PILLA TALKS TAXES

DAN PILLA'S MONTHLY TAX AND FINANCIAL BULLETIN

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IRS Destroyed 30,000 Tax Documents

That's One Way to Catch Up

As the IRS struggles to dig out of the backlog of millions of unprocessed tax documents and incoming correspondence, it stumbled upon a potential solution to the problem: Why not just destroy the returns that can't be processed? As crazy as that sounds, that's exactly what the agency did.

In early May, 2022, The Treasury Inspector General for Tax Administration (TIGTA) reported that a year ago, IRS management elected to destroy an estimated 30 million paper-filed information returns because they simply could not process them.

Information returns are Forms W-2 and 1099 (of which there are dozens of varieties). Such returns report payments by third parties to individual taxpayers and businesses. They are used to carry out the computerized process of confirming income amounts reported on tax returns.

For example, IRS computers compare the income reported for a given taxpayer as reflected, say, in Forms W-2, with that reported on the taxpayer's income tax return (Form 1040). If the W-2s show more income was received than was reported on the return, the computers kick out a notice advising the taxpayer that he under-reported wage income. The notice computes the new tax liability and demands payment of the alleged additional tax owed.

The notices so generated flow from two specific operations: 1) the Automated Underreported Program,

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ADS

and 2) the Automated Substitute for Return Program. The latter program issues notices to individuals with reported income but who have not filed a tax return. According to IRS data, approximately 1.6 million notices under both programs were mailed for tax year 2020.

Information returns are overwhelming the IRS. In tax year 2020, the IRS received over 3.409 *billion* (that's with a *B*) information returns. When combined with the various families of tax return documents citizens and businesses file, the IRS receives about 10 documents for every man, woman and child alive in America today. This does not even address the over 100 million letters and statements mailed to the IRS annually.

And as far as the agency is concerned, the inflow of data is not enough. Every year the IRS presses Congress for more information reporting requirements that would just add to the mountain of data that has already buried the agency. The latest example of this is the Biden Administration's failed proposal (see October 2021 issue of *PTT*) to require bank reporting on all accounts with net transactions of $600 per year or more. Even considering that Congressional Democrats revised the proposal upward to a threshold of $10,000 per year, the law would have caused an explosion in the number of information returns collected by the government.

The only solution offered by the IRS and Congress to the overwhelming river of data flowing into the agency is to simply press for new rules mandating the efiling of tax documents. Indeed, the Taxpayer First Act (enacted July 1, 2019) contained three specific provisions (see article below) mandating that businesses efile certain tax returns. Presently about 81 percent of individual income tax returns are efiled, and about 35 percent of business tax returns are efiled.

Either way, the countless trillions of bytes of data – regardless of how it flows into the agency – must still be processed, assimilated and put to effective use in tax law enforcement. The more data that flows into the agency, the less likely the IRS will be able to use it, as evidenced by the 30 million documents destroyed last year.

It is clear that the brain trust in Washington has devised the most *inefficient* way possible to administer a tax system. But how could it be anything else? Our tax system is based on income. To fully ascertain the correct amount of income tax owed, and to enforce the assessment and collection of that tax, the taxing authority must

