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"GOTCHA" — UNANTICIPATED AUDIT ISSUES AFTER QUIET DISCLOSURES

By Frank Agostino, Esq.
Lawrence A. Sannicandro, Esq.[1]

I. **Introduction**

Some taxpayers not willing to pay the 27.5% penalty that otherwise applied under the traditional Offshore Voluntary Disclosure Programs have made quiet disclosures or entered into the Streamlined Filing Compliance Procedures ("Streamlined Program"). Many of these taxpayers rejected the protections of the Offshore Voluntary Disclosure Programs in favor of what they perceived to be a more cost-effective quiet or streamlined disclosure. These taxpayers have subjected themselves to criminal liability and audit adjustments which, depending upon the source of the unreported income, could easily eclipse the 27.5% penalty under the traditional program. In this regard, audits of returns submitted as quiet disclosures or under the Streamlined Program have been (and should be) troubling to both practitioners and clients.

This article discusses common audit adjustments that can apply to returns for taxpayers with international activities, including: the disallowance of deductions and credits for U.S. citizens, resident aliens, and nonresident aliens; the disallowance of the foreign earned income exclusion for U.S. citizens and resi-

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dent aliens; and the Internal Revenue Service's ability to recharacterize as ordinary income purported gifts and bequests from a partnership or a foreign corporation under Treas. Reg. § 1.672(f)-4. This article also highlights those taxpayers who are most likely to be negatively affected by each type of adjustment. Finally, for taxpayers who imprudently made a quiet disclosure, this article discusses how to transition the taxpayer from a quiet disclosure to a traditional Offshore Voluntary Disclosure Program.

II. **Audits of Offshore Returns, Generally**

The audit risk to a taxpayer who corrected errors related to his or her foreign activities often depends upon whether the taxpayer came into compliance under an Offshore Voluntary Disclosure Program, the Streamlined Program, or a quiet disclosure. The authors are unaware of any statistics issued by the Internal Revenue Service ("Service" or "IRS") in this regard, but there is much to be gleaned from following anecdotal observations. First, as practitioners likely know, most traditional offshore voluntary disclosures are resolved without a formal audit.[2] Thus, the audit risk for taxpayers in a traditional Offshore Voluntary Disclosure Program has been and continues to be relatively low.

Second, the Service does not automatically audit streamlined returns but may select such returns for examination under the existing audit selection process that generally applies to federal tax returns.[3] Under the Streamlined Program, eligible taxpayers will not, under the current program, be made liable for failure-to-file penalties, failure-to-pay penalties, accuracy-related penalties, information return penalties, or penalties for failure to file FinCEN Form 114, *Report of Foreign Bank and Financial Accounts* ("FBAR").[4] Anecdotally, we have seen very few audits of returns submitted under the Streamlined Program. Where streamlined returns are audited, those returns have essentially been treated as qualified amended returns in which the revenue agents do not disallow legitimate deductions and credits on the grounds discussed in this article.[5] Thus, while there is audit risk for taxpayers in the Streamlined Program, any proposed audit adjustments should not be especially surprising to practitioners.

Third, the Service reviews amended returns submitted as quiet disclosures and can select any return for examination.[6] According to a 2013 report by the U.S. Government Accountability Office ("GAO"), upwards of 10,595 quiet disclosures were made between 2003 and 2008, a number much higher than the potential quiet disclosures the Service identified.[7] Anecdotally, the Service has taken a much harder line in auditing these quiet disclosures, sometimes disallowing legitimate deductions and credits on credits on the grounds discussed in this article. Thus, for the many returns submitted as quiet disclosures, the risk of audit is high, and the proposed adjustments are potentially sizable.

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Practitioners should understand the various audit adjustments that can apply in deciding the type of disclosure to make or whether to transition from one program (or a quiet disclosure) to another program. The balance of this article discusses the most common and, perhaps, surprising audit adjustments that could apply to taxpayers with international activities.

III. **Disallowance of the Foreign Earned Income Exclusion for U.S. Citizens and Resident Aliens**

One rule that is often overlooked with respect to late-filed returns submitted by U.S. citizens or resident aliens is that the foreign earned income exclusion may be denied on account of a late-filed return. By way of background, Code Sec. 911(a) authorizes a qualified individual to elect to exclude foreign earned income from his or her gross income.[8] The U.S. Department of the Treasury ("Treasury"), pursuant to a specific grant of authority under Code Sec. 911(d)(9), established timing requirements by which an election to exclude foreign earned income must be made.[9] Specifically, Treas. Reg. § 1.911-7(a)(2)(i) provides four alternative timing methods by which a taxpayer may make a valid election to exclude foreign earned income, namely: (1) with an income tax return that, including extensions, is timely filed; (2) with an amended return that is filed within three years from the time the original return was filed or within two years from the time the tax with respect to the original return was paid; (3) with an original income return that is filed within one year after the due date of the return (determined without regard to any extension of time to file); or (4) with an income tax return filed after any of the foregoing dates provided that, after taking into account the foreign earned income exclusion, either (i) the taxpayer does not owe federal income tax before or after the Service discovers that the taxpayer failed to elect the exclusion, or (ii) the taxpayer owes federal income tax before the Service discovers that the taxpayer failed to elect the exclusion.[10]

A recent opinion by the United States Tax Court ("Tax Court") confirms that the failure to make an election as specified by Treas. Reg. § 1.911-7 can result in total disallowance of the foreign earned income exclusion. Specifically, in McDonald v. Commissioner,[11] the Tax Court held that a taxpayer was not entitled to the foreign earned income exclusion because she failed to timely make an election to exclude her income in accordance with Treas. Reg. § 1.911-7(a)(2). The disallowance of the foreign earned income exclusion can be expensive for a U.S. citizen or a resident alien who is otherwise eligible to elect the benefits of such exclusion, but who fails to timely make the election. Thus, especially for taxpayers who made a quiet disclosure, disallowance of the foreign earned income exclusion may be cause for concern.

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IV. **Reduction in Foreign Tax Credit for U.S. Citizens and Resident Aliens**

Another rule that is often overlooked with respect to late-filed returns submitted by U.S. citizens or resident aliens is that a foreign tax credit may be disallowed on account of a late-filed information return reporting an interest in a controlled foreign corporation or a controlled foreign partnership. As practitioners may know, Code Sec. 6038 requires information reporting with respect to ownership interests in certain foreign corporations and partnerships.[12] In practice, taxpayers who own an interest in a controlled foreign corporation satisfy the Code Sec. 6038(a) reporting requirement by filing with the Service Form 5471, *Information Return of U.S. Persons With Respect to Certain Foreign Corporations.* Taxpayers who own an interest in a controlled foreign partnership satisfy the Code Sec. 6038 reporting requirement by filing with the Service Form 8865, *Return of U.S. Persons With Respect to Certain Foreign Partnerships.*

Penalties for failing to file required information returns are sizable. Code Sec. 6038(b) authorizes the Service to impose a $10,000 per incident penalty for any taxable year starting after March 18, 2010.[13] In addition, Code Sec. 6038(c) generally provides that a failure to timely file a required information return with respect to a controlled foreign corporation or a controlled foreign partnership generally results in a reduction in foreign tax eligible for the foreign tax credit. For the failure to file information returns required by Code Sec. 6038, the amount of foreign taxes paid or deemed paid by the U.S. person for purposes of determining the foreign tax credit under Code Sec. 901 is reduced by 10%.[14] The amount of the 10% reduction is increased an additional 5% if the failure to file the information return continues for 90 days or more after the Service notifies the taxpayer of the failure to file.[15] Finally, the reduction of the foreign taxes paid is limited to the greater of (i) $10,000, or (ii) the foreign entity's income for the annual accounting period in which the failure to report occurred.[16] For taxpayers who fail to timely file required information returns with respect to an interest in a controlled foreign corporation or a controlled foreign partnership, the reduction of the foreign tax credit can be costly.

