Dalton I, II, III and IV

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> "E. Protections for Taxpayers Subject to Audit or Collection Activities
> 1. Due process in IRS collection action
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> …
>
> Senate Amendment
>
> The Senate amendment establishes formal procedures designed to insure due process where the IRS seeks to collect taxes by levy (including by seizure)."
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> From *IRS Restructuring and Reform Bill of 1998, Conference Report* as released on June 24, 1998, CCH, p. 82-83.

These words describe the intent of Congress in establishing collection due process hearings. The words "due process" appear twice in these few words. "Due process" is a term of art which does not have much meaning out of context. The *Black's Law Dictionary* definition of "due process of law" covers over half a page. A single sentence from that definition might cover the definition for our purposes, "A course of legal proceedings according to those rules and principles which have been established in our systems of jurisprudence for the enforcement and protection of private rights." The emphasis here is on a legal procedure whose purpose is to protect private rights against the overwhelming power of the government. That was the explicit purpose of Congress when it adopted the rules to be followed in collection due process hearings. That is, to make it harder for the IRS to take money and property from taxpayers by force; to be sure the taking was fair; to be sure that all the taxpayer's arguments were considered in an unbiased way. This article is about due process as it has developed since 1998 in collection due process hearings.

Why should EAs care about this? This article will not be easy reading. Why should you invest the time? I believe there are several reasons. First, collection due process hearings represent a huge market for our services. The IRS conducts approximately 100,000 of these each year and the number has been growing. In order to deal with the volume, the IRS basically tries to throw taxpayers out on "technicalities." Without proper representation, this is how many of them end.

Second, the process, while conducted informally, is a quasi-judicial one. Both sides must follow very specific rules in order to develop a "record" which can support an appeal to the Tax Court. As we will see below, if the record is not properly constructed, the taxpayer loses.

Third, it might be the only path available to solve your clients' problem. Of course, it would always be better to settle the matter with a revenue officer, but, many times taxpayers have already blown through that process by the time they realize they need help. There will only be one "Notice of Your Right to a Hearing" for each tax period. EAs have a responsibility to insure that the rights of clients are respected.

Finally, collection due process hearings are the acme of EA practice. At this venue, your license affords you the same authority as one who went to law school and passed the bar exam. Tax

return preparers are prohibited from practice. It should be your pleasure to practice at a collection due process hearing.

The Record

The "record" referred to here is simply the file kept by the settlement officer who conducts the hearing. It should contain all the facts and all legal arguments about those facts considered by the settlement officer. Congress granted jurisdiction to the Tax Court to hear appeals from collection due process hearings with a single sentence.[1] Unfortunately the statutes are silent as to exactly what this grant of jurisdiction meant. The Courts have found it necessary to look to the *Conference Committee Report* where the following information is found:

> The amount of the tax liability will in such cases be reviewed by the appropriate court on a *de novo* basis. Where the validity of the tax liability is not properly part of the appeal, the taxpayer may challenge the determination of the appeals officer for abuse of discretion.[2]

This material contains two terms of art which have been argued about, and are being argued about, to this day. The first is "*de novo*." *Black's Law Dictionary* defines this one as, "Anew; afresh; a second time." In our context, it means that the Tax Court is not bound by previous findings with regard to the tax liability. It can start from scratch to compute the tax. Both sides must present evidence to support their positions and the Court may determine what is admissible and what is not. This is normal Tax Court procedure.

The definition of "abuse of discretion" is not so short. Here is a part of the definition:

> A discretion exercised to an end or purpose not justified by and clearly against reason and evidence. Unreasonable departure from considered precedents and settled judicial custom, constituting error of law.

I used this because it includes the word "unreasonable." Presumably, if the decision was "reasonable," it would not meet this definition and would not be an abuse of discretion. Note that the definition is *subjective*. What is reasonable to one person might not be to another. The Courts have tied themselves in knots over this ever since 1998. We will return to this idea of "reasonableness."

The practical effect of this definition is to limit the Tax Court to the "record" as established by the settlement officer with regard to collection issues. The thinking here is that, if the facts or arguments relied upon by the taxpayer were not presented to the settlement officer (and are therefore not found in the record), then the settlement officer could not have acted unreasonably, and did not commit an abuse of discretion.

NAEA and the *IRS Restructuring and Reform Act*

The years 1997 and 1998 were heady times for NAEA and its members. Margaret M. Richardson had been Commissioner from May 27, 1993 to May 23, 1997. The major event of

her term was the reorganization of the IRS. We lost "regions" to be replaced with "areas." We lost "districts" to be replaced by "territories." We lost "district directors" to be replaced by unknown people with unknown titles and unknown responsibilities. The main result of this was that IRS employees became disoriented and unsure as to exactly what they were supposed to do. Some of them decided to mistreat taxpayers.

By 1997 the problems had attracted the interest of Congress which established the "National Committee on Restructuring the IRS." This committee existed for almost a year and NAEA was an active participant in its deliberations. NAEA member Joe Lane attended meetings and provided testimony almost every month. William Stevenson was not actually listed as a witness, but attended the meetings. Bryan Gates was also active in the process and was called to deliver the NAEA testimony before the Senate Committee on Finance Chaired by Senator William V. Roth, Jr. Bryan raised three main points: the statute of limitations on collections was often not recognized by the IRS; unrestricted authority of revenue officers to seize personal residences; and seizures of property from people under summonses.[3] All three of these items were addressed in the final bill. All three NAEA members, and others too, are proud of their efforts during this period as they should be.

