INDIVIDUAL INCOME TAX UPDATE
By
RICHARD M. COLOMBIK, JD, CPA
and
LINDA GODFREY, JD

I. INCOME 4

A. Gain From Sale of Right to Receive Future Annual Lottery Payments Taxable as Ordinary Income 4
B. Code Section Taxing Award of Damages For Emotional Distress Held Unconstitutional 4
C. Cooperative Payments to Farmer Taxable in Year Calculated 5
D. Taxpayers Not Permitted to Exclude JROTC Instructor Compensation from Income 5
E. SSA Disability Benefits Not Considered Payments For Service-Connected Injury Excludible from Income 6

II. DEDUCTIONS 7

A. Held That Lump Sum Alimony Payment is Not Deductible Under Pre-1985 Section 71 7
B. Court Denies Exclusion as Employee Housing Was Not on Employer's Business Premises 7
C. Federal Grazing Permit Is Not Property Interest and Its Waiver Does Not Constitute Charitable Contribution 8
D. Taxpayer May Deduct Certain Meal and Incidental Expenses As He Was "Away From Home" Under Section162 9
E. Tuition Paid to Religious Schools Not Deductible as Charitable Contribution 10

III. TAXES AND BANKRUPTCY 10

A. Limitations Period Suspended for After-Acquired Property by Time Taxpayer Was in Bankruptcy 10
B. Refund from Child Tax Credit Property of Bankruptcy Estate 11
C. Court Holds Forms Filed After IRS Assessment are Returns under 11 U.S.C. Section 523 11
D. Computer Printout of Electronic Return Data Satisfied Return Provision Rule 12
E. Debtor's Refund From IRS Offsets Debt Owed to Other Federal Agency 12
F. Debtor Must File Returns Prior To Creditors' Meeting, Even if Not Yet Due 13

IV. COLLECTIONS 13

A. Criminal Tax Fraud Conviction Not Determinative in Civil Fraud Case 13
B. Remittance Made With Extension Request Is Payment and Subject to Look-Back Provision of '6511 14

C. Tax Court Holds That Premature Request for Collection Due Process Hearing Is Ineffective 15
D. Acceptance of Qualified Offer Bars Reduction of Stated Amounts by NOLs 16
E. Deficiency Notice Must Precede Collection Regardless of Closing Agreement on Other Issues 16
F. Held That Unauthorized Tax Court Petition Still Tolls Running of Statute of Limitations 17

V. RETURNS, PAYMENTS, INTEREST AND PENALTIES **18**

A. Third Circuit Indicates Assessment Not A Necessary Element of Tax Evasion 18
B. Petition Disputing 1992 Liability, Request For 1999 Refund Constitute Informal Claim 19
C. Penalties Dismissed as IRS Failed to Satisfy Burden of Proof 19
D. Summary Judgment Precluded Where Evidence Supporting Informal Claim Doctrine May Apply 20
E. District Court Finds Remittance of Funds Prior to Assessment to be Deposit, Not Payment 21

VI. INNOCENT SPOUSE RELIEF **21**

A. Non-Requesting Spouse Lacks Standing to Appeal Tax Court's Decision to Grant Innocent Spouse Relief 21
B. Nonrequesting Spouse's Petition May Be Dismissed for Failure to Prosecute 22

VII. ESTATES 22

A. Assets Transferred to Family Limited Partnership Included in Decedents' Estates Under Section 2036 23
B. Will Directing Payment of Death Taxes from Residue Ambiguous Because Residue Insufficient to Pay 23
C. Estate Tax Return Properly Valued Decedent's Stock in Closely Held Company 24
D. Restrictive Agreement Controls Value of Decedent's Stock for Estate Tax Purposes 24

VIII. MISCELLANEOUS **25**

A. Mailbox Rule Not Applicable to Claim Postmarked With Private Postage Meter 25
B. Prison Mailbox Rule Held Inapplicable To Inmate's Filing of Tax Court Petition 26
C. Misconduct By IRS Attorneys Not Cause For Exceeding Statutory Rate Cap Under Section 7430 26
D. Sanctions on Tax Protester Adjusted for Inflation and Doubled Due to Repeat Offense 27

E. No Property Rights Found in Property Sold To Related Parties 20 Years Prior to Lien 28
F. Taxpayer May Not Audio Record Collection Due Process Hearing Held by Telephone 28

I. INCOME

A. Gain From Sale of Right to Receive Future Annual Lottery Payments Taxable as Ordinary Income

The Tax Court held in Womack v. Comr., T.C. Memo 2006-240 (11/7/06) that the gain from the sale of the right to receive future annual lottery payments is taxable as ordinary income. The Tax Court reaffirmed that the substitute for ordinary income doctrine applies to lottery rights sold, regardless of whether they may be comparable to the categories of capital assets as defined in Section 1221.

The taxpayer argued that the Tax Court should reconsider its established precedent of the ordinary income doctrine. The court rejected the Taxpayer's argument The Taxpayer's attempt to limit the application of the ordinary income was also rejected. The court held that although lottery rights are recognized as property in federal case law regarding bankruptcy, domestic relations, and estate and gift taxes, these descriptions do not convert ordinary gain to capital gain. Finally, the court rejected T's argument that lottery rights are comparable to debt instruments.

This is a consolidation of two cases where the petitioners each won the lottery and reported annual installment payments as ordinary income. At a later date, the taxpayers sold the right to the remaining installment payments and claimed the gain as a capital gain. Also, there were 57 related cases that were not consolidated with this case that agreed to be bound by the outcome of this case.

B. Code Section Taxing Award of Damages For Emotional Distress Held Unconstitutional

In Murphy v. IRS, No. 05-5139 (D.C. Cir.8/22/06) the court held the award of damages for emotional distress or mental anguish and loss of reputation not taxable because compensation for nonphysical personal injury was not income under 16th Amendment. The court stated that the compensation the taxpayer received in lieu of what she lost cannot be considered income. They said that damages were awarded to M to make her emotionally and reputationally whole and not to compensate her for lost wages or taxable earnings. The emotional well-being and good reputation she enjoyed, before her former employer diminished them, were not taxable as income. The court stated that since the term "incomes," as understood in 1913, did not include damages received in compensation for a physical personal injury, the court inferred that it likewise did not include damages received for a nonphysical injury and unrelated to lost wages or earning capacity.

The taxpayer was awarded damages for mental pain and anguish and for injury to her professional reputation. The taxpayer wanted to exclude the compensatory damages

she received from her gross income. She argued that those damages were exempt from taxation. The IRS denied the taxpayer's claim for a refund, stating that the taxpayer did not demonstrate that the compensatory damages were attributable to physical injury or physical sickness. The taxpayer filed a refund suit.

The district court granted summary judgment for the IRS. The court held that the damages awarded to the taxpayer for injury to her professional reputation and for pain and mental anguish resulting from her former employer's discriminatory action did not qualify for exclusion. The taxpayer appealed the judgment.

C. Cooperative Payments to Farmer Taxable in Year Calculated

In Scherbart v. Comr., No. 05-1325 (8th Cir.7/5/06) the court affirmed by stating the value-added payments received by the taxpayer from the cooperative were taxable in year calculated because an agency relationship between cooperative and taxpayer prevented application of the installment sale rules since transactions were not sales.

The court rejected the argument that the taxpayer had made dispositions of corn to the cooperative and the value-added payment was a final installment payment for the corn, stating that the transactions at issue were not sales. The court also stated at no time did ownership of the corn pass from the taxpayer to the cooperative. The court also rejected the argument that he should be allowed to defer recognition of the payments because he had already elected to defer receipt of any post-audit value-added payments before the cooperative had calculated if such a payment would be made at all. The court stated that self-imposed limitations on receipt did not trump the general rule that receipt by an agent was equivalent to receipt by the principal even if the agent agreed not to distribute the income until the following year

The taxpayer was a member of a cooperative. The taxpayer received payments for their deliveries. He also received "value-added" payments derived by splitting the cooperatives net proceeds at the end of each fiscal year among the units of equity participation. The taxpayer received letters from cooperative advising him that value-added payments would be calculated after their annual audit and would be paid out in mid-November. The letters offered the option to have these payments deferred until January of the next taxable year. Each year, the taxpayer elected to defer the value-added payment to the following taxable year.

