Court wrote that a ''tax on going without health insurance does not fall within any recognized category of direct tax.'' It found the recognized categories of direct taxes to be capitations and taxes on the ownership of land or personal property.

The Court said the mandate was not a capitation because it is triggered by the specific circumstance of earning a specific amount of income while not obtaining health insurance.

''Essentially, the Court guts the constitutional requirement that capitations be apportioned,'' said Steven J. Willis of the University of Florida Levin College of Law. ''If what would otherwise be a capitation has any exceptions or exemptions, it is not a capitation. That is so easily accomplished as to render meaningless what was a major issue at the Constitutional Convention,'' he said. (For an article coauthored by Willis arguing that the mandate is an unconstitutional direct tax, see *Tax Notes*, July 12, 2010, p. 169, *Doc 2010-11669*, or *2010 TNT 133-6*.)

Future

Practitioners and their clients are now turning fully to the requirements of the law. ''Employers must move to implement requirements under the act, including some that are effective this year,'' said Kendra L. Roberson of Covington & Burling LLP. ''Many will be pressed for time to do so by the end of the year.''

Lee E. Allison of Ropes & Gray LLP said, ''It appears that the income tax provision, section 1411, will stand, and taxpayers will continue to plan for this new code provision being active in 2013.''

Harvey D. Cotton, also of Ropes & Gray, said the November elections represent another uncertainty. The election results ''may lead to changes in the regulatory and enforcement efforts of the regulatory agencies charged with implementing the ACA or to the ACA itself by congressional amendment,'' he said. ''The final chapter has not yet been written.''

''In a number of instances, Treasury, [the Department of Health and Human Services], and the other agencies charged with implementing the ACA have delayed issuing guidance on politically contentious issues that will need to be resolved before 2014,'' said David Gamage of the University of California Berkeley School of Law. ''It will be interesting to see whether such guidance will be forthcoming now that the constitutional challenges have been resolved, or whether the guidance will be further delayed until after November's elections.'' ■

Jaime Arora contributed to this article.

NEWS ANALYSIS

Waiting for Direction On Refund Penalties

By Jeremiah Coder — jcoder@tax.org

Refund claims are an ordinary part of life for both individual and corporate taxpayers. Yet congressional tinkering with penalties could significantly disrupt the practice of refund claims if the IRS doesn't narrowly draft guidelines for applying an erroneous refund penalty under section 6676.

Congress in 2007 authorized the IRS to impose a 20 percent penalty on abusive refund claims when the taxpayer lacked a reasonable basis for asserting the claim. Lawmakers enacted the penalty following IRS concern over a small number of abusive refunds, often in the research credit area. The penalty applies to the excess amount of the claim — that is, the portion of the refund that is disallowed by the government. However, the statute does not define what a reasonable basis means for purposes of imposing the penalty, and in the absence of regs providing any contrary interpretation, practitioners assume that the standard in section 6662 applies.

Although practitioners have expressed some concern since the section 6676 penalty was enacted, the lack of action by the IRS and the absence of regulations have helped keep discussions to a minimum among the tax bar. National Taxpayer Advocate Nina Olson in her 2008 annual report to Congress included a detailed breakdown of all penalty assertions for the prior fiscal year, which showed no penalty assertions under section 6676. (For Olson's 2008 annual report, see *Doc 2009-241* or *2009 TNT 4-21*.)

Alex E. Sadler of Ivins, Phillips & Barker said the rarity of asserted penalties under section 6676 is probably partly because of the absence of guidance. ''The section 6676 penalty has not been assessed against any of my clients, which is consistent with my perception that the penalty is not being widely assessed at this time while agents wait for more guidance,'' he said.

For the past several years, Treasury and the IRS have continued to list regulations under section 6676 on the priority guidance plan, but no government officials have said publicly that the reg project is nearing completion. There has been scant informal guidance on the issue. (For the updated 2011-2012 priority guidance plan, see *Doc 2012-9103* or *2012 TNT 83-57*. For SBSE-20-0111-001, see *Doc 2011-104* or *2011 TNT 3-22*. For prior coverage of section 6676 issues, see *Tax Notes*, Aug. 16, 2010, p. 710, *Doc 2010-17725*, or *2010 TNT 153-1*.)