A related issue may arise with respect to foreign tax credits claimed by dual citizens (i.e., individuals who are recognized as a resident of both the U.S. and a foreign country). Pursuant to the Model U.S. Tax Treaty, the foreign tax credit is available for dual citizens, but is subject to limitations under U.S. law.[17] By way of background, Code Sec. 901 limits the foreign tax credit to "any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States."[18] Code Sec. 903, in turn, extends the foreign tax credit to also include "a tax paid in lieu of a tax on income, war profits, or excess profits otherwise generally imposed by any foreign country or by any possession of the United States." In order to be creditable under Code Secs. 901 or 903, a "foreign levy" must be a "tax".[19]

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In general, a foreign levy is a tax only if it requires a compulsory payment pursuant to the authority of a foreign country to levy taxes.[20] A payment is not compulsory, and thus not an amount of tax paid for purposes of computing the foreign tax credit, to the extent that the amount paid exceeds the amount of the liability under foreign law.[21] Thus, in order for a foreign tax credit to be creditable for U.S. tax purposes, U.S. taxpayers are required to reduce their foreign tax by using all reasonable interpretations and applications of the substantive and procedural provisions of foreign law (including applicable tax treaties).[22] The Service takes the position that the amount by which the foreign tax credit could have been reduced – for example, by making an election under foreign law to reduce the taxpayer's foreign tax liability or by claiming an allowable refund from a foreign tax authority – is a compulsory payment for which no foreign tax credit is allowed.[23] As a practical matter, the foregoing limitations on noncompulsory payments tend to fall disproportionately on dual citizens who may lack expertise in tax or the financial means to reduce their foreign tax liability under foreign law. Depending upon the facts of a particular case, to the extent the Service challenges payment of tax to a foreign jurisdiction as noncompulsory, the adjustments as a result of the disallowed foreign tax credit may be sizable.

V. **Disallowance of Deductions and Credits for Nonresident Aliens**

Still another rule that is often overlooked with respect to late-filed returns submitted by nonresident aliens is that deductions and credits may be disallowed solely on account of the late-filing of the return. For example, in the case of individuals, Code Sec. 874(a) has been interpreted to restrict a nonresident alien taxpayer's ability to claim deductions and credits with respect to a late-filed return.[24] The authority for this interpretation of Code Sec. 874(a) is found in Treas. Reg. § 1.874-1(b)(1), which provides:

> (b) Filing deadline for return—(1) General rule. …If no return for the taxable year immediately preceding the current taxable year has been filed, the required return for the current taxable year (other than the first taxable year of the nonresident alien individual for which a return is required to be filed) must have been filed no later than the earlier of the date which is 16 months after the due date, as set forth in section 6072, for filing the return for the current taxable year or the date the Internal Revenue Service mails a notice to the nonresident alien individual advising the nonresident alien individual that the current year return has not been filed and that no deductions or credits … may be claimed by the nonresident alien individual.

The United States Tax Court ("Tax Court") addressed the nuances of Code Sec. 874 in *Espinosa v. Commissioner.*[25] There, a nonresident alien individual failed to file returns for 1987 through 1991, even though he owned two rental properties in the United States that produced gross rental

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income totaling approximately $10,000 per year.[26] After taking into account the taxpayer's rental expenses, including depreciation, each property produced an annual loss.[27] The Service repeatedly notified the taxpayer of his failure to file returns, but the taxpayer failed to file the requested returns.[28] In turn, the Service prepared substitute returns for him under Code Sec. 6020(b) without the benefit of any deductions.[29] After the filing of the substitute returns for 1987 through 1991, but before a notice of deficiency was issued, the taxpayer submitted federal income tax returns for all years in issue that reflected net losses on account of the above-described rental expenses.[30] The Service declined to process the returns and instead issued a notice of deficiency determining deficiencies on the gross rents received.[31]

The Tax Court sustained the Commissioner's deficiency determinations by holding that a nonresident alien may not avoid the sanctions of Code Sec. 874(a) by filing returns after the Service prepared returns for the taxpayer, but before the Service issued a notice of deficiency.[32] The Tax Court noted that Code Sec. 874(a), on its face, contained no time limit within which a nonresident alien must file an income tax return. However, the Tax Court looked to the above-quoted Treas. Reg. § 1.1874-1(b)(1) to conclude that Code Sec. 874(a) creates a timely filing requirement. By virtue of the inferred timely filing requirement, the Court ruled that "there is a cut-off point or terminal date after which it is too late to submit a tax return and claim the benefit of deductions."[33] The holding in *Espinosa*, through a similar reading of Code Sec. 882(c) and Treas. Reg. § 1.882-4(a)(3), has been interpreted to deny deductions and credits to foreign corporations that do not file Federal tax returns within 18 months of the filing deadline.[34]

Treas. Reg. § 1.874-1(b)(1) and *Espinosa* clearly can apply to deny otherwise legitimate deductions and credits claimed on nonresident aliens' late-filed returns. Depending upon the source of the unreported income which prompted the streamlined filing or the quiet disclosure, the cost to a nonresident alien from such disallowed deductions and credits could eclipse the 27.5% penalty that would apply if he or she became compliant with the internal revenue laws through the offshore voluntary disclosure program. Practitioners representing clients who operate a rental activity, a traditional Schedule C trade or businesses, or other expensive-heavy activity, ought to consider whether a quiet disclosure or a submission under the Streamlined Program potentially jeopardizes valuable deductions and credits. For such taxpayers, the traditional Offshore Voluntary Disclosure Program may be the preferred alternative.

VI. **Recharacterization of Gifts Through Foreign Partnerships and Corporations**

Problems may also arise when taxpayers use partnerships or foreign corporations to make direct or indirect gifts or bequests to U.S. persons. This is because often overlooked Treasury Regulations require a U.S. donee who receives a purported gift or bequest from a partnership or a foreign corporation to include the amount of such gift in his or her income as ordinary income re-

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gardless of whether the purported gift or bequest is received directly or indirectly.[35] More specifically, in the case of any transfer directly or indirectly from a partnership or foreign corporation which the transferee treats as a gift or bequest, Code Sec. 672(f)(4) authorizes the Service to re-characterize the transfer so as to prevent a foreign grantor from being deemed to own any portion of a trust under the grantor trust rules. Treas. Reg. § 1.672(f)-4(a), in turn, generally requires a U.S. donee who receives a purported gift from a partnership or a foreign corporation to include the amount of such "gift" in his or her income as ordinary income.[36]

Where a gift is made to a U.S. citizen or a resident alien through a partnership or a foreign corporation, practitioners might be inclined to simply advise clients to not enter into the Offshore Voluntary Disclosure Program and simply file past-due Forms 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Foreign Gifts*, with an understanding that the failure to file the Form 3520 will be excused under the reasonable cause exception in Code Sec. 6039F(c). Such advice ignores that Treas. Reg. § 1.672(f)-4) can require a U.S. donee who receives a distribution from a partnership or a foreign corporation to include the amount of such distribution as ordinary income. The Service has never raised this argument in a reported decision, and anecdotally, revenue agents are not relying on this regulation in audits of streamlined returns or late-filed Forms 3520. But, the regulation exists, and practitioners should be aware of the adverse impact it may have during an audit of a return submitted as a quiet disclosure or under the Streamlined Program.

