Can Taxpayers Rely on IRS Form Instructions?

By Dashiell C. Shapiro


Dashiell C. Shapiro

Dashiell C. Shapiro is of counsel with Wood LLP in San Francisco (http://www.WoodLLP.com) and was previously a trial attorney with the Justice Department Tax Division. He would like to thank Robert W. Wood for his helpful comments on previous drafts. This discussion is not intended as legal advice and cannot be relied on for any purpose without the services of a qualified professional.

In this article, Shapiro argues that taxpayers can sometimes rely on IRS form instructions and that there must be limits on the IRS's power to mislead taxpayers with informal publications.

Taxpayers sometimes claim that a position is justified by language in an IRS form instruction or IRS publication. Depending on the specifics and exactly what the words say, this can be a terribly sympathetic position. Unfortunately, this argument often lacks merit and is used to justify ill-considered positions.

When a taxpayer claims to rely on form instructions, the government regularly responds with a long line of opinions stating that the only authoritative sources of tax law are official statutes, regulations, and judicial opinions.[1] This is generally correct, and there is a wealth of authority on the government's side.[2] Sometimes the taxpayer simply misunderstands the form instructions.[3] In other cases, the taxpayer has a plausible interpretation of the instructions, but the courts still hold for the IRS.

The following show some situations in which courts have rejected taxpayers' attempts to rely on IRS form instructions:

- Taxpayer claimed that a settlement payment was not subject to FICA taxes because an IRS publication said that settlement proceeds should be reported as "Other Income" on line 21 of Form 1040.[4]
- Taxpayer claimed that his resident housekeeper was an independent contractor because an IRS publication stated that "individuals who furnish personal attendance, companionship, or household care services to children," and who are not employees of a placement service, "are generally treated as self-employed for all federal tax purposes."[5]
- Taxpayer claimed that when he filed his return, an IRS publication and a revenue ruling supported his position that a deduction for educational expenses need not be reduced by the amount of benefits paid by the Veterans Administration.[6]
- Taxpayer claimed that his contributions to an IRA were not subject to excise tax, based on language in an IRS publication suggesting that

[1]*See, e.g.*, *Montgomery v. Commissioner*, 127 T.C. 43, 65 (2006) ("It is settled law that taxpayers cannot rely on [IRS] instructions to justify a reporting position otherwise inconsistent with controlling statutory provisions."); *Johnson v. Commissioner*, 620 F.2d 153 (7th Cir. 1980); *Aldridge v. Commissioner*, 51 T.C. 475 (1968).

[2]*United States v. Hom*, 45 F. Supp.3d 1175 (N.D. Cal. 2014); *Houlberg v. Commissioner*, T.C. Memo. 1985-497; *Graham v. Commissioner*, T.C. Memo. 1995-114; *Seely v. Commissioner*, T.C.

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Memo. 1986-216; *McGuire v. Commissioner*, T.C. Memo. 1983-261; *Umstead v. Commissioner*, T.C. Memo. 1982-573; *Besch v. Commissioner*, T.C. Memo. 1982-15; *Hames v. Commissioner*, T.C. Memo. 1983-532; *Clark v. Commissioner*, T.C. Memo. 1966-22.

[3]*Casa de la Jolla Park Inc. v. Commissioner*, 94 T.C. 384, 396 (1990); *Zimmerman v. Commissioner*, 71 T.C. 367 (1978); *Green v. Commissioner*, 59 T.C. 456 (1972); *Trull v. Commissioner*, T.C. Summ. Op. 2001-168; *Cramer v. Commissioner*, T.C. Summ. Op. 2003-2; *Torre v. Commissioner*, T.C. Memo. 2001-218; *Seabury v. City of New York*, 97 A.F.T.R. 2d 2561 (E.D.N.Y. 2006); *Taylor v. United States*, 57 Fed. Cl. 264 (2003).

[4]*Gerstenbluth v. Credit Suisse Sec. (USA) LLC*, 728 F.3d 139 (2d Cir. 2013) ("This informal advice hardly amounts to a concession as to the appropriate treatment for FICA purpose.").

[5]*United States v. Josephberg*, 562 F.3d 478, 498 (2d Cir. 2009) (statement in publication "could not reasonably be taken at face value").

