

[COMMITTEE PRINT]

JEOPARDY AND TERMINATION ASSESSMENTS,
ADMINISTRATIVE SUMMONS, COMPREHENSIVE
ADMINISTRATIVE PACKAGE, STATE CONDUCTED
LOTTERIES, AND MISCELLANEOUS

PREPARED FOR THE USE OF THE
COMMITTEE ON WAYS AND MEANS
BY THE STAFF OF THE
JOINT COMMITTEE ON INTERNAL REVENUE TAXATION



SEPTEMBER 25, 1975

U.S. GOVERNMENT PRINTING OFFICE
WASHINGTON : 1975

59-023

JCS-40-75

CONTENTS

	Page
A. Jeopardy and termination assessments.....	1
General	1
Present law.....	1
Use of section 6861 jeopardy assessments.....	2
Use of section 6862 jeopardy assessments.....	2
Use of termination assessments.....	3
Problem	4
Alternative approaches.....	4
B. Administrative summons.....	5
Present law.....	5
Problem	6
Alternative proposals.....	6
C. Comprehensive administrative package.....	7
D. State-conducted lotteries.....	7
E. Miscellaneous	7

A. JEOPARDY AND TERMINATION ASSESSMENTS

General

Under normal assessment and collection procedures, prior to collection a taxpayer has significant warnings that the Internal Revenue Service is proposing to assess and collect taxes from him. However, under present law, the IRS has been given broad authorization, under certain circumstances, to expedite the assessment and collection of taxes pursuant to jeopardy and termination assessment procedures.

As a result of concern in this area, the Joint Committee on Internal Revenue Taxation, on December 27, 1974, requested the General Accounting Office to act as its agent in reviewing the procedures followed by the Internal Revenue Service in making jeopardy assessments. The review was to include how the IRS uses these enforcement tools, how often they are used, and whether their use varies significantly from district to district. Since this area was listed for consideration by the committee in phase one of tax reform, the GAO expedited its review and therefore limited its work to two IRS districts. The GAO submitted its draft report to the Joint Committee at the end of last week. The material contained in this part of the pamphlet is largely adopted from this GAO report.

Present Law

Under a normal assessment, there is generally a considerable lapse of time between a taxpayer's first notice that the Internal Revenue Service is seeking to collect taxes from him and the actual enforced collection of those taxes. For example, if a taxpayer does not agree with a proposed assessment of income taxes, he may require that the IRS issue a deficiency notice and may then pursue administrative appeals (followed by a petition to the Tax Court and subsequent appeals) without paying the tax allegedly due. On the other hand, when there is an indication that the collection of a tax may be in jeopardy, the IRS may forgo the normal time-consuming assessment and collection procedures and immediately assess and collect the tax. For this purpose, there are two basic types of special assessments—jeopardy assessments and termination assessments.

A jeopardy assessment (sec. 6861 and 6862 of the code) may be made if it is determined that the collection of any tax is in jeopardy after the expiration of a taxpayer's taxable period and the statutory date of payment has passed. Jeopardy assessments under section 6861 are for income, estate, and gift taxes while section 6862 jeopardy assessments are for all other taxes.

A termination assessment (sec. 6851 of the code) may be made when it is determined that the collection of an income tax is in jeopardy prior to the expiration of a taxpayer's normal tax year or prior to the statutory date the taxpayer is required to file a return and pay the tax.

In such a situation, the IRS serves a notice of termination of the taxpayer's taxable year or segment of the taxable year and demands immediate payment of any tax determined to be due for the terminated period.¹

Use of Section 6861 Jeopardy Assessments

Under a section 6861 jeopardy assessment, the IRS may determine that a deficiency exists and is then authorized immediately to (1) assess, (2) send a notice and demand for payment, and (3) levy upon all the taxpayer's property whenever it believes that the assessment or collection of the deficiency would be jeopardized by delay. The 10-day waiting period normally required between demand for payment and seizure of the taxpayer's property does not apply. If the jeopardy assessment is made before the statutory notice of deficiency is sent to the taxpayer, the IRS is required to send the notice within 60 days after the jeopardy assessment is made.

The judicial remedies available to a taxpayer who has been subject to a section 6861 jeopardy assessment are identical to the remedies available for a normal assessment. Upon receiving a notice of deficiency, the taxpayer may file a petition for redetermination in the Tax Court.² Or the taxpayer may pay the full amount of the deficiency, file a claim for refund with the IRS, wait 6 months (unless the claim is denied by IRS sooner), and then file a refund action in a Federal district court or the Court of Claims.