VII. **Late Entry Into the Offshore Voluntary Disclosure Program**

Taxpayers who unadvisedly filed returns as a quiet disclosure without considering the financial impact of the foregoing adjustments are not without recourse. As applied to taxpayers who made a quiet disclosure, the Service instructs that such taxpayers are still encouraged to participate in the Offshore Voluntary Disclosure Program by "submitting an application, along with copies of their previously filed returns (original and amended), and all other required documents and information … to the IRS's Voluntary Disclosure Coordinator."[37] Importantly, for a taxpayer to be eligible to transition to the Offshore Voluntary Disclosure Program, the Service may not have initiated a civil examination for any year, regardless of whether the audit relates to undisclosed foreign financial assets.[38] Thus, it is important that taxpayers who made quiet disclosures contact the Service before the Service contacts the taxpayer. As applied to taxpayers who submitted returns pursuant to the Streamlined Program, these taxpayers may generally not transition to an Offshore Voluntary Disclosure Program.[39] But, as noted above, revenue agents have generally treated such returns as qualified amended returns that do not warrant the same hard line as quiet disclosures. Thus, as a practical matter, the inability to transition from the Streamlined Program to a traditional Offshore Voluntary Disclosure Program is less concerning.

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VIII. **Conclusion**

Practitioners worry about audits of returns submitted as quiet disclosures for good reason. The Service has been far less draconian in submissions under a traditional Offshore Voluntary Disclosure Program or the Streamlined Program, but revenue agents have taken a hard line in disallowing otherwise deductions and credits with respect to quiet disclosures. In this regard, the Service is granted broad authority to deny legitimate deductions, credits, and income exclusions, and to recast transactions to not only prevent the avoidance of U.S. tax but to impute income to U.S. donees and legatees. Practitioners should consider these issues when advising taxpayers to submit returns as quiet disclosures, pursuant to the Streamlined Program, or under the traditional Offshore Voluntary Disclosure Program. Finally, it is important for practitioners to reevaluate whether the quiet disclosure was in fact a more cost-effective alternative than the traditional Offshore Voluntary Disclosure Program before being contacted by the Service.

Footnotes:

1. Frank Agostino, Esq. is a principal of, and Lawrence A. Sannicandro, Esq. is an associate at Agostino & Associates, P.C.
2. *See, e.g.*, IRS, *Offshore Voluntary Disclosure Program, Frequently Asked Questions and Answers 2014*, Q&A-1, https://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised (last updated Feb. 8, 2016) (noting that the 2009, 2012, and 2014 Offshore Voluntary Disclosure Programs have "enabled the IRS to centralize the civil processing of offshore voluntary disclosures and to resolve a very large number of cases without examination").
3. *See* IRS, *Streamlined Filing Compliance Procedures*, https://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures (last updated Aug. 6, 2015). Of course, in the context of the Offshore Voluntary Disclosure Program, an audit will normally not be made, though the Service reserves the right to conduct an examination. *See* IRS, *Offshore Voluntary Disclosure Program Frequently Asked Questions and Answers*, FAQ 27, https://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers (last updated June 10, 2015).
4. *See* IRS, *U.S. Taxpayers Residing Outside the United States*, https://www.irs.gov/Individuals/ International-Taxpayers/U-S-Taxpayers-Residing-Outside-the-United-States (last updated Aug. 12, 2015). Of course, if streamlined returns are selected for audit, and it is determined that the original tax compliance was fraudulent or willful, then the Service reserves the right to assert such penalties. *Id.*
5. The qualified amended return procedure is designed to address civil violations of the Internal Revenue Code in a manner that protects the taxpayer from certain accuracy-related penalties. A qualified amended return is an amended return that is filed after the original properly extended due date of the return but before any of the following events:

   (1) The date the taxpayer is first contacted by the IRS for any examination, including a criminal investigation;

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(2) The date any person is contacted for a tax shelter promoter examination under section 6700 with respect to any tax benefit claimed on the return;

(3) The date the IRS issues a John Doe summons under section 7609(f) relating to the tax liability of a person, group, or class that includes the taxpayer;

(4) The date the Commissioner announces a settlement initiative to compromise or waive penalties with respect to a listed transaction; and/or

(5) With respect to a pass-through item, the date the pass-through entity is first contacted by the IRS for any examination with respect to the entity's return.

See Treas. Reg. § 1.6662-2(c)(3). The qualified amended return procedure allows a taxpayer to treat the amount of tax reported as the tax reported on the original return so that the accuracy-related penalty will not apply. Treas. Reg. § 1.6664-2(c)(2). However, if the IRS determines that the failure to report is due to fraud, the taxpayer is potentially liable for criminal prosecution, or at the very least a fraud penalty equal to 75% of the underpayment of tax. In addition, the QAR procedure does not protect the taxpayer from other civil penalties. For a discussion of qualified amended returns, *see Correcting an Incorrect Tax Return: Amended Returns and Voluntary Disclosure*, AGOSTINO & ASSOCIATES, P.C. NEWSLETTER, (Jan. 2014), *available at* https://drive.google.com/file/d/0B719qAMBEjGQeGNxN3Q1Umx5Ums/edit.

6. IRS, *Voluntary Disclosure: Questions and Answers*, Q&A-49, https://www.irs.gov/uac/Voluntary-Disclosure:-Questions-and-Answers (last updated Dec. 2, 2015). A quiet disclosure typically involves the taxpayer filing amended returns, including delinquent FBARs and international information returns, and paying the resulting tax and interest on previously unreported offshore income without otherwise notifying the Service. A taxpayer who makes a quiet disclosure does not receive immunity from potential criminal prosecution or from the assessment of civil and criminal monetary penalties.
7. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-13-318, OFFSHORE TAX EVASION: IRS HAS COLLECTED BILLIONS OF DOLLARS, BUT MAY BE MISSING CONTINUED EVASION, 24 (2013). The GAO was clear that the Service should pay attention to these quiet disclosures, because "[i]f taxpayers are able to quietly disclose and pay fewer penalties than they would have in an offshore program, the incentive for other noncompliant taxpayers to participate in a program is reduced." *Id.* at 23.
8. To qualify for the foreign earned income exclusion, the taxpayer must generally satisfy a three-part test: (1) the taxpayer must be a U.S. citizen who is a bona fide resident of a foreign country for an entire taxable year or physically present in a foreign country at least 330 days out of a 12-month period, *see* Code Sec. 911(d)(2); (2) the taxpayer must have earned income from personal services rendered in a foreign country, *see* Code Sec. 911(d)(2); and (3) the taxpayer's home for the period must be outside of the United States, *see* Code Sec. 911(d)(3).
9. *See generally* Treas. Reg. § 1.911-7.
10. Treas. Reg. § 1.911-7(a)(2)(i). Additionally, a taxpayer filing an income tax return pursuant to Treas. Reg. § 1.911-7(a)(2)(i)(D) (*i.e.*, under either of the fourth alternatives) must type or legibly print at the top of the first page of the Federal income tax return claiming the exclusion: "Filed Pursuant to Section 1.911-7(a)(2)(i)(D)." Treas. Reg. § 1.911-7(a)(2)(i)(3).
11. T.C. Memo. 2015-69. The taxpayer in *McDonald* challenged the validity of Treas. Reg. § 1.911-7(a)(2), but the Tax Court upheld the regulation as meeting steps one and two of the two-step test articulated by the U.S. Supreme Court in *Chevron, U.S.A., Inc. v. Nat'l Res. Dev. Council*, 467 U.S. 837, 842-43 (1984).
12. Code Sec. 6038(a). Moreover, Code Sec. 6046(a) require the following persons, among others, to file a Form 5471 information return: (1) a U.S. citizen or resident who is an officer or director of a foreign corporation in which a U.S. person acquires 10% or more of the stock's value or voting power or an additional interest that brings his or her interest in the foreign corporation to 10% or more; (2) a U.S. person who acquires a 10% or greater interest in a foreign corporation, or an additional interest that brings his or her interest in a foreign corporation to 10% or more; (3) each person who becomes a U.S. person while owning 10% or more of the value or voting power of a foreign corporation; and (4) a U.S. person who disposes of enough stock in the foreign corporation to reduce his or her ownership to less than 10%. *See* Treas. Reg. § 1.6046-1(c)(1). Code Sec. 6046A requires the following persons to file a Form 8865 information return: (1) a U.S. person who acquires an interest in a foreign partnership; (2) a U.S. person who disposes of an interest in a foreign partnership; or (3) a U.S. person whose "proportional interest in a

