It's Not Over Till It's Over: Lessons from *Crandall* About Closing Agreements and Key Procedural Issues in Tax Disputes

*By Hale E. Sheppard**

I. Introduction

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It's not over till it's over. An overused adage, yes, but still very true when it comes to tax disputes with the Internal Revenue Service ("IRS"). To have success against the IRS, taxpayers and/or their advisors must understand substantive tax law *and* procedure. Too many people are clueless about the latter, and this ultimately causes their downfall. Among the critical procedural issues they fail to grasp are the many different manners of ending a tax dispute, and what each means for taxpayers in terms of post-resolution actions, either by the IRS or taxpayers. This article analyzes a recent Tax Court case, *Crandall*, using it as a springboard for learning important lessons about so-called Closing Agreements with the IRS, unique steps in rectifying international tax issues through a voluntary disclosure program, and procedural questions that often arise in tax battles.[1]

II. Overview of Closing Agreements

Appreciating *Crandall* requires some background about Closing Agreements between taxpayers and the IRS.

The IRS can enter into a Closing Agreement with any taxpayer relating to the liability of such taxpayer, with respect to any tax, for any period.[2] The rationales for the IRS to conclude a matter *via* a Closing Agreements are expansive. Indeed, the IRS can utilize a Closing Agreement in any case where there appears to be a benefit in having it "permanently and conclusively closed," or if the taxpayer presents "good and sufficient reasons" for a Closing Agreement, and the IRS will not sustain any disadvantage.[3] The IRS, in its sole discretion, decides whether the requisite criteria have been satisfied in a particular situation.[4]

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With respect to finality, a Closing Agreement generally is "final and conclusive," the matters covered shall not be reopened by the IRS, and in any subsequent lawsuit, action or proceeding, a Closing Agreement shall not be annulled, modified, set aside, or disregarded.[5] There are exceptions, of course. The general rules are inapplicable where the taxpayer engaged in fraud, malfeasance, or misrepresentation of material fact.[6]

The IRS warns its personnel about the permanence of Closing Agreements, explaining that, "[b]ecause of the finality with which [Closing Agreements] are imbued, it is extremely important that they be carefully drafted."[7] The IRS further admonishes that, in the case of a dispute with a taxpayer regarding a Closing Agreement, the courts might consider extrinsic evidence, but the focus will be on the specific language of the Closing Agreement itself.[8] The IRS also emphasizes to its troops that they should prepare Closing Agreements "with great caution" because any ambiguities will be resolved against the drafter, the IRS.[9]

The IRS uses different types of Closing Agreements depending on the circumstances, with the main ones being Form 866 (*Agreement as to Final Determination of Tax Liability*) and Form 906 (*Closing Agreement as to Final Determination Covering Specific Matters*).[10]

III. Analysis of the Case

The scope and stature of Closing Agreements, along with other interesting international tax and procedural issues, are examined in *Crandall*.

A. Main Facts

The taxpayers in *Crandall* are a married couple, with the wife being a dual citizen of the United States and Italy. The taxpayers split their time between the two countries. At some point, the wife worked for the Italian government and became eligible for a government pension.

The years relevant to the case are 2003 through 2011. During this period, the taxpayers received pension payments, annuities, interest, and dividends from Italian sources ("Italian Passive Income"). They paid income tax in Italy on such amounts.

The taxpayers filed timely joint Forms 1040 (*U.S. Individual Income Tax Returns*) for 2003 through 2010. They did *not* report the Italian Passive Income on such Forms 1040, but they did *not* claim foreign tax credits ("FTCs") for the taxes that they paid to the Italian government either.

In 2011, the taxpayers realized that they had misunderstood their duties, and they hired U.S. attorneys to help them pro-actively rectify matters with the IRS, through the Offshore Voluntary Disclosure Program ("OVDP"). As they were working on the materials for their OVDP application packet, the deadline for 2011 arrived, and the taxpayers wanted to start doing things correctly. Therefore, they filed a timely joint Form 1040 for 2011, reporting Italian Passive Income, along with an FTC of $14,156 for the taxes that they already paid abroad.

The taxpayers filed their application packet for the OVDP one month later. Among other things, it contained (i) Forms 1040X (*Amended U.S. Individual Income Tax Returns*) for 2003 through 2011, reporting all Italian Passive Income received each year and claiming the corresponding FTCs, and (ii) nine separate checks, one for each year, to cover the liabilities related to the Forms 1040X.