The taxpayer who has been jeopardy assessed under section 6861, however, does not have all the protection afforded the ordinary taxpayer during the judicial review. In the normally assessed tax case, the IRS is prohibited from taking collection action against a taxpayer's property or assets prior to the time allowed for filing a petition for redetermination and while litigation is pending in the Tax Court. In the case of section 6861 jeopardy assessments, however, the IRS is authorized immediately upon assessing the deficiency and demanding payment, to take immediate collection action, including seizure of the taxpayer's property. Although the IRS is precluded from selling any property seized prior to or during Tax Court litigation, the jeopardy taxpayer—unlike the ordinary taxpayer—loses the benefit of whatever property and assets are seized by IRS while he seeks relief in the Tax Court.

Use of Section 6862 Jeopardy Assessments.

A section 6862 jeopardy assessment differs from a section 6861 jeopardy assessment in that the taxpayer does not have the right of timely appeal of the tax liability.

As in the case of a section 6861 jeopardy assessment, the IRS may determine that a tax is due and is then authorized to immediately

¹The Internal Revenue Manual provides that jeopardy and termination assessments should be used sparingly; care should be taken to avoid excessive and unreasonable assessments; and such assessments should be personally approved by the district director. In addition, the district director is not to approve a termination or jeopardy assessment unless at least one of the following three conditions are met:

(1) The taxpayer is or appears to be designing quickly to depart from the United States or to conceal himself;

(2) The taxpayer is or appears to be designing quickly to place his property beyond the reach of the Government either by removing it from the United States, or by concealing it, or by transferring it to other persons, or by dissipating it; or

(3) The taxpayer's financial solvency is or appears to be imperiled.

²The notice is a jurisdictional prerequisite to litigation in the Tax Court.

assess and levy upon all the taxpayer's property whenever it believes that the assessment or collection of the deficiency would be jeopardized by delay. Unlike the prohibition that prevents the IRS from selling any property seized under a section 6861 jeopardy assessment prior to the exhaustion of appeal rights to the Tax Court, property seized as a result of a section 6862 jeopardy assessment can be sold prior to the taxpayer having a right to contest the tax liability.

The appeal rights for a taxpayer who has been subject to a section 6862 jeopardy assessment begins after he pays the tax deficiency and files for a refund with IRS. The taxpayer must wait 6 months—unless the IRS denies the claim sooner—and then either the Federal district court or Court of Claims will consider a refund action on behalf of the taxpayer.

Use of Termination Assessments

Under a section 6851 termination assessment which may be made only to collect income taxes if the IRS finds that the collection of a tax is jeopardy, it is authorized to:

- (1) serve notice on the taxpayer of the termination of his taxable period;
- (2) demand immediate payment of any tax determined to be due for the terminated period; and
- (3) if payment is not received, to immediately levy upon all of the taxpayer's property.

Any amount collected as a result of the termination assessment is applied against the tax finally determined to be due on the taxpayer's annual return. The 10-day waiting period normally required between demand for payment and seizure of the taxpayer's property does not apply when a termination assessment is made.

At present, the law is not clear on the judicial remedies available to taxpayers who have been subject to termination assessments. Two cases currently are pending before the Supreme Court in which a taxpayer's right to deficiency notice and Tax Court review is at issue.³

(A notice of deficiency has to be issued before the Tax Court will review the tax determination.) In addition, the cases include the question of whether the IRS has the authority to sell property seized pursuant to a termination before the taxpayer has had any opportunity for judicial review.

It is the IRS' position that, with respect to termination assessments, its authority to assess is *not* limited by requirements (such as found in section 6861) that the IRS must send to the taxpayer a deficiency notice within 60 days after payment.⁴ Thus, under the IRS' position, a taxpayer who has been subject to a termination assessment may contest the assessment only by (1) paying the assessed tax, (2) filing a claim for refund with the IRS, and (3) after 6 months, unless the refund claim is denied sooner, filing a refund petition with the Federal district court or U.S. Court of Claims.

It is the IRS' practice not to consider a refund claim until after the end of the taxpayer's normal tax year. Thus, there could be a con-

³ *United States v. Hall*, 493 F.2d 1211 (6th Cir. 1974); *Laing v. United States*, 496 F.2d 853 (2d Cir. 1974).

⁴ Some courts have adopted this position, see, e.g., *Laing v. United States*, 496 F.2d 853 (2d Cir. 1974), but other courts have rejected it. See, e.g., *Rambo v. United States*, 492 F.2d 1244 (6th Cir. 1974).

siderable delay until the taxpayer can obtain judicial review of his case and during this delay he is deprived of the use of any refund to which he would be entitled.