Taxpayers Defense Institute Consulting Members

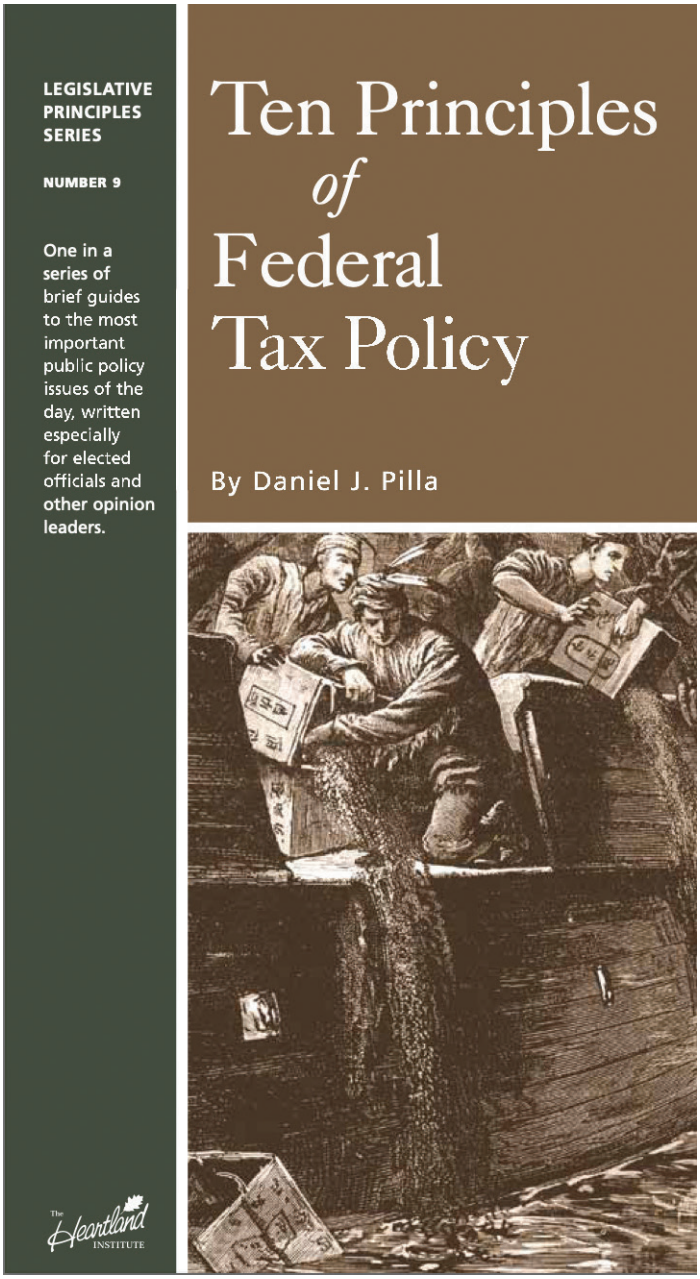
Name	Ability Level	Territory (City located)	Phone	Email
James Chase	Attorney	AL, GA (Pensacola FL)	(850) 434-3601	jchase@chaseattorneys.com
Donald MacPherson	Attorney	AZ (Glendale)	800-BEAT IRS	mac@beatirs.com
Donald MacPherson	Attorney	S California	800-BEAT IRS	mac@beatirs.com
Lawrence Stephens	CPA	CA:Northern (Modesto)	(209) 543-0490	lhs@saccon.com
James Olson	CPA	Colorado (Golden)	(720) 328-8624	Financial.Forensics.LLC@comcast.net
Julius Janusz	Enrolled Agent	CT (New Britain)	(860) 225-2867	tax@jjtax.com
Steven Klitzner	Attorney	FL (Miami)	(305) 682-1118	Steve@FloridaTaxSolvers.com
Darrin Mish	Attorney	FL (Tampa)	(813) 229-7100	dmishesq@getirshelp.com
Patricia Gentile	Attorney, CPA	MA, NH (Nashua, NH)	(800) 880-8388	PGentileCPA@comcast.net
Charles Markham	Enrolled Agent	MA (Norwell)	(781) 659-6600	charles@markhamandcompany.com
Manuel Mendoza	Enrolled Agent	MD (Bethesda)	(301) 962-1700	mendoza@mendozaco.com
Daniel J Pilla	EA, US Tax Court	MN (Stillwater)	(800) 553-6458	support@taxhelponline.com
Chris Churchwell	CPA	MO (Joplin)	(417) 781-1829	chris@chtaxgroup.com
Tom Zeiders	Attorney	OK, Tulsa	(918) 743-2000	tom@tax-amnesty.com
Robyn McQuown	CPA	OK, Norman	(702) 265-1159	mcquown@cox.net
Mitchell Gerstein	CPA	PA (Bala Cynwyd))	(484) 434-2041	mgerstein@isdanerllc.com
Kenneth Eichner	CPA	TX (Houston)	(713) 781-8892	kde@kdepc.com
Dionne Cheshier	Enrolled Agent	TX (Dallas)	(972) 514-1424	dionne@cheshiertaxresolution.com
Frank Rooney	Attorney	VA (Arlington), MD & DC	(703) 527-2660	rooneyf@irsequalizer.com

know everything there is to know about every person: where and how they earn income, where they spend it, the details of their lifestyle, etc., etc. That is to say, the taxing authority must be omniscient – you know, like God.

