Current Federal Tax Developments

Week of October 28, 2019

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ACCOUNTING
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CURRENT FEDERAL TAX DEVELOPMENTS
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Kaplan Financial Education

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SECTION: STATE TAX
CALIFORNIA RULES THAT DIRECTORS FEES ARE SOURCED TO STATE WHERE HIGHEST RANKING OFFICERS CARRY OUT THE BOARD'S DIRECTIONS

Citation: California Chief Counsel Ruling 2019-03, California Franchise Tax Board, 10/7/19

In Chief Counsel Ruling 2019-03[1], the Franchise Tax ruled on the application of California's market based sourcing rules as applied to an outside director that attended a shareholder or board of directors meeting in California.

Market based sourcing is increasingly being used by states to determine whether the state has the right to impose an income tax on the amounts paid to an out of state organization or resident for services rendered. Previously states had generally looked to the location of the sale being tied to where the services were primarily performed.

Under California's market based sourcing rules, the sale will be sourced to where the service recipient is deemed to receive the benefit of the services.[2] Under California Regulation section 25136-2(b)(1) the benefit is deemed received where the customer has directly or indirectly received the benefit of the service.

In this case the company had independent directors on its board of directors who made up a majority of the board. This governance rule is a requirement for the company to be listed on New York Stock Exchange. The Company is domiciled outside California[3]

The ruling seeks to answer the following question:

> Whether compensation paid to an independent director, who is a nonresident of California, is sourced to California if the Company

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[1] Chief Counsel Ruling 2019-03, California Franchise Tax Board, October 7, 2019, https://www.ftb.ca.gov/tax-pros/law/chief-counsel-rulings/2019-03.pdf, retrieved October 22, 2019

[2] California Revenue and Taxation Code §25136

[3] Chief Counsel Ruling 2019-03, California Franchise Tax Board, October 7, 2019, https://www.ftb.ca.gov/tax-pros/law/chief-counsel-rulings/2019-03.pdf, retrieved October 22, 2019, p. 1

> holds a shareholder meeting or board of directors meeting in California which the director attends?[4]

The ruling, looking at the situation in question, gives the following analysis of where the benefit of the service is received:

> Here, the independent director is providing a service to the Company and its shareholders that is unique — to act, with the other directors, to govern the Company. One role of the Board of Directors is to oversee management's assessments of major risk factors facing the Company and review options to mitigate such risks. Directors also serve on Board committees which require their independence to meet best practices and NYSE requirements with respect to audit policies, compensation practices and other corporate governance requirements.
>
> The benefit of that service is received where the Company received value from the delivery of that service. The value of an independent director's services does not derive from the place from which the Board of Directors confers and makes decisions, but rather from that place the decisions and actions of the Board detailed above are executed. Unlike consulting or similar services, these services do not merely recommend actions that may be taken by management. Independent directors are in a very distinct class of service-providers. The Board of Directors, acting as a body, gives authority to and directs management to take action. Since these services go to the core of the governance of the Company and the implementation of any such decisions are taken by the highest echelons of management, the location of that benefit is the place where the highest-ranking corporate officers carry out these directions.[5]

Thus, the ruling comes to the following formal answer to the question initially posed:

> No. The fees or other compensation received from the Company by the independent director of the Company for services performed in

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[4] Chief Counsel Ruling 2019-03, California Franchise Tax Board, October 7, 2019, https://www.ftb.ca.gov/tax-pros/law/chief-counsel-rulings/2019-03.pdf, retrieved October 22, 2019, p. 2

[5] Chief Counsel Ruling 2019-03, California Franchise Tax Board, October 7, 2019, https://www.ftb.ca.gov/tax-pros/law/chief-counsel-rulings/2019-03.pdf, retrieved October 22, 2019, p. 3

> California will be sourced to where the highest-ranking corporate officers carry out the Board's directions.[6]

When advisers consider the reason for states moving to market-based sourcing, the answer makes perfect sense even if the state in this case is passing on being able to tax the fees paid to these directors, assuming the highest ranking officers perform their services outside of California. Market based sourcing is meant to remove the incentive to locate service providing employees outside of a state. If a company wishes to sell services to residents of the state in question, the company is going to have a sale in the state regardless of where the service is performed.

