

# CRS Report for Congress

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## **Taxpayer Bill of Rights 3: 1998 Tax Law Part 3: Attorneys' Fees and Damages for IRS Abuses**

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### **Summary**

This is one of a series of reports designed to analyze taxpayer protection and rights provisions made by the Taxpayer Bill of Rights 3, enacted as Title III of the IRS Restructuring and Reform Act of 1998, P.L. 105-206. This report discusses the provisions expanding a court's authority to award attorneys' fees and costs in certain cases and permitting a taxpayer to collect damages for negligent collection actions by IRS agents. Specific statutory changes include an increase in the previous statutory cap on attorney's fees, the provision of fees to accountants and enrolled agents, and the authority to pay fees for successful pro bono representation. These provisions are found in sections 3101 and 3102 of the statute and in IRC §§ 7430, 7433, and 7426.

The Taxpayer Bill of Rights 3, title III of P.L. 105-206, contains a number of provisions designed to strengthen taxpayer rights in dealings with the Internal Revenue Service. This report discusses the provisions expanding a court's authority to award attorneys' fees and costs in certain cases and permitting a taxpayer to collect damages for negligent collection actions by IRS agents. Section 3101 of the law liberalizes the rules on attorneys' fees in Internal Revenue Code §7430, and section 3102 permits taxpayers and third parties to collect damages for negligent actions of IRS collection agents under IRC §§ 7433 and 7426.

### **Attorneys' Fees and Costs**

Under prior law, any person who substantially prevailed in a tax case involving determination, collection, or refund of taxes, interest, or penalties could 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 could be awarded costs. The biggest component of reasonable costs is attorneys' fees, but reimbursement for attorneys' fees was limited to \$110 per hour (as adjusted for inflation). In certain cases,

a court could award more than \$110 per hour if the court found that a special factor justified a higher rate. In no case could reasonable costs exceed the amount actually paid or owed. Under prior law taxpayers could 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. Only actual costs could be reimbursed, which meant that taxpayers could not be awarded costs for representation by pro bono attorneys.

The Taxpayer Bill of Rights 3 made seven changes to IRC § 7430, the provision dealing with awards of costs. First, although the statutory cap on attorneys' fees was retained, judges are 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. The hourly rate cap was raised to \$125 per hour and will be adjusted for inflation.

Second, administrative costs can be awarded for fees incurred after 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 almost all administrative costs.

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 allows a court to award appropriate attorney's fees to those who undertake pro bono representation of taxpayers, providing the fee is paid to the attorney or the attorney's employer.

Fifth, in determining whether the position of the IRS was substantially justified, the court is 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, indicated that the court may also take into account whether the United States has won in courts of appeal for other circuits. The Senate report, S.Rept. 105-174, at 47, and the conference report, H.Rept. 105-599, at 243, are silent on this issue. This provision presents 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.

Sixth, a taxpayer will be treated 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. This provision does not apply to judgments issued pursuant to a settlement or to proceedings when the amount of the tax liability is not in issue (e.g., declaratory judgments, proceedings involving summons, actions to restrain disclosure under IRC § 6110(f)). The IRS will only be responsible for costs incurred on and after the date of the qualified offer. Seventh, a taxpayer may be awarded attorneys' fees, in addition to damages, if the taxpayer prevails in a case involving unauthorized inspection or disclosure of a tax return or tax return information under IRC § 7431.

The net worth requirements were not amended. These changes apply to costs incurred or pro bono services performed more than 180 days after July 22, 1998, i.e., after January 18, 1999.

## **Damages for Disregard of the Law by IRS Employees**

Under prior law, IRC § 7433, if an IRS officer or employee *recklessly or intentionally* disregarded the law while collecting the taxpayer's taxes, the taxpayer could sue the Government for the lesser of actual damages plus the costs of the suit or \$1 million. Damages could be reduced if the taxpayer did not exhaust available administrative remedies or if the taxpayer did not take reasonable steps to mitigate damages. Suit had to be brought in a U.S. district court within two years of the cause of action accruing. Under prior IRC § 7426, third parties whose property was wrongfully sold or levied on by the IRS could sue the IRS for up to \$1 million of damages if an IRS officer or employee *recklessly or intentionally* disregarded the law while collecting a taxpayer's taxes.

The Taxpayer Bill of Rights 3 expanded the authority to pay damages to include cases where the IRS causes a taxpayer or a third party economic damages because of *negligent* disregard of the Internal Revenue Code or regulations while collecting a taxpayer's taxes. Damages for negligence are limited to \$100,000 and both taxpayers and third-parties continue to have to exhaust available administrative remedies before a court can award any damages.

In addition to damages for violations of the law in regular tax collection actions, IRC § 7433 was amended to permit a taxpayer in bankruptcy to petition the bankruptcy court to recover damages against the IRS if an officer or employee of the IRS willfully violates the automatic stay provisions or the effect of discharge provisions of the bankruptcy code or bankruptcy regulations. Damages for violations of title 11 (the bankruptcy code) can be awarded by a bankruptcy court.

These provisions apply to actions of officers and employees of the Internal Revenue Service after July 22, 1998.