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

OFFICE OF
CHIEF COUNSEL

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MEMORANDUM FOR ASSOCIATE AREA COUNSEL (SB/SE) -

FROM: Mitchel S. Hyman
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Collection, Bankruptcy and Summonses CC:PA:CBS:BR1

SUBJECT:

In response to your memorandum dated September 5, 2001, we have reviewed five arguments that you intend to make in defending a Collection Due Process Notice of Determination. This assignment was coordinated with Branch 3 of the Office of Assistant Chief Counsel (Administrative Provisions and Judicial Practice). Our analysis and recommendations follows. This document may not be used or cited as precedent. I.R.C. § 6110(k)(3).

LEGEND

Year 1
Amount A
Date
Date 2
Date 3

ISSUES

1. Whether I.R.C. § 6201(a)(1) authorized the Service's assessment pursuant to the amended return filed by taxpayers.

2. Whether the amended return filed by the taxpayers constitutes a waiver of the restrictions on assessment.

3. Whether the taxpayers had an opportunity to dispute the tax liability during the pendency of the prior Tax Court case and are now precluded by I.R.C. § 6330(c)(2)(B) from arguing that the assessment violated I.R.C. § 6213(a).

4. Whether taxpayers are equitably estopped from contesting the validity of the assessment due to taxpayers' prior position taken in the stipulated settlement.

5. Whether the stipulated settlement that incorporated the assessment is a valid contract.

CONCLUSIONS

1. Yes. The circumstances in the current case are distinguishable from those in Powerstein v. Commissioner, 99 T.C. 466 (1992).

2. No. This argument is not consistent with Chief Counsel's position and should not be made in this case.

3. No. Whether an assessment is premature under I.R.C. § 6213(a) does not involve the existence or amount of the underlying tax liability.

4. Yes. This argument is supported by the facts. In addition, it is recommended that the argument of the duty of consistency doctrine be asserted.

5. Yes. The law of contracts applies to settlement agreements including stipulated settlements. However, we recommend that this argument be developed more fully.

BACKGROUND

The individual taxpayers, who filed a joint income tax return for Year 1, were issued a Notice of Deficiency containing several adjustments for Year 1 including an increase in gain on the sale of business property. The taxpayers timely filed a petition with the Tax Court assigning error to all of the Service's determinations. In addition, on the same date the taxpayers mailed the Tax Court petition, the taxpayers mailed to the Service an amended Year 1 Form 1040X wherein they reported an increase in income from the sale of business property resulting in an additional tax of $ Amount A.

The Service Center received the amended return on Date 1, and made an assessment based on the amended return on Date 2. The assessment was made because for unknown reasons, the Service did not enter a freeze code on taxpayers' account indicating a Tax Court petition had been filed until the same cycle as the one in which the assessment was made.

The taxpayers and Appeals ultimately entered into a stipulated decision for Year 1. Throughout the pendency of the case, the taxpayers were aware that the Service had made an assessment per their Year 1 Form 1040X. In fact, the taxpayers were receiving notices from the Service indicating that their account had been changed pursuant to the Form 1040X. In addition, the Appeals Officer gave the taxpayers computations for settlement purposes and such computations noted that the Form 1040X had been considered when issuing the report. At no point during the pendency of the Tax Court case did the taxpayers raise any objection to the assessment.
On Date 3, the Service issued the taxpayers a Form 1058-Notice of Intent to Levy for the taxes due for Year 1. The taxpayers timely filed a request for a Collection Due

Process hearing. Subsequent to this hearing, Appeals issued a Notice of Determination sustaining the Service's collection actions. Taxpayers timely petitioned Tax Court for review. In this petition, the taxpayers allege that the assessment of the $ Amount A tax liability was illegal and violated the restrictions on assessment under I.R.C. § 6213(a).

DISCUSSION

1. I.R.C. § 6201(a)(1) authorized the Service assessment pursuant to the amended return filed by the taxpayers. Section 6213 does not prohibit assessment in such cases.

Response: This argument can be made if an attempt is made to distinguish the present case from the fact situation in Powerstein v. Commissioner, 99 T.C. 466 (1992).