The IRS issued a notice of deficiency that the taxpayer could not defer the value-added payments since the payments were earned and payable in the preceding taxable year. The taxpayer filed a petition with the Tax Court, which ruled in favor of the IRS.

D. Taxpayers Not Permitted to Exclude JROTC Instructor Compensation from Income

In Dorsey v. Comr., T.C. Memo 2006-50 (3/22/06) the court held that JROTC instructor compensation is not excludible from gross income. The court stated that no part of the amount received from a school district by a retired military officer for services as a JROTC instructor is excludible from gross income as a housing or subsistence allowance. They stated that JROTC instructors are employed by the educational institutions in which they teach and not by the federal government. The court noted that a JROTC instructor receives income from the school as compensation for services rendered and not by reason of that instructor's status as a member or former member of the Armed Forces. The court also explained that the authoritative sources of federal tax law are statutes, regulations, and judicial decisions and that administrative guidance in an informal IRS publication is not an authoritative source of federal tax law and does not bind the government.

Facts: The taxpayer retired from the United States Army. A public school district employed him as a Junior Reserve Officers' Training Corps instructor. The IRS determined a deficiency in the taxpayer's federal income tax. The taxpayer argued that under U.S. Army regulations, JROTC instructors are active members of the armed forces. Therefore, the taxpayer stated that his status as an active member of the armed forces permitted him to exclusions from gross income for subsistence, housing and uniforms.

The IRS argued since the taxpayer was not an active duty member of the armed forces he was not entitled to exclude from gross income allowances for subsistence, housing, and uniforms. The IRS declared that the payments the taxpayer received with respect to his employment as a JROTC instructor was income from the school district for services rendered that must be included in his gross income.

E. SSA Disability Benefits Not Considered Payments For Service-Connected Injury Excludible from Income

In Reimels v. Comr., No. 04-6175-ag (2d Cir.1/31/06) the court affirmed the Tax Court decision that SSA disability benefits are not considered payments for underlying service-connected injury and cannot be excluded from income. The court determined that the SSA payments were not made for the taxpayer service-connected injury, but were made for his inability to work. The court stated that SSA disability benefits are wage-replacement benefits awarded on the basis of an applicant's inability to engage in any substantial gainful activity and are not excludible from income. The VA's service-connected disability compensation, on the other hand, is awarded because of personal injuries from active service in the armed forces and is excludible from income.

The taxpayer is a Vietnam War veteran who was exposed to Agent Orange. He left active military service and accepted private sector employment. The taxpayer stopped working after being diagnosed with lung cancer and applied for service-connected disability compensation from the Department of Veteran Affairs (VA) and disability benefits from the Social Security Administration (SSA). The government conceded T's lung cancer resulted from exposure to Agent Orange and the VA found him

eligible for service-connected disability compensation at a 100% rating level. He received disability compensation from the VA at the 100% level and properly excluded it from his reported income that year. The taxpayer also received disability benefits from SSA due to his inability to work because of the lung cancer. He did not include the SSA disability benefits as income on his income tax return. The IRS sent a notice of deficiency.

The taxpayer filed a petition in the Tax Court, arguing that the SSA disability benefits were excludible as amounts received for an injury or sickness resulting from active military service. The Tax Court held that pertains only to pensions, annuities, or similar allowances that are received under what are essentially military disability compensation statutes. The Tax Court stated that SSA disability benefits are designed to prevent public dependence by protecting workers and their families against common economic hazards and cannot be excluded because they are not designed to provide compensation for military injuries.

II. DEDUCTIONS

A. Held That Lump Sum Alimony Payment is Not Deductible Under Pre-1985 Section 71

In Johnson v. Comr., No. 04-72322 (9th Cir.3/28/06) the court held the 1997 agreement was a modification of the 1976 divorce decree. Therefore, none of the taxpayer's $400,000 is deductible as alimony. No part of the taxpayer's payment is deductible as alimony since the payment was not a periodic payment.

The court stated that Section 71 was amended in 1984. The old Section 71 provided that payments are deductible only if they are made periodically. The court stated that the language requiring that payments be periodic in order to be deductible is absent in new Section 71.

The taxpayer and his wife divorced in 1976. The taxpayer was required to pay alimony. In 1997, the taxpayer and his former spouse agreed that the taxpayer would pay $400,000 in one lump sum that would be the final alimony payment. This alimony payment was paid in 1997. The taxpayer claimed a deduction for this alimony payment on his 1997 tax return. The IRS disallowed the $400,000 alimony payment. The taxpayer petitioned the Tax Court for a redetermination. The Tax Court granted a partial summary judgment in favor of the IRS because the new Section 71 applies only to divorce instruments that were effective or modified after December 31, 1984.

B. Court Denies Exclusion as Employee Housing Was Not on Employer's Business Premises

In Hargrove v. Comr., T.C. Memo 2006-159 (8/8/06) the court held that the taxpayer's living quarters did not qualify for the exclusion under Section 119 because the lodging was not on the employer's business premises. The court explained that the provided housing was not an integral part of the employer's business and that having the taxpayer occupy those particular homes served no important business functions. The court stated that no business activities occurred at the taxpayer's housing.

The taxpayers were employees of an overseas company and worked for this company in Australia during the relevant years. They worked at a defense facility. The overseas company was a U.S. Government contractor providing services at a defense facility. The taxpayers were required to accept assigned housing as a condition of their employment. The assigned housing was not within the physical boundaries of the defense facility. The taxpayers did not pay any rent or utility expenses for their homes in during the years at issue. The taxpayers never conducted any business at their homes. The IRS determined that petitioners were not entitled to the exclusions the taxpayer claimed on their return.

C. Federal Grazing Permit Is Not Property Interest and Its Waiver Does Not Constitute Charitable Contribution

In Bischel v. U.S., No. 2:04-cv-1537-RLH-RJJ (D. Nev. 2/7/06) court granted the motion for summary judgment and held that the taxpayer did not hold a viable property interest in the permit that has a value. The taxpayer who waived back to government his right to graze cattle on neighboring parcels of government-owned land upon sale of their ranch was not entitled to charitable deductions for that waiver. The governing regulations are clear that grazing and livestock use permits convey no title, right, or interest to the permit holder. If a permitee sells his base property, the permit must be waived back to the United States, or it will be cancelled. The court found the Fifth Amendment requires no compensation, nor authorizes the attachment of any value to grazing permits to qualify a permit holder to claim an interest or value donated as a charitable contribution. The court stated that the United States received no value when the taxpayer waived their permit back to it, because it already held all right, title and interest in that property. The court concluded that the taxpayer could not donate something they do not own or possess. The court also found that the taxpayer did not meet the statutory requirements for substantiating or qualifying the contribution. The taxpayer failed to obtain a contemporaneous acknowledgment of the alleged contribution from the United States. The court concluded that the IRS was justified in denying the taxpayer's claim of a deduction for a charitable contribution of $40,000 from their waiver of their grazing permit rights.

The taxpayer owned a cattle ranch and had a grazing permit from the U.S. Forest Service. This grazing permit allowed the to graze cattle on a parcel of government-owned land located in a neighboring national forest. The grazing permit is normally issued for 10 years and does not permit sale or transfer by its holder. The regulations state that if the permit holder sells his ranch the permit must be waived back to the

government, or it will be canceled. The taxpayer sold his ranch. He waived the permit back to the government. The taxpayer then filed an amended income tax return for deducting the alleged value of the grazing permit as a charitable contribution. The IRS denied their request for a refund. The government moved for summary judgment.

D. Taxpayer May Deduct Certain Meal and Incidental Expenses As He Was "Away From Home" Under Section162

In Bissonnette v. Comr., 127 T.C. No. 10 (10/23/06) the court held the taxpayer was entitled to deduct meal and incidental expenses incurred during off-peak season, but not during peak season, because taxpayer was "away from home" during off-peak season. The taxpayer was subject to 50% reduction

In determining whether a taxpayer's work does requires him to be away from home overnight, The court referred to the "sleep or rest rule" to determine whether the taxpayer’s work required him to be away from home overnight. The sleep or rest rule applies if the taxpayer's employment is such that when away from home during released time, it is reasonable for the taxpayer to need or obtain sleep or rest in order to meet the needs of his employment. Therefore, his expenses related to his obtaining sleep or rest are deductible. The court stated, in respect to the peak travel season, the taxpayer's expenses are disallowed for meals on one-day business trips. The court determined that the taxpayer was not away from home during the peak-seasons. The court stated that during the off-peak season, it was reasonable for the taxpayer to obtain sleep or rest in order to meet the needs and business demands of his employment. The court rejected the IRS's argument that the taxpayer incurred expenses during the six to seven hour layovers due to scheduling rather than for the taxpayer's need for rest and sleep. The court held it was reasonable the taxpayer obtain sleep or rest and was away from home. The taxpayer was also required to reduce his allowable meal and incidental expenses by 50%.