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foreign partnership changes substantially. *See* Treas. Reg. § 1.6046A-1. A partner's proportional interest in a foreign partnership may change for a number of reasons, including by operation of the partnership agreement by reason of changes in other partners' interests resulting from a partner withdrawing from the partnership. Treas. Reg. § 1.6046A-1(b)(3). Finally, it is worth noting that the period of limitations on assessment with respect to an information return does not begin to run until three years after the date on which the Commissioner is furnished with the information required to be reported on such return. Code Sec. 6501(c)(8).

13. Code Sec. 6038(b)(1). Once the Service has notified the taxpayer of a delinquent filing, Code Sec. 6038(b)(2) authorizes an additional $10,000 penalty for each 30-day period (or fraction thereof) that the taxpayer fails to cure the delinquent filing after receiving notice thereof, up to a maximum of $50,000.
14. Code Sec. 6038(c)(1)(B).
15. Code Sec. 6038(c)(1).
16. Code Sec. 6038(c)(2), (3). A domestic corporation which desires to avoid a reduction in the foreign tax credit must make an affirmative showing of all facts alleged as reasonable cause for such failure in the form of a written statement containing a declaration that is made under penalties of perjury. *See* Treas. Reg. § 1.6038-1(j)(4). No similar exception is available for individuals. *See generally* Treas. Reg. § 1.6038-1.
17. *See* UNITED STATES MODEL INCOME TAX CONVENTION OF NOVEMBER 15, 2006, Art 23.
18. Code Sec. 901(b)(1).
19. *See* Treas. Reg. § 1.901-2(a)(1).
20. Treas. Reg. § 1.901-2(a)(2)(i).
21. Treas. Reg. § 1.901-2(e)(5)(i).
22. *Id.*
23. *See, e.g.*, *id.*; IRS Chief Counsel Advice 2009040714014556 (Apr. 7, 2009); IRS Chief Counsel Advice 200622044 (Sept. 5, 2006); *see also* IRS Tech. Adv. Mem. 200807015 (Nov. 7, 2007). To the extent the statute of limitations for claiming the refund in the foreign jurisdiction has expired, the taxpayer has no effective and practical remedies to reduce his or her tax, and the amount otherwise available to be refunded is a compulsory payment that is creditable. *See* Treas. Reg. § 1.901-2(e)(5)(ii), Ex. 4.
24. Code Sec. 874(a), entitled "Return prerequisite to allowance," provides as follows:

> A nonresident alien individual shall receive the benefit of the deductions and credits allowed to him in this subtitle only by filing or causing to be filed with the Secretary a true and accurate return, in the manner prescribed in subtitle F (sec. 6001 and following, relating to procedure and administration), including therein all the information which the Secretary may deem necessary for the calculation of such deductions and credits. This subsection shall not be construed to deny the credits provided

For a thorough analysis of the history of Code Sec. 874(a), and the corollary rules that applies to foreign corporations under Code Sec. 882(c), *see* Guillaume H. Goff, *Playing the U.S. Audit Lottery: An Update for Foreign Taxpayers*, 65 TAX LAW. 511 (2012).

25. 107 T.C. 146 (1996).
26. *Id.* at 147.
27. *Id.*
28. *Id.* at 148.
29. *Id.*
30. *Id.*
31. *Id.*
32. *Id.* at 150, 158.
33. *Id.* at 157.
34. *See, e.g.*, Code Sec. 882(c), Treas. Reg. § 1.882-4(a)(3); *see also Swallows Holding, Ltd. v. Commissioner*, 515 F.3d 162, 172 (3d Cir. 2008), *vacating* 126 T.C. 96 (2006). Treas. Reg. § 1.882-4(a)(3)(i) requires that a foreign corporation file a return within 18 months of the filing deadline set forth in Code Sec. 6072 to claim deductions and credits.
35. *See generally* Treas. Reg. § 1.672(f)-4.

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36. Treas. Reg. § 1.672(f)-4(a)(1), (2). Numerous exceptions to the general rule are available. First, a transfer will not be recharacterized as ordinary income if the U.S. donee establishes to the satisfaction of the Service that: (1) a U.S. citizen or resident alien individual who directly or indirectly held and interest in the partnership or foreign corporation treated and reported the purported gift or bequest for federal tax purposes as a distribution to such individual and a subsequent gift or bequest to the U.S. donee; or (2) a nonresident alien individual who directly or indirectly held an interest in the partnership or foreign corporation treated and reported the purported gift or bequest for purposes of the tax laws of the nonresident alien's individual country of residence as a distribution to such individual and a subsequent gift or bequest to the U.S. donee, and to the extent applicable, that the U.S. donee timely complied with the reporting requirements of Code Sec. 6039F (*i.e.*, the U.S. donee filed a Form 3520, *Annual Return to Report Transactions With Foreign Trusts and Receipt of Foreign Gifts*) *See* Treas. Reg. § 1.672(f)-4(b)(1). Second, a gift or bequest from a domestic partnership will not be recharacterized as ordinary income if the U.S. donee establishes to the satisfaction of the Service that all beneficial owners of the partnership are U.S. citizens or residents or domestic corporations. *See* Treas. Reg. § 1.672(f)-4(b)(2). Third, the transfer will not be recharacterized as ordinary income if the U.S. donee is a corporation which can establish that the purported gift or bequest was treated for U.S. tax purposes as a contribution to the capital of the corporate donee. Treas. Reg. § 1.672(f)-4(b)(3). Fourth, the transfer will not be recharacterized as ordinary income if the U.S. donee is a tax-exempt charitable, religious, educational, scientific, or other similar organizations described in Code Sec. 170(c) or one that received a ruling or determination letter under Code Sec. 501(c)(3). *See* Treas. Reg. § 1.672(f)-4(b)(4). Fifth, under a catch-all provision that generally applies to all instances in which a donee seeks to avoid U.S. taxes, Treas. Reg. § 1.672(f)-4(e) grants the Service broad discretion to recharacterize the transaction in accordance with the form or economic substance of the transfer. Fifth, irrespective of the foregoing rules, a transfer will not be recharacterized as ordinary income if the amount of the transfer did not exceed $10,000. *See* Treas. Reg. § 1.672(f)-4(f).
37. *See* IRS, *Offshore Voluntary Disclosure Program, Frequently Asked Questions and Answers 2014*, Q&A-1, https://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised (last updated Feb. 8, 2016).
38. IRS, *Offshore Voluntary Disclosure Program, Frequently Asked Questions and Answers 2014*, Q&A-14, https://www.irs.gov/Individuals/International-Taxpayers/Offshore-Voluntary-Disclosure-Program-Frequently-Asked-Questions-and-Answers-2012-Revised (last updated Feb. 8, 2016).
39. *See* IRS, *Streamlined Filing Compliance Procedures*, https://www.irs.gov/Individuals/International-Taxpayers/Streamlined-Filing-Compliance-Procedures (last updated Aug. 6, 2015) (stating that once a taxpayer makes a submission under the Streamlined Program, the taxpayer may not participate in the Offshore Voluntary Disclosure Program).

