

NOT YET SCHEDULED FOR ARGUMENT

No. 11-1298

IN THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

STEPHEN J. JOHNSON,

Petitioner-Appellant

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee

ON APPEAL FROM THE DECISION OF
THE UNITED STATES TAX COURT

BRIEF FOR THE APPELLEE

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CERTIFICATE AS TO PARTIES, RULINGS,
AND RELATED CASES

(1) *Parties and Amici.* The parties to this suit in both the Tax Court and this Court are Stephen J. Johnson (taxpayer) and the Commissioner of Internal Revenue. There are no amici.

(2) *Rulings Under Review.* The rulings under review are the opinion of the United States Tax Court (Judge David Gustafson), published at 136 T.C. 475, determining that the IRS Office of Appeals did not abuse its discretion in sustaining the filing of the federal tax lien and the proposed levy. The court accordingly entered a decision on June 3, 2011 (Doc. 29), sustaining the determination of Appeals and allowing collection to proceed.

(3) *Related Cases.* This case has not previously been before this Court or any other court and the Commissioner is not aware of any case that is related to this case.

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* Authorities on which we chiefly rely are marked with asterisks.

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* Authorities on which we chiefly rely are marked with asterisks.

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GLOSSARY

Appeals	IRS Office of Appeals
Br.	Appellant's Brief
CDP	Collection due process
Claremont	Claremont LLC
the Code	Internal Revenue Code
Commissioner	Commissioner of Internal Revenue
DCM	DCM II Doll Technology Investment Fund II LP
I.R.C.	Internal Revenue Code
I.R.M.	Internal Revenue Manual
IRS	Internal Revenue Service
OIC	Offer in compromise
RCP	Reasonable collection potential
the Secretary	Secretary of the Treasury
Tax Ct. R.	Tax Court Rules of Practice and Procedure
Taxpayer	Stephen J. Johnson
Treas. Reg.	Treasury Regulation (26 C.F.R.)

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ON APPEAL FROM THE DECISION OF
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BRIEF FOR THE APPELLEE

JURISDICTIONAL STATEMENT

The Internal Revenue Service (IRS) Office of Appeals (Office of Appeals or Appeals) issued a Notice of Determination Concerning Collection Action under Sections 6320 and 6330 of the Internal Revenue Code (26 U.S.C.) (the Code or I.R.C.)¹ to Stephen J. Johnson (taxpayer)

¹ Unless otherwise indicated, all statutory references are to the Code, as amended and in effect with respect to the taxable years in question.

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on April 17, 2009, approving a lien and proposed levy to collect his delinquent federal income tax liabilities for the years 1999 and 2000.

(Ex. 44-J.)² On May 13, 2009, within thirty days thereafter, taxpayer timely filed a petition in the Tax Court. (Doc. 1.) The Tax Court had jurisdiction pursuant to I.R.C. § 6330(d)(1).

On June 3, 2011, the Tax Court (Judge David Gustafson) entered a decision sustaining the notice of determination, which was a final, appealable order that disposed of all claims of all parties. (Doc. 29.) On August 16, 2011, within 90 days after entry of the Tax Court's decision, taxpayer filed a timely notice of appeal. (Doc. 30.) *See* I.R.C. § 7483 and Fed. R. App. P. 13(a). This Court has jurisdiction under § 7482(a)(1).

STATEMENT OF THE ISSUE

Whether the Tax Court correctly concluded that the Office of Appeals did not abuse its discretion by declining to accept taxpayer's offer in compromise and, accordingly, allowing a federal tax lien to stand and a federal tax levy to go forward.

² "Doc." references are to documents in the original record, as numbered by the Clerk of the Tax Court and "Ex." references are to the exhibits attached to the stipulation of facts (Doc. 20). Page references in the exhibits are to the Bates numbers stamped at the bottom.

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STATUTES AND REGULATIONS

Most of the applicable statutes and regulations are contained in the brief of the appellant; the remainder are contained in the Addendum, *infra*.

STATEMENT OF THE CASE

Taxpayer brought this suit in the Tax Court to contest the determination of the IRS Office of Appeals, after a collection-due-process (CDP) hearing, to let stand a notice of federal tax lien that had been filed to secure his delinquent federal income tax liabilities for the years 1999 and 2000 and to allow a levy to go forward to collect those liabilities. (Doc. 1.) On motion by the Commissioner (Doc. 7), the Tax Court remanded the case for further proceedings in Appeals (Doc. 9). After Appeals issued a supplemental notice of determination (Ex. 60-J), the parties jointly moved to submit the case without trial under Tax Ct. R. 122, based on their stipulation (Docs. 18, 19). The court issued an opinion granting judgment to the Commissioner and entered a decision sustaining the notice of determination as supplemented. (Docs. 27, 28, 29.) Taxpayer now appeals. (Doc. 30.)

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STATEMENT OF FACTS

1. Taxpayer's background

Taxpayer was born in 1967, earned a degree from the Wharton School of Business at the University of Pennsylvania, and worked as an investment banker with UBS AG. (Doc. 27 at 3; Doc. 20 at 1; Ex. 45-J at 560.) Taxpayer left UBS AG and in 1999 established Asiawerks Global Investment Group, Pte., Ltd. (Asiawerks), in Singapore. (Doc. 27 at 3-4; Doc. 20 at 1.) Asiawerks was an investment firm in which taxpayer held a 50-percent ownership interest. (Doc. 27 at 4; Doc. 20 at 1.) In 1999 and 2000, taxpayer's primary sources of regular income were his Asiawerks salary and tribal income he received as a member of the Saginaw Chippewa Indian Tribe. (Doc. 27 at 4; Ex. 41-J at 540.)

2. Taxpayer's 1999 and 2000 liabilities

During 1999 and 2000, taxpayer liquidated a number of investments to fund a divorce settlement. (Doc. 27 at 4; Doc. 20 at 2.) The gain realized on these investments, combined with his other earnings, resulted in adjusted gross income of \$1,740,936 in 1999 and \$1,809,767 in 2000, and in Federal income tax liabilities of \$514,164 for

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1999 and \$565,268 for 2000. (Doc. 27 at 4; Doc. 20 at 2.) Taxpayer filed returns for the years 1999 and 2000 in December 2002, but did not make any payments towards his liabilities for those years. (Doc. 27 at 4; Doc. 20 at 2.)

3. The IRS's notice of lien and notice of levy

On October 30, 2007, the Internal Revenue Service (IRS) issued taxpayer a "Notice of Federal Tax Lien Filing and Your Right to a Hearing under IRC 6320," advising him that a Federal tax lien had been filed with respect to his outstanding income tax liabilities for 1999 and 2000, and that he had a right to a CDP hearing. (Doc. 27 at 5; Doc. 20 at 2, 5; Ex. 1-J.) Two days later, on November 1, 2007, the IRS issued taxpayer a "Final Notice – Notice of Intent to Levy and Notice of Your Right to a Hearing" for the same tax liabilities, pursuant to Section 6330(a)(1), advising him that the IRS intended to levy upon his property and that he had a right to a hearing before the levy. (Doc. 27 at 5; Doc. 20 at 2-3; Ex. 2-J.) As of that time, taxpayer's liabilities for 1999 and 2000 – including interest and penalties – totaled \$1,586,952.45. (Doc. 27 at 5; Doc. 20 at 3.) On November 19, 2007, the IRS received from

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taxpayer's representatives a Form 12153, "Request for a Collection Due Process Hearing." (Doc. 27 at 5; Doc. 20 at 3; Ex. 4-J.)

4. Hearing before Settlement Officer Hunt

Taxpayer's CDP hearing was initially assigned to Settlement Officer Mark Hunt, who calculated taxpayer's total tax liability with accruals to be \$2,324,895. (Doc. 27 at 6; Doc. 20 at 6; Ex. 16-J at 325.)

On November 30, 2007, taxpayer submitted his first formal offer in compromise (OIC) dated October 21, 2007 (October 2007 OIC). (Doc. 27 at 6; Doc. 20 at 4; Ex. 5-J.) Under the October 2007 OIC, taxpayer proposed to pay a total of \$225,000 in 23 monthly installments of \$9,375, plus a deposit in the same amount, in settlement of his outstanding tax liabilities. (Doc. 27 at 6; Doc. 20 at 4; Ex. 5-J.) With the OIC, taxpayer submitted a deposit in the amount of \$28,125, and an installment payment in the amount of \$9,375. (Doc. 20 at 4; Ex. 5-J.)