By looking not to where directors' meetings are held but rather to where the headquarters of the organization is, the ruling serves to remove an incentive for organizations to hold such meetings outside California.

But the ruling is not necessarily good news—it suggests that any individual located anywhere performing such governance services for an organization headquartered in California will have California source income.

SECTION: SECURITY
CHIEF COUNSEL ESTABLISHES PROCEDURES TO USE S/MIME AND ENCRYPTED ZIP TO COMMUNICATE WITH TAXPAYERS WITH MATTERS BEFORE COUNSEL'S OFFICE

Citation: Chief Counsel Notice 2020-002, 10/18/19

In Chief Counsel Norice 2020-002 the IRS Chief Counsel provides for two methods to use secure email to communicate personally identifiable information (PII) and return information with taxpayers and representatives involved in Tax Court litigation or in regard to letter ruling and closing agreements.[7]

The notice provides the following changes in procedures to communicate with taxpayers for Chief Counsel employees:

> Effectively immediately, Chief Counsel employees may exchange PII and return information with taxpayers or their representatives during

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[6] Chief Counsel Ruling 2019-03, California Franchise Tax Board, October 7, 2019, https://www.ftb.ca.gov/tax-pros/law/chief-counsel-rulings/2019-03.pdf, retrieved October 22, 2019, p. 3

[7] Chief Counsel Notice 2020-002, October 18, 2019, https://www.irs.gov/pub/irs-ccdm/cc-2020-002.pdf

> Tax Court litigation and letter ruling or closing agreement processes, using one of two email encryption methods:
>
> 1. **The LB&I Secure Email System (SEMS)**, which authorizes the exchange of encryption certificates under specific circumstances, allowing the exchange of fully-encrypted emails and attachments, and
>
> 2. **SecureZIP** encrypted email attachments, allowing the sending of password-protected encrypted email attachments to anyone with a compatible zip utility.[8]

Before either system can be used, the notice requires the Chief Counsel employees to comply with the following initial steps:

> Before using either SEMS or SecureZIP to send email containing encrypted PII or return information to taxpayers or their representatives, Counsel employees must first discuss the use of encrypted email with the taxpayer or representative and confirm the identity of the email recipient. This can be done in a face-to-face meeting or by telephone. To further ensure that Counsel is dealing with the taxpayer or authorized representative, all initial email communications with the taxpayer or representative used in establishing the MOU and in establishing the associated list of email addresses authorized to receive encrypted content should be made only to the specific email address or telephone number (i) included in Petitioner's Tax Court pleading signature block pursuant to T.C. Rule 23(a)(3), or (ii) in the original request for a letter ruling, closing agreement, or accompanying Form 2848, Power of Attorney and Declaration of Representative. See CCDM 32.3.2.3; IRB 2019-1 §7.01(15).[9]

The SEMS program is based on a secure message transfer system that has been built into most major email clients (including *Microsoft Outlook*) for years, but which is not widely used except by those with access to on-site IT support—Secure/Multipurpose Internet Mail Extensions (S/MIME). As the notice describes the issues:

> LB&I's authorized SEMS program is intended for use by authorized taxpayer representatives (but not individual taxpayers) that have the technical ability to exchange email encrypted with Secure/Multipurpose Internet Mail Extensions (S/MIME) certificates.

