Some folks view our tax rules as an edict from the IRS. That’s not quite the case. It is true that the IRS is an ominous bureaucracy with broad powers. Nevertheless, the IRS is not the law maker but the administrator of a tax system enacted by Congress. The purpose of this chapter is to give you fundamental knowledge of the legal system relating to federal taxation and to explain the interrelationship between the IRS, the courts, and Congress. It is not necessary to read this chapter to fill out your tax return. However, it is a must read if you ever receive an audit notice from the IRS.

**Legislative, Administrative, and Judicial Authority**

Our government was established under the Constitution with a system of checks and balances. The Legislative Branch (Congress) enacts the laws, the Administrative Branch (the President and cabinet) enforces the laws, and the Judicial Branch (the courts) makes sure the other two branches are operating legally and within their constitutional authority. The President delegates the administration of tax laws to the U.S. Treasury Department, which includes the IRS. You have recourse in the courts if the IRS tries to deny you rights (like deductions, exemptions, and credits) that Congress has authorized.
Now for the tricky part: How do you know if the IRS is denying you a legitimate right? The answer to that question requires a closer look at the Legislative, Administrative, and Judicial Branches as they pertain to taxation.

When tax legislation is enacted by Congress and signed into law by the President, it adds to or amends the Internal Revenue Code of 1986 (which is Title 26 of the U.S. Code). The Internal Revenue Code (Code) contains all of our country's tax laws, which the IRS is required to administer and enforce.

Often the laws written by Congress are either unclear or are not specific enough to apply to particular circumstances. To enforce these laws, it is necessary for the Treasury Department and the IRS to provide interpretations. These interpretations generally come in the form of regulations from Treasury and revenue rulings and letter rulings from the IRS. The IRS also publishes revenue procedures, which tell taxpayers about IRS administrative practices.

**Regulations**

The Treasury Department issues tax regulations under authority granted by Congress. The purpose of regulations is to explain, in relatively normal language, the meaning of all or part of a Code section. They generally expand on the language and provide examples to help taxpayers comply with the Code section. Some regulations merely interpret what the Code section itself says. These are called interpretive regulations. In some Code sections, Congress provides authority for the Treasury to come up with certain rules on its own, as long as they comply with the overall intent of the Code section. These are called legislative regulations. Regulations are the highest form of administrative authority and carry considerable weight with the courts. Legislative regulations carry the force and effect of the law itself, as long as they comply with the intent of the Code section under which they are issued. Regulations are not law, however. The validity of a regulation can be questioned. Courts are not bound by regulations and can overrule them if they are unreasonable and plainly inconsistent with the Code.

You can tell when a regulation is being referred to, as opposed to a Code section, because it will begin with the number one (if issued under an income tax Code section) followed by a decimal, then the number of the Code section. For example, Regulation Section 1.61-1 is the citation for the first regulation issued under Section 61. You will also see it cited as Reg. § 1.61-1.

**Revenue Rulings**

The National Office of the IRS issues revenue rulings. These are generally official replies by the IRS to specific questions raised by taxpayers. They also interpret tax law, but are not as authoritative as regulations (meaning the courts
are more likely to disagree with them). They tend to deal with much more limited issues than regulations, often addressing a specific legal question. They are published to provide guidance in cases having similar facts to those presented in the rulings and are generally only one or two pages long.

Here’s an example of a citation for a revenue ruling: Rev. Rul. 80-52, 1980-1 C.B. 100. The “80-52” means it was the 52nd revenue ruling issued in the year 1980. The “1980-1 C.B.” means this ruling can be found in the first volume of the 1980 Cumulative Bulletin. The “100” at the end means it can be found on page 100 of that Cumulative Bulletin. After 1999, revenue rulings have four digits representing the year rather than two. An example is Rev. Rul. 2000-10. For the most recent rulings, you see “I.R.B.” instead of “C.B.” for the citation reference. That means it can be found in the Internal Revenue Bulletin rather than the Cumulative Bulletin. What the Cumulative Bulletin and the Internal Revenue Bulletin are, and where they can be found, is discussed later under “Where to Find This Stuff” on page 8.