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The breadth of the penalty became clear shortly after its enactment, when the IRS defined some contours of section 6676. In a legal memorandum, the Office of Chief Counsel provided to the field an example regarding calculation of the section 6676 penalty. The example posits an amended individual tax return (Form 1040X) with changes to itemized deductions yielding a $2,000 refund. The Service allows only $1,000 of the refund and subjects the resulting ''excessive amount'' of $1,000 to the erroneous refund penalty (no reasonable basis exists), resulting in a $200 penalty. (For ILM 200747020, see *Doc 2007-25978* or *2007 TNT 227-4*.)

'There needs to be a proper balancing of concerns and a very controlled system for asserting the penalty,' Rocen said.

The government's simplistic example, if taken literally and applied in other contexts, provides significant opportunity for penalizing taxpayers. Any claimed refund amount with which the IRS disagrees and for which the taxpayer has no reasonable basis risks assertion of the penalty. The strict liability nature of the penalty, featuring immediate assessment, creates harsh results for taxpayers, whether big or small, who misjudge the size of their allowable refund — or the extent to which the IRS agrees with their calculations.

''It is unfortunate that you need penalties to enforce rational behavior,'' said Donald T. Rocen of Miller & Chevalier. Penalty measures like section 6676 are necessary to prevent illegitimate claims, he said, but he cautioned that the IRS must be judicious in applying the penalty. ''While this gives the IRS another measure to curb bad behavior, the Service needs regulations to spell out the process'' in which a claim will be deemed improper, he said, adding, ''There needs to be a proper balancing of concerns and a very controlled system for asserting the penalty.''

Refundable Credit Claims

The statute expressly prohibits imposing the penalty for taxpayer missteps regarding the earned income tax credit. However, there have been recent fears that low- and middle-income taxpayers could be affected by overbroad application of the penalty when dealing with confusing refundable credits like the first-time home buyer credit.

In her 2011 annual report, Olson recommended that Congress enact legislation to provide relief for taxpayers who get tripped up by the erroneous refund claim rules in seeking a refundable credit when acting with reasonable cause and in good faith. The risk of inadvertent errors is significant given the proliferation of refundable credits, Olson said. (For the 2011 annual report, see *Doc 2012-588* or *2012 TNT 8-16*.)

According to the report, taxpayers hit with a section 6676 penalty must pay immediately with no recourse to the Tax Court before payment. That is because the erroneous refund penalty is an assessable penalty rather than an addition to tax like the section 6651 accuracy-related penalties.

Sharyn M. Fisk of Hochman, Salkin, Rettig, Toscher & Perez PC said that because of the immediate assessment, the IRS has informally agreed on the need for appeal rights. A taxpayer facing a penalty assessment would probably be offered the opportunity to file a protest and discuss the issue with an Appeals officer before payment is required, she said.

Practitioners have tried to prevent the imposition of erroneous refund penalties by including reasonable basis grounds when making an administrative refund claim, Fisk said. ''We hope that forecloses the IRS from pursuing a penalty,'' she said. The variance doctrine requires that the rationale pursued in refund litigation be described in the administrative claim, so providing a reasonable basis argument upfront is necessary, she noted.

The problem is that ''many accountants are simply unaware of the existence of this penalty,'' Fisk said, adding, ''Most practitioners believe that when they file a refund claim, that refund claim has, at a minimum, reasonable basis.''

'Most practitioners believe that when they file a refund claim, that refund claim has, at a minimum, reasonable basis,' Fisk said.

