paid their own income and self-employment taxes.[74]

Section 530 is like a self-fulfilling prophecy. It provides that if a company treated a worker as an independent contractor for certain tax periods, then the worker *shall* be deemed to be an independent contractor for such periods, provided that the company (i) filed federal tax and information returns in a manner consistent with the worker's status as an independent contractor, (ii) treated all workers holding substantially similar positions as independent contractors, and (iii) had a "reasonable basis" for treating the worker as an independent contractor.[75]

If a company establishes a *prima facie* case that it was reasonable to treat the workers as independent contractors, and the company has "fully cooperated" during the audit, then the burden of proof with respect to the classification issue shifts to the IRS.[76] Citing the high incidence of worker classification disputes, the fact that many of these disputes involve small businesses without adequate resources to challenge the IRS, and the costly litigation resulting from the disputes, Congress further clarified its reasons for placing the burden on the IRS:

> [I]n light of the unique nature of the legislative history to Section 530 which provides it should be construed liberally in favor of taxpayers, the Committee believes that the burden of proof should generally be on the IRS once the taxpayer establishes a prima facie case that it was reasonable not to treat the worker as an employee *and provided the taxpayer fully cooperates with reasonable requests for information by the IRS*.[77]

VI. Conclusion

This article demonstrates that (i) while the IRS has a statutory duty to provide taxpayers and their representatives certain information about Forms 872, it sometimes fails to do so, (ii) taxpayers nearly always get a chance to present their cases to the Appeals Office at some point, irrespective of whether they grant Forms 872, (iii) there are certain strategic reasons for "cooperating" during an audit, (iv) the concept of "cooperation" has different meanings in different tax contexts, and taxpayers must be hyper-aware of what is specifically required, and (v) refusing to grant Forms 872 generally does not mean that a taxpayer is not "cooperating" with the IRS. These constitute important issues for any taxpayer under audit when the IRS comes brandishing a Form 872 or other assessment-period extension form.

ENDNOTES

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1 Code Sec. 6501(a).

2 Code Sec. 6501(c)(1). In order for the assessment-period to be infinitely extended, the IRS must prove by clear and convincing evidence that the taxpayer's return was false or fraudulent, and that the taxpayer intended to conceal, mislead, or otherwise prevent the collection of taxes. *See* *J.S. Payne*, CA-5, 2000-2 USTC ¶50,668, 224 F3d 415, *supplemented by* 82 TCM 477, Dec. 54,469(M), TC Memo. 2001-231; *U.R. Neely*, 116 TC 79, Dec. 54,241 (2001).

3 Code Sec. 6501(c)(4)(A). Other common extension forms consist of Form 872-A (*Special Consent to Extend the Time to Assess Tax*), Form 872-B (*Consent to Extend the Time to Assess Miscellaneous Excise Taxes*), Form 872-D (*Consent to Extend the Time on Assessment of Tax Return Preparer Penalties*), Form 872-H (*Consent to Extend the Time to Assess Tax on a Trust*), Form 872-P (*Consent to Extend the Time to Assess Tax Attributable to Partnership Items*), Form 2750 (*Waiver Extending Statutory Period for Assessment of Trust Fund Recovery Penalty*), and Form SS-10 (*Consent to Extend the Time to Assess Employment Taxes*). *See* IRM Exhibit 25.6.22-1. For the sake of simplicity, this article only refers to Form 872.

