TAX PROCEDURE: TENTH CIRCUIT UPHOLDS LIMITS ON THE SCOPE OF COLLECTION DUE PROCESS HEARINGS

Posted on **February 28, 2017** by **Jim Malone**

As part of the 1998 IRS Restructuring and Reform Act, Congress provided every taxpayer with an opportunity for an administrative hearing before the IRS files a tax lien or levies against the taxpayer's property. I.R.C. §§ 6320; 6330. The hearing, which is known as a collection due process hearing, is conducted by an IRS appeals officer who is required to determine whether the IRS has complied with all procedural requirements for the lien filing or levy. I.R.C. § 6330(c)(1). In addition, the appeals officer should consider any innocent spouse issue, any specific challenge that the taxpayer raises to the collection action, and any collection alternative that the taxpayer offers, such as an installment agreement. I.R.C. § 6330(c)(2)(A)(i)-(iii). Finally, in some limited situations, the merits of the tax assessment can be challenged; a taxpayer can challenge the underlying tax liability in a collection due process hearing "if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability." I.R.C. § 6330(c)(2)(B). If the result of the collection due process hearing is unsatisfactory, the taxpayer can file a petition for Tax Court review.

The IRS has issued detailed regulations governing the conduct of collection due process hearings, and the regulations interpret section 6330(c)(2)(B) of the Code to mean that "a prior opportunity for a conference with Appeals" will preclude a taxpayer from challenging the merits of the underlying tax liability. Treas. Reg. § 301.6330-1(e)(3), Q & A E2. On February 21st, the Tenth Circuit sustained the Treasury Regulation. *Keller Tank Servs. II v. Comm'r*, No. 16-9001, 2017 U.S. App. LEXIS 2914 (10th Cir. Feb. 21, 2017).

In *Keller Tank*, the taxpayer participated in an employee benefit plan but did not report the transaction on its tax return; the IRS assessed the taxpayer with a $57,781.50 penalty under section 6707A because the benefit plan was a "listed transaction." *Keller Tank*, 2017 U.S. App. LEXIS 2914 at *19. A listed transaction is either the same as or "substantially similar to, a transaction specifically identified by the Secretary as a tax avoidance transaction." I.R.C. § 6707A(c)(2). The penalty determination under section 6707A is not subject to Tax Court review; instead, the taxpayer must pay the penalty and then sue for a refund to obtain judicial review.

After the IRS proposed the penalty under section 6707A, the taxpayer filed a protest, which triggered an appeals conference; the taxpayer participated in the conference and the penalty was sustained by the appeals officer. 2017 U.S. App. LEXIS 2914 at *20. The IRS then proceeded with collection and the taxpayer requested a collection due process hearing after receiving a notice of intent to levy. *Id.* at *20-*21. The taxpayer did not offer a collection alternative; its sole basis for requesting the hearing was that the assessment was made without the right to challenge the determination that the benefit plan was a listed transaction. *Id.* at *21.

The appeals officer sustained the IRS levy, and the taxpayer filed a Tax Court petition. Keller Tank fared no better there; the Tax Court promptly granted summary judgment to the IRS, since the court had previously sustained the relevant regulation in *Lewis v. Commissioner,* 128 T.C. 48 (2007).

On appeal, the taxpayer argued that it should only be precluded from challenging the merits of its tax liability if it had a prior opportunity for *judicial* review. 2017 U.S. App. LEXIS 2914 at *30. The Tenth Circuit, however, sustained the regulation based upon *Chevron* deference.

Initially, the Court determined that the critical statutory language in section 6330(c)(2)(B), the phrase "opportunity to dispute," was ambiguous. The Court of Appeals agreed with the Tax Court's view in *Lewis* that an "opportunity to dispute" could refer to an administrative proceeding, a judicial proceeding, or both. 2017 U.S. App. LEXIS 2914 at *38. The court also indicated that the surrounding context of section 6330(c)(2)(B) "contribute[d] to this ambiguity, since section 6330(c)(4)(A) bars taxpayers from raising issues that were addressed in the course of a prior "administrative or judicial proceeding." *Id.* (quoting I.R.C. § 6330(c)(4)(A)).

Next, the Tenth Circuit determined that the regulation rested "on a permissible construction of the statute." *Id.* at *39. The court's analysis was as follows:

- *First*, it examined the plain language of section 6330(c)(2)(B) and concluded that there was nothing in the statutory language that would preclude an administrative hearing from qualifying as an "opportunity to dispute" the relevant tax liability. Consequently, the Court of Appeals held that the language of the statute supported the reasonableness of the regulation. at *39.
- *Second*, the court considered the surrounding statutory context; noting that section 6330(c)(4)(A) provides that an issue addressed in a prior administrative hearing could not be raised in a collection due process hearing, which was consistent with treating an administrative proceeding as an opportunity to challenge the liability that could preclude further administrative litigation under section 6330(c)(2)(B). at *39-*40.
- *Third,* the Tenth Circuit was persuaded by the Tax Court's analysis in *Lewis* that reading section 6330(c)(2)(B) to bar consideration of the merits of tax liability only in cases where there had been an opportunity for judicial review was inconsistent with the statutory purpose of providing taxpayers with a more informal process than litigation. at *40-*41.

Accordingly, the Tenth Circuit held that the regulation was a reasonable interpretation of the statutory language. This outcome is not terribly surprising since challenges to regulations that are arguably consistent with the language of a statute are quite difficult to sustain.

In the specific context of section 6707A penalties, this outcome is unfortunate, as there is no Tax Court review available, and courts have held that the penalty is not a divisible tax. The penalties in some of those cases have been quite substantial, which means that particular taxpayers may be unable to challenge the penalty because they lack sufficient funds to pay the penalty in full and seek a refund. *Keller Tank* suggests that any relief for that problem will probably have to come from Congress.

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