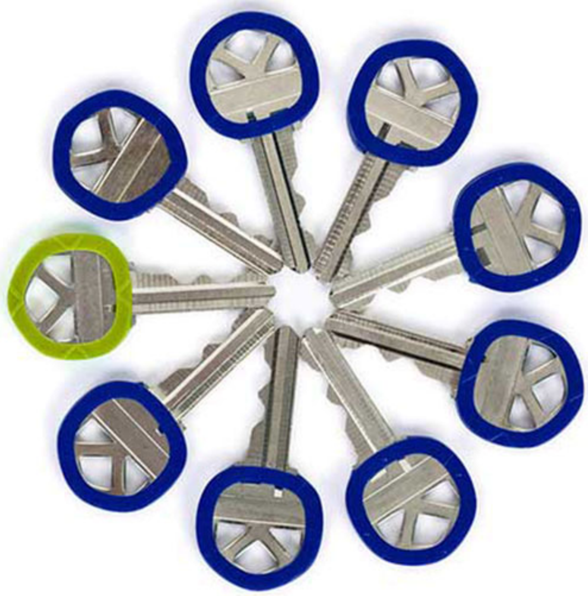

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TIGTA Issues Report on LB&I Campaign Selection

On September 27, 2019, the Treasury Inspector General for Tax Administration ("TIGTA") issued a report titled *Initial Compliance Results Warrant a More Data-Driven Approach to Campaign Issue Selection* (the "Report").[1] The TIGTA report assessed the Large Business and International ("LB&I") division's methodology for identifying and selecting LB&I "campaigns."

TIGTA noted that, although LB&I originally expected that campaigns would significantly overtake traditional case selection methods, the campaigns have not met this expectation. As of September 2018, only 6 percent of LB&I's case inventory was generated by campaigns. By February 2019, that percentage rose to 15 percent.[2]

TIGTA found that issues for campaigns were not identified and selected based on past compliance results or potential impact on compliance. According to TIGTA, results from the current campaigns indicate LB&I's could accomplish more

[1] TIGTA, Initial Compliance Results Warrant a More Data-Driven Approach to Campaign Issue Selection (Sep. 27, 2019), available online at www.treasury.gov/tigta/auditreports/2019reports/201930066fr.pdf (accessed Nov. 2019).
[2] *See id.*, at 6 – 7.

with its limited resources if it were to select campaigns based on past compliance results and potential impact on future compliance.[3]

TIGTA recommended that LB&I:

1. Consider adopting a formal process for campaign selection and prioritization that uses past compliance results and potential impact on future compliance4 and
2. Use actionable metrics and measures, including compliance results and impact on compliance, to assess campaign effectiveness.[5]

The IRS agreed to:

1. Continue to use documented processes for using past compliance results and potential impact on future compliance to select and prioritize campaigns,[6] and
2. Continue to document real-time compliance results and incorporate actionable metrics and measures.[7]

District Court Holds that Taxpayer's Letter Was a Valid Informal Claim for Refund

In *Chenette v. United States*,[8] a district court held that – under the informal claim doctrine – a taxpayer's refund claim was timely because the taxpayer filed a valid informal refund claim together with the payment of the tax.

Background

In 2012, the taxpayer ("Taxpayer") sold stock for a loss. She claimed the losses on her 2012 federal income tax return. In September 2014, the Taxpayer received a notice from the Internal Revenue Service ("IRS") disallowing the losses and increasing her reported income.[9]

In October 2014, Taxpayer responded to the notice with a detailed explanation as to why she was entitled to claim the losses on the return and did not have unreported income. She signed this letter under penalties of perjury. The Taxpayer included payment of the tax due with the October 2014 letter.[10]

In November 2016, the Taxpayer filed a Form 1040X, *Amended US Individual Income Tax Return*, that included the same information that Taxpayer included in her October 2014 letter.[11] In June 2017, the IRS reduced Taxpayer's tax liability and informed her that she was due a refund. Sometime in 2019, however, the IRS informed the Taxpayer that she would not be receiving a refund of the October 2014 payment because the November 2016 Form 1040X was filed after the period of limitations for claiming a refund of that payment had expired.[12]

