Taking Off the Gloves: What to Expect in U.S. Tax Court

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Structure

- Article I court, n/ an Article III court
- Largely self-governing
- 19 Tax Court judges appointed by the President w/ the advice and consent of the Senate, each for a 15-year term
- The Chief Judge of the Tax Court can appoint "special trial judges" to hear "small tax cases" – those under a specified dollar amount – as well as any case assigned to them by the Chief Judge

Procedures

- Tax Court is based in Washington, D.C., but its judges travel to hear cases on regular calendars in various cities around the country
- At trial, TP may be represented by anyone admitted to practice before the Tax Court, which includes non-attorneys who have *passed an exam*
- IRS is represented in Tax Court by attorneys from the IRS Chief Counsel's Office
- U.S. Tax Court applies the rules of evidence applicable in trials w/o a jury in the U.S. District Court of the District of Columbia
- U.S. Tax Court follows its own procedural rules

Opinions & Decisions

- After the case has been submitted, the Tax Court makes a report in the form of an opinion. The decision is the U.S. Tax Court *equivalent* of a judgment in the federal district court in the sense that it closes the case and is the action from which an appeal is taken

Opinions & Decisions

- Tax Court issues *three* types of opinions:
  - Division Opinions,
  - Memorandum Opinions,
  - Summary Opinions in small tax cases

Opinions & Decisions

- **Division Opinions**
  - Have precedential value and are officially published
  - Tax Court's *first* pronouncement on a question of law
  - Court-reviewed cases: Chief Judge can refer a Division Opinion for review by the entire court. This means that the Tax Court judges can reconsider the case in conference after reviewing the written record. Such opinions are labeled "reviewed by the court"

Opinions & Decisions

- **Memorandum Opinions**
  - Have no official precedential value, but are privately published
  - Apply clear law to new facts

Opinions & Decisions

- **Summary Opinions in small tax cases**
  - Have no precedential value but are privately published

Opinions & Decisions

- Chief judge decides whether to issue a decision as a Division Opinion or Memorandum Opinion
- **Stipulated decisions**: If TP and the IRS settle a case after it is docketed w/ the Tax Court, the settlement is entered by the court as a *stipulated decision*
- **No voluntary dismissal**: Once TP commences a case in Tax Court, only the court can *remove* the case from its jurisdiction

Appeals of Tax Court Decisions

- Appeal from a Tax Court decision is taken by filing the notice of appeal w/ the Tax Court within *90 days of the decision*
- **Appellate venue**: Tax Court appeals are taken to the Court of Appeals for the circuit in which the TP resided *at the time he filed the Tax Court petition*

Appeals of Tax Court Decisions

- Appeal of *fewer* than all tax years
  - Issue: Does a Court of Appeals have *jurisdiction* over a matter in which certain tax years have been disposed of by the Tax Court (and appealed) while others remain undecided?
  - Third Circuit rule: A judgment disposing of *less* than all claims is *not* appealable unless it is accompanied by a determination that the order is final and that there is no just reason to delay

Appeals of Tax Court Decisions

- Deference to tax court decisions
  - Review of Tax Court decisions are comparable to review of district court decisions: “U.S. Court of Appeals has exclusive jurisdiction to review the decisions of the Tax Court … in the same manner and to the same extent as decisions of the district courts in civil actions tried without a jury”
  - But Congress did n/ repeal the predecessor of Code section 7482(c)(1) which suggests that appellate courts do n/ have the power to modify or reverse the Tax Court’s findings of fact

Tax Court's Jurisdiction & Caseload

- U.S. Tax Court has *jurisdiction* over:
  - Cases involving tax deficiencies,
  - Overpayment claims,
  - Declaratory judgment actions (e.g. tax-exempt status of an organization),
  - Disclosure actions,
  - Actions for relief of joint and several liability, and
  - Collection due process cases ("Lien and levy actions")

Notice of Deficiency

- Notice of deficiency is the TP's "ticket" to Tax Court's jurisdiction: Tax Court jurisdiction over federal tax deficiencies is based on a notice of deficiency mailed by the IRS to the TP
- Definition of *deficiency*: TP's correct tax liability as determined by the IRS *less* the amount reported on the return

Notice of Deficiency

- **The Notice**
  - The determination and explanation: Should "describe the basis for, and identify the amounts (if any) of, the tax due, interest, additional amounts, additions to the tax, and assessable penalties included in such notice."