**Letter Rulings**

Letter rulings are issued to a particular taxpayer at the taxpayer’s request, and describe how the IRS will treat a proposed transaction. If the taxpayer carries through with the transaction exactly as described in the ruling request, the IRS is bound to abide by the ruling. If the taxpayer changes any of the facts of the transaction, the IRS is no longer obligated to follow the ruling. This is a way for you to get the IRS to tell you in advance what the tax effects of a particular transaction will be. The IRS limits its letter rulings to only certain types of transactions, though. Also, the answer better be pretty important to you. A ruling request can cost as much as $7,000. However, ruling requests are only $625 if your gross income is less than $250,000. And if your ruling request involves a business-related tax issue, such as home-office expenses or residential rental property issues, you can get one for $625 if your gross income is less than $1 million.

Letter rulings used to be called private letter rulings, because they were not available to the public. Since 1976, however, they have been available to read, after all the information that could identify the taxpayer has been deleted. They are still private in another sense though: A letter ruling is a two-party contract between the IRS and the taxpayer who requested the ruling. The IRS is not obligated to treat a similar transaction by another taxpayer in the same way. That means you cannot rely on someone else’s letter ruling with certainty; you’ve got to get your own. With this in mind, letter rulings still provide evidence to the public of how the IRS will handle a transaction. Tax practitioners tend to use them to support their treatment of similar transactions. If enough taxpayers request rulings on the same question, the IRS will issue a revenue ruling stating its position, which can be relied on by all taxpayers.
Here's an example of the citation for a letter ruling: LTR 9624010. It is always a seven-digit number if it was issued prior to 1999, and a nine-digit number if it was issued since. The first two numbers (first four after 1998) indicate the year the ruling was issued, the next two indicate the week of the year the ruling was issued, and the last three numbers indicate the number among the rulings issued that week. So the letter ruling cited was issued in 1996 during the 24th week, and it was the 10th ruling issued that week.

Revenue Procedures

Revenue procedures are issued in the same manner as revenue rulings, but they deal with different issues. They tell you about IRS practices and procedures instead of answering specific legal questions. The IRS has its own peculiar way of doing things, and revenue procedures tell you how to do things the IRS's way. A revenue procedure is also used to provide the annual inflation adjustments for everything in the Code that is supposed to be adjusted for inflation. These include individual tax rates, exemptions, the standard deduction, and several other things. This is useful information for doing tax planning for the current year. Rev. Proc. 2004-715 shows what these amounts are for 2005.

Revenue procedures are cited just like revenue rulings, except they begin with “Rev. Proc.” rather than “Rev. Rul.” They are found in the Internal Revenue Bulletin (I.R.B.) and the Cumulative Bulletin (C.B.), which are discussed under “Where to Find This Stuff” on page 8.

An Example of Interpreting a Code Section

Here's an example of a Code section that has fairly simple wording. IRC Section 61 provides a definition of gross income (the term Congress uses to define income subject to tax, before being reduced by allowable deductions). This is part of what it says:

Sec. 61. Gross Income Defined

(a) General Definition—Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

1. Compensation for services, including fees, commissions, fringe benefits, and similar items
2. Gross income derived from business
3. Gains derived from dealings in property . . .

This Code definition of gross income might seem understandable enough, but now let's try to apply it to an actual situation. Let's say you are in the business of selling newspapers. You have sold $500 worth of newspapers for cash during the year and your cost of the papers was $250. In addition, some guy
came by one day on his way to work, carrying his lunch in a paper bag. He had
forgotten his wallet, but really wanted to buy a paper. You, being an astute
businessperson, traded the guy a newspaper for his lunch. We’ll assume the
lunch had a value of two dollars.

What is your gross income? Does it include the value of the guy’s lunch? Does
it include gross cash sales or cash sales minus the cost of the papers? Here are
the options. It could be: (a) $500, or (b) $502, or (c) $250, or (d) $252. The
wording of Section 61 does not make it entirely clear which answer is correct,
does it? This is where Treasury regulations come in handy.

There are several interpretive regulations issued under Section 61. Regulation
Section 1.61-1 provides a general definition, and Regulation Section 1.61-3
tells what “gross income derived from business” means. Regulation Section
1.61-1 says in part:

Gross income includes income realized in any form, whether in money, property,
or services. Income may be realized, therefore, in the form of services, meals, ac-
commodations, stock, or other property, as well as in cash.