In recent years, most taxpayers who have been subject to termination assessments have been suspected of dealing in narcotics. Particularly during 1972 and 1973, a concerted effort was made to utilize termination assessments to reduce the profitability of dealing in illegal drugs. In 1974, however, the IRS revised its guidelines to emphasize that termination assessments (and jeopardy assessments) were to be utilized to achieve maximum compliance with the internal revenue laws rather than to disrupt the distribution of narcotics.

Problem

The jeopardy and termination assessment powers granted to the Internal Revenue Service are generally considered valuable weapons which the IRS can effectively utilize in unusual circumstances to prevent taxpayers from avoiding the payment of taxes. However, a taxpayer who has been subjected to such an assessment may suffer considerable hardship. This may result from the suddenness with which action may be taken. Hardship may also result because of the requirement that, if the assessment is made under section 6851 or 6862, the taxpayer must pay the tax, file a claim for refund, and then wait six months before filing a suit for refund. (By contrast, the taxpayer who has been assessed under normal procedures, or even under a jeopardy assessment pursuant to section 6861, may file a petition with the Tax Court without being required to pay the taxes and file a refund suit.) In addition, property seized following a jeopardy assessment under section 6862 apparently can be sold prior to the taxpayer having a right to contest the tax liability. Although the law is not clear, the IRS may also be able to sell property seized pursuant to a termination assessment prior to the time the taxpayer can contest the tax liability.

The GAO draft report indicated that most jeopardy assessments and termination assessments were utilized against taxpayers engaged in illegal activities, although some of the jeopardy assessments under section 6862 were utilized to collect penalty taxes from persons who had failed to collect employment taxes. Although the GAO generally found that these types of assessments had not been misused, it did note that the termination assessments were generally unproductive from a tax collection viewpoint, since in 25 cases which had been completed at the time of review, \$742,294 was assessed and the total tax deficiency after audit was \$36,665 (4.9 percent of the assessments). GAO also noted that, in at least one case where a section 6862 jeopardy assessment was used to collect penalty taxes resulting from a corporation's failure to pay employment taxes, it was at least possible that the taxpayer was not liable for payment of the penalty tax.

Alternative Approaches

General Accounting Office

In its draft report to the Joint Committee on Internal Revenue Taxation, the General Accounting Office recommended that taxpayers against whom section 6862 jeopardy assessments and section 6851

termination assessments are made should have timely appeal rights similar to taxpayers against whom section 6861 jeopardy assessments are made. In the case of jeopardy assessments made under section 6862, the taxpayer should have a more timely right to judicial review than is currently provided under the Code. In the case of a taxpayer whose taxable period has been terminated and payment of the tax for the taxable period demanded under section 6851, the Secretary or his delegate should be required to mail to the taxpayer a notice of the tax due. Such notice must be mailed within 60 days after termination of the taxable period and will constitute a determination of a tax deficiency for purposes of petitioning the Tax Court for a redetermination of a deficiency.

Also, the General Accounting Office recommended that the IRS should be precluded from selling taxpayers' property seized pursuant to a section 6862 jeopardy assessment until the judicial review process is completed.

Mr. Ullman

His proposal is the same as the GAO recommendation.

B. ADMINISTRATIVE SUMMONS

Present Law

Under present law, the IRS is given authority, during the course of an investigation to determine the tax liability of a person, "to examine any books, papers, records, or other data which may be relevant or material" to the investigation. This includes not only the right to examine records in the possession of the taxpayer but also the authority to issue a summons to "any person" having possession or custody of records "relating to the business of the person liable for tax" as well as the authority to take the testimony of any such person under oath (sec. 7602). In certain cases, where the Service has reason to believe that certain transactions have occurred which may affect the tax liability of some taxpayer, but is unable for some reason to determine the specific taxpayer who may be involved, the Service may issue a so-called "John Doe" summons, which means that books and records relating to certain transactions are requested, although the name of the taxpayer involved is not specified (*United States v. Bisceglia*, 95 S. Ct. 915 (1975)). The summons issued by the Internal Revenue Service, which may be referred to as administrative summonses, may be enforced where necessary by appropriate court procedure.

Where the summons is issued to a person who is not the taxpayer (i.e., a third-party summons), the third-party witness may challenge the summons for procedural defects (i.e., on grounds that the summons is not validly served or is ambiguous, vague or otherwise deficient in describing the material requested), on grounds of the attorney-client privilege (where applicable) and on other grounds, such as an assertion that the material subject to summons is not relevant to a lawful investigation, or that it is not possible for the witness to comply (as where the records are not in his possession).