Fisk said that uncertainty over how long the IRS can assert the penalty continues to worry the tax bar. ''It's possible under the Service's interpretation of the statute that they could assert the penalty after a taxpayer has lost a refund claim in federal district court,'' or even in connection with a protective refund claim, she said. ''It seems to me that the IRS is unclear how to use the penalty consistent with the statute,'' which in turn has been a contributing factor to the lack of definitive guidance, she said.

Research Credit Targeted

A January 2009 IRS directive provides supplemental guidance on research credit claims within the Tier I designation and requires agents to address the applicability of the section 6676 erroneous refund penalty in all cases in which a section 41

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research credit claim is disallowed in part or in full. (For LMSB-4-0608-035, see *Doc 2009-1684* or *2009 TNT 15-17*.)

In response to the directive, examiners first took a fairly aggressive approach because of the requirement that a manager sign off on any decision not to assert section 6676 in a research credit refund claim. However, the attention to section 6676 penalties has waned, with few penalty assertions being made, practitioners say.

Many taxpayers are unaware of the penalty's existence, but it is ''certainly on practitioners' minds in advising clients making refund claims,'' Sadler said. In preparing refund claims, particularly in the research credit area, taxpayers have to ensure that the submitted factual content giving rise to the credit is sufficiently complete to avoid a penalty assertion, he said.

''The penalty affects the calculus of whether to make a refund claim, as it is less likely that a claim will be filed if the taxpayer and its advisers are on the edge of whether it is reasonable or not,'' Sadler said.

But Sadler said that reasonable basis is not a particularly hard standard to meet, so the penalty may have little effect on the number of refund claims being made by companies. ''This is a developing area of the law,'' he said. ''The IRS will probably become more comfortable in asserting section 6676 penalties over time.''

> ***'The penalty affects the calculus of whether to make a refund claim, as it is less likely that a claim will be filed if the taxpayer and its advisers are on the edge of whether it is reasonable or not,' Sadler said.***

Rocen said advisers are making clients understand that there must be real substance to a refund claim, whether pursued formally or informally, to avoid a significant penalty on the excess of the claim. ''The penalty alerts taxpayers to the fact that they cannot just be dropping refund claims on the IRS,'' he said, noting the unfair administrative burden the Service faces in ''plowing through claims to determine which ones are legitimate.''

Constitutional Concerns

One law firm, writing on behalf of a taxpayer who has been penalized under section 6676, recently warned Treasury and the IRS that assessment of the penalty could be unconstitutional and asked for guidance that takes into account the constitutional concerns. (For the letter, see *Doc 2012-12603* or *2012 TNT 114-15*.)

The letter's author, Derek T. Ho of Kellogg, Huber, Hansen, Todd, Evans & Figel PLLC, told Tax Analysts that one reason for the letter was to help prompt the government to give more precise guidance. ''Everyone is working in a vacuum right now because there are no regulations, and there remains a lot of uncertainty about what the standard is,'' he said. ''Section 6676(a) is meant to be a safe harbor by preventing application of the penalty when reasonable basis exists, but if the contours of reasonable basis are unclear, then it's not much of a safe harbor.''

> ***'Given that litigation to vindicate a federal tax position is one of the clearest, most unequivocal exercises of the right to petition, being penalized for that action' violates the Constitution, Ho said.***

The section 6676 constitutional concerns that Ho and his client raised center on the fundamental ''right to petition the government for redress of grievances, which is protected in all but the most exceptional circumstances, namely, when the petition is both frivolous and filed in bad faith and therefore deemed a sham,'' Ho said. There is tension between the tax code's traditional definition of reasonable basis and the First Amendment, which requires that taxpayers be permitted to seek adjudication of a refund claim without the threat of being penalized for exercising that right, he said.

''If Treasury defines reasonable basis as a petition that is something other than a sham, then section 6676(a) would fit'' within the legal precedent governing the First Amendment right to petition, Ho said. ''If a reasonable basis does not mean that, but rather is interpreted as requiring a higher showing of support for the taxpayer's position, then section 6676(a) runs into constitutional problems,'' he said, because the IRS is put in the position of imposing penalties for refund claims that are constitutionally protected. ''Our letter asks for a definition that tracks the constitutional requirements,'' he said.