Senator Roth held office as a Republican Senator from Delaware from January 1, 1971 to January 3, 2001. He was Chairman of the Senate Committee on Finance from September 12, 1995 to January 3, 2001. The reason I mention him is that the inclusion of collection due process hearings was instigated by him (and other members of the Committee) and was a complete shock to everyone. Not one of the NAEA people who were active in the matter had any idea that this was coming, nor did anyone else.

At the time, it seemed that EAs would be able to practice before a junior "court" whose purpose was to resolve collection issues. It turned out to be not quite that good, but almost. The government is still working out the details of its authority. The Act basically put the IRS out of business as far as collection activity for a couple of years.

Robinette **and the Record**

It took six years from 1998 to 2004 for a major case concerning "the record" and abuse of authority to be decided by the Tax Court. The focus of the storm was a U.S. Tax Court decision in *Robinette v. Commissioner.* There are a number of indicia that this was an important case. First, it was designated a "National Office" case by the IRS. That meant that local attorneys representing the IRS had almost no authority to make any decisions. Every single one was reviewed by the National Office. Next, this was a "reviewed" decision by the Court. In this situation, seventeen judges participated. In normal decisions, a single judge is considered sufficient. These seventeen judges participated in various combinations in the opinion, a dissenting opinion, and five concurring opinions. Finally, the Office of Chief Counsel saw fit to issue a notice describing in detail how its attorneys were to deal with situations which might be affected by the *Robinette* decision. At that point and without knowing anything further about the case, many stalwart people would have rationally decided that they did not want to step into the middle of this mess. I think I can tell you that Dr. Robinette wished fervently that he had never heard of a collection due process hearing.

In extreme abbreviation, the issue concerned an offer in compromise negotiated on behalf of Dr. Robinette in which the government compromised $989,475 in taxes due for payments totaling $100,000. Dr. Robinette also promised to file his returns on time and pay the taxes due on time for five years. The IRS now claimed that he had filed one of those returns late thereby defaulting on the offer and voiding it.

Troy C. Talbott was the Appeals Officer assigned to the CDP hearing. Mr. Talbott did review the IDRS and (surprise!) found no record of the receipt of the 1998 return. He then concluded that Dr. Robinette had defaulted on the offer in compromise. The "hearing" consisted of a telephone call on January 29, 2001 at which Mr. Coy [lawyer representing Dr. Robinette – Mr. Coy had also prepared and mailed the tax return in question] argued that the return was filed on time and described the events of October 15, 1999 when he filed the return. Mr. Talbott rejected this position because it did not meet the requirements of IRC section 7502. He further stated that he did not know if he had authority to reinstate the OIC anyway. Appeals officers have not been delegated authority from the Commissioner to accept offers in compromise. If this is true, then how can they reinstate them? He tried on at least two occasions to get advice from the National Office and was refused. The Internal Revenue Manual was silent on the issue.

The entire "record" created at the hearing consisted of the original Form 12153, the parties' recollections as to what was said during the January 29, 2001 telephone call, and a single paragraph written by Mr. Talbott stating that the OIC was defaulted because the return was not filed on time.

The Court reviewed the record of the CDP hearing and found it lacking. There was simply not enough information to make a decision as to the default of the OIC. Instead, it allowed the taxpayer a complete trial *de novo* before the Tax Court. This allowed the taxpayer, his lawyer, and other witnesses to testify — something which was not available at the CDP hearing. Documents were accepted into evidence. In short, the Court did not just review Mr. Talbott's decision; instead, it substituted a complete trial for the hearing as if the hearing had not taken place. Then it compared the result of the trial with Mr. Talbott's finding and decided that he had abused his discretion.

In one respect, the trial result was the same as Mr. Talbott's: the return was not filed on time and the OIC could be defaulted on this basis. In order to find the abuse of discretion, the Court came up with a long and complicated analysis of Arkansas contract law to determine that the breach of contract was not "material." These arguments were not presented by anyone. Not Mr. Coy. Not the petitioner's lawyer at trial. Not the IRS. Apparently the Court came up with the arguments on its own — a fact pointed out in the single dissenting opinion.

This case was so important because it was a part of the battle between the Tax Court and the IRS as to which was to control collection due process hearings. If Dr. Robinette won on appeal, then the Tax Court would control the hearings, if not, the IRS would control them. Dr. Robinette (and the Tax Court) lost when the Eighth Circuit overturned *Robinette*.[4]

The Tax Court is a resourceful organization and it fought back over the next few years with what I call the "do over." That is, in cases where the record produced by the settlement officer was clearly inadequate, the Tax Court would remand the case back to Appeals with instructions as to what information should be included in the new and improved "record" for the case. While the IRS still controlled the hearing and its record, this gave taxpayers a second chance to get their arguments and facts on the record. The IRS does not like "do overs." The Dalton series of cases is the most recent battle in the war between Tax Court and the IRS.

