1998

Practice Before the IRS After the Restructuring and Reform Act

T. Keith Fogg

Robert E. Lee

PRACTICE BEFORE THE IRS

AFTER THE RESTRUCTURING AND REFORM ACT

By
T. Keith Fogg, Esq.
IRS District Counsel for
Virginia and West Virginia

And

Robert E. Lee, Esq.
Mezzullo & McCandlish
Richmond, Virginia

Table of Contents

I. GREATER NOTICE 1

A. Summonses 1

B. Notice of Deficiency 1

C. Extending the Statute of Limitations 2

1. Assessment statute 2

2. Collection statute 2

D. Third Party Contacts 2

1. Requirements 2

2. Exceptions 3

E. Refund Disallowance 3

F. Summary of Notice Provisions 3

II. GREATER PROTECTION FOR "LITTLE GUYS" 3

A. Small Tax Court Cases 3

B. Extended Refund Statute of Limitations for Disability 4

C. Suspension of Interest and Certain Penalties if IRS Does Not Quickly Conclude Audit 4

1. Current situation 5

2. Prerequisite to receiving benefit of this provision 5

3. Notice required 5

4. General provisions 5

5. Exceptions 5

D. Innocent Spouse and other Spousal Relief 6

1. New innocent spouse procedures for relief applicable to all joint filers 6

2. Special procedures to limit liability for taxpayers no longer married or living together 6

3. Equitable relief the Secretary may exercise at his discretion 7

4. Time period to make the election 7

E. Funding of Pro Bono Clinics 7

F. Summary of Greater Protections for the "Little Guy" 7

III. GREATER PROTECTION FROM COLLECTION 7

A. Due Process 7

1. Lien process 8

2. Levy process 8

B. Offer in Compromise and Installment Agreements 8

1. Offers 8

2. Installment agreement changes 9

C. Damages for Negligent Acts in Collection 10

1. Pre-existing law 10

2. New provision 10

D. Expanded Taxpayer Assistance Orders 11

IV. GREATER PROTECTION FOR CONFIDENCES AND A SHIFTING OF THE BURDEN OF PROOF 11

A. Privileged Communications 11

B. The Burden of Proof in Court Proceedings 13

IV. Final Remarks 16

PRACTICE BEFORE THE IRS

AFTER THE RESTRUCTURING AND REFORM ACT

Congress made several changes in the way the IRS must deal with the taxpayers upon whom it focuses its examination and collection efforts. This outline discusses certain of those changes. The changes can be broken into three broad categories: 1) Greater notice; 2) Greater protection for the "little guy"; 3) Greater protection from collection. Each of the three categories contains several Restructuring and Reform Act (RRA 98) provisions illustrating the theme.

I. GREATER NOTICE

A. **Summonses** - Under prior law the IRS was required to notify the taxpayer if it summonsed information from certain third parties, including attorneys and accountants. This new provision requires notification of the taxpayer whenever any third party is summonsed. No longer is notification limited to those situations where a particular class of persons is summonsed.

Taxpayers will have the opportunity to stop enforcement of the summons; however, their rights to do so are not expanded by this statute. Certain summonses continue to be excepted from this provision. Those are principally the ones issued in criminal cases, in collection matters and to determine if records exist. This statute fosters the concern to let taxpayers know more of what is happening in their cases although only a small percentage of cases have summonses used in aid of examinations. Code section amended: 7609. Effective date: 7-22-98.

B. **Notice of Deficiency** - When the IRS and taxpayer disagree at the conclusion of an examination concerning the correctness of assessing additional taxes, the IRS issues a notice of deficiency. This document, sent by certified mail, alerts the taxpayer of the additional amount due and provides the basis for the taxpayer to go to the Tax Court if litigation prior to assessment is sought. The current notice informs the taxpayer that a petition should be filed in the Tax Court within 90 days if the taxpayer wishes the opportunity to litigate in that forum. Each year numerous taxpayers file their Tax Court petitions late and lose their prepayment forum for contesting the tax.

To provide taxpayers with better notice of their rights and when the Tax Court petition must be filed, the new provision requires that the notices issued after December 31, 1998, contain a statement of the last date on which to file a Tax court petition. Congress felt that providing taxpayers with the specific date by which they must file would assist them in meeting the deadline. Code section amended: 6213(a). Effective date: Notices issued after 12-31-98.