Notice of Deficiency

- Procedural requirements
  - Date to file a petition: ’98 Restructuring Act imposes a requirement that the notice of deficiency state the latest date for TP to file the Tax Court petition. Courts have held that the IRS’s failure to meet this requirement does n/ render the notice of deficiency fatally defective, so a TP receiving a notice w/in the 90-day period that does n/ contain the latest date to file the petition *must still file the petition timely*

Notice of Deficiency

- Notice of Taxpayer Advocate's Office: The notice should advise TP of the right to contact the Taxpayer Advocate's Office and the location and phone number of the office

Notice of Deficiency

- Last Known Address Requirement
  - Notice must be sent to TP's *last known address*. Code does n/ require TP to *actually* receive the notice of deficiency b/c it would be virtually impossible for the Commissioner to prove that TP actually received it
  - Why is the last known address requirement so important? If TP does n/ receive the notice or receives it late, TP cannot file a petition in the U.S. Tax Court, and the legal predicate to a prepayment remedy will fail b/c the IRS will then assess and require payment b/c no petition was filed to continue prohibition on assessment

Notice of Deficiency

- Courts require the IRS to check its most recent computer records to determine the last known address. Generally, the last known address will be the address on TP's latest properly filed and processable tax return
- **Exception to invalidity of improperly addressed notice of deficiency**: Even if the address *fails* the last known address requirement, if TP *actually* receives the notice within sufficient time to petition the Tax Court, then the notice of deficiency is still valid!

Notice of Deficiency

- Explanation of the basis for the deficiency: Deficiency notices must describe the basis for the deficiency but failure to do so will n/ invalidate the deficiency. TP has a statutory *right* to the information in the notice of deficiency, but no statutory *remedy* if he does n/ receive it in the notice

Notice of Deficiency

- Consequences of invalidity of the notice
  - If the notice of deficiency is invalid or never sent for any reason, any assessment requiring a notice as a predicate is likewise invalid. In other words, TP can assert that a subsequent assessment is *invalid*.

Notice of Deficiency

- Prohibition on assessment
  - If TP decides to litigate in Tax Court, there will be no assessment while litigation in the Tax Court is pending
  - If TP does n/ litigate in the Tax Court, the IRS will make the assessment *after the 90-day period expires*

Tax Court Pleading Requirements

- To initiate litigation, TP must file a petition w/ the Tax Court for a re-determination of the deficiency.
- TP need n/ pay the amount in dispute in order to obtain Tax Court jurisdiction.
- TP can also claim in the petition a *refund* of an overpayment.
- NOTE WELL: If TP is only filing a claim for refund and there is *no deficiency involved*, then TP must file that refund claim in *federal district court*.

Tax Court Pleading Requirements

- The petition is a “notice” pleading that should be a summary statement to fairly notify the IRS as to the matters TP contests

Tax Court Pleading Requirements

- Tax Court rules provide a checklist of the matters the petition should contain:
  - A copy of the Notice of Deficiency (or Notice of Determination);
  - Statement of Taxpayer Identification Number;
  - Request for place of trial; and
  - $60 filing fee
  - Note: Tax Court rules protect taxpayer privacy by *excluding* from the public record a TP's social security number or Employer Identification Number and other private information

Tax Court Pleading Requirements

- The Court serves the petition on the Commissioner.
- The Commissioner must file an answer within 60 days.
- The purpose of the answer is to notify TP which of the issues raised in the petition are in dispute.
- TP must file a reply to matters raised in the Commissioner's answer as to which the Commissioner bears the burden of proof

Tax Court Pleading Requirements

- A Tax Court case will be *dismissed* if TP is sent a valid notice of deficiency but files his petition late!

New Matters

- New matters raised *in answer*
  - IRS can raise new matters in its answer that:
    - Increase the amount of the deficiency on a basis n/ asserted in the notice of deficiency, or
    - Justify the deficiency asserted on some basis n/ asserted in the notice of deficiency

New Matters

- The IRS can seek additional taxes n/ previously asserted b/c the SOL is suspended during the period the Tax Court case is pending (e.g. suspended from date the notice of deficiency is issued)

New Matters

- New matters raised *after IRS has filed its original answer*
  - IRS's ability to raise new issues after its original answer is limited by rules of fairness. If IRS asserts new matters *after filing its original answer*, it must *amend* the original answer. New issues cannot be injected so late in the process that they deny TP an effective opportunity to respond.
  - IRS bears the burden of proof w/ respect to new matters

New Matters

- New theories or grounds are NOT new matters
- What's good for the goose is good for the gander! TP can also raise new issues. If so, he will carry the burden

