DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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October 16, 2000

MEMORANDUM FOR RONALD D. PINSKY, ASSOCIATE AREA COUNSEL (SBSE) – WASHINGTON, D.C. CC:SB:2:WAS:1

FROM: Lawrence H. Schattner
Chief, Branch 3 (Collection, Bankruptcy Summonses)

SUBJECT: Trust Fund Recovery Penalty (TFRP) – Different Service responses to destroyed files recommending the TFRP

This responds to your request of July 3, 2000, on the above subject. You requested general guidance on how the Appeals function should handle Collection Due Process (CDP) hearings and equivalent hearings challenging a trust fund recovery penalty (TFRP) assessment, pursuant to I.R.C. § 6672, when the Service has destroyed the administrative file that it created with respect to assertion of the TFRP. For the reasons described further below, it is not clear to us that different handling by the Service of the TFRP assessments at issue in your examples, involving the Customer Service, Collection, and Appeals functions, was not appropriate under the circumstances.

BACKGROUND

Your request for assistance attached a prior memorandum of May 13, 1999, now reproduced at 1999 IRS CCA LEXIS 172, which suggested that it would not be appropriate for the Customer Service function, as part of its project to clean up aged Non-Master File accounts (which include many TFRP assessments), to (1) investigate whether the Service's administrative file recommending assertion of the TFRP in each case had been destroyed, or (2) abate the unpaid portion of every TFRP assessment on the Service's books where the Service's TFRP file recommending assessment should have or has been destroyed, pursuant to the Service's ordinary document retention policy. The prior memorandum cited appropriate legal authority for the proposition that the Service need not be able to produce the original documentation for all of its actions in a taxpayer's case, that a certified copy of an IRS Form 4340 (Certificate of Assessments and Payments) constitutes prima facie proof that a timely and proper assessment was made. We stand by the above-described advice offered in the prior memorandum.

Consistent with the prior memorandum of May 13, 1999, and footnote 3 in particular from that memorandum, you note that your office has recently advised a Collection Offer-in-Compromise (OIC) manager in a particular Collection OIC case that the Service was not obliged to abate the unpaid portion of a TFRP assessment merely because the Service has now destroyed its original file recommending that the TFRP be asserted.

Next, you indicate that the Appeals function in your district also recently considered a taxpayer's old TFRP assessment in an "equivalent hearing" case under Temp. Treas. Reg. § 301.6330-1T:(i) (part of the Collection Due Process regulation), and the Service had also destroyed the TFRP recommendation file for this taxpayer before the taxpayer requested the equivalent hearing, as part of the Service's ordinary record retention policy. However, in the Appeals function case, you understand that the ultimate decision made by the Service was to abate the unpaid portion of the TFRP assessment and that a part of the basis for this decision was the destruction of the TFRP recommendation file.

Because the Service does ordinarily retain its TFRP recommendation files for a number of years after making a TFRP assessment, none of the examples discussed above involves a challenge to a TFRP assessment that could even arguably be covered by the burden of proof provisions of I.R.C. § 7491,[1] and this should remain true for many more years to come in any TFRP cases where the Service's TFRP recommendation files have been destroyed as part of the Service's record retention policy. Again, because the Service does ordinarily retain its TFRP recommendation files for a number of years after making a TFRP assessment, the Appeals function and the other examples discussed above also did not involve challenges to TFRP assessments where the taxpayer received the preliminary 60 day notices (for proposed TFRP assessments made after June 30, 1996) described in I.R.C. § 6672(b). However, we do discuss the 60 day notice requirement below because it is relevant to whether the Appeals function should, in future cases, consider the merits of a TFRP assessment in a CDP or equivalent hearing case brought under the Collection Due Process regulation. As more fully discussed

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[1] Section 7491 applies only in court proceedings arising in connection with examinations that commenced after July 22, 1998, which would mean that TRFP assessments arising from investigations opened before July 22, 1998, should clearly be unaffected by the burden of proof provision added in 1998. For TFRP investigations begun after July 22, 1998, there is no case authority as yet on whether the TFRP may in substance be treated as a "tax" other than a "tax imposed by subtitle A or B" (and therefore not covered by section 7491(a)) or whether the TFRP may be considered a "penalty" covered by section 7491(c). See Sotelo v. United States, 436 U.S. 268, 275 (1978) (TFRP is not a "penalty" for purposes of Bankruptcy Act); Chief Counsel Notice N(35)000-164 ("Burden of Proof and Section 7491," Sept. 23, 1999) (also taking the position that the TFRP is not a "penalty" for purposes of section 7491(c)).

below, in CDP or equivalent hearings where the file recommending assertion of the TFRP is unavailable, we do not expect the merits of the TFRP to be an appropriate issue in most cases because the taxpayer will have received notice from the Service of a prior opportunity to dispute the merits of the TFRP in an Appeals function hearing.

ISSUES & CONCLUSIONS

Issue 1: Is it appropriate for the Appeals function to consider the merits of a challenged TFRP assessment in a Collection Due Process (CDP) hearing or in an equivalent hearing under the Collection Due Process regulation (Temp. Treas. Reg. § 301.6330-1T)?

> Conclusion: It is appropriate for the Appeals function to consider the merits if the taxpayer has not had a previous opportunity to contest the liability. If a taxpayer received the 60 day preliminary notice of the Service's proposed TFRP assessment required by section 6672(b) (after June 30, 1996) or received another prior opportunity (pre- or post-assessment) for a conference with Appeals to dispute liability for the TFRP, then the existence or amount of the TFRP assessment may not be raised by a taxpayer in a CDP hearing or equivalent hearing under the Collection Due Process regulation. Similarly, if the taxpayer was a party in or otherwise participated meaningfully in a judicial proceeding in which the taxpayer's liability for the TFRP was at issue (e.g., a tax refund suit regarding the TFRP, a suit or counterclaim by the United States to reduce the TFRP to judgment, or the Service filed a proof of claim for the TFRP in the taxpayer's bankruptcy case), then the existence or amount of the TFRP assessment may not be raised by the taxpayer anew in a CDP hearing or equivalent hearing under the Collection Due Process regulation.