C. **Extending the Statute of Limitations** - The IRS routinely seeks consents from taxpayers to extend the statute of limitations on assessment and collection. In some instances consenting taxpayers find that the IRS' ability to assess or collect extends many years beyond the original statutory period. Congress was concerned that taxpayers were extending the statute without appreciating the consequences.

1. **Assessment statute** - In order to obtain a statute extension for assessment the IRS must notify the taxpayer of two things when seeking the extension:

    a. that the taxpayer has the right to refuse to extend and

    b. that the extension, if given, can be limited to specific matters. Code section amended: 6501(c)(4). Effective date: Extensions after 12-31-99.

2. **Collection statute** - With respect to the ten year collection statute of limitations, the period cannot be extended except in two circumstances:

    a. in conjunction with an installment agreement; and

    b. in conjunction with the release of a levy.

    The current circumstance in which the statute of limitations is currently extended routinely is offers in compromise where the extension is built into the form requesting the offer in compromise. Code section amended: 6502. Effective date: Extensions after 12-31-99; however, extensions entered into before that date will expire no later than 12-31- 2002 with the exception of extensions made in connection with installment agreements.

D. **Third Party Contacts** - The IRS routinely contacts third parties during the course of its examination and collection activities. Under prior law it had no requirement to notify the taxpayer of such contacts unless it issued a third party recordkeeper summons.

1. **Requirements** - The change in the law concerning third party contacts requires three things:

a. reasonable notice must be given to the taxpayer in advance of the contact during the course of the examination or the collection effort that third party contacts may be made;

b. a record of all third party contacts must be maintained; and

c. the record of third party contacts must be provided to the taxpayer periodically or upon request of the taxpayer.

2. **Exceptions**: Three exceptions to the requirement of notification exists:

a. contacts by the IRS which the taxpayer has authorized;

b. where the IRS determines, for good cause, that notice to the taxpayer would jeopardize collection or cause reprisal against any person; and

c. with respect to pending criminal investigations. Code section amended: 7602(c).
Effective date: Contacts made after 1-18-99.

E. **Refund Disallowance** - In the past when the IRS disallowed a taxpayer's refund claim it was not obligated to provide a reason for the disallowance. This amendment requires the IRS to notify the taxpayer of the reason or reasons for full or partial disallowance so that the taxpayer can respond to the specific concerns of the IRS. Code section amended: 6402(k). Effective date: Disallowances after 1-18-99.

F. **Summary of Notice Provisions** - Individually, the five provisions discussed above are relatively minor changes affecting the relationship between taxpayers and the IRS in relatively small ways and perhaps not changing the outcome in most examinations. Taken together and taken with other provisions enacted in the Restructuring and Reform Act of 1998, they are part of a significant shift toward a new relationship between the tax administrator and those upon whose its attention is focused. Even if these changes do not result in a different outcome from the standpoint of the tax determined or collected, the hope of these changes lies in the belief that improved relations of the participants in the system will result from increased notification.

II. GREATER PROTECTION FOR "LITTLE GUYS"

A. **Small Tax Court Cases** - Congress established a procedure for handling small cases in Tax Court in 1969. The procedure is available solely at the option of the taxpayer. Once selected the taxpayer enjoys relaxed rules of evidence at trial in an atmosphere better suited to accommodate pro se litigants, usually faster decisions and no appeal of the decision. The procedure is limited to litigants whose tax at issue falls below certain dollar amounts. The dollar amount was last changed almost 15 years ago to $10,000 per year.

The amendment here opens up the small case procedures in the Tax Court to those with proposed deficiencies under $50,000 per year. Approximately, 70% or the petitions filed in Tax Court are pro se. This change will insure that almost all of those pro se litigants will have the opportunity to elect this procedure. Code section amended: 7463(a); Effective date: Proceedings commenced after 7-22-98.