The IRS evaluates an offer in compromise in light of the taxpayer's "reasonable collection potential" (RCP), which is calculated in light of his net realizable equity; his future income, less allowable living expenses; his foreign and other assets beyond the Government's reach;

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and the amounts collectible from third parties (*e.g.*, transferees).

Internal Revenue Manual (I.R.M.) § 5.8.4.3(2) (June 1, 2010). In determining reasonable collection potential, a taxpayer's assets may be considered to include the value of "dissipated" assets that he has spent or transferred with a disregard for his unpaid taxes. I.R.M. § 5.8.5.5 (Sept. 23, 2008).

On March 27, 2008, after an exchange of letters and a telephone conference with taxpayer's representatives (Doc. 20 at 6-9; Exs. 7-J – 15-J), Settlement Officer Hunt issued a preliminary determination in which he calculated taxpayer's reasonable collection potential to be \$707,386 and recommended rejection of the October 2007 OIC (Doc. 27 at 6-7; Doc. 20 at 9-10; Ex. 16-J.) Taxpayer's representatives subsequently submitted an informal proposal to amend the October 2007 OIC upward to \$456,064, which taxpayer would fund with distributions from his investment in DCM II Doll Technology Investment Fund II LP (DCM) and his interest in Claremont LLC (Claremont). (Doc. 27 at 7; Doc. 20 at 10-11; Ex. 17-J.) However, in June 2008 taxpayer amended the October 2007 OIC downward to

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\$350,000, stating that he planned to sell his interest in DCM to an unrelated investor for 75 percent of the value reflected on his financial statements. (Doc. 27 at 7; Doc. 20 at 12-13; Ex. 22-J.)

During an October 28, 2008 telephone conference, taxpayer's representatives informed Settlement Officer Hunt and his manager that Asiawerks was having financial difficulty, and that taxpayer had contributed a portion of his 2008 distribution from DCM, which had been earmarked to fund the October 2007 OIC and subsequent OICs, to Asiawerks to pay his salary. (Doc. 27 at 7; Doc. 20 at 21-22.) The parties also discussed the inclusion of certain dissipated assets in taxpayer's RCP, the value of taxpayer's interest in Asiawerks, and the disallowance of a monthly loan payment. (*Id.*)

On December 17, 2008, after a series of further discussions, taxpayer's representatives faxed to Settlement Officer Hunt an amended offer in compromise proposing a \$400,000 cash offer payable within eight months. (Doc. 27 at 8; Doc. 20 at 25; Ex. 39-J.) Taxpayer amended this offer a week later on December 24, 2008, proposing to pay \$400,000 in five bimonthly installments of \$80,000. (Doc. 27 at 8; Doc.

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20 at 25-26; Ex. 40-J.) The first installment of \$80,000 consisted of \$42,500 (which Mr. Johnson would pay upon acceptance of the December 24, 2008 OIC) plus the \$37,500 previously paid in connection with the October 2008 OIC. (Doc. 27 at 8 n.7; Doc. 20 at 25.) Taxpayer made a deposit of \$42,500 in connection with the December 24, 2008 OIC (Doc. 20 at 38, Ex. 56-J), which, together with his earlier deposit of \$28,125 and installment payment in the amount of \$9,375 made in connection with the October 2007 OIC (Doc. 20 at 4; Ex. 5-J), brought his deposits up to \$80,000.

In a January 2009 draft Appeals case memorandum (ACM), Settlement Officer Hunt calculated taxpayer's total tax liability as of August 31, 2008, to be \$2,365,541. (Ex. 41-J at 538.) He recommended acceptance of taxpayer's December 24, 2008 OIC after calculating taxpayer's RCP to be \$364,392 (which did not take into account the \$80,000 already paid in connection with previous offers). (Doc. 27 at 8 n.8; Doc. 20 at 26; Ex. 41-J.) Settlement Officer Hunt's manager, however, rejected this recommendation. (Doc. 27 at 8; Doc. 20 at 26.) Shortly thereafter, Settlement Officer Hunt assumed an acting position

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in management and taxpayer's case was reassigned to Settlement Officer D.W. DeVincenz. (Doc. 27 at 9; Doc. 20 at 26-27.)

5. Hearing before Settlement Officer DeVincenz

After reviewing all the prior correspondence and records, Settlement Officer DeVincenz recalculated taxpayer's RCP to be \$513,872 – \$77,820 in future income potential plus \$436,592 in asset equity. (Doc. 27 at 9 n.9; Doc. 20 at 27.) The increase in future income potential resulted from a determination that only a part of a \$3,000 monthly payment taxpayer paid on a loan secured by his mother's house was allowable as a necessary expense, and the increase in asset equity represented the inclusion of taxpayer's interest, through Asiawerks, in a coal mine. (*Id.*) Based on this analysis, Settlement Officer DeVincenz advised taxpayer's representatives, in a March 30, 2009 telephone conference, that a short-term cash offer of \$500,000, with an additional \$20,000 down payment, would be an acceptable collection alternative. (Doc. 27 at 9; Doc. 20 at 30.)

On April 10, 2009, taxpayer's representatives informed Settlement Officer DeVincenz that Asiawerks was in the process of winding up,

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and that taxpayer could no longer afford the payment schedule proposed in his December 24, 2008 offer in compromise for \$400,000. (Doc. 27 at 9; Doc. 20 at 31; Ex. 43-J.) Taxpayer's representatives also reported that taxpayer had used the remainder of his DCM distributions to fund the business operations of Asiawerks and for living expenses, and that his only asset was his remaining interest in DCM, valued at \$60,000. (Doc. 27 at 9-10; Doc. 20 at 31; Ex. 43-J.) For that reason, he was amending the December 24, 2008 OIC downward to \$140,000, which would consist of the \$80,000 he had previously remitted for deposit and the projected proceeds from sale of his remaining \$60,000 interest in DCM. (Doc. 27 at 10; Doc. 20 at 31-32; Ex. 43-J.)

6. Notice of Determination, Tax Court petition, and remand

The Office of Appeals, on April 17, 2009, issued a notice of determination sustaining the lien and proposed levy and rejecting taxpayer's OIC. (Ex. 44-J.) Taxpayer filed a petition in the Tax Court challenging the IRS's rejection of his OIC, arguing that his "revised \$140,000 offer in compromise" was "equivalent to [his] reasonable collection potential." (Doc. 1 at 2.) The Commissioner subsequently

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moved for remand on the ground that the notice of determination did not explain how Settlement Officer DeVincentz had calculated taxpayer's RCP (Doc. 7), and the Tax Court remanded the case to the Office of Appeals on December 17, 2009 (Doc. 9).

7. Supplemental hearing and determination

Settlement Officer Cynthia Covey was assigned to the hearing on remand. (Doc. 27 at 10; Doc. 20 at 34.) On the basis of the administrative record from the original proceeding, Settlement Officer Covey calculated taxpayer's unpaid balance (including interest and penalties) as \$2,468,936 and tentatively calculated taxpayer's RCP to be \$568,408. (Doc. 27 at 11; Doc. 20 at 34; Ex. 54-J.) In a letter dated January 28, 2010, she informed taxpayer of this conclusion, explained her calculations, and requested that he provide the following documents by February 14, 2010: (1) support for any disagreement about any item in her calculations; (2) Forms 433-B, Collection Information Statement for Businesses, for all companies in which he held an interest, including Asiawerks, DCM, Pinewerts, Spore Co., and Claremont; (3) an appraisal of taxpayer's Toyota Harrier; and (4) with respect to any listed assets

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that had been liquidated, closing or sale documents and proof of how the funds were disbursed. (Doc. 20 at 34-35; Ex. 54-J.)

A face-to-face conference was held on March 2, 2010, between Settlement Officer Covey and taxpayer's representatives, in which they discussed, among other things, the dissipation of the \$277,000 distribution that taxpayer had received from DCM in 2008. (Doc. 27 at 11; Doc. 20 at 35-37.) Taxpayer's representatives did not provide any of the requested documents. (Doc. 20 at 35-36.) Taxpayer's representatives claimed that the 2008 DCM distribution was used to pay their legal fees in connection with the ongoing Tax Court proceeding and to fund the down payment of the December 24, 2008 OIC, and that any remaining funds were either reinvested into the failing Asiawerks or used for personal living expenses. (Doc. 27 at 11; Doc. 20 at 36.) Settlement Officer Covey requested that taxpayer provide, by March 16, 2010, substantiation of his current financial situation, including:

(1) proof of disbursements from the 2008 DCM distribution and the liquidation of taxpayer's investment in Claremont; (2) closing statements, settlement sheets, and bank statements verifying

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taxpayer's claim that the money he reinvested in Asiawerks to pay his salary had been used for necessary living expenses; (3) taxpayer's current Form W-2, Wage and Tax Statement, to corroborate a supposed reduction in his tribal income; (4) current statements establishing taxpayer's remaining interests in DCM and Claremont; (5) and Forms 433-B for all companies in which taxpayer held an interest. (Doc. 27 at 11-12; Doc. 20 at 37-38.)