Issue 2: In a proper merits challenge of a TFRP assessment in a CDP hearing or in an equivalent hearing under the Collection Due Process regulation, is it appropriate for an Appeals officer to consider the Service's hazards of litigation on the merits?

> Conclusion: Yes. If a taxpayer is permitted to and does properly contest the existence or amount of a TFRP assessment in a CDP hearing, it is appropriate for the Appeals officer to consider the Service's hazards of litigation on these issues, including the destruction of the Service's file recommending the TFRP. Although a taxpayer has no right to obtain judicial review of an adverse Appeals function determination resulting from an equivalent hearing under the Collection Due Process regulation, an Appeals officer should consider the same issues at an equivalent hearing that the Appeals officer would have considered in a timely requested CDP hearing, including consideration of the Service's hazards of litigation on the merits of the TFRP, where appropriate.

Issue 3: Is it appropriate for an Appeals officer to give substantial weight to an IRS Form 4340 (Certificate of Assessments and Payments) in considering various types of taxpayer challenges to a TFRP assessment?

> Conclusion: Yes. In a CDP hearing or equivalent hearing under the Collection Due Process regulation, an Appeals officer may rely on an IRS Form 4340 as presumptive evidence that the TFRP has been validly assessed by the Service against a taxpayer and to otherwise verify the Service's compliance with the requirements of applicable law and administrative procedures, for purposes of I.R.C. § 6330(c)(1). Davis v. Commissioner, 115 T.C. No. 4 (July 31, 2000). The case law cited in Davis and in the prior memorandum illustrate many circumstances where the courts have given substantial weight to IRS Forms 4340 in considering taxpayer challenges to various tax liabilities, but the Service does not ordinarily rely solely on Forms 4340 to defend a permissible merits challenge by a taxpayer to a TFRP assessment.

Issue 4: When a taxpayer makes a permissible merits challenge of a TFRP assessment, is the destruction or missing status of the Service's administrative file regarding the TFRP recommendation against that taxpayer necessarily fatal to the Service's case?

> Conclusion: No. The destruction of the Service's administrative file regarding a TFRP assessment (in merits challenge circumstances) may sometimes lead a court to consider whether the Service has only a "naked assessment" for the TFRP, which is not entitled to a presumption of validity. However, most courts will first allow the Service an opportunity to conduct discovery or otherwise develop or reconstruct probative evidence regarding the TFRP liability, such that the burden of proof remains on the taxpayer by the time of trial. The employer's Form 941 and other returns, Secretary of State records, bank signature cards, and the testimony of other employees or officers may often still be available to the Service as a more than adequate substitute for the destroyed or lost administrative file on various challenged elements of the TFRP liability.

Issue 5: When the Service's administrative file regarding a TFRP assessment has been destroyed and the merits of the TFRP assessment are being considered in the Appeals function, are there mandatory internal guidelines or tolerances as to how much time Appeals should give the Collection function to reconstruct or gather evidence supportive of the TFRP assessment or how many hours the Collection function should expend on this task of reconstructing or gathering evidence before concluding the effort is not likely to be cost effective or otherwise worthwhile?

> Conclusion: No. The Appeals function should generally attempt to conduct all CDP hearings or equivalent hearings under the Collection Due Process

regulation as expeditiously as possible, but there are no time limits by law on how soon Appeals must hold the hearing or issue its Notice of Determination (for a CDP hearing) or its Decision Letter (for an equivalent hearing). If a TFRP case requires further factual development when the TFRP assessment is first proposed, the Appeals function may retain jurisdiction of the case but send it back to the Collection function for at least 45 days to take any necessary action, with extensions possible through mutual agreement of the two functions. See IRM 8.11.1.8.8:(3). In a CDP hearing or equivalent hearing context, where the Service is similarly stayed by law from levying (in the case of a CDP hearing) or where the Appeals function may ask the Collection function to stay its levy activity if it wants further time to reconstruct or develop the facts (in the case of an equivalent hearing), the Appeals function should also first afford the Collection function at least 45 days, subject to mutually agreed extensions, to attempt to reconstruct or develop facts that may support the TFRP assessment which was the subject of the destroyed or lost administrative file, if the taxpayer has brought a proper merits challenge to the liability. However, the local Collection function, after coordinating the matter appropriately within the new SBSE structure, may agree in advance with the local Appeals function that cases within certain tolerances (e.g., total dollar amounts, of a certain age, and/or with minimal known levy sources) are not cost effective for the Service to attempt to reconstruct or support after the administrative file has been destroyed.

DISCUSSION

Not less than 30 days before the day of the Service's first levy (after the effective date of I.R.C. § 6330) with respect to a particular tax and a particular tax period, the Service is required to give a taxpayer the notice described in I.R.C. § 6330(a)(3) (a CDP notice). Among other things, a CDP notice advises a taxpayer that the taxpayer may request a hearing (a CDP hearing) in the Service's Appeals function to consider the proposed levy and other related matters by making a written request to the office which issued the CDP notice within 30 days. I.R.C. § 6330(a)(3)(B). If the taxpayer makes a request for an Appeals function hearing with respect to a CDP notice more than 30 days after the CDP notice was issued, then the taxpayer may not obtain a CDP hearing, but may receive an equivalent hearing, pursuant to Temp. Treas. Reg. § 301.6330-1T:(i). In an equivalent hearing case with the Appeals function under the Collection Due Process regulation, the Appeals function considers the same issues that it would have considered in a CDP hearing case on the same matter, but the Service's collection limitation period is not suspended while an equivalent hearing case is in the Appeals function, the Service is not automatically stayed (but may choose to stay) its proposed levy activity while the equivalent hearing case is pending, and the taxpayer has no right to judicial review of an adverse decision by the Appeals function arising from an equivalent hearing. See Temp. Treas. Reg. §§ 301.6330-1T:(i)(2)Q&AI1-5.