B. **Extended Refund Statute of Limitations for Disability** - Taxpayers sometimes fail to claim a refund of taxes to which they are clearly entitled because of a physical or mental disability. Several cases reached the Circuit Courts in the past decade on arguments that the statute of limitations on refund actions should be extended because of such disabilities. The Supreme Court, siding with the majority of Circuit Court decisions, recently held that the statute of limitations is a rule of law that cannot be extended based on equitable considerations. Several of these cases pointed out the difficult situations of the taxpayers who lost the equitable tolling arguments.

The new provision creates a new concept that provides limited relief for taxpayers whose delay in requesting a refund results from certain disabilities. The concept is "financially disabled." The definition is that the individual is under a medically determinable medical or physical impairment that:

1. can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than one year, and

2. renders the person unable to manage his or her financial affairs.

The person making the claim of disability must provide proof of the disability to the IRS. The taxpayer must not have been in a position where a "non-disabled" person had the capacity to act for them while the statute of limitations was running. Code section amended: 6511(h). Effective date: Periods of disability before, on or after 7-22-98; however, it does not apply if, without regard to the disability, the refund was barred on that date by operation of law or any rule of law including res judicata.

C. **Suspension of Interest and Certain Penalties if IRS Does Not Quickly Conclude Audit** - Similar to the concern discussed above regarding the new notice rules for extending the statute of limitations, a new provision encourages speedier audits by suspending interest and certain penalties when audits take too long. This provision establishes numerous exceptions and two separate time frames for interest and penalty suspension. It also stops the suspension of interest when the IRS sends a new type of notice so predicting its impact is difficult; however, it is clear that its purpose, and probably its effect, will be to shorten the time frame within which examination of individual income tax returns occurs.

1. **Current situation** - Currently, interest and penalties run without regard to the length of the examination of a tax return. The IRS had no financial incentive to quickly conclude the examination of the income tax returns of individuals. By the conclusion of lengthy examinations, interest could add a substantial additional amount to the liability of the taxpayer. This new provision "encourages", but does not require, the IRS to change its examination inventory tactics for individual taxpayers in order to avoid losing interest and penalties after a period of time from the due date of the return before it reaches its decision on the result of the examination

2. **Prerequisite to receiving benefit of this provision** - Like several of the provisions of RRA 98 this section provides a benefit available only to taxpayers who timely file their individual income tax return. A prerequisite to the benefit of the suspension of interest and penalties under this statute is a timely filed return. The failure to timely file the return, even if it is barely late, precludes relief under this statute.

3. **Notice required** - The notice that the IRS must send to specifically notify the taxpayer of the results of the examination to keep this statute from operating or to stop the continued suspension under this statute is not the statutory notice of deficiency but a new notice existing for the purpose of this statute.

4. **General provisions** - With those preliminary provisions aside, the basic operation of the statute is that the IRS must issue the notice within 18 months of the date the return is filed or the due date of the return without regard to extensions, whichever is later. If it does not do so the suspension provision goes into effect at the end of that 18 month period and remains in effect until 21 days after the issuance of the notice. The 18 month period will be reduced to one year for taxable periods beginning after 12-31-2003.

5. **Exceptions** - The provision does not apply in four circumstances:

   a. penalties imposed under 6651;

   b. cases involving fraud;

   c. to the taxes shown as due on the return as filed; and

   d. to criminal penalties.

Code section amended: 6404(g). Effective date: Tax years beginning after 7-22-98.

D. **Innocent Spouse and Other Spousal Relief** - There are now three ways to obtain relief in situations where one spouse finds themselves disadvantaged by the joint return they filed:

1. **New innocent spouse procedures for relief applicable to all joint filers** - The first method follows a similar path as the pre-existing innocent spouse provisions but with some increased benefits for taxpayers. The requirement that the understatement be "substantial" has been eliminated. The item for which relief is sought no longer needs to be grossly erroneous. Relief now becomes available for the unknown portion of the understatement when the electing spouse establishes a lack of actual or constructive knowledge as to the extent of the understatement.