The taxpayer was director of marine operations and senior captain for a company that owned and operated ferryboats. The taxpayer's voyages began and ended within the same 24-hour period at the company's homeport in Seattle, Washington. Because of his early starting time and long commute to and from his residence, he remained in Seattle and slept on a cot stored aboard one of the company's vessels. The company did not require him to stay overnight, pay him during this time, or provide him an allowance for meals or incidental expenses.

The company's voyages during the year were classified as occurring during either peak travel season or off-peak travel season. During the peak-season, the taxpayer had 30-minute to one-hour layovers between ports. During all layovers, since the taxpayer did not go off duty, the company provided a second captain so the taxpayer could rest. During the off-peak travel season, he typically had a six to seven hour layover in Victoria, Canada, before returning to Seattle. The taxpayer was not paid an hourly wage for the layover period in Victoria or reimbursed for his meals and incidental expenses he incurred during these layovers

E. Tuition Paid to Religious Schools Not Deductible as Charitable Contribution

In Sklar v. Comr., 125 T.C. No. 14 (12/21/05) the court ruled that none of taxpayers' payments for tuition, fees and other classes are deductible as charitable contributions because the taxpayers did not pay the tuition with detached and disinterested generosity and expected a substantial benefit in return and the schools that the children attended were not organized exclusively for religious purposes and did not provide solely intangible religious benefits.

The court stated that when a taxpayer receives an item of value for a payment to a charitable organization, the payment is not deductible unless the taxpayer intends to make a gift. Any deduction is limited to the excess of the payment over the fair market value of what is received in exchange. A taxpayer may not deduct a payment as a charitable contribution if the taxpayer receives a substantial benefit for a payment to a charitable organization. If the size of a taxpayer's payment to a charity is disproportionately larger than the benefit received, the taxpayer may claim a charitable contribution equal to the difference between a payment to the charitable organization and the market value of the benefit received in return.

The court stated the taxpayers did not show that any part of their tuition payments were a charitable contribution. The court concluded the taxpayers received a substantial benefit for their tuition payments and the tuition was not paid with a detached and disinterested generosity. The court concluded that these schools provide both a religious and a secular education and do not provide solely intangible religious benefits.

Facts: The taxpayers are educating their children at private day schools. During the tax year in question, the taxpayers paid a total of $27,283 for tuition, registration, and other mandatory fees. The taxpayers argued that they may deduct $15,000 of those payments as a charitable contribution because the religious education provided was an intangible religious benefit.

III. TAXES AND BANKRUPTCY

A. Limitations Period Suspended for After-Acquired Property by Time Taxpayer Was in Bankruptcy

In U.S. v. Doe, No. C2-04-092 (S.D. Ohio3/27/06) the court granted summary judgment for the IRS in reference to their claim that the ten-year statute of limitation period is suspended while the taxpayer was in bankruptcy. The court stated the federal tax liens that encumbered the real property are subject to the IRS liens. The court held

that the ten-year period of limitations for the government to collect the unpaid federal income tax liabilities assessed against the taxpayer was extended by the period of time he was in bankruptcy plus an additional six months. Therefore, the IRS's complaint was timely filed. The court rejected the taxpayer's argument that the ten-year statute of limitations did not toll since the property in question was not in the custody of the bankruptcy court. The plain meaning of the statute states that the period in which IRS is prohibited from attempting to collect because of the automatic stay does not relate to the location or availability of assets and property that the debtor-taxpayer may later acquire or have possession of once the actual collection activity begins

The IRS assessed various taxes, penalties, and interest against the taxpayer and filed a notice of federal tax lien for each assessment. The taxpayer filed for bankruptcy protection and the bankruptcy petition was dismissed before he acquired his interest in the real property. A warranty deed transferred their interest in the property to a third party for consideration. The federal tax liens did not appear on the preliminary title report. The taxpayer died leaving unpaid federal income tax liabilities. The IRS contends that the taxpayer's spouse transferred her interest in the property subject to the federal tax liens for their federal income tax liabilities for those years.

B. Refund from Child Tax Credit Property of Bankruptcy Estate

In Law v. Stover (In re Law), No. 05-6034WM (B.A.P. 8th Cir.1/26/06) the court held that tax refunds are contingent interests and are considered property of the bankruptcy estate.

Facts: The debtors filed Chapter 7 petitions and after filing their income tax returns, they filed amended bankruptcy schedules to disclose their income tax refunds and to allocate a share of the refunds to the bankruptcy estate. The debtors argued that the portion of their federal tax refunds due to the child tax credit is not property of the estate. The debtors subtracted the amount of the refund due to the Child Tax Credit refund before calculating the amount to be turned over to the bankruptcy trustee. The trustee objected and argued that the amount of the refund resulting from the Child Tax Credit is property of the bankruptcy estate. Orders were entered holding that the refundable portion of the Child Tax Credit is property of the bankruptcy estate.

C. Court Holds Forms Filed After IRS Assessment are Returns under 11 U.S.C. Section 523

In Colsen v. U.S. (In re Colsen), No. 05-2476 (8th Cir.5/4/06) the court stated that if a document "contains sufficient information to permit a tax to be calculated, and claims to be a return, is sworn to as such, and evinces an honest and genuine endeavor to satisfy the law," it is a return. The court stated that to be a return, a form must demonstrate an honest and genuine attempt to satisfy the laws. No inquiry into the circumstances under

which a document was filed is necessary. Therefore, the court reasoned, the honesty and genuineness of the filer's attempt to satisfy the tax laws should be determined from the face of the form itself, not from the filer's delinquency or the reasons for it.

The court also noted that in 2005, language was added to provide that the term 'return' means a return that satisfies the requirements of applicable non-bankruptcy law which includes the applicable filing requirements. This language was not applied here since the bankruptcy petition was filed before the effective date of the amendment.

Facts: The debtor did not file timely individual tax returns for multiple years. The IRS prepared substitutes for the missing returns and issued notices of deficiency. The IRS assessed taxes, interest, and penalties against the debtor for those years. The debtor filed the delinquent tax returns and four years later he filed a Chapter 7 bankruptcy petition. He claimed that his federal income tax liabilities were dischargeable. The IRS moved for summary judgment arguing that the tax returns the debtor filed were not returns because they were filed after the IRS's assessments. The bankruptcy court held that the tax returns qualified as returns and therefore the tax liabilities were dischargeable. The bankruptcy appellate panel affirmed the holding.

D. Computer Printout of Electronic Return Data Satisfied Return Provision Rule

The court In re Houston, No. 05-15912-SSM (E.D. Va. 2/23/06) denied the trustee's motion to dismiss the petition. The court held that the debtor substantially complied with return provision requirement by submitting computer printout summarizing data from an electronically filed tax return. The court concluded that the debtor had substantially complied with the statutory requirement, or if not, her noncompliance was due to circumstances beyond her control. The debtor took reasonable steps to comply and believed in good faith that she had complied.

The debtor filed her bankruptcy petition and furnished a computer printout that summarized the data from her electronically filed return and copies of her W-2s. The trustee stated that the printout and other information provided by the debtor did not satisfy the requirement that a debtor provide the trustee with a copy of the most recent federal income tax return. The debtor then provided the trustee with a photocopy of her tax return. The trustee moved to dismiss the petition since the debtor did not comply.

E. Debtor's Refund From IRS Offsets Debt Owed to Other Federal Agency

In re Baucom, No. 05-60654 (Bankr. W.D. Mo.3/15/06) the court held the debtor's unsecured obligation to Rural Housing Department was properly offset by the income tax refund due from IRS. Holding: The court stated that, for purposes of setoff under the Bankruptcy Code, all agencies of the United States are a single governmental unit and therefore, there was mutuality between the two obligations. The court stated the

debtor only has a right to the refund after the government has credited the refund to other underpaid taxes.

