Pilla Talks Taxes

DAN PILLA'S MONTHLY TAX AND FINANCIAL BULLETIN

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The IRS Wants Your Picture

But It Might Have to Wait a Bit Longer

About two months ago I was on the phone with an IRS Revenue Officer (RO) talking about a client's situation. We got on the topic of the IRS's backlog of unprocessed tax returns and the difficulty they are having working through the pile of mail that stacked up during COVID stay-at-home orders in 2020 (which are least in part, ongoing).

According to the National Taxpayer Advocate's (NTA) 2021 Annual Report to Congress (December 2021), the IRS was backlogged almost 12 million tax returns left over from the 2020 filing season (tax year 2019 returns). It took the agency until June 2021 before all those returns were processed. Meanwhile, starting in March 2021 the IRS received another 17 million paper returns to process. Even worse, at the same time, the IRS had another 9.8 million returns in its error processing system. The protocol there requires that each return in that system be processed *by hand*.

According to the NTA, it is now taking the IRS about eight months to process paper tax returns.

During calendar year 2021, the IRS mailed millions of letters and notices to taxpayers covering all kinds of issues. Most letters carry a time deadline under which taxpayers must respond. If they do not, the IRS can take adverse action without further notice. For example, if the IRS mails a Final Notice of Intent to Levy and Notice of Your Right to a Hearing, the taxpayer must respond to the notice within 30 days. If he does, the case goes to the IRS's Appeals Office without enforcement action. If

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not, the IRS can levy a pay check or bank account.

The problem is that it's taking the IRS six months or longer to process incoming mail. In the case of a final notice, a taxpayer may well have filed his request for a hearing on time, but because of processing delays, the IRS would not know that for many months after the letter was physically received. In the meantime, the agency's computer-driven Automated Collection System would have kicked in and potentially issued a wage or bank levy against the citizen.

All of this brings me back to the recent discussion I had with the RO. He insisted that much of the IRS's problems were caused by its antiquated computer systems, what he referred to as "1960s technology." He said without more money for updated computers, nothing will change.

That got me thinking. How can the IRS process over 260 million business and personal tax returns with its electronic filing system using 1960s technology? How can the agency process more than 3.8 billion information returns (Forms W-2 and 1099) received in machine-readable format using 1960s technology? Plus, the IRS has a web site on which taxpayers can make payments instantly through direct debits from their back accounts. And, by the way, how is it possible that the agency deployed facial recognition software using 1960s technology?

Let's talk about that facial recognition software. The IRS began using the technology in a limited way in 2021. They intended to roll it out to all citizens in the summer of 2022. By then, if you wished to gain access to your IRS account online, you would have to jump through a few extra hoops. Under the auspices of combating identity theft, the IRS intended to add facial recognition as a new "security filter."

Under the program, one was to create an account with ID.me, which advertises itself as a secure digital ID network designed to provide identify authentication and verification to users. According to the IRS's website, the ID verification elements needed to access your account include your name, email address, SSN and a photo ID, such as a driver's license or passport.

In addition, you would be required to provide—get this—"a selfie" taken from your cell phone or other device. The selfie is then digitally compared to the image on the photo ID to determine whether you are in fact the person attempting to access the account.

Make no mistake about it. This is not just about

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ID theft protection. The IRS document describing the program confirms that the system uses, among other things, GPS and biometrics technology "in the event of an investigation into a user." PIA ID No. 6565, Approved November 1, 2021. Apparently there is no limit to the nature of an investigation in which the selfie could be used. Once the IRS has it, it's theirs to use as they see fit.

Consider just this one possibility as an example. Imagine you are under a "routine" tax audit. Questions arise regarding the frequency, location and duration of the trips or vacations you might take. The auditor is probing into these areas because he's testing the veracity of the income you claimed on the tax return in question. The auditor believes that trips and vacations might potentially suggest that you earned more income than reported. This is a common audit technique I discuss in my book ***How to Win Your Tax Audit.***

Now suppose, like most Americans, you have an active social media presence, and you regularly post photos of your journeys and experiences. By the time the agent asks you about the frequency, location and duration of your vacations, he already used facial recognition software to scour the Internet for any evidence of your recreational and other activities. He has a pretty good idea of your lifestyle before he even asks you the first question.

As you might imagine, there has been quite a bit of push back over this idea once it came to light. Senators and Congressmen from both sides of the isle lodged objections. Republicans cried out about the invasion of privacy. Democrats complained that facial recognition software is—you guessed it—racist.

