POINTS TO **REMEMBER**

INTRODUCTION: The Points to Remember in this issue range from tax procedure to international tax and conclude with employee benefits. First, Leandra Lederman and Stephen Mazza explain when a taxpayer has a right to an administrative appeal. Nancy Beckner then illuminates the effects of newly proposed and final regulations on withholding obligations of partnerships with foreign partners. Back on the domestic front, new section 409A continues to confound, so Frank Tripodi explains how that provision applies in the case of severance payments.
–Alice G. Abreu, Philadelphia, PA

WHEN DOES THE TAXPAYER HAVE A **RIGHT TO AN IRS APPEAL?**

by Leandra Lederman, Bloomington, IN, and Stephen Mazza, Lawrence, KS

The Internal Revenue Manual provides that "[t]he Appeals mission is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service." I.R.M. ¶ 8.1.1.1(2) (Feb. 1, 2003). As the recent decision in *Estate of Weiss v. Commissioner*, 90 T.C.M. (CCH) 566 (2005), T.C. Memo. 2005-284, suggests, taxpayers sometimes assert in deficiency cases that they have a substantive right to an Appeals conference, relying on regulations that provide:

> In any case in which the district director has issued a preliminary or "30-day letter" and the taxpayer requests Appeals consideration and files a written protest when required…against the proposed determination of tax liability, except as to those taxes described in paragraph (a)(3) of this section, the taxpayer has the right (and will be so advised by the district director) of administrative appeal to the Appeals organization.

Proc. Reg. § 601.106(b).

Case law, however, holds the regulations "directory and not mandatory in legal effect," Luhring v. Glotzbach, 304 F.2d 560, 565 (4th Cir. 1962); *see also* Rosenberg v. Comm'r, 450 F.2d 529, 533 (10th Cir. 1971). Thus, courts have held that IRS failure to provide a conference with Appeals is not a violation of due process, *Rosenberg, supra*, at 533; Cupp v. Comm'r, 65 T.C. 68, 83 (1975), *aff'd,* 559 F.2d 1207 (3d Cir. 1977) (unpublished table decision), and does not invalidate a notice of deficiency, *Luhring, supra*, at 563; Anderson v. Comm'r, 85 T.C.M. (CCH) 1187 (2003), T.C. Memo. 2003-112; Wisniewski v. Comm'r, 56 T.C.M. (CCH) 1227 (1989), T.C. Memo. 1989-60.

A taxpayer who ignores a 30-day letter usually will receive a notice of deficiency. If the notice of deficiency was not issued by Appeals and the taxpayer timely petitions the Tax Court, IRS Counsel typically will refer the case to the Appeals Office for "consideration of settlement" under Revenue Procedure 87-24, 1987-1 C.B. 720. *Estate of Weiss, supra,* points out that "once a taxpayer's case is docketed in the Tax Court, there is no provision in the procedural rules for a taxpayer to request an Appeals conference" (citing cases). Thus, although docketing the case in Tax Court will likely result in Appeals consideration of any case in which Appeals did not issue the notice of deficiency, petitioning the Tax Court will not give the taxpayer an opportunity to request an Appeals conference (unlike the opportunity generally afforded in a 30-day letter), much less give rise to a right to such a conference.

A case in Appeals on a "protest" basis (responding to a 30-day letter) is known as a "nondocketed" case. I.R.M. ¶ 8.1.1.4.2(2)(F) (Feb. 1, 2003).

Requesting an Appeals conference in response to a 30-day letter is particularly important if the taxpayer will seek the recovery of litigation costs under section 7430. Section 7430(b)(1) provides that litigation costs cannot be awarded if the taxpayer did not "exhaust[] the administrative remedies available to such party within the Internal Revenue Service." Treasury regulation section 301.7430-1(b)(1)(i)-(ii) interprets that provision to require the taxpayer's participation in a nondocketed IRS Appeals conference, or, if no conference was granted, to have requested such a conference and filed a protest if necessary in order to obtain a conference. That regulation has been applied to preclude eligibility for section 7430 recoveries in some cases in which taxpayers did not participate in Appeals conferences. *See, e.g.,* Haas & Assocs. Accountancy Corp. v. Comm'r, 117 T.C. 48 (2001), *aff'd,* 55 Fed. Appx. 476 (9th Cir. 2003) (unpublished); Davis v. Comm'r, 90 T.C.M. (CCH) 166 (2005), T.C. Memo 2005-202.

Thus, in the deficiency context, an Appeals conference is not a right, but forgoing such a conference can adversely affect a future claim under section 7430. Could the IRS's failure to provide Appeals consideration nonetheless create some procedural advantage for the taxpayer? The petitioner in *Estate of Weiss* maintained that the IRS's failure to grant the estate an Appeals conference constituted grounds for shifting the burden of proof to the IRS. Section 7491 reallocates the burden of proof from the taxpayer to the IRS, but only if the taxpayer satisfies certain conditions and only in court proceedings arising from audits beginning after July 22, 1998. Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 3001(a). Because of the effective date of the legislation, section 7491 did not apply to the estate's proceeding. Moreover, the Tax Court found that no other

authority supported a burden of proof shift in these circumstances.