The figures for 2011 are key to the dispute in *Crandall*. On their Form 1040 for 2011, the taxpayers reported $63,902 of Italian Passive Income and an FTC of $14,156. Later, on their Form 1040X, the taxpayers increased the Italian Passive Income by $496 (bringing it to $64,398) and increased the FTC by $123 (bringing it to $14,279). Importantly, aside from the FTC, the taxpayers did *not* claim any other credits on their Form 1040 or Form 1040X for 2011, such as an alternative minimum tax ("AMT") credit.[11]

The IRS audited the OVDP application packet and rejected all the Forms 1040X. The taxpayers and IRS vacillated on the issues for approximately two years. Then, in May 2015, the Revenue Agent sent an Examination Report, proposing additional tax liabilities on all Forms 1040X ("Examination Report"). Such liabilities did not result from increases in the amount of Italian Passive Income received, but rather from decreases in the FTCs allowed.

With respect to 2011, the Examination Report indicated that the appropriate FTC was $2,165, instead of the $14,156 that the taxpayers claimed on their Form 1040, or the $14,279 that they subsequently claimed on their Form 1040X. Critically, in the Examination Report, the Revenue Agent "inadvertently allowed" the taxpayers an AMT credit of $6,661. The Revenue Agent was the sole cause of the AMT credit situation; the Tax Court recognized that the taxpayers never claimed any AMT credit.[12]

In June 2015, the taxpayers, with hopes of concluding matters after nearly three years of dealing with the OVDP process, sent the Revenue Agent a check satisfying all

liabilities asserted in the Examination Report, including those for 2011.

Soon thereafter, in July 2015, the Revenue Agent sent the taxpayers a Closing Agreement. This was standard practice at the end of the OVDP process. The taxpayers dutifully executed the Closing Agreement and returned it to the Revenue Agent that same month. For its part, the IRS executed the Closing Agreement in September 2015.

B. Key Parts of the Closing Agreement

As tedious as it sounds, reviewing the key aspects of the Closing Agreement is necessary to understand the decision by the Tax Court in *Crandall*. This is broken down into three parts, the recitals, substantive paragraphs, and conclusion.

Recitals are introductory, explanatory clauses that generally begin with the word "Whereas." The Closing Agreement in question offered the following recitals:

> Whereas, Taxpayer underreported federal income taxes for tax years 2003 through 2011 through offshore financial arrangements.
>
> Whereas, Taxpayer paid or accrued foreign income taxes to Italy and various other countries during tax years 2003 through 2011.
>
> Whereas, Taxpayer wants to resolve for 2003 through 2011 the proper amount of federal income taxes and applicable penalties, with payment of agreed liabilities for taxes, penalties, and interest on terms acceptable to the [IRS].

After listing the preceding recitals and others, the Closing Agreement featured 10 numbered paragraphs, the relevant of which are described below:

- Paragraph 1 states that the taxpayers "had additional unreported income and overstated deductions for tax years 2003 through 2011 relating to the voluntary disclosure, as follows." The income increases and deduction decreases, on a year-by-year basis, followed in a chart. Data about 2011 was included.
- Paragraph 3 states that the taxpayers "paid or accrued foreign income taxes to Italy and various other countries eligible for foreign tax credit under Section 901 of the Internal Revenue Code as follows." The corresponding chart showed the specific FTC amounts allowed for 2003 through 2010, but data about 2011 was absent.
- Paragraph 4 states that "[d]uring tax years 2003 through 2011, Taxpayer was entitled to a foreign tax credit under Section 901 of the Internal Revenue Code for foreign income taxes paid or accrued to a foreign country or U.S. possession." Thus, unlike Paragraph 3, this confirms that the taxpayers should get an FTC for 2011, without noting a specific amount.
- Paragraph 8 states that the Closing Agreement does not prevent the IRS "from auditing Taxpayer for tax years 2003 through 2011 and proposing adjustments *unrelated* to offshore financial arrangements," and it allows the IRS to later propose adjustments "*related* to offshore financial arrangements [but] not included in Taxpayer's voluntary disclosure referred to in paragraph 1" of the Closing Agreement.

Finally, the Closing Agreement ends the way they all do, stating that it "contains the complete agreement between the parties" and "is final and conclusive," unless the taxpayers engaged in fraud, malfeasance, or misrepresentation of material fact. The Closing Agreement never mentions the earlier Examination Report or the amount of the FTC for 2011.

C. Actions After Execution of the Closing Agreement

After participating in the multi-year ordeal with the IRS, the taxpayers likely were relieved after executing the Closing Agreement in July 2015 and receiving the finalized version from the IRS in September 2015. This turned out to be premature, though, as the IRS summarily "assessed" additional income taxes and penalties for 2011 just two months later, in November 2015. It is important to focus on the numbers. The new assessment exceeded the amount on the earlier Examination Report by $6,661, which, emphasized the Tax Court, was the exact same amount as the AMT credit for 2011 that the Revenue Agent "accidentally allowed" the taxpayers.[13]

The IRS sent the taxpayers a bill, which they disputed. They also sought assistance from the Taxpayer Advocate Service. Thanks to these efforts, the IRS saw the light, at least temporarily. The IRS agreed to eliminate the tax liability of $6,661 and related penalty in August 2016. It issued a Notice CP21C, showing that the taxpayers owed $0 for 2011.