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[8] Chief Counsel Notice 2020-002, October 18, 2019, https://www.irs.gov/pub/irs-ccdm/cc-2020-002.pdf

[9] Chief Counsel Notice 2020-002, October 18, 2019, https://www.irs.gov/pub/irs-ccdm/cc-2020-002.pdf

> SEMS encrypts both attachments and the body of emails and is the type of encryption used with internal IRS email. External parties must exchange S/MIME certificates with the Counsel employees with whom they will be emailing. This requires the external party to use a compatible email system such as Microsoft Outlook, and to have the technical sophistication to exchange and install S/MIME certificates.[10]

Note that this system requires the taxpayer or representative to have an S/MIME certificate from a recognized authority to send to the IRS, since this system only allows sending secured emails to recipients who have provided the sender with such a certificate. Obtaining and installing such a certificate often trips up individuals without access to IT support.

The IRS employees are warned that SEMS does on encrypt the subject of the message, only the text. For this reason, personally identifiable information should not be included in the subject of any email sent via SEMS.

The IRS employees must take the following specific steps to use SEMS:

> Before Counsel employees may use SEMS to send email containing PII or return information to taxpayer representatives, the taxpayer (not merely the representative) must execute a MOU acknowledging the risks inherent in use of email and authorizing the exchange of encrypted email with their representative.
>
> The required MOU language for SEMS is contained in Attachment A.
>
> The taxpayer must return the executed memorandum to Counsel before any encrypted email containing PII or return information may be sent, and the MOU must be retained in the case file.[11]

The SecureZIP system works by using encrypted ZIP files to hold the confidential information. As the notice describes the system:

> SecureZIP is a compression utility that allows the password-enabled encryption of email attachments and other files. To use SecureZIP, both the sender and recipient must have SecureZIP or a compatible decompression/decryption utility installed (several compatible free utilities exist, including PKWARE's ZIP Reader). Counsel employees may use SecureZIP to email encrypted attachments to authorized

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[10] Chief Counsel Notice 2020-002, October 18, 2019, https://www.irs.gov/pub/irs-ccdm/cc-2020-002.pdf

[11] Chief Counsel Notice 2020-002, October 18, 2019, https://www.irs.gov/pub/irs-ccdm/cc-2020-002.pdf

> external stakeholders, including taxpayers and taxpayer representatives unable to use the LBI Secure Email Program. As noted above, if a taxpayer representative is able to use the LBI Secure Email Program, that method of encryption should be used instead of SecureZIP.[12]

As the last sentence notes, this system is not the preferred method. But it's likely many small taxpayers and advisers in firms that don't have sufficient IT support will end up only being able to use this system.

Under this system, the information to be sent must be placed in a separate document and then encrypted using a password. The password must be communicated to the receiving party *but should not be sent via email* since that defeats the purpose—any party that intercepts the emails would be able to decrypt and read the confidential information. This password problem is a key reason why this system is less preferred—S/MIME does not require an exchange of passwords.

Unfortunately, while the IRS notes the password problem, the agency only requires the password not be in the email that contains the zip file. The notice reads:

> The password should never be sent in the same email with the encrypted attachment. It should be provided to the recipient by telephone or in a separate email. Never put the password in the body of the email with the encrypted attachment. [13]

Advisers should only agree to use this program if the IRS employee agrees ***not to send the password via email but uses another method to deliver it to the adviser.***

The IRS employees are given the following information on using the program:

> Because SecureZIP will not encrypt either the subject line or the body of the email, all PII, return information, and other information about specific tax matters must be included only in the encrypted attachment.
>
> With SecureZIP enabled, after clicking "send," a dialogue box opens asking if the user would like to zip the message. Select the "encrypt attachments" and "include unzip instructions" checkboxes and click "next." The next dialogue box will ask the user to type and confirm an

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[12] Chief Counsel Notice 2020-002, October 18, 2019, https://www.irs.gov/pub/irs-ccdm/cc-2020-002.pdf

[13] Chief Counsel Notice 2020-002, October 18, 2019, https://www.irs.gov/pub/irs-ccdm/cc-2020-002.pdf

> 8-character minimum password. Record the password for future reference.[14]

The following are the steps that must be taken before SecureZIP is to be used by IRS employees:

> Before Counsel employees may email encrypted email with encrypted attachments containing PII or return information to taxpayers or taxpayer representatives, the taxpayer must execute a MOU acknowledging the risks inherent in use of email and authorizing the exchange of encrypted email attachments.
>
> The MOU for SecureZIP is contained in Attachment B.
>
> The taxpayer must return the executed memorandum to Chief Counsel before any encrypted email attachments containing PII or return information may be sent, and the MOU must be retained in the case file.[15]

Given the IRS preference for S/MIME and the questionable advice being given to IRS employees about transferring passwords when ZIP files are used, advisers who work cases that involve communication with the Chief Counsel's office should consider obtaining and installing certificates to enable the use of S/MIME in their mail program.

SECTION: 280E
§280E IS NOT AN EXCESSIVE FINE UNDER THE EIGHTH AMENDMENT AND ALSO IS NOT LIMITED JUST TO BARRING DEDUCTIONS UNDER §162

Citation: Northern California Small Business Assistants Inc. v. Commissioner, 153 TC No. 4, 10/23/19

A majority of the Tax Court concluded in the case of *Northern California Small Business Assistants Inc. v. Commissioner*, 153 TC No. 4,[16] that the denial of deductions for those

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[14] Chief Counsel Notice 2020-002, October 18, 2019, https://www.irs.gov/pub/irs-ccdm/cc-2020-002.pdf

[15] Chief Counsel Notice 2020-002, October 18, 2019, https://www.irs.gov/pub/irs-ccdm/cc-2020-002.pdf

[16] *Northern California Small Business Assistants Inc. v. Commissioner*, 153 TC No. 4, October 23, 2019,

operating businesses trafficking in cannabis is not a fine. Therefore, the provision could not be found to be an excessive fine.

The Eighth Amendment to the U.S. Constitution provides:

> Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted.

The taxpayer, a medical marijuana dispensary operating under California law that allows such operations, argued that IRC §280E served as an excessive fine under the Eighth Amendment and thus should be disregarded by the Court.

IRC §280E provides:

> No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.

Marijuana is defined by statute to be a controlled substance, and thus all deductions or credits related to the operations are denied by the statute aside from those properly deducted as a cost of sale.

The majority opinion finds that the denial of a deduction is not a fine under this provision of the Constitution. First, the Court notes that the 16th Amendment gives the Congress the absolute right to tax income and that deductions are also left to Congress' discretion.

> Congress has the power to lay and collect income taxes under Article I, Section 8 of the Constitution. The Sixteenth Amendment grants Congress the power to lay and collect taxes on "incomes, from whatever source derived" without requiring apportionment among the States as required by Article I. The Supreme Court has held that any deductions from gross income are a matter of legislative grace and can be reduced or expanded in accordance with Congress' policy objectives. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934); see *Keeler v. Commissioner*, 70 T.C. 279, 284-285 (1978). Under the Sixteenth Amendment, "[t]he power of Congress to tax gross income is

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https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12102, retrieved October 23, 2019

> unquestionable." *Bagnall v. Commissioner*, 96 F.2d 956, 957 (9th Cir. 1938), *aff'g* 35 B.T.A. 1 (1936).
>
> … Deductions from gross income do not turn on equitable considerations; rather they are pure acts of legislative grace, the prudence of which is left to Congress. *Deputy v. du Pont*, 308 U.S. 488, 493 (1940); *White v. United States*, 305 U.S. 281, 292 (1938); *Hokanson v. Commissioner*, 730 F.2d 1245, 1250 (9th Cir. 1984), *aff'g* T.C. Memo. 1982-414; *United States v. Akin*, 248 F.2d 742, 743 (10th Cir. 1957); *Gen. Fin. Co. v. Commissioner*, 32 B.T.A. 949, 954 (1935), *aff'd*, 85 F.2d 846 (3d Cir. 1936). Congress is free to grant, restrict, and deny deductions as it sees fit. *J.E. Riley Inv. Co. v. Commissioner*, 110 F.2d 655, 658 (9th Cir. 1940), *aff'd*, 311 U.S. 55 (1940); *Barbour Coal Co. v. Commissioner*, 74 F.2d 163 (10th Cir. 1934).[17]