A bankruptcy debtor filed a Chapter 7 bankruptcy petition. He listed a general unsecured debt owed to the Rural Housing Department (RHD), which is an agency of the federal government. He also debtor listed an income tax refund. The debtor received his discharge and the case was closed. The debtor then filed a motion to reopen his case to obtain an order to require the RHD to turn over his income tax refund, which the RHD intercepted as an offset against the foreclosure deficiency obligation. The debtor argued the setoff was a violation of the automatic stay. The government asserted the setoff was proper under the Bankruptcy Code. The government also asserted the debtor's obligation to the RHD and entitlement to the income tax refund both arose in prepetition. The debtor argued the setoff is improper because the obligations are not mutual since they involve different governmental agencies.

F. Debtor Must File Returns Prior To Creditors' Meeting, Even if Not Yet Due

In re French, No. 06-20066 (Bankr. E.D. Wis.3/21/06) the court held the debtor is required to file tax returns, even if not yet due, prior to the creditors' meeting. Holding: The court denied the debtors motion demanding confirmation. They held that the trustee's interpretation of the Bankruptcy Code is correct. The court stated that Bankruptcy Code focuses on the question of whether applicable non-bankruptcy law requires the debtor to file a return at all, not on when the applicable non-bankruptcy law requirement must be met.

The debtor filed for Chapter 13 bankruptcy protection. The trustee notified the debtor that the first meeting of creditors would be rescheduled to a later date in order to allow the debtor to file her current year tax return. The trustee cited a new provision of the Bankruptcy Code that provides that if the debtor is required to file a tax return under applicable non-bankruptcy laws, they must be filed no later than the day before the day before the first meeting of the creditors. The debtor disagreed and argued that the deadline for her to file her income tax return would not occur until April 15. The debtor moved for an order of confirmation even though there had been no meeting of creditors and the trustee has not recommended confirmation. The trustee had delayed the meeting of creditors and the recommendation regarding confirmation because the debtor has not filed her income tax return.

IV. COLLECTIONS

A. Criminal Tax Fraud Conviction Not Determinative in Civil Fraud Case

In McGowan v. Comr., No. 05-13751 (11th Cir. 6/28/06): the court held that the taxpayer was collaterally estopped in the civil case from arguing that he did not act with specific intent to evade tax based on his prior criminal false return conviction. Though

prior criminal tax conviction for willfully making false return is a badge of fraud, the burden of proof remains on IRS in the civil tax fraud case to show by clear and convincing evidence that taxpayer intended to evade tax. The court stated that the Tax Court found that the typical indicia of an intent to evade taxes were not present and determined the IRS had not carried its burden of presenting clear and convincing evidence demonstrating that the taxpayer had the specific intent to evade. The court also stated that the IRS did not address the taxpayer's claim of confusion between him and his accountant at trial.

The taxpayer underreported his income for multiple years and was indicted and convicted on three counts of willfully making and subscribing false individual income tax returns, and three counts of willfully aiding and assisting in the preparation of false corporate income tax returns. The taxpayer was also ordered to cooperate with the IRS to determine his civil tax liability. The IRS issued a deficiency notice for the years at issue and asserted civil fraud penalties. Under Section 6501(c)(2), the deficiencies would be time-barred unless the taxpayer's underpayments were related to a specific intent to evade tax. The taxpayer petitioned the Tax Court. At trial, the taxpayer claimed that the underpayments were the result of confusion between him and his accountant. He had been advised that diverted funds were either repayments of loans that he had made to his company or were a return of shareholder equity. Rather than address T's confusion, however, The IRS rested on the earlier conviction in the criminal case rather than address the taxpayer's claim of confusion. The Tax Court held that the IRS failed to meet its burden of proving the taxpayer's intent to evade tax by clear and convincing evidence. The court stated that, while T's criminal conviction was a badge of fraud, the IRS could not rely solely on the prior conviction to demonstrate the taxpayer's intent to evade tax in the civil context. The IRS appealed.

B. Remittance Made With Extension Request Is Payment and Subject to Look-Back Provision of '6511

In Deaton v. Comr., No. 05-60278 (5th Cir.2/9/06) the court affirmed the holding that the remittance of estimated tax liability with a request for extension of time to file was a payment, not a deposit. The taxpayer is subject to three-year look-back provision of '6511(b)(2)(A) and will not be able to recover the overpayment. Holding: The court noted there was no evidence supporting the taxpayer's T's contention that he intended the amount to be a deposit. The court found the taxpayer did not attempt to use the IRS procedures for making a deposit. The court also noted that the IRS had always treated their overpayment as an excess collection, and not a deposit.

The taxpayer filed an extension form on April 15, 1994. He enclosed a check for $125,000 as the estimated balance due on his tax liability. The taxpayer did not file his 1993 return until January 2000. He also did not file tax returns for the years of 1994, 1995, and 1996. The filed 1993 return showed a refund due of $50,221. The taxpayer requested the overpayment be carried forward and credited as a payment toward his tax liabilities for the years following 1993. The IRS formally assessed the amounts reported

as tax on each of the returns. The IRS posted the overpayment of $50,221 to an "excess collections" account and did not carry it forward on the taxpayer's account as a credit for subsequent tax years as the taxpayer requested.

The IRS stated the taxpayer's credit request was barred by '6511(b)(2)(A), which limits the amount of a credit or refund claimed by a taxpayer to the amount paid within the "look-back period". Since the taxpayer had paid nothing to the IRS within the applicable look-back period, his credit was limited to zero. The IRS sought to levy the taxpayer's property to satisfy the 1994-1996 tax liabilities. The taxpayer requested a collection due process hearing. The taxpayer claimed the 1994 remittance of $125,000 was a "deposit" not a "payment". This status would have protected the remittance from the look-back period for credits and refunds. The Appeals office this claim and classified the 1994 remittance as a payment, subject to '6511(b)(2)(A)'s look-back period, and sustained the IRS's proposed levy. The Tax Court held that the remittance was a payment made outside the look-back period and sustained the Appeals office's determination.

C. Tax Court Holds That Premature Request for Collection Due Process Hearing Is Ineffective

In Andre v. Comr., 127 T.C. No. 4 (8/28/06) the court held the taxpayers' premature request for collection due process hearing before notice of levy is not effective. The court stated Section 6330(e) requires the IRS, once it receives a request for a collection due process hearing, to stop trying to levy, to start tolling the period of limitations for collection and any criminal prosecution, and to toll the period for a taxpayer to file a refund or wrongful levy suit under Section 6532. The court stated the IRS is a bulk-processing organization and is lenient regarding the form of a request for a collection due process hearing, but subject to human limitations. The court explained the Code's provisions for collection and the IRS's data processing are geared to a particular sequence of actions. The court then stated that allowing a taxpayer to disrupt the sequence with a premature collection due process request could possibly cause prejudice and could, for example: (1) allow taxpayers to unilaterally suspend collection action against them before the IRS decided whether to try to collect through a levy; (2) cause confusion in calculating the period of limitations affected by the suspension of collection that a proper collection due process request triggers; and (3) force the IRS to look through every piece of correspondence sent in by a taxpayer concerning an unpaid liability to determine whether it met the requirements as a collection due process hearing request. The court stated that the taxpayers' argument that the notice of determination included the years 1990-1994 rested too heavily on what appears to be a typographical error.

The IRS sent the taxpayers a notice that they had filed a federal tax lien on their property to collect unpaid taxes from 1996 through 2000. They included a form to be filled out and returned if they wanted a hearing. The taxpayer completed the form and checked the box stating that they disagreed with the IRS's "notice of levy." In the space marked "Taxable Period(s)", they wrote down "1990-2000." The IRS sent a form letter

informing the taxpayer they had checked the wrong box, and included another blank collection due process hearing request form. The taxpayer completed that form the same as he had the original form. The IRS sent another notice informing stating that it intended to levy on their property to collect their unpaid taxes from 1990-1994. A notice of determination that only discussed the notice of federal tax lien for 1996-2000. But listed prominently on the first and third pages under the heading "Tax Periods" both 1990-1994 and 1996-2000 were typed. The taxpayer filed a petition in the Tax Court. The IRS moved to dismiss the case for lack of jurisdiction and to strike as to tax years 1990-1995. The IRS records show that the taxpayer did not owe any tax for 1995, and they did not contest the government's motion to dismiss as to that year.