After the conference, taxpayer's representative faxed Settlement Officer Covey a letter on March 12, 2010, advising her that the Claremont investment had paid out \$11,317 and was now finished, and that taxpayer was seeking an appraisal of Asiawerks and its coal mine investment. (Doc. 27 at 12; Doc. 20 at 39; Ex. 57-J.) He stated that taxpayer's position was that dissipated assets should not be included in taxpayer's RCP, and reiterated that taxpayer's current offer was \$140,000, consisting of \$80,000 that he had previously deposited in connection with earlier OICs plus \$60,000 which he intended to fund from his remaining DCM investment – in other words, that he proposed to pay the IRS only \$60,000. (Doc. 27 at 12; Doc. 20 at 39-40; Ex. 57-J.)

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In a follow-up telephone call, Settlement Officer Covey reminded taxpayer's representative that she had not received the documents she had requested, and further explained her calculation of taxpayer's RCP. (Doc. 20 at 40-41.)

Most of the requested documents were never provided to Settlement Officer Covey. (Doc. 27 at 12.)

Settlement Officer Covey ultimately concluded that neither of taxpayer's proposed offers – i.e., neither the informal proposal of \$140,000, nor the December 24, 2008 OIC of \$400,000 that he had withdrawn or amended – would be an acceptable offer, given her calculation of his RCP. (Doc. 27 at 13; Ex. 60-J.) In evaluating taxpayer's proposals, Settlement Officer Covey noted that taxpayer had failed to provide documents she had requested, including substantiation of the alleged reduction in tribal income and accounts showing the distribution of funds from the sale of assets. (Ex. 60-J at 680.) She calculated taxpayer's RCP to be \$445,181 (i.e., about 18 percent of his total liability of about \$2.5 million), on the basis of total equity in assets

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of \$288,317 and future income potential of \$156,864. (Doc. 27 at 13; Ex. 60-J.) Her asset computation was as follows:

Personal bank accounts	\$7,500
Value of remaining DCM interest	60,000
Dissipated assets:	
Claremont interest sold 4/2009	11,317
DCM interest sold 6/2009	209,500
Total	288,317

The calculation did not include the fair market value of taxpayer's interest in Asiawerks, the coal mine partly owned by Asiawerks, Pinewerks, or Spore Co., for which the value was listed as "Unknown." (Ex. 60-J at 679.) Settlement Officer Covey included a portion of the proceeds of the most recent sale of DCM and distribution from Claremont as dissipated assets because they were received after the rejection of taxpayer's OIC and taxpayer voluntarily reinvested them into his company, rather than using them to pay his taxes, and because taxpayer had not provided documentation of how the funds were spent. (*Id.*)

Settlement Officer Covey's determination of taxpayer's future income potential first computed his monthly disposable income (income over allowable expenses) and then multiplied that amount by 48

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months, to yield four years' worth of disposable income. (Doc. 27 at 13; Ex. 60-J at 679-680.) For taxpayer's monthly income, Settlement Officer Covey took the figures – wages of \$3,267 per month and tribal income of \$6,510 per month, totaling \$9,777 per month – from taxpayer's financial statement. (Doc. 27 at 13; Ex. 60-J at 680; Ex. 45-J at 565.) Settlement Officer Covey's monthly expense figures differed somewhat from taxpayer's (in some respects to his advantage, but overall to his disadvantage) as follows:

	<u>Taxpayer</u>	<u>Settlement Officer Covey</u>
Monthly income	\$9,777	\$9,777
Monthly expenses:		
National Standard	\$600	\$760
Housing & utils.	\$3,117	\$3,117
Health care	0	\$60
Taxes	\$1,500	\$1,500
Transportation— operating cost	\$385	\$385
Transportation— ownership cost	\$915	\$489
Child care	\$300	\$198
Loan payment	\$3,000	0
Total expenses	\$9,817	\$6,509
Monthly disposable income	0	\$3,268
Future income potential (Net x 48)	0	\$156,864

(Ex. 60-J at 680.)

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Settlement Officer Covey therefore recommended sustaining the collection actions, and the Office of Appeals issued a supplemental notice of determination on April 20, 2010, sustaining the notice of lien and the proposed levy. (Doc. 27 at 15; Doc. 20 at 42; Ex. 60-J.)

8. The Tax Court opinion and decision

The parties submitted the case to the Tax Court fully stipulated under Tax Ct. R. 122. (Docs. 19, 20.) After briefing, the court issued an opinion upholding the collection actions. (Docs. 27, 28.) The court held that Appeals did not abuse its discretion in rejecting the December 24, 2008 offer of \$400,000 on two grounds (1) taxpayer amended or withdrew the offer, and (2) the offer was, in any event, defective because (a) taxpayer had stated that he could not fund the offer, and (b) the offer was for less than taxpayer's RCP. (Doc. 27 at 21-25.)

The court further found that the only offer pending at the time of the original notice of determination was the \$140,000 offer which was, in effect, an offer to pay only an additional \$60,000. (Doc. 27 at 25-26.) The court concluded that Appeals did not abuse its discretion in rejecting this offer because taxpayer's RCP exceeded \$60,000 on three

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grounds, each of which was independently sufficient to support the denial of the offer. First, Appeals had properly included over \$200,000 in dissipated assets because taxpayer had sold assets during the CDP hearing and, despite repeated requests, had not substantiated the application of the funds realized from those sales. In particular, he did not substantiate his contention that the distributions were used for necessary living expenses. Second, taxpayer had \$7,500 in personal bank accounts, which, added to the \$60,000 expected from sale of his remaining interest in DCM, yields an RCP of more than \$60,000. Third, Settlement Officer Covey had correctly calculated that taxpayer had a future earning potential that would exceed his necessary living expenses. (Doc. 27 at 27-33.)

The Tax Court found no support in the record for taxpayer's argument that the IRS had reneged on acceptance of earlier offers. (*Id.* at 33-36.) The court also rejected taxpayer's argument that Appeals had improperly delayed the proceedings, noting that, contrary to taxpayer's contention, there is no requirement in § 6330 that the CDP hearing not be "more intrusive than necessary" and, in any event, "the long duration

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of [the] CDP hearing was largely attributable to [taxpayer]” who had “presented a moving target, as his financial affairs drastically fluctuated.” (*Id.* at 36-37.) Accordingly, the Tax Court concluded that the determination of the Office of Appeals, including the rejection of taxpayer’s offer, was not an abuse of discretion, and that the Commissioner could proceed with collection. (*Id.* at 38.)

The Tax Court issued a decision upholding the notice of determination as supplemented (Doc. 29), and taxpayer appealed (Doc. 30).

SUMMARY OF ARGUMENT

Taxpayer is an investment banker with a business degree from Wharton who left his job with a large bank, UBS AG, to start his own investment firm, Asiawerks, in which he held a 50 percent interest. He also receives tribal income as a member of the Saginaw Chippewa Indian Tribe, which he reported on his financial statement as \$6,510 per month (over \$78,000 per year). During 1999 and 2000, when he was in his early 30’s, taxpayer liquidated a number of investments and paid \$1.25 million to his former wife as part of a divorce settlement. The

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gain realized from liquidating those investments, combined with his other earnings, resulted in adjusted gross income of \$1,740,936 in 1999 and \$1,809,767 in 2000, which, in turn, resulted in Federal income tax liabilities of \$514,164 for 1999 and \$565,268 for 2000. Taxpayer reported the taxes on his returns for those years, but did not make any payments on the liabilities, even though his combined adjusted gross income for the two years totaled over \$3.5 million, which would have left him over a million dollars to live on had he paid both his ex-wife and his taxes. He ultimately offered to pay only \$140,000 (consisting of \$80,000 already deposited with the IRS, plus an additional payment of \$60,000) to satisfy his tax liabilities for those years, which, at the time of the offer, exceeded \$2.5 million. The IRS did not abuse its discretion in rejecting this offer.