The majority opinion therefore concludes:

> Petitioner does not cite, and we are not aware of, any case where the disallowance of a deduction was construed a penalty. This is especially telling given that Congress enacted section 280E over 37 years ago in 1982, and over that 37 years it has never been held to be a penalty by any Federal court. See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, sec. 351(a), 96 Stat. at 640. The overwhelming precedent establishing that deductions from gross income are a matter purely left to congressional discretion by the Sixteenth Amendment explains why over the last 37 years an Eighth Amendment attack on any section of the Code that limits deductions from gross income has been a nonstarter. … The Sixteenth Amendment does not accommodate the assertion that the disallowance of a deduction is a penalty. There is simply no way to reconcile the argument that section 280E creates a penalty with the authority of Congress to tax gross income. Therefore, we hold that section 280E is not a penalty provision and, consequently, the Eighth Amendment's Excessive Fines Clause does not apply.[18]

While all Tax Court judges agreed in the result of this case (the taxpayer should not prevail in its claim that §280E represented an excessive fine), five judges held that the taxpayer failed to show the amount was excessive. Two judges specifically declined to rule on whether §280E was a penalty or not (finding it wasn't relevant if there was no

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[17] *Northern California Small Business Assistants Inc. v. Commissioner*, 153 TC No. 4, pp. 7-8

[18] *Northern California Small Business Assistants Inc. v. Commissioner*, 153 TC No. 4, pp. 11-13

evidence of it being excessive),[19] while three held that §280E did operate as a fine but since there was no evidence presented that it was excessive, the taxpayer could not prevail.[20]

The taxpayer advanced other theories, one of which deserves some additional comment. The taxpayer argued that §280E's bar on deductions only applied to those allowed under IRC §162 (for ordinary and necessary business expenses). As the majority opinion notes:

> Petitioner would have us find that section 280E applies only to section 162 deductions. According to petitioner, the text of section 280E "tracks" that of section 162, which allows for all ordinary and necessary business expense deductions, suggesting that section 280E should apply only to limit section 162 deductions.[21]

IRC §164 allows a deduction for taxes paid by the taxpayer, while §167 allows the deduction for depreciation. Applying the taxpayer's logic, the dispensary would also apparently be allowed deductions under §179 (for expensing equipment purchases) and §199A (the qualified business income deduction).

But the Tax Court determined that §280E broadly denies *any* deduction aside from cost of sales, ruling:

> However, petitioner's argument misses the first line of section 280E: "No deduction or credit shall be allowed". (Emphasis added.) Congress could not have been clearer in drafting this section of the Code.
>
> The broader statutory scheme also supports our conclusion that section 280E means what it says — no deductions under any section shall be allowed for businesses that traffic in a controlled substance. Section 261, in part IX of subchapter B of chapter 1 of the Code, provides that "no deduction shall in any case be allowed in respect of the items specified in this part." Section 280E is in part IX. Similarly, section 161 provides that deductions found in part VI of subchapter B of chapter 1 of the Code are allowed "subject to the exceptions provided in part IX". Part VI provides a comprehensive list of allowable

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[19] *Northern California Small Business Assistants Inc. v. Commissioner*, 153 TC No. 4, p. 21

[20] *Northern California Small Business Assistants Inc. v. Commissioner*, 153 TC No. 4, pp. 22, 44

[21] *Northern California Small Business Assistants Inc. v. Commissioner*, 153 TC No. 4, pp. 11-13