The essential thrust of this argument is that the $Amount A was voluntarily reported by the taxpayers on an amended return and, therefore, is not a deficiency as defined by section 6211. See I.R.C. § 6211. Because section 6213 specifically refers to assessment of deficiencies, that provision would be inapplicable to the situation in the instant case.

In Powerstein, the Tax Court ruled that amounts shown on a taxpayers' amended return were still subject to the restrictions of section 6213, due to the circumstances surrounding the filing of that amended return. In that case, however, the amount the taxpayers indicated on the amended return was an amount clearly in dispute with the Service and within the jurisdiction of the Tax Court at the time the amended return was filed. The Court in Powerstein further opined that the facts and circumstances surrounding the filing of the amended return conclusively indicated that the taxpayers were protesting the amount, in light of Treas. Reg. § 301.6211-1(a). Specifically, the taxpayers included handwritten notations on the returns that referred to the notice of deficiency and Tax Court proceedings that the Tax Court viewed as indicia of protest.

In the present case, there was no such situation: the $ Amount A increase in tax liability shown on the amended return was not being disputed. While the amended return was filed the same day as the taxpayers' petition and the two could be taken together as indicia of protest, each document was sent to a different entity and neither document contained a reference to the other. Moreover, unlike Powerstein, there was nothing on the face of the return to indicate the amount shown remained in dispute. Further, the taxpayers' later actions acknowledging the $ Amount A as part of the agreed tax liability for the year belie any suggestion that they intended to dispute liability for the amount at the time the amended return was filed. This factual situation strongly suggests that there was no clear indicia of protest that could be perceived by recipients of these documents. The present case, therefore, has several important distinctions from Powerstein and we have a strong argument that it is not subject to the determination made in that prior case.

2. The amended return filed by the taxpayers constitutes a waiver of restrictions on assessment, therefore the assessment was proper under section 6213(d).

<u>Response</u>: This argument is inconsistent with the position the office of Chief Counsel has recommended in other cases. To comply with relevant authority and ensure unity of position, this argument should not be asserted in this case.

Under section 6213(d), taxpayers can waive restrictions on assessment and collection of any deficiency by filing a signed notice in writing at any time, regardless of whether a notice of deficiency has been issued. Absent a statement that it is intended to be a waiver, an amended return (Form 1040X) in general is not considered to be a waiver. Amended returns, absent additional specific language, do not contain statements indicating or implying that they are meant to serve as waivers of restrictions on collection and assessment.

The Office of Chief Counsel has previously expressed the opinion that amended returns unaccompanied by payment or other indication of intent to waive restrictions on assessment do not constitute a waiver of restrictions on assessment. In GCM 36343 (July 23, 1975), the Office of Chief Counsel took the position that any waiver of restrictions on assessment imposed by IRC § 6213(d) must be clear and unambiguous. In the situation contemplated in GCM 36343 and identical to the present case, where the only communication from a taxpayer is a standard 1040X form, too much ambiguity exists as to the intent of the taxpayer to construe the amended return as a waiver.

3. Taxpayers had opportunity to dispute the tax liability during pendency of the prior Tax Court case and are precluded from doing so now under section 6330(c)(2)(B).

<u>Response</u>: This argument should not be asserted in this case because the question of whether the assessment violated I.R.C. § 6213(a) does not relate to the "existence or amount " of the tax liability.

I.R.C. § 6330(c)(2)(B) provides:

> [T]he person may also raise at the hearing challenges to the existence or amount of the underlying tax liability for any tax period if the person did not receive any statutory notice of deficiency for such tax liability or did not otherwise have an opportunity to dispute such tax liability.

In the present case, the taxpayers received a Statutory Notice of Deficiency for Year 1 and filed a petition to redetermine the deficiency with the Tax Court. Thus, it is clear that the taxpayers had a prior opportunity to dispute the existence or the amount of the underlying tax liability and were precluded in the CDP hearing from contesting the underlying tax liability under I.R.C. § 6330(c)(2)(B).