The IRS has discretion under Section 7122 to accept an offer in compromise for less than the full amount owed. The IRS may compromise a tax liability where the taxpayer cannot pay the full amount and makes an offer that is equal to or greater than his “reasonable collection potential” (RCP), which consists of his assets plus

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expected future income in excess of necessary living expenses. The IRS's decision to reject an offer in compromise is reviewable by the Tax Court when, as here, it is made in the context of a collection due process hearing by the IRS Office of Appeals under I.R.C. §§ 6320 and 6330. But review by the Tax Court and by this Court is only for abuse of discretion, and is highly deferential to the judgment of the Office of Appeals.

Here, the Office of Appeals did not abuse its discretion in determining that taxpayer's reasonable collection potential exceeded his offer of an additional \$60,000. Taxpayer proposed to fund the offer by selling what he claimed was his only remaining asset, which he valued at \$60,000. Accordingly, denial of the offer was reasonable if there was reason to believe either that he had some additional assets or that he had some future income potential in excess of his necessary expenses. Both were present here.

As an initial matter, taxpayer's failure to include his reported bank account balance in the offer was sufficient to justify denial. Further, in calculating RCP, the Office of Appeals included dissipated

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assets, which are, in essence, assets that the taxpayer disposed of after the liability arose that he could have used to pay his taxes. As this Court recently explained in *Tucker v. Commissioner*, 676 F.3d 1129, 1135 (D.C. Cir. 2012), dissipated assets are properly included in reasonable collection potential not because they are available to pay the tax, but in order to discourage delinquent taxpayers from dissipating their assets. Here there were several assets listed on taxpayer's financial information statement at the beginning of the CDP proceeding that he no longer had at the time of the offer in issue, for which he admitted he had received money. And, although the Settlement Officer had repeatedly asked for documentation of taxpayer's contention that he had spent the proceeds of the dissipated assets on necessary living expenses, he failed to provide that documentation. This failure alone would be sufficient to support denial of the offer.

Finally, Appeals reasonably concluded that taxpayer had future earning potential. Although his business had failed, he was well-educated, in his early forties at the time of the offer, and provided no reason to believe that he was not highly employable. And, because

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taxpayer's tribal income alone was sufficient to cover his necessary living expenses, any money he earned could be applied to paying his taxes.

Taxpayer's argument that including dissipated assets in his RCP was inherently unfair is precluded by this Court's decision in *Tucker*. His contention that he used the proceeds from the disposition of the assets for necessary living expenses fails because he did not provide any documentation of the disposition of those assets. He also argues that his necessary living expenses should have included a \$3,000 monthly payment he was making on a loan secured by his mother's home, but did not provide the requested documentation to show how the proceeds of the loan were used. In any event, because taxpayer's tribal income was sufficient to cover his necessary living expenses, he cannot establish that either the dissipated assets or the proceeds of the loan were needed to pay his necessary living expenses.

Accordingly, the Tax Court decision should be affirmed.

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ARGUMENT

The Tax Court correctly concluded that the IRS Office of Appeals did not abuse its discretion in rejecting taxpayer's offer in compromise and sustaining the collection actions

Standard of review

Where the validity of the underlying liability is not properly at issue in a CDP case (as is the situation here), the Tax Court and court of appeals review the determination of Appeals for an abuse of discretion. *Living Care Alternatives of Utica, Inc. v. United States*, 411 F.3d 621, 626 (6th Cir. 2005). The court of appeals reviews the Tax Court's decision *de novo*, *Murphy v. Commissioner*, 469 F.3d 27, 32 (1st Cir. 2006), meaning that the court "review[s] the IRS's disposition of an offer in compromise following a CDP hearing for abuse of discretion, ceding no special deference to the Tax Court's intermediate review," *Dalton v. Commissioner*, 682 F.3d 149, 154 (1st Cir. 2012).

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A. The Collection-Due-Process procedures provide for limited review of certain IRS collection actions

This case concerns the result of a hearing under I.R.C. §§ 6320 and 6330 requested by taxpayer in response to a notice of federal tax lien and notice of intent to levy to collect his delinquent taxes for 1999 and 2000. I.R.C. § 6320(a)(3)(B) requires the IRS to notify a taxpayer of his right to a collection due process (CDP) hearing before the IRS Office of Appeals upon the filing of a notice of lien, and I.R.C. § 6330(a) requires the IRS to notify a taxpayer of his right to a CDP hearing before levying on a taxpayer's property. Following a timely request, the taxpayer is entitled to a hearing before the IRS Office of Appeals "with respect to the taxable period to which the unpaid tax . . . relates." I.R.C. §§ 6320(b)(1), (2), 6330(b)(1), (2); Treas. Reg. § 301.6330-1(b), (d) (26 C.F.R.).

At the hearing, the Appeals Officer is required to "obtain verification from the Secretary that the requirements of any applicable law or administrative procedure have been met." I.R.C. § 6330(c)(1). A taxpayer may raise "any relevant issue relating to the unpaid tax or the proposed levy," including, as is relevant here, offers of collection

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alternatives, such as posting a bond, substitution of other assets, an installment agreement, or an offer in compromise. I.R.C.

§ 6330(c)(2)(A); Treas. Reg. § 301.6330-1(e)(3) Q&A-E6.

CDP hearings are informal, and the Appeals Officer is not required to hold a face-to-face meeting with the taxpayer or the taxpayer's representative. Treas. Reg. § 6330-1(d)(2) Q&A-D6. A CDP hearing thus may consist of a face-to-face meeting, one or more written communications, or some combination thereof. *Id.* After the hearing, the Office of Appeals issues a notice of determination setting forth its decision as to 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.” I.R.C. § 6330(c)(3)(C); *see* Treas. Reg. §§ 301.6330-1(e)(3) Q&A-E8, 301.6330-1(f)(1).

As the Tax Court correctly pointed out (Doc. 27 at 37), “section 6330(c)(3)(C) does not provide that the CDP process must not be ‘more intrusive than necessary,’ but rather that the proposed ‘collection action [e.g., lien or levy] be no more intrusive than necessary.’” Accordingly,

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taxpayer's argument (Br. 13; *see also* Br. 14, 15) that the Office of Appeals abused its discretion because the length of the CDP hearing was “more intrusive than necessary” and “fundamentally unfair” is wide of the mark. There is no prescribed “time period within which a CDP hearing must be concluded.” *Murphy*, 469 F.3d at 32. In any event, as the Tax Court also pointed out, the duration of the CDP hearing here was largely attributable to taxpayer, whose changing financial circumstances presented a “moving target.” (Doc. 27 at 37.)

Section 6330(d)(1) allows a taxpayer to seek judicial review in the Tax Court within 30 days after such a determination. Where, as here, the underlying tax liability was not at issue in the CDP hearing, the Tax Court reviews the Office of Appeals's determination only for an abuse of discretion. *Olsen v. United States*, 414 F.3d 144, 150 (1st Cir. 2005); *see also* H.R. Conf. Rep. No. 105-599, at 266 (1998), *reprinted in* 1998-3 C.B. 747, 1020. Judicial review is to be based solely on the administrative record. *Keller v. Commissioner*, 568 F.3d 710, 716 (9th Cir. 2009); *Murphy*, 469 F.3d at 31; *Robinette v. Commissioner*, 439 F.3d 455, 459 (8th Cir. 2006). And where, as here, the Tax Court remands a case to

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Appeals for a supplemental determination, it is the supplemental determination that the Tax Court reviews, not any of the previous determinations. *Hoyle v. Commissioner*, 136 T.C. 463, 467-468 (2011); *Kelby v. Commissioner*, 130 T.C. 79, 86 (2008) (“the position of the Commissioner that we review is the position taken in the last supplemental determination.”) Accordingly, taxpayer’s contention (Br. 14-15) that the Tax Court should have ruled that Appeals abused its discretion in 2009, by refusing his December 24, 2008 offer of \$400,000, is misplaced.³

Review of a determination by the IRS Office of Appeals in a CDP case is more deferential than appellate review of more formal agency decisions. *Dalton v. Commissioner*, 682 F.3d 149, 155 (1st Cir. 2012) (“a court should set aside determinations reached by the IRS during the CDP process only if they are unreasonable in light of the record

³ In any event, although taxpayer argues (Br. 15) that the Tax Court should have reviewed the December 24, 2008 offer based on his “RCP at the time such offer was made,” he does not even allege, let alone demonstrate, that the December 24, 2008 offer represented his RCP at the time he submitted it (*see* Doc. 20 at 27-28), but states only that he was at that time able to pay the amount offered (Br. 15) and was later unable to do so.