Cast of Characters

Arthur and Beverly Dalton.

Everyone involved accepts the following description of the Daltons. The description was included with their Form 12153, Request for a Collection Due Process Hearing. Judge Wells included it in his *Dalton I* decision (see below). Everyone agreed with it including the settlement officer and various lawyers representing the IRS.

> Since 1996, the taxpayers have been in contact with the IRS regarding the satisfaction of this obligation. Mr. Dalton is in his mid 60's [sic]. He is totally disabled as a result of workplace injuries suffered over time and resulting arthritis. Mr. Dalton has suffered cardiac problems and has undergone open chest by-pass surgery. Mr. Dalton has limited employment options and has been unable to work since 2000. Mrs. Dalton is in her mid-60's [sic]. Until recently, Mrs. Dalton has been the caretaker for Mr. Daltons [sic] elderly mother who suffers from senile dementia and other health problems. Mrs. Dalton has been and remains unemployable. The Daltons have not made enough money in any year since 1999 to require the filing of federal tax returns. There is no possibility that they will ever be able to pay the accumulated tax obligation. [The first two grammatical errors are noted by me, the last is in Judge Wells's original.]

Ralph A. Dyer

Mr. Dyer is the attorney who represented the Daltons starting with an offer in compromise in 1999 through *Dalton I, Dalton II*, and *Dalton III*. He retired in about 2011 before the appeal in *Dalton IV* could be heard.

I searched the internet under his name and came up with an article dated September 20, 2011 in *The Portland Press Herald* headed, "Unprofessional conduct fine upheld against lawyer." The article contained the following about the fine, "The state's supreme court in December fined Ralph Dyer $2,500 for 'an escalating tirade of unsupported accusations and aspersions' that questioned the independence and competence of a lower-court judge." I thought to myself upon reading this, "Whoa. Mr. Dyer must be a *lawyer*!"

John W. Geismar

Mr. Geismar is an attorney whose office is in Lewiston, Maine. He inherited the case from Mr. Dyer and was one of two lawyers who represented the Daltons before the First Circuit. He was kind enough to speak with me about the case on the telephone on December 5, 2013. Of course he knew Mr. Dyer and used some colorful words to describe a colorful guy. He said Mr. Dyer was, "a remarkable guy," "a Don Quixote," and that he, "pissed off everyone."

Thomas B. Wells

Tax Court Judge Wells wrote decisions for *Dalton I, Dalton II, and Dalton III*. He was born in 1945 and therefore was 65 years old when he finished *Dalton III*. It must have been one of his last cases because he assumed senior status on January 1, 2011. His education included various degrees from Miami University, Emory University School of Law and New York University Graduate School of Law. He was nominated by Ronald Reagan and his first term began October 31, 1986.

Bruce M. Selya

Judge Selya wrote the decision in *Dalton IV*. Because of this, I will use his name when referring to the decision, even though three judges participated. In using the author's name, I intend to refer of the panel of three judges.

If Judge Selya was 21 years old when he received his undergraduate degree from Harvard, he was about 78 years old when he wrote *Dalton IV*. He received his law degree from Harvard Law School. He was appointed to District Court in 1982 and to the First Circuit in 1986, which would indicate that Ronald Reagan nominated him. Two other judges participated. Michael Boudin would have been about 72 years old when *Dalton IV* was decided if he received his undergraduate degree from Harvard when he was 21. He also received his law degree from Harvard Law School. He worked in the Justice Department under Ronald Reagan and was appointed to District Court and to the First Circuit under George H. W. Bush. Sandra L. Lynch would have been about 65 years old when *Dalton IV* was decided if she received her undergraduate degree from Wellesley College when she was 21. She received her law degree from Boston University School of Law. She was appointed by Bill Clinton.

Dalton IV

I would like to start with the conclusion because the final decision is the most newsworthy.[5] The first three went by pretty much unnoticed. Dalton IV has been widely covered in the tax press for the proposition that the IRS must only be "reasonable" in the positions it takes in collection due process hearings. It is not necessary at all that the positions be "correct."[6] Here are the first three paragraphs of the decision which pretty well summarize the whole thing:

> This appeal turns primarily on the standard of review that courts should apply when examining conclusions reached by the Internal Revenue Service (IRS) following a collection due process (CDP) hearing. *See* 26 U.S.C. § 6330(b). While courts generally have agreed that review in this context is for abuse of discretion, no court has had the occasion to parse that standard and analyze how it

> plays out with respect to subsidiary factual and legal determinations made by the IRS during the CDP process. We grapple with that issue today.
>
> The issue arises in a case in which the taxpayers offered to settle their tax liability for pennies on the dollar. The IRS determined that the taxpayers could afford to pay more because they owned valuable real estate and, therefore, rejected the offer in compromise. In a first-tier appeal, the Tax Court reviewed the IRS's underlying ownership determination *de novo*, found that the taxpayers were not the owners of the real estate in question, and directed the IRS to accept the offer in compromise. It later ordered the IRS to pay attorneys' fees to the taxpayers as prevailing parties.
>
> We hold that the Tax Court employed an improper standard of review with respect to the IRS's subsidiary determinations. Applying a more deferential standard to these determinations consistent with the nature and purpose of the CDP process, we conclude that the IRS did not abuse its discretion when it rejected the taxpayers' offer in compromise. The IRS acted reasonably in determining that the taxpayers were the owners of the property and, thus, the equity in the property was appropriately considered when the IRS evaluated the compromise offer. Consequently, we reverse the Tax Court's judgment.[7]

