
# PILLA TALKS TAXES

DAN PILLA'S MONTHLY TAX AND FINANCIAL BULLETIN

June 2022
Vol. 34 Issue 5


# Surviving the "Great Shred" of 2022

## *How to Keep From Being Victimized by IRS Housecleaning*

The lead article in last month's *PTT* reported that the IRS destroyed 30 million tax documents. That article was also published by *National Review* and resulted in a number of inquiries from citizens concerned about potential problems growing from shredded documents. People are worried that their tax returns or other submissions to the IRS might have been shredded. Because of these questions, additional clarification is in order.

### WHAT THE IRS *DIDN'T* SHRED

It is clear from the report of the Treasury Inspector General for Tax Administration (TIGTA) what the IRS did, and did *not*, shred. See, TIGTA Report No. 2022-40-036 (May 4, 2022) (*www.treasury.gov/tigta*).

The agency shredded only paper-filed *information* returns. These are Forms 1099 and W-2, which report income paid by third parties. The agency did not shred *income tax* returns or any incoming correspondence from taxpayers (at least not that has been disclosed to date). Nor did the IRS shred incoming payments made by taxpayers.

I've been asked dozens of times in the days following the release of my article whether the agency's house-cleaning mission in March 2021 is the reason for the fact that their correspondence hasn't been answered.

The answer is no.

IN THIS ISSUE



ADS

Certainly, delays are attributable to the ongoing document-processing backlog the IRS is struggling with, but that is largely caused by the agency's work-stoppage in May and June 2020 due to the COVID shutdown. Any delays processing checks are likewise attributable to those same factors.

## POTENTIAL PROBLEMS FOR TAXPAYERS

The next question is whether the IRS's spring cleaning might negatively impact citizens and businesses. This is an important question and we must understand to how to insulate ourselves from the potential impact. There are two possible scenarios.

**1. Wage-earners.** Forms W-2 are filed by employers to report the amount of wage income paid to their employees. The forms also report the amount of federal and state taxes withheld from wages. A W-2 is a key form in the preparation of one's tax return. The reason is that the best way an employee can know with certainty the amount withheld for federal and state taxes is by information reported on Form W-2.

When the IRS receives a tax return, its computers compare the income and withholding information reported on the return with that reported on Forms W-2. If there's a discrepancy, a CP2000 notice is automatically mailed to the taxpayer. The notice explains the discrepancy and recalculates the tax owed—then adds interest. The notice demands payment by a certain date.

If the IRS failed to process one or more W-2s for a particular individual, it is likely that its computers will see that more withholding is claimed on the return than was reported by employers. That will lead to the issuance of notice CP2000. The notice will explain that the IRS reduced the amount of the claimed withholding credit. That in turn causes a dollar-for-dollar increase in the tax allegedly owed.

**2. Small business owners.** Business owners are the people responsible for filing all of the information returns demanded by the system. And, as reported, it was information returns—30 million of them—that were destroyed. When information returns are not filed correctly or on time, the IRS issues penalties (which can be egregious) against the offending business.

I anticipate that the IRS will issue penalties against businesses which in fact did file required information returns, that were never processed. There is simply no way to anticipate the number of businesses that will be hit with penalties they don't owe for failing to file forms the IRS itself destroyed.

## HOW TO RESPOND

A proper and timely response is critical. I address the required response for both individuals and businesses.

**1. Wage-earners.** A CP2000 notice carries a "response" page as part of the notice. The response page gives the recipient the chance to either: (a) entirely agree with the changes, (b) partially agree, or (c) entirely disagree. In this case, one must return the response page indicating full disagreement with the calculation.

Along with your response, provide copies of your copies of Forms W-2. You must state that the withholding reported on your tax return is exactly the amount reported on the W-2s received from your employers. Ask the IRS to correct its calculation to reflect the correct withholding reported on your forms.

Mail your response using certified mail, or U.S. Priority Mail with tracking, by the deadline stated in the CP2000. Keep copies of everything you send, including your Forms W-2.

**2. Small business owners.** Every penalty assessment is subject to cancellation when the citizen can demonstrate that the failure to act was in good faith and based on some reasonable cause, and not out of deliberate disregard of IRS rules or regulations. It is also true that any penalty (and interest) attributable to an IRS error is likewise subject to cancellation.