In the situation at bar, the question is whether a taxpayer's argument that the assessment was prohibited by I.R.C. §6213(a) relates to the "existence or amount" of the underlying tax liability. The Internal Revenue Code provides that taxpayers are required to pay taxes owed "without assessment or notice and demand from the Secretary..." I.R.C. § 6151(a); see Teixeira v. United States, 85 A.F.T.R.2d (RIA) 1657 (D.S.C. 2000). Persons are subject to tax liability as a matter of law and not as a consequence of assessment. Zeier v. United States, 80 F.3d 1360 (9th Cir. 1996). Assessment is "essentially a bookkeeping notation that is made when the Secretary or his delegate establishes an account against the taxpayer..." Laing v. United States, 423 U.S. 161, 170 (1976). Moreover, it is not necessary that a tax be assessed for the taxpayer to be liable for the tax. Bronson v. United States, 28 Fed. Cl. 756 (1993). In Lewis v. Reynolds, 284 U.S. 281, 283 (1932), the Court held that although a statute of limitations barred the assessment of an additional sum, it did not impair the right of the United States to retain payment when these payments did not exceed the amount that might have been properly assessed. Thus, the existence of a tax liability is dependent upon the tax being imposed pursuant to the Internal Revenue Code and not whether the tax was properly or timely assessed.

In a Collection Due Process (CDP) hearing, the Secretary is to obtain verification that the requirements of any applicable law or administrative procedure have been met. I.R.C. § 6330(c)(1). It is our position that determining whether a tax was properly assessed is a procedural question to be addressed under I.R.C. § 6330(c)(1). I.R.C. § 6330(c)(2)(B) provides for an Appeals hearing to address procedural matters such as the validity of an assessment, spousal defenses, and possible alternative means of collection. The taxpayer's argument that the assessment was made in violation of I.R.C. § 6213(a) is specifically the type of issue meant to be raised in a CDP hearing.

Thus, our position is that the question of whether the assessment was premature under I.R.C. § 6213(a), is a procedural matter that can be raised at a CDP hearing despite the prior issuance of the notice of deficiency and is not barred by I.R.C. § 6330(c)(2)(B).

4. Taxpayers are equitably estopped from contesting the validity of the assessment, due to the taxpayers' prior position taken in the stipulated settlement, wherein the assessment of the $ Amount A was a clear term of that settlement.

Response: This argument has a likelihood of success. In addition, we recommend that you add an argument under the related duty of consistency doctrine.

Equitable estoppel is appropriately raised in the present case. As discussed in the incoming memorandum from the field, the elements of equitable estoppel are present. Equitable estoppel is designed to prohibit a party from inducing detrimental reliance by another party in a transaction and has six elements required for application, which are described in the memorandum from field counsel. [redacted]

[redacted]

[redacted] the related equitable doctrine known as quasi-estoppel and commonly referred to as the "duty of consistency" should be raised as an alternative argument. Whereas equitable estoppel is a general legal doctrine that can be applied to a broad range of legal issues, the duty of consistency has been narrowly tailored to apply to cases arising under federal income tax laws. See Beltzer v. United States, 495 F.2d 211 (8th Cir. 1974); Lefever v. Commissioner, 103 T.C. 525 (1994); Unvert v. Commissioner, 72 T.C. 807 (1979); Hollen v. Commissioner, T.C. Memo 2000-99, 79 T.C.M. (CCH) 1719 (2000); Hughes and Luce, L.L.P. v. Commissioner, T.C. Memo 1994-559, 68 T.C.M. (CCH) 1169 (1994); 15 Mertens, The Law of Federal Income Taxation 60:05 (2000); Steve R. Johnson, The Taxpayer's Duty of Consistency, 46 Tax L. Rev. 537 (1991).

The duty of consistency has been developed by the courts into a specific doctrine with simplified applicability. According to this argument, where a taxpayer takes a defined position on an issue in one tax year or makes a representation to the Commissioner, the duty of consistency prohibits the taxpayer from taking a different position on that same issue regarding a later tax year or the same tax year at a later time, particularly where the Commissioner would be prevented from recalculating or reassessing tax liability stemming from the earlier year due to statutes of limitation.