2. **Special procedures to limit liability for taxpayers no longer married or living together** - The second method provides for a separate or limited liability for the electing spouse as though the spouses had filed separate tax returns for the year or years in question.

   a. **Requirements to make the election** - To qualify to make the election the electing spouse must:

      (1) no longer be married to the non-electing spouse, or

      (2) be legally separated from the non-electing spouse, or

      (3) the electing spouse must not have been a member of the same household as the non-electing spouse for at least a 12 month period ending on the date an election is filed. For purposes of this section a taxpayer is no longer married if the taxpayer is widowed.

   b. **Mechanics of making the allocation** - The mechanics of allocating the liability for the deficiency are first to allocate the separate deficiency items to the spouse whose item it is, and then if there are joint deficiency items to allocate those items between the spouses as if the individuals had filed separate returns. This provision is ineffectual if the IRS can demonstrate that the assets were transferred between the spouses as part of a fraudulent scheme joined in by both spouses. Next, the provision is inapplicable if the IRS can prove that the electing spouse had actual knowledge that an item on the return is incorrect unless the electing spouse signed the return under duress.

3. **Equitable relief the Secretary may exercise at his discretion** - The third method available to obtain relief is through the Secretary's discretionary application of equity. This provision may apply even in circumstances beyond deficiency liabilities. The legislative history contained an example where one spouse took the money intended to pay the tax and used it for personal purposes unbeknownst to the other spouse. Code section amended: 6015. Effective date: All liabilities arising after 7-22-98 and all liabilities arising before 7-22-98 but unpaid as of that date.

4. **Time period to make the election** - The period for making the election under the first two provisions described is two years after the first collection activity taken against the spouse making the election. There is a transition rule providing that this period shall not expire any earlier than two years after the first collection activity after 7-22-98.

E. **Funding of Pro Bono Clinics** - Concern existed that a network of assistance was available for low income taxpayers at the return preparation stage but little assistance was available if the federal tax problem extended beyond mere return preparation. To address this concern federal matching funds are made available to clinics that serve this segment of the population. The effect of this provision should be to increase funds available to these programs making them more widely available to low income taxpayers. In Virginia, the Community Tax Law Project based in Richmond is the type of organization qualifying for these matching funds. Code section amended: 7526. Effective date: 7-22-98.

F. **Summary of Greater Protections for the "Little Guy"** - As with the provisions discussed in the first section dealing with greater notice, the provisions in this section follow a theme of greater protection for individual taxpayers and particularly those individuals in the lower economic strata. The spousal protection provisions will undoubtedly provide benefits to the greatest number of individuals; however, all of the sections provide real benefits to individuals and should make their trip through the federal tax system easier.

III. GREATER PROTECTION FROM COLLECTION

A. **Due Process** - This provision makes significant changes in the manner in which the IRS collects taxes. The changes occur in two distinct aspects of the collection process, the lien process and the levy process. The operation of the provision differs with respect to each process but in each creates a similar method for contesting the decision of the IRS.

1. **Lien process** - When the IRS files a notice of federal tax lien, it must give the taxpayer an opportunity to have a conference with the Appeals Division to discuss the appropriateness of the decision to file the lien. Here the IRS sends the taxpayer a notice of filing the lien within five days of its filing. For 30 days following the conclusion of this notice period, the taxpayer has the opportunity to request an appeals hearing. If requested, taxpayer has the opportunity to discuss the procedural correctness of the collection action, the appropriateness of the collection action versus possible available actions and, in certain circumstances, the correctness of the underlying liability. At the conclusion of this period if Appeals sustains the filing of the lien as an appropriate collection action, the taxpayer has 30 days following the determination by appeals to go to court to litigate the same issues.

2. **Levy process** - A similar process exists if the IRS seeks to levy on the taxpayer; however, unlike the lien situation in which the opportunity to have a hearing occurs prior to the filing of the lien, the opportunity in the levy situation occurs prior to the levy. Once the IRS seeks to levy, it must notify the taxpayer of the opportunity for a hearing with appeals. If the taxpayers chooses to have such a hearing, no levy action can occur, absent jeopardy, until the appeals consideration and any subsequent court action are concluded. Obviously, this creates a significantly different situation for collection than exists under the current procedures. Code section amended: 6320 (Lien); 6330 (Levy). Effective date: Liens filed or levy action taken after 1-18-99.

B. **Offer in Compromise and Installment Agreements** - Several aspects of the offer program have changed as a result of the new provisions or may change as a result of implementing regulations.