As a result of the flack, the IRS backed off on the idea—at least for now. On February 7, 2022, the agency released a statement saying it will "transition away" from using facial recognition for ID confirmation purposes. Commissioner Charles Rettig said "we are quickly pursuing short-term options that do not involve facial recognition." See: IR-2022-27, February 7, 2022.

Circling back to the questions I asked earlier—about the IRS's technological capabilities—the answers are clearly obvious. The IRS most certainly is not using 1960s technology. It has spent billions of dollars just since 2000 alone upgrading computers. Now those systems include the power to track you across the Internet with facial recognition software.

The agency is steadily working toward its goal of having real-time access to all the personal data of every American. And while the recent development is certainly positive, the IRS's lust for data is never satiated. My guess is that over time, we will see this plan surface again.

IRS to Stop Sending Certain Collection Notices

Processing Backlog to Blame

Under the auspices of providing "additional help to people" during this ongoing period of national difficulty, the IRS announced on February 9, 2022, that it will suspend the mailing to citizens of certain automated collection notices.

The IRS claims they are suspending the mailing of these notices as a means of helping taxpayers get through trouble times. IRS Commissioner Rettig said, "IRS employees are committed to doing everything possible with our limited resources to help people during this period."

The reality, however, is the IRS is overloaded with backlogged tax returns and incoming mail that it cannot dig out from under. As I explain in the opening article,

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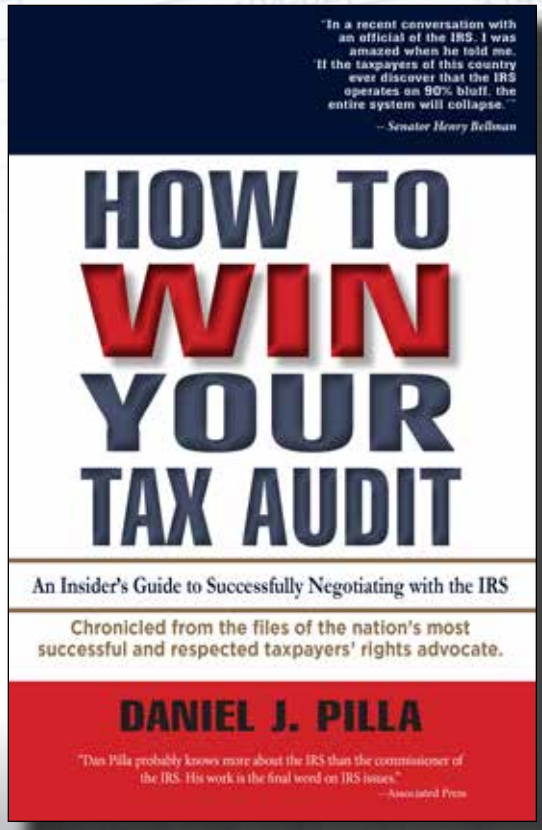

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the IRS is buried under a mountain of nearly 12 million unprocessed tax returns, and another nearly 5 million incoming letters from citizens responding to IRS notices.

The fine print in the IRS's statement reveals the true reason the agency is shutting down the mailing of certain automated notices:

> These automatic notices have been temporarily stopped until the backlog is worked through. The IRS will continue to assess the inventory of prior year returns to determine the appropriate time to resume the notices. See: IRS New Release IR-2022-31, 2-9-2022.

How long it will take to clean up the mess is impossible to tell because on top of what the load agency already has, the 2022 filing season is now in full swing. Over the next several months, the IRS will receive another 160 million individual tax returns, and about 105 million business returns. About 15 percent or so of the personal returns will be paper-filed, meaning the IRS has to process them the old-fashioned way.

WHICH NOTICES ARE SUSPENDED?