Although hard to believe, the IRS later started an audit of the taxpayers for 2011, assigning the case to the same Revenue Agent who previously handled the OVDP and issued the erroneous Examination Report giving the taxpayers an AMT credit that they never

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solicited. Eventually, the Revenue Agent issued a Notice of Deficiency for 2011, claiming that the taxpayers owed $6,661 in taxes, plus penalties.

In terms of justifications, the Notice of Deficiency featured two, inconsistent ones. First, it enclosed a document indicating that the AMT credit was overstated by $6,661. Second, the Notice of Deficiency enclosed another document, this one stating that the proposed deficiency was triggered by a decrease in FTCs, without any type of explanation for such reduction.

In February 2017, the taxpayers made a "deposit" with the IRS to stop interest accrual. They then filed a Petition with the Tax Court, disputing the Notice of Deficiency.

D. Analysis by the Tax Court

1. Main Positions of the Parties

The taxpayers made several arguments, the primary of which was that the Closing Agreement already covers the FTC issue for all years contemplated by the OVDP, 2003 through 2011, and it prevents the IRS from later issuing the Notice of Deficiency for 2011.

The IRS saw it differently, of course. It acknowledged that the Closing Agreement applied to 2003 through 2011, it covered FTC matters for all such years, and it stated that the taxpayers were entitled to an FTC for 2011. However, the IRS contended that the absence of a specific amount of the FTC in the Closing Agreement means that the taxpayers and IRS never agreed on that score, such that the IRS was free to challenge the FTC *via* a Notice of Deficiency.

2. Primer on Contract Interpretation

The Tax Court devoted approximately four pages to explaining general tax and contractual principles, which few, if any, readers of this article want to endure. The highlights were the following: Closing Agreements generally are final, conclusive, and binding on the parties; Closing Agreements may not be annulled, voided, modified, disregarded or rescinded, unless there is a showing of fraud, malfeasance, or misrepresentation of a material fact; Closing Agreements are strictly construed to encompass only the issues expressly addressed therein; Recitals in a Closing Agreement are explanatory and provide insight regarding the intent of the parties, but they are not substantive provisions; Closing Agreements are contracts and thus subject to the normal rules of contract interpretation; Closing Agreements are interpreted according to the intent of the parties at the time they contracted; Closing Agreements must be read as a whole, taking into account the context; and Courts cannot consider extrinsic evidence (*i.e.*, anything beyond the mere words of the Closing Agreement) to determine intent, except in situations where the language of the Closing Agreement creates ambiguity.

3. General Conclusiveness of Closing Agreements

With the initials matters out of the way, the Tax Court began its analysis.

The Tax Court explained that Paragraph 4 of the Closing Agreement is the only segment that addresses the eligibility of the taxpayers to claim an FTC for 2011. It says that "[d]uring tax years 2003 through 2011, Taxpayer was entitled to a foreign tax credit … for foreign income taxes paid or accrued to a foreign country or U.S. possession." Paragraph 4 confirms that the taxpayers should get an FTC for 2011, but it does not set a specific amount. The amount of FTC allowed is covered in Paragraph 3, continued the Tax Court. It states that the taxpayers "paid or accrued foreign income taxes to Italy and various other countries eligible for foreign tax credit." The corresponding chart shows the exact FTC amounts allowed for 2003 through 2010, but it is silent about 2011. The Tax Court observed that, when one reads Paragraph 4 and Paragraph 3 together, they show an agreement that the taxpayers should get an FTC of an unstated amount.

The Tax Court then turned to Paragraph 8 for more guidance. It states that the Closing Agreement does not prevent the IRS from later auditing the taxpayers and proposing adjustments "*unrelated* to offshore financial arrangements," and it permits the IRS to propose changes "*related* to offshore financial arrangements [but] not included in Taxpayer's voluntary disclosure referred to in Paragraph 1" of the Closing Agreement. Next, the Tax Court looked to the end of the Closing Agreement, which says that the Closing Agreement "is final and conclusive," unless the taxpayers engaged in fraud, malfeasance, or misrepresentation of material fact. The Tax Court ultimately concluded that, when Paragraph 8 and the end of the Closing Agreement are jointly considered, they reflect an intent by the parties to grant finality to the tax consequences stemming from the OVDP. Therefore, observed the Tax Court, the Closing Agreement precludes the IRS from issuing the Notice of Deficiency, unless the FTC for 2011 constitutes either (i) an item "*unrelated* to offshore financial arrangements" or (ii) "*related* to offshore financial arrangements [but] not included in Taxpayer's voluntary disclosure referred to in paragraph 1" of the Closing Agreement.