Issue 1: Considering the Merits of TFRP Assessments in a CDP Hearing

In a CDP hearing, a taxpayer may be allowed to challenge the existence or amount of the underlying liability (the merits), but only if the taxpayer did not receive a statutory notice of deficiency for such tax liability (not applicable in TFRP cases) or "did not otherwise have an opportunity to dispute such liability." Further, a taxpayer may not raise an issue (including the merits) at a CDP hearing if the issue was raised and considered in any previous administrative or judicial proceeding in which the taxpayer participated meaningfully. I.R.C. §§ 6330(c)(2)(B) and (c)(4). The Collection Due Process regulation explains that "an opportunity to dispute such liability" includes a prior opportunity for an Appeals function conference either before or after assessment of the liability. One of the examples in the Collection Due Process regulation of this principle specifically concerns a TFRP assessment; it explains that when the Service offers the taxpayer an opportunity to request an Appeals function conference to dispute a TFRP liability and the taxpayer fails to take advantage of that opportunity, then the taxpayer is precluded from challenging the existence or amount of the TFRP at a subsequent CDP hearing (or equivalent hearing). See Temp. Treas. Reg. §§ 301.6330-1T:(e)(3)Q&AE8 and (e)(4)Ex.3.

For proposed TFRP assessments made after June 30, 1996, the Service has been required (except in jeopardy situations) to give the taxpayer a 60 day preliminary notice which generally informs the taxpayer of the proposed TFRP assessment and offers the taxpayer an opportunity to request an Appeals function conference within 60 days to dispute the proposed TFRP liability. The Service uses a Letter 1153(DO) to provide this 60 day notice of proposed TFRP assessments to taxpayers; the Service has generally decided to send the Letter 1153(DO) to a taxpayer by certified mail to the taxpayer's last known address.[2] I.R.C. § 6672(b); IRM 5.7.3.6:(3). The examples discussed in your memorandum requesting our assistance did not involve TFRP assessments made after June 30, 1996, but we believe it is useful here to discuss the 60 day preliminary notice requirements of section 6672(b) (effective after that date) because the Service's prior compliance with this provision should ordinarily satisfy the prior "opportunity to dispute" exception in section 6330(c)(2)(B) with regard to the merits of a TFRP assessment and thereby preclude consideration of the merits of the TFRP liability in a CDP hearing or equivalent hearing conducted by the Appeals function for that taxpayer. This issue preclusion, in turn, should alleviate some of the complications that may otherwise be caused to the Service in old TFRP cases by the Service's document retention policy of destroying some of its older files recommending TFRP assessments before the collection limitation period for the TFRP has expired.

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[2] Certified mailing of the 60 day notice, return receipt requested, is not required by law, but is the preferred mailing method selected by the Collection function for these notices, in part so that mailing and receipt of the 60 day notice may be more easily proven by the Service if these matters are ever later contested. The 60 day notice may also now be delivered in person to the taxpayer.

Prior to June 30, 1996, we understand that it was also the Service's general policy to offer taxpayers an opportunity either before or after assessment of the TFRP to obtain an Appeals function conference regarding the merits of their TFRP liability. However, since Appeals function conferences regarding proposed TFRP assessments were not a matter of right before the effective date of section 6672(b), it may generally be more difficult for the Service to show whether or not a particular taxpayer was offered an Appeals function conference to discuss a proposed or assessed TFRP if the TFRP recommendation file with respect to that taxpayer no longer exists. Nevertheless, if the Service can show that the taxpayer received notice of a prior opportunity to request an Appeals function conference on the TFRP liability, then the taxpayer would be precluded from challenging the merits of the TFRP liability in a CDP or equivalent hearing.

For TFRP assessments made after June 30, 1996, however, a taxpayer who was properly mailed a notice of his/her opportunity to request an Appeals function conference to consider the merits of a TFRP assessment by the Service may still be able to avoid preclusion of the underlying liability as an appropriate subject for a CDP hearing (or equivalent hearing) if the taxpayer shows that he/she did not receive the notice. See Temp. Treas. Reg. §§ 301.6330-1T:(e)(3)Q&AE2 and (e)(4)Ex.2 (discussing the consequences of a taxpayer's failure to receive a statutory notice of deficiency on the taxpayer's ability to contest the underlying liability in a CDP hearing). Regardless of whether the TFRP assessment was made prior to or after June 30, 1996, the Service and the courts are not obliged to accept, without question, a taxpayer's statement that he/she does not recall having received such notice. In the absence of clear evidence to the contrary, the Tax Court has found in a CDP hearing context that presumptions of official regularity and of delivery justify the conclusion that a notice by the Service was sent and that delivery was attempted by the Post Office at the address the Service used in its notice. In the same CDP hearing case, the Tax Court also held that a taxpayer may not defeat actual notice of an opportunity to contest a tax liability by refusing to accept delivery of mail from the Service. Sego v. Commissioner, 114 T.C. No. 37 (June 30, 2000).[3]

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[3] The Service may enhance the likelihood of showing that a taxpayer received a particular document by maintaining a centralized register of receipts for outgoing certified mail and by maintaining the register for 10 years, as the Service is now doing for CDP notices with respect to liens. See IRM 5.12.3.1.4:(5). Alternatively, for recent TFRP assessments, the Service may rely on information found in the Automated Trust Fund Recovery Penalty Program (ATFRPP). The ATFRPP now reportedly allows the Collection function to enter a textual history note on the date it receives a certified mailing receipt of delivery (e.g., the customary green card) for a Letter 1153(DO), indicating that delivery of the 60 day notice of proposed TFRP assessment to the taxpayer by the Post Office has occurred. Since ATFRPP records for recent TFRP liabilities may not be readily available to the Appeals function in every city, it would be prudent for the Collection function to include any ATFRPP information which may exist with respect to delivery of the Letter 1153(DO) in the summary statement portion of the

In light of the foregoing discussion of the issue preclusion effect (for the merits of a tax liability) of a taxpayer having been given and received prior notice of an opportunity to contest the TFRP with the Service's Appeals function, it would be prudent for the Collection function to document prior notice and receipt before referring future CDP hearing or equivalent hearing cases to the Appeals function, and to note these facts in its transmittal to Appeals.[4] It may also be prudent for a revenue officer newly assigned to collect an older TFRP assessment to ask the taxpayer, before issuing a CDP notice, what types of prior notices the taxpayer has received from the Service regarding the TFRP liability and to document the taxpayer's response.