D. Acceptance of Qualified Offer Bars Reduction of Stated Amounts by NOLs

In Johnston v. Comr., No. 04-73833 (9th Cir.9/1/06) the court affirmed the Tax Court holding that IRS's acceptance of taxpayer's qualified offer bars the taxpayer from reducing amounts stated in qualified offer for years at issue by the amount of net operating losses sustained in other years. The court held that the taxpayer's reliance on the qualified offer regulations was misplaced. These regulations provide the method for determining whether a taxpayer who has succeeded in litigation after the IRS rejects a qualified offer becomes a prevailing party entitled to attorneys' fees. These rules have no bearing on when the issue of NOL's must be raised. The courts have consistently held that a taxpayer cannot raise the issue of NOL's after settlement. The taxpayer's attempt to raise the NOL issue after the IRS's acceptance came too late. When the ordinary principles of contract law are applied to the taxpayer's offer and the IRS's acceptance, it is clear the taxpayer may not use his NOLs to reduce his liability after settlement.

The taxpayer reported large tax losses for the years between 1988 and 1995 that the IRS disputed. The taxpayer offered to resolve all adjustments for $105,000 and the IRS accepted the offer. The taxpayer then stated that he intended to apply net operating losses to reduce his liability under the settlement. The Tax Court held that the parties entered into a contract to settle the cases and the taxpayer could not claim his NOLs after the settlement. The taxpayer argued that the qualified offer regulations changed the analysis. The taxpayer claimed he could not raise the issue of the NOLs in the settlement offer since the regulations on qualified offers require the taxpayer to specify the amount of liability "with respect to all of the adjustments at issue in the administrative or court proceeding at the time the offer is made and only those adjustments."

E. Deficiency Notice Must Precede Collection Regardless of Closing Agreement on Other Issues

In Manko v. Comr., 126 T.C. No. 9 (4/20/06) the court held that although the IRS and taxpayer had closing agreement on specific issues, the IRS must still issue deficiency notice before assessing the taxpayer's taxes. The Court stated that the existence of a closing agreement covering specific matters for the years at issue does not abrogate the

IRS's duty to issue the taxpayer a deficiency notice before assessment on the other issues. The court stated that by failing to issue the taxpayer a deficiency notice, the IRS deprived him of the opportunity of filing a deficiency suit to dispute these computations and to argue that other adjustments should be made to their liabilities for the years at issue.

The closing agreement executed by the IRS and the taxpayer explained that the parties wish to determine with finality the taxpayer's distributive share of income, gains, losses, deductions, and credits with respect to a partnership for the years at issue, The IRS was also examining the taxpayer's returns for non-partnership items. Two years after the closing agreement was executed, the IRS sent the taxpayer an Income Tax Examination Changes document to reflect the IRS's calculation of the tax liabilities after the agreed treatment of the partnership items were taken into account. The IRS then assessed deficiencies based on that document. The IRS did not issue the taxpayer a deficiency notice. The IRS continued to change the amounts the taxpayer owed for the years at issue and sent the taxpayer five more Income Tax Examination documents. The IRS never issued a deficiency notice for the years at issue, and the taxpayer never executed a formal waiver of the restrictions on assessment. The IRS sent the taxpayer a Final Notice of Intent to Levy with respect to the years at issue. The taxpayer requested a hearing. The taxpayer stated the proposed levy should not proceed since he never received a deficiency notice, he made payments toward the liabilities for the years at issue, and he had an increased net operating loss for a prior year that would decrease his liability for the years at issue. The IRS issued a notice of determination that sustained the proposed levy for the years at issue after the hearing.

F. Held That Unauthorized Tax Court Petition Still Tolls Running of Statute of Limitations

In Martin v. Comr., No. 04-9003 (10th Cir.2/6/06) the court affirmed the Tax Court decision and held the filing of a petition for redetermination suspends the running of the statute of limitations. When a petition to the Tax Court contesting a validly issued notice of deficiency is dismissed because it was not authorized by taxpayer, the filing of the petition still suspends the limitations period on assessment and collection. The court stated the text of Section 6503(a) does not suggest that a petition must be authorized or ratified by a taxpayer. The statute of limitations is tolled when matters are being litigated in the Tax Court under any circumstances. The court stated that the rules permit petitions to be signed by either a taxpayer or the taxpayer's representative.

The taxpayer filed a joint federal income tax return for 1980 that was examined by the IRS. The IRS issued notices of deficiency to the taxpayer. A lawyer at the law firm filed a petition on behalf of the taxpayer seeking a redetermination of their tax liability. The lawyer did not attach a copy of the notice that the IRS had sent to the taxpayer in the petition and did not send a copy of the petition to the taxpayer.

The taxpayer filed a motion in Tax Court seeking to dismiss the proceeding resulting from the petition. He argued the Tax Court lacked jurisdiction over him

because he had not filed or ratified the petition. The Tax Court held the taxpayer did not file, authorize, or ratify the filing of the petition and granted the taxpayer's request to be dismissed from the case arising from the petition. The IRS assessed income tax and interest against the taxpayer based on his 1980 tax liability and issued a final notice to the taxpayer notifying him of their intent to levy. The taxpayer requested a pre-levy hearing and the Appeals office determined the statute of limitations had not expired prior to the IRS's assessment of the taxpayer's 1980 income tax liability.

The taxpayer appealed the determination to the Tax Court. He argued that the 1980 Tax Court petition was insufficient to suspend the running of the statute of limitations under Section 6503(a)(1) because the taxpayer did not authorize or ratify the filing of the petition and that the petition was defective since it did not attach a copy of the notice of deficiency. The Tax Court held in favor of the IRS holding that though the taxpayer did not authorize the 1980 petition and the taxpayer's copy of the notice of deficiency was not attached, the petition placed a "proceeding in respect of the deficiency" on the Tax Court's docket and therefore suspended the running of the statute of limitations for assessment.

V. RETURNS, PAYMENTS, INTEREST AND PENALTIES

A. Third Circuit Indicates Assessment Not A Necessary Element of Tax Evasion

In U.S. v. Farnsworth, No. 06-1425 (3d Cir.8/8/06) the court held it lacked jurisdiction over the government's appeal. The court stated an appeal by the prosecution in a criminal case is not favored and must be based upon express statutory authority and therefore rejected the government's argument that the district court's ruling constituted a dismissal. The court also stated that the ruling by the district court might be reconsidered or modified before the end of the trial may be mooted by any number of unanticipated developments at trial, or it may prove harmless. The court stated it could not conclude that the proposed jury instruction was clearly erroneous.

F was on trial for tax evasion in violation of Section 7201. During a pretrial conference, the court discussed whether the indictment charged F with methods of tax evasion and the attempted evasion of the assessment and attempted payment of taxes. The court also discussed whether proof of an assessment is necessary to prove attempted evasion of payment. The court ruled the indictment charged F with two methods of tax evasion and that it would instruct the jury that to prove attempted evasion of payment, the government must show that there had been either a self-assessment or an assessment by the IRS. The government asked the district court to reconsider its determination that proof of either a self-assessment or an assessment by IRS was necessary to prove attempted evasion of payment. The government informed the court that there was no evidence that F self-assessed or that the IRS had made a assessment for the years in question. The court denied the government's motion. The government appealed what it considered to be an erroneous pretrial oral ruling in which the district court determined how it would instruct the jury with respect to the crime of attempted evasion of payment

of a tax. The government contended that the ruling essentially dismissed the attempted evasion of payment charge from F's indictment.

B. Petition Disputing 1992 Liability, Request For 1999 Refund Constitute Informal Claim

In Greene-Thapedi v. U.S., No. 03 C 3294 (N.D. Ill.3/17/06) the court held that the taxpayer's petition disputing her 1992 tax liability together with her refund request for her 1999 overpayment constitute a sufficient informal refund claim for her 1992 overpayment. The petition disputing the taxpayer's 1992 tax liability and her refund request for 1999 constitute a sufficient informal refund claim for the 1992 overpayment.