In this case, a failure to file penalty is purely attributable to IRS actions (shredding documents), and not due to an individual's failure to act. However, the burden of proof is on the taxpayer. The IRS doesn't have to prove you made a mistake; you must prove you did not.

Thus, you cannot prevail by simply arguing that the IRS "may have" shredded your documents in March 2021. You must establish that you in fact submitted them as required. You do that with a written statement of facts, signed under penalty of perjury, along with a request that the IRS abate the penalties.

If you initially mailed your information returns to the IRS using certified or registered mail, it will be a simple matter to prove you met the filing requirement. A copy of your postage receipt for certified mail, together with your declaration under penalty of perjury that you in fact mailed the materials, will carry the day.

The handicap here is that most people do not send paper documents to the IRS using such methods. They simply drop them in the nearest mailbox with faith that they will arrive at their destination and that the IRS will process them correctly. Well, guess again.

If that's what you did, you'll need to establish that you in fact mailed the documents. To do this, you must provide a statement signed under penalty of perjury declaring that you mailed the documents. The fact that you don't have a postage receipt is a handicap but is not fatal if your statement is specific as to when, where and how you mailed the documents. If you have copies of what you mailed, provide them with the declaration. See my book *The IRS Problem Solver* for details on how to create a declaration.

Make sure your declaration affirmatively declares that you mailed the documents. Don't use qualifiers such as, "might have," "probably did," "must have" or other such statements. You must establish that you did—in fact—mail the documents as required.

## THE APPEAL PROCESS

Your written response must include a statement to the effect that if the IRS does not correct its calculation or abate the penalties, you wish the case to be forwarded to the agency's Office of Appeals. You are entitled to a review of your case by an independent Appeals Officer whenever you disagree with the agency's initial decision. See chapter 13 of my book, *How To Win Your Tax Audit.*

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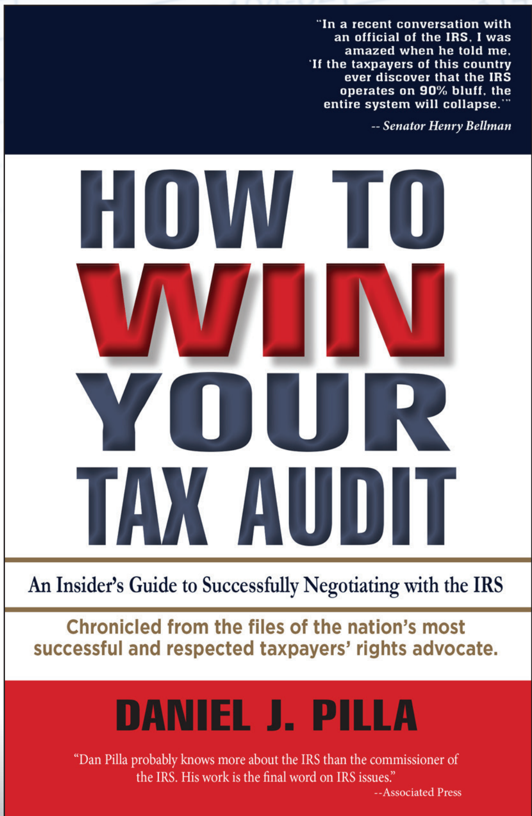


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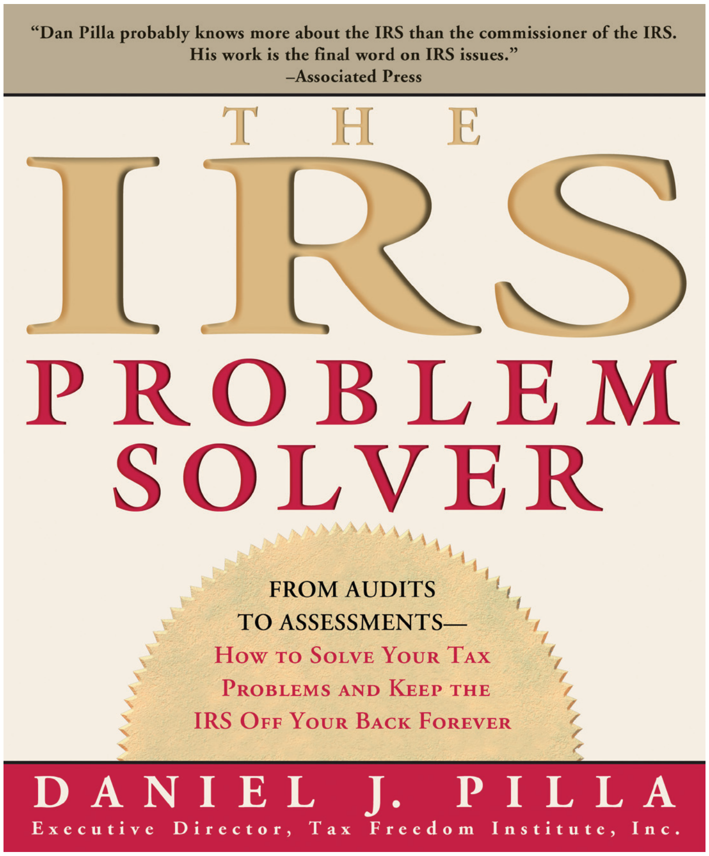