1. **Offers -**

a. **Background of the offer program** - The offer program has existed for several decades; however, prior to 1992 was little used by the IRS. In that year the IRS undertook an effort to accept offers that reflected more that it would otherwise collect. The amount that reflects more than the IRS would otherwise collect is not an amount with which taxpayers and the IRS easily agree. As the program evolved the IRS established specific standards it allowed for expenses based upon the community in which the taxpayer lived. These standards, adopted in 1995, were designed to eliminate disparity between taxpayers in different districts but they introduced a rigidity to the system that Congress addresses in the new provision.

b. **Additional flexibility provided by the new legislation** - Congress addresses this rigidity by statutorily providing the IRS with flexibility to consider equitable grounds for compromising and inviting the IRS to work out the system of exercising these equitable grounds through regulations. Because the regulations have not yet been written, the scope of the exercise of equitable features of the statute is not yet clear.

c. **Other changes in offers provided by the new legislation** - In addition to providing additional flexibility in the system, other changes in the offer program were also made.

(1) First, the policy that the IRS adopted in 1959 of not taking enforced collection while an offer is pending was fixed in the statute. The IRS may not levy, absent jeopardy or a taxpayer waiver, while the offer is pending .

(2) If the IRS rejects the offer the taxpayer has the right to go to appeals to discuss the rejection.

(3) During that appeal levy action continues to be stayed.

(4) The statute of limitation on collection is suspended during the period the IRS is prohibited from taking levy action.

(5) The IRS must establish procedures to review an offers it rejects administratively before notifying the taxpayer of the rejection.

(6) The IRS also must establish a policy statement concerning offers that communicates to taxpayers certain information about offers. The review procedures and the policy statement are yet to be written. Code section amended: 7122; Effective date: Generally, 7-22-98; however the levy provisions become effective for offers pending on or made after 12-31-99.

2. **Installment agreement changes** - The installment agreement provisions also had several changes designed to make them more attractive to taxpayers.

a. First, taxpayers who meet certain criteria are guaranteed an installment agreement.

b. Second, all taxpayers in installment agreements will now receive an annual statement setting out the taxpayer's balance at the beginning of the year, the payments made, how they were applied and the remaining balance at the end of the year.

c. Third, taxpayers in installment agreements, who filed their tax returns timely, receive a break on the failure to pay penalty while making payments under the agreement. The penalty is one half what it ordinarily would be were they not in the installment agreement. Code sections amended: 6159 and 6651(h). Effective dates: 7-22-98 on guaranteed installments; 7-1-2000 is date by which IRS must begin providing annual statements; 12-31-99 for application of penalty reduction.

C. **Damages for Negligent Acts in Collection -**

1. **Pre-existing law** - Taxpayer Bill of Right's I in 1988 created a remedy for taxpayers damaged by certain unauthorized collection actions. The right was limited to actions where the IRS employee intentionally or recklessly disregarded the Internal Revenue Code or regulations. Because of the high standard, few taxpayers have met this standard. The remedy was increased in 1996 from the original cap of $100,000 to a cap of $1,000,000.

2. **New provision** - The provision became significantly more useful to taxpayers in this new legislation because a second standard for damages permitting recovery when the IRS employee negligently disregards the Internal Revenue Code or regulations was added. Damages under the negligence standard are capped at $100,000.

   a. **Requirement that administrative remedies be exhausted** - The taxpayer must exhaust administrative remedies to receive an award under this section.

   b. **Relief for third parties** - In addition to damages for the taxpayer, damages are also available under the revised statute for third parties.

   c. **Recovery** - The taxpayer or third party must show the "actual, direct economic damages sustained ...." Their recovery is limited to the amount so shown plus the costs of the action.

d. **Statute of Limitations -** The suit for recovery under this statute needs to be brought within two years from the date that the right to the action accrued.

e. **Damages for violation of the automatic stay or discharge injunction -** Damages occurring when the IRS violates the automatic stay or discharge injunction of the Bankruptcy Code are also provided under this revised statute. This provision allows recovery for up to $1,000,000 in civil damages for willful violations. Code section amended: 7433; Effective date: Actions of IRS officers or employees occurring after 7-22-98.