Since the guy’s lunch is property, the regulation says its value is included in
your gross income. That narrows down the answer to either (b) $502, or (d) $252.

Regulation Section 1.61-3 says in part:

In a manufacturing, merchandising, or mining business, “gross income” means
the total sales, less the cost of goods sold . . .

This regulation excludes the cost of sales from the term gross income, thus
giving us the correct answer to our question—$252 ($500 sales less $250 for
cost of goods sold plus a $2 lunch). Note that the cost of sales is not a deduction
like other normal costs of operating your business; it is an exclusion, which is
an amount that is never included in gross income in the first place.

We found some issues here that were not addressed in the Code section, but
were explained in the regulations. Other issues might not be discussed in the
regulations, but are found in revenue rulings or letter rulings. The answers pro-
vided by these documents are opinions of the IRS—they are not the law. Once
in a while taxpayers disagree with the IRS and choose to have the courts decide
who is right. The courts sometimes interpret the law differently than the regu-
lations and rulings. That means it is important to consider judicial interpreta-
tion contained in the many volumes of opinions that have been handed down
over the years.

Judicial Authority

If you disagree with the amount of tax the IRS thinks is due, does that mean you
must automatically fork over whatever the IRS says to pay? Heck no! That’s what
the judicial system is for—to settle disputes between the IRS and taxpayers.
Sometimes the dispute relates to a *factual* issue, such as the amount a taxpayer has incurred for a business expense, or the value of an art object donated to charity. Other times the argument relates to a *legal* issue, such as the proper interpretation of a particular Code section.

**THE TRIAL COURTS**

If a taxpayer and the IRS can't come to some agreement during the administrative appeals process (discussed next), a taxpayer has a choice of three judicial forums to begin litigation. They are the United States Tax Court, the United States Court of Federal Claims, and the United States District Court for the district in which the taxpayer lives.

The United States Tax Court (Tax Court) is the court of choice for most taxpayers. It is a court of national jurisdiction, and it hears only tax cases. The judges are very knowledgeable in tax matters, so its opinions tend to be more highly regarded as precedent than decisions of the other two trial courts. Its decisions are appealable to the regional court of appeals having jurisdiction where the taxpayer lives, as discussed next.

District courts are regional courts, and their judges hear an array of federal issues. There is at least one district court in each state, and the more populous states have more than one. Decisions from these courts are appealable to the regional court of appeals in the same manner as Tax Court decisions.

The United States Court of Federal Claims (commonly called the Court of Claims) is a national court like the Tax Court. The difference is, the Court of Claims sits in Washington, DC, while the Tax Court hears cases all over the country. This court hears most types of federal tax cases, in addition to other cases in which there is a claim against the federal government. The Court of Claims has its own appeals court; its decisions are appealable to the United States Court of Appeals for the Federal Circuit.

**THE APPELLATE COURTS**

The loser in the trial court, be it the taxpayer or the IRS, has the right to appeal the decision to an appellate court. A trial court decision can only be appealed to the appellate court that has jurisdiction over the case. If the trial court is the Tax Court or a district court, the case must be appealed to the regional appellate court having jurisdiction where the taxpayer lives. Cases from the Court of Claims can only be appealed to the Court of Appeals for the Federal Circuit.

With the exception of the Court of Appeals for the Federal Circuit, our federal appellate system is a territorial arrangement. It is made up of twelve courts of appeal, each having jurisdiction over a particular area of the country. For instance, if you happen to live in Texas, Louisiana, or Mississippi, you are under the jurisdiction of the Fifth Circuit Court of Appeals. If you live in Minnesota, North
Dakota, South Dakota, Nebraska, Iowa, Missouri, or Arkansas, you are subject to the Eighth Circuit Court of Appeals. Each of these appellate courts is an independent jurisdiction, and they do not have to agree with one another. Consequently, a question considered by the Ninth Circuit Court of Appeals might be decided differently than the same question considered by the Second Circuit Court of Appeals. If an appellate court has issued an opinion on a particular issue, the trial courts whose decisions are appealable to that appellate court are obligated to follow the opinion. If an issue is handled differently by different circuit courts, the IRS will treat taxpayers in those jurisdictions accordingly. Taxpayers will not be treated uniformly in such cases unless the Supreme Court settles the dispute or Congress clarifies the law.