The taxpayer sought to recover an overpayment of taxes for 1999. The taxpayer was also in a proceeding disputing interest and penalties her 1992 taxes. In 2002 the IRS offset an overpayment the taxpayer made on her 1999 taxes to her disputed 1992 tax liability. This offset eliminated the 1992 liability. The IRS stated the taxpayer no longer had a claim for refund of taxes for 1999 but a claim for refund of taxes overpaid for 1992. The IRS argued that the court could not treat the case as seeking a refund of the 1992 overpayment since the taxpayer did not file a refund claim for the overpayment. The IRS moved to dismiss the action. The court denied the motion because the IRS did not establish it would not have to refund any portion of the taxpayer's overpayment even if those funds were credited to the 1992 tax year rather than 1999. The taxpayer asked the case by stayed pending an appeal.

C. Penalties Dismissed as IRS Failed to Satisfy Burden of Proof

In Wheeler v. Comr., 127 T.C. No. 14 (12/6/06), the Tax Court failed to sustain the Section 6651 and 6654 penalties for taxpayer's failure to file return since the IRS failed to satisfy burden of proof. But the court imposed a Section 6673 penalty against taxpayer for frivolous litigation.

The court stated the IRS must produce evidence that it is appropriate to impose the relevant penalties. The court further stated that a "substitute for return"(SFR), which is prepared by the IRS, qualifies as a return. The court found that though the IRS alleged an SFR was prepared and filed, they did not introduce it into evidence or prove that an SFR had been prepared. Since the record did not contain evidence the taxpayer failed to pay the tax shown on the return, the court concluded that the IRS failed to satisfy its burden of production with respect to the Section 6651 addition to tax.

If reference to the Section 6654 penalty the IRS had to introduce evidence that the taxpayer had filed a return for the preceding tax year in order to calculate the estimate amount. In order to satisfy its burden of production, the IRS had to introduce evidence showing the taxpayer filed a return for the preceding taxable year and, if so, the amount of tax shown on that return. The court held the IRS failed to do. The court could not then

do the calculations necessary for the Section 6654 penalty and therefore could not conclude that the taxpayer had a required annual payment for 2003 that was payable in installments under Section 6654.

The court found that imposition of the Section 6673 penalty was warranted as the taxpayer's arguments were contrary to well-established law and were frivolous. The court also found that the taxpayer had been provided with ample warning of the potential implications of continuing to assert those frivolous and groundless arguments.

The taxpayer did not file a federal income tax return for 2003. The IRS allegedly prepared a substitute for return and issued a deficiency notice that included additions to tax under for failing to make estimated payments. The taxpayer petitioned disputing the full amount of the deficiency, the additions to tax, and that there was a multitude of other errors in the determinations. Most of the allegations concerning errors were either unintelligible or frivolous. The taxpayer was warned at a pretrial conference that he had not raised any non-frivolous issues regarding the deficiency determination and should he continue with similar arguments at trial, the court would consider imposing a penalty under Section 6673.

D. Summary Judgment Precluded Where Evidence Supporting Informal Claim Doctrine May Apply

In Stevens v. U.S., No. 05-03967 SC (N.D. Cal.6/26/06) the court denied the government motion for summary judgment. The court stated that in evaluating the motion, it accepted the evidence presented by the trustee as true. Since the "informal claim doctrine" could apply to this case and a reasonable jury could find, on the basis of the evidence presented by the trustee, that he made an adequate informal claim within three and a half years of the estate's estimated tax payment, there are unresolved questions of material fact which preclude a summary judgment at this time The court concluded that internal government documents alone could suffice as the written component of the alleged informal claims.

The trustee of an estate sent the IRS an extension form and a check for the estimated amount of tax due on the original due date for the return. The six-month extension was granted but the trustee did not file the return until more than three years and eight months later. The return claimed a refund. The IRS sent a letter to the trustee denying the refund claim and stating that the return was filed more than three years after the due date and in order to claim the overpayment as a refund or credit, the return had to be filed within three years from its due date. The trustee filed a complaint asserting that in addition to the official contacts between him and the IRS, a series of less formal contacts between himself or another in his family and the IRS, took place. The IRS denies the informal contacts took place and moved for summary judgment on the ground that the trustee submitted the refund claim too late to reach any overpayment previously remitted.

E. District Court Finds Remittance of Funds Prior to Assessment to be Deposit, Not Payment

In Blom v. U.S., No. 05-2383 (E.D. Pa.5/31/06) the court denied the government's motion for summary judgment and held the remittance was a deposit. The court stated that when a remittance is made before a notice of deficiency, the question of whether the remittance is a deposit or a payment is resolved by inquiring into the timing of the remittance, the intent of the taxpayer in making the remittance, and the IRS's treatment of the remittance upon receipt. The court stated that any undesignated remittance made before the liability is proposed to the taxpayer in writing (e.g. before the issuance of a revenue agent's or examiner's report), would be treated as a deposit in the nature of a cash bond.

The executrix of an estate believed the estate consisted of two distinct parts one part of the decedent’s assets and the other of her late husband's assets that were in trust. The executrix requested the trustee to transfer the trust to the decedents estate. The trustee refused to do so which precipitated litigation. The executrix filed an extension and sent it to the IRS with two checks totaling $140,000. The IRS accepted the checks as payment of estimated taxes on the estate and approved the requested extension. The executrix did not file the estate tax return by the due date. The IRS issued delinquency notices. The estate filed its estate tax return more than three years after the due date. The estate tax return reflected that no taxes were due. The IRS treated the return as a request for a refund of the $140,000 and acknowledged that no taxes were owed. They declined to issue the refund because the request was made after the three-year statute of limitations had run. B filed suit to recover the $140,000 plus interest. The executrix stated she the payment was a deposit not a payment and the statute of limitations does not apply.

VI. INNOCENT SPOUSE RELIEF

A. Non-Requesting Spouse Lacks Standing to Appeal Tax Court's Decision to Grant Innocent Spouse Relief

In Baranowicz v. Comr., No. 04-71327 (9th Cir.12/23/05) the court held the taxpayer does not have standing to appeal Tax Court's decision to grant his former spouse innocent spouse relief because Section 6015(e) does not grant such standing and taxpayer did not demonstrate any redressable injury.

The court stated that in order for the taxpayer to have standing he must allege some concrete injury in fact, the injury must be traceable to the IRS's actions, it must be likely, not merely speculative, and that a favorable decision will provide redress. The court disagreed with the taxpayer that the Tax Court's determination constitutes an actual injury since it causes the entire tax deficiency to fall upon his shoulders. The grant of relief to the former spouse has not caused the taxpayer a redressable injury. Therefore,

the only harm would be to the IRS, in depriving it of an additional source from which to recover. The court further declared that the taxpayer cannot show that he has a sufficient tangible interest to support standing since his tax liability would remain the same whether or not it was to affirm or reverse the Tax Court's determination.

While they were married, the taxpayer and his former spouse deducted certain amounts pertaining to an improper tax shelter on their joint returns. The IRS disallowed the deductions and issued a notice of deficiency. The former spouse filed for innocent spouse relief both administratively and in the Tax Court and was granted her request by the IRS. The taxpayer objected in the Tax Court but the Tax Court also found that the former spouse was entitled to innocent spouse relief. The taxpayer appealed the Tax Court's determination.

B. Nonrequesting Spouse's Petition May Be Dismissed for Failure to Prosecute

In Tipton v. Comr., 127 T.C. No. 15 (12/18/06) the Tax Court granted the IRS's motion to dismiss the husband for failure to prosecute and moved to file the proposed decision granting Section 6015 relief to the former wife.

The court stated the intervenor becomes a party and is not granted rights or immunities superior to those of the other parties when he intervenes. The court explained that it could dismiss a case and enter a decision against a petitioner for failing to properly prosecute the case, comply with the court's rules or any order, or inexcusably fail to appear at trial and not otherwise participate in the resolution of the claim. The court concluded that an intervenor who properly has been notified of trial has no immunity from dismissal for failure to appear in court when the case is called for trial.

A husband and wife filed a joint tax return for 2002 and divorced the following year. In 2005, the IRS issued a deficiency notice for 2002. The former wife timely petitioned the Tax Court for a redetermination of the deficiency. She requested innocent spouse relief under Section 6015. The IRS notified the husband of the former wife's request for Section 6015 relief and of his right to intervene. The husband filed a timely notice of intervention. The IRS sent the husband a letter explaining that the former wife would be given complete Section 6015 relief if he failed to appear at trial. The IRS requested that he notify the IRS as to whether he planned to appear at trial. The husband failed to contact the IRS and did not appear for trial. The IRS moved to dismiss the husband for failure to properly prosecute. The IRS and the former wife sought to file a proposed decision, stipulated by the IRS and the former wife, but not signed by husband, that would grant Section 6015 relief to the former wife.