One of the ten principles of sound tax policy is that the tax system must be *efficient*. Paying taxes to support the necessary and legitimate functions of government is our responsibility as citizens. But being forced to annually undertake the mind-numbing task of reporting to the government every aspect of one's private life, and all the interactions one had with others, is simply intolerable in a free society. For more on the ten principles, see my treatise ***Ten Principles of Federal Tax Policy***, available here:

https://taxhelponline.com/wp-content/uploads/2022/03/Ten_Principles_of_Federal_Tax_Policy.pdf

It is well past time that we seriously and honestly discuss the need to abolish the federal income tax and adopt a tax system that does not make every American a spy for the government in the name of tax collection.



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Stronger Push for Efiling

Fallout from the IRS Document-destruction Episode

The aftermath of the revelation by the Treasury Inspector General for Tax Administration (see the opening article) is TIGTA's observation that the events causing the IRS to destroy an estimated 30 million wage and income documents "highlight the need for the IRS to develop a Service-wide strategy to further increase efiling." TIGTA, Report Number: 2022-40-036, May 4, 2022, pg 5.

Such strategy involves the press for more legislation to mandate the efiling of income and information returns. The practical reasons for efiling are readily apparent. The processing of such data is much faster and cheaper than paper-filed documents. For example, TIGTA observes that the cost of processing paper-filed returns ranges from $3.04 to $15.21 per document, while the cost to processes the same efiled returns runs from $0.01 to $0.37. Ibid, pg 1.

Regardless of the relative cost of processing paper-filed information, I find it hard to believe that the IRS could timely process the over 3.4 *billion* information returns (W-2s and 1099s) filed annually. So Congress presses for more mandated efiling.

Subtitle D of the Taxpayer First Act, Pub. L. 116-25 (July 1, 2019) imposed three additional efiling mandates. Two are pointed at businesses (including tax pros) and one at the agency itself.

1. As to practitioners and businesses, the law gradually reduces the threshold at which the number of returns filed requires efiling. The threshold drops from 250 returns to just 10 by 2022. Thus, any tax pro or business filing ten or more returns must

efile those returns in 2022. An exception is provided for tax pros located in areas with limited or no internet access.

2. The law extends the requirement that all tax-exempt organizations must efile all Form 990-series returns and statements. All political organizations filing Form 8872 must efile all returns.
3. The IRS has until January 1, 2023 to build a website that provides access to resources and guidance offered by the IRS, and which allows people to (a) prepare and file with the IRS Forms 1099, (b) prepare Forms 1099 for distribution to payees, and (c) maintain a record of Forms 1099 prepared, filed and distributed to payees.

The IRS is in the process now of building and testing that website. It must be functional by the end of this year.

TIGTA is pushing the IRS to more systematically assess penalties for failure to efile returns. These penalties will be pointed at partnerships with more than 100 partners, Highway Vehicle Use Tax returns (Form 2290) for more than 25 vehicles, corporate income tax returns (Forms 1120/1120S/1120F), exempt organizations returns, and employment tax returns (Forms 940x series).

TIGTA wants the IRS to "develop processes and procedures to consistently identify business filers that are not compliant with efiling requirements and assess penalties when applicable." Ibid, pg 14.

This will most certainly be an enhanced practice area going forward. Practitioners must understand the mandatory efiling requirements and the exceptions provided in the law. We must also understand the general "reasonable cause" exceptions to penalties as they apply to efiling requirements. For a full and complete discussion of the "reasonable cause" criteria, see chapter 17 of ***Dan Pilla's Small Business Tax Guide***.