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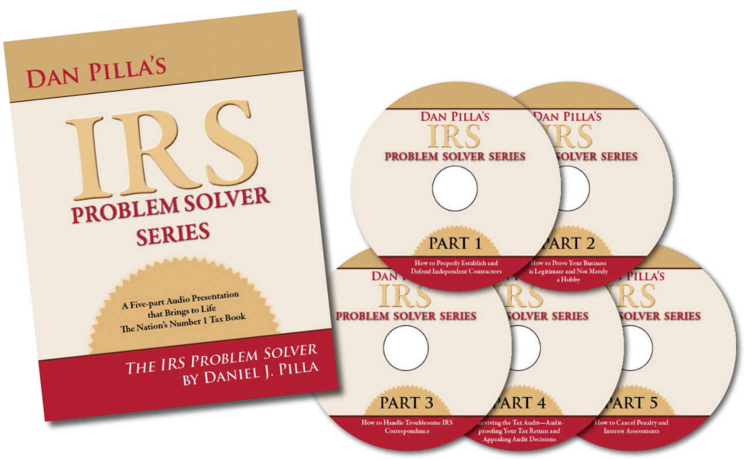


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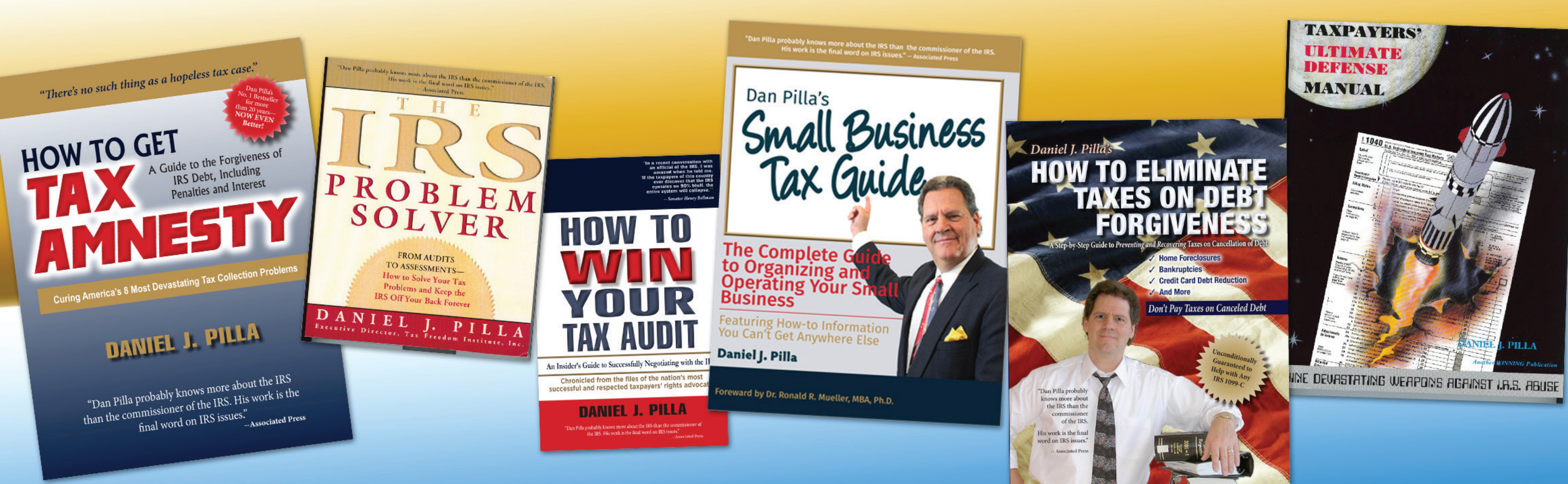