As an example, a number of years ago the singer Ethel Merman performed on Broadway for a little over two years in the musical *Gypsy*. During the run of the play on Broadway, Ethel lived in New York, but her permanent residence at the time was in Colorado. So she deducted her meals and lodging expenses while in New York as traveling expenses while *away from home* under the authority of Code Section 162(a). The IRS interpretation was that her tax home had become New York, so she was not away from home and her expenses were not deductible. Ethel took the issue to court in New York, and after being denied the deductions by the trial court, appealed the case to the Second Circuit Court of Appeals. The Second Circuit held that *home* means a taxpayer’s permanent abode, and allowed Ethel the deductions because she was away from her home in Colorado.6 In doing so, it created a rule that conflicted with the opinions of six other appellate courts.7 The IRS did not request a hearing before the Supreme Court on this issue, but later Congress amended Code Section 162(a) to deny a deduction for away-from-home expenses for “any period of employment if such period exceeds 1 year.”

**THE SUPREME COURT**

This is the only Court that lays down precedent that must be followed by all of the lower courts. The IRS must also follow rulings of the Supreme Court as precedent. This would clear up much confusion in our tax laws except for a couple of problems.

First, the Supreme Court has complete discretion over whether it will hear a case. A party requests a hearing by Writ of Certiorari. If at least four members of the Court believe the issue is of sufficient importance to be heard by the Court it will grant the Writ (*cert. Granted*). Most often, however, it will deny jurisdiction (*cert. Denied*). It is generally persuaded to hear a tax case only when there is a conflict on the issue among the appellate courts (that is, two or more appellate courts have decided the issue differently). Even then, sometimes the Supreme Court will not hear the case.
Furthermore, even when the Supreme Court steps in and handles a tax case, its decision often has the effect of muddling the issues rather than clarifying them, leaving us even more confused and bewildered.

With all this in mind, you can see that the answers to tax questions often are not clear-cut. Sometimes when the IRS says no, the courts say yes; or some courts say yes and other courts say maybe. Having an appreciation for this puts you at an advantage when dealing with the IRS. You should never submit to an IRS agent’s adjustment on your return unless it is backed up by appropriate authoritative support. The next section tells you how to find the various sources of authority.

**Where to Find This Stuff**

People who are not tax professionals generally have no interest in reading tax cases or IRS rulings. However, you might get the urge to look up one of the sources cited in this book just to see for yourself what it says. If you have a particular burning question, you might even become inspired to go further and explore the tax services discussed next. This might even lead to an intriguing new hobby for you. So if you’re in the mood for sleuthing, slip on your trench coat and keep reading.

You could start by looking up the government documents department of any public library. Call and ask if they have current IRS rulings and Treasury regulations. If you are near a university that has a business school, its library probably has a business reference section that contains these documents. Or if you are close to a law school, call its library and ask if it has a tax reference section, and whether you can gain access to it. The completeness and currency of the documents will vary among these locations, so try to find the best one.

**THE CUMULATIVE BULLETIN AND INTERNAL REVENUE BULLETIN**

Now that you have found a place that has tax documents, ask if it has the Cumulative Bulletin and the Internal Revenue Bulletin. The Internal Revenue Bulletin is published on a weekly basis. Each weekly volume is a small pamphlet that contains everything issued by the IRS during that week. Included are revenue rulings, revenue procedures, and other pronouncements. Every six months these bulletins are gathered together, reorganized by Code section, and published in a bound volume. The bound volume is the Cumulative Bulletin. That means there are at least two Cumulative Bulletins per year. The first volume contains IRS pronouncements from the first half of the year, and the second volume has the stuff from the second half.

Besides rulings issued by the IRS, the Cumulative Bulletin also contains the entire text of any tax legislation enacted during the year and the committee reports that accompany it. Committee reports are written by the tax
legislative committees of Congress, and provide explanation and insight into the congressional intent of the legislation. If there is major legislation during the year, there might be additional volumes of the Cumulative Bulletin to handle the legislation.

TAX SERVICES
Tax services are multivolume references to Code sections that provide commentary and explanation. They are also updated regularly, and refer you to the most recent cases and rulings affecting a particular subject. A library might have these tax services in the same area as the Cumulative Bulletin, or they might be shelved separately in the business section.