The IRS is suspending the use of certain automated collection notices. These are the "you owe taxes" letters the agency routinely mails to delinquent citizens. The specific notices subject to this decision are as follows:

NOTICE	EXPLANATION
CP80	Shows credits IRS made to an account for which no return was filed; demands the missing return be filed
CP59 and CP516	Mailed when there's no record of a return being filed for the year stated; demands the missing return be filed
CP518	Final notice demanding the filing of a missing tax return; threatens the filing of a "substitute for return"
CP501 and CP503	1st and 2nd notices of a balance due and demand for payment
CP504	3rd notice of balance due and statutory notice that IRS will levy a state tax refund if payment is not made by the due date
CP280	Statement to citizens identified as having under-withholding of taxes from wages; explains how to adjust withholding to the correct amount
CP259	Business version of CP59, described above; demands the missing return be filed

THE SIGNIFICANCE OF THE SUSPENDED NOTICES

The notices above generally do not require a response, expect to the extent that the IRS is seeking the filing of a delinquent tax return. In that case, you simply file the missing return to comply with the agency's demands. However, a CP501, for example, requires no specific response to the letter within a stated time period. Again, just pay the tax if possible.

But, of course, people do respond, especially to the CP504, which is very misleading. The notice is a final notice of intent to levy a state tax refund. Only a state tax refund can be levied per that notice. However, the somewhat vague wording leaves most people believing the IRS can levy a paycheck or bank account per that notice. It cannot.

The IRS's general levy power arises only after it mails a Final Notice, Notice of Intent to Levy and Notice of Your Right to a Hearing, as required by code sections 6330 and 6331. This is the notice that carries Collection Due Process Appeal Rights. The Final Notice letter takes one of three forms (because it's way too simple to just have one letter). They are: a) CP90, b) LT11 and c) Letter 1058. The first two are generally issued by Automated Collection. The third is issued by a Revenue Officer (tax collector) who's been assigned to the case.

NOTE WHICH NOTICES ARE NOT MENTIONED

The notices not mentioned above include the statutory notices the IRS is

required to mail by law. For example, I mentioned the Final Notice of Intent to Levy and Notice of Your Right to a Hearing. The use of that letter (in all three forms) has not been suspended. Thus, if the string is out on collection, one might still receive a Final Notice letter, which requires action within 30 days of the date of mailing or one loses Collection Due Process Appeal Rights.

The IRS addressed this in its statement of January 27, 2022, prior to issuing the above-mentioned directive. The statement provides in part:

> It is important to appreciate that many IRS notices are statutorily required to be issued within a certain timeframe to be legally valid. This means they must be sent, absent congressional action. We will continue to explore areas where the IRS can make changes and are in the process of reviewing the full set of notices that we send to determine where we can make adjustments while we continue to work through unprocessed returns and taxpayer correspondence.

Statutory notices not covered by the directive include (but are not limited to) the following:

NOTICE	DESCRIPTION
CP90; LT11	Final notice of intent to levy; required before IRS may levy any assets; 30 days to submit request for CDP Appeal
Letter 1058	Same as above; issued by a Revenue Officer
Notice of Deficiency	Final administrative determination that one owes taxes; must file timely Tax Court Petition to challenge
Notice of Determination	Final Appeals Office determination in CDP appeal; must file timely Tax Court Petition to challenge
CP523	Notice of rejection/termination of installment agreement; 30 days to submit appeale
Letter 1153	Notice of Trust Fund Recovery Penalty assessment; 30 days to submit appeal

CONCLUSION

It is clear that the suspension in sending preliminary collection notices is not a suspension of the IRS's collection function. They did that for a time during the summer of 2020, but that is not the case here. In most delinquency cases, the IRS will continue to issue the final notice letters, along with the other statutory notices, described above. For a full discussion of the collection process, along with the process of appealing collection various actions, see ***How to Get Tax Amnesty.***

Passport Certification Litigation

Challenges to Enforced Collection

BY CHARLES R. MARKHAM, MST, EA, USTCP

Recently, in *Ruesch v. Commissioner,* 154 T.C. No. 13 (U.S.T.C. June 25, 2020), the Tax Court issued an opinion downplaying the court's role in litigation involving the suspension or revocation of one's passport under code section 7345. The court has jurisdiction under that section to review the IRS's certification of one as "seriously delinquent" as defined in the statute. As to the Tax Court's jurisdiction, the court held:

We do not have jurisdiction, under I.R.C. sec. 7345 or otherwise, to consider in this case petitioner's challenge to her underlying liability for the penalties…Held Further, we have jurisdiction to review petitioner's challenge to respondent's certification of her liabilities as "seriously delinquent." See IRS sec. 7345(e). However, because Respondent has reversed that certification as erroneous and so notified the Secretary of State, Petitioner's challenge in that respect is moot.