Issue 2: Weighing Litigation Hazards on TFRP Merits in Equivalent Hearing

If the merits of a TFRP liability (e.g., responsibility and willfulness) are properly at issue in a CDP hearing, the Appeals function may be required to weigh the taxpayer's and the Service's respective hazards of litigation in deciding whether to sustain, compromise, or concede the amount of the unpaid TFRP assessment. See H.R. Conf. Rep. No. 105-599, 105th Cong. 2d Sess. 266 (validity of tax liability reviewed de novo); see also IRM 5.1.9.3.8:(5). The destruction of the Service's file recommending assertion of the TFRP at issue against the taxpayer may affect the Service's hazards of litigation on the merits of the taxpayer's challenge to the TFRP liability, but the destruction of this TFRP file is not necessarily fatal to the Service's case, as discussed further below. In a CDP hearing context where the merits of the TFRP liability are properly at issue, the Appeals function gives the taxpayer a written Notice of Determination at the end of the hearing process which should address the TFRP merits issues and the other issues the taxpayer was allowed to and did raise. A Notice of Determination also advises the taxpayer of the taxpayer's right to seek judicial review of the Appeals function's determinations within 30 days, by filing a complaint in U.S. District Court in the case of a TFRP liability. See Temp. Treas. Reg. § 301.6330-1T:(e)(3)Q&AE7. In this manner, a taxpayer's CDP hearing challenge to an unpaid TFRP liability that is no longer supported by the Service's original file recommending assertion of the TFRP may be brought to court to consider the merits of the unpaid TFRP liability.

The Service issues a Decision Letter, rather than a Notice of Determination, at the conclusion of an equivalent hearing process and the taxpayer has no right to judicial review of the Appeals function's resolution of the issues in a Decision Letter. Nevertheless, even though the equivalent hearing process in the Appeals function may not lead directly to a taxpayer's right to litigate the outcome in court,

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transmittal for a CDP or equivalent hearing case involving the TFRP liability to the Appeals function.

[4] A Form 3210 is the transmittal form used for this purpose, and the summary statement attached to it should contain information of this type that would assist the Appeals function in its determination. See IRM 5.1.9.3.6:(13) and 8.7.1.1.9.12:5.

the Service has decided that it is appropriate for the Appeals function to consider the same issues that it would have considered at a CDP hearing on the same matter, including the hazards of litigation to the Service's position. See Temp. Treas. Reg. § 301.6330-1T:(i). This policy decision reflected in the regulation also makes good practical sense in the case of an unpaid TFRP liability. If the Service goes forward with its proposed levy action, the Service's levy activity may then easily result in the collection of enough of the TFRP liability (the trust fund taxes owed with respect to one employee for one quarter)[5] to entitle the taxpayer to make a request for a refund of the liability paid and to put the merits of the previously unpaid TFRP liability (with its attendant hazards of litigation) before a U.S. District Court for decision. Alternatively, a taxpayer denied an opportunity to discuss the parties' hazards of litigation with respect to the merits of a TFRP liability in an equivalent hearing by the Appeals function could file bankruptcy and obtain an opportunity to litigate his/her liability for the TFRP in the bankruptcy case, if the Service files a bankruptcy proof of claim for the unpaid TFRP liability.[6]

Issue 3: Reliance on Forms 4340 to Establish Elements of TFRP Liability

In a CDP hearing or equivalent hearing case, the Appeals function is required, prior to issuing a Notice of Determination or Notice of Decision, to obtain general verification from the Collection function that the requirements of applicable law or administrative procedure have been met by the Service, in addition to considering the issues properly raised by the taxpayer. I.R.C. § 6330(c)(1); Temp. Treas. Reg. §§ 301.6330-1T:(e)(1) and (e)(3)A-E1(i). In Davis v. Commissioner, 115 T.C. No. 4 (July 31, 2000), the Tax Court held that it was not an abuse of discretion for an Appeals function hearing officer in a CDP case to rely on an IRS Form 4340 (Certificate of Assessments and Payments) for purposes of complying with section 6330(c)(1). Indeed, as you have concluded and the prior memorandum you attached with your request for assistance suggests, it is highly appropriate and proper for an Appeals function hearing officer and for other Service employees to

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[5] See Steele v. United States, 280 F.2d 89 (8th Cir. 1960), wherein the United States confessed error and stipulated that the full payment rule for income tax refund actions, discussed in Flora v. United States, 357 U.S. 63 (1958), does not apply to assessments of divisible taxes such as the TFRP.

[6] These practical, alternative opportunities for a taxpayer to obtain judicial review with respect to the merits of an unpaid TFRP liability may also admittedly exist with respect to the merits of the liability in some of the issue preclusion circumstances (when the taxpayer receives prior notice of an opportunity for a prior Appeals function conference) discussed in relation to issue 1 above. Nevertheless, as a policy matter, it is not appropriate for the Appeals function to consider the Service's hazards of litigation on the merits in these issue preclusion circumstances. Otherwise, there would be no limit to the number of Appeals function conferences a taxpayer might seek on the same tax or issue, and taxpayers would not be appropriately encouraged to seek timely conferences with the Appeals function.

rely on a Form 4340, first, to satisfy the requirements of section 6330(c)(1) and, second, to overcome a variety of arguments a taxpayer may raise with respect to a TFRP assessment at a CDP or equivalent hearing pursuant to section 6330(c)(2), even when the Service's file recommending the TFRP assessment against the taxpayer has been destroyed. However, an IRS Form 4340 alone does not overcome all potentially proper challenges (e.g., a factually supported merits challenge to the underlying liability) that a taxpayer may raise to a TFRP assessment in a CDP or equivalent hearing case. Further, if there are material discrepancies between the information reflected on an IRS Form 4340 and other available evidence or if the IRS Form 4340 does not contain relevant entries that address the issues raised by the taxpayer, then an Appeals function hearing officer or a reviewing court may seek or receive further explanations from the interested parties rather than give conclusive weight to the information reflected on the Form 4340, even when the merits of the TFRP liability are not properly at issue.