There are only three commonly cited elements to the duty of consistency: "(1) the taxpayer made a representation or reported an item for Federal income tax purposes in one year, (2) the Commissioner acquiesced in or relied on that representation or report for that year, and (3) the taxpayer attempts to change that representation or report in a subsequent year, after the period of limitations has expired with respect to the year of the representation or report, and the change is detrimental to the Commissioner." Hughes and Luce, 68 T.C.M. at 1171. All other cases cited herein use these three elements with the same or similar language. This simplified framework indicates that the duty of consistency is more easily applied, with fewer elements to satisfy than other estoppel theories. Southern Pacific Transportation v. Commissioner, 75 T.C. 497, 838-839 (1980) (where the Tax Court stated: "[q]uasi-estoppel, or 'duty of consistency,' is akin to [equitable] estoppel and has the same effect but is sometime applied when one of the technical elements of estoppel is not present. It is based on the theory that the taxpayer owes the Commissioner the duty to be consistent with his tax treatment of items and will not be permitted to benefit from his own prior error or omission."); Mertens, supra at 60-25. (stating that the duty of consistency can be raised even where all six elements of equitable estoppel are not present). Specifically, the duty of consistency differs from equitable estoppel in that the duty of consistency "is applied even where reliance [by the party asserting estoppel] is not based upon any misstatement of fact, whether innocent or otherwise." Id. The Tax Court in Hollen stated that "the duty of consistency applies equally to a taxpayer who innocently misrepresents a fact in a time-barred year and one who misleads intentionally." T.C. Memo 2000-99.

As used by the Tax Court, the duty of consistency and the attendant terminology and elements of applicability appear to be best suited for tax cases. In each case cited above, the taxpayer made a representation of fact that affected tax liability in a particular year. When next reporting on a different tax year that involved the same fact or where reassessing items for the same tax year at a later date, the taxpayer made a different representation or sought to recharacterize the earlier-reported fact situation. In each case, the Tax Court prevented the taxpayer from changing the representation of fact in any way from the initial representation of that same fact.

We recommend alternative arguments under the doctrine of equitable estoppel and duty of consistency. We believe the facts support both theories [redacted]

5. The stipulated settlement that incorporated the assessment of the $12,655 is a valid contract. Contesting the validity of the assessment at this point would require the Service to vacate the entire settlement and enter the disputed assessment as a deficiency.

Response: The law of contracts is deemed to apply to settlement agreements, including stipulated settlements entered by the Tax Court. Kokernot v. Commissioner, 70 T.C. Memo 1995-590, 70 T.C.M. (CCH) 1559, 1561, aff'd 112 F.3d 1290 (5th Cir. 1997) (where the Tax Court stated, "[l]ike contracts, stipulations of settlement bind the parties thereto to the terms thereof."). Several federal courts have stated that a settlement of tax liability creates a contract between the taxpayer and the Internal Revenue Service. Smith v. United States, 850 F.2d 242 (5th Cir. 1988); United States v. Lane, 303 F.2d 1 (5th Cir. 1962); Cooper Agency v. United States, 301 F.Supp. 871 (D. S.C. 1969), aff'd per curiam 422 F.2d 1331 (4th Cir. 1969), cert. denied 400 U.S. 904 (1970); Rink v. Commissioner, 100 T.C. 319 (1993); Temple v. United States, 11 Cl. Ct. 302 (1986). A contract thus created, the principles of contract law govern the behavior of the parties and the interpretation of the agreement. Cooper Agency, 301 F.Supp. at 875. The agreement itself is interpreted according to its language and the circumstances surrounding the formation of the agreement. McGivney v. Commissioner, T.C. Memo 2000-224, 80 T.C.M. (CCH) 94; Robbins Tire & Rubber Co. v. Commissioner, 52 T.C. 420 (1969). In this case, this suggests both that the stipulated settlement between the taxpayers and the Service is an enforceable contract and that the below-the-line references to the $ Amount A assessment can be viewed as part of the contract.

[redacted]

[redacted]

If you have any questions, please call the attorneys assigned to this case at 202-622-3610.