Courts Restrict Refund Rights

Irrational Decision Limits CDP Appeal Rights

BY SCOTT MACPHERSON

In an opinion barely two pages long, the Fourth Circuit recently handed down a disturbing decision concerning tax refunds. The case is *McLane v. Commissioner*, 24 F.4th 316 (January 25, 2022). The decision is disturbing in three ways: (1) it restricts the jurisdiction of the Tax Court with respect to Collection Due Process ("CDP") appeals, (2) it treats similar taxpayers differently, and (3) it is illogical. I explain all of those points in turn.

The cogent facts of the case are simple enough. McLane timely filed his 2008 return and he partially paid the tax shown due. His tax return included a Schedule C, *Profit or Loss From Business*, for his contracting business. He was audited and the IRS disallowed most of the business deductions. This of course resulted in an increased tax debt. The IRS mailed a Notice of Deficiency asserting the liability but McLane never received it (the IRS conceded this point).

Because McLane did not file a petition with the U.S. Tax Court within the required 90-day period, the IRS assessed the debt. It then filed a notice of tax lien, and mailed to McLane a notice of federal tax lien. McLane received the lien notice, and he requested his Collection Due Process hearing.

The result of the CDP hearing was a determination that McLane was entitled to more deductions than he originally claimed, to the point where he actually overpaid his taxes. Not surprisingly, McLane wanted his refund, but the IRS's Settlement Officer said "no," and this is what the case is about.

McLane appealed to the Tax Court. Surprisingly, the

court said it lacked jurisdiction to order a refund. And everyone says, "But wait! Doesn't the Tax Court have authority to issue refunds?"

The answer is, yes it does, and that authority is found in code section 6512(b)(1).

McLane appealed to the Fourth Circuit Court of Appeals, and the circuit court affirmed the Tax Court's decision (meaning, according to the Fourth Circuit, the Tax Court does not have jurisdiction to issue a refund in a CDP appeal) — but not before the Tax Freedom Institute (now known as the Taxpayers Defense Institute) made an appearance in the case.

With the assistance of TFI executive director Dan Pilla, TFI founding member Mac MacPherson wrote and filed an amicus brief in the name of TFI, arguing to the Fourth Circuit the points that should be self-evident. Regarding the first of my three reasons the decision is troubling, that of restricting the jurisdiction of the Tax Court, TFI argued:

- This was a CDP appeal;
- CDP decisions are appealable to the Tax Court per §6330(d)(1);
- In a CDP appeal the Tax Court has jurisdiction to hear and decide "any relevant issue relating to the unpaid tax or the proposed levy" per §6330(c)(2)(A);
- Whether the taxpayer overpaid his taxes is a relevant issue relating to his "unpaid" tax; and
- Therefore, the Tax Court had jurisdiction to hear and decide whether McLane overpaid. (Dkt 32, Opening Brief of Tax Freedom Institute, Inc., as Amicus Curiae, pp. 8-10.)

Recall that McLane did not receive the Notice of Deficiency. In such situation, code §6330(c)(2)(B) (the statute controlling CDP hearings) expressly provides that a taxpayer "may also raise at the hearing challenges to the existence or amount of the underlying tax liability for any tax period." As explained by TFI:

> The fulcrum in this case is §6330(c)(2)(B), which provides that if - as in this case - the taxpayer "did not receive any [NOD]," the taxpayer may "raise at the hearing *challenges to the* existence or *amount of the underlying tax liability.*" (Emphasis supplied.) Key here is the plain statutory language "or *amount* of the underlying tax liability"; i.e., whether a negative or positive number. (Emphasis supplied.) For McLane, the number is negative, meaning he is entitled to a Tax Court decision for overpayment, a decision the Tax Court expressly refused, …" (Dkt. 32, p. 5 (emphasis in original)).