4 Code Sec. 6501(c)(4)(B).

5 Rev. Proc. 57-6.

6 IRM §25.6.22.2.1 (Mar. 26, 2019).

7 IRM §25.6.22.3 (Mar. 26, 2019).

8 IRM §25.6.22.3 (Mar. 26, 2019).

[9] IRM §25.6.22.3 (Mar. 26, 2019).
[10] Reg. §601.506(a).
[11] Reg. §601.506(a)(3).
[12] IRM §25.6.22.2.1 (Mar. 26, 2019).
[13] IRM §25.6.22.3 (Mar. 26, 2019).
[14] IRM §25.6.22.5.13 (Mar. 26, 2019).
[15] Treasury Inspector General for Tax Administration. Fiscal Year 2019 Statutory Audit of Compliance with Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute. Reference No. 2019-30-054 (Aug. 7, 2019).
[16] Treasury Inspector General for Tax Administration. Fiscal Year 2019 Statutory Audit of Compliance with Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute. Reference No. 2019-30-054 (Aug. 7, 2019), at 7.
[17] Treasury Inspector General for Tax Administration. Fiscal Year 2019 Statutory Audit of Compliance with Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute. Reference No. 2019-30-054 (Aug. 7, 2019), at 7.
[18] Treasury Inspector General for Tax Administration. Fiscal Year 2019 Statutory Audit of Compliance with Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute. Reference No. 2019-30-054 (Aug. 7, 2019), at 8.
[19] Treasury Inspector General for Tax Administration. Fiscal Year 2019 Statutory Audit of Compliance with Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute. Reference No. 2019-30-054 (Aug. 7, 2019), at 8.
[20] Treasury Inspector General for Tax Administration. Fiscal Year 2019 Statutory Audit of Compliance with Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute. Reference No. 2019-30-054 (Aug. 7, 2019), at 8.
[21] Treasury Inspector General for Tax Administration. Fiscal Year 2019 Statutory Audit of Compliance with Notifying Taxpayers of Their Rights When Requested to Extend the Assessment Statute. Reference No. 2019-30-054 (Aug. 7, 2019), at 8.
[22] IRS Publication 1035 (*Extending the Assessment Period*) (Rev. 9-2017), at 1
[23] Rev. Proc. 87-24, 1987-1 CB 720; Proposed Reg. §601.106(e)(3)(i)(A).
[24] Rev. Proc. 87-24, 1987-1 CB 720; Proposed Reg. §601.106(e)(3)(i)(B)(1).
[25] Rev. Proc. 87-24, 1987-1 CB 720, Section 2.04; *see also* Proposed Reg. §601.106(e)(3)(i)(C).
[26] Rev. Proc. 87-24, 1987-1 CB 720, Section 2.06.
[27] Notice 2015-72 contained the proposed version of what later became Rev. Proc. 2016-22.
[28] Rev. Proc. 2016-22, IRB 2016-15, 577, Section 3.01.
[29] Rev. Proc. 2016-22, IRB 2016-15, 577, Section 3.02.
[30] Rev. Proc. 2016-22, IRB 2016-15, 577, Section 3.05.
[31] IRM §35.5.1.4.1 (Aug. 11, 2004).
[32] IRM §8.4.1.4 (Oct. 26, 2007).
[33] U.S. Joint Committee on Taxation. Description of H.R. 1957, the Taxpayer First Act of 2019. JCX-15-19, April 1, 2019, at 2–5; U.S. House of Representatives. Taxpayer First Act of 2019, 116th Cong., 1st Session, Report 116-39, Part I, April 9, 2019, at 28–32.
[34] Code Sec. 7803(e)(1) and (3).
[35] Code Sec. 7803(e)(4).
[36] Code Sec. 7803(e)(5)(A).
[37] Code Sec. 7803(e)(7)(A). This access is limited to "specified taxpayers," which are defined as (i) in the case of an individual, a taxpayer whose adjusted gross income does not exceed $400,000 for the tax year to which the dispute relates, and (ii) in the case of all other taxpayers, a taxpayers whose gross receipts do not exceed $5 million for the tax year to which the dispute relates. *See* Code Sec. 7803(e)(7)(C)(i).
[38] IRM §4.10.7.6.1.3.1 (Jan. 1, 2006).
[39] IRM §4.10.7.6.1.3.2 (Jan. 1, 2006).
[40] Code Sec. 6201(a).
[41] Code Sec. 6041.
[42] *See* IRM §5.18.1.5.11.14 (Apr. 6, 2016).
[43] *See also* Joint Committee on Taxation, Description of Amendment in the Nature of a Substitute to H.R. 2337, Taxpayer Bill of Rights 2, JCX-7-96, March 20, 1996, at 12–13; U.S. House of Representatives, Taxpayer Bill of Rights 2, Report 104-506, 104th Cong., 2nd Session, March 28, 1996, at 36.
[44] *R. Portillo*, CA-5, 91-2 USTC ¶50,304, 932 F2d 1128.