A popular tax service is the *Standard Federal Tax Reporter* published by Commerce Clearing House (CCH). Another is the *United States Tax Reporter* by Research Institute of America (RIA). These volumes are organized by Code section and have a topical index. For each Code section, you will find the law itself, regulations, selected Committee Reports, a plain language explanation by the publishers, and references to all the cases and rulings pertaining to that Code section.

COURT CASES
Both CCH and RIA also reproduce federal court decisions dealing with tax issues. All federal tax cases, other than those from the Tax Court, are found in the *United States Tax Cases* (CCH) and the *American Federal Tax Reporter* (RIA). The “Citator” for each of these services provides an alphabetical index to the cases.

Tax Court decisions are divided into two categories: “Regular” decisions are published by the U.S. Government Printing Office in volumes called the *U.S. Tax Court*. “Memorandum” decisions are not published by the government, but are published by private tax services like CCH and RIA. Memorandum decisions are just like regular decisions, but they are designated by the Chief Judge of the Tax Court as less precedential. This is because they either deal with factual issues or address questions that have been answered before by the Tax Court.

ONLINE RESOURCES
There are many sites on the World Wide Web that offer tax information. For forms, publications, current news, and tax regulations in plain English, visit the IRS Web site at www.irs.gov. A site that links you to just about every other tax site that’s useful is www.taxesites.com. This site, maintained by University of Northern Iowa Professor Dennis Schmidt, will lead you to federal, state, and city tax resources.
If you are a member of an online service, such as America Online, you will find a wealth of tax information by using a key-word search for “tax” or “taxes,” though finding an answer to a particular burning question might prove frustrating. Two virtual law libraries operated by private companies are Lexis and Westlaw. These provide online access to every tax resource available in a law school library. These services are primarily used by attorneys and tax professionals, and are expensive. However, you might find a law school or business library in your area that makes these services available to the public free of charge.

Now that you know where the rules come from and how to look them up, you might like to know how the IRS administers them on an individual basis. The next section describes what you have to look forward to if you are audited, and what your rights are if you disagree with the results.

The Audit Process and Your Appeal Rights

We all have our own particular phobias. What might frighten one person, someone else can take in stride. But the one thing that seems to traumatize just about all of us is the prospect of an audit from the IRS. Perhaps the greatest fear of this process is not knowing what to expect. If that’s the case, this section should ease your mind somewhat.

Only a small percentage of U.S. taxpayers are audited each year. Those who run a small, unincorporated business are better candidates than other individuals, but even they have about a 95 percent chance of not getting audited. The IRS has limited resources, so it tries to make its audit program as efficient as possible. It does this by selecting returns for audit that appear to be the best prospects for additional tax.

This is done through a computer program called the Discriminant Function System (DIF). This program scores each return for potential error based upon prior experience. For example, let’s say you decide to cheat, and you claim exemptions for a few of the neighborhood kids in addition to your own. Your return will receive a large DIF score. That will make it pop out of the computer like a piece of burnt toast, right into the waiting hands of your friendly neighborhood IRS agent.

The Examination

Many examinations are done strictly by mail. This is called a correspondence examination. You get a letter asking for documentation or additional information on a particular line item of your return. If you provide the requested information, the IRS might agree with you. If it does not, it should explain the reasons for any changes. Do not hesitate to ask questions if you do not understand the
changes. If you have questions you cannot resolve through the mail, you can request a personal interview with an agent. Additionally, if you feel that handling the examination through correspondence is impractical or places you at a disadvantage, you can request an office examination conference immediately.

If an examination is conducted through a personal interview with an agent, you have the right to ask that it take place at a convenient time and place. It might take place at the IRS office, your home or place of work, or the office of your accountant or attorney. If you are claiming home-office deductions, the agent will likely want to visit your home office. If you had someone prepare your return for you, make sure they show up, too. If you would like to let your representative handle it, you could even grant your attorney or accountant a “power of attorney” (IRS Form 2848, Power of Attorney and Declaration of Representative) and let him or her meet with the agent alone.