Or as McLane phrased it in his brief:

> The Tax Court's refusal to "complete the puzzle" and determine the correct amount of tax due simply because it would have resulted in a liability less than what [McLane] reported and paid, requiring a corresponding refund to [McLane], was error. Liability encompasses positive and negative amounts. There are not separate entries for deficiencies and credits – they are one and the same, either increasing or decreasing the tax liability, and the Tax Court was required to complete the determination until reaching the correct amount of tax.
>
> * * *
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> In calculating the correct amount of tax, the liability does not reduce to zero and then no longer exist when it becomes negative. The liability remains; however, when it falls below zero, the liability is no longer owed by the taxpayer to the Government – it is owed by the Government to the taxpayer. The debtor and creditor may change places, but it remains a federal *tax liability*. (Dkt. 61, Petitioner's Corrected Opening Brief, p. 17-18 (emphasis in the original).)

McLane argued that, "The Tax Court's decision lends itself to absurd results, clearly contrary to the statutory scheme of the Code and Congress's intent for CDP procedures within that context." (Dkt 61, p. 26.) And he is correct.

Of course deductions, credits and self-assessments are just component parts that make up the amount (or even the existence) of a tax liability. To hold that the Tax

Court has the jurisdiction and the duty to calculate the liability amount only until it decreases to zero, and to go no further than zero, defies the plain language of the statute and common sense. (Dkt 61, p. 19.) Everyone knows that an "amount" can be negative (meaning an overpayment), or zero, or positive (meaning a tax due).

Everyone, that is, except (apparently) the judges of Fourth Circuit because they did not accept that argument. In affirming the Tax Court's decision, the circuit court said:

> When, as here, the Commissioner has already conceded that a taxpayer has no tax liability and that the lien should be removed, any appeal to the Tax Court of the Appeals Office's determination as to the collection action is moot. No collection action remains, for which there is underlying tax liability, to appeal. *McLane* at 316.

Regarding now the second reason the decision is disturbing, that it treats similar taxpayers differently, TFI outlined its legal argument this way:

1. In 1929 Congress gave to the taxpayer in an NOD case the opportunity to prove a tax overpayment (§6512(b)(1)), an issue raised by McLane in his supplemental brief filed with the Tax Court;

2. Clearly, under §6330(c)(2)(B) an individual like McLane who timely files a CDP petition to the Tax Court for lack of receipt of an NOD is – as to determination of the liability – on precisely the same footing as one who timely files a petition in response to an NOD; and

3. In an NOD case, the Tax Court has express jurisdiction under §6512(b)(1) to determine a tax overpayment even without the filing by the taxpayer of a refund claim.

Therefore, the Tax Court denied McLane his right to due process of law by refusing to recognize its overpayment jurisdiction under §6512(b)(1), and in turn, refusing to proceed with the determination of the extent of McLane's overpayment. (Dkt. 32, p. 8.) TFI added in its reply brief,

> This conclusion is reinforced by §6330(d)(1): "the Tax Court shall have jurisdiction with respect to [all of §6330(c)], which includes "amount," and which also includes an overpayment. (Dkt 44, Reply Brief of Tax Freedom Institute, Inc., as Amicus Curiae, p. 4.)

The circuit court did not address this argument in its opinion, but the government did in its brief. The government said:

> The Tax Court's jurisdiction to order a credit or refund in a deficiency case is limited to the portion of tax that was paid after the notice of deficiency was mailed to the taxpayer or in regard to which a timely claim for refund was pending (or could have been filed) on the date the notice of deficiency was mailed. I.R.C. § 6512(b)(3). (Dkt 35, Informal Brief for the Appellee, p. 11-12.)

Effectively, that remains the current law in the Fourth Circuit.

Lastly, as to the court's illogical thinking, the third point in my trilogy, TFI argued as follows:

> Given that the word "overpayment" is not included in §6330, how is this Court to conclude that the "amount of the underlying tax liability to be determined" by the Tax Court under §6330(c)(2)(B) includes "overpayment"? The answer lies in the examination of the plain language: "existence *or* amount of the underlying tax liability." (Emphasis supplied.) (Dkt 32, p. 9.)

In other words, Congress distinguished mere existence (zero versus not zero) from the exact amount, and obviously an overpayment is one type of amount and a refund is another type of amount. Of course that makes sense, but the appellate court did not accept it.