Refund suit

Taxpayer then sued for a refund in the US District Court for the Northern District of California. The government then moved to dismiss on the grounds that Taxpayer did not file the November 2016 Form 1040X until more than 2 years

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[3] *See id.*, at 7 – 10.
[4] *See id.*, at 14.
[5] *See id.*, at 15.
[6] *See id.*, at 14.
[7] *See id.*, at 15.
[8] *Chenette v. United States*, No. 3:19-cv-02998-JCS (Oct. 16, 2019).
[9] *See id.*, Slip. Op. at 2.
[10] *See id.*, Slip. Op. at 2 – 3.
[11] *See id.*, Slip. Op. at 3.
[12] *See id.*, Slip. Op. at 3 – 4.

passed after she paid the tax in October 2014.[13] Taxpayer alleged that the October 2014 payment was a deposit under section 6603 and not a payment. The IRS disagreed, arguing that Taxpayer did not properly designate the October 2014 payment as a deposit under section 6603.

Taxpayer also alleged that the October 2014 letter was an informal claim that was cured when she filed the untimely Form 1040X in November 2016. The IRS did not respond to this argument as the government did not file a reply brief.

The court focused its attention on Taxpayer's informal claim doctrine argument. Under the informal claim doctrine, an informal claim that does not comply with the regulatory requirements for a valid refund claim and is filed before the expiration of period of limitations may stop the running of the statute of limitations for a refund if it is followed by a valid, formal refund claim after the limitations period has expired.[14]

The court noted that the October 2014 letter was received by the IRS and included all of the information that was included in the Form 1040X.[15] Thus, the court concluded that – under the informal claim doctrine – the October 2014 letter was a valid informal claim that was timely cured by the untimely filing of the Form 1040X.[16] Because the court concluded that Taxpayer had filed a timely informal refund claim, the court did not address whether the October 2014 payment was a payment under section 6511.

Conclusion

This case illustrates the necessity of being aware of when the period of limitations for claiming a refund for a particular payment expires. In addition, if the limitations period does expire, taxpayers should determine whether there are communications with the IRS that might constitute a valid informal refund claim.

Tax Court Holds that a Partial Underreporting of Gain Due to Sham Transaction Was Not an Omission of Gross Income

In *Beverly Clark Collection, LLC v. Commissioner*,[17] the Tax Court held that partners who partially underreported their gain due to the partners entering into a sham sale of a percentage of their partnership interests did not constitute an omission of gross income. Thus, the Internal Revenue Service ("IRS") could not apply a six-year period of limitations on assessment for a substantial omission of gross income.

Background

In 1999, the owners (the "Clarks") of an LLC ("Beverly Clark Collection") sold an 80.01% interest in the LLC to a trust (the "Trust") in exchange for a $10.4 million Treasury note. This sale was reported on Beverly Clark Collection's 1999 Form 1065, *US Return of Partnership Income*. Before the sale, the Clarks contributed Treasury notes and a small amount of cash to Beverly Clark Collection. Beverly Clark Collection then sold the Treasury notes, recognizing a small loss. The IRS characterized the transaction as a "Son-of-Boss" transaction.[18]

In 2000, Beverly Clark Collection liquidated and sold its assets. Beverly Clark Collection's 2000 Form 1065 reported gross proceeds and gain from the liquidation and allocated $2.08 million of gross proceeds and $1.41 million of gain from the post-liquidation sale to the Clarks. The Clarks reported these amounts and gross income of $811,512 of gross income on their 2000 Form 1040, *US Individual Income Tax Return*. Beverly Clark Collection's 2000 Form 1065 also

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[13] *See* IRC §§ 6511(b)(2)(B), 7422(a).
[14] *See Chenette*, No. 3:19-cv-02998-JCS, Slip. Op. at 8 – 9 (citing *Comm'r v. Ewing*, 439 F.3d 1009, 1015 (9th Cir. 2006)).
[15] *See id.*
[16] See id., Slip. Op. at 10.
[17] T.C. Memo. 2019-150.
[18] *See id.*, Slip Op. at 2 – 3.