[6]*Manocchio v. Commissioner*, 710 F.2d 1400, 1402-1403 (9th Cir. 1983) (retroactive application of rule was "not an abuse of discretion").

he may contribute to an IRA if he was not an active participant ''during any part of the tax year.''[7]

- Taxpayer claimed that he was a foreign resident despite living in the United States, citing a Treasury Department ''Tax Guide for U.S. Citizens Abroad,'' which suggested all he needed was a clear intention to return to his country of origin.[8]
- Taxpayer claimed that an IRS handbook on domestic international sales corporation rules, published after the statute had gone into effect but before domestic international sales corporation regulations had been issued, was controlling.[9]
- Taxpayer claimed that a court order regarding custody entitled her to take a dependency exemption, when the instructions in forms 501 and 504 were ''less than clear and may even be misleading,'' although the statute required the custodial parent to sign a release.[10]

In most instances, taxpayers lose these fights even if they have a credible reading of the form instructions.[11] Nevertheless, it is worth asking whether the weight of authority means that taxpayers can *never* cite form instructions, as the IRS claims. As is so common with blanket statements in our Byzantine tax system, it is not true in every case.

In fact, courts have held the government to its informal publications when the instructions clearly contradicted the government's litigating position.[12] (''How could it be otherwise?'' a taxpayer might ask.) It is hard to dispute the notion that simple words in IRS form instructions must be part of IRS tax law.

Could a toy manufacturer escape liability by arguing that its instructions on how to assemble the toy are irrelevant and not part of the product? In that sense, it is worth revisiting the issue of form instructions despite the IRS's position that its own instructions are simply irrelevant.

The key taxpayer victory on the issue of form instructions, *Wilkes v. United States*, is more than 15 years old. But apparently, no other court has cited *Wilkes* on that point.[13] And with each successive repetition, the government's ''established principle'' that form instructions are irrelevant appears more solid, overwhelming, and uncontroverted. Yet, the reality is less one-sided. How did this situation come to be?

Tax Litigation Favors the Government

In a tax dispute, the odds are stacked against the taxpayer. In civil and criminal tax cases, the IRS tends to have the upper hand. Lawyers working at the Department of Justice Tax Division and at the IRS are accustomed to winning: Remarkably, the Tax Division's success rate is greater than 90 percent.[14]

In fact, the Justice Department touts its solid numbers as having ''an enormous effect on voluntary tax compliance.'' That is surely true, because our tax system is mostly one of self-assessment. Self-assessment works best when there is at least some fear of audit and an assumption that if there is an audit, the taxpayer may have a tough burden to carry.

However, a high success rate can have downsides. In particular, it can make at least some government lawyers overconfident about their positions. It might even make some overeager in applying authorities to support their positions.

That is entirely understandable. For one thing, government tax lawyers frequently contend with a large docket of cases. And although they do their best to consider cases individually, many cases seem generic and some border on being frivolous.[15]

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[7]*Johnson v. Commissioner*, T.C. Memo. 1978-426 (''Even though we assume that Publication 590 may be read as petitioner reads it, the statute . . . and the proposed regulations . . . are clearly to the contrary.'').

[8]*Carpenter v. United States*, 495 F.2d 175, 184 (5th Cir. 1974) (''We sympathize with the taxpayer who in fact relies upon what he accepts as an authoritative interpretation of the law and of the Treasury publications. But nonetheless it is for the Congress and the courts and not the Treasury to declare the law applicable to a given situation.'').

[9]*Caterpillar Tractor Co. v. United States*, 589 F.2d 1040, 1043 (Fed. Cir. 1978) (''It is hornbook law that informal publications all the way up to revenue rulings are simply guides to taxpayers, and a taxpayer relies on them at his peril.'').

[10]*Miller v. Commissioner*, 114 T.C. 184, 195 (2000) (''The authoritative sources of Federal tax law are the statutes, regulations, and judicial decisions; they do not include informal IRS publications.'').

[11]*See, e.g.*, *Sherwin-Williams Co. Employee Health Plan Trust v. Commissioner*, 115 T.C. 440, 451 (2000) (acknowledging that the instructions to Forms 990-T ''are not as clearly stated as section 512(a)(3)(B)'' but that ''we are not bound by the instructions''); *rev'd*, 330 F.3d 449 (6th Cir. 2003).

[12]*See Wilkes v. United States*, 50 F. Supp.2d 1281, 1287 (M.D. Fla. 1999).

[13]*Id.*

[14]Department of Justice Tax Division, ''U.S. Department of Justice FY 2013 Congressional Budget,'' at 2 n.2 (Feb. 1, 2012).

[15]*See, e.g.*, National Taxpayer Advocate, ''2014 Annual Report to Congress'' (Jan. 14, 2015), most litigated tax issues. The top 10 most litigated issues were: (1) accuracy-related penalty (section 6662(b)(1), (2), and (3)); (2) trade or business expenses; (3) summons enforcement (sections 7602(a), 7604(a), and 7609(a)); (4) gross income (section 61 and related code sections); (5) collection due process hearings (sections 6320 and 6330); (6) failure to file penalty (section 6651(a)(1)), failure to pay penalty (section 6651(a)(2)), and failure to pay estimated tax penalty (section 6654); (7) civil actions to enforce federal tax liens or to

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Bad Cases Can Make Bad Law

The aphorism that ''bad cases make bad law''[16] might be particularly true regarding tax law. The consequences of that bad law can be serious. When one considers any rule — including the notion that one cannot rely on the IRS's own instructions — how did it come about that contrary authority was not even cited?