At the end of the examination, the agent will give you a report if there are any proposed changes to your return. Remember that the IRS must follow the Internal Revenue Code and Supreme Court decisions. But the IRS does not have to follow the precedent of lower court decisions, and may still apply its own interpretation to your situation. If you do not agree with the report after the agent has explained the adjustments and your available appeal rights, you can request a meeting with the agent’s supervisor. As a tactical strategy, sometimes an agent will discover one point but fail to develop another point that could result in even more tax. Here it may be advisable to accept the proposed adjustment because carrying the case forward might lead to the opening of other items on the return.

APPEAL WITHIN THE IRS

If you cannot resolve the dispute with the supervisor, the agent will send you a notice of proposed deficiency, commonly called a 30-day letter. This letter tells you about your right to appeal the proposed changes within 30 days to the IRS Appeals Office. Accompanying the letter you will receive:

- A copy of the examination report explaining the agent’s proposed changes.
- An agreement or waiver form (Form 870).
- A copy of IRS Publication 5, Appeal Rights and Preparation for Unagreed Cases.

You have the option of accepting the proposed adjustments by signing the waiver form and paying the tax, or you can appeal the proposed changes. The letter will explain what steps you should take, depending on which action you choose.
The regional IRS Appeals Office, which is independent of the District Director or the Service Center, is the only level of appeal within the IRS. You may or may not be required to file a written protest, and the conference is conducted in an informal manner. Most disputes are settled at this level. The appeals officer has the authority to compromise, and the IRS is generally not interested in going to court if it doesn’t have to. Many legal issues are not amenable to compromise, however, and the IRS is not likely to back down. That means if you want to press the issue, you will have to go to court.

THE 90-DAY LETTER

If you cannot come to terms with the appeals officer, the IRS will send you a statutory notice of deficiency, commonly called a 90-day letter. If you do not respond within 90 days of the date this letter is mailed, the IRS can issue an assessment and begin collection proceedings. Don’t put yourself in this position—collection people are not fun to deal with. If you do not want to go to court, and you do not have the money to pay, ask the IRS for Publication 594, *Understanding the Collection Process*. This tells you about arranging installment payments, delaying collection action, and submitting an offer in compromise.

A proper response to the 90-day letter is your only way of preserving your right to litigate the issues. Your options within the 90-day period are to: (1) pay the tax and be done with it, (2) not pay the tax and file a petition with the Tax Court, or (3) pay the tax to stop the accrual of interest, then file a petition with the Tax Court. If you do not file a petition with the Tax Court within this 90-day period, you lose your right to litigate the case in the Tax Court. If you pay the tax and later decide to litigate one or more of the issues, you can still take your case to the Court of Claims or your district court. To do this you must file a claim for refund with the IRS; then you can sue for the refund if it is denied.

Taking Your Case to the Tax Court

Over 95 percent of tax litigation begins in the Tax Court. This is probably because when you file a petition with the Tax Court, you do not have to pay the disputed tax until after final determination. Final determination means you have exhausted all your appeal rights, and the courts still say you owe the tax. You can stop the accrual of interest by prepaying the tax if you wish, but only after you have received the 90-day letter. If you pay the tax prior to receiving the 90-day letter, you might ruin your chances of taking your case to the Tax Court. This is because if you send in the entire amount due, the IRS will not send you a 90-day letter, and you can only file a petition in the Tax Court after receiving a 90-day letter. 
If your petition is properly filed within the 90-day period, the court will schedule your case for trial at a location convenient to you. You can represent yourself in court or you can hire an attorney to argue your case.

The Tax Court is a national court, with judges who travel the country to hear cases. There are 19 regular judges who are appointed by the president, and a number of special trial judges who are also authorized to hear cases. One judge presides over each case, and the trial judge’s opinion is reviewed by the Chief Judge before it is final. If the Chief Judge believes the case deals with issues that are controversial or particularly important, the case will be reviewed by all 19 regular judges.

Tax Court judges are very knowledgeable of tax issues. Many are former IRS or Justice Department litigators. Because of this, some say the Tax Court is biased in favor of the IRS. It is true that the IRS tends to win more cases in the Tax Court than taxpayers. On the other hand, you would be surprised at some of the cases in which the court seems to bend over backwards to give the taxpayer a fair shake.