[45] *Portillo*, CA-5, 91-2 USTC ¶50,304, 932 F2d 1128, 1134.
[46] *Perez*, TC Summ. Op. 2009-94.
[47] Tax Court Rule 142(a)(1).
[48] *See also* Philip N. Jones, *The Burden of Proof: The Tax Court Responds to the Eighth Circuit's Directive*, 100 JOURNAL OF TAXATION 243 (Apr. 2004); Joni Larson, *Burden of Proof in the Tax Court After the IRS Restructuring and Reform Act of 1998 and Shea v. Commissioner*, 36 GONZAGA LAW REVIEW 49 (2000/2001); Adriana Wos-Mysliwiec, *The Internal Revenue Restructuring and Reform Act of 1998: Does It Really Shift the Burden of Proof to the IRS?* 14 ST. JOHN'S JOURNAL OF LEGAL COMMENTARY 301 (Fall 1999); David A. Baker and William R. Franzen, *20,000 Litigants and 2 Million Audits: The True Impact of Shifting the Burden of Proof*, 13 PROBATE AND PROPERTY 45 (Mar./Apr. 1999); Lisa M. Ivancic and Richard E. Coppage, *Taxpayers Remain Burdened Despite Shifted Burden of Proof*, 62 PRACTICAL TAX STRATEGIES 284 (May 1999); Megan L. Brackney, *The Impact of Code Sec. 7491 Burden-Shifting in Tax Controversy Litigation*, J. TAX PRACTICE & PROCEDURE, Aug.–Sept. 2007, at 27.
[49] Code Sec. 7491(a)(2).
[50] U.S. House of Representatives, Internal Revenue Service Restructuring and Reform Act of 1997, Report 105-364, 105th Congress, 1st Session, October 31, 1997, at 56.
[51] U.S. House of Representatives, Internal Revenue Service Restructuring and Reform Act of 1997, Report 105-364, 105th Congress, 1st Session, October 31, 1997, at 56–57.
[52] U.S. Senate, Internal Revenue Service Restructuring and Reform Act of 1998, Report 105-174, 105th Congress, 2nd Session, April 22, 1998, at 45–46 (The last sentence was derived from Footnote 22). *See also* U.S. House of Representatives, Internal Revenue Service Restructuring and Reform Act of 1998, Conference Report 105-599, 105th Congress, 2nd Session, June 24, 1998, at 238–242.
[53] U.S. Senate, Internal Revenue Service Restructuring and Reform Act of 1998, Report 105-174, 105th Congress, 2nd Session, April 22, 1998, at 45–46. *See also* U.S. House of Representatives, Internal Revenue Service Restructuring and Reform Act of 1998, Conference Report 105-599, 105th Congress, 2nd Session, June 24, 1998, at 238–242.
[54] U.S. Senate, Internal Revenue Service Restructuring and Reform Act of 1998, Report 105-174, 105th Congress, 2nd Session, April 22, 1998, at 45–46. *See also* U.S. House of Representatives, Internal Revenue Service Restructuring and Reform Act of 1998, Conference Report 105-599, 105th Congress, 2nd Session, June 24, 1998, at 238–242.
[55] Code Sec. 7430(a).
[56] Code Sec. 7430(c)(2).
[57] Code Sec. 7430(c)(1).
[58] Code Sec. 7430(c)(4)(A).
[59] Code Sec. 7430(b)(1).
[60] Chief Counsel Advice 200919037 (May 8, 2009).
[61] Code Sec. 7430(b)(1).
[62] Code Sec. 7430(b)(3).
[63] Code Sec. 7430(c)(4)(B)(i).
[64] Code Sec. 7430(c)(4)(B)(ii).
[65] Code Sec. 7430(c)(4)(B)(iv)(I); Reg. §301.7430-5(c)(3).
[66] Code Sec. 7430(c)(4)(B)(iv)(II); Reg. §301.7430-5(c)(3).
[67] Code Sec. 7430(c)(4)(B)(iii).
[68] Reg. §301.7430-5(c)(1).
[69] Reg. §301.7430-5(c)(1); Reg. §301.7430-5(h) Ex. 1.
[70] The Revenue Act of 1978, P.L. 95-600.
[71] For purposes of this article, the term "employment taxes" refers to three items: (i) The federal income taxes that an employer is required to withhold from an employee; (ii) Amounts under the Federal Insurance Contributions Act ("FICA"), consisting of Social Security taxes and Medicare, which are paid partly by the employer and partly by the employee; and (iii) Amounts under the Federal Unemployment Tax Act ("FUTA"), which are paid solely by the employer.
[72] Code Sec. 530(a)(1).
[73] P.L. 95-600 (1978), Code Sec. 530.
[74] Senate Report No. 95-1263, 95th Cong. 2nd Sess. (1978), at 209–211.
[75] Code Sec. 530(a)(1); Rev. Proc. 85-18, 1985-1 CB 518.
[76] Code Sec. 530(e)(4)(A).
[77] S. Rep. 104-281, 104th Cong., 2nd Sess., 26 (1996) (emphasis added).