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unable to recover these costs because, as of the date these costs were incurred, A had not presented relevant information under A's control and relevant legal arguments supporting A's position to the appropriate Internal Revenue Service personnel. Accordingly, the position of the Internal Revenue Service was substantially justified at the time the costs were incurred.

Example 2. In the purchase of an ongoing business, taxpayer B obtains from the previous owner of the business a covenant not to compete for a period of five years. On audit of B's individual income tax return for the year in which the business is acquired, the Internal Revenue Service challenges the basis assigned to the covenant not to compete and a deduction taken as a business expense for a seminar attended by B. Both parties agree that the covenant not to compete is amortizable over a period of five years. However, the Internal Revenue Service asserts that the proper basis of the covenant is $2X while the taxpayer asserts the basis is $4X. Thus, under the Internal Revenue Service's position, B is entitled to a deduction of two-fifths $X in the year under audit and for each of the subsequent four years. B's position, however, would result in a deduction of four-fifths $X for the year under audit and each of the subsequent four years. The deduction for the seminar attended by B was reported on the return in question in the amount of $X. The Internal Revenue Service's position is that the deduction for the seminar should be disallowed entirely. In the notice of deficiency, the Internal Revenue Service determines adjustments of two-fifths $X (the difference between the Internal Revenue Service's position of two-fifths $X and the reported four-fifths $X) regarding the basis of the covenant not to compete, and $X resulting from the disallowance of the seminar expense. Thus, of the two adjustments determined for the year under audit, that attributable to the disallowance of the seminar is larger than that attributable to the covenant not to compete. However, due to the impact on the next succeeding four years, the covenant not to compete adjustment is objectively the most significant issue to both B and the Internal Revenue Service.

Example 3. The Collection Branch of a Service Center of the Internal Revenue Service determines in the matching process of various Forms 1099 and W–2 that taxpayer C has not filed an individual income tax return. The Internal Revenue Service sends notices to C requesting that C file an income tax return. C does not file a return, so the Service Center's Collection Branch prepares a substitute for return pursuant to section 6020(b). The calculation is sent to C requesting that C either sign the return pursuant to section 6020(a) or file a tax return prepared by C. C does not respond to the Internal Revenue Service's request and the Service Center's Collection Branch issues a notice of deficiency based on information in its possession. C does not file a petition with the Tax Court and does not pay the asserted deficiency. The Internal Revenue Service then assesses the tax shown on the notice of deficiency and issues a notice and demand for tax pursuant to section 6303. After receiving notice and demand, C contacts the Collection Branch and convinces Collection to stay the collection process because C does not owe any taxes. The Collection Branch recommends that the Examination Division examine the tax liability and make an adjustment to income. The Examination Division then redetermines the tax and abates the assessment due to information and arguments presented by C at that time. The costs C incurred before the Collection Branch are incurred in connection with an action taken by the Internal Revenue Service to collect a tax. Therefore, these costs are incurred with respect to a collection action and not an administrative proceeding. Accordingly, they are not recoverable as reasonable administrative costs. Costs incurred before the Examination Division are reasonable administrative costs; however, C may not recover any reasonable administrative costs with respect to the proceeding before the Examination Division because, as of the date the costs were incurred, C had not previously presented all relevant information under C's control and all relevant legal arguments supporting C's position to the Collection Branch or Examination Division personnel (the appropriate Internal Revenue Service personnel under § 301.7430–5(c)), and thus, the position of the Internal Revenue Service was substantially justified based upon the information it had.

[T.D. 8542, 59 FR 29364, June 7, 1994]

§ 301.7430–6 Effective date.

Sections 301.7430–0, and 301.7430–2 through 301.7430–6, other than § 301.7430–2(c)(5), apply to claims for reasonable administrative costs filed with the Internal Revenue Service after December 23, 1992, with respect to costs incurred in administrative proceedings commenced after November 10, 1988. Section 301.7430–2(c)(5) is effective March 23, 1993.

[T.D. 8542, 59 FR 29366, June 7, 1994]

§ 301.7432–1 Civil cause of action for failure to release a lien.

(a) *In general.* If any officer or employee of the Internal Revenue Service knowingly, or by reason of negligence, fails to release a lien on property of the taxpayer in accordance with section