> deductions for taxpayers. This list includes section 162 and section 165 deductions, which we have previously disallowed pursuant to section 280E. See *CHAMP*, 128 T.C. at 180-181 (disallowing section 162 deductions under section 280E); *Beck v. Commissioner*, T.C. Memo. 2015-149, at *18 (disallowing a section 165 loss deduction under section 280E). As relevant here, part VI also includes sections 164 and 167, two additional sections petitioner believes would allow it a deduction. Clearly, sections 164 and 167 are limited by the exceptions in part IX, including section 280E. Thus, section 280E precluded petitioner from taking any deductions under sections 164 and 167 that are tied to its medical marijuana dispensary.[22]

Note IRC §199A is also found in part VI of subchapter B of chapter 1 of the Code, so the reference in §161 limiting such deductions to those not barred by part IX would also appear to apply to that provision. As well, IRC §164 would be the provision under which state income taxes are deducted, so the decision also appears to bar the deduction for corporate income taxes paid by a dispensary organized as a C corporation.

SECTION: 6221
INTERIM GUIDANCE ISSUED TO APPEALS EMPLOYEES ON BBA PARTNERSHIP AUDIT CASES

Citation: Memorandum AP-08-1019-0013, 10/18/19

The IRS has issued guidance to Appeals Employees regarding procedures that will be used in cases involving the Bipartisan Budget Act of 2015's (BBA) revision to the partnership audit rules.[23]

The memorandum consists of a summary of procedural changes, followed by interim guidance until IRM 18.9 is revised along with an appendix containing the interim procedures and a glossary of BBA terms.. The interim guidance has an expiration date of October 18, 2021.

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[22] *Northern California Small Business Assistants Inc. v. Commissioner*, 153 TC No. 4, pp. 14-15

[23] Memorandum AP-08-1019-0013, October 18, 2019, https://www.irs.gov/pub/foia/ig/appeals/ap-08-1019-0013.pdf, retrieved October 22, 2019

The memorandum provides the following explanation of the purpose of the guidance:

> Purpose: This memorandum provides interim guidance to Appeals employees on new case procedures for different phases of the BBA centralized partnership audit regime, including the following:
>
> - Early Election into BBA;
> - Administrative Adjustment Request (AAR);
> - Notice of Proposed Partnership Adjustment (NOPPA);
> - Modification Disputes; and,
> - Notice of Final Partnership Adjustment (FPA).[24]

The memorandum summaries the new procedures as follows:

> **Procedural Change:**
>
> - For tax years beginning after November 2, 2015, and before January 1, 2018, eligible partnerships may elect into BBA within 30 days of the date the IRS first notifies the partnership in writing that the return has been selected for examination. Either the Tax Matters Partner (TMP) or an individual authorized to sign the partnership return for the taxable year under examination is authorized to make the election by completing the Form 7036, Election under Section 1101(g)(4) of the Bipartisan Budget Act of 2015. IRS examiner will issue Letter 5893, Notice of Administrative Proceeding, to the Partnership at least 30 days after a valid election is received by the IRS.
> - After January 1, 2018, this election may also be made when filing an Administrative Adjustment Request (AAR) under Section 6227 as amended by BBA for tax periods beginning after November 2, 2015 and before January 1, 2018.
> - If an early election into BBA was requested or the entity is covered under BBA for tax years beginning on or after January 1, 2018, BBA cases will have Appeals rights.

[24] Memorandum AP-08-1019-0013, October 18, 2019, https://www.irs.gov/pub/foia/ig/appeals/ap-08-1019-0013.pdf, retrieved October 22, 2019, p. 1

- If there is a dispute on any BBA case, the examiner will issue a 30-day BBA letter (Letter 5891) with a summary report for the taxpayer to request an Appeals hearing. The dispute may cover the substantive audit issues, penalties and/or imputed underpayment adjustment groupings and subgroupings disputes.

- At the end of the Appeals process and issuance of the Notice of Proposed Partnership Adjustment (NOPPA) for all disputed tax issues (resolved and unresolved), Appeals will send the BBA case to Ogden BBA Unit for processing.