reported a $10.53 million distribution and each of the Clarks' 2000 Schedules K-1, *Partner's Share of Income*, reported flow-through losses of $7.28 million.[19]

On August 25, 2008, the IRS issued a final partnership administrative adjustment ("FPAA") to Beverly Clark Collection that, among other things, determined that the Clarks' sale of the 80.01% interest in Beverly Clark Collection to the Trust was a sham. The FPAA was issued more than three years, but less six years (plus extensions of the assessment period of limitations), after the close of the relevant tax years.

Tax Court Proceedings

Beverly Clark Collection petitioned the Tax Court to challenge the adjustments determined in the FPAA. Beverly Clark Collection filed a motion for summary judgment, arguing that the FPAA was issued after the expiration of the applicable period of limitations on assessment. The IRS argued that a six-year period of limitations applied because the Clarks did not report the entire proceeds of the post-liquidation sale of Beverly Clark Collection's assets on their 2000 Form 1040, as the IRS determined that the sale of the Clarks' interests in Beverly Clark Collection to the Trust was a sham.

Beverly Clark Collection's 2000 Form 1065 was subject to the, now repealed, Tax Equity and Fiscal Responsibility Act of 1982[20] ("TEFRA") partnership audit procedures. Under TEFRA, the IRS was authorized to assess tax on the partners of a TEFRA partnership, like Beverly Clark Collection, if either one of two periods of limitation had not expired. First, section 6501 generally provides that the IRS can assess a tax against a partner within three years from the time the partner's return was deemed filed.[21] Second, former section 6229 generally provides that the IRS can assess tax with respect to a partnership item (or an affected item) against the partners in a TEFRA partnership within three years from the time that the partnership's return was deemed filed.[22] The three-year period under section 6501 is extended to six years if the partner omits a substantial amount of gross income on the partner's return,[23] and the three-year period under former section 6229 is extended to six years if the partnership omits a substantial amount of gross income on its return.[24] A substantial omission of gross income includes an omission of an amount of gross income that is greater than 25% of the amount of gross income reported on the partner or partnership's return.[25]

In *United States v. Home Concrete & Supply, LLC*,[26] the Supreme Court held that an overstatement of basis is not an omission of gross income for purposes of extending the period of limitations. As the Tax Court explained, an omission of an amount of gross income only occurs where the amount is omitted entirely.[27]

In this case, the issue was whether the Clarks' failure to report 80.01% of the gross income from Beverly Clark Collection on their 2000 Form 1040 is an omission of gross income where the failure to report the correct amount was due to a sham sale of the Beverly Clark Collection interests to the Trust. The Tax Court concluded the Supreme Court's holding in *Home Concrete* applies with equal force here.[28] The Tax Court reasoned that the Clarks did not "omit" an amount of gross income; they merely reported an incorrect amount.[29] Thus, the Tax Court held that a six-year period of limitations under section 6501(e)(1)(A) or former section 6229(c)(2) does not apply and, therefore, the FPAA was untimely.

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[19] *See id.*, Slip Op. at 3 – 4.
[20] Pub. L. No. 97-248, § 402(a), 96 Stat. at 648 (repealed by the Bipartisan Budget Act of 20115, Pub. L. No. 114-74, § 1101(a), 129 Stat. at 625).
[21] *See* IRC § 6501(a).
[22] *See* IRC § 6229 (repealed).
[23] *See* IRC § 6501(e)(1)(A).
[24] *See* IRC § 6229(c)(2) (repealed).
[25] *See* IRC § 6501(e)(1)(A)(i).
[26] 566 US 478 (2012).
[27] *See Beverly Clark Collection*, T.C. Memo. 2019-150, Slip Op. at 11; *CNT Inv'rs, LLC v. Comm'r*, 144 T.C. 161 (2015).
[28] *See id.*, Slip Op. at 12.
[29] *See id.*, Slip Op. at 13.

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