The standard interpretation of this decision can be found in an article by William E. Taggert, Jr. in the October-November 2012 issue of *The Journal of Tax Practice and Procedure*.[8] Mr. Taggert is a tax lawyer whose practice is in Oakland, California. He has represented a number of tax cases at Circuit Courts of Appeals. I discussed his article with him during a telephone call on November 30, 2013. He said that the Daltons were stonewalling the IRS and that the Tax Court fell for this stonewalling and the First Circuit did not. He gave the impression that he was happy that the Daltons and their lawyer had been caught in their scheme. He insisted that the Tax Court exceeded its authority in determining the accuracy of the IRS brief on the Daltons' ownership interest in real estate. He said that IRS positions had only to be "reasonable," and not "correct." I asked if there was any conceivable circumstance where the Tax Court could correct an obvious error in a determination of law made by the IRS in a collection due process hearing. He did not respond to this question.

I object to this impression on both an emotional level and on an objective one. I will explain the objective arguments below, but the emotional argument goes like this: Here we have the Daltons who are destitute, aged, and sick (as proven by ten years of litigation). They were represented by Mr. Dyer who, according to Mr. Geismar, was acting *pro bono* because he sincerely believed that the Daltons rights were being disrespected by the IRS. Again, according to Mr. Geismar, Mr. Dyer knew he could file a claim for his fees if he won, but he also knew that actually being paid was a long shot at best. His objective was fair treatment for the Daltons. Mr. Dyer feared the results demanded by the First Circuit because the Daltons would then suffer IRS collection activity for the rest of their lives and because the IRS probably would never collect the $5,000 that the Daltons had offered. In these circumstances, it beggars credulity to conclude that the destitute Daltons and a *pro bono* lawyer were "stonewalling" a defenseless IRS! Furthermore,

the conclusion would be that Mr. Dyer, in addition to being obstreperous, was participating in a fraud against the IRS by maintaining frivolous positions during litigation which lasted a decade.

So much for the emotional arguments on both sides. Now back to the case and the decision in *Dalton IV*. The First Circuit determined that this issue of IRS positions in collection due process hearings was new (this was in contrast to Judge Wells who thought he should be able to review IRS positions under the abuse of discretion rules). If the issue was new, then the First Circuit had a particular responsibility to define the new standard. It used the word "reasonable" in this regard several times. Here are several quotations from the case using the word:

1. "…a court's role in the CDP process is simply to confirm that the IRS did not abuse its wide discretion and – as part and parcel of that inquiry – to ensure that the agency's subsidiary factual and legal determinations were reasonable."
2. "Thus, a court should set aside determinations reached by the IRS during the CDP process only if they are unreasonable in light of the record compiled before the agency."
3. "…is for a reviewing court to consider whether the factual and legal conclusions reached at a CDP hearing are reasonable, not whether they are correct."

Repeated use of the same word does not define the word. In fact, one can search in vain for a definition of the word "reasonable" in the entire decision. Then one contemplates a "more deferential standard. [See quotation above.]" What the heck does this mean? More deferential than what? More deferential than "reasonable"?[9]

Judge Wells and "abuse of discretion"

Before proceeding to some details about the IRS position and how Judge Wells dealt with it, I should say that Mr. Geismar was quite upset over his appearance at the First Circuit. He had reviewed every case where Judge Wells had been appealed and found there were about eleven. Judge Wells was reversed on the very first one of these in his career, but had been sustained in every single one after the first. In other words, Judge Wells had been sustained in ten appeals in a row. Mr. Geismar determined in his own mind that the legal brief relied on by the appeals officer during the collection due process hearing was "second rate." After reviewing Judge Well's legal arguments, he agreed, as a lawyer who practices in Maine, that Judge Wells had "nailed" the legal issues regarding ownership under Maine law. In short, he thought the appeal was an "open-and-shut" case. He thought he would win walking away.

When he stood to make his arguments, he identified himself and was immediately peppered with hostile questions. The panel did not allow him to make his presentation and refused to accept his answers to their questions. They made it perfectly clear that their minds were made up regardless of what he said and that he was going to lose. On the drive back home, Mr. Geismar tried to figure out what had happened. This was among the few times in his career when he felt bereft of due process.

By the time *Dalton III* was decided in 2011, Judge Wells had been on the bench for 25 years. In general, his decisions were well-respected by his peers. At that time he had worked on the Dalton cases for at least four years and had written three decisions. He had worked with the

concept of “abuse of discretion” on a practical level at least since before *Robinette* in 2004 (seven years).

One can only speculate that Judge Wells was as shocked as Mr. Geismar had been over the decision by the First Circuit. Judge Selya simply brushed aside a lifetime of professional experience and declared that Judge Wells did not understand concepts which Judge Wells had spent most of his professional life dealing with. As to the definition of reasonableness, Judge Selya brushed aside at least four years of personal experience dealing with the parties and the mental exercise of writing three decisions. The author does not know what Judge Wells thought, but one can appreciate that he might have felt insulted and angry.