# Law Requires Supervisory Approval of Penalty Assessments

## *Ninth Circuit Court of Appeals Addresses the Question of "When"*

**BY SCOTT MACPHERSON**

In March of this year, in a 2:1 decision, the Ninth Circuit overturned a favorable Tax Court decision in *Laidlaw's Harley Davidson Sales, Inc. v. Commissioner,* 29 F.4th 1066 (9th Cir. 2022). The Ninth Circuit's unfavorable decision establishes the rule that IRS revenue agents can mislead taxpayers regarding penalty assessments.

The facts of the case were not disputed. Per Code § 6011 and associated regulations, the taxpayer corporation Laidlaw was supposed to disclose its participation in "listed transactions" by way of attachments to its annual tax returns. Laidlaw did not make the required disclosures.

Failure to make the required disclosures risks a penalty under § 6707A. Laidlaw was audited and the revenue agent proposed the penalty by way of an examination report, known as a "30-day letter." The 30-day letter stated that if Laidlaw did not agree with the penalty, it could request a conference with the Appeals Office by filing a written protest of the penalty. Alternatively, it could seek judicial review by paying the penalty, and then suing for a refund in either the district court or the Court of Federal Claims.

The letter also stated that, "if Taxpayer took no action by the 30-day response date (June 27, 2011), '[the IRS] will assess the penalty and begin collection procedures.'" *Id.* at 1068. It is that sentence that was the problem in this case. You see, as of the date the letter was mailed, there was no decision to assess that penalty.

Section 6751(b)(1) provides:

> No penalty under this title shall be assessed unless the initial determination of such assessment is personally approved (in writing) by the immediate supervisor of the individual making such determination or such higher level official as the Secretary may designate.

The § 6707A penalty is subject to this rule, "[a]nd, as it turns out, no supervisor had yet provided written approval of the § 6707A penalty that the letter represented would be assessed against Taxpayer." *Id.* at 1069. Rather, written approval was given two months after the 30-day deadline, and one month after Laidlaw submitted its protest.

Laidlaw disputed the penalty, lost the administrative appeal, and the IRS assessed the penalty. Laidlaw did not pay the penalty. It then received a levy notice and requested a CDP hearing. It lost again at that hearing. Laidlaw then petitioned the Tax Court, where it "argued that the IRS had not complied with the written supervisory approval requirement in § 6751(b)(1) and that the Appeals Office had, therefore, abused its discretion in sustaining the proposed levy." *Id.* at 1069.

Stated another way, because the 30-day letter was premature, the penalty assessment was improper. The Tax Court (Judge David Gustafson) agreed with Laidlaw:

> The Tax Court rejected the Commissioner's argument that § 6751(b)(1) requires that the IRS secure supervisory approval only before the assessment of a penalty. … Accordingly, the court ruled that Supervisor Korzec's written approval of the penalty after that communication

> to Taxpayer was untimely, thus invalidating the penalty assessment. *Id*. at 1070.

The government appealed.

The Ninth Circuit, as it should, began its analysis correctly, saying: “When interpreting a statute, our inquiry begins with the statutory text, and ends there as well if the statute’s text is unambiguous.” *Id*. at 1070 (internal quote omitted). The government argued that § 6751(b)(1) permits written supervisory approval at any time before the assessment of the penalty, so long as the supervisor still has discretion whether to approve the penalty. *Id*. at 1071.

The Ninth Circuit agreed that a supervisor cannot approve a penalty assessment unless the supervisor possesses discretion to withhold approval. The Court concluded that the supervisor did still have discretion when she approved the penalty two months after the initial letter was sent. However, the Ninth Circuit then abandoned its own rule about tracking the statutory text, saying:

> The problem with Taxpayer’s and the Tax Court’s interpretation is that it has no basis in the text of the statute. Section *6751(b)(1)* “contains no express requirement that the written approval be obtained at any particular time prior to assessment.” *Chai*, 851 F.3d at 218. The statute does not make any reference to the communication of a proposed penalty to the taxpayer, much less a “formal” communication. *Id*. at 1072.