NEW JERSEY TAX COLLECTION

By Frank Agostino, Esq.
Jairo G. Cano, Esq.[1]

Taxpayers with outstanding liabilities to the Internal Revenue Service ("IRS") and the State of New Jersey need to be mindful of the differences in the collection procedures used by each taxing authority. A taxpayer should not assume that the collection process can be managed the same way with both jurisdictions. Furthermore, a taxpayer would be wrong to assume that a liability owed to the IRS has priority over a liability owed to the State of New Jersey. Successful management of both cases requires a thorough understanding of the procedures available in each jurisdiction. The purpose of this article is to explain the laws related to the New Jersey Division of Taxation's ("Division") enforced collection of taxes and to provide guidance on how to effectively work with the Division to resolve a taxpayer's collection case.

Enforced Collection – Notice Process and Pioneer Credit Recovery

When a taxpayer disregards his obligation to pay an outstanding liability, the collection process begins with the mailing of an initial Underpayment Notice. If there is no response to the initial Underpayment Notice, the Division will issue a second Underpayment Notice. This notice informs the taxpayer of his obligation to pay the outstanding liability.[2] If the taxpayer does not respond to the second Underpayment Notice, the taxpayer's file may be submitted to Pioneer Credit Recovery ("Pioneer") for collection. In addition, the taxpayer may be assessed with a 5% failure to pay penalty and a 10% collection recovery fee.

Pioneer is a private collection agency that was retained by the Division to assist in its efforts to collect unpaid taxes.[3] Once Pioneer assigns a caseworker, that individual will review the file and mail an initial contact letter together with an updated Schedule of Liabilities detailing the current balance due. If the issue remains unresolved for 30 days, Pioneer will issue a Notice of Demand for Payment" via certified mail. This Notice provides the taxpayer with either 30 days (for deficient items) or 90 days (for delinquent items) to resolve the case. If the case remains unresolved after this period of time, a Certificate of Debt will be filed with the Clerk of the New Jersey Superior Court. The filing of a Certificate of Debt will result in the addition of a fee for the cost of collection on the taxpayer's file. In addition, the Division has the right to assess a referral cost recovery fee of 10% of the amount of tax liability.

Enforced Collection – Certificate of Debt

A tax liability is either self-assessed, i.e., reported on the taxpayer's tax return, or assessed as a result of an examination that resulted in the issuance of a notice of deficiency. The assessment becomes final if the taxpayer fails to file a timely response to a statutory notice, or if the New Jersey Tax Court determines that the assessment should be sustained.

If the taxpayer does not pay an assessed tax, the taxpayer's property is subject to a lien that arises at the time that the debt became due.[4] For cases involving assessments made as a result of an examination, the tax lien is perfected once the taxpayer's right to protest the liability expires.[5] When the liability is self-assessed, the lien is perfected on the date that the tax return is filed.[6] This is a key distinction between a federal tax lien and a New Jersey tax lien. At the federal level, a lien also arises at the time that the tax debt becomes due and owing. However, the lien is not perfected until the IRS files a Notice of Federal Tax Lien. Because the New Jersey tax lien is perfected upon creation, the Division may have priority over a federal tax lien if the Notice of Federal Tax Lien is filed after the New Jersey tax assessment date.[7] This point was affirmed by the U.S. Court of Appeals for the Third Circuit in *Monica Fuel, Inc. v. IRS*, where the Court concluded that the Division's lien had priority over the IRS's lien because the liability owed to the Division was perfected, i.e., assessed, prior to the perfection of the IRS liability.

Once the New Jersey tax lien is perfected, it is enforceable without the need for a judicial proceeding.[8] In order to enforce the lien, the Division may either issue a warrant of execution on the taxpayer's property[9] or file a Certificate of Debt with the clerk of the Superior Court of New Jersey, who enters the debt as a judgment.[10] The filing of the Certificate of Debt provides the Division with all of the remedies that are available to a creditor that seeks to recover from a judgment in a legal proceeding.[11]

Judicial Review of a Certificate of Debt and Underlying Tax Liability

When the IRS files a Notice of Federal Tax Lien or Final Notice of Intent to Levy, the taxpayer can file a request for a Collection Due Process hearing. During the hearing, the taxpayer can challenge the underlying tax liability if the taxpayer did not receive a notice of deficiency with respect to that liability, or if the taxpayer did not otherwise have an opportunity to challenge the tax.[12] In New Jersey, the taxpayer has similar rights, but the procedures used to obtain judicial review are different.

The New Jersey Tax Court is authorized to grant legal and equitable relief in cases where it has jurisdiction.[13] This includes jurisdiction to review the Division's decision to file a Certificate of Debt. The taxpayer has 90 days from the date that a Certificate of Debt is filed to file a complaint with the Tax Court to challenge the Division's decision.[14] Unfortunately, the Certificate of Debt issued to taxpayers does not alert them of this right. Therefore, taxpayers and their representatives should be mindful of their rights and determine if and when a complaint must be filed in the New Jersey Tax Court.

When a Certificate of Debt is filed, the taxpayer can challenge underlying tax liability if the time to file a complaint to challenge the underlying assessment has not previously expired.[15] Therefore, the taxpayer should have the right to challenge the underlying tax liability in cases where the Division failed to mail a valid notice of deficiency to the taxpayer, and the taxpayer did not discover the assessment until the Certificate of Debt was filed. If there is a reasonable belief that the Division did not issue a proper notice, the taxpayer should obtain the information necessary to determine whether proper assessment procedures were followed. The taxpayer can file a request under the Open Public Records Act to obtain a copy of the administrative file in his or her case. However, the taxpayer will not have a response before the 90 day period expires. Therefore, it is more prudent to make a request for the administrative file during the discovery period that follows the closing of the pleadings in the case.[16]

If a notice of deficiency was issued or the taxpayer otherwise failed to file a timely protest or complaint, the taxpayer may only challenge procedural defects with the Certificate of Debt during the Tax Court proceeding.[17]

Enforced Collection – Levies and Seizures

As previously stated, the filing of the Certificate of Debt allows the Division to proceed with enforced collection as if it were a judgment creditor. Therefore, in cases where the Division wants to proceed with seizure of a taxpayer's property, the Division will issue a warrant of execution against the taxpayer's assets. Afterward, the Division can seize the taxpayer's assets and sell them at auction. If the Division issues a warrant of execution against a taxpayer, that taxpayer may be denied access to property registered in the state. For example, if the taxpayer has a motor vehicle registered with the state, the Motor Vehicle Commission will prevent the taxpayer from selling, registering, or transferring title in the vehicle until the tax issues are resolved.