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compiled before the agency”); *Fifty Below Sales & Marketing, Inc. v. United States*, 497 F.3d 828, 830 (8th Cir. 2007) (review is “markedly deferential”); *Living Care Alternatives of Utica, Inc. v. United States*, 411 F.3d 621, 625 (6th Cir. 2005). As the First Circuit explained (*Dalton*, 682 F.3d at 159):

Whether an IRS determination reached during the CDP process rests upon a purely factual question, a purely legal question, or a mixed question of fact and law, a reviewing court’s mission is the same: to evaluate the reasonableness of the IRS’s subsidiary determination. The CDP process presents no occasion for a reviewing court to demand incontrovertibly correct answers to subsidiary questions, whatever their nature. Rather, the IRS acts within its discretion as long as it makes a reasonable prediction of what the facts and/or the law will eventually show.

B. The IRS has discretion to accept an offer in compromise when it determines that it likely cannot collect more

Although this case arises under §§ 6320 and 6330, the only issue in dispute is whether the Office of Appeals properly rejected taxpayer’s final offer in compromise (OIC). Consideration of an OIC submitted in the context of a CDP hearing is governed by I.R.C. § 7122, which sets out the exclusive method of compromising federal tax liabilities. *See Olsen*, 414 F.3d at 153; I.R.C. § 7122. There are three grounds for

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compromise: (1) doubt as to liability, (2) doubt as to collectibility, and (3) the promotion of effective tax administration. Treas. Reg.

§ 301.7122-1(b). “Doubt as to collectibility exists in any case where the taxpayer’s assets and income are less than the full amount of the liability.” Treas. Reg. § 301.7122-1(b)(2). “A determination of doubt as to collectibility will include a determination of ability to pay,” and the Secretary is to permit taxpayers to retain sufficient funds to pay basic living expenses, based on “the evaluation of the individual facts and circumstances presented by the taxpayer’s case.” Treas. Reg.

§ 301.7122-1(c)(2)(i). To assist the IRS in evaluating such offers, and any other issues raised during a CDP proceeding, “[t]axpayers will be expected to provide all relevant information requested by Appeals, including financial statements, for its consideration of the facts and issues involved in the hearing.” Treas. Reg. § 301.6330-1(e)(1).

The decision whether to accept or reject an OIC “is left to the discretion of the Secretary.” Treas. Reg. § 301.7122-1(c). Even outside the CDP process, courts have been reluctant to substitute their judgment for that of IRS officials who are responsible for insuring the

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timely collection of taxes, holding that the “decision to accept or reject a compromise offer is discretionary and cannot be compelled by any action.” *Addington v. United States*, 75 F. Supp. 2d 520, 524 (S.D. W. Va. 1999) (citing *Carroll v. Internal Revenue Service*, 14 A.F.T.R.2d (RIA) 5564 (E.D.N.Y. 1964)). Likewise, in reviewing CDP determinations, the courts have been reluctant to substitute their judgment for that of Appeals. *See, e.g., Dalton*, 682 F.3d at 159-160 (IRS’s rejection of OIC upheld because it was based on a “reasonable” determination about taxpayer’s ownership of property, regardless of whether that determination should ultimately be upheld); *Orum v. Commissioner*, 412 F.3d 819, 821 (7th Cir. 2005) (decision to levy rather than enter into installment agreement “is the sort of decision committed to executive officials”); *Living Care Alternatives*, 411 F.3d at 631 (absent an abuse of discretion, no further CDP proceedings are appropriate, lest “the judiciary [] inevitably become involved on a daily basis with tax enforcement details that judges are neither qualified, nor have the time, to administer”).

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An offer based on doubt as to collectibility may be considered an acceptable alternative to collection only where it reflects the taxpayer's "reasonable collection potential" (RCP). Rev. Proc. 2003-71, 2003-2 C.B. 517, § 4.02(2); *Tucker v. Commissioner*, 676 F.3d 1129, 1135 (D.C. Cir. 2012). Thus, the IRS does not abuse its discretion in rejecting an offer if it "reasonably determines that more than the proffered amount may be collectable." *Dalton*, 682 F.3d at 157. *Accord Keller*, 568 F.3d at 718 (finding no abuse of discretion where the Commissioner rejected offer "because it was substantially lower than what the RCP calculation showed the Taxpayer could afford to pay."); *Murphy v. Commissioner*, 469 F.3d 27, 33 (1st Cir. 2006). "Reasonable collection potential" is calculated in light of the taxpayer's net realizable equity; his future income, less allowable living expenses; his foreign and other assets beyond the Government's reach; and the amounts collectible from third parties (*e.g.*, transferees). Internal Revenue Manual (I.R.M.) § 5.8.4.3.1 (June 1, 2010).

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In determining RCP, a taxpayer's assets may be deemed to include the value of "dissipated" assets. I.R.M. § 5.8.5.5 (Sept. 23, 2008)⁴; *Tucker*, 676 F.3d at 1135 -1136. Dissipated assets are defined as "assets (liquid or non-liquid) [that] have been sold, gifted, transferred, or spent on non-priority items and/or debts and are no longer available to pay the tax liability." I.R.M. 5.8.5.5(1). Such assets may be included in computing reasonable collection potential if they have been dissipated "with a disregard" for an outstanding tax liability. I.R.M. 5.8.5.5(4). They need not be included if, for example, the taxpayer can show that the funds have been used to pay for "necessary living expenses." I.R.M. 5.8.5.5(4). If, however, the taxpayer does not provide "information showing the disposition of funds from transferred assets," the IRS will consider including the transferred assets in RCP. I.R.M. 5.8.5.5(8). *See also Olsen*, 414 F.3d at 154 ("Given [taxpayer's] failure to cooperate fully despite the appeals officer's repeated attempts to obtain the information deemed necessary to evaluate the offer (and, in particular, [taxpayer's]

⁴ Although the Internal Revenue Manual section on dissipated assets has since been amended, the September 23, 2008 version was in effect at the time of the remand hearing, in early 2010.

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claimed inability to pay), we cannot say the appeals officer abused her discretion”); *Shebby v. Commissioner*, 101 T.C.M. (CCH) 1612, 2011 WL 2260487, at *5-6 (2011) (“When an Appeals officer refuses to consider an offer-in-compromise because of a taxpayer’s failure to provide financial information, courts have held that there was no abuse of discretion.”); Treas. Reg. § 301.6330-1(e)(1). The inclusion of dissipated assets must be justified by the case file and documented. I.R.M. 5.8.5.5 (3).⁵

Here the Tax Court correctly concluded that the Office of Appeals did not abuse its discretion in rejecting an OIC that was less than taxpayer’s reasonable collection potential, and for which taxpayer failed to provide financial documents requested by the Settlement Officer.

C. The Office of Appeals did not abuse its discretion when it rejected taxpayer’s offer in compromise

The only issue on appeal, and the only issue that was before the Tax Court, is whether the Office of Appeals abused its discretion in

⁵ On appeal, taxpayer repeats his contention (Br. 17; *see also* 2, 6, 9, 11) that the I.R.M. limits inclusion of dissipated assets to “unusual cases.” But as the Tax Court correctly observed, the I.R.M. does not include any such requirement, but requires only that the inclusion “must clearly be justified.” (Doc. 27 at 19 n. 12, citing I.R.M. 5.8.5.5(3)).

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rejecting taxpayer's most recent OIC based on doubt as to collectibility. Because the Office of Appeals rejected the OIC on the ground that the amount offered was less than taxpayer's RCP, the issue is whether the Office of Appeals abused its discretion in calculating taxpayer's RCP.

Taxpayer made a formal offer of \$400,000 on December 24, 2008. (Doc. 27 at 8; Doc. 20 at 25-26; Ex. 40-J.) As he acknowledges (Br. 15), however, he later informally amended the offer "downward" to \$140,000. (Doc. 20 at 31-32; Ex. 43-J.)

Settlement Officer Covey calculated taxpayer's RCP to be \$445,181 (about 18 percent of his total liability of about \$2.5 million), based on total equity in assets of \$288,317 and future income potential of \$156,864. (Doc. 27 at 13; Ex. 60-J.) Accordingly, she determined that neither the formal offer of \$400,000 nor the informal amended offer of \$140,000 was acceptable because they were both less than taxpayer's RCP. (Ex. 60-J.) As demonstrated below, this conclusion was correct.