But, doesn’t that miss the point? The point that Laidlaw argued, and that the Tax Court understood, was that the 30-day letter was issued before the penalty was approved—emphasis on *before*. That was the problem. The Ninth Circuit continued:

> However, the language of the statute provides no reason to conclude that an “initial determination” is transformed into “something more like a final determination” simply because the revenue agent who made the initial determination subsequently mailed a letter to the taxpayer describing it. We think “initial,” as used in § 6751(b)(1)’s phrase “initial determination,” more naturally indicates that a subordinate’s determination to assert a penalty lacks the imprimatur of having received supervisory approval, rather than that the determination has not yet been formally communicated to the taxpayer. Moreover, Taxpayer does not argue that the “determination” that Supervisor Korzec approved differed in any way from RA Czora’s initial determination to assert the § 6707A penalty. *Id*. at 1072.

Restating that for the sake of clarity, the Ninth Circuit majority held that a revenue agent can freely mail a proposed assessment to a taxpayer without the approval expressly required by § 6751, so long as a supervisor *eventually* approves the penalty. Or, said another way, a revenue agent can violate this statute as long as his supervisor later says it was okay to violate the statute.

The majority shamelessly admitted its holding is contrary to law and reason:

> We are troubled by the language of the letter and the attachments Taxpayer received, which include the statements that (1) if Taxpayer took no action by the 30-day response date “we will assess the penalty and begin collection procedures,” (2) that it is the “government’s position” that “[t]he Taxpayer is subject to the penalty under § 6707A,” and (3) that the “Taxpayer is liable for the penalty under § 6707A in the amount of $96,900.00.” A natural interpretation of the letter is that, in absence of action from Taxpayer, “we [the IRS] will [ineluctably] assess the penalty.” As it turns out, the letter’s threat was premature because a supervisor had not yet approved the initial determination. [fn8] But the recipient would not know this from what was written in the letter. And a taxpayer in a similar position that received such a letter might be misled about the probability of the assessment of the penalty as calculated in the letter and, for this reason, more inclined to settle.

> However, we "undertake to apply the law as it is written, not to devise alternative language that might accomplish Congress's asserted purpose more effectively. 'Our task is to apply the text, not to improve upon it' [internal citations omitted]. And, here, the language of § 6751(b)(1) does not support Taxpayer's interpretation of the statute." *Id.* at 1073.

To be clear, the statute requires supervisor approval before threatening an assessment. The revenue agent threatened assessment without supervisor approval. But according to the Ninth Circuit, the statute does not require supervisor approval before threatening an assessment. The most telling part of the opinion is footnote 8 marked in the quote above. The footnote reads:

> The dissent misstates the majority's position as requiring that the 30-day letter "essentially ... lied to the taxpayer" on the grounds that "despite, what the letter said, the subordinate who signed the letter had no authority to make a tentative determination that would become effective unless objected to by the taxpayer, whether the determination was in fact approved by a supervisor or not." Dissent op. 19. We agree with the dissent that if the supervisor had approved the initial determination before the letter was sent, the letter would not have made a threat that was premature in light of § 6751(b)(1).

So the majority agreed that if the supervisor had approved the initial determination before the letter was sent, the letter would not have made a threat that was "premature." But, is "premature" different than "not the truth"? Let's try this another way. At the exact hour the revenue agent mailed that 30-day letter, his supervisor had not approved the penalty. So, did the 30-day letter misstate the truth? (The answer is "yes.") The dissent points out this lie and calls it what it is:

> To accommodate this view, the majority treats the 30-day letter sent in this case as essentially having lied to the taxpayer. On the majority's view, despite what the letter said, the subordinate who signed the letter had no authority to make a tentative determination that would become effective unless objected to by the taxpayer, whether the determination was in fact approved by a supervisor or not. *Id.* at 1074-75 (dissent).