VII. ESTATES

A. Assets Transferred to Family Limited Partnership Included in Decedents' Estates Under Section 2036

In the Estate of Korby v. Comr., No. 06-1201 (8th Cir.12/8/06), the court affirmed the Tax Court holding that the assets parents transferred to family limited partnership are to be included in their estates under Section 2036. The court found the parents retained a right to the partnership assets and rejected the claim that payments to the living trust were "management fees" for work performed as the partnership's general partner. There was no documentation of any work done. The transfer to the partnership did not satisfy the Section 2036(a) exception for bona fide sales for adequate consideration.

A husband and wife created a revocable living trust and a family limited partnership. The husband and wife transferred stocks and bonds to the FLP in exchange for a 98% limited partnership interest. The Trust transferred a savings account to the FLP in exchange for a 2% general partnership interest.

In 1995, husband and wife gave the 98% limited partnership interest in equal shares to four irrevocable trusts for their sons. Between 1995 and 1998, the FLP made distributions to the Trust as general partner and to the sons' trusts as limited partners. The payments to the Trust were used to pay the wife’s nursing home costs, husband and wife’s taxes, medical bills, and other expenses. The distributions to the sons' trusts were intended to pay the limited partners' income taxes. Husband and wife both died in 1998.

B. Will Directing Payment of Death Taxes from Residue Ambiguous Because Residue Insufficient to Pay

The Illinois Appellate Court held In re Estate of Williams v. Wells Fargo Bank, No. 3-05-0629 (Ill. App. Ct.7/20/06) that the decedent’s will is ambiguous since it is silent as to what occurs when the residuary estate is insufficient to cover death taxes and administrative expenses. Illinois does not have an equitable apportionment statute but the Illinois courts have consistently applied equitable apportionment to testate and intestate estates. The equitable apportionment to nonprobate assets is not allowed if the testator expressed a clear intent to the contrary.

The decedents will bequeathed cash and her residence to her beneficiary. Her estate also included nonprobate assets, which consisted of a marital trust. The trust assets generated nearly half of the estate taxes incurred. Her will stated that all debts and expenses should be paid from the residue without apportionment or reimbursement. However, her residuary estate was insufficient to pay the taxes. The estate planned to reduce the beneficiary’s bequest to pay the taxes and administration expenses not covered by the residue. The beneficiary filed a claim to recover those taxes and expenses from the trust. The beneficiary argued, under the doctrine of equitable apportionment, that the trust is liable for 47.54% of all death taxes and expenses. The trust argued the beneficiary’s will expressed a clear intent to prohibit equitable apportionment that the

will demonstrates the decedents intent that the taxes are to be paid from the residuary estate and not from the nonprobate assets in the trust.

C. Estate Tax Return Properly Valued Decedent's Stock in Closely Held Company

In Kohler v. Comr., T.C. Memo 2006-152 (7/25/06) the tax court held that the value of the stock was the value reported by the estate on the alternative valuation date. Therefore, the court did not address the accuracy-related penalties.

The court stated that it gave no weight to the IRS's expert's valuation of the stock since the Commissioner's expert did not understand business and he spent only two and a half hours meeting with management. The Commissioner's expert also decided the expense structure in the company's projections were wrong and invented his own expense structure for his income approach analysis. Finally, the Commissioner's expert decision not to use a dividend-based method was unreasonable since the company had periodically and historically paid large dividends. The court determined the estate's valuation of the stock provided thoughtful valuations used reliable valuation methods. The Commissioner had the burden of proof and produced no evidence or arguments to persuade the court that the estate's value was incorrect because the court gave no weight to the Commissioner's expert.

The decedent, who died in 1998, owned 12.85% of all of the outstanding stock of a well-known international manufacturer. This manufacturer had remained privately owned by the decedent's family. The estate obtained an appraisal of the stock from a certified appraisal company. The IRS sought to increase this value based on its own appraisal.

D. Restrictive Agreement Controls Value of Decedent's Stock for Estate Tax Purposes

In the Estate of Amlie v. Comr., T.C. Memo 2006-76 (4/17/06) the Tax Court held that the agreement restricting decedent's closely held stock controls value of stock for estate tax purposes because agreement satisfies requirements of Section 2703(b) and prior law.

The Tax Court held that the value of the stock was fixed at the $118 price by the 1995 FSA. Therefore, the value as reported on the estate tax return was correct. In valuing D's stock, the court explained that a restrictive agreement can control the value of stock for estate tax purposes if it satisfies Section 2703. Since the estate did not undervalue the stock, the estate was not liable for a '6662(a) accuracy-related penalty on the stock. As to the agricultural land, the court reviewed the parties' opinions, the estate's expert's testimony, and the comparables used. The court adjusted some of the values and lowered the fractional discount amount to 15%

The decedent died in 1998 and was survived by a son, a daughter, and two adult children of a deceased child. In 1995 a family settlement agreement was signed (1995 FSA). The 1995 FSA guaranteed the decedent's estate and the heirs a price of approximately $118 per share for her stock after her death. The FSA prohibited the daughter and grandchildren from transferring stock without the consent of the son and his family, provided that all transfers of stock to the son's trust under her will would be satisfied in kind with the stock valued for this purpose at the $118 price. The $118 price was based on an earlier restrictive stock agreement. A valuation consultant was hired who determined that the $118 price was fair. A local court approved the 1995 FSA as in the decedent's best interests.

The estate tax return valued all of the stock at the $118 price per share based on the 1995 FSA. The IRS sent a deficiency notice to the estate claiming that the 1995 FSA did not fix the value of the stock and that the estate had undervalued the stock and the agricultural land. The IRS imposed a Section 6662(a) accuracy-related penalty on the estate for the under valuation of the stock.

VIII. MISCELLANEOUS

A. Mailbox Rule Not Applicable to Claim Postmarked With Private Postage Meter

In Kalman Est. v. U.S., No. 2:04-2442-12 (D.S.C.2/16/06) the court held that under 26 U.S.C.S. §§ 6511 and 7422 the estate's refund claim was not timely filed and therefore court lacked subject matter jurisdiction over the suit and granted the government's motion to dismiss. The mailbox rule under which timely mailing of refund claim is deemed timely filed does not apply to the estate's refund claim postmarked with a private postage meter that does not bear a postmark date.

The Section 7502 mailbox rule applies to postmarks not made by the U.S. Postal Service. This regulation requires private postmarks bear a legible date on or before the last day of the period prescribed for filing a claim. The court stated that the estate's claim for a refund does not have a postmark date on it and therefore does not comply with Section 7502. The court stated that since the U.S. Postal Service does not postmark privately metered mail, the fault for the lack of a postmark date lies with the decedent's estate.

The estate mailed the return on the morning of the final day before the statute of limitations expired. The envelope was postmarked at the estate administrator's office using a private postage meter. The date function on the postage meter had been turned off and as a result, the envelope carrying the return did not have a postmark date on it.

B. Prison Mailbox Rule Held Inapplicable To Inmate's Filing of Tax Court Petition

The court held in Crook v. Comr., No. 04-9015 (10th Cir.3/27/05) that the prison mailbox rule does not apply to inmate's filing of Tax Court petition. The Section 7502 mailbox rule is not available since the inmate's only evidence of mailing is his self-serving declaration. Therefore, the Tax Court upheld the affirmed the order for dismissal for lack of jurisdiction.

The taxpayer was in prison when he received a notice of deficiency on August 28, 2003. On April 6, 2004 the Tax Court received a letter from the taxpayer dated March 31, 2004 inquiring on the status of his petition for redetermination. The Tax Court filed the letter as a petition for redetermination of the deficiency. The IRS moved to dismiss the case for lack of jurisdiction since the petition was not timely filed. The taxpayer declared he had timely filed the petition by placing it in the prison mail. The Tax Court granted the IRS's motion. The taxpayer appealed and argued that he is entitled to the benefit of the prison mailbox rule, which states that timeliness is determined by the date he gave his petition to the prison authorities for mailing to the court. The Tax Court never received the petition. The taxpayer presented no evidence of timely mailing as required by 26 U.S.C.S. § 7502. The only evidence as to the mailing of his petition was his uncorroborated assertion that he submitted his petition to prison authorities. The taxpayer did not provide evidence relating to an actual postmark date or that he used registered mail. He made no attempt to require the prison to produce mail logs, which presumably would have provided corroborating evidence of the mailing date.