Part of the explanation might be that many Tax Court cases involve individuals proceeding pro se. That is a separate, but still worrisome, subject. The taxpayer advocate's recent study of the most commonly litigated issues in Tax Court reported that 62 percent of taxpayers in those cases represented themselves.[17]

Without counsel to point out contrary authority in many cases, Tax Court opinions often read as though there is none. The judges try to do their best in these difficult settings. However, pro se cases are certainly not the whole story. Not all cases involve pro se litigants, and the courts have a role to play as well.

Whether pro se or with counsel, taxpayers should be concerned and alert. When IRS attorneys insist that a particular position is an established principle of tax law, everyone's spider sense should perk up. Tax Court judges should also be on guard. There might be contrary authority that could call into question the IRS's case, and indeed there often is.

Taxpayers Cannot Rely on Form Instructions?

In one oft-cited case, *Adler v. Commissioner*,[18] the Ninth Circuit rejected the taxpayer's attempt to claim he was ''misled'' by language in an IRS pamphlet into thinking that his dancing lessons were deductible. The taxpayer argued that the pamphlet was misleading because it used the phrase ''medical expenses'' rather than ''medical care.'' The Ninth Circuit noted that language in government pamphlets cannot ''act as an estoppel against the government, nor change the meaning of taxing statutes; any more than a dance studio manager can bind the government in its effort to collect taxes.''

Similarly, in *Green v. Commissioner*,[19] the taxpayer claimed that language in an IRS publication entitled him to deduct commuting expenses. The court noted that even if the publication should be read the way the taxpayer urged, ''it is clear that the sources of authoritative law in the tax field are the statute and regulations, and not informal publications such as 'Your Federal Income Tax.''' The Tax Court went on to note that the taxpayer's reading was not reasonable.

The court said the taxpayer's strained reading placed ''excessive reliance on the few words he selects from 'Your Federal Income Tax,' and ignores the clear purport of the booklet as a whole.'' Bad facts do make bad law, and perhaps taxpayers trying to rely on form instructions might be unusually prone to have bad facts. But what about a taxpayer with *good* facts, one who legitimately relies on instructions in an IRS publication?

Not every case of a taxpayer relying on form instructions or an IRS publication involves a misreading of the words. The IRS does make mistakes and misstatements, and in the right circumstances, there should be consequences. Regardless of whether the government's conduct is intentional, innocent, or somewhere in between, Joe Taxpayer is sometimes correct in relying on his reading of an IRS publication.

In short, there *must* be limits on the IRS's power to mislead and misrepresent. And despite the long line of cases that say taxpayers cannot rely on instructions, there is indeed contrary authority.

Yes, You Can Rely on IRS Instructions

A key case supporting the taxpayer's right to rely on form instructions is *Wilkes v. United States*.[20] In *Wilkes*, the IRS sought to hold an estate's executor liable for unpaid estate taxes. The executor had previously sold the estate's stock shares to an employee stock ownership plan and believed that doing so had discharged him from liability.

The executor pointed to the instructions for Form 706 as support for his position. The form instructions stated that ''if you properly make this election, part or all of the estate's tax liability . . . will be assumed by an employee stock ownership plan.'' The IRS, however, had claimed that the executor could still be liable even after transferring funds to an ESOP.

The court noted that the IRS's position was inconsistent with the statute, the legislative history, and the form instructions, all of which indicated that making the ESOP election would relieve the executor of liability. The court clearly acknowledged that the form instructions were not dispositive. Nonetheless, the court appropriately stated that ''general principles of equity dictate that the IRS should not be allowed to issue instructions for completing its forms and later disavow those instructions.''

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subject property to payment of tax (section 7403); (8) frivolous issues penalty (section 6673 and related appellate-level sanctions); (9) charitable deductions (section 170); and (10) passive activity losses and credits (section 469).

[16]*See, e.g.*, *United States v. Monea Family Trust I*, 626 F.3d 271 (6th Cir. 2010); *Haig v. Agee*, 453 U.S. 280 (1981).

[17]*See supra* note 15.

[18]330 F.2d 91 (1964).

[19]59 T.C. 456, 458 (1972).

[20]50 F. Supp.2d 1281.

The court also questioned the government's citing *Zimmerman v. Commissioner*.[21] That case held that informal publications of the IRS are not authoritative. The court noted that other cases have given form instructions "more weight than Defendant's reading of *Zimmerman* would allow."