In addition, the Division may contact another state agency that issued a taxpayer a license and demand that the agency suspend the license pending resolution of the taxpayer's liability.[18] The authors of this article are not aware of instances where the Division has used this provision as a means to suspend a taxpayer's driver's license. However, the procedures have been used to suspend required business licenses. Although the taxpayer may negotiate with the case worker assigned to his or her case to have the license reinstated, the taxpayer does not have a pre-suspension right to a hearing. Therefore, it is in the best interest of a taxpayer that needs a license to remain in business to work with the Division and resolve its tax liabilities before the Division is forced to undertake these procedures to enforced collection.

Levy Review

In New Jersey, taxpayers do not have a right to a pre-levy hearing for a review of the Division's decision to levy the taxpayer's assets. This can create difficulty in negotiations on behalf of taxpayers who will face financial hardship as a result of a levy. That said, the Division does recognize the need to protect indigent taxpayers as it articulates on its website:

> Upon receipt of documentation supporting hardship reasons, the Division will speed the delivery of levy releases to the financial institution. Taxpayers seeking an expedited release for levies should contact their assigned representative at the phone number shown on the notice of levy to discuss available options.[19]

The applicable statutes and regulations do not identify the elements required to prove a hardship. However, the elements used to support a similar argument to the IRS are helpful in this regard. Pursuant to IRC § 6343(a)(1)(D), the IRS is required to release a levy that creates an economic hardship due to the financial condition of the taxpayer. The relevant inquiry is whether the taxpayer is able to satisfy his or her reasonable basic living expenses if the levy is not released.[20]

If the Division does not agree with the taxpayer's request for a levy release, the taxpayer may file a complaint for a review of the Division's determination. However, this would be a post-levy review of the Division's determination. Moreover, the taxpayer should file a request for the New Jersey Taxpayer Advocate to review the case and evaluate the decision to sustain a levy that is creating an economic hardship. The request for Taxpayer Advocate review can also be filed prior to the levy when the threat of the levy is imminent.[21]

<u>Judicial Proceedings – Enforced Collection</u>

The Division can file an application for execution of the taxpayer's assets, including wages, debts, earnings, salaries, income from trusts, or profits due and owing.[22] The amount of the wage execution cannot exceed 10%, unless the taxpayer's income exceeds 250% of the poverty level for an individual with the same family size.[23] In those cases the court has the discretion to order a larger percentage.[24] Moreover, the following items are exempt from levy:

1. $1,000 plus an exemption for all wearing apparel;[25]
2. Household goods and furniture not exceeding $1,000 in value;[26]
3. Land held for burial purposes;[27]
4. All payments from workers' compensation;[28]
5. A partner's interest in specific partnership property, but not his interest in the partnership;[29]
6. New Jersey Old Age Assistance Payments;[30]
7. Funds located in an individual retirement account ("IRA");[31]
8. Funds located in a pension plan established pursuant to the Employee Retirement Income Security Act ("ERISA");[32]

The exemptions for funds held in retirement accounts do not apply to funds that were deposited pursuant to a fraudulent transfer.[33] Finally, the State of New Jersey does not provide a homestead exemption, but the property rights of a spouse that is not liable for the tax are protected if the property is owned with the debtor spouse as tenants by the entirety.

Statute of Limitations – Collection

For New Jersey Gross Income Tax cases, the tax lien is on the taxpayer's property for a period of 20 years. Thereafter, the Division must file a new warrant to extend the lien.[34] Furthermore, the Division has the discretion to release the taxpayer's property from a lien if it determines that its interests will not be jeopardized by the release.[35] For other types of taxes, the statute of limitations period is also 20 years.[36] Therefore, if the Division does not successfully file a timely motion to renew judgment before the statutory time period expires, the lien will not be enforceable after 20 years.[37] In estate or inheritance tax cases, the property of the decedent is subject to a lien commencing on the date of death and lasting for a period of 15 years unless paid prior to that date.[38]

Judicial Review – Improper Collection Action

When a collection officer knowingly disregards the tax laws, administrative provisions, or regulations in the collection proceedings, or if the collection officer knowingly, recklessly, or negligently fails to release a lien, then the taxpayer may file a complaint against the collection worker or the Director of the Division of Taxation in the New Jersey Tax Court. The complaint must be filed within two years from the date that the taxpayer would have reasonably discovered the improper action. The complaint must set forth the actual damages incurred from the improper conduct.

New Jersey Top Debtors and Criminal Prosecutions

In an effort to bolster its ability to collect outstanding debts from taxpayers, the State of New Jersey established a program where it publishes lists of the top business and individual taxpayer debtors in the state. These are taxpayers who have been previously notified of their outstanding obligations, but who nevertheless failed to reach out to the Division in order to resolve their tax liabilities. The amounts owed by the businesses reported on the list range from approximately $650,000 to approximately $4 million.[39] The amounts owed by the individuals identified in the list range from approximately $300,000 to approximately $2.2 million.[40]

In addition to the public stigma associated with having a name published on this list, the Division is aggressively pursuing the taxpayers identified in the list to ensure that they repay their outstanding obligations. Typically, when a taxpayer ignores the Division's efforts to collect outstanding tax liabilities including enforced collection efforts, the New Jersey Office of Criminal Investigation Technical Enforcement Unit ("TEU") will evaluate the case to determine whether a criminal investigation is warranted.

For example, in 2015, taxpayer Gregory Cobbs was sentenced to five years probation and 364 days in the Mercer County Correction Center. The prison term was suspended provided that Mr. Cobbs agreed to pay his outstanding liability of $150,000 on a court approved installment agreement.[41]

How does a collection case go from a civil collection case to a criminal collection case? The impetus for the criminal prosecution is generally a continued disregard for the Division's collection efforts. Indeed, the Office of Criminal Investigation noted in the Cobbs case that "[d]espite numerous efforts by the Division of Taxation to collect these taxes from Cobbs, he refused to pay and never responded to attempts to resolve the case before criminal charges were filed."[42] Furthermore, the TEU will also prosecute individuals who submit payments with a bad check or failed electronic transfer payment if they fail to replace those payments. Once a case moves forward for criminal prosecution, the suit is brought in the Superior Court, typically in Mercer County. The New Jersey Tax Court does not have jurisdiction over criminal cases.

Collection Alternatives – Installment Agreements

In order to request an installment agreement, a taxpayer must be current with all of his or her return filing obligations.[43] Moreover, the request must include all periods for which there is an outstanding balance due.[44] Requests for installment agreements should be for repayment between three to 36 months, but a longer repayment period may be requested. Under those circumstances, the request must be approved either by the assigned case worker or the Deferred Payment Control Unit.[45] Furthermore, if the request for a longer period of time involves a business tax liability, the Division will forward the case to an outside collection agency to process the request.[46]

For installment agreement requests where the balance owed is $2,500 or less, the Division will not file a Certificate of Debt unless the taxpayer defaults on the installment agreement. If the request is to repay more than $2,500 and the plan is to repay the amount within 12 months, a Certificate of Debt will only be filed if the taxpayer defaults.[47] For installment agreements to repay more than $2,500 over more than 12 months, the Division will file a Certificate of Debt.[48] Moreover, the Division will add a 10% cost of collection fee to the taxpayer's liability.[49]

Collection Alternatives – Offers in Compromise

The Division is authorized to compromise tax liabilities in cases where there is either doubt as to liability or doubt as to collectability.[50] The policy justification for an offer in compromise based on doubt as to collectability is that government resources should not be wasted on futile efforts to collect from a taxpayer who does not have the means to pay an outstanding liability. The policy reasons for providing a compromise system are articulated on the Division's website, which notes:

> With many individuals and businesses facing financial difficulties, the Division is ready to help those who owe back taxes. We recognize that we must balance our responsibility to enforce the tax laws with the economic realities and hardships facing New Jersey businesses and individuals.[51]

Even though the policy reasons for both the state and federal offer programs are the same, this is where the similarities end.