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4. Potential Applicability of Exceptions

The IRS argued that the FTC for 2011 was an item "*unrelated* to offshore financial arrangements." The Tax Court roundly rebuffed this argument. It explained that the FTC for 2011 clearly relates to the offshore arrangements of the taxpayers because their FTC arose from the payment of foreign income taxes on the Italian Passive Income.

Alternatively, the IRS tried to convince the Tax Court that the FTC for 2011 was "*related* to offshore financial arrangements [but was] not included in Taxpayer's voluntary disclosure referred to in paragraph 1" of the Closing Agreement. The Tax Court rejected this contention, too, for the following two reasons.

Paragraph 1 of the Closing Agreement states that the taxpayers "had additional unreported income and overstated deductions for tax years 2003 through 2011 relating to the voluntary disclosure." Applying pure textualism, the IRS claimed that FTCs were "not included" in Paragraph 1, as it only expressly covers foreign income and deductions.

The Tax Court acknowledged the limiting language of Paragraph 1, but emphasized that it is inconsistent with other aspects of the Closing Agreement. For instance, the Recitals state that the taxpayers desire to resolve, for 2003 through 2011, the proper amount of income taxes, penalties, and interest. The Tax Court concluded that the FTCs are related to the "offshore financial arrangements" of the taxpayers, they were addressed in the Closing Agreement, they affected the calculation of the total liabilities under the OVDP, and they, along with the Italian Passive Income to which they correspond, are "the heart of the Closing Agreement."[14]

If its aversion to the IRS's argument was not yet clear enough, the Tax Court continued. It explained that, even if the Closing Agreement were ambiguous, extrinsic evidence supports the Tax Court's conclusion. The taxpayers filed Forms 1040X for 2003 through 2011 as part of the OVDP, reporting additional Italian Passive Income, along with the matching FTCs. The FTCs were the principal area of dispute because the IRS rejected the Forms 1040X and issued an Examination Report significantly decreasing them. Thus, reasoned the Tax Court, the FTCs for all years, including 2011, were an "integral part" of the OVDP negotiations, and thus they were items the parties intended to finalize through the Closing Agreement.[15]

The IRS then took another tack. It suggested that, even if the FTCs were within the scope of the Closing Agreement, the IRS nevertheless was allowed to later adjust the FTC for 2011 because the failure to specify the amount of the FTC in the Closing Agreement means that the parties never agreed on it. The Tax Court pointed to Paragraph 4, which states that the taxpayers were entitled to an FTC for 2011, and then concluded as follows: "If [the taxpayers] were entitled to an FTC for 2011, they must have been entitled to an FTC of some amount. The parties' failure to specify that amount does not mean there was no agreement concerning the 2011 FTC."[16]

The Tax Court recognized that the amount was ambiguous, so it looked to extrinsic evidence for clarity about intent. The Tax Court outlined three possible sources for determining the proper amount of FTCs for 2011: (i) The FTC of $14,156 that the taxpayers claimed on their Form 1040; (ii) The FTC of $14,279 that the taxpayers claimed on the Form 1040X they filed as part of the OVDP; or (iii) The FTC of $2,165 that the Revenue Agent suggested in the Examination Report.

The Tax Court started in reverse order, beginning with the third option. Because the taxpayers paid the IRS to conclude the OVDP based on the figures in the Examination Report, the taxpayers "seemingly agreed" with the FTC calculation by the Revenue Agent for all relevant years, including 2011. However, pointed out the Tax Court, since the IRS attorneys failed to raise this argument as part of the litigation, the Tax Court considered it waived. The Tax Court then analyzed the second option. The Tax Court explained that the IRS rejected the Forms 1040X filed by the taxpayers, which shows that the parties never agreed on the FTC of $14,279 claimed on the Form 1040X for 2011. By process of elimination, the Tax Court concluded that the parties must have agreed to an FTC of $14,156, which was the figure shown on the Form 1040 for 2011.

The Tax Court ultimately ruled that the Closing Agreement was final as to all issues it covered, including the FTCs in 2011. The IRS, therefore, could not collect any additional tax revenue for 2011 by issuing the Notice of Deficiency.

IV. Interesting and Obscure Procedural Issues

The Tax Court's analysis in *Crandall* about the effect of the Closing Agreement is noteworthy, but the case raises other interesting issues, too. These are examined below.

