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6 Key Aspects Of The Taxpayer First Act

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With Congress now on August recess, it is a good time to highlight an important piece of tax legislation already enacted during the 116th United States Congress.

On July 1, the Taxpayer First Act — which attempts to redesign the Internal Revenue Service to better serve taxpayers — became law. Although many of the act's provisions focus on lower-income, individual taxpayers, there are a handful of provisions of which all taxpayers should be aware. We discuss them below.[1]

IRS Administrative Appeals

The act renames the IRS' Office of Appeals the "Internal Revenue Service Independent Office of Appeals" and codifies the Office of Appeals' mission to resolve tax controversies without litigation on a fair and impartial basis. Before the act, the Office of Appeals had a similar mission — described in the Internal Revenue Manual — and the IRS was already statutorily required to "ensure an independent appeals function."[2]

However, for the first time, the act enshrines in a statute a right of access to the Office of Appeals that is "generally available to all taxpayers."[3] The act also requires that a "Chief of Appeals," appointed by the IRS Commissioner, head Appeals.

The act also added some additional protections regarding the appeals process. For example, the act attempts to promote impartiality by limiting contact — "to the extent practicable" — between appeals employees and IRS Office of Chief Counsel employees who previously worked on a taxpayer's case or who are involved in preparing such a case for litigation. Stated differently, the Office of Appeals generally will not receive advice from chief counsel employees who worked on the matter before its referral to appeals.[4]

Additionally, Congress added a process that allows taxpayers to protest the IRS' decision to deny Office of Appeals access. Unfortunately, this process is limited to cases in which a taxpayer has already received a notice of deficiency.[5]

Whistleblower Reforms

In recent years, a number of large multinational taxpayers in a range of industries have dealt with public, high-dollar tax disputes regarding, or stemming from, whistleblowers. The act strengthens the provisions in the Code regarding tax whistleblowers in two critical respects.[6]

First, new Section 6103(k)(13)[7] provides for mandatory and permissive disclosures to whistleblowers. The IRS is now required to provide whistleblowers certain updates about investigations stemming from whistleblowing and is authorized to provide other information to whistleblowers in response to whistleblowers' requests.

Second, Congress added anti-retaliation protections for tax whistleblowers similar to those provided to whistleblowers under the False Claims Act and the Sarbanes-Oxley Act. The penalties for violating the anti-retaliation provisions include "all relief necessary to make the employee whole" and compensatory damages such as reinstatement, 200% of any back pay and special damages like litigation costs, expert witness fees and reasonable attorney fees.[8]

These amendments further facilitate whistleblowing and increase risk for taxpayers who become aware of, or suspect, that an employee has blown the whistle.

Comprehensive Customer Service Strategy to Be Included in Guidance and the IRM

The act also requires the IRS to develop a comprehensive customer service strategy and for the secretary of the Treasury to submit the strategy to Congress within one year. The act requires the IRS to update "guidance and training materials," including the IRM, accordingly and to make the updated content public within two years.[9]

Historically, courts have held that the IRM does not create enforceable rights for taxpayers.[10]One rationale is that the IRM is not issued pursuant to a congressional mandate or delegation.[11] Another is that the IRM's provisions are often procedural — not substantive — in nature and do not convey substantive rights or duties on taxpayers.[12]

It is not entirely clear how the act's comprehensive customer service strategy and reference to the IRM fit into, or might alter, this rubric.

Taxpayers should follow this development and any potential future congressional references to the IRM.

Notice Before Third-Party Contacts

Prior to the act, Section 7602 precluded the IRS from contacting third parties without giving the taxpayer "reasonable notice in advance" of such contacts.[13] In broad terms, this provision was enacted to protect taxpayers from potentially damaging reputational effects of the IRS communicating with third parties — such as friends, neighbors or employers — about a taxpayer's potential tax liability.

Hearings related to the act explained that the IRS was indiscriminately sending a generic notice to all taxpayers at the beginning of every audit. In one recent case, the IRS even unsuccessfully argued that a section in IRS Publication 1 titled "Potential Third-Party Contacts" satisfied Section 7602's notice requirements.[14]

The act reflects Congress' determination that it makes more sense to require actual notice of impending contact with third parties. Now, the IRS must provide taxpayers with a notice specifying the period — which may not exceed one year — within which it might make third-party contacts.[15] The IRS must provide the notice at least 45 days before the contact period begins.[16] Further, the IRS must have a present intent to contact third parties.

Given this new notice requirement, taxpayers now should have a more meaningful opportunity to resolve factual issues and volunteer information before the IRS seeks it from third parties.

On the other hand, the contours of the remedies for violations of these provisions are not entirely clear. At a minimum, seeking to quash a summons issued in violation of the provisions is one potential path to a remedy.

Modifications to Summons Authority

The act makes several other changes to the IRS' authority to issue summonses.