Since Judge Wells must have a different definition of the term “reasonable” than Judge Selya, perhaps we could gain some purchase on the difference by seeking Judge Wells’s definition in *Robinette*. Indeed, when the case is reviewed, we find that Judge Wells voted for the final decision. He concurred with additional decisions written by Gerber, Foley, Marvel, and Wherry. He also wrote one of his own.

Before proceeding to Wells in *Robinette*, we should remember that the whole mess was overturned by the Eighth Circuit. Everyone now agrees that the Tax Court can’t find an abuse of discretion if the basis for the abuse was not present in the record of the collection due process hearing. The Tax Court can’t conduct a trial to establish new facts and arguments not available to the appeals officer. In *Robinette*, the Tax Court was wrong to come up with a bunch of complex arguments about state contract law which were never put to the appeals officer by either the IRS or the taxpayer and then use them to find an abuse of discretion.

Judge Wells did not make this mistake. Here is his description of “due process” in collection due process hearings as he wrote in his concurring decision:

> I respectfully write separately to express my belief that the majority opinion may have unnecessarily focused its analysis on contract law to decide whether respondent abused his discretion in the instant case. Section 6330(c)(3)(C) requires the Appeals officer to consider “whether any proposed collection action balances the need for the efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary.” This provision requires the Appeals officer, when conducting a hearing under section 6330, to carry out a balancing of competing considerations between the Government and the person against whom the collection action is instituted. Given this balancing requirement, I do not believe the Appeals officer should be required to <u>rigidly</u> apply contract law in determining whether the Government should proceed with collection of a liability where that liability, as in the instant case, has been compromised in an agreement between the Government and the person against whom the collection action has been instituted. Such a requirement would detract from the flexibility and discretion Congress granted the Appeals officer in section 6330(c)(3)(C) to balance competing interests between the Government and those persons. Consequently, I believe the focus of the

> analysis in should be on whether respondent failed to undertake the balancing required under section 6330(c)(3)(C). [Footnote omitted.]

Judge Wells then goes to find that the "balancing" should have gone in favor or the taxpayer:

> The abuse of discretion in failing to undertake the required balancing becomes apparent when taking into account the petitioner had timely filed his other returns as agreed in the offer-in-compromise agreement, had made a good faith effort to timely file the 1998 return, and had paid all the tax due in that return and was due a refund.

This balancing is obviously a completely subjective act and Judge Wells came to the opposite conclusion from Mr. Talbott. The Eighth Circuit agreed that a balancing was required, but found that Mr. Talbott had done it correctly (!):

> We also believe that he appeals officer did reasonably "…balance the need for efficient collection of taxes with the legitimate concern of the person that any collection action be no more intrusive than necessary." 26 U.S.C. § 6330(c)(3)(C). His memorandum specifically referred to this balancing test and noted the absence of any acceptable alternative that would be less intrusive than the levy. (Ex. 28-j). Robinette had been relieved by the original offer-in-compromise of his obligation to pay more than $800,000 in taxes that he owed to the Treasury. In exchange, the compromise included an express condition that Robinette file future tax returns in a timely manner. Robinette then elected to follow a practice of seeking multiple extensions of time and filing his return on the last possible day. As an apparent consequence of this practice, the 1998 return was not timely filed. The appeals officer acted within a reasonable range of discretion by concluding that merely reinstating the original offer, despite Robinette's breach of an express condition of the agreement, was not an acceptable alternative.[10]

Apparently the Eighth Circuit thought that, in a balancing of $800,000 against a return which might have been a few hours late and cost the government little or nothing, the late return "weighed" more. I can tell you with some confidence that the next stop for Dr. Robinette's lawyer was to be the professional liability insurance policy purchased by Mr. Cox (Mr. Robinette's lawyer/tax return preparer).

We now conclude that Judge Wells probably thought that Congress intended that the offer of due process in section 6330 was to redress the overwhelming power of the IRS when directed against individual taxpayers. Taxpayers were to have a bit of wiggle room in collection due process hearings. Appeals officers were to rule against their employer (the IRS) when it acted with too much zeal. (Notice the almost impossible conflict of interest suffered by appeals officers!) The Eighth Circuit disagreed with this and held that taxpayers must follow every detail of offer-in-compromise agreements to the letter despite section 6330.

Judge Wells and "reasonableness"

Now it is back to the Daltons and our search for a definition of "reasonable" when it comes to legal positions taken by the IRS in collection due process hearings. Since we do not have a general definition, perhaps we should look to the actual positions taken by the IRS in this very case to see if they were "reasonable." These positions must meet the definition we are seeking or the First Circuit would not have found them to be reasonable.