As to what the statute does empower the court to do, the *Ruesch* Court went on to state:

> Section 7345(e)(1) circumscribes quite narrowly our jurisdiction in passport cases. The only determination we are authorized to make is whether the Commissioner's certification of a taxpayer as a person having a seriously delinquent tax debt (or his failure to reverse a certification) "was erroneous." Sec. 7345(e)(1). And the only relief we are authorized to grant is to order respondent "to notify the Secretary of State that such certification was erroneous." Sec. 7345(e)(2). *Ruesch v. Commissioner,* 154 T.C. No. 13, at *11 (U.S.T.C. June 25, 2020)

In a few specific instances, the passport revocation petition can be a very valuable tool. In fact, in the right case, it can be the key to completely resolving a taxpayer's collection problem. The key is that the tax debt in question must have become unenforceable but for some reason, the IRS believes the debt is valid.

One example is where the Collection Statute Expiration Date ("CSED") has passed but the IRS believes it is not expired. According to the Taxpayer Advocate, this happens frequently. Another example is where a bankruptcy discharged the taxes but the IRS did not abate the assessments. Instead, it continues its attempts to collect.

As to this latter example, I offer the following as a case study, which is my recent Tax Court case of *Stover v. Commissioner* (22483-21). This case was settled by stipulation. Unfortunately, because of that, no decision will be published. As such, I discuss the case from my personal point of view as counsel of record in the case.

THE SITUATION

The clients filed a Chapter 13 bankruptcy and completed the 5-year bankruptcy payment process, after which they received a routine discharge from the court. There was nearly $500,000 of federal income taxes listed in the bankruptcy case.

At the conclusion of the case, some of the taxes were paid down and the IRS discharged the rest. For certain years there was a tax lien filed and for others there was not. The IRS issued a release of lien.

The taxpayers have a large home with substantial equity that was exempt from the bankruptcy process. At the immediate conclusion of the case, the taxpayers had no balance due to the IRS.

If you are schooled in bankruptcy and taxes, you will be aware that the tax lien on their house should have survived the bankruptcy even though the taxes were discharged. For a detailed discussion of this issue, see Dan Pilla's book, ***How to Get Tax Amnesty,*** chapters 13 and 14.

A year or two after the discharge, the IRS re-instated

the balance. Soon thereafter, the taxpayers started to receive collection notices. In addition, the IRS issued a certificate to revoke the lien release. I believe someone at the IRS figured out that the tax lien had value and should not have been released. The agency wanted to collect. We are talking about $300K in past due taxes for which the clients are now suddenly receiving bills.

The bankruptcy attorney was of no particular use. He simply took the position: "I never promised that the taxes would be discharged. If they had been, that's great. But if they weren't, well, too bad." This is a standard talking point for a consumer bankruptcy attorney, most of whom are ignorant of the nuances of discharging taxes in bankruptcy, and worse, who are not interested in battling the IRS in Bankruptcy Court.

The clients came to me regarding the reinstituted collection action.

While I realize a tax lien ordinarily survives the bankruptcy, I had concerns about the process that took place, i.e., how were the taxes discharged and then reinstated, and why was the lien released and then reinstated? Also, there were liens in several counties and certain timing issues caught my attention. In a nutshell, while a tax lien survives a bankruptcy, does the IRS lose its opportunity to collect when the agency releases its lien? To put it more succinctly, "*Can they just do all that?*"

THE BACK STORY

All of the above happened in the 2018-2019 time frame. Beginning in late 2018 and continuing through January 2019, the IRS (and other federal government agencies) shutdown due to the lack of a budget agreement. As a result, situations like this had a habit of going into black holes. That's what happened here. Then, in March 2020 the pandemic hit. The IRS shut down again beginning in May 2020. So things just "sat there" for a while.

However, none of these extraordinary factors had any impact on the CSED date. The clock continued to tick and I was hopeful that the CSED might come and go (in 2023) without anybody at the IRS taking an interest. This "wait-it-out" strategy was acceptable to my clients.

FAST FORWARD TO LATE 2021

In late 2021, the most senior Revenue Officer in my area was assigned the case and began sniffing around. My hope for a quiet ending proved fruitless. The total owed was now at $340K. I've known this RO for years. He's good at his job. The client's have plenty of equity in their home and to make matters worse, they have AGI in the mid six- figures. No OIC here!