THE SMALL CASE PROCEDURE

A unique feature of the Tax Court is its Small Case Procedure. If the amount of tax in dispute is $50,000 or less for any tax year, the Tax Court will hear your case in an informal setting. That means you do not have to comply with a lot of formal legal procedures making it easy to present your case in court without having to hire an attorney or an accountant. The downside of using the Small Case Procedure is that the judge’s opinion is final, and there is no right to appeal. You can get more information on the Tax Court procedures by writing the United States Tax Court, 400 Second Street, N.W., Washington, DC 20217.

Litigating in Your District Court or the Court of Claims

Perhaps you have paid the tax and failed to file a petition in the Tax Court, but you still believe the IRS is wrong and you want your money back. You start by filing a claim for refund with the IRS. This will not get you your money unless someone at the IRS sends it back by mistake. However, this enables you to sue the IRS for a refund when it rejects your claim, or does not act within six months from the date you file the claim. To enforce your claim, you must file suit in your United States district court or in the Court of Claims within two years after your claim is rejected by the IRS. The Tax Court is not an option at this point.

Litigating in the district court might be an advantage if you think you could benefit from a jury trial. This is only an option in a district court (not the Tax Court or Court of Claims), and the jury can only decide issues of fact, not law.
On the other hand, taking your case to the Court of Claims might be best if the argument you wish to make has been heard in a previous case and rejected by the Tax Court, your district court, or the court of appeals in your area. If your argument has not been rejected by the Court of Claims, that court does not have to follow the precedent of the other courts.

You can get more information about procedures for filing suit in either court by contacting the clerk of your district court or the clerk of the Court of Claims. The address for the Court of Claims is: United States Court of Federal Claims, 717 Madison Place, N.W., Washington, DC 20005. Addresses for all district courts are listed in IRS Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund.

**Recovering Litigation or Administrative Costs**

Although it is possible to represent yourself in court, it is not advisable unless you happen to be an attorney and are familiar with courtroom procedures. (Being a regular viewer of Law and Order doesn't make it.) The only situation in which you are not at a disadvantage in representing yourself in a tax case is if you are litigating in the Tax Court under the Small Case Procedure. Litigation is therefore costly, even if you win, because you will have attorney fees and other costs to pay. To prevent the IRS from using this fact to coerce taxpayers into submitting to trumped up charges, Congress passed a law that requires the IRS to refund you for reasonable litigation or administrative costs under certain circumstances.12

You may be able to recover these litigation or administrative costs if you are the *prevailing party* and if:

- You have exhausted your administrative remedies within the IRS.
- Your net worth is not more than $2 million ($7 million if the taxpayer is a business) when the litigation or administrative proceedings began.
- You do not unreasonably delay the proceedings.

You are considered the *prevailing party* if:

1. You have substantially prevailed with respect to the amount in controversy or with respect to the most significant issues.
2. You establish that the position of the IRS in the proceedings was not substantially justified.

If the controversy has gone to court, the court will decide whether or not you are the prevailing party. If it is an administrative action, the IRS will decide, subject to appeal by you to the Tax Court.
**CAN I COMPLETELY AVOID PAYING INCOME TAX?**

**What Costs Are Recoverable?**

As long as they are reasonable, you can generally recover the following:

- Attorney fees that generally may not exceed $150 per hour (for 2005).
- The costs of studies, analyses, engineering reports, and other projects that are necessary to prepare your case.
- Court costs.
- Expenses for expert witnesses.
- Administrative fees charged by the IRS for administrative proceedings.

To find out more, see IRS Publication 556.

**Can I Completely Avoid Paying Income Tax?**

I had my roof reshingled a few years ago by a guy with impressive references and the lowest bid. The guy’s name was Hal. Hal was a pleasure to do business with and a straight shooter. One day, while settled into his lawn chair in my back yard—from which he directed his crew on the roof, Hal attempted to enlighten me about the illegality of the federal income tax system. Not only did Hal pay no income tax (hence the low bid), he paid no employment taxes for his crew of five (who also paid no income tax). “The Supreme Court declared the income tax illegal, and the only reason people pay it is because they’re too stupid to know better,” Hal explained.