In any event, as the Tax Court correctly concluded, the offer before Appeals in the remand proceedings, and thus the only offer before the court, was taxpayer's informal amended offer of \$140,000. (Doc. 27 at

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25; Doc. 20 at 39-40; Ex. 57-J.) This offer, in turn, consisted of \$80,000 that taxpayer had already deposited in connection with previous formal offers, plus an additional payment of \$60,000, which taxpayer intended to fund through a sale of his remaining investment in DCM. (*Id.*)

Accordingly, as the Tax Court pointed out (Doc. 27 at 26), taxpayer “essentially offered an additional \$60,000 in settlement of a Federal income tax liability of approximately \$2.5 million.” Further, as the Tax Court also correctly pointed out (*id.*), the offer assumed that taxpayer’s “entire collection potential consisted of the value of a single asset” – that is, his remaining interest in DCM.

In order to sustain the rejection of this offer, this Court need not determine whether Appeals correctly determined taxpayer’s RCP to be \$445,181 (Ex. 60-J at 676, 678, 680); it need only determine that taxpayer’s RCP exceeded \$60,000. Further, because taxpayer presented the proposed \$60,000 payment as a liquidation of his remaining DCM investment (Doc. 20 at 39-40; Ex. 57-J), rejection was proper if it was reasonable to believe that taxpayer had any other asset or any future income potential. Conversely, in order to prevail, taxpayer must show

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that there was no reasonable ground for concluding either that he had any other asset or that he had any future income potential. He falls far short of this goal and does not even demonstrate any error in the calculation of his RCP as \$445,181.

The Tax Court correctly points to three separate and independently sufficient grounds on which Appeals properly based its conclusion that taxpayer's RCP exceeded his \$60,000 offer. Taxpayer disputes only two of these grounds, and his arguments with respect to those are meritless.

1. Taxpayer's omission of the balance of certain bank accounts from his OIC is a sufficient reason to reject the offer

Appeals included in taxpayer's assets \$7,500 in bank accounts (Ex. 60-J at 679) – an amount taken from taxpayer's Form 433-A (Ex. 45-J at 561). Taxpayer does not dispute this figure. As the Tax Court pointed out (Doc. 27 at 30), including the bank accounts shows that taxpayer could pay substantially more than the offered \$60,000; adding the \$7,500 to the \$60,000 taxpayer proposed to realize from his remaining DCM investment would increase the offer by 12.5 percent (\$7,500

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divided by \$60,000). Because taxpayer does not contest this conclusion in his opening brief, he has forfeited any challenge to it. *Kapche v. Holder*, 677 F.3d 454, 460 (D.C. Cir. 2012). Further, because, as the Tax Court pointed out (*id.*), this finding in itself was sufficient to uphold the rejection of the amended offer, this Court need go no further. In any event, as explained below, taxpayer's challenges to other elements of the calculation of his RCP are meritless.

2. It was reasonable for the IRS to include dissipated assets in calculating taxpayer's RCP

The Tax Court held that Appeals properly included dissipated assets in calculating taxpayer's RCP. (Doc. 27 at 28-29.) Taxpayer's Form 433-A, which was signed in 2007, listed three assets under "investments": DCM, valued at \$375,000; Claremont 6300, valued at \$25,000; and Asiawerks, for which he did not provide a value. (Ex. 45-J at 561.) The Office of Appeals included in the calculation of taxpayer's assets as dissipated assets \$209,500 of taxpayer's distributions from DCM (out of proceeds in the amount of \$277,00, and a listed value on taxpayer's 2007 Form 433-A of \$375,000 (Ex. 45-J at 561)) and \$11,317 (out of an initial reported value of \$25,000) that taxpayer's

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representatives stated he would receive as a final distribution from Claremont on the grounds that (1) the assets were liquidated during the CDP proceeding, (2) despite the federal tax lien, taxpayer “voluntarily reinvested” these amounts in his business, rather than using them to pay his delinquent taxes, and (3) taxpayer had failed to provide requested documentation to show the amounts received and the disbursement of the funds and thus had failed to support his contention that all or most of the proceeds were spent on necessary living expenses. (Ex. 60-J at 679-680.)

As noted above, the I.R.M. provides for inclusion of dissipated assets if they have been dissipated “with a disregard” for an outstanding tax liability, I.R.M. 5.8.5.5(4), *or* if the taxpayer does not provide “information showing the disposition of transferred assets,” I.R.M. 5.8.5.5(8). Here it is undisputed (*see* Br. 11) that taxpayer disposed of assets during the CDP proceeding. He did not use the proceeds of these sales or distributions to pay his taxes. (Exs. 61-J, 62-J.) Further, although Settlement Officer Covey advised taxpayer’s representatives that a substantial part of the DCM distribution in 2008 would be

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included as a dissipated asset unless he established that the proceeds were used for necessary living expenses (Doc. 20 at 36) and repeatedly asked for documentation to substantiate the amount and application of funds from any listed assets that had been liquidated (Doc. 20 at 34-35, 37-38, 40-41; Ex. 54-J, 58-J), taxpayer did not supply those documents (Doc. 20 at 35-36, 40-41).⁶ This failure by itself was sufficient to justify rejecting the OIC and sustaining the proposed collection action. *See Olsen*, 414 F.3d at 154; *Shebby*, 101 T.C.M. (CCH) 1612; 2011 WL 2260487, at *5-6; Treas. Reg. § 301.6330-1(e)(1); I.R.M. 5.8.5.5(8). *See also* I.R.M. 5.8.5.5(4) (dissipated assets need not be included in RCP “[w]hen the taxpayer *can show that* funds have been spent to provide for necessary living expenses.” (emphasis added)).

⁶ Accordingly, taxpayer’s reliance (Br. 20) on *Salahuddin v. Commissioner*, 103 T.C.M. (CCH) 1764, 2012 WL 1758628 (2012) is entirely misplaced. The Tax Court in *Salahuddin* determined that where Appeals rejected an offer for inadequate documentation, evidence that an employee of the Office of Appeals had told taxpayers that their submission was “sufficient” precluded summary judgment. In light of the repeated reminders from Settlement Officer Covey that taxpayer had not provided required documentation (Doc. 20 at 34-35, 37-38, 40-41; Ex. 54-J, 58-J), taxpayer’s contention (Br. 20), that he had been “advised that his submission was ‘sufficient’” is unfathomable.

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Accordingly, taxpayer's contention (Br. 9) that Appeals "failed to take account of [his] financial condition" is disingenuous. He was given ample opportunity to provide documents that would have enabled Settlement Officer Covey to take account of his then-current financial condition, but he failed to do so. And taxpayer's contention (Br. 18) that "[t]he Commissioner abused his discretion by not giving weight to the statements of the taxpayer" is wide of the mark. Taxpayer was required to provide documents to support his statements, and Settlement Officer Covey did not abuse her discretion by requesting them. *See* Treas. Reg. § 301.6330-1(e)(1); *Olsen*, 414 F.3d at 151 (OIC based on inability to pay "mak[es] it reasonable for the IRS to inquire carefully into [taxpayer's] circumstances.")

Taxpayer's argument (Br. 17) that the inclusion of dissipated assets is unfair because "[i]t is a harsh thing to do to require a person to pay money he does not have," misses the point. As this Court explained, in *Tucker*, 676 F.3d at 1135, "[i]n calculating the RCP, Appeals inflates it by the amount of 'dissipated assets' – not because they are in fact accessible to the taxpayer (they obviously are not), but to discourage

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such dissipation.” Similarly, taxpayer’s contention (Br. 17) that the inclusion of dissipated assets “is the basic unfairness in this case” ignores the unfairness to other taxpayers that would be caused by failure to include such assets. As the Tax Court here explained (Doc. 27 at 20):

Conscientious taxpayers would object – and the system would suffer – if a taxpayer with overdue taxes and with money in hand could spend his money on “non-priority items” and nonetheless effectively obtain forgiveness of his liability simply by proving in the collection context that he really did reduce his collection potential by wasting the assets. Removing dissipated assets from RCP could create perverse incentives, and the tax collector must have discretion to avoid that problem.