D. **Expanded Taxpayer Assistance Orders** - In order to obtain assistance from the Taxpayer Advocate many taxpayers found themselves frustrated under prior law by the definition of significant hardship. The new provisions provide greater latitude to the Taxpayer Advocate to determine that the taxpayer is suffering or about to suffer significant hardship and to provide relief to that taxpayer. Code section amended: 7811(a); Effective date: 7-22-98.

IV. GREATER PROTECTION FOR CONFIDENCES AND A SHIFTING OF THE BURDEN OF PROOF

A. **Privileged Communications -**

1. Common law recognizes an attorney/client privilege with respect to certain communications between a client and an attorney.

2. The common law attorney/client privilege is limited and complex.

a. The privilege only extends to those instances in which the client is seeking legal advice or seeking to obtain legal services.

b. The privilege belongs to the client and may be waived only by the client.

c. The privilege does not exist if the attorney is acting in a capacity other than as an attorney. There is a split in the Circuits on the issue of whether an attorney engaged to prepare a tax return is acting as an attorney.

d. The privilege does not exist if:

(1) It has been waived, even if the waiver is inadvertent.

(2) The communication is not made in confidence -- i.e., if a third party other than an employee or agent of the attorney is present at the meeting in which the communications were made.

(3) The client makes the information available to persons unrelated to the person seeking legal advice.

(4) The client seeks legal advice for the purpose of committing a crime or a tort.

e. Generally the privilege does not cover the identity of the client, the existence of a retainer or the amount of the fees.

f. However, the privilege does prevent the forced disclosure of the identity of a client for whom an attorney has paid back taxes where the disclosure of the client's identity would be tantamount to disclosing protected confidential information. Baird v. Koerner, 279 F.2d 623 (9th Cir. 1960).

g. Corporations as well as natural persons are clients for the purposes of the privilege.

(1) The privilege can apply to communications between the corporation's attorney and employees at any level. The employees need not be among the group in control of the corporation.

h. Documents privileged in the hands of the client remain privileged in the hands of the attorney provided the transfer was enacted to obtain legal advice.

(1) However, documents used to prepare tax returns transferred to an attorney are not protected by the privilege

i. The Supreme Court has ruled that no accountant/client privilege exists with respect to work papers prepared by an independent auditor. A. Young & Co., 465 U.S. 805 (1984).

j. The Supreme Court has also indicated that a claim of work product immunity does not exist for certified public accountants who are acting as independent auditors because such CPAs serve the public's interest.

3. RRA 98 extends the common law attorney/client privilege to any "federally authorized tax practitioner" just as if the advising individual were an attorney. Code § 7525(a)(1).

   a. A federally authorized tax practitioner includes any non-attorney who is authorized to practice before the Internal Revenue Service. Code § 7525(a)(3)(A).

   b. Tax advice is defined as advice given by an individual with respect to a matter that is within the scope of the individual's authority to practice before the Internal Revenue Service. Code § 7525(a)(3)(B).

   c. The privilege does not apply to any written communication between a covered practitioner and a director, shareholder or officer/employee, agent or representative of a corporation in connection with the promotion of a tax shelter in which the corporation is a direct or indirect participant. Code § 7525(b).

   d. The Conference Committee Report states that a tax shelter is any partnership, entity, plan or arrangement, a significant purpose of which is the avoidance or evasion of income tax.

      (1) Tax shelters for these purposes will include those required to be registered under Code § 6111(d) (confidential corporate tax shelter arrangements).

   e. The privilege only applies to non-criminal proceedings before the Internal Revenue Service and in Federal courts. It does not apply to proceedings before other federal and state regulatory bodies or in state and local tax matters and proceedings.

   f. However, some states have enacted an account/client privilege that may apply independently of this Federal privilege.

4. Effective for communications made on and after June 9, 1998.

B. **The Burden of Proof in Court Proceedings -**

1. Under the Federal Rules of Civil Procedure and the Tax Court Rules, at trial the taxpayer generally bears the burden of proof.

2. The Internal Revenue Code contains numerous examples of instances in which the Internal Revenue Service has the burden of proof.

3. Examples are:

   a. Fraud. Code § 7422(e).

   b. Transferee liability. Code § 6902(a).

   c. Certain accumulated earnings tax proceedings. Code § 534.

   d. Jeopardy assessments. Code § 6201(d).