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A. Small Tax Disputes Can Render Big Rulings

One adage is that taxpayers are only entitled to as much justice as they can afford, and another is that taxpayers would be wise not to throw good money after bad. In the context of tax disputes, these mean that taxpayers with limited financial resources and those facing relatively small tax liabilities often do not get their day in court, so to speak. Instead, measuring potential benefits against the time, stress, and costs involved with fighting the IRS, taxpayers in these conditions frequently settle matters with the IRS swiftly, on unfavorable terms, even though they disagree with the outcome. The IRS is aware of this reality, and cynics would suggest that the IRS exploits it to maximize tax revenue. However, this was not the case in *Crandall*, where the taxpayers endured a long, and likely expensive, process to obtain a victory involving relatively small dollars.

In *Crandall*, the proposed tax liability for 2011 was $6,661 and the negligence penalty was $1,332, for a total of merely $7,993. The taxpayers ultimately prevailed in Tax Court, but at what cost? Remember, the taxpayers discovered their unintentional U.S. international tax non-compliance in 2011, retained attorneys and accountants, and submitted their OVDP application packet in November 2012. The IRS then conducted a multi-year audit of the Forms 1040X, which concluded in September 2015, when the IRS delivered the executed Closing Agreement. Next, in November 2015, the IRS assessed additional taxes and penalties for 2011, sending the taxpayers a bill. They disputed it, enlisted assistance from the Taxpayer Advocate Service, and finally received an IRS notice indicating that all had been squared away, the liability was $0 for 2011. Shortly thereafter, the same Revenue Agent involved with the OVDP initiated another audit, focused on 2011, trying to fix an error that she made on the earlier Examination Report issued in connection with the first audit. The IRS later sent the taxpayers a Notice of Deficiency, which they challenged by filing a Petition with the Tax Court in early 2017. After approximately four more years, in March 2021, the Tax Court issued its decision in favor of the taxpayers.

In the end, it took the taxpayers more than a decade, from 2011 through 2021, to resolve their international tax issues, after they pro-actively approached the IRS in the first place.

B. Reasons for Participating in the OVDP

One motive of the taxpayers in *Crandall* for participating in the OVDP was to declare the Italian Passive Income, which consisted of several items, including those stemming from an Italian pension plan. This triggers an interesting issue. A recent analysis by the Government Accountability Office ("GAO Report") strongly criticized the IRS and Congress for perpetuating a complex, obscure, and inconsistent system affecting foreign retirement plans.[17]

The GAO Report starts by underscoring the size of the problem; there are nearly nine million U.S. citizens living abroad, many of whom have interests in foreign retirement instruments.[18] It then describes the distinct manner in which the U.S. tax system treats domestic versus foreign retirement plans. In the United States, contributions by employees, contributions by employers, and passive earnings (such as interest, dividends, and capital gains) within a "qualified" retirement plan generally are *not* taxed until the employee receives actual distributions from the plan.[19] By contrast, the GAO Report explains that foreign retirement plans ordinarily are not considered "qualified" plans under the Internal Revenue Code, so American expatriates do not enjoy the same benefits as their counterparts with "qualified" domestic plans. Depending on several factors, including the characteristics of the plan, local law, and provisions in the applicable bilateral treaty, U.S. individuals who participate in foreign retirement plans might be currently taxed on (i) contributions made to the plans, by themselves or their employers, (ii) the accrued-but-undistributed earnings in the plans, and (iii) distributions from the plans that they have not actually received, such as transfers of assets between or among various foreign plans.[20]

The GAO Report acknowledges that the IRS has provided some limited guidance about foreign workplace retirement plans, such as the International Tax Gap Series and Publication 54, titled "Tax Guide for U.S. Citizens and Resident Aliens Abroad." However, the GAO Report explains that neither item "describes in detail how taxpayers are to determine if their foreign workplace retirement plan is eligible for tax-deferred status, or how to account for contributions, earnings, or distributions on their annual U.S. tax return, particularly whether and when contributions and earnings should be taxed as income."[21]

Lack of clarity from the IRS has created disagreement among U.S. tax practitioners about how to treat foreign plans, including pensions. The GAO Report highlights

that different professionals have different approaches, including reporting foreign plans as passive foreign investment companies, foreign accounts, foreign financial assets, or foreign trusts.[22]

The analysis by the Tax Court in *Crandall* did not provide details about how the taxpayers characterized the Italian pension in the OVDP, but experience dictates that this likely was one of the trickier issues.

C. Making a "Deposit" with the IRS

The taxpayers in *Crandall* did something unique; that is, they made a "deposit" with the IRS, after it issued the Notice of Deficiency, but before they filed their Petition with the Tax Court. For those readers who noticed this detail and find themselves scratching their heads as to the motive of the taxpayers, here is an explanation.

Taxpayers generally have the option of making a "cash deposit," as opposed to a "payment," with respect to an income tax liability that has not yet been assessed.[23] To the extent that the IRS ultimately uses the deposit to satisfy a tax liability, the taxes shall be treated as having been paid by the taxpayer on the date that he made the deposit.[24] Rev. Proc. 2005-18 contains the specific rules and procedures about pre-assessment deposits.