C. Misconduct By IRS Attorneys Not Cause For Exceeding Statutory Rate Cap Under Section 7430

Dixon v. Comr., T.C. Memo 2006-97 (5/10/06) held that where IRS attorneys acted improperly by entering into secret agreements with petitioners, the Tax Court did not find cause to exceed statutory rate cap for a Section 7430 award. The Ninth Circuit reversed and remanded, finding that the misconduct of the IRS attorneys constituted a fraud on the court. The court directed the Tax Court to enter decisions in favor of all other taxpayers on equivalent terms provided in the secret settlement agreements.

The Tax Court held that the petitioners were entitled to relief under Section 7430. However, the misconduct of the IRS attorneys did not justify a departure from the statutory rate cap under Section7430(c)(1)(B)(iii). The Tax Court stated that disregarding the statutory rate cap would improperly add a punitive aspect to the fee award.

A group of individual taxpayers participated in an investment program and tax shelter. This program was marketed as a legitimate investment that would enable participants to claim interest deductions on their individual tax returns. The IRS disallowed the interest deductions and stated these transactions were shams. The Tax Court agreed to a test case to determine liability. Two of the IRS attorneys entered into

contingent settlement agreements with two of the test case participants prior to the test case trial. The IRS attorneys did not notify their superiors, the Tax Court, or the other test case petitioners of these contingent settlement agreements.

The Tax Court vacated the decision upholding the IRS's determinations regarding the investment program transactions on the ground that misconduct by the IRS attorneys required further inquiry regarding whether the undisclosed settlement agreements affected the trial of the test cases or the opinion of the court. The Tax Court held an evidentiary hearing and found the misconduct resulted in harmless error and sanctions were imposed against the government. The other test case petitioners appealed.

D. Sanctions on Tax Protester Adjusted for Inflation and Doubled Due to Repeat Offense

The Seventh Circuit adjusted sanctions for the tax protester litigant for inflation and doubled the adjustment amount due to repeat offense in Szopa v. U.S., No. 05-4788 (7th Cir.7/5/06). The Seventh Circuit substituted the United States as the defendant, affirmed the judgment of the district court and imposed an interim sanction of $5,400.

The court stated frivolous litigation is sanctionable and that in Cohn v. Comr., 101 F.3d 486 (7th Cir. 1996), the normal sanction for an appeal resting on tax-protest arguments was set at $2,000. According to the Justice Department $2,000 is an estimate of the amount required to respond to frivolous tax appeals in 1985 and 1995. The court stated that $8,000 is somewhat less than the $11,042 that the government claims represents the average expense incurred in the defense of frivolous taxpayer appeals in during 2004 and 2005. The court stated an adjustment to keep the sanction amount constant in inflation-adjusted dollars is appropriate and set the amount at $2,700. The court stated that if the government can justify a larger number, it will be allowed 14 days to further substantiate the amount.

The court stated that since the taxpayer is a repeat the sanction for the second or successive frivolous tax appeal is set at double the $2,700

The taxpayer asserts only corporations and foreign citizens should pay income tax. The IRS sent the taxpayer a notice of intent to levy on her assets to satisfy income taxes due for the years 1991 through 2000. The taxpayer requested a hearing but offered only tax-protester arguments that were frivolous. They were frivolous since by the time a notice of levy has been sent it was too late to contest the assessment of taxes and she offered no objection to the proposed means and timing of collection.

The taxpayer was informed she could obtain review in the U.S. Tax Court. Instead, the taxpayer filed suit in the U.S. District Court. She contended she is entitled to review by a district court since the Tax Court would lack jurisdiction. She did not sue the United States or the Commissioner of Internal Revenue but sued Prescilla White, manager of the administrative group that rejected her request for a hearing. The taxpayer

stated the Tax Court cannot consider litigation on what she maintains is an "employment tax" not an "income tax" and the Tax Court is not a "court" and therefore cannot resolve disputes about points of law. Her arguments were based on the proposition that, since she is a U.S. citizen, the tax assessed is an "employment tax" and all disputes about its collection are outside the Tax Court's authority.

The district court dismissed the suit for lack of jurisdiction and because the taxpayer's claim could have been filed in and resolved by the Tax Court. The government seeks to impose sanctions in the amount of $8,000.

E. No Property Rights Found in Property Sold To Related Parties 20 Years Prior to Lien

The court held in U.S. v. Swan, No. 06-1298 (7th Cir.11/1/06) that no property rights exist for attachment where the taxpayer sold the property to related parties twenty years prior to a lien even though the taxpayer continued to occupy the property. The Seventh Circuit affirmed the judgment of the district court, holding that the grants of options to the taxpayers were not property rights to which a lien could attach but contract rights. The court stated in reply to the government's theory that the current property owner was an "alter ego" or "nominee" of the taxpayer does not make the transaction suspicious even though the property owner was the taxpayers attorney in a previous matter.

The government wants to foreclose a tax against the taxpayers for back taxes. An action was filed against the current property owners. The taxpayers currently live on property and have lived there since 1976. The taxpayer has not had legal title to the property since 1987. The current property owner purchased the house in August 2003. It was agreed the taxpayers could continue to live in the house for 24 months. During that time the taxpayers would have the right to buy the house by paying the new property owners what they had paid for it plus interest and costs. If the taxpayers did not buy the house within that period, but it was later sold it for more than $420,000, the taxpayers would be entitled to the difference between the sale price and $420,000. The taxpayers did not buy the property and the property has not yet been sold. The current property owners would like to sell the house but they cannot sell it at a decent price until the dispute over the government's lien is resolved.

F. Taxpayer May Not Audio Record Collection Due Process Hearing Held by Telephone

In Calafati v. Comr., 127 T.C. No. 16 (12/26/06), the Tax Court concluded the right to audio record a collection due process hearing does not apply to hearings held by telephone. The Tax Court held that '7521(a)(1) does not entitle the taxpayer to make an audio recording of his telephone hearing and stated that the term "in-person interview" in '7521(a)(1) refers to an interview in which the IRS representative and the taxpayer and/or

his representative are face-to-face, meaning within each other's physical presence. The court remanded the case to the IRS Appeals Office to give the taxpayer an opportunity to have a face-to-face hearing, which he may audio record.

The IRS issued a notice of deficiency in which it determined the taxpayer was liable for a deficiency and for an accuracy-related penalty for 1998. The taxpayer appealed the notice and the IRS assessed the deficiency. The IRS then issued a final notice of intent to levy and notice of right to a hearing. The taxpayer filed a request for a collection due process hearing. After the taxpayer requested the hearing, the Tax Court held, in Keene v. Comr., 121 T.C. 8 (2003), that a taxpayer is entitled to audio record a face-to-face hearing.

The IRS Appeals Officer sent a letter to the taxpayer informing him his hearing was scheduled to take place at the IRS's Appeals Office. The taxpayer's representative rescheduled the hearing and requested the hearing be conducted by telephone and stated he intended to audio record the telephone hearing. The Appeals Officer stated that an audio recording would not be allowed. The taxpayer's representative sent a facsimile to the Appeals Officer confirming the date and time for the telephone hearing and reiterating his intent to record the hearing "pursuant to IRC '7521(a)(1)" and "the recent Tax Court decision [*Keene*]." The Appeals Officer did not advise the taxpayer or his representative of the IRS's policy that a taxpayer would be allowed to record a face-to-face hearing but not a telephone hearing.

On the hearing date, the Appeals Officer and the taxpayer's representative agreed that the hearing started and ended with no substantial issues discussed because of the impasse regarding the audio recording issue. The IRS then issued a notice of determination that informed the taxpayer that the IRS had determined a levy was appropriate to collect the tax liability. A petition contesting the notice of determination was filed. The taxpayer filed a motion for summary judgment stating he had a right to record the telephone hearing as a matter of law because the telephone interview qualified as an "in-person interview" under '7521(a)(1). The taxpayer alternatively argued the IRS had an obligation to provide him with information regarding its policy so he could make an informed decision regarding the type of hearing to request.