Had section 7491 applied, would the IRS's failure to afford the taxpayer a nondocketed Appeals hearing, standing alone, have resulted in a shift in the burden of proof? Aside from a net worth limitation, which applies to partnerships, corporations, and trusts, the conditions that must be satisfied to cause the burden to shift represent affirmative obligations on the *taxpayer's* part. Among other requirements, the taxpayer must supply credible evidence supporting the taxpayer's factual assertions, satisfy applicable substantiation requirements, and cooperate with IRS requests for "witnesses, information, documents, meetings, and interviews." I.R.C. § 7491(a)(1), (2). The legislative history to section 7491 expands upon the cooperation requirement: "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)." H.R. Conf. Rep. No. 105-599, 105th Cong., 2d Sess. 239.

Thus, while a taxpayer seeking a burden shift under section 7491—much like a taxpayer seeking litigation costs under section 7430—is compelled to have participated in Appeals consideration, if available, nothing in the burden of proof shift rules appears to establish an obligation on the IRS's part to provide taxpayers in deficiency cases with access to administrative settlement procedures. The statute merely requires that the IRS's requests for information and access be "reasonable;" it does not establish conditions under which those requests must be made. I.R.C. § 7491(a)(2)(B).

In contrast with deficiency cases, a taxpayer who is the subject of a federal tax lien or levy proceeding has the affirmative right to request an Appeals hearing as part of the Collection Due Process (CDP) procedures. I.R.C. §§ 6320(b)(1) (CDP appeal rights triggered by notice of federal tax lien); 6330(b)(1) (CDP appeal rights available prior to levy). Unless the taxpayer failed to receive a notice of deficiency or did not otherwise have an opportunity to challenge the underlying tax liability, the taxpayer may not dispute the existence or amount of the asserted liability during the CDP hearing. I.R.C. § 6330(c)(2)(B). *Cf.* Montgomery v. Comm'r, 122 T.C. 1 (2004) (holding that taxpayers who had not been sent notice of deficiency could challenge amount of self-reported liability). The taxpayer may raise spousal defenses and discuss collection alternatives during the CDP hearing. *See* Treas. Reg. § 301.6320-1. The taxpayer also has the right to obtain judicial review of the Appeals Officer's determination. I.R.C. § 6330(d).

Since the CDP process was established in 1998, the IRS and the courts have struggled to establish the precise rules for requesting and conducting CDP hearings. *See, e.g.,* Keene v. Comm'r, 121 T.C. 8 (2003) (reviewed by the court) (Tax Court decision finding taxpayer entitled to audio record a CDP hearing despite previously issued Treasury Regulations); Nestor v. Comm'r, 118 T.C. 162 (2002) (reviewed by the court) (Tax Court considered but did not decide whether taxpayer was entitled to a copy of his transcript of account from Appeals officer). Nonetheless, if the taxpayer properly requests Appeals consideration as part of the CDP process, some form of Appeals consideration usually must occur. Treas. Reg. § 301.6330-1(d)(1). *But see* Lunsford v. Comm'r, 117 T.C. 183 (2001) (reviewed by the court) (Tax Court refused to remand the case for a CDP hearing and decided case on the record before it); Chief Counsel Notice CC-2003-031 (Sept. 11, 2003) (taxpayer not entitled to face-to-face CDP hearing if taxpayer intends to raise only frivolous arguments).

Thus, generally a taxpayer who receives a 30-day letter has the opportunity to request Appeals consideration as part of a deficiency case, and may wish to do so to protect procedural opportunities under sections 7430 and 7491. A taxpayer who petitions the Tax Court in response to a 90-day letter may also end up negotiating with Appeals but lacks a formal opportunity to request an Appeals conference. The deficiency context contrasts with collection cases, in which the taxpayer, having received a lien or levy notice, has the affirmative right to request Appeals consideration. The *Estate of Weiss* case confirms that, outside the CDP context, there is no substantive right to an Appeals conference.

LIMITED RELIEF FROM OVER-WITHHOLDING FOR PARTNERSHIPS AND THEIR FOREIGN PARTNERS: NEW SECTION 1446 REGULATIONS

by Nancy Beckner, Newville, PA

A previous Point that appeared in the Fall 2003 issue of this NewsQuarterly briefly described section 1446 withholding and what were then newly proposed section 1446 withholding regulations (the "2003 Proposed Regulations"), as part of a broader discussion of the use of partnerships by inbound foreign investors. Treasury has now published final section 1446 regulations (Treas. Reg. §§ 1.1446-1 through -5 [the "Final Regulations"]), and temporary and proposed regulations (Temp. Reg. §1.1446-6T and Prop. Reg. §1.1446-6 [collectively, the "Temporary Regulations"]). These regulations (T.D. 9200, 70 Fed. Reg. 28702, May 18, 2005) are generally effective for partnership taxable years beginning after May 18, 2005, but a partnership may elect to have them apply to partnership taxable years beginning after December 31, 2004. The preamble (the "Preamble") includes an extensive description of both the Final and Temporary Regulations.

OVERVIEW OF SECTION 1446 REGIME

Section 1446 requires partnerships having foreign partners to withhold U.S. income tax with respect to each foreign partner's allocable share of