The legislative history, set forth below, provides a good overview:

> [Section 6603] allows a taxpayer to deposit cash with the IRS that may subsequently be used to pay an underpayment of [various types of] taxes. Interest will not be charged on the portion of the underpayment that is deposited for the period that the amount is on deposit. Generally, deposited amounts that have not been used to pay a tax may be withdrawn at any time if the taxpayer so requests in writing. The withdrawn amounts will earn interest at the applicable federal rate to the extent they are attributable to a disputable tax.[25]

In addition to the overview, the legislative history provides a helpful example:

> [A]ssume a calendar year individual taxpayer deposits $20,000 on May 15, 2005, with respect to a disputable item on its 2004 income tax return. On April 15, 2007, an examination of the taxpayer's year 2004 income tax return is completed, and the taxpayer and the IRS agree that the taxable year 2004 taxes were underpaid by $25,000. The $20,000 on deposit is used to pay $20,000 of the underpayment, and the taxpayer also pays the remaining $5,000. In this case, the taxpayer will owe underpayment interest from April 15, 2005 (the original due date of the return) to the date of payment (April 15, 2007) *only* with respect to the $5,000 of the underpayment that is not paid by the deposit. The taxpayer will owe underpayment interest on the remaining $20,000 of the underpayment *only* from April 15, 2005, to May 15, 2005, the date the $20,000 was deposited.[26]

The taxpayers in *Crandall* are uncommon in two ways. First, they were aware of the possibility of making a "deposit" with the IRS to halt interest accumulation, which is a rarity. Second, they actually decided to take this path. Many taxpayers with knowledge of the "deposit" rules pass for the following reasons: They believe that they will achieve a better overall financial result by maintaining their funds and aggressively investing them, instead of prematurely giving them to the IRS and merely earning interest at the applicable federal rate; They want to avoid the administrative hassle and professional fees associated with making a deposit pursuant to Rev. Proc. 2005-18 and then ensuring that the IRS appropriately handled the "deposit"; They fear potentially having the money characterized as a "payment" to the IRS instead of a "deposit," thereby converting the matter into a refund situation and depriving the taxpayer of his ability to fight in Tax Court; and Although they have the right to demand that the IRS return the deposit at any time, they worry that the IRS will invoke its authority to refuse on grounds that tax collection is "in jeopardy."

D. Effect of Unclear or Erroneous Notices of Deficiency

Code Sec. 7522(a) generally requires that certain documents issued by the IRS, including Notices of Deficiency, "describe the basis for" and "identify the amounts of" any proposed taxes, penalties, interest, and other items. However, to the chagrin of taxpayers, the provision goes on to state that "[a]n inadequate description … shall not invalidate the notice."[27] The legislative history puts these rules in context:

> The committee believes that the IRS should provide as much information as possible to the taxpayers as early as possible in the administrative process. In this manner, taxpayers can respond promptly and

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> usefully to contacts by the IRS and assert their positions more effectively.[28]
>
> Although [Section 7522] is limited to specific notices [including Notices of Deficiency], the conferees believe that all correspondence should be sufficiently clear to enable a taxpayer to understand an IRS question about a tax return as well as any adjustments or penalties applied to a tax return.[29]

Despite the statutory language and congressional intent, the courts have frequently upheld IRS notices with many shortcomings. For example, the courts have ruled that Notices of Deficiency were valid even though they failed to specify the last day for filing a Petition with the Tax Court,[30] stated an incorrect reason for the tax adjustment,[31] omitted the tax provision, regulation, case or other support for the proposed liability,[32] contained legal or tax theories that were not raised in earlier Examination Reports,[33] and merely concluded, without supplying any detail whatsoever, that all deductions were disallowed because the taxpayer did not establish that he was entitled to them.[34]

As explained above, the Revenue Agent in *Crandall* issued the Notice of Deficiency for 2011, claiming that the taxpayers owed $6,661 in taxes, plus penalties, based on two conflicting theories. The Notice of Deficiency featured two attachments, with one stating that the liability was attributable to the improper allowance of an AMT credit, and the other explaining that the cause was excessive FTCs. Setting the bar quite low, the Tax Court explained that earlier cases have validated Notices of Deficiency, as long as they objectively place a reasonable taxpayer on notice that the IRS is proposing a tax liability for a particular year and amount. The Tax Court then held that the Notice of Deficiency issued in *Crandall* was acceptable, despite introducing conflicting grounds for the liability and providing no details:

> The notice of deficiency in this case *does not clearly describe the adjustments underlying the deficiency*. However, the notice clearly reflects respondent's determination that [the taxpayers] have a deficiency in income tax of $6,661 for 2011. Thus, the notice is valid despite [the IRS's] *confusing description of the underlying adjustments*.[35]

E. Inconsistent Positions by the IRS

The IRS's overarching position in *Crandall* was that it essentially should be allowed to ignore or reinterpret the Closing Agreement because it wanted to correct earlier errors by the Revenue Agent with respect to the AMT credit and the FTC for 2011. Interestingly, although the taxpayers did not bring this to the attention of the Tax Court in *Crandall*, the IRS has taken inconsistent stances on similar issues in the past.