In the Davis case, the taxpayer failed to allege that he did not receive a statutory notice of deficiency for the income tax deficiencies in issue, nor did he allege that he did not have a prior opportunity to contest the Service's deficiency determinations. Accordingly, the Tax Court opinion started with the conclusion that the taxpayer's underlying tax liability (the merits) was not properly before the court in this CDP review case. The procedural argument raised by the taxpayer in Davis was that the Appeals function hearing officer should not have relied on a Form 4340 in the CDP hearing to establish the date and amount of assessments made by the Service against him, that the hearing officer should instead have attempted to go behind the Form 4340 to verify from personal inspection of the original documents that IRS Forms 23C (Summary Records of Assessment) were actually signed by an IRS Service Center assessment officer on the dates and for the amounts shown in the Service's certified records. The Tax Court rejected this frivolous procedural argument, citing several prior circuit court decisions on the issue. The Tax Court correctly observed that IRS Forms 4340 provide presumptive evidence that a tax has been validly assessed under I.R.C. § 6203, and noted that the taxpayer did not demonstrate any irregularity in the assessment procedure.

The prior memorandum you referred to and the Davis opinion each cite a number of court decisions, decided outside the context of a CDP hearing, in which the Service and the courts have relied upon IRS Forms 4340 as presumptive proof of the regularity of various procedural matters, such as: (1) whether the Service properly made a record of the assessment, under section 6203; (2) whether the Service properly gave notice and demand for payment, under section 6303; (3) whether the Service's records reflect the actual assessment date of a tax, to measure the timeliness of a suit by the United States to reduce the tax to judgment before the collection limitation period expired under section 6502; or (4) whether the Service's records reflect the actual amount of a non-divisible tax assessment made by the Service, to evaluate the taxpayer's compliance with the Flora full payment rule so that the taxpayer could properly initiate a refund suit for the tax under section 7422.

Three circuit court cases involved quiet title challenges by taxpayers (pursuant to 28 U.S.C. § 2410) to the procedural regularity of the Service recording its assessments and/or the Service giving the taxpayer proper notice and demand for payment, under sections 6203 and 6303, respectively. Challenges to the merits of a federal tax liability are not permitted in a quiet title action. In each case, the circuit court relied upon IRS Forms 4340 as presumptive proof of the Service's proper compliance with sections 6203 and/or 6303, and the taxpayers failed to show any discrepancies between the Forms 4340 and any of the available evidence. See Geiselman v. United States, 961 F.2d 1 (1st Cir. 1992), cert. denied, 506 U.S. 891 (1992); Koff v. United States, 3 F.3d 1297 (9th Cir. 1993), cert. denied, 511 U.S. 1030 (1994); Gentry v. United States, 962 F.2d 555 (6th Cir. 1992).

Two other circuit court cases involved suits by the United States to reduce unpaid assessed taxes to judgment, the taxpayer raised non-merits objections to the assessed taxes, and the courts relied on the information reflected on IRS Forms 4340 to resolve the disputes in the Service's favor. In United States v. Chila, 871 F.2d 1015 (11th Cir. 1989), cert. denied, 493 U.S. 975 (1989), the taxpayer challenged whether the Service had properly recorded a TFRP assessment against him and whether the Service had made proper notice and demand for payment on the taxpayer, for purposes of sections 6203 and 6303. In United States v. Miller, 318 F.2d 637 (7th Cir. 1963), an heir to a decedent argued that an estate tax liability had been assessed by the Service earlier than the date shown on an IRS Form 4340, so as to make the suit by the United States to reduce the unpaid tax to judgment untimely (i.e., outside of the collection limitation period).

Two other circuit court cases involved tax refund suits brought by taxpayers, the taxpayers were not permitted to or did not contest the merits of the taxes in their appeals, and the courts again relied upon the information shown on Forms 4340 to resolve the disputes in the Service's favor. In Hefti v. Internal Revenue Service, 8 F.3d 1169 (7th Cir. 1993), the merits of the tax liabilities contested by the taxpayer could not be contested because the taxes had been previously determined in prior tax cases that were then res judicata, so the taxpayer's challenge was limited to a bare allegation the Service had failed to comply with section 6203 in making its assessments of the tax. In Rocovich v. United States, 933 F.2d 991 (Fed. Cir. 1991), the lower court dismissed the taxpayer's refund case for a federal estate tax because the taxpayer had not fully paid the tax before filing the suit, and the taxpayer alleged that the IRS Form 4340 overstated the amount of the estate tax assessment that the executor was required to pay in full in order to bring the refund action.

While the eight circuit court cases described above showcase procedural challenge circumstances where the Service has prevailed by offering certified Forms 4340 in evidence, other procedural challenges to the Service's actions have not been fully resolved by IRS Forms 4340 when the courts have found there was some evidence of material discrepancies or of data missing from the Forms 4340. In United States v. McCallum, 970 F.2d 66 (5th Cir. 1992), a suit by the United States to reduce unpaid income tax deficiency assessments to judgment, the court relied on certified