Whereas the Tax Court ignored the word "amount" when expressing its decision, the Fourth Circuit said the distinction of "existence or amount" simply doesn't even matter: "McLane contends that the phrase 'underlying tax liability' (a phrase Congress left undefined) confers jurisdiction on the Tax Court to determine that he overpaid and order a refund. We disagree." *McLane* at 316.

And that's that. The circuit court said that a taxpayer is permitted to challenge the amount of his underlying liability in the collection due process hearing "*only* in the context of determining whether the collection action could proceed." *McLane* at 316 (emphasis by the court).

That was in fact done for McLane, and in his favor. As such, the proposed lien against McLane was not sustained. Case closed—but he gets no refund.

Editor's note: The 2022 Defense Conference will focus on refund issues. We will address at length all statutory and procedural issues related to tax refunds. Don't miss this conference. See details below.

Scott MacPherson *is a second-generation TFI/TDI member. He is an attorney licensed in AZ and CA, a regular contributor to PTT, and a frequent speaker at our* Taxpayers Defense Conference. *Scott is part of the The MacPherson Group along with his father Mac MacPherson and brother Nathan. Scott can be reached at* scott@beatirs.com

Senator Rick Scott's Platform

"Cut the IRS by Half"

There is little doubt that Senator Rick Scott (R-FL) is running for president. In March he released a 31-page document that can only be called his campaign platform. It's titled, ***An 11 Point Plan to Rescue America.*** See the full plan here:

https://rescueamerica.com/wp-content/uploads/2022/02/RickScott-11-Point-Policy-Book.pdf

Point 6 of Sen. Scott's plan raised some eyebrows and caused some consternation in Washington. In fact, IRS Commissioner Charles Rettig was asked about the plan while testifying to the House Ways and Means Committee earlier this year.

Point 6 of Sen. Scott's plan calls for sweeping government reform. Specifically, he wants to either move many government agencies out of Washington, or, he says, they should be "shuttered entirely." As to the IRS, he says he wants to "drastically simplify the tax code" and "cut the IRS."

It is the "cutting the IRS" part that got all the attention. Scott says he will "cut the IRS funding and workforce by 50%."

My response: Cutting it by half is a good start, *but it doesn't go far enough.*

During his testimony to the Ways and Means Committee, Rettig was asked about the idea. Keep in mind that Rettig was testifying to the committee about the need to *increase substantially* both the IRS's annual operating budget *and* its worçkforce. As to the idea of cutting the agency's appropriation by half, Rettig sarcastically responded by saying, "If the IRS budget was cut by 50%, you might be better off and save more money by just shutting it down completely."

I couldn't agree more—shut it down.

I've said for more than 20 years that the federal tax system is broken beyond repair. As I prove in my treatise *Ten Principles of Federal Tax Policy* (see opening article), our current income tax system is built on an unsound foundation. It is unsound morally, economically, and constitutionally.

When you have a building sitting on an unsound foundation, it doesn't matter how many times you fill the nail holes and paint the walls. That won't fix the problem. The only way you fix the problem is by bulldozing the structure and starting over.

The tax code now consists of more than 4 millions words. For context, the code was just 1.4 million words in 2000. Plus, the code has been changed more than 5,900 times since 2001, and that doesn't even include all the COVID changes that occurred in 2020 and 2021. We've created a monster that nobody understands and that the IRS itself cannot administer or enforce—and more money and more people cannot and will not fix the problem.

It's time to bulldoze the tax system and start over, and not with a flat tax.

A flat tax is still an income tax, and you can't have freedom and an income tax coexisting in the same society. One must necessarily drive out the other. My challenge is this: which one are you willing to live without?

How You Can Ask Dan Pilla a Question

If you have questions or problems you'd like Dan Pilla to address, please write to Dan at:

215 W. Myrtle Street
Stillwater, MN 55082

or e-mail to:

expert@taxhelponline.com

Write the word "newsletter" in the subject line.