First, the act requires that John Doe summonses issued under Section 7609(f)[17] be "narrowly tailored to information that pertains to the failure (or potential failure)" to comply with one or more "identified" provisions of the internal revenue law.[18]

In explaining this addition, the House Committee on Ways and Means noted that John Doe summonses — which generally seek from third parties, such as banks, information about unnamed potential taxpayers, such as account holders — are "not intended to be an opening bid for information from the party being served nor ... intended to be used for the purposes of a fishing expedition."[19]

Several recent court cases have addressed John Doe summonses, including a November 2017 opinion that upheld a broad John Doe summons the IRS issued to a virtual currency exchange but later narrowed so that it applied to far fewer — but still more than 10,000 — potential taxpayers.[20] Whether connected to these cases or not, the act's requirements for John Doe summonses are certainly timely.

Second, the act imposes additional limitations on the issuance of designated summonses, which are generally issued to large, corporate taxpayers in complex cases and can suspend the period of limitations on assessment.

Because issuing a designated summons is a "serious step in the examination of a tax return,"[21] the act requires that the IRS receive review and written approval of the summons prior to its issuance by the head of the relevant IRS operating division and the IRS chief counsel.[22]

The approval must state facts clearly establishing that the IRS has made reasonable requests for the information, which the IRS must also establish in any court proceeding to enforce the summons.

Limiting Actions by Contractors

Section 6103(n) has long allowed the IRS to share tax-return information with third parties to the extent necessary in connection with tax administration.[23]

In 2015, the public learned that the IRS hired a private law firm to assist the IRS in evaluating tax claims against a taxpayer, including by allowing the private law firm to participate in interviews of the

taxpayer's employees.

At the time, former Senate Finance Committee Chairman Orrin Hatch noted that the hiring of the third party appeared "to violate federal law and the express will of the Congress," removed "taxpayer protections by allowing the performance of inherently government functions" by private contractors and called "into question the IRS' use of its limited resources."[24]

The act closes the door on having third parties question witnesses under oath by expressly limiting the questioners to IRS or chief counsel employees.[25] However, the act still allows traditional outside experts — such as economists and appraisers — to review books and records if they "require such information for the sole purpose of providing expert evaluation and assistance" to the IRS.[26] Challenges in the future may revolve around the proper interpretation and scope of "expert evaluation and assistance."

Conclusion

While focused on lower-income taxpayers, the act has potentially far-reaching implications for all taxpayers in several respects. Taxpayers should continue to monitor the IRS' implementation of these new laws, both when Congress returns from recess and beyond.

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[1] In addition to the changes discussed below, the act establishes requirements for cybersecurity and identity protection, and requires the IRS to appoint a Chief Information Officer, improve agency technology and better protect taxpayers' personal data.

[2] Internal Revenue Service Restructuring and Reform Act of 1998, Section 1001(a)(4), Pub. L. No. 105-206.

[3] Section 1001 of the act.

[4] IRC Section 7803(e)(6)(B).

[5] IRC Section 7803(e)(5). For additional coverage of this topic, see Gaps in the IRS Appeals Reform Proposal, https://www.morganlewis.com/pubs/gaps-in-the-irs-appeals-reform-proposal.

[6] Section 1405 of the act.

[7] IRC Section 6103(k)(13).

[8] Id.

[9] Section 1101 of the act.

[10] See, e.g., Fargo v. Commissioner, 447 F.3d 706, 713 (9th Cir. 2006) ("The Internal Revenue Manual does not have the force of law and does not confer rights on taxpayers. This view is shared among many of our sister circuits.").

[11] First Federal Sav. and Loan Ass'n of Pittsburgh v. Goldman, 644 F. Supp. 101, 103 (W.D. Pa. 1986).

[12] Id.; c.f. Wadleigh v. Commissioner, 134 T.C. 280, 294 n.13 (2010) (examining the IRM and considering but not deciding whether reference in the Code to "administrative procedures" included the IRM so as to make it binding on the IRS).

[13] IRC Section 7602.

[14] J.B. v. United States, 916 F.3d 1161 (9th Cir. 2019) (quashing summons issued to third party for failure to comply with Section 7602).

[15] Section 1206 of the act.

[16] Id.

[17] IRC Section 7609(f).

[18] Section 1204 of the act.

[19] Taxpayer First Act of 2019, Report of the Committee on Ways and Means on HR 1957, at 41 (Apr. 9, 2019).

[20] United States v. Coinbase Inc., 17-cv-1431 (N.D. Cal. Nov. 28, 2017).

[21] Id. at 47.

[22] Section 1207 of the act.

[23] IRC Section 6103(n).

[24] Hatch Questions IRS' Outsourcing of Taxpayer Examination, United States Senate Committee on Finance (May 13, 2015).

[25] Section 1208 of the act.

[26] Compare H.R. 3167 and S. 2809 (2015-2016) (unpassed bill that modified Section 6103(n) to restrict any person from being designated to receive summoned books, papers, record, or other data and to take summoned testimony under oath).