- In response to the NOPPA, the partnership may request modification. If there is a dispute regarding modification, the taxpayer will have an opportunity to appeal this dispute. Appeals will not reconsider an unagreed previous disputed tax issue if the entire case is later returned to Appeals for modification hearing.

- LB&I will issue the Notice of Final Partnership Adjustment (FPA) notice. The FPA allows the partnership to either request a push out the adjustments for its partners to take into account, petition for judicial review of the adjustments, or both. Under normal circumstances Appeals will not issue the FPA.[25]

Attached is a 21 page appendix that contains interim procedures under IRM 18.19.14 and an appendix of BBA terms.

SECTION: 7623
TAX COURT CANNOT ORDER THE IRS TO REEXAMINE

[25] Memorandum AP-08-1019-0013, October 18, 2019, https://www.irs.gov/pub/foia/ig/appeals/ap-08-1019-0013.pdf, retrieved October 22, 2019, pp. 1-2

TAXPAYER WHEN WHISTLEBLOWER BELIEVES IRS ASSESSMENT IS "WOEFULLY INADEQUATE"

Citation: Apruzzese v. Commissioner, TC Memo 2019-141, 10/21/19

A whistleblower found out that his award is limited to what the IRS decides to collect, even if the whistleblower believes the agency should have assessed substantially more tax in the case of *Apruzzese v. Commissioner*, TC Memo 2019-141.[26]

The plaintiff and his co-claimant had submitted a Form 211, *Application for Award for Original Information*, to the IRS Whistleblower Office (WO). The plaintiff and the co-claimant had been involved in litigation against an estate and claimed the estate had omitted substantial assets from its Form 706 filed with the IRS, understating its estate tax by several million dollars.[27]

At this point the IRS took the following actions:

> The target's estate tax return was already under examination when petitioner submitted his information to the WO. Before receiving petitioner's information, E&G Attorney Bryan Babcock was preparing to issue the target a "No Change" letter. However, upon reviewing petitioner's information, Mr. Babcock changed course and pursued information pertaining to the lawsuit referenced in petitioner's Form 211. Subsequently, Mr. Babcock's discovery that the target had used "tax affecting" business valuations prompted him to select four of the decedent's gift tax returns for examination.
>
> At the conclusion of the expanded examination, the IRS and the target agreed to adjustments to the estate tax return and gift tax returns. The IRS assessed tax and interest of $424,019, which the target promptly paid. Mr. Babcock submitted Form 11369, Confidential Evaluation Report on Claim for Award, to the WO. Therein Mr. Babcock stated

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[26] *Apruzzese v. Commissioner*, TC Memo 2019-141, October 21, 2019, https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12087, retrieved October 21, 2019

[27] *Apruzzese v. Commissioner*, TC Memo 2019-141, October 21, 2019, https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12087, retrieved October 21, 2019, p. 1

> that petitioner had "substantially contributed to the examination of the estate tax return."[28]

As $424,019, while not a small number, is far less than "several million dollars" of missing estate tax, the whistleblower aware computed by the IRS was substantially less than what the whistleblower expected, being awarded $43,424.[29] In fact, the plaintiff called the IRS assessment "woefully inadequate" given the information they had provided.[30]

As the opinion explained:

> The final decision in this case does not reference section 7623(b) but rather section 7623(a), which provides for discretionary awards. However, the final decision states that the WO considered petitioner's information and "made a final decision" to give petitioner an award of $43,424. Inherent in that decision is respondent's determination that petitioner is not entitled to a mandatory section 7623(b) award exceeding $43,424.[31]

The taxpayer did not dispute the computation of the award based on the amount the IRS had collected. Rather, the taxpayer went to Tax Court to attempt to force the IRS to reverse its decision to collect the amount it and the estate had agreed to settle the case, and to force the IRS to re-examine the estate.[32]

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[28] *Apruzzese v. Commissioner*, TC Memo 2019-141, October 21, 2019, https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12087, retrieved October 21, 2019, p. 3