Forms 4340 to defeat the taxpayer's allegation that the taxes were not properly recorded for purposes of section 6303, but the court remanded the case for proof that a statutory notice of deficiency had been properly mailed to the taxpayer by the Service and that the taxpayer defaulted before the deficiencies were assessed, because the taxpayer denied that he received a notice of deficiency and the IRS Forms 4340 did not address this procedural issue. In Huff v. United States, 10 F.3d 1440 (9th Cir. 1993), cert. denied, 512 U.S. 1219 (1994), the taxpayers filed a quiet title action challenging the procedural regularity of the Service's tax liens and the court accepted certified Forms 4340 as evidence the Service made proper notice and demand for payment for section 6303 purposes, but the Ninth Circuit found the Forms 4340 in the case were defective for purposes of section 6203 because the documents did not show a "23C date" that indicated when the IRS Forms 23C were signed. Earlier, in Farr v. United States, 990 F.2d 451 (9th Cir. 1993), cert. denied, 510 U.S. 1023 (1993), the Ninth Circuit also stated that while Forms 4340 are "proper evidence" of the propriety of the assessment procedures followed by the Service, the forms are not "necessarily conclusive evidence;" the Farr court suggested that the United States could rely on IRS Forms 4340 in a summary judgment proceeding to show that a notice of deficiency was mailed by the Service to the taxpayer's last known address, but that the taxpayer was first entitled to conduct discovery on the issue and that the taxpayer's case could not be dismissed at the outset for an alleged failure to state a claim on the basis of the information reflected on IRS Forms 4340.[7]

Finally, in a recent district court case where the United States was seeking to reduce an old TFRP assessment to judgment and the Service had destroyed a Form 941 return of the taxpayer's former employer, the court was unwilling to conclude that no material issue of fact remained for trial for one of the TFRP quarters at issue. A certified IRS Form 4340 showed that the TFRP assessment against the taxpayer for that quarter was made for an amount that was about $110,000.00 larger than the Service had asserted that the corporate employer owed for that same quarter in an amended bankruptcy proof of claim that the Service filed a few months after the TFRP assessment was made. When the issue of the correct amount owed for this quarter is brought to trial, the court indicated that the initial burden of proving by a preponderance of the evidence that the TFRP assessment for this quarter was arbitrary and erroneous would lie with the taxpayer. United States v. Watson, 102 F. Supp. 2d 351 (S.D. Tex. 1999).

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[7] See also Godfrey v. United States, 997 F.2d 335 (7th Cir. 1993). In Godfrey, the Service argued that it mailed the taxpayers a timely refund check, the taxpayers alleged that they did not receive the check, a new refund check was issued by the Service, and the taxpayers sued the Service for interest that was due them on the tax refund amount only if the Service failed to mail the taxpayers the original check on the date shown with the notation "Refund of Overpayment" on an IRS transcript other than a Form 4340. Without explanatory testimony, the Seventh Circuit was unwilling to interpret the transcript notation as meaning the refund check was mailed on that date.

Issue 4: Defending TFRP Liability on the Merits When Files were Destroyed

In United States v. Janis, 428 U.S. 433 (1976), the Supreme Court was primarily concerned with whether the exclusionary rule (a criminal law deterrent to improper police conduct) should be applied to prohibit a federal agency (the Service) from using evidence that was improperly seized by California state police from a taxpayer's business in support of the federal agency's civil assessment (of the federal wagering tax) against the taxpayer. The Supreme Court ultimately decided that the exclusionary rule should not be extended to these circumstances, that the Service was not barred from using the evidence of gambling activity by the taxpayer that it received from the California state police in support of its civil, federal wagering tax assessments against the taxpayer. If the evidence improperly seized by the state police could not have been used by the Service, then it had conceded that it would not have had any admissible evidence (other than Forms 4340) to support its federal wagering tax assessments against the taxpayer. Moreover, if the Service had been barred from using the evidence improperly seized by the state police, any later efforts by the Service to reconstruct or supplement the same type of evidence on its own could have been construed as tainted fruits of the improper search, and also deemed inadmissible. Before it considered the historical policies behind the exclusionary rule and announced its decision on that issue, the Supreme Court first discussed (in dicta, Janis at 441-3) what the status of the Service's "naked assessments" would have been if the exclusionary rule had been applied, as follows:

> What we have is a "naked" assessment without any foundation whatsoever if what was seized by the Los Angeles police cannot be used in the formulation of the assessment. The determination of tax due then may be one "without rational foundation and excessive," and not properly subject to the usual rule with respect to the burden of proof in tax cases. ... There appears, indeed, to be some debate among the Federal Courts of Appeals, in different factual contexts, as to the effect upon the burden of proof in a tax case where there is positive evidence that an assessment is incorrect. ... However that may be, the debate does not extend to the situation where the assessment is shown to be naked and without any foundation. ... Certainly, proof that an assessment is utterly without foundation is proof that it is arbitrary and erroneous. ... We are willing to assume that if the District Court was correct in ruling that the evidence seized by the Los Angeles police may not be used in formulating the assessment (on which both the levy and the counterclaim were based), then the District Court was also correct in granting judgment for Janis in both aspects of the present suit. This assumption takes us, then, to the primary issue.

Seven years after Janis, the Sixth Circuit considered a federal income tax refund action where the Government conceded that it no longer had in its possession any reports, workpapers or other documents to support the notice of deficiency the Service had issued to the individual taxpayers a little over 10 years before the refund suit was commenced. Coleman v. United States, 704 F.2d 326 (6th Cir.

1983). In the Coleman case, the court also found that the taxpayers had delivered their relevant financial records to the Service in the course of the audit many years before, that the Service's notice of deficiency to the taxpayers was returned as unclaimed by the Post Office, that the taxpayers sought to learn the basis for the assessment from the Service relatively soon after they discovered the Service was trying to collect it, and that as early as three years after the assessment was made the Service admitted to the taxpayers that it could not locate the financial records the taxpayers had given them during the audit, nor could the Service locate it own files to explain the basis for its assessment. In these circumstances, the Sixth Circuit relied on the above-described dicta from Janis and held that the taxpayers had established that the Service's "naked assessments" were arbitrary and could not be enforced. However, the Sixth Circuit clarified (Coleman, at 329) that it was not saying that the Service, in another case involving missing original records, could not have preserved the presumption of correctness for its assessment by the use of non-original records:

> It should be noted that reversing the district court here does not strip the IRS of the ability to collect taxes in the absence of original records. ... Had such "secondhand" records been available in the matter sub judice, or any demonstrably reasonable methodology of estimation, it is likely that even the destruction of the Colemans' original returns would not have precluded reliance upon the assessment's presumption of correctness.