But I still have serious doubts about the bankruptcy discharge and reinstatement process that took place, along with the validity of the refiled tax liens. But I honestly didn't have much confidence. I thought maybe the IRS committed a "foot fault," but I know the tax lien did survive the bankruptcy and that may be a collection opportunity for the IRS.

More importantly, *what's my forum?* While I practice in Tax Court, I am not an attorney and the client's bankruptcy attorney wasn't about to file an adversary proceeding in Bankruptcy Court against the IRS. Moreover, the taxpayer's CDP rights have long since lapsed.

I discussed with the RO my belief that the debt was discharged and thus was invalid, but he wasn't hearing any of it.

ENTER THE PASSPORT ISSUE

On the transcripts I noted that the client's were certified as "seriously delinquent" some time previously. As such, their passports were suspended/revoked. I considered filing a passport case in the Tax Court for several reasons. First, to certify a taxpayer under section 7345, there needs to be a valid lien (§7345(b)(1)(C)(i)) or a current levy (§7345(b)(1)(C)(ii)) and I believed that, *technically*, due to oddities in some filing dates in various counties, the IRS might not have a valid lien in place. (I want to be clear: I did not see this as anything other than a "technicality" that could be readily corrected by the IRS. But I could at least hang my hat on it.)

Second, there is no time limit on filing a passport certification case in Tax Court. The case can be filed at any time, regardless of when the IRS certifies the taxpayer as "seriously delinquent" and issues the required

notice to the Department of State (and corresponding notice to the taxpayer).

Third, and perhaps most importantly, passport litigation in Tax Court does not toll the CSED. The downside of this is that it doesn't automatically suspend collection either. However, my hope was that the Revenue Officer would stand down considering that litigation was pending.

I explained to my clients that I didn't expect the Tax Court filing to accomplish much other than to buy a little time and push them closer to the CSED. This was just fine with them.

So, we filed a passport certification case with the Tax Court. In the petition, I raised concerns about the validity of the debt, but only tangentially. Instead, I focused on the validity of the lien and that, per the statute (cited above), a valid tax lien must be in place for the passports to be certified.

THE IRS'S RESPONSE

Guess what happened? In its Answer, IRS counsel conceded that the $350K was in fact discharged in bankruptcy. Further, counsel agreed to abate the full balance of the assessment, release the lien, and decertify the passport. *Huh*?

Trying very hard to restrain my excitement on the phone, I calmly explained to counsel that assuming the debts were removed and the liens released, we did not object to respondent's motion to dismiss on the grounds of mootness.

Counsel then had the tax assessments abated—again—and the liens released. My clients' passports were reinstated. Finally, IRS counsel filed a motion to dismiss.

CONCLUSION

While the Tax Court goes to lengths to explain in *Ruesch* how its hands are tied and that it can't look at the underlying liability, the court does agree that it can consider whether or not the tax debt is legally collectible. *Ruesch* at *12, reads:

> We are also authorized to consider whether the tax debt "has been fully satisfied or has become legally unenforceable." IRC Sec. §7345(c)(2)(A). The latter would be true where the collection period of limitations had expired. See sec. 6502(a)."

Practitioners need to focus on this issue of enforceability. For example, if the IRS followed proper procedures in making its assessments, and there is nothing invalid about the procedures used, then do not use a passport petition. On other hand, if, for example, the proper deficiency procedures weren't followed, the CSED has run, the tax debt has been bankrupted, in those cases, one can argue that the tax debt is "legally unenforceable."

PASSPORT LITIGATION PROCESS

If you raise this issue and can document your position, it is very likely that you won't even go to trial. The case will likely settle.

In my case, I requested a trial in Boston. I was surprised to be contacted by IRS Counsel from Kansas City. When I reviewed various docketed passport cases, I kept seeing the same IRS attorneys' names over and over, including the one that contacted me. It turns out that the IRS is funneling all of these cases to a select set of attorneys in Kansas City. This centralization allows the IRS to pursue and manage a very focused litigation strategy.

Whether my observation that the existence or validity of the debt can be decided by the Tax Court via passport litigation is realistic, the takeaway is that IRS Counsel—*if you make a good case for it*—will likely stipulate to abatement or discharge of the invalid debt as opposed to going forward to trial. The Kansas City group seems particularly mindful of litigation hazards.

Charles Markham *is a consulting member of TFI/TDI. He has been a member for over 20 years and is a regular attendee and contributor at our* Taxpayers Defense Conference. *He is admitted to practice in the U.S. Tax Court. Charles can be reached at* charles@markhamandcompany.com.