Taxpayer’s contention (Br. 16) that the requested information “was already part of the administrative file” is not supported by the record. As an initial matter, taxpayer had ample opportunity either to explain to Settlement Officer Covey where she could find the requested documents in the file, or to resubmit them; he did neither. (*See* Doc. 20 at 34-42; Exs. 54-J, 57-J, 58-J.) In any event, the exhibits he cites (Br. 16) – *i.e.*, Exhibits 5-J, 8-J, 34-J, 45-J – are dated in 2007 and 2008, and thus cannot have provided any information about taxpayer’s financial

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situation in early 2010, the time of the remand hearing (*see* Doc. 20 at 34-35, 37-38; Exs. 54-J).

Similarly flawed is taxpayer's contention (Br. 16) that Settlement Officer Covey improperly ignored "materials in the administrative file which showed that taxpayer's expenses exceeded his income." Far from showing that his necessary expenses exceeded his income, the Form 433-A (Ex. 45-J) on which he relies (Br. 16), supports the contrary conclusion. The supplemental notice of determination, which is based on the records, including the Form 433-A, reflects a monthly disposable income – that is, an *excess of income* over necessary living expenses – of \$3,268. (Ex. 60-J at 680.) Indeed, given that taxpayer's admitted (Br. 11) tribal income of \$6,510 per month roughly equaled his necessary living expenses of \$6,509 as calculated by Appeals (Ex. 60-J at 680), it would be unreasonable on this record to conclude that taxpayer needed any of the proceeds from the disposed-of assets to cover his necessary living expenses.

Taxpayer's contention (Br. 16) that the supplemental notice of determination improperly "disregard[ed]" material in the administrative

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file which showed “that Asiawerks did not have value” is beside the point. Settlement Officer Covey’s calculation did not include the fair market value of taxpayer’s interest in Asiawerks, for which the value was listed as “Unknown.” (Ex. 60-J at 679.) In any event, at the beginning of the remand hearing, taxpayer’s representative reported to Settlement Officer Covey that taxpayer was “seeking a current third-party valuation of Asiawerks including the value of its coal mine investment” (Ex. 57-J at 661), which strongly suggests that taxpayer did not think that the record as it stood established the value, or lack of it, of Asiawerks.

Taxpayer’s references (Br. 19) to revisions of some of the I.R.M. sections relied on by Appeals and by the Tax Court, and to an IRS memorandum on offers in compromise, both dated May 21, 2012, are irrelevant to the issue before the Court – whether Appeals abused its discretion in its April 20, 2010 supplemental notice. Even assuming that taxpayer is correct that his offer might fare better under the revised standards, which is by no means obvious, his remedy is to

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submit an offer after this proceeding is over. *See Keller*, 568 F.3d at 719 (appeal of a CDP proceeding “is not necessarily the end of the road.”)

In sum, taxpayer has provided no reason for concluding that the inclusion of dissipated assets in the RCP calculation was an abuse of discretion.

3. The IRS did not abuse its discretion in calculating taxpayer’s future disposable income

Future income is an estimate of taxpayer’s ability to pay based on gross income, less necessary living expenses for a specific number of months in the future. I.R.M. 5.8.5.18 (October 22, 2010.) Taxpayer makes clear (Br. 19) that he does not dispute the calculation of his income and disputes only the determination to disallow his \$3,000 monthly payment on his mother’s mortgage as a necessary expense.

Allowable expenses for the purpose of calculating future income potential must meet the “necessary expense test” and be reasonable. I.R.M. 5.15.1.7(1) (Oct. 02, 2009). The necessary expense test limits necessary expenses to those “*that are necessary to provide for a taxpayer’s and his or her family’s health and welfare and/or production of income.*” *Id.* (emphasis in original). The total necessary expenses

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establish the *minimum* a taxpayer and family needs to live. *Id.* (emphasis added).

Accordingly, taxpayer must show that the payments he makes on his mother's loan are part of the minimum amount he and his family need to live. He does not do so. Indeed, he acknowledges (Br. 19) that his payments are made "[a]s a matter of love and duty," which suggests that they are not necessary. Contrary to taxpayer's suggestion (Br. 20), his mere conclusory statements that he used the loan proceeds to pay necessary expenses were not sufficient to establish that the payments on the loan met the necessary expenses test. Indeed, he cannot sustain this contention because, as explained above, his undisputed tribal income was sufficient to cover his undisputed necessary expenses – that is, all claimed necessary expenses other than the loan payments. In any event, taxpayer acknowledged that he had, during the years in issue, used the proceeds of the loan, among other things, to travel, and to prop up Asiawerks, which was already "technically bankrupt." (*See, e.g.*, Ex. 37-J.)

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In sum, taxpayer has demonstrated no error in the calculation of his RCP by the Office of Appeals and thus no error in its rejection either of his formal offer or of the amended offer.

CONCLUSION

The decision of the Tax Court should be affirmed.

Respectfully submitted,

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AUGUST 2012

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/s/ Sara Ann Ketchum

Attorney for Commissioner of Internal Revenue

Dated: August 24, 2012

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It is hereby certified that on August 24, 2012, I electronically filed the foregoing brief with the Clerk of the Court for the United States Court of Appeals for the District of Columbia by using the appellate CM/ECF system. Counsel of record registered as ECF Filers will be served via the Notice of Docket Activity generated by the CM/ECF system.

/s/ Sara Ann Ketchum

SARA ANN KETCHUM

Attorney

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ADDENDUM

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ADDENDUM

Treas. Reg. (26 C.F.R.) § 301.6330-1 (excerpts)

§ 301.6330-1 Notice and opportunity for hearing prior to levy.

(a) Notification--(1) In general. Except as specified in paragraph (a)(2) of this section, the Commissioner, or his or her delegate (the Commissioner), will prescribe procedures to provide persons upon whose property or rights to property the IRS intends to levy (hereinafter referred to as the taxpayer) on or after January 19, 1999, notice of that intention and to give them the right to, and the opportunity for, a pre-levy Collection Due Process (CDP) hearing with the Internal Revenue Service (IRS) Office of Appeals (Appeals). This pre-levy Collection Due Process Hearing Notice (CDP Notice) must be given in person, left at the dwelling or usual place of business of the taxpayer, or sent by certified or registered mail, return receipt requested, to the taxpayer's last known address. For further guidance regarding the definition of last known address, see § 301.6212-2.

* * * *

(b) Entitlement to a CDP hearing--(1) In general. A taxpayer is entitled to one CDP hearing with respect to the unpaid tax and tax periods covered by the pre-levy or post-levy CDP Notice provided to the taxpayer. The taxpayer must request the CDP hearing within the 30-day period commencing on the day after the date of the CDP Notice.

* * * *

(d) Conduct of CDP hearing--(1) In general. If a taxpayer requests a CDP hearing under section 6330(a)(3)(B) (and does not withdraw that request), the CDP hearing will be held with Appeals. The taxpayer is entitled to only one CDP hearing under section 6330 with respect to the unpaid tax and tax periods shown on the CDP Notice. To the extent practicable, the CDP hearing requested under section 6330 will be held in conjunction with any CDP hearing the taxpayer requests under section 6320. A CDP hearing will be conducted by an employee or officer of Appeals who, prior to the first CDP hearing under section 6320 or

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section 6330, has had no involvement with respect to the tax for the tax periods to be covered by the hearing, unless the taxpayer waives this requirement.

(2) Questions and answers. The questions and answers illustrate the provisions of this paragraph (d) as follows:

* * * *

Q-D6. How are CDP hearings conducted?

A-D6. The formal hearing procedures required under the Administrative Procedure Act, 5 U.S.C. 551 et seq., do not apply to CDP hearings. CDP hearings are much like Collection Appeal Program (CAP) hearings in that they are informal in nature and do not require the Appeals officer or employee and the taxpayer, or the taxpayer's representative, to hold a face-to-face meeting. A CDP hearing may, but is not required to, consist of a face-to-face meeting, one or more written or oral communications between an Appeals officer or employee and the taxpayer or the taxpayer's representative, or some combination thereof. A transcript or recording of any face-to-face meeting or conversation between an Appeals officer or employee and the taxpayer or the taxpayer's representative is not required. The taxpayer or the taxpayer's representative does not have the right to subpoena and examine witnesses at a CDP hearing.