For instance, Rev. Rul. 73-459 dealt with "whether an unintentional mistake in a Revenue Agent's report that was used as a basis for a Closing Agreement constitutes a misrepresentation of a material fact upon which the Closing Agreement may be set aside" under Code Sec. 7121. The main facts were as follows. The taxpayer filed his Form 1040 for the relevant year, the IRS initiated an audit and eventually issued an Examination Report showing certain adjustments, and the parties ended the audit by executing a Closing Agreement prepared in accordance with the Examination Report. Soon thereafter, the taxpayer filed a claim for refund for the pertinent year on grounds that the Revenue Agent mistakenly omitted certain deductions to which the taxpayer was entitled, and such error caused the liability shown on the Closing Agreement to be too high. The taxpayer alleged in his claim for refund that the Revenue Agent's error constituted a "misrepresentation of material fact," such that the taxpayer had the right to essentially invalidate a portion of the earlier Closing Agreement.

The IRS began its analysis in Rev. Rul. 73-459 by describing the general rules about Closing Agreements derived from Code Sec. 7121. It indicated that the purpose of such provision is to provide a means of settling tax controversies finally and completely, to protect the taxpayer against reopening of the case by the IRS later, and to prevent the taxpayer from subsequently filing a claim or lawsuit for refund of taxes paid pursuant to a Closing Agreement. The IRS, citing a few cases from yesteryear, explained that "mere errors or innocent mistakes" do not equate to material misrepresentations. The IRS concluded as follows:

> A Revenue Agent's unintentional oversight in failing to include certain deductions [favorable to the taxpayer] in arriving at the result upon which the Closing Agreement was based does not constitute a misrepresentation of a material fact relied upon by the taxpayer. In view of the above, where [an Examination Report] sets out an amount which is stated to represent the tax liability of the taxpayer and a Closing Agreement is duly executed on the basis of such [Examination Report], a mistake in one

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of the items on the [Examination Report] does not constitute a misrepresentation of material fact upon which a [Closing Agreement] may be set aside.

In *Crandall*, where mistakes by the Revenue Agent with respect to the AMT credit and FTC for 2011 were *detrimental* to the IRS, it argued that the IRS essentially should be able to overlook aspects of the Closing Agreement. By contrast, in Rev. Rul. 73-459, where mistakes by the Revenue Agent concerning deductions were *favorable* to the IRS, it claimed that the taxpayer should not be able to alter the Closing Agreement. One might be tempted to accuse the IRS of talking out of both sides of its mouth regarding the status of Closing Agreements.

V. Conclusion

Crandall undoubtedly represents a victory for the taxpayers in principle, but a cost-benefit analysis of a multi-year fight with the IRS must have diminished the satisfaction somewhat. This is not the point, though. The case serves as a valuable tool for taxpayers and their advisors to better understand important procedural issues, including the legal effect of Closing Agreements, methods employed by the IRS to revisit issues thought to be resolved, uncertainty about the proper treatment of certain foreign assets, how and whether to make a "deposit" to halt interest accrual, consequences to the IRS of issuing unclear or erroneous Notices of Deficiency, and more.

ENDNOTES

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[1] *J.K. Crandall*, 121 TCM 1272, Dec. 61,846(M), TC Memo. 2021-39.

[2] Code Sec. 7121(a); Reg. §301.7121-1(a); Reg. §601.202(a).

[3] Reg. §301.7121-1(a); Reg. §601.202(a)(2).

[4] Rev. Proc. 68-16, Section 3.01.

[5] Code Sec. 7121(b); Reg. §301.7121-1(c).

[6] Code Sec. 7121(b).

[7] Rev. Proc. 68-16, Section 7.01.

[8] Rev. Proc. 68-16, Section 7.02.

[9] IRM 8.13.1.2.1(1) (May 25, 2018).

[10] Reg. §601.202(b); Rev. Proc. 68-16, Sections 6.01 and 6.02; IRM 8.13.1.2.1(10) (May 25, 2018).

[11] *Crandall*, 121 TCM 1272, Dec. 61,846(M), TC Memo. 2021-39, footnote 3.

[12] *Crandall*, 121 TCM 1272, Dec. 61,846(M), TC Memo. 2021-39, footnote 3.