Seven years after Coleman, the Seventh Circuit considered the meaning of a "naked assessment" in a case involving a TFRP liability that the Service admitted before the second phase of a trial that it had miscalculated. United States v. Schroeder, 900 F.2d 1144 (7th Cir. 1990). In Schroeder, the Service originally miscalculated the TFRP owed by two responsible persons by failing to account for part of a prior payment by the employer that was applied to the trust fund taxes it owed; when the Service originally made the TFRP assessment, the total amount assessed was excessive by about 4.8%. As the collection limitation period for the TFRP approached, the Service believed that it had collected about 88.5% of the total TFRP, but it had in fact collected about 93.4% of the liability (not including a large interest accrual since assessment), due to its original calculation error. The United States then brought suit to reduce the unpaid portion of the TFRP liability and the unpaid accrued interest to judgment. Due to the Service's original miscalculation of the TFRP and considering the amounts collected and applied toward the total TFRP since assessment, the United States eventually admitted that it had sought judgment against the taxpayers for an unpaid TFRP amount that was overstated by about 58% (not including the large interest accruals). The Service's witness in the computation phase of the trial was also unable to provide the court with revised interest computations that accounted for the corrected TFRP amount. In these circumstances, the district court found the Service had an arbitrary, erroneous and invalid assessment for the TFRP and that the United States was liable to the taxpayers for attorney fees. The Seventh Circuit reversed, explaining (Schroeder, at 1148-9) as follows:

> When a court is faced with an incorrect but otherwise valid assessment the proper course is not to void the assessment, as did the district court, but to determine what, if anything, the taxpayer owes the government. See Helvering v. Taylor, 293 U.S. 507, 55 S. Ct. 287, 79 L. Ed. 623 (1935). This course should be followed, whenever a taxpayer's liability is capable of being determined by some approved method of calculation, even when the original assessment was arbitrarily computed and excessive in amount. ... The [district] court apparently believed this was a case like Janis, where the circumstances are such that the government's assessment is without effect. It is not. ... [A]n assessment excessive in amount, without more, is not void under Janis. For the assessment to be void, it must be more than incorrect, for the correctness of the amount assessed is quite irrelevant. It must be arbitrary in the sense that the calculation has no support and the true amount of tax owed is incapable of being ascertained. Thus, where records supporting an assessment are excluded from evidence, see Janis, supra, or are nonexistent, see Coleman v. United States, 704 F.2d 326 (6th Cir. 1983), so that the basis upon which an assessment is calculated is beyond the knowledge of the court, the assessment is "arbitrary and erroneous." It is beyond saving. Such an assessment, however, does not exist here. There are plenty of records, documents, and other "foundational" items upon which a correct determination of the defendants' liability may be made. Consequently, there was no need to void the assessment. There was at most a need to calculate the correct amount of tax due the government.

By the time that tax refund and other suits involving the merits of a TFRP assessment are sometimes brought to court by the taxpayers or the United States, it is not uncommon for the Service to have destroyed or lost some portion of its original records that might potentially be relevant to some aspect of the liability challenged by the taxpayers. In these circumstances, the United States is ordinarily able to show – through the original records it may still have (such as the employer's tax returns or files), documents obtained from neutral third parties (e.g., Secretary of State information, bank signature cards), or the testimony and other information obtained from witnesses related to the employer through discovery – that it has some foundation for its assessment and that the burden of proof should remain upon the taxpayer. In Morales v. United States, 805 F. Supp. 1062 (D.P.R. 1992), the taxpayers argued that the TFRP assessment against them was "naked" because the Service had apparently lost its file with respect to the employer who failed to pay the trust fund taxes at issue. Nevertheless, the district court in Morales found that the United States presented considerable evidence in that case to show that the TFRP assessments were not lacking an evidentiary foundation, so the burden of proof remained on the taxpayers. In United States v. Tarlow, 98-1 U.S.T.C. ¶ 50,473 (E.D.N.Y. 1998), the taxpayers sought to dismiss a TFRP assessment as invalid and lacking a rational foundation because the Service had apparently destroyed its original administrative file recommending the TFRP assessment against the taxpayer and the Service's revenue officer who made the TFRP recommendation had since retired and could not be located. Since the taxpayers and/or the United States had apparently earlier made and retained

copies of some of the pertinent records from the later destroyed TFRP file and the Service was going to provide the taxpayers either with a Certificate of Destruction or with an affidavit explaining the efforts it had made to locate the missing TFRP file, the district court concluded that it was not presented with a "naked assessment" case and it held that the presumption of correctness for the TFRP assessment remained.[8]

In another recent tax refund case involving a TFRP assessment and a missing administrative file of the Service with respect to the TFRP recommendation, Judge Francis Allegra of the U.S. Court of Federal Claims provided a thoughtful analysis of the meaning of the Janis and Coleman cases, and the possible effect of a "naked assessment" on the burden of proof in the taxpayer's case in chief (for refund of the paid portion of the TFRP assessment) and on the counterclaim of the United States (for the unpaid balance of the TFRP). See Cook v. United States, 46 Fed. Cl. 110 (Fed. Cl. 2000). In the Cook case, the court found that it could not determine whether the Service's loss of the TFRP recommendation file for the taxpayer gave rise to a "naked assessment" until the time of trial, when the United States would first be given an opportunity to show a foundation for the TFRP assessment. Judge Allegra noted, Cook at 114-5, that the Government's evidence to establish a foundation for a TFRP assessment need not include any documents or information that were originally in its possession when the TFRP assessment was made, as follows:

> As described in Janis and its progeny, however, an assessment is not "naked" simply because the administrative file supporting its entry is lost – what is critical, given the de novo nature of the proceedings before this court, is that admissible evidence exists to support the assessment. [citations omitted]. If such evidence exists, and is admitted by the court, it is irrelevant whether it is the same evidence that the Service relied upon in originally making its assessment. ... Indeed, consistent with the "no-look" doctrine, courts have repeatedly held that the government may support a tax assessment based on any admissible evidence, including that first disclosed in discovery, and conversely, need not rely solely, or at all, on the evidence reviewed administratively by the Service.

