Tax Procedure, § 1

Professor Billman

Assignment for First Class
August 31, 2006

1. Go to Class Blackboard website and familiarize yourself with the site.

2. Unit I is available on the website. Do the reading for the course Introduction and prepare Questions 1-4 of Unit I. In addition to the required casebook, supplementary readings are available on the website with each Unit.

[This version of the first assignment is only for posting on the Law School website for those students not officially registered for the course. It does not contain all of the Items to be used for the first assignment. Those student who are registered for the course should obtain all of the materials from the class Blackboard website via NYUHome.]
New York University School of Law

TAX PROCEDURE

Introduction

The goal of Tax Procedure is to introduce students to the fundamental procedural issues of the tax law. It seeks to raise questions that will be important to every tax practitioner, not just those who pursue tax litigation as a career. Even those tax attorneys who do not specialize in tax controversy work will invariably encounter procedural issues in their practice. This course differs from the Survey of Tax Procedure course in that it will explore some issues in greater depth, and it will examine other issues not covered in the Survey course. A Projected Course Outline is available on the course website to provide a general idea of the intended direction of the course.

This course will use Problems and Materials in each class. The materials will come from three sources – (1) Code and Regulations assigned with each Problem; (2) a series of Items that will be assigned with each Problem; and (3) readings from the casebook Watson and Billman, Federal Tax Practice and Procedure (hereinafter referred to as "W & B").

Much of the procedural tax law is statutory, although judicial doctrines have in many cases expanded upon or limited the scope of the statute. The procedural and administrative provisions of the Code are found in Subtitle F (which begins with Code section 6001). Students should skim the table of contents appearing in the Code at the beginning of Subtitle F to acquaint themselves with the organization of this part of the Code.

Before turning to the assignment for Unit I, you should read W & B pages 1-9, 67-68, and 81-84 for general background information.
General Facts

In the first three units, we will follow Sam and Betty Smith in their hypothetical dispute with the IRS. Due to time constraints, we will touch only briefly upon return filing requirements and the early stages of the examination process. The problems begin with the issuance of the revenue agent's report, which is typically accompanied by a "thirty day letter". The discussion will then turn to the procedures that the IRS must follow when it wishes to assert a tax deficiency (Unit I). Unit II addresses the Tax Court as a forum for litigating tax disputes. Unit III discusses procedures applicable when taxpayers wish to obtain a refund from the government of disputed taxes paid.

Taxpayers Betty Smith and Sam Smith were married for 10 years from 1992 to 2002. For each of those calendar years, the couple filed joint returns. Betty is a tax accountant with a large accounting firm, and Sam manages a men's clothing boutique.

In 2002, Betty brought a substantial client to her firm, and the firm granted her a bonus of $85,000, in addition to her annual salary of $125,000. This bonus was much larger than those Betty earned in prior years, which typically ranged between $5,000 and $10,000. Sam's total compensation in 2002 was $35,000.

Due to the impending breakup of the marriage, Betty did not want Sam to know about her bonus, as she feared he would claim a portion of it in the property settlement. She, therefore, asked her employer to defer payment of the bonus until 2003, contrary to the firm's normal practice of paying bonuses in late December. When Betty received the bonus in January of 2003, she deposited it in a bank account in her mother's name, and never disclosed it to Sam.

In addition, because Betty was concerned that Sam would claim large alimony, she attempted to minimize her 2002 income by prepaying $25,000 of 2003 business expenses.

When Betty prepared the couple's 2002 income tax return, she did not report the bonus, and deducted the $25,000 in prepaid business expenses (in addition to $20,000 of business expenses she actually incurred in 2002.) The return showed the following:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Gross Income</td>
<td>$160,000</td>
</tr>
<tr>
<td>Business Expenses</td>
<td>(45,000)</td>
</tr>
<tr>
<td>Adjusted G.I.</td>
<td>$115,000</td>
</tr>
<tr>
<td>Itemized Deductions</td>
<td>15,000</td>
</tr>
<tr>
<td>Taxable Income</td>
<td>$100,000</td>
</tr>
<tr>
<td>Tax (40% rate)</td>
<td>$40,000</td>
</tr>
</tbody>
</table>

Both Sam and Betty signed the 2002 joint return, which they filed on April 1, 2003. They were divorced during 2003, and in that year each filed separately. Sam used his new home address on his 2003 return. Betty used her office address on her 2003 return and included the $85,000 bonus on that return.
Unit I