[13] *Crandall*, 121 TCM 1272, Dec. 61,846(M), TC Memo. 2021-39, at 11 and footnote 7.

[14] *Crandall*, 121 TCM 1272, Dec. 61,846(M), TC Memo. 2021-39, at 25.

[15] *Crandall*, 121 TCM 1272, Dec. 61,846(M), TC Memo. 2021-39, at 25–26.

[16] *Crandall*, 121 TCM 1272, Dec. 61,846(M), TC Memo. 2021-39, at 26.

[17] U.S. Government Accountability Office, *Workplace Retirement Accounts: Better Guidance and Information Could Help Plan Participants at Home and Abroad Manage Their Retirement Savings*, GAO-18-19 (Jan. 2018); *See also* Veena K. Murthy, *Selected Cross-Border Equity and Deferred Compensation Issues with Fund Foreign Plans*, 42 Compensation Planning J. 67 (Apr. 2014); Lawrence J. Chastang and Steve Yeager, *Foreign Pensions and Florida Practitioners*, Florida CPA Today, May/June 2013; Cynthia Blum, *Migrants with Retirement Plans: The Challenge of Harmonizing Tax Rules*, 17 Florida Tax Review (2015).

[18] U.S. Government Accountability Office, *Workplace Retirement Accounts: Better Guidance and Information Could Help Plan Participants at Home and Abroad Manage Their Retirement Savings*, GAO-18-19 (Jan. 2018), at 3.

[19] U.S. Government Accountability Office, *Workplace Retirement Accounts: Better Guidance and Information Could Help Plan Participants at Home and Abroad Manage Their Retirement Savings*, GAO-18-19 (Jan. 2018), at 11–12.

[20] U.S. Government Accountability Office, *Workplace Retirement Accounts: Better Guidance and Information Could Help Plan Participants at Home and Abroad Manage Their Retirement Savings*, GAO-18-19 (Jan. 2018), at 12–14.

[21] U.S. Government Accountability Office, *Workplace Retirement Accounts: Better Guidance and Information Could Help Plan Participants at Home and Abroad Manage Their Retirement Savings*, GAO-18-19 (Jan. 2018), at 37.

[22] U.S. Government Accountability Office, *Workplace Retirement Accounts: Better Guidance and Information Could Help Plan Participants at Home and Abroad Manage Their Retirement Savings*, GAO-18-19 (Jan. 2018), at 38–39. Different taxpayers have filed Forms 8621 (*Information Return by a Shareholder of a Passive Foreign Investment Company or Qualified Electing Fund*), FinCEN Form 114 (*Report of Foreign Bank and Financial Accounts*), Form 8938 (*Statement of Specified Foreign Financial Assets*), Form 3520 (*Annual Return to Report Transactions with Foreign Trusts and Receipt of Certain Foreign Gifts*), or Form 3520-A (*Annual Information Return of Foreign Trust with a U.S. Owner*).

[23] Code Sec. 6603(a).

[24] Code Sec. 6603(b).

[25] U.S. House of Representatives, American Jobs Creation Act of 2004, Conference Report, 108th Congress, Second Session, Report 108-755 (Oct. 7, 2004), at 647.

[26] U.S. House of Representatives, American Jobs Creation Act of 2004, Conference Report, 108th Congress, Second Session, Report 108-755 (Oct. 7, 2004), at 647–648.

[27] Code Sec. 7522(a).

[28] U.S. Senate, Tax Rights and Excise Tax Collection Procedures, 100th Congress, Second Session, Report 100-309 (Mar. 29, 1988), at 8.

[29] U.S. House of Representatives, Technical and Miscellaneous Revenue Act of 1988, 100th Congress, Second Session, Conference Report, Report 100-1104, Volume II (Oct. 21, 1988), at 219.

[30] *J.A. Rochelle*, 116 TC 356, Dec. 54,348 (2001).

[31] *L.R. Schmaus Co., Inc.*, 26 TCM 959, Dec. 28,627(M), TC Memo. 1967-197.

[32] *W.E. Stevenson*, 43 TCM 289, Dec. 38,718(M), TC Memo. 1982-16.

[33] *P.F. Flynn*, 40 TC 770, Dec. 26,237 (1963).

[34] *QinetiQ U.S. Holdings, Inc.*, CA-4, 110 TCM 17, Dec. 60,340(M), TC Memo. 2015-123, *aff'd* 119 AFTR 2d 2017-330 (the Notice of Deficiency stated that the deduction for wages that the taxpayer claimed under Code Sec. 83 was disallowed in full "as you have not established that you are entitled to such a deduction.")

[35] *Crandall*, 121 TCM 1272, Dec. 61,846(M), TC Memo. 2021-39, at 14–15 (emphasis added).

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