Issue 5: Appeals/Collection Coordination re Missing TFRP Information

In a taxpayer's CDP hearing or equivalent hearing case, where the merits of an unpaid TFRP liability are properly at issue (because the issue was timely raised by the taxpayer, and consideration of the merits is not precluded), the Appeals function should be no less deferential than the courts have been in affording the Service an opportunity to reestablish an appropriate foundation for a TFRP liability where all or part of the Service's original file recommending the TFRP assessment

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[8] At the eventual trial of the Tarlow case, the Government was ultimately unsuccessful. See United States v. Tarlow, 99-1 U.S.T.C. ¶ 50,338 (E.D.N.Y. 1999).

has been destroyed. In keeping with the independent review mission of the Appeals function, however, it is not the responsibility of the Appeals function to attempt to reassemble or gather the information necessary to provide a foundation for a TFRP assessment when the Service's file recommending the TFRP has been destroyed. Instead, as with other Appeals function hearing matters where further factual development of a Collection function case is necessary to make a full and fair determination, the Appeals function should retain jurisdiction of the case but refer the matter back to the Collection function for an appropriate time period.[9] The Collection function may then determine, under the particular circumstances of the case, whether it would be a cost effective use of its resources in that case to attempt to gather foundational evidence to support the unpaid TFRP liability.[10]

An appropriate model of Appeals/Collection function coordination may be found where a taxpayer protests a proposed TFRP assessment to the Appeals function. When the Collection function issues 60 day preliminary notices of proposed TFRP assessments to taxpayers, pursuant to section 6672(b), the Service's original file recommending the TFRP should almost always be readily available for consideration by the Appeals function. If a taxpayer files a timely protest to such a 60 day notice, the Appeals function still may decide that it is appropriate to retain jurisdiction of a case but to hold its consideration in suspense while matters requiring further factual development are referred back to the Collection function. In these cases of timely protests from 60 day notices, the time allowed by the Appeals function to the Collection function for further factual development is ordinarily at least 45 days, with extensions possible by mutual agreement of the parties. See IRM 8.11.1.8.8:(3). While these 60 day notice TFRP cases are being further developed by the Collection function, the Service does not assess the TFRP and, therefore, the taxpayer should not be prejudiced by the delay.

While it is generally desirable for the Appeals function to conduct and conclude its CDP hearings and equivalent hearings as expeditiously as possible, there are no time limits by law or regulation on when the Appeals function must issue its Notice of Determination or Decision Letter in a case. See Temp. Treas. Reg. § 301-6330-

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[9] A Form 2209 or another locally acceptable form may be used for this purpose. See IRM 5.1.9.3.6:(12) and 8.7.1.1.9.12:4.

[10] Whether or not the Service has retained the TFRP recommendation file for older TFRP liabilities should be an issue of lessening importance in a CDP context in future years. First, most taxpayers who were issued 60 day notices of proposed TFRP assessments pursuant to section 6672(b) (after June 30, 1996) should find that consideration of the merits of the TFRP liability is precluded in a CDP hearing or equivalent hearing. Second, most taxpayers who are liable for a TFRP liability in future year cases should be receiving their one CDP hearing notice per period much earlier in the collection process, and therefore be precluded from receiving a CDP hearing or equivalent hearing for the same liability when collection activity is again contemplated closer to the expiration of the collection limitation period for the liability.

1T:(e)(3)Q&AE8. Moreover, while a CDP hearing case is pending with the Appeals function, the proposed levy action by the Collection function that was the subject of the requested hearing is generally suspended. I.R.C. §§ 6330(e) and (f). When a taxpayer properly requests an equivalent hearing, the Service's proposed levy action is not automatically suspended, but the Appeals function may also request on a case-by-case basis that the Collection function suspend its proposed levy action in appropriate circumstances. See Temp. Treas. Reg. § 301-6330-1T: (i)(2)Q&AI-3. When the merits of a TFRP liability are properly at issue in a taxpayer's equivalent hearing request and the Collection function wants further time to reestablish the foundation for a TFRP liability because its original file recommending assertion of the TFRP has been destroyed, it would generally be appropriate (absent jeopardy circumstances) for the Collection function to agree to suspend its proposed levy action while an equivalent hearing case is pending with the Appeals function. Accordingly, while these CDP hearing or equivalent hearing TFRP cases with missing files are being further developed by the Collection function, the prejudice caused to the taxpayer by reasonable delays in the hearing process should be minimal.[11]

Therefore, as with 60 day notice cases involving the TFRP, it is appropriate for the Appeals function in a CDP hearing or equivalent hearing case to allow the Collection function no less than 45 days to decide whether to and to complete reconstruction of any necessary foundation evidence for a TFRP liability that is properly challenged by a taxpayer on the merits when the Service's original file recommending assertion of the TFRP has been destroyed. When the Collection function decides that it is cost effective for the Service to reconstruct the evidence supportive of the unpaid TFRP liability in these circumstance, but more than 45 days are required by the Collection function for this task, we believe the Appeals function should generally agree to reasonable extensions of the initial 45 day period. In some cases of this type, we expect the Collection function will decide that attempting to reconstruct the evidence is not a cost effective use of the Service's resources. The Collection function alone or the Collection and Appeals functions together may recommend advance selection tolerances to apply in these circumstances, with appropriate coordination and approval through the new SBSE structure. Such tolerances may be varied locally, with appropriate approval from the new SBSE structure, because workload and general deterrence considerations may differ in various parts of the country.

Please call the attorney assigned to this case at 202-622-3630 if you require further assistance.

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[11] During hearing process delays of this type, interest will admittedly continue to accrue on the assessed TFRP liabilities that are unpaid.