Manko v. Commissioner, 126 T. C. 195 (U. S. Tax Ct. 2006)

In Manko v. Commissioner, the U. S. Tax Court ruled that the IRS must issue a deficiency notice before assessing taxes when a closing agreement covers only specific items, not the entire tax liability. The court emphasized that taxpayers must be given the opportunity to challenge the IRS's computations before assessments are made. This decision underscores the importance of procedural safeguards in tax collection processes, ensuring taxpayers can litigate their tax liabilities in court before collection begins.

Parties

Bernhard F. Manko and his spouse, petitioners, sought review of the Commissioner of Internal Revenue's determination to proceed with a proposed levy to collect their federal income tax liabilities for 1988 and 1989. The Commissioner of Internal Revenue was the respondent in the case.

Facts

Bernhard F. Manko, a 99% partner in Comeo, entered into a closing agreement with the IRS on Form 906 regarding the treatment of Comeo items on their joint federal income tax returns for the years 1988 and 1989. This agreement did not cover all items affecting their tax liabilities for those years. After the agreement, the IRS assessed tax deficiencies without issuing a deficiency notice, despite ongoing examinations of other unrelated items. The IRS later sent multiple income tax examination changes adjusting the amounts owed by the petitioners, the latest in 2001. The petitioners terminated their consent to extend the assessment period in January 2003 and never received a deficiency notice or formally waived restrictions on assessment.

Procedural History

The petitioners timely requested a hearing after receiving a final notice of intent to levy. The IRS issued a notice of determination sustaining the proposed levy on December 1, 2004. The petitioners then filed a timely petition with the U. S. Tax Court, which had jurisdiction to review the determination notice under section 6330(d)(1)(B). The Tax Court reviewed the determination de novo regarding the underlying tax liability.

Issue(s)

Whether the Commissioner is required to issue a deficiency notice before assessing taxes for years subject to a closing agreement that covers the treatment of only certain items?

Rule(s) of Law

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Under section 6213(a) of the Internal Revenue Code, the Secretary generally may not assess a deficiency in tax unless the Secretary has first mailed a deficiency notice to the taxpayer and allowed the taxpayer to petition the Tax Court for a redetermination. Exceptions to this requirement include assessments arising from mathematical or clerical errors, tentative carryback or refund adjustments, or based on the receipt of a payment of tax (section 6213(b)). Additionally, a taxpayer may waive the restrictions on assessment (section 6213(d)). Closing agreements on Form 906 cover specific matters but do not conclusively determine a taxpayer's total tax liability for the year.

Holding

The Tax Court held that the Commissioner is required to issue a deficiency notice before assessing taxes for years subject to a closing agreement that covers the treatment of only certain items, not the entire tax liability for those years.

Reasoning

The court reasoned that a deficiency notice is crucial for providing taxpayers with procedural safeguards, allowing them to litigate their tax liabilities before the IRS makes an assessment and initiates collection proceedings. The court distinguished between the two types of closing agreements: Form 866, which determines a taxpayer's final liability for a year, and Form 906, which covers specific matters but not the entire liability. Since the closing agreement in this case was on Form 906 and did not cover all items affecting the petitioners' tax liabilities, the IRS could not dispense with the deficiency notice requirement. The court emphasized that the petitioners were deprived of the opportunity to challenge the IRS's computations and argue for other adjustments without a deficiency notice. The court also clarified that their holding did not allow the petitioners to challenge the terms of the closing agreement itself, which remained binding.

Disposition

The Tax Court ruled that the Commissioner may not proceed with collection of the petitioners' tax liabilities for 1988 and 1989 because the IRS failed to issue the required deficiency notice before assessment.

Significance/Impact

This case is significant for reinforcing the procedural rights of taxpayers in tax assessments, particularly when a closing agreement covers only specific items. It clarifies that a deficiency notice remains necessary to allow taxpayers to challenge the IRS's computations before assessment, even if a closing agreement has been executed. This ruling impacts IRS practices in tax collection and underscores the importance of the deficiency notice as a safeguard against unilateral assessments. It also highlights the distinction between different types of closing agreements and

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their effects on tax assessments and collection processes.

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