

CRS Report for Congress

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Taxpayer Protections in the IRS Restructuring Bill: Attorneys' Fees and Damages for IRS Abuses

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Summary

The Internal Revenue Service Restructuring and Reform Act of 1997, H.R. 2676, 105th Congress, contains a number of provisions designed to strengthen taxpayer rights in dealings with the Internal Revenue Service. The House passed its version of the bill on November 5, 1997. The Senate passed its version on May 7, 1998. This is one of a series of CRS reports designed to discuss certain taxpayer protection and rights provisions in that bill. This report discusses the proposals to expand a court's authority to award attorneys' fees and costs in certain cases and the proposal to permit a taxpayer to collect damages for negligent collection actions by IRS agents. These provisions are covered in sections 311 and 312 of the House version and in sections 3101 and 3102 of the Senate version.

The Internal Revenue Service Restructuring and Reform Act of 1997, H.R. 2676 (105th Congress), contains a number of provisions designed to strengthen taxpayer rights in dealings with the Internal Revenue Service. This report discusses the proposals to expand a court's authority to award attorneys' fees and costs in certain cases and the proposal to permit a taxpayer to collect damages for negligent collection actions by IRS agents. Section 311 of the House version and section 3101 of the Senate version would liberalize the rules on attorneys' fees in Internal Revenue Code §7430, and House section 312 and Senate section 3102 would permit taxpayers to collect damages for negligent actions of IRS collection agents.

Attorneys' fees and costs.

Under present law, any person who substantially prevails in a tax case involving determination, collection, or refund of taxes, interest, or penalties may be awarded reasonable administrative costs (incurred after the earlier of the date the taxpayer receives the notice of the decision of the IRS Office of Appeals or the date of the notice of deficiency) and reasonable litigation costs. Only individuals with a net worth of \$2 million or less and corporations with a net worth of \$7 million or less can be awarded costs. The

biggest component of reasonable costs is attorneys' fees, but reimbursement for attorneys' fees is limited to \$110 per hour (as adjusted for inflation). In certain cases, a court may award more than \$110 per hour if the court finds that a special factor justifies a higher rate. In no case can reasonable costs exceed the amount actually paid or owed. Under current law taxpayers can only be awarded attorneys' fees for services of attorneys, although CPAs and enrolled agents are authorized to practice before the Tax Court and the IRS. Currently, only actual costs may be reimbursed.

The House version of the bill proposes five minor changes in IRC § 7430, the provision dealing with awards of costs. First, although the bill retains the statutory cap on attorneys' fees, judges would be permitted to adjust the award of attorneys' fees upward based on the difficulty of the issues presented in the case or on the local availability of tax expertise. Second, administrative costs could be awarded on the earliest of three occasions: the two under existing law (i.e., the date of Appeals Office notice or the date of notice of deficiency), or the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent. This change should allow taxpayers to be reimbursed for administrative costs incurred before the actual notice of deficiency. Third, fees for the services of CPAs and enrolled agents authorized to practice before the Tax Court or before the Internal Revenue Service may be awarded to prevailing taxpayers as if those individuals were attorneys. Fourth, the statute would be amended to allow a court to award appropriate attorney's fees to those who undertake pro bono representation of taxpayers. Fifth, in determining whether the position of the IRS was substantially justified, the court would be required to take into account whether the IRS has lost in courts of appeal for other circuits on substantially similar issues. The Committee on Ways and Means report, H.Rept. 105-364, at 59, indicates that the court may also take into account whether the United States has won in courts of appeal for other circuits. This provision could present courts with the decision of whether to punish the IRS for inappropriately pursuing a lost cause or whether to tolerate an IRS attempt to obtain a conflict between circuits in order to have the Supreme Court decide an issue.

The Senate version contains seven changes to current law. (1) It would eliminate the statutory cap on attorneys' fees and permit the award of reasonable fees paid or incurred. (2) Like the House bill, it would permit administrative costs to be awarded for attorneys' fees incurred as early as the date on which the first letter of proposed deficiency which allows the taxpayer an opportunity for administrative review in the Internal Revenue Service Office of Appeals is sent. (3) Like the House bill, the substitute would permit fees to be awarded to those individuals admitted to practice before the Tax Court or the IRS. (4) Courts could award reasonable attorneys' fees in excess of those actually paid or incurred if an individual represented a prevailing party for free or for a nominal fee. (5) The Senate version is identical to the House bill in taking into account whether the IRS has lost in courts of appeal for other circuits on substantially similar issues. (6) The Senate bill goes beyond the House bill in that it would treat a taxpayer as having substantially prevailed if IRS wins, but the judgment is for less than a qualified offer made by the taxpayer during the qualified offer period. (7) The Senate version would allow a taxpayer to be awarded attorneys' fees, in addition to damages allowed under current law, if the taxpayer prevails in a case involving unauthorized inspection or disclosure of a tax return or tax return information under IRC § 7431.

The bills do not propose changes to the net worth requirements. In both versions, the changes are proposed to apply to costs incurred or for pro bono services performed more than 180 days after the date of enactment.

Damages for disregard of the law.

Under present law, IRC § 7433, a taxpayer may sue the Government for up to \$1 million of damages caused by an IRS officer or employee who recklessly or intentionally disregarded the law while collecting the taxpayer's taxes. Damages can be reduced if the taxpayer did not exhaust available administrative remedies or if the taxpayer did not take reasonable steps to mitigate damages. Both versions of H.R. 2676 propose to expand the authority to pay damages to include cases where the IRS causes a taxpayer economic damages because of *negligent* disregard of the Internal Revenue Code or regulations while collecting a taxpayer's taxes. Damages for negligence would be limited to \$100,000 and taxpayers would have to exhaust available administrative remedies before a court could award any damages. The Committee on Ways and Means report, H.Rept. 105-364, indicates (at 59) that "inadvertent errors in IRS functions, such as in computer programming, do not trigger the application of this provision."

The Senate version would provide for payment of damages in two additional situations. First, it would amend IRC § 7426, which under current law gives third parties whose property has been wrongfully sold or levied on by the IRS certain remedies. The Senate version would permit third parties to recover the lesser of \$1 million or actual damages sustained as the result of an IRS employee's reckless or intentional disregard of the internal revenue laws. The limit would be the lesser of \$100,000 or actual damages if the IRS employee's actions were negligent. Plaintiffs would be required to exhaust administrative remedies before going to court. Second, IRC § 7433 (relating to damages for unauthorized collection actions) would be amended to include willful violations of certain provisions of the Bankruptcy Code (including the automatic stay provisions and the effect of discharge provisions). Damages for violations of title 11 (the Bankruptcy Code) could be awarded by a bankruptcy court.

Both versions would apply to actions of officers and employees of the Internal Revenue Service after the date of enactment.