* * * *

(e) Matters considered at CDP hearing--(1) In general. Appeals will determine the timeliness of any request for a CDP hearing that is made by a taxpayer. Appeals has the authority to determine the validity, sufficiency, and timeliness of any CDP Notice given by the IRS and of any request for a CDP hearing that is made by a taxpayer. Prior to issuance of a determination, Appeals is required to obtain verification from the IRS office collecting the tax that the requirements of any applicable law or administrative procedure with respect to the proposed levy have been met. The taxpayer may raise any relevant issue relating to the unpaid tax at the hearing, including appropriate spousal defenses, challenges to the appropriateness of the proposed levy, and

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offers of collection alternatives. The taxpayer also may raise challenges to the existence or amount of the underlying liability, including a liability reported on a self-filed return, for any tax period specified on the CDP Notice if the taxpayer did not receive a statutory notice of deficiency for that tax liability or did not otherwise have an opportunity to dispute the tax liability. Finally, the taxpayer may not raise an issue that was raised and considered at a previous CDP hearing under section 6320 or in any other previous administrative or judicial proceeding if the taxpayer participated meaningfully in such hearing or proceeding. Taxpayers will be expected to provide all relevant information requested by Appeals, including financial statements, for its consideration of the facts and issues involved in the hearing.

* * * *

(3) Questions and answers. The questions and answers illustrate the provisions of this paragraph (e) as follows:

* * * *

Q-E6. What collection alternatives are available to the taxpayer?

A-E6. Collection alternatives include, for example, a proposal to withhold the proposed levy or future collection action in circumstances that will facilitate the collection of the tax liability, an installment agreement, an offer to compromise, the posting of a bond, or the substitution of other assets. A collection alternative is not available unless the alternative would be available to other taxpayers in similar circumstances. See A-D8 of paragraph (d)(2).

* * * *

Q-E8. How will Appeals issue its determination?

A-E8. (i) Taxpayers will be sent a dated Notice of Determination by certified or registered mail. The Notice of Determination will set forth Appeals' findings and decisions. It will state whether the IRS met the requirements of any applicable law or administrative procedure; it will resolve any issues appropriately raised by the taxpayer relating to the unpaid tax; it will include a decision on

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any appropriate spousal defenses raised by the taxpayer; it will include a decision on any challenges made by the taxpayer to the appropriateness of the collection action; it will respond to any offers by the taxpayer for collection alternatives; and it will address whether the proposed collection action represents a balance between the need for the efficient collection of taxes and the legitimate concern of the taxpayer that any collection action be no more intrusive than necessary. The Notice of Determination will also set forth any agreements that Appeals reached with the taxpayer, any relief given the taxpayer, and any actions the taxpayer or the IRS are required to take. Lastly, the Notice of Determination will advise the taxpayer of the taxpayer's right to seek judicial review within 30 days of the date of the Notice of Determination.

(ii) Because taxpayers are encouraged to discuss their concerns with the IRS office collecting the tax, certain matters that might have been raised at a CDP hearing may be resolved without the need for Appeals consideration. Unless, as a result of these discussions, the taxpayer agrees in writing to withdraw the request that Appeals conduct a CDP hearing, Appeals will still issue a Notice of Determination, but the taxpayer can waive in writing Appeals' consideration of some or all of the matters it would otherwise consider in making its determination.

* * * *

(f) Judicial review of Notice of Determination--(1) In general. Unless the taxpayer provides the IRS a written withdrawal of the request that Appeals conduct a CDP hearing, Appeals is required to issue a Notice of Determination in all cases where a taxpayer has timely requested a CDP hearing. The taxpayer may appeal such determinations made by Appeals within the 30-day period commencing the day after the date of the Notice of Determination to the Tax Court.

* * * *

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Internal Revenue Manual

Part 5 - Collecting Process

Chapter 5.15 - Financial Analysis

5.15.1 - Financial Analysis Handbook

5.15.1.7 - Allowable Expense Overview (10-02-2009)

(1) Allowable expenses include those expenses that meet the necessary expense test. *The necessary expense test is defined as expenses that are necessary to provide for a taxpayer's and his or her family's health and welfare and/or production of income.* The expenses must be reasonable. The total necessary expenses establish the minimum a taxpayer and family needs to live.

Reminder: The Allowable Living Expense standards are not applicable to corporations, partnerships, LLCs, where the LLC is identified as the liable taxpayer, or any BMF expenses.

Note: Allowable Living Expense (ALE) standards are not available for international taxpayers. In the absence of standardized figures for foreign countries, a fair and consistent approach should be applied to what is allowed as living expenses for international taxpayers. Collection employees should not use any other non-ALE figures as pre-determined guideline figures or arbitrarily select any location in the United States as a starting point for allowances. In those cases where there are no ALE standards or leverage to enforce collection of a balance due, the taxpayers' submission of living expenses should generally be accepted, provided they appear reasonable.

(2) There are three types of necessary expenses:

- National Standards
- Local Standards
- Other Expenses

(3) National Standards: These establish standards for Food, Clothing and Other Items and Out-of-Pocket Health Care Expenses.

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(a) Food, Clothing and Other Items - These establish reasonable amounts for five necessary expenses: food, housekeeping supplies, apparel and services, personal care products and services, and miscellaneous. These standards come from the Bureau of Labor Statistics (BLS) Consumer Expenditure Survey. Taxpayers are allowed the total National Standards amount monthly for their family size, without questioning the amounts they actually spend.

Note: All five standards are included in one total national standard expense.

(b) Out-of-Pocket Health Care Expenses - These establish reasonable amounts for out-of-pocket health care costs including medical services, prescription drugs, and medical supplies (e.g., eyeglasses, contact lenses). The table for health care allowances is based on Medical Expenditure Panel Survey data. Taxpayers and their dependents are allowed the standard amount monthly on a per person basis, without questioning the amounts they actually spend.

(4) Local Standards: These establish standards for two necessary expenses: housing and utilities and transportation. Taxpayers will normally be allowed the local standard or the amount actually paid, whichever is less.

(a) Housing and Utilities- Standards are established for each county within a state and are derived from Census and BLS data. The standard for a particular county and family size includes both housing and utilities allowed for a taxpayer's primary place of residence. Housing and Utilities standards include mortgage (including interest) or rent, property taxes, insurance, maintenance, repairs, gas, electric, water, heating oil, garbage collection, telephone and cell phone.

(b) Transportation - The transportation standards consist of nationwide figures for loan or lease payments referred to as ownership costs, and additional amounts for operating costs broken down by Census Region and Metropolitan Statistical Area.

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Operating costs include maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking and tolls. If a taxpayer has a car payment, the allowable ownership cost added to the allowable operating cost equals the allowable transportation expense. If a taxpayer has a car, but no car payment only the operating cost portion of the transportation standard is used to figure the allowable transportation expense. There is a single nationwide allowance for public transportation for taxpayers with no vehicle.

Note: Vehicle Operating standards are based on actual consumer expenditure data obtained from the United States Bureau of Labor Statistics (BLS) which are adjusted with Consumer Price Indexes (CPI) to allow for projected increases throughout the year. (These CPI are used to adjust all ALE standards.) Vehicle operating standards are not based on average commuting distances. Fuel costs, which are part of Vehicle Operating Costs, have a separate fuel price adjustment which is based on Energy Information Administration (EIA) data which allows for projected fuel price increases.

(5) National and local expense standards are guidelines. If it is determined a standard amount is inadequate to provide for a specific taxpayer's basic living expenses, allow a deviation. Require the taxpayer to provide reasonable substantiation and document the case file.

Note: If the taxpayer or the Service believes reviewing the last three months of expenses are not reflective of the actual yearly expenditures additional months, up to one year, may be reviewed.

(6) Other - Other expenses may be allowed if they meet the necessary expense test. The amount allowed must be reasonable considering the taxpayer's individual facts and circumstances.

(7) Conditional expenses. These expenses do not meet the necessary expense test. However, they are allowable if the tax liability, including projected accruals, can be fully paid within five years.

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(8) Generally, the total number of persons allowed for national standard expenses should be the same as those allowed as exemptions on the taxpayer's current year income tax return. Verify that exemptions claimed on the taxpayer's income tax return meet the dependency requirements of the IRC. There may be reasonable exceptions. Fully document the reasons for any exceptions. For example, foster children or children for whom adoption is pending.

(9) A deviation from the local standard is not allowed merely because it is inconvenient for the taxpayer to dispose of valued assets or reduce excessive necessary expenses.

(10) Revenue officers should consider the length of loan payments. Although it may be appropriate to allow for payments made on a secured debt that meets the necessary expense test, if the debt will be fully repaid in one year only allow those payments for one year.