[29] *Apruzzese v. Commissioner*, TC Memo 2019-141, October 21, 2019, https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12087, retrieved October 21, 2019, p. 4

[30] *Apruzzese v. Commissioner*, TC Memo 2019-141, October 21, 2019, https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12087, retrieved October 21, 2019, p. 11

[31] *Apruzzese v. Commissioner*, TC Memo 2019-141, October 21, 2019, https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12087, retrieved October 21, 2019, p. 7

[32] *Apruzzese v. Commissioner*, TC Memo 2019-141, October 21, 2019, https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12087, retrieved October 21, 2019, pp. 4-5

The Tax Court notes that the state under which the plaintiff is being awarded an award has the following conditions prior to receiving an award:

> Under this statutory scheme a whistleblower cannot qualify for a nondiscretionary award unless two conditions are met. First, the Secretary must "proceed[] with an[] administrative or judicial action described in subsection (a) based on information brought to the Secretary's attention" by the whistleblower. Sec. 7623(b)(1). Second, the Secretary must derive proceeds from this action. Id.; see *Cohen v. Commissioner*, 139 T.C. 299, 303 (2012) ("We can provide relief under section 7623(b) only after the Commissioner has initiated an administrative or judicial action and collected proceeds."), *aff'd*, 550 F. App'x 10 (D.C. Cir. 2014); *Cooper v. Commissioner (Cooper II)*, 136 T.C. 597, 600 (2011) ("[A] whistleblower award is dependent upon both the initiation of an administrative or judicial action and collection of tax proceeds.")[33]

Unfortunately for the plaintiff, the law does not allow the Tax Court to provide the relief sought:

> While we have jurisdiction to review the Commissioner's award determination, we do not have authority to "review the Commissioner's determinations of the alleged tax liability to which the claim pertains." *Cohen v. Commissioner*, 139 T.C. at 302. Nor do we have authority "to direct the Secretary to proceed with an administrative or judicial action." *Cooper II*, 136 T.C. at 600.[34]

The opinion refers to the Tax Court's prior decision in *Cooper v. Commissioner (Cooper II)* noted earlier. The Court described that situation which it found to control the decision in this case:

> In *Cooper II*, 136 T.C. at 598, an attorney-whistleblower alleged that certain taxpayers had failed to pay millions of dollars in estate and generation-skipping transfer tax. The whistlebower provided the IRS with information pertaining to the estate. *Id*. The WO forwarded the information to the appropriate IRS office, which decided not to pursue administrative or judicial action against the taxpayer. *Id*. at 599.

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[33] *Apruzzese v. Commissioner*, TC Memo 2019-141, October 21, 2019, https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12087, retrieved October 21, 2019, p. 9

[34] *Apruzzese v. Commissioner*, TC Memo 2019-141, October 21, 2019, https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12087, retrieved October 21, 2019, p. 9

Because there was no administrative or judicial action that led to the collection of proceeds, the WO determined that the whistleblower was not entitled to an award. *Id*. Like petitioner in this case, the *Cooper II* whistleblower appealed the WO's determination and asked this Court to direct the Commissioner "to undertake a complete re-evaluation of the facts in this matter, begin an investigation, open a case file, and take whatever other steps are necessary to detect an underpayment of tax." See *id*. at 600. Granting the IRS' motion for summary judgment, the Court in *Cooper II* explained: "Our jurisdiction under section 7623(b) does not contemplate that we redetermine the tax liability of the taxpayer. * * * [A]lthough Congress authorized the Court to review the Secretary's award determination, Congress did not authorize the Court to direct the Secretary to proceed with an administrative or judicial action." *Id*[35]

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[35] *Apruzzese v. Commissioner*, TC Memo 2019-141, October 21, 2019, https://www.ustaxcourt.gov/UstcInOp/OpinionViewer.aspx?ID=12087, retrieved October 21, 2019, pp. 11-12