The position in question had to do with whether the Daltons had a nominee interest in the corpus of a trust established by Mr. Dalton's father for Mr. Dalton's children. This trust was established more than a decade before the Daltons encountered their tax problems. In order to make this determination it was necessary to review detailed provisions of Maine's trust law and court cases. Mr. Dyer argued adamantly that they did not. The settlement officer had no clue. Therefore, she sought and obtained an advisory opinion from the IRS Office of Chief Counsel. This opinion found that the Daltons did have such an interest. The settlement officer, being herself not competent to form such an opinion, and also being reluctant to overrule an opinion from Chief Counsel, and putting aside the issue of her authority to do so, followed the Chief Counsel opinion. This failure to give equal weight (as required by section 6330) to the opinions of Mr. Dyer and the IRS was, in the view of Judge Wells, an abuse of discretion.

At this point the reader might feel the need to examine the facts and legal reasoning as to whether the Daltons had an interest in the trust property so as to form his or her own opinion as to the reasonableness of the position. Such readers can find this in *Dalton II*.[11] Unfortunately, this decision prints out to fifty-four pages of complex legal reasoning which, the author hopes, will prove unnecessary here. As to the facts, the Daltons were not completely sympathetic figures because they were living rent-free in the house owned by the trust for the benefit of their two sons. This fact probably fouled up the income computations on Form 433-A and probably *did* give the IRS a reason to reject a token offer amount. Also, the relationship between the Daltons and the trust was not documented at all and trust records were a mess. Unfortunately, these did not give the Daltons a nominee interest in the trust property under Maine law.

So here is where we are from the point of view of Judge Wells: The IRS has rejected an offer-in-compromise for the sole reason that it did not include a nominee interest in the trust property. The only support for its position was the advisory opinion from Chief Counsel. Judge Wells thought that the only way to tell if the IRS had abused its discretion was to determine if the opinion was a "reasonable' interpretation of Maine law. He knew full-well that the opinion did not have to be "correct" but only "reasonable." In order to do this, it was necessary for him to learn what the Maine law on the point was. Otherwise, he would have no basis on which to judge reasonableness. As you may read in *Dalton II*, he found that the opinion was not correct and that it was not reasonable. Here are Judge Wells's words from *Dalton II*:

> We must decide whether respondent abused his discretion in the supplemental notice of determination by rejecting petitioners' offer-in-compromise on the basis that the offer did not include petitioners' alleged nominee interest in the Poland property. In doing so, we must decide whether petitioners have such a nominee interest.

The weakness of the IRS position is found most clearly in *Dalton III* where Attorney Dyer petitioned for reimbursement of his litigation expenses which came to over $55,000.[12] Here is Judge Wells's definition of "reasonableness" (at least he made an attempt at it as opposed to Judge Selya who did not bother):

> The Commissioner's position is substantially justified if it has a reasonable basis in both fact and law and is justified to a degree that could satisfy a reasonable person. [Two citations omitted.] The reasonableness of the Commissioner's position is determined on the basis of the available facts that formed the basis for the position, as well as the controlling law. [Three citations omitted.] A position that was reasonable when established may become unreasonable in the light of changed circumstances. [Citation omitted.]

Here are a few choice words about the IRS position also from *Dalton III*:

> In our Opinion in *Dalton II*, we rejected respondent's legal position, concluding that Maine law is not undeveloped on the issue of nominee interest and that under Maine law petitioners did not have a nominee interest in the trust property. … We also concluded that, even using the Federal factors analysis, petitioners did not have an interest in the trust property. … When we decide that the Commissioner's Appeals Office has abused its discretion, we are holding that its conclusion is "without sound basis in fact or law."

This was not a case where the difference between a "correct" position and a "reasonable" position had any significance. The Judge found that the position was absolutely, completely, 100% wrong!

Dalton I and _Dalton II_: Things Get Worse

I have been writing in the singular about the opinion from the Office of Chief Counsel. Actually, there were multiple instances of poor legal work. This was not a one-off event.

Judge Wells wrote *Dalton I* in response to respondent's motion for summary judgment as to "…whether it was an abuse of discretion by respondent's Office of Appeals to reject an offer-in-compromise from petitioners because of an alleged interest in a trust."[13] In considering this argument, Judge Wells looked at the opinion from Chief Counsel, determined that it was crucial to the decision, and found it to be professionally deficient. These are my words, his are as follows:

> With respect to the instant motion, the record fails to establish that respondent's Office of Appeals applied or even considered the correct standard in evaluating petitioners' interest in the Maine property. We are unable to conclude, on the basis of the instant record, whether respondent made the requisite State law inquiry in order to reach respondent's determinations that petitioners held a nominee interest in the Poland property.

The Judge ordered a "do-over" so that the IRS would have a chance to come up with a more substantial opinion than the one used by the settlement officer. In this situation, the "do-over" was *not* to help the Daltons, who apparently had the better of the arguments.

For a year or two Attorney Dyer and the IRS went at it again. They argued at length about the existence of the Dalton's possible interest in the trust. In the end, neither side changed their positions at all. The IRS issued another Notice of Determination rejecting the offer and Mr. Dyer appealed to the Tax Court in *Dalton II*.[14]

After *Dalton I*, Ms. Russo, the same settlement officer who conducted the first hearing, had the same problem determining the value of the nominee interest. This time she referred the question to District Counsel's office. Judge Wells could not have been happy to find that the conclusion was the same as the one he had already found to be incorrect:

> The District Counsel's office performed an analysis of the issues presented and determined that Maine does not have developed law regarding nominee ownership [directly contradicting his findings in *Dalton I* where he lists, by my count, at least five citations]. The District Counsel's office then concluded that, under Federal nominee factors, the trust is petitioners' nominee [again, this directly contradicted his findings in *Dalton I* which were that State law must be used].