The *Wilkes* opinion shows that the IRS's own instructions to its forms can indeed be cited to support a tax position. Especially if the law is unclear on a particular issue, the IRS's own form instructions could be particularly instructive. Form instructions can aid in legal interpretation, yet *Wilkes* also appropriately raises issues of equitable estoppel.

Plainly, *Wilkes* does not mean that the IRS is bound by any statement in an informal publication. Presumably it all depends on the facts of a particular case. There is a large gap between the attempted medical deductions for dancing lessons in *Adler* and the sympathetic facts of the *Wilkes* case. Such a range of authority, rooted in distinguishable factual situations, is common in the law.

Perhaps it is even more common in the enormously varied and often quite colorful nuances of the tax law. What is odd — *quite* odd — is that later opinions do not even *mention Wilkes*. There is no "*but see*" or "*cf.*" citation in the many subsequent Tax Court opinions or other federal tax cases concluding, almost by rote, that taxpayers *cannot* rely on form instructions.[22] The notion that taxpayers cannot rely on form instructions is simply brought down as a bedrock principle of the tax law.

The reality is (and should be) more conflicted. Beyond the reasoning of *Wilkes*, other authority supports holding the government to statements in its informal publications. For example, in *Paige v. Harris*,[23] the Seventh Circuit indicated that some internal rules of the Department of Housing and Urban Development establishing personnel policies and procedures might be binding on HUD.[24] In a later case, the Seventh Circuit cited *Paige* and noted that in proper circumstances, a federal agency can be bound by its own regulations even though those regulations merely establish internal operating procedures.[25] When an agency issues instructions to the public, as is the case with IRS form instructions, the argument seems even stronger for holding the government to its words.

The IRS might claim that those cases are outside the tax context and therefore irrelevant. Yet the trend, both in the courts and within the academy, has been increasingly to recognize that there is no "tax exceptionalism" when it comes to administrative law.[26] As these cases show, there is authority for citing IRS form instructions in the right circumstances.

The Blame Game

When the government says something is "established authority," it is as if it is saying that everyone knows it is true. This can lead to confirmation bias and flawed legal reasoning.[27] Tax litigation presents a particularly challenging situation. Many participants are pro se litigants, yet the subject matter is deeply complex, and the relevant authorities are often quite difficult to find.

In fact, the IRS might not even be aware of the contrary authority. If it is, the IRS might be understandably hesitant to cite it. Pro se litigants in tax cases can be quick to cling like a terrier to any potentially favorable authority, even if it is a decided outlier. The IRS (and the courts) often do not want to be bombarded with more voluminous and incoherent argumentation.

Yet, when legitimate contrary authority goes unnoticed and unmentioned, even by courts, it becomes a serious problem. Arguably, it undermines the legitimacy of the tax law and can distort results for deserving taxpayers as well. If individual taxpayers are expected to be familiar with all relevant statutes, regulations, and judicial opinions, arguably the government's tax lawyers should be too.

Form instructions are relevant to tax law and tax administration, even if they are not technically part of the tax law. And occasionally the IRS should be held to them even if it argues otherwise. But the more important lesson is that taxpayers and their counsel should be careful in litigation against the government and should always look for outlier cases that support their position. They are often waiting to be found.

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[21]71 T.C. 367 (1978).

[22]*See, e.g.*, *Gerstenbluth*, 728 F.3d 139; *Josephberg*, 562 F.3d 478; *Seabury*, 97 A.F.T.R. 2d 2561; *Taylor*, 57 Fed. Cl. 264, 266; *Sherwin-Williams*, 115 T.C. 440, 451; *Miller*, 114 T.C. 184, 195; *Trull*, T.C. Summ. Op. 2001-168; *Cramer*, T.C. Summ. Op. 2003-2; *Torre*, T.C. Memo. 2001-218.

[23]584 F.2d 178 (7th Cir. 1978).

[24]*Id.* at 185.

[25]*Bartholomew v. United States*, 740 F.2d 526, 530-531 (7th Cir. 1984).

[26]*See, e.g.*, *Mayo Foundation for Medical Education and Research v. United States*, 562 U.S. 44 (2011); Gene Magidenko, "Tax Exceptionalism: Wanted Dead or Alive," *U. Mich. J.L. Reform*, Vol. 45, Issue 1 (2012); Kristin E. Hickman, "The Need for *Mead*: Rejecting Tax Exceptionalism in Judicial Deference," 90 *Minn. L. Rev.* 1537 (2006); Roger Dorsey, "*Mayo* and the End of 'Tax Exceptionalism' in Judicial Deference," 87 *Prac. Tax Strategies* 63, 63 (2011).

[27]*See, e.g.*, R.S. Nickerson, "Confirmation Bias: A Ubiquitous Phenomenon in Many Guises," 2 *Rev. of Gen. Psychol.* 175-220 (1998).