Battling the Backlog

What the IRS's Hiring Spree Looks Like

The IRS entered the 2022 filing season covered in millions of unprocessed paper tax returns, amended returns and written correspondence from taxpayers. In an ordinary filing season, say 2019 for example, the IRS would begin the year with a backlog of about 1 million unprocessed documents. This 2022 filing season, the IRS faced an inventory of more than 15 times that many. Obviously, most of this is attributable to the agency shutdown that occurred during May and June, 2020.

But the agency also blames budget cuts and a reduced workforce. It is certainly true that the IRS's workforce is down. In 2010, for example, the IRS had just about 95,000 employees. In 2020, it had just under 76,000 employees. And it is also true that the IRS faced additional new challenges in 2020 and 2021, not directly related to the COVID shutdown, but certainly attributable to the aftermath of the pandemic. I refer to the explosion of tax legislation that flowed from Congress like lava from a volcano.

For example, the IRS had to hand out three rounds of stimulus checks to 85% of American households totaling over $830 billion. The agency is responsible for administering the new advanced Additional Child Tax Credit, which generated monthly checks to millions of households during 2021. On top of that, several new but temporary amendments were made to business and personal tax regulations because of all that legislation. The IRS had to adapt to all of that, and more.

To work through the ongoing backlog of documents, IRS Commissioner Rettig said the agency is taking an "all-hands-on-deck approach" and they are determined to bring on "new employees and reassign current IRS employees to process inventory."

Here's what the hiring spree looks like.

1. 10,000 new employees. The IRS began holding job fairs in various parts of the country as part of its press to hire 5,000 new employees in the short term, and another 5,000 over the next year. The IRS has obtained direct hiring authority for these employees to cut through the red tape generally associated with government new-hires.

2. Build the "surge team." In February, the IRS moved 800 people from other positions in the agency to directly address the backlog of unprocessed documents. They will add 700 more employees to that team. This will occur at the Kansas City, Ogden and Austin submission processing centers where most of the paper filings are received.

3. Mandatory overtime. The IRS has issued mandatory overtime orders to 6,000 employees who work in returns processing. Optional overtime is available to another 10,000 workers to process amended returns and taxpayer correspondence. In all three of the submission processing centers, employees are now working night shifts on these tasks.

4. Obtaining outside help. The IRS is pursuing "contracting options" presumably from outside sources to help with paper return processing and incoming mail. Since the summer of 2021, the IRS has used 2,000 contractors to respond to taxpayer phone calls about stimulus payments and the Additional Child Tax Credit. These contractors have answered over 40 million calls.

How many additional employees, and how much more money will it take for the IRS to run smoothly? No one can answer that question. My own opinion is that there is not enough money or people available to do the job so long as Congress keeps changing the law and creating new programs to be administrated by the IRS.

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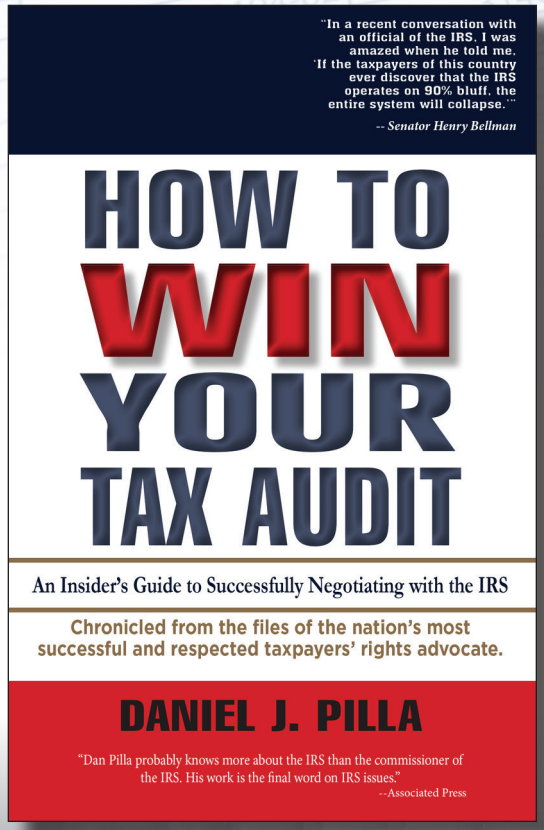

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