The taxpayer who is involved may also challenge the summons under certain facts and circumstances. However, there is no legal require-

ment that the taxpayer be informed that a third-party summons has been issued. Moreover (although the law in this area is not entirely clear), in order to successfully challenge a summons issued to a third party, the taxpayer must generally be required to establish either (1) that he has a proprietary interest in the books or records; or (2) that the summons was issued for an improper purpose or (3) that the attorney-client privilege is involved.

The Service has instituted an administrative policy designed to establish certain safeguards in this area. Under this policy, IRS representatives are instructed to obtain information from taxpayers and third parties on a voluntary basis where possible. Where a third party summons is issued, advanced supervisory approval is required. In the case of a John Doe summons, the advance supervisory approval must be obtained on a high level basis.

Problem

The use of the administrative summons, including the third-party summons, is a necessary tool for the IRS in conducting many legitimate investigations concerning the proper determination of tax. The administration of the tax laws requires that the Service be entitled to obtain records, etc., without an advance showing of probable cause or other standards which usually are involved in the issuance of a search warrant. On the other hand, the use of this important investigative tool should not unreasonably infringe on the civil rights of taxpayers, including, among others, the right to privacy, and the right to participate in and be informed of the course of an investigation into the taxpayer's affairs.

It has been suggested that many of the problems in this area would be cured if taxpayers were advised of the issuance of a third-party summons, and were afforded a reasonable and speedy means to challenge the summons where appropriate. While the third-party witness also has this right of challenge, even under present law, the interest of the third-party witness in protecting the privacy of the records in question is frequently far less intense than that of the taxpayer.

In the case of a John Doe summons, advance notice to the taxpayer is obviously not possible. Here it has been suggested that the IRS agent should be required to show adequate grounds for issuing the summons in an independent review process before any such summons can be issued.

Alternative Proposals

Mr. Ullman

He would provide that taxpayers would be notified contemporaneously when a third-party administrative summons was served. Also, in such situations, taxpayers would be entitled to an administrative hearing at which time the taxpayer could raise any issues which could be raised if the summons had been served on the taxpayer personally. In the case of all administrative summonses, issuance would have to be preceded by an independent prior review, at appropriate levels within the Service of the basis for the summons.

Mr. Pickle

He would disallow any use of John Doe summonses.

C. Comprehensive Administrative Package

Mr. Vanik

He proposes that a separate bill be developed dealing with administrative provisions which have no tax or revenue impact. His proposed legislation:

1. Provides GAO authority to oversee the IRS and report annually on IRS activities;
2. Makes available to the public clear information on taxpayer rights in audits, appeals, etc.;
3. Establishes a taxpayer service and complaint assistance office—a sort of ombudsman to deal with improper treatment by IRS officials and to provide relief in special cases where IRS actions are resulting in unnecessary injury to the taxpayer;
4. Provides a pilot project of independent legal assistance to taxpayers in audits and appeals; this project will be limited to four cities over a three year period;
5. Places limitations on the power of jeopardy assessment and termination of tax year, including an increase in the amount which cannot be assessed but which must be left to the taxpayer for living expenses;
6. Establishes safeguards against the political misuse of the Internal Revenue Service through limitations on non-tax related surveillance and penalties for illegal surveillance;
7. Provides for new limitations on disclosure of tax information and permits taxpayers civil liability recovery for damages caused by disclosure of personal tax data.

In addition, he intends to deal with tax return preparers, declaratory judgments of tax-exempt organizations, John Doe summonses and private rulings.

D. State Conducted Lotteries

1974 committee bill

Last year the committee would have removed the requirement that the ultimate winners of State lotteries must be determined on the basis of the results of a horse race. The committee also would have exempted vending machines which dispenses lottery tickets conducted and maintained by State lottery agencies from the occupational taxes on wagering. (In addition, as described in the pamphlet on withholding, for lottery winnings, the committee would have instituted a 20-percent withholding for income tax whenever the proceeds exceed \$100.)

Messrs. Burke, Rostenkowski, and Cotter

The proposal would repeal both the present excise tax on the receipts of State lotteries and the occupational tax on the seller of State lottery tickets. (Their proposal, however, does not include any provision for withholding.)

E. Miscellaneous

Messrs. Schneebeli and Steiger

The proposal would require a study of the feasibility of establishing a court of tax equity or other similar mechanism for dealing with tax equity problems by the Joint Committee and/or the Treasury Department.