The threat of a penalty is having a ''significant chilling effect on taxpayers who are contemplating filing a refund claim,'' even protective ones, Ho said. For example, when a taxpayer is involved in litigation with the IRS in federal court over an issue that spans several tax years, the taxpayer will likely want to file a protective refund claim pending the outcome of the litigation. However, the taxpayer will be deterred by the IRS's ability to impose a section 6676 penalty if the taxpayer loses the litigation and the IRS decides the taxpayer lacked a reasonable basis for seeking the refund claim.

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"Given that litigation to vindicate a federal tax position is one of the clearest, most unequivocal exercises of the right to petition, being penalized for that action" violates the Constitution, Ho said.

One practitioner has offered a technical argument for avoiding large refund penalties by asserting that taxpayers can claim a notional amount in the refund claim but perhaps increase the refund request once in litigation. If successful, that maneuver would limit the amount that could be assessed under a section 6676 penalty once the IRS disallowed it, yet theoretically allow the taxpayer to seek the full amount it believes should be refunded once the suit has been filed in federal district court. But most tax professionals view that as risky, because both the government and courts have sought to aggressively enforce the variance doctrine. (For the article, see *Tax Notes*, Nov. 14, 2011, p. 871, *Doc 2011-21754*, or *2011 TNT 221-13*.)

Conclusion

Guidance as a means of transparency is always appreciated, and tax professionals want more public details to ensure that the IRS doesn't abuse the excessive refund claim penalty by catching taxpayers by surprise. It's unclear whether the reg project under section 6676 would even address the substantive points that concern practitioners. A best-case scenario is that the IRS targets the penalty toward clear instances of taxpayers seeking illegitimate refunds and that taxpayers with a justifiable position don't get caught in the crossfire. Time will tell.■

Offshore FAQs Offer New Relief For U.S. Citizens Living Abroad

By Shamik Trivedi — strivedi@tax.org

The IRS on June 26 released a long-awaited update to frequently asked questions for the latest iteration of the offshore voluntary disclosure program (OVDP), tightening eligibility guidelines for interested taxpayers and announcing a plan to help U.S. citizens living abroad meet their filing responsibilities.

Practitioners welcomed the news, but some told Tax Analysts that the FAQs fell short of their expectations, given the long development time. (For the updated FAQs, see *Doc 2012-13612* or *2012 TNT 124-17*. For prior coverage of the third OVDP, see *Tax Notes*, Jan. 16, 2012, p. 276, *Doc 2012-445*, or *2012 TNT 6-1*.)

The IRS said in a news release that more than 33,000 taxpayers came forward under the first two disclosure programs, with the government collecting more than $5 billion. About 1,500 disclosures have been made so far under the third OVDP. (For IR-2012-64, see *Doc 2012-13611* or *2012 TNT 124-8*.)

"We continue to make strong progress in our international compliance efforts that help ensure honest taxpayers are not footing the bill for those hiding assets offshore," IRS Commissioner Douglas Shulman said in the release. "People are finding it tougher and tougher to keep their assets hidden in offshore accounts."

> ***'We continue to make strong progress in our international compliance efforts that help ensure honest taxpayers are not footing the bill for those hiding assets offshore,' said Shulman.***

Practitioners working with offshore issues have had a busy few weeks. On June 22 Treasury announced joint statements with Switzerland and Japan for implementing the Foreign Account Tax Compliance Act. Meanwhile, practitioners were scrambling to finalize and submit for clients Form TD F 90-22.1, "Report of Foreign Bank and Financial Accounts," which was due June 30. (For prior coverage, see *Tax Notes*, June 25, 2012, p. 1553, *Doc 2012-13291*, or *2012 TNT 121-1*.)

Pension and Nonresident Relief

The IRS announced a proposed new procedure intended to help U.S. citizens living abroad and dual citizens with low compliance risks become current on their income tax return filing obligations

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