The dissent then took the majority to task:

> [The statute] does not say that no penalty shall be assessed *until* the initial determination of such assessment is personally approved by a supervisor. It says "[n]o penalty ... shall be assessed *unless* the initial determination of such assessment is personally approved (in writing)" by a supervisor. 26 U.S.C. § 6751(b)(1) (emphasis added). Unlike the word "until," the word "unless" is not a temporal limitation but a substantive one; it tells us that A may not happen "unless" B happens. … That is, absent such approval of the initial determination, "[n]o penalty ... shall be assessed." *Id.* at 1075 (dissent).

In other words, the majority did not read the words of the statute and follow its own rule requiring analysis of the text of the statute. The dissent continued:

> Nor does the statute say that the *assessment* must be personally approved or even that the *determination* of the assessment must be personally approved. It says the "*initial* determination" of such assessment by "the individual making *such determination*" must be personally approved in writing by a supervisor. *Id.* (emphasis added). "Such determination" refers back to the "initial determination." So that determination, not the final determination, is what must be approved by a supervisor.
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> * * *
>
> According to the majority's reading of the statute, approval is not required until the moment before the penalty is finally assessed. In other words, the supervisor must approve the *final* penalty determination, here, one made after the taxpayer has had an opportunity to contest

> the initial determination. But why, then, does the statute refer to the "initial determination"? Why would Congress refer to "the individual making such determination," if that individual was only making recommendations to a superior, not interacting with the taxpayer in a manner meant to have determinative consequences for the taxpayer? And why would Congress invoke the concept of approval? *Id.* at 1075-76.

Again, the dissenting judge is pointing out that the majority did not read the words of the statute. Let us hope that future circuits listen to the dissent. Let us also hope that at some point in time the IRS takes seriously its responsibility to communicate with taxpayers in simple, non-technical terms, which I take to include "honestly and accurately."

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# Is the IRS Preparing to Torpedo the Right to Counsel?

## *"I'm From the Government, and I'm Here to Help"*

The IRS recently announced that it updated the Dirty Dozen, the agency's list of consumer alerts for scams designed to target innocent taxpayers with fraudulent schemes. Historically, the list included obviously illegal plots to defraud taxpayers in various ways, including IRS impersonation scams, email attacks, ID theft, and Social Security Number theft, etc.

The news release announcing a change to the Dirty Dozen list goes well beyond merely alerting taxpayers of illegal schemes. The statement blatantly encourages citizens to avoid consulting counsel with regard to a delinquent tax problem. See: News Release IR-2022-119, June 7, 2022.

Is the IRS attempting to chill one's constitutional right to counsel?

For reference, there are millions of people facing assessments of unpaid taxes. When such assessments are not immediately paid, citizens face potential enforced collection, including wage and bank levies, property seizures and tax liens. These citizens also face the assessment of penalties and interest, which often double or triple (or worse) the amount of the original tax.

Most people are unaware of the various programs available to mitigate enforcement action and, in certain cases, reduce or eliminate one's debt. Such programs include, among other things, an installment agreement, penalty abatement relief, audit reconsideration appeals, etc.

The IRS's flagship settlement program is known as the Offer in Compromise (OIC). An OIC allows a qualifying citizen to reduce one's tax debt in any one of four circumstances. Most commonly, an OIC is used when the tax cannot be paid due to lack of sufficient income or equity in assets. See chapter 12 of *How to Get Tax Amnesty* for all of the details on the OIC program.

This is the program the IRS specifically mentions when encouraging delinquent citizens to avoid consulting counsel. The news release headline says it all: "IRS urges anyone having trouble paying their taxes to avoid anyone claiming they can settle tax debt for pennies on the dollar." This plainly suggests that a claim of the ability to settle one's debt for less than is owed is fraudulent.

But it's the headline itself that's fraudulent. The IRS's own website plainly states that the OIC program "…allows you to settle your tax debt for less than the full amount you owe. It may be a legitimate option if you can't pay your full tax liability or doing so creates a financial hardship."

This language defies the news release's allegation that tax pros offering OIC representation "make outlandish claims" that they are able to "settle a person's tax debt for pennies on the dollar." But that's exactly what the program allows one to do, as explained by the IRS's own website. For example, if one owes $100,000, but can pay just $10,000, he can settle through an OIC for ten cents on the dollar—i.e., "pennies on the dollar."