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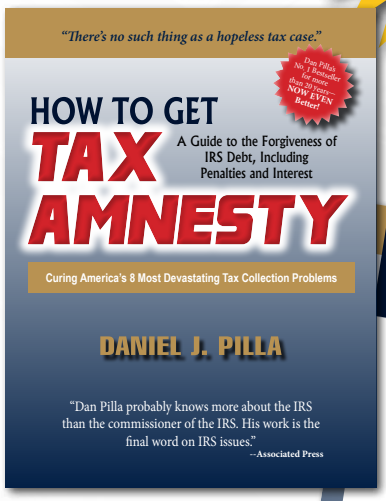

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Dan and Scott MacPherson lead discussion at the Defense Conference

Dan with Larry Heinkel, who presented an ethics session.

Group shot of Defense Conference attendees

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The Other Progressive Income Tax

How It Robs Seniors

DR. MERRILL MATTHEWS, PH.D.

Democrats have long sought to make the federal income tax even more progressive than it already is—and it is very progressive now. But there is an additional progressive income tax–a tax that most people don't really know or think about – and it primarily punishes seniors, imposing a sort of tax double-whammy on them.

Seniors who are 66 years old – the current retirement age for Social Security benefits – or older can begin receiving their Social Security benefits and still earn income without incurring an earnings penalty. (That penalty applies only to those who begin taking their Social Security benefits early, between the ages of 62 and 66.)

But if seniors who have reached the full retirement age continue working, or if they have other sources of income (e.g., interest or dividends, pensions, royalties or profit from investments or IRAs), they may have to pay income taxes on part of their Social Security benefits. So, the government forces workers (and employers, since the payroll tax is split equally between them) to pay the Social Security payroll tax and then may tax the benefits when the government starts returning the money after retirement.

In other words, seniors may face two progressive income taxes. The more income they have, the higher their regular income tax rate will be. And that higher tax rate will be applied to a growing portion, up to 85 percent, of their Social Security benefits. The practical effect of this tax on Social Security benefits is to rob seniors of some of the benefits they have worked for and are entitled to. And it's not like the income thresholds are high.

According to the Social Security Administration (SSA), if a retirement-age senior filing an individual tax return has a total annual income (excluding their Social Security benefits) between $25,000 and $34,000, that senior will have to pay federal income taxes on up to 50 percent of their Social Security income. If a senior's annual income is more than $34,000, he or she will have to pay federal income taxes on up to 85 percent of their Social Security income.

For a couple filing jointly, they will have to pay federal income tax of up to 50 percent on income between $32,000 and $44,000, and up to 85 percent on income above $44,000. And the more income they have by remaining a productive member of the labor force, the higher the percentage of their Social Security benefit the government will tax.

Oh, and if they continue working, they and their employer are continuing to pay the Social Security payroll tax, even though those seniors are receiving Social Security benefits that are being taxed. And it's not just income from work. Seniors withdrawing funds from a traditional IRA or other tax-preferred account must pay standard income tax rates on those funds — taxes the individual avoided, or delayed, when the money was initially deposited in the IRA or other retirement account.

Those newly withdrawn funds count as income that makes a senior subject to the Social Security benefits tax. Here's how the Social Security Administration puts it:

> Some of you have to pay federal income taxes on your Social Security benefits. This usually happens only if you have other substantial income in addition to your benefits (such as wages, self-employment, interest, dividends and other taxable income that must be reported on your tax return).

So, a senior who is retired and isn't working but is withdrawing, say, $50,000 a year from an IRA to live on will see part of his Social Security benefits taxed.

Some might argue that imposing income taxes on Social Security benefits encourages seniors to leave the workforce to make way for younger workers who need a job. But any such rationale – thinking that was part of the initial Social Security legislation that passed during the Great Depression, when jobs were scarce – no longer applies, and hasn't for a long time. We need workers young and old, and now more than ever.

Of course, taxing Social Security benefits brings more money into a federal government that has for decades refused to live within the bounds of its tax revenue—or even close to it. So, it's unlikely a spend-happy Congress will eliminate the Social Security benefits tax anytime soon, even if it does rob seniors of some of the benefits they deserve.

Indeed, the bigger threat is Congress making it worse. Because if there is one thing the left likes more than a progressive income tax, it's two progressive income taxes.

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