Assessment Procedures

Code: §§ 6013(a); 6015; 6072(a), (b); 6081(a); 6091(b); 6151(a); 6201(a)(1); 6203; 6211(a), (b); 6212; 6213(a)-(d), (g); 6303(a); 6304; 6321; 6331(a), (b); 6401(a); 6404(g); 6501(a)-(c), (e); 6502; 6503(a); 6601(a), (b)(1), (c), (e); 6621; 6622(a); 7121; 7421(a); 7430(a), (b)(1); 7481; 7483; 7485; 7491; 7502(a)-(d), (f); 7503

Regs: § 301.6501(b)-1(a)

Materials: Questions 1-4

W & B 220, 227-230, 237-251, 297-311 (Background reading)
W & B 337-340 (Form 870)
Form 870 (Item 1)
Form 870AD (Item 2)
30-day letter (Item 3)
Appeal Rights (Item 4)
90-day letter (Item 5)
Rev. Proc. 98-54 (Item 6)
W & B 316-328 (Last known address)
Rev. Proc. 2001-18 (Item 7)
Rev. Rul. 97-23 (Item 8)

Questions 5-7

Rev. Rul. 81-269 (Item 9)
W & B 357-380 (Statute of limitations)
Benderoff (Item 10)
W & B 221-227 (What is a return?)
Form 872 (Item 11)
Form 872-A (Item 12)

Problem:

Sam and Betty's 2002 return was selected for audit, and the examining agent challenged the deferral of the $85,000 bonus and the deduction of the $25,000 in prepaid business expenses. On January 15, 2006, the agent issued a report showing the following adjustments:
Taxable income as reported $100,000
Adjustments to taxable income
  Betty's bonus 85,000
  prepaid expenses 25,000
Taxable income as revised $210,000
Tax (40% rate) $ 84,000
Tax per return 40,000
Deficiency $ 44,000

With his report the agent included a 30 day letter and Form 870, and sent all to the address shown on Sam's and Betty's 2002 return, which was Betty's office address.

Assume for purposes of (1)-(3) that Sam does not raise any personal defenses that would relate only to his personal liability.

(1) Betty retains you to represent Sam and her. What are the couple's options in responding to the 30 day letter? What affirmative reasons are there in favor of each of those options?

(2) Assume no protest is filed, and on March 10, 2006 the IRS mails to Betty and Sam, at Betty's office address, a 90 day letter asserting the $44,000 deficiency.

(a) If Betty and Sam decide not to file a Tax Court petition, what is the earliest date on which the Commissioner may assess the deficiency? What remedies are available to Sam and Betty if the IRS begins collection action prior to that date?

(b) What is the latest date on which the Commissioner may assess the deficiency (assuming the bonus is properly excluded from the 2002 return)?

(c) How would the answer to (a) and (b) change if Betty and Sam file a Form 870 on March 16, 2006? What if the Form 870 was filed on March 4, 2006?

(d) Why might you advise them to file a Form 870? What is the difference between a Form 870 and a Form 870AD?

(e) Can the IRS rescind a 90 day letter? Under what circumstances?

(3) During what period(s) will interest run on the deficiency if:

(a) The Smiths file a Form 870 on March 16, 2006, the IRS sends a notice and demand for payment on April 1, 2006, and the Smiths pay on May 2, 2006?

(b) Same facts as question (a), but the Smiths pay on April 8?

(c) A Form 870 is filed March 16, notice and demand is sent on May 2, and
payment is made May 5?

(d) Same facts as (c) but payment is made June 1?

(4) If the Service proceeds individually against Sam, what argument(s) does Sam have to protect himself from liability?

(5) What is the latest date on which the Commissioner may assess the deficiency if the bonus should have been included on the 2006 return? Would your answer change if Betty had noted on the return that her bonus would be reported on her 2003 return?

(6) What if the IRS establishes that Betty acted fraudulently in filing the 2002 return?

(a) What if, after filing the fraudulent 2002 return, Betty had filed a correct amended return for 2002?

(7) How does the filing of Form 872 affect the statute of limitations? Why might a taxpayer be willing to sign a form 872?
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Projected Course Outline – Fall 2006

Introduction

Unit I – Assessment Procedures

Unit II – Litigating Disputes in the Tax Court

Unit III – Overpayments and Refund Procedures

Unit IV – Jeopardy and Termination Assessments; Injunctions

Unit V – Rulings and Administrative Settlements

Unit VI – Transactional Issues: The Case Law and The Statutory Response

Unit VII – Civil Penalties