Even worse than suggesting that OIC settlement claims are per se bogus is the claim regarding the IRS's ability to help. Commissioner Rettig is quoted as saying, "No one can get a better deal for taxpayers, than they can usually get for themselves by working directly with the IRS to solve their tax issues." Does anybody really believe that the IRS is going to "get you a deal" if you just ask for it? In other words, Rettig suggests that people should avoid getting independent professional help. Instead, they should just take to heart the old adage that promises, "I'm from the government and I'm here to help."

Imagine the outrage of the A.C.L.U. if any state or local law enforcement agency issued an announcement saying nobody needs to consult counsel when dealing with such agency, because no lawyer can get them a better deal than "they can get for themselves by dealing directly with the police to resolve their issues."

Rettig goes on make another absurd statement: "Taxpayers can check online for their best deal…" Though it's true that the OIC is discussed on the IRS's website, it's equally true that the site provides no specific instructions on how to prepare, submit, argue, negotiate, or appeal an OIC. Moreover, it is impossible to submit an OIC online because the application must be filed in writing only with the IRS's Centralized Offer in Compromise (COIC) Unit, which is a specialized group of examiners who work only Offer cases. Thus, the idea that one can win an OIC online is completely false and misleading.

The Commissioner follows that remark with yet another statement totally lacking any credibility whatsoever. He says that (in addition to checking on line), taxpayers can call a "specialized collection line where they can get fast service by using voice and chat bots or opting to speak with a live phone assister."

We all know there's no such thing as "fast service" when it comes to calling the IRS. Wait times for collection representatives are just about as bad as they can be. But even if you were able to get a call answered quickly, there's no such thing as a "specialized collection line" for OICs. As stated, they must be submitted in writing and are handled exclusively by COIC Unit examiners. It is simply impossible to get an OIC accepted over the phone or through a website.

And regarding the claim that taxpayers can get their best deal "by using voice and chat bots" — is the Commissioner suggesting that citizens can use the agency's newly launched artificial intelligence tools to win acceptance of an OIC? This too is simply impossible, not just for the reasons already stated, but because every person's financial facts and circumstances are unique. OICs take into account the totality of one's personal and business financial circumstances as reflected in a lengthy financial statement (and voluminous supporting documents) that must be submitted with the OIC application. Most citizens are unable to navigate the byzantine financial statement without experienced counsel.

People in tax trouble generally find out the hard way that the IRS does not work like other law enforcement agencies. When dealing with the IRS, the burden of proof is on you. When it comes to an OIC, you must prove you qualify for the program and that the amount offered is the most you can reasonably expect to pay under the circumstances. The IRS doesn't have to prove you don't qualify.

And there's the rub. The OIC program is controlled by Internal Revenue Code section 7122 (a statute that explicitly provides for a pennies-on-the-dollar settlement of tax debts!) and regulations thereunder, along with the massive Internal Revenue Manual, which has a lengthy chapter dedicated to the processing, evaluation, investigation, and acceptance or rejection of an OIC—plus the appeal rights associated therewith. This means that people often need professional help to get through the IRS's labyrinth of rules, regulations, procedures, forms, and instructions.

For the Commissioner to suggest that one can get an OIC using "voice and chat bots" controlled by artificial intelligence is, at best, a farce, and at worst, an outright false and misleading statement.

One might ask what would drive an effort to chill the right to counsel. After all, the right to counsel is one of the ten essential taxpayer rights, as expressed in code section 7803(a)(3). My answer is to point to the tax gap. The IRS and the Treasury Department are apoplectic over the reported tax gap of $400-plus billion. They're promising more agents, increased audits, and more aggressive enforcement to get the money.

On the other hand, an accepted OIC means citizens actually pays less in taxes than they otherwise might. In 2020 and 2021 respectively, the IRS accepted about 15,000 OICs. In every single case, the settlement meant the taxpayer paid *less than was owed*. The IRS does not tell us how much was written off, but it must have been in the billions of dollars. And believe me, they want the money.

By chilling the right to representation, and in turn inducing people to simply call the IRS to “make their best deal,” the IRS will force more people into long term installment agreements which they often cannot afford. Such agreements usually make matters worse because people end up using current tax revenue to pay their back tax debt. This only leads to the citizen racking up more delinquent years. That is to say, the problem is made worse, not better.

Make no mistake about it. The IRS is working to chill your right to counsel by falsely branding all tax pros as frauds and scammers. They’re doing it because they intend to make every effort to squeeze blood from a turnip.

## 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:

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