A taxpayer facing financial difficultly may be inclined to submit an offer. The applicable statute requires the taxpayer to use of the Division's forms.[52] However, the taxpayer will quickly discover that the Division currently does not have a form dedicated to the submission of a request for an offer in compromise. Instead, the taxpayer must file Form 906, *Closing Agreement Request*, together with a "Financial Statement of Debtor." Generally, the taxpayer can expect to experience delays in the processing of their requests. When the taxpayer faces considerable delay in the administrative evaluation of his offer request, he or she should consider filing a complaint in lieu of a prerogative writ in the New Jersey Superior Court to compel an evaluation of the offer request. A prerogative writ is an official order that directs the behavior of a governmental agency. In lieu of a prerogative writ, the New Jersey Constitution provides that such relief must be granted in the Superior Court. Accordingly, the taxpayer needs to file a complaint in such court to compel review of his offer.[53] In some cases, the filing of a complain in lieu of a prerogative writ can be an effective tool to compel prompt resolution of the taxpayer's offer request.

For taxpayers facing enforced collection, it is important to note that the Division has the discretion to withhold enforced collection if the delay will not jeopardize collection efforts.[54] However, the statute does not guarantee a stay on collection activity during the review of the taxpayer's offer. The offer can only be accepted by the Division in writing.[55] Likewise, the Division must notify the taxpayer in writing that the offer has been rejected.[56] If an offer is rejected, the Division must return the amount tendered with the offer and all periodic payments submitted unless the taxpayer agreed to have the tendered amount applied to his tax liabilities.[57] There are currently no opinions on this issue from the Tax Court; however, the taxpayer should have a right to file a complaint for judicial review of the Division's determination to reject the offer in compromise.[58]

Conclusion

Taxpayers are encouraged to be proactive in their efforts to resolve their outstanding tax obligations to the Division. Given the procedures available to taxpayers in New Jersey, it is important that taxpayers proactively engage with the Division to resolve their collection issues. Once the case proceeds to a point where the taxpayer's inaction has frustrated the Division's collection efforts, the taxpayer may be in a situation where he or she can no longer effectively negotiate for a favorable resolution.

Footnotes:

1. Frank Agostino is principal at, and Jairo G. Cano is an associate at Agostino & Associates, PC, in Hackensack, NJ. The authors wish to acknowledge the contributions and public outreach by employees of the New Jersey Division of Taxation and the Office of the Attorney General, New Jersey including but not limited to the Honorable Joseph Andresini (Tax Court of New Jersey); Lou Cafiero (North Region Supervisor, Division of Taxation); Ramanjit Chawla, Esq. (Deputy Attorney General, New Jersey); John Ficara (Acting Director, Division of Taxation); Dennis Shilling (Deputy Director, Operations, Division of Taxation); Donald Krulewicz (New Jersey Office of Criminal Investigation); and Charles Giblin (New Jersey Office of Criminal Investigation).
2. State of New Jersey, Department of the Treasury, Division of Taxation, Second Notice *available at* http://www.state.nj.us/treasury/taxation/pdf/TGINoVoucher.pdf (last visited Feb. 17, 2016).
3. State of New Jersey, Department of the Treasury, Division of Taxation, *Who is Pioneer Credit Recovery? available at* http://www.state.nj.us/treasury/taxation/PioneerCreditRecoveryWebNotice.shtml (last updated Nov. 25, 2015).
4. NJSA 54:49-1; *see also* 2016 GUIDEBOOK TO NEW JERSEY TAXES ¶ 2007 (Susan A. Feeney & Michael A. Guariglia eds., 2016)[hereinafter 2016 GUIDEBOOK].
5. *See, e.g. Monica Fuel, Inc. v. IRS*, 56 F.3d 508 (3d Cir. 1995).
6. *See, e.g. In re Johns*, 242 B.R. 265, 269 (D.N.J. 1999).
7. *See, e.g. Monica Fuel, Inc.*, 56 F.3d 508.
8. NJSA 54:49-1.
9. NJSA 54:49-13(a).
10. NJSA 54:49-12; *see also* 2016 GUIDEBOOK, *supra* note 4, at ¶ 2013.
11. S*ee, e.g. Monica Fuel, Inc.*, 56 F.3d at 509.
12. IRC § 6330(c)(2)(B).
13. NJSA 2B:13-3.
14. NJSA 54:51A-14.
15. N.J. CT. R. 8:3-5(b)(2); *see, e.g. Millwork Installation, Inc. v. State Dept. of Treasury, Div. of Taxation*, 25 N.J. Tax 452 (2010).
16. *See* N.J. CT. R. 8:6-1(a)(2)(The taxpayer has 180 days following the filing of the Division's answer to the complaint to make discovery requests. The time period may be extended by the Court's discretionary power or by the agreement of the parties.).
17. *See, e.g. Millwork Installation, Inc.*, 25 N.J. Tax 452.
18. NJSA 54:50-26.3.
19. State of New Jersey, Department of the Treasury, Division of Taxation, *Help for Individuals and Businesses with State Taxes Owed to New Jersey*, http://www.state.nj.us/treasury/taxation/helpwithdebt.shtml#LevyRelease (last updated Aug. 20, 2014).
20. Treas Reg. § 301.6343-1(b)(4).
21. *See* State of New Jersey, Department of the Treasury, Division of Taxation, *Office of the Taxpayer Advocate*, *available at* http://www.state.nj.us/treasury/taxation/ota/otainfo.shtml (last updated Dec. 10, 2015) (The New Jersey Taxpayer Advocate can assist taxpayers who are facing undue hardship as a result of their dealings with the Division.).
22. NJSA 2A:17-56.
23. *Id.*
24. *Id.*
25. NJSA 2A:17-19.
26. NJSA 2A:26-4.
27. NJSA 45:27-20.
28. NJSA 34:15-29.
29. S*ee Federal Deposit Ins. Corp. v. Birchwood Builders, Inc.*, 240 N.J. Super. 260, 266 (App. Div. 1990) *citing Schultz v. Ziegenfuss*, 105 N.J. Super. 468, 473 (App. Div. 1969)("The interest in specific partnership property is not subject to attachment or execution to satisfy the debt of one partner."); *see also* NJSA 42:1-28 (A debtor's interest in a partnership is subject to execution.).
30. NJSA 44:7-35.
31. NJSA 25:2-1.