Judge Wells must have been quite upset when he began writing up complete legal arguments finding that the Daltons were not nominees either under Maine law or under the Federal standards. The decision does not specify exactly where these arguments came from. One presumes they were presented by Mr. Dyer in the records of the hearings leading up to *Dalton I* and *Dalton II*.

This second opinion might have changed the situation from one where a low-level person at Chief Counsel's office might have just made a mistake to one where using sloppy legal work to bully the Daltons became willful IRS policy. I do not know what Judge Wells thought, but he would have none of it.

Let's Finish Off *Dalton IV*

Reading *Dalton IV* in the context of what actually happened in *Dalton I, Dalton II*, and *Dalton III*, changes its meaning completely. *Dalton IV* makes it sound like Judge Wells did not know what "abuse of discretion" meant; and, that he was nitpicking a "reasonable" position of the IRS. Instead we find that Judge Wells knew exactly what he was doing and that the IRS position was not a reasonable interpretation of the law at all.

Let us return to those mentions of the word "reasonable" in *Dalton IV* from above:

1."…a court's role in the CDP process is simply to confirm that the IRS did not abuse its wide discretion and – as part and parcel of that inquiry – to ensure that the agency's subsidiary factual

and legal determinations were reasonable." Judge Wells did exactly this, except that he found the agency's legal position not reasonable.

2."Thus, a court should set aside determinations reached by the IRS during the CDP process only if they are unreasonable in light of the record compiled before the agency." Again, Judge Wells did find the agency's position unreasonable in light of the record and he set it aside.

3."…is for a reviewing court to consider whether the factual and legal conclusions reached at a CDP hearing are reasonable, not whether they are correct." Judge Wells found that the positions were both unreasonable and incorrect.

The problem here is not with the process or with Judge Wells's understanding of the rules. The problem is that the panel of judges did not like the results. They simply substituted their judgment of what was reasonable for that of the trial judge in order to obtain a different result.

The Italians have a saying which translates to something like, "There is no limit to the worst." Even though I couldn't find a specific definition of "reasonableness" in *Dalton IV*, Judge Selya did use another adjective with regard to government positions in collection due process hearings. That word is "unimpugnable." The entire sentence is, "We have held that the IRS's rejection of the offer in compromise was unimpugnable." This puts the definition beyond correctness and beyond reasonableness. Apparently, in actual practice, the Tax Court has no authority to review legal positions taken by the IRS *at all*.

Conclusions

So we have come full circle. Back in 1997, many were upset with sharp collection practices at the IRS. Senator Roth dreamed that taxpayers could gain due process rights before collection action was taken and added IRC section 6330 to the *IRS Restructuring and Reform Bill of 1998*. Now, after a decade and a half, the IRS is back in control of collection activity at least in the First Circuit. With hardly any restraints on its ability to define what the law is, it can end taxpayer due process by simply drafting an opinion which supports the position it needs to win. The *Daltons* must be casting a pall over collection due process hearings in the First Circuit and probably around the country as well.

Practice Notes

First, we now know that the *Robinette* record idea holds for both the facts and for legal theories. An EA practicing in a collection due process hearing must try to control this record and make sure that all the facts and legal arguments are included. Otherwise, a sympathetic Tax Court Judge will have nowhere to go. For practical purposes, telephone conversations do not make it into the record. In order to overcome this, I send all the facts and arguments to the settlement officer in writing before the telephone conference. Then after the conference, I send a letter memorializing what was said and what was decided and ask that they get back to me if I have made any mistakes. The purpose of these letters is to make absolutely clear what was presented to the settlement officer and to argue for my view of the "correct" solution to the problem. All of my letters should be included in the "record." Also, I find that clients appreciate the letters

because they can see that I am actually doing something for them that they could not do themselves.

I have never had a settlement officer request an advisory opinion, but, based on the *Daltons*, I have some suggestions. First I would ask the settlement officer his or her views on whether they can overrule an unfavorable (to me) opinion letter. If they do not believe they can, then, if they are serious about according due process in this hearing, I should have a role in drafting their request for the opinion, and I should get a chance to talk to the person who will draft the opinion. Basically, authority for the outcome of the hearing has been transferred from the settlement officer to that person and it would be unfair to prevent me from arguing my case. Furthermore, if the Service has an advisory opinion letter, then we should present an opposing letter which should be considered equally by the settlement officer. We want to be sure the Tax Court judge will see in the record the balancing which should have been done so he or she can determine if it was fair to the taxpayer.

Epilog

After the dust settled, Mr. Geismar was left feeling that due process as defined under IRC section 6330 had been denied to the Daltons. An appeal to the Supreme Court was out of the question, and the Daltons did not have enough money to do that anyway. As long as the IRS insisted that the value of the phantom trust interest was in excess of $400,000, currently uncollectible status and an offer-in-compromise were out of the question. The Daltons did not have enough income to support an installment agreement, which would have been difficult anyway with the Form 433-A balance sheet showing enough equity to pay the taxes in full.