I told Hal that it would be prudent not to tell people that he did not pay income taxes. Hal was not aware of it, but the IRS is authorized to pay rewards to informants with information on people who cheat on their taxes. As a former revenue auditor, tax practitioner, and tax professor with a PhD in taxation, I could say with certainty that the Supreme Court had not invalidated the income tax, and I told Hal that he was mistaken. In 1892, the Supreme Court did invalidate the income tax, but that decision led to the ratification of the Sixteenth Amendment that authorizes an income tax. Hal was unimpressed with my credentials and my opinion. “I know a web site you can look at.” Hal said, “Maybe you can learn something.”

A couple of years later I happened to see a notice in the paper that Hal had been convicted of tax evasion and sentenced to a prison term. (No, I did not turn him in—he guaranteed my roof for twenty years and I wanted him around to fix it.) I am sure Hal considers himself to be an honest man—just like thousands of others who make their home in a federal prison cell because they believed they could evade taxes. Perhaps they simply have a brain defect that prevents them from using logic and reason when it comes to evaluating tax evasion schemes.
Recently, I got an inquiry on my online tax forum from someone with the same brain defect. Windy asked if someone could tell her about an exclusion of taxes forever. “I know saying I am an Oregon State national may not mean anything to some. Someone knows what I need to know. Please help me...” Windy went on to say, “There is a gentleman I met for a moment who hasn’t paid taxes legally for eight years.”

I explained to Windy that there is no exclusion of federal income tax simply because she lives in Oregon. Windy was as unimpressed with my opinion as Hal. “I will ask more questions and do my own research to find out if it was true,” Windy responded.

Here is a bit of advice that Hal and Windy had no interest in hearing: If a tax scheme sounds too good to be true, it always is. Tax protest is an American tradition, but if you evade taxes, you may end up sharing a minimum-security cell with Hal or Windy. Here is the IRS web site that gives you a legal analysis of many of the tax evasion schemes populating the Internet: www.irs.gov/individuals/index.html.

Additional Resources

Although the IRS presents only its point of view on legal issues, its tax publications provide useful general guidance in a variety of areas. Additional information on the examination and appeal process and access to the courts can be found in IRS Publication 556, Examination of Returns, Appeal Rights and Claims for Refund. Publication 1, Your Rights as a Taxpayer, explains your rights at each step in the tax process. Publication 594, Understanding the Collection Process, explains IRS procedures after you have been issued an assessment notice. Publication 910, Guide to Free Tax Services, provides a list of free tax publications and an index of tax topics and related publications. It also describes other free tax information available from the IRS, including tax education and assistance programs.

You can get these publications free by calling the IRS at (800) TAX-FORM [(800) 829-3676]. If you have access to TTY/TDD equipment, you can call (800) 829-4059. To download them from the Internet, go to www.irs.gov (World Wide Web), or ftp.irs.gov (FTP). If you would like to get forms and instructions (not publications) by FAX, dial (703) 368-9694 to reach IRS Tax Fax.

Notes

1 IRC § 7805.
4 IRC § 6110(j)(3).
6 Robert F. Six and Ethel Merman Six v. United States, 450 F.2d 66 (2d Cir. 1971).
7 Coerver v. Commissioner, 297 F.2d 837 (3d Cir. 1962); Bercaw v. Commissioner, 165 F.2d 521 (4th Cir. 1948); Commissioner v. Mooneyman, 404 F.2d 522 (6th Cir. 1968); England v. United States, 345 F.2d 414 (7th Cir. 1965); Jenkins v. Commissioner, 418 F.2d 1292 (8th Cir. 1969) Wills v. Commissioner, 411 F.2d 357 (9th Cir. 1969); and York v. Commissioner, 160 F.2d 385 (D.C. Cir. 1947).
8 See IRS Publication 1, Your Rights as a Taxpayer.
9 See IRS Publication 556, Examination of Returns, Appeal Rights, and Claims for Refund.
10 Ibid.
11 Ibid.
12 IRC § 7430.
13 See IRC § 7623. Reg. § 301.7623-1 provides the details with respect to informer rewards, including eligibility for rewards, the submission of information to the IRS, and the amount that may be paid for the information.
14 One tax protester claim is that the Sixteenth Amendment is not valid, but this claim has been rejected by the courts. United States v. Foster, 789 F.2d 457 (7th Cir.), cert. denied, 479 U.S. 883 (1986).