32. *See, e.g. Gilchinsky v. National Westminster Bank N.J.*, 159 N.J. 463 (1999).
33. *See* NJSA 25:2-1; *see also Gilchinsky*, 159 N.J. 463.
34. NJSA 54A:9-12(g).
35. *Id.*
36. *See* NJSA 2A:14-5; 2A:17-3.
37. *See* NJSA 2A:14-5; *see also Cumberland County Welfare Board v. Roberts, et. al.*, 139 N.J. Super. 126 (Law Div. 1976)(A judgment is not valid after 20 years unless a timely motion to renew the judgment is filed in the appropriate court.).
38. NJSA 54:35-5.
39. State of New Jersey, Department of the Treasury, Division of Taxation, *Top Business Debtors*, *available at* http://www.state.nj.us/treasury/taxation/pdf/septtopdebtbus.pdf (last visited Feb. 17, 2016).
40. State of New Jersey, Department of the Treasury, Division of Taxation, *Top Individual Debtors, available at* http://www.state.nj.us/treasury/taxation/pdf/septtopdebtind.pdf (last visited Feb. 17, 2016).
41. Press Release, Office of the Mercer County Prosecutor, One of New Jersey's Top Debtor's Sentenced (Apr. 23, 2015) available at http://www.state.nj.us/treasury/taxation/pdf/cobbssentencing.pdf.
42. *Id.*
43. State of New Jersey, Department of the Treasury, Division of Taxation, *Deferred (Installment) Payment Plans*, http://www.state.nj.us/treasury/taxation/dpc.shtml (last updated Sept. 29, 2015).
44. *Id.*
45. *Id.*
46. *Id.*
47. *Id.*
48. *Id.*
49. *Id.*
50. NJSA 54:53-7(a); *see also* 2016 GUIDEBOOK, *supra* note 4, at ¶ 2014.
51. *Help for Individuals and Businesses with State Taxes Owed to New Jersey*, *supra* note 19.
52. NJSA 54:53-10.
53. *See, e.g. Villines v. Harris*, 487 F. Supp. 1278, 1280 (D.N.J. 1980)(There does not need to be a specific statute that authorizes the Superior Court's review of an agency's action or inaction.).
54. NJSA 54:53-11.
55. NJSA 54:53-12.
56. NJSA 54:53-13.
57. *Id.*
58. *See* NJSA 2B:13-3(a); N.J. CT. R. 8:2(a)("The Tax Court shall have initial review jurisdiction of all final decisions including any act, action, proceeding, ruling, decision, order or judgment ... of the Director of the Division of Taxation.").

MONTHLY TAXPAYERS ASSISTANCE CORPORATION TIP: GETTING CURRENTLY NOT COLLECTIBLE STATUS WITHOUT FILING DELINQUENT RETURNS

Before the IRS grants an individual Currently Not Collectible (CNC) status for economic hardship, there is an investigation and verification of income and assets. For some time, in addition to verifying economic hardship, the IRS required filing compliance. A U.S. Tax Court decision, as a result of a Collection Due Process appeal of a proposed levy, modified that filing requirement.

In *Vinatieri v. Commissioner*,[1] the taxpayer provided verification of economic hardship, and the settlement officer agreed; however the Internal Revenue Manual required all delinquent returns be filed before outstanding liabilities were placed in CNC status. All returns were not filed, so the Appeals determination was to sustain the levy. The Tax Court did not agree and ruled that if there is a finding of economic hardship, any levy must be released pursuant to IRC § 6343(a)(1)(D). The Court could find no support in that section nor in the underlying Treasury Regulations for the proposition that the taxpayer be compliant with filing all returns to qualify for release of the levy, and proceeding with a levy that must be immediately released would be unreasonable.[2]

Although the IRM directs IRS employees that all open filing requirements must generally be resolved and closed appropriately,[3] it also says if a Collection Information Statement can be *verified*, even if there are unfiled returns, the account can be placed in CNC status.[4] Although the IRS may still ask for an unfiled return if needed to confirm a hardship determination (i.e., income, expenses and/or assets reported on an IRS Form 433-A) before closing an account as uncollectible, levies cannot be issued.

— Desa Lazar, Esq.

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1. [1]133 T.C. 392 (2009)
2. *Id.* at 401.
3. IRM, pt. 5.16.1.2(5) (Jan. 1, 2016).
4. IRM, pt. 5.16.1.2.9(12) (Aug. 25, 2014).

FIRM NEWS

Lawrence Sannicandro Selected ABA Nolan Fellow

Lawrence ("Larry") Sannicandro, an associate with Agostino & Associates, was recently awarded the John S. Nolan Fellowship by the American Bar Association's Section of Taxation for 2016-2017.

Mr. Sannicandro is one of six attorneys nationwide to receive the prestigious Fellowship, which is awarded to young attorneys who are actively involved in the Taxation Section and who have shown leadership qualities. He is the second Agostino & Associates attorney to become a Nolan Fellow, after Jairo Cano was named a Nolan Fellow last year.

Mr. Sannicandro joined Agostino & Associates in 2013 and quickly made an impression as both a litigator and an expert in valuation issues. He has co-authored or significantly contributed to two books—one on taxation and identity theft, and one on valuation and qualified appraisal issues—as well as numerous articles published in different tax law journals. In October 2015, the New York County Lawyers' Association awarded Mr. Sannicandro its 2015 pro bono award for his dedication to representing low-income taxpayers as part of the U.S. Tax Court Calendar Call Pro Bono Program.

With the ABA, Mr. Sannicandro served as a team leader of the Section of Taxation's comments on reform to the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) as it relates to litigation and tiered partnerships. Mr. Sannicandro has also appeared on numerous ABA panels to discuss, among other things, tax litigation, valuation, and the innovative "hot-tubbing" method for receiving expert testimony. Additionally, he has organized various social and networking events within the ABA and has cultivated relationships with the AICPA and with enrolled agents.

Prior to entering private practice, Mr. Sannicandro served as a law clerk for the United States Tax Court, and before that, as an attorney for the IRS. He earned his LLM in Taxation from Georgetown University Law Center, his JD from the University of Florida Levin College of Law, and his MBA in Finance from Binghamton University.

Welcome, Fordham Intern!

Agostino & Associates welcomes Ruiwen (Riva) Zhu, a graduate student at Fordham's Gabelli School of Business, who is interning with us for the spring semester. Ms. Zhu received her undergraduate degree in accounting from Jiangnan University in Wuxi, China and is studying for the CPA exam and the U.S. Tax Court exam. She will be attending all the U.S. Tax Court Calendar Call sessions this term.

Upcoming United States Tax Court Calendar Calls

All Calendar Calls Are Held at:
Jacob K. Javits Federal Building
26 Federal Plaza
Rooms 206, 208
New York, NY 10278

February 22, 2016 - Newark, NJ

February 29, 2016 - Newark, NJ &
New York City

March 14, 2016 - Westbury, NY

Seminar News: PLI on Tax Penalties

On March 14, the Practising Law Institute will be holding a seminar titled, *Nuts and Bolts of Tax Penalties 2016: A Primer on the Standards, Procedures and Defenses Relating to Civil and Criminal Tax*. Frank Agostino is among the esteemed faculty who will be speaking at this all-day event, which will run from 9:00 a.m. to 5:00 p.m. at PLI New York Center, 1177 Avenue of the Americas, 2nd Floor, New York, NY 10036. Continuing Legal and Professional Education credits will be available.

For more information and registration informaition, please see **http://www.pli.edu/re.aspx?pk=144606&t=DKV6_NBTP6**.

Agostino & Associates, P.C. Contact Information

Frank Agostino, Esq. Fagostino@agostinolaw.com	Ext. 107
Patrick Binakis, Esq. Pbinakis@agostinolaw.com	Ext. 125
Jairo Cano, Esq. Jcano@agostinolaw.com	Ext. 144
Jeffrey Dirmann, Esq. Jdirmann@agostinolaw.com	Ext. 119
Eugene Kirman, Esq. Ekirman@agostinolaw.com	Ext. 142
Jeremy Klausner, Esq. Jklausner@agostinolaw.com	Ext. 130
Dolores Knuckles, Esq. Dknuckles@agostinolaw.com	Ext. 109
Tara Krieger, Esq. Tkrieger@agostinolaw.com	Ext. 118
Lawrence Sannicandro, Esq. Lsannicandro@agostinolaw.com	Ext. 128
Michael Wallace, EA Mwallace@agostinolaw.com	Ext. 143
Caren Zahn, EA Czahn@agostinolaw.com	Ext. 103