I could hear the relief in his voice as he described his next step, which took him away from the collection due process process. This step brought him in contact with “normal” and “reasonable” lawyers in the Justice Department. He moved for a declaratory judgment in U.S. District Court for the District of Maine on behalf of the trust establishing its clear title in the trust assets. The Justice Department objected and they settled the matter in short order (a couple of months).

The Daltons did not have a nominee interest in the trust property. Judge Wells was correct in this. However, there was a transaction in which the trust property was pledged as collateral for a loan. The proceeds of the loan were used to bail one of the trust beneficiaries out of a bad business deal. This transaction was accomplished without professional advice and was found not to maintain adequate distance between the trust and the Daltons personally. In fact, it was found to be “fraudulent.” The word in this case does not mean that the Daltons committed a crime or that they deceived anyone. The word is appropriate only in a technical sense. Mr. Geismar agreed with this finding. Because of this, the IRS was granted a lien against the trust property in the amount of about $75,000. The value of the house was about $750,000 so everyone was happy with this.

Was the intransigence of the IRS justified in the end? It is a subjective question of course, but I think not. The IRS could have had $10,000 cash by accepting the offer. Instead it incurred the expenses of *Dalton I*, a second collection due process hearing (which took over a year), *Dalton II*, *Dalton III*, *Dalton IV* and the hearing in U.S. District Court in exchange for a $75,000 lien.

The value of the lien should be discounted because the Service will not receive any cash until the Dalton brothers decide to clear the title to the property. There will be additional expenses in keeping track of the lien for potentially a long time. All of this was caused by a second rate legal opinion which caused a wildly exaggerated valuation of the trust interest.

No. The IRS has a Pyrrhic victory here and taxpayers are left with a diminished right to due process as dreamt by Senator Roth.

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[1] § 6330(d)(1), 2014(16), *Stand. Fed. Tax Rep.* (CCH), ¶ 38,182.

(1) JUDICIAL REVIEW OF DETERMINATION. – The person may, within 30 days of a determination under this section, appeal such determination to the Tax Court (and the Tax Court shall have jurisdiction with respect to such matter).

[2] S. Conf. Rep. No. 105-599, 105th Cong., 2d Sess. (1998), 2014(16). *Stand. Fed. Tax Rep.* (CCH), ¶ 38,132.

[3] The last might not be familiar to younger EAs. The revenue officer would issue and administrative summons which directed the delinquent taxpayer to appear at the IRS office at a certain time. The taxpayer, being under legal compulsion to appear, would usually drive his or her car to this appointment. The revenue officer would then harass and terrorize the taxpayer for half an hour or so. After the meeting was over, the taxpayer would walk out to the parking lot to discover that the car was gone. It had been seized by the IRS. (Ah! The good old days!)

[4] *James M. Robinette v. Commissioner*, 439 F3d 455, 8th Cir., USTC ¶ 50,213, (March 8, 2006).

[5] *Arthur Dalton, Jr. and Beverly Dalton v. Commissioner*, 2012-1 USTC ¶ 50,411 (1st Cir. 2012) (*Dalton IV*).

[6] See for example, William E. Taggart, Jr., *The Dalton Cases—Be Careful What You Ask For—You May Get It!*, 14, 5 Journal of Tax Practice & Procedure, (Oct.-Nov. 2012), at 19.

[7] *Dalton v. Commissioner, supra.*

[8] *Supra*. Note 7.

[9] The word "deferential" in the context of collection due process hearings has been used by the First Circuit in the past. Here is the quote, "in providing for CDP hearings on what is ordinarily a scant record, Congress must have been contemplating a more deferential review of these tax appeals than of more formal agency decisions." Why a scant record should cause the courts to be more deferential to the IRS as opposed to more deferential to the taxpayer has not been explained by the First Circuit. *Olsen v. United States*, 2005-2 U.S.T.C. ¶ 50,537, 414 F.3d 144, 150 (First Circuit). The word "deferential" also appears in the context of judicial review of administrative regulations – a subject not relevant here. If you are interested in this subject, see Irving Salem, *Mayo Deference Examined Under the Six-Year Statute of Limitations Cases—A Proposal for a Constitutionally Sound Allocation of Lawmaking Authority*, 99, 3, Taxes, (Mar 2012), at 71. Mr. Salem has time to philosophize about such things after "47 wonderful years at the IRS/Treasury, Caplin & Drysdale and Latham & Watkins LLP."

[10] *Supra*. Note 5.

[11] *Arthur Dalton, Jr. and Beverly Dalton v. Commissioner*, 135 T.C. No. 20, USTC ¶ 58,341 (September 23, 2010) (*Dalton II*).

[12] *Arthur Dalton, Jr. and Beverly Dalton v. Commissioner*, T.C. Memo 2011-136, USTC ¶ 58,666(M) (June 20, 2011) (*Dalton III*).

[13] *Arthur Dalton, Jr. and Beverly Dalton v. Commissioner*, T.C. Memo 2008-165, USTC ¶ 57,484(M), (July 7, 2008) (*Dalton I*).

[14] *Supra*, Note 12.