4. Generally, in civil cases, the burden of proof is the burden to produce evidence that will persuade the trier of fact that the proposition the party with the burden is asserting is more likely than not.

   a. In some instances, for example, fraud cases in which the burden of proof is on the Internal Revenue Service, the burden is to produce "clear and convincing" evidence of the proposition asserted by the party with the burden.

   b. In some instances, for example, in criminal cases, the burden of proof is to produce evidence that establishes a fact "beyond a reasonable doubt."

5. The burden of proof is frequently analyzed as consisting of two components – the burden of producing evidence (or the burden of going forward) and the burden of persuasion. The burden of producing evidence frequently shifts when the party (usually the plaintiff) has discharged its initial duty. The burden of persuasion becomes crucial only when each party has sustained its burden of producing evidence and the trier of fact is actually in doubt. *McCormick on Evidence*, 4th Edition, § 336.

6. The so-called "presumption of correctness" that applies in favor of the Internal Revenue Service is a procedural device that in effect places the burden of proof on the taxpayer.

7. RRA 98 shifts the burden of proof in court proceedings with respect to any factual issue that is relevant in determining the taxpayer's tax liability if the taxpayer presents credible evidence with respect to that issue and satisfies certain other conditions. Code § 7491.

   a. Those conditions are:

      (1) The taxpayer must have complied with all substantiation

requirements of the Code and regulations. Code § 7491(a)(2)(A).

(2) The taxpayer must maintain all records required by the Code and must cooperate with all reasonable requests by the Internal Revenue Service for witnesses, information, documents, meetings and interviews. Code § 7491(a)(2)(B).

(a) Cooperation apparently includes providing within a reasonable period of time access and inspection of witnesses, information and documents within the taxpayer's control as reasonably requested by the Internal Revenue Service.

(b) Further, the taxpayer must establish the applicability of any privilege such as the confidentiality privilege.

(c) Cooperating also means that the taxpayer must exhaust his or her administrative remedies, including any administrative appeals.

(d) Cooperation does <u>not</u> require agreeing to extend the statute of limitations. See the Senate Finance Committee Report on RRA 98.

(3) The provision applies to individual taxpayers and to other taxpayers whose net worth does not exceed the limitations that apply for awarding attorneys' fees. Code § 7491(a)(2)(C).

b. Before the burden of proof shifts to the Internal Revenue Service, the taxpayer must introduce credible evidence with respect to the factual issue in dispute.

(1) The term "credible evidence" is not defined in the Code.

(2) The Senate Finance Committee Report indicates that credible evidence is "the quality of evidence which, after critical analysis, the Court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted (without regard to the judicial presumption of IRS correctness). A taxpayer has not produced credible evidence for these purposes if the taxpayer merely makes implausible

factual assertions, frivolous claims, or tax protester-type arguments. The introduction of evidence will not meet this standard if the Court is not convinced that it is worthy of belief."

8. Code § 7491(c) specifically provides that, in the case of an individual, the burden of proof is on the Internal Revenue Service with respect to any item of income that the Internal Revenue Service attempts to establish solely using statistical information from unrelated taxpayers. Code § 7491(b).

9. In penalty cases involving individuals, the Internal Revenue Service initially has the burden of proof producing evidence that it is appropriate to apply a penalty, an addition to the tax, or an additional amount. Code § 7491(c).

   a. If the Internal Revenue Service initially comes forward with evidence regarding the appropriateness of applying a particular penalty, the taxpayer then has the burden of going forward to show reasonable cause, substantial authority or other similar defense to the penalty. See Senate Finance Committee Report. Presumably, the burden of persuasion remains on the Internal Revenue Service.

10. The changes to the burden of proof made by RRA 98 apply to court proceedings arising in connection with examinations commencing after June 9, 1998.

V. FINAL REMARKS

This outline is not designed to provide a detailed analysis of the new provisions of the Code. Several publishers have created text to accomplish that purpose. Rather, the purpose is to group certain of the provisions that will directly affect taxpayers working with the IRS, particularly those working their way toward litigation, and provide a framework for discussing the new working relationships that will exist between taxpayers and the IRS.