Discovery in Tax Court

- Discovery is more limited in Tax Court than in the federal district courts
- *Branerton* rule: Interrogatories and other discovery procedures, such as requests for admissions and depositions, are available in Tax Court. However, they are available only if necessary after the parties have conducted discovery through informal means.
- Letters making an informal request for information or for a conference to communicate informally have become known as *Branerton* letters

Discovery in Tax Court

- Tax Court relies heavily on *stipulation of facts*
  - Stipulations represent the parties' agreement as to the facts and law in the case
  - Parties to a Tax Court case are required to stipulate to the facts to the *fullest extent possible*. This includes stipulations of the evidence, so that key documents such as tax returns typically are attached to the stipulation of facts as exhibits
  - A party may move to compel the other party to stipulate, however, that motion must be filed *no later than 45 days before trial* for it to be dealt with

Pre-trial Memorandum

- Each party must submit a *short pretrial memo* alerting the Court as to the general issues to be tried and any problems that the party anticipates to develop at trial

Briefing

- At the end of trial, the judge will set a briefing schedule for the parties and take the case under advisement. The briefing will include detailed proposed findings of fact and legal arguments

Precedent Applicable to Tax Court Cases

- Issue # 1: What legal *precedent* applies in Tax Court cases – Tax Court precedent or Court of Appeals precedent?
- Rule: Tax Court cases are appealable to the Court of Appeals for the circuit in which TP resided *at the time he filed his Tax Court petition*. Under *Golsen*, if that circuit has precedent "**squarely on point**," then that precedent applies in Tax Court and the Tax Court decision would be constrained by that circuit's binding precedent.

Precedent Applicable to Tax Court Cases

- Net effect of *Golsen* rule: If two similar cases are governed by conflicting court of appeals precedent, *Golsen* allows the possibility of inconsistent Tax Court decisions

Precedent Applicable to Tax Court Cases

- Issue # 2: What if the circuit of TP's residence does NOT have legal precedent squarely on point?
- The *Golsen* rule permits the Tax Court to follow *its own precedent* despite contrary precedent in other circuits. This is radically different to the position that some courts of appeals take – that in the *absence* of that circuit court having spoken on the issue, that court should give *respectful consideration* to other circuits' decisions because of the importance of *uniformity* (i.e., stare decisis)

Precedent Applicable to Tax Court Cases

- Strategy
  - In deciding whether the Tax Court is a favorable or unfavorable forum, TP must look n/ only to the precedent of the Tax Court but also to the *precedent of the court of appeals to which an appeal may be taken*.
  - Unfavorable Tax Court precedent but favorable appellate court precedent will produce a winner in the Tax Court

Tax Court's Small Tax Case Procedure

- An elective, informal procedure for cases involving relatively *small amounts of money*
- For deficiency cases, this small tax procedure is available if neither the deficiency placed in dispute nor any claimed overpayment *exceeds $50K for any one taxable year*

Tax Court's Small Tax Case Procedure

- Obtaining eligibility to elect the small tax case procedure in deficiency cases
  - TP can concede amounts that exceed the jurisdictional cap
  - E.g. If a notice of deficiency reflects a deficiency of $55K, TP can concede $5K of it and be eligible to have the case heard under the small tax case procedure

Tax Court's Small Tax Case Procedure

- TP has the option to elect the small tax case procedure, so long as the Tax Court agrees. The Tax Court will agree to the designation as a small tax case *unless* the case involves a recurring issue for which precedent is needed

Tax Court's Small Tax Case Procedure

- Differences between S cases and regular cases
  - There is no appeal from an S case,
  - S case opinions have no precedential value,
  - S cases are conducted more informally than regular cases (FRE do n/ apply),
  - Tax Court travels on a regular basis to more cities to hear S cases than it does to hear regular cases

Calendar Calls

- Clerk of Court will call a case for entry of appearance (these are cases that haven't been resolved).
- If TP doesn't show up, IRS attorney will move for entry of dismissal for failure of prosecution. The Tax Court judge may ask the IRS attorney to reach out for TP once more to protect TP and his rights. Most judges bend over backwards to make TP aware that he has a right to be there.
- Most of the time, the Tax Court judge will grant the IRS's motion to dismiss a case for lack of prosecution and then issue an assessment.

Calendar Calls

- **Penalties**: Sometimes, there will be a formal trial just on this issue, alone. For example, if TP fails to appear and the TC judge grants the IRS's motion to dismiss the case, the next issue will be the issue of penalties. A trial for penalties can be held regardless of whether TP is present (i.e., in TP's absence)

Calendar Calls

- **Continuances**: Sometimes judges will grant adjournments, other times they won't. TP needs to contact the other side in advance to see if they will consent. He or she has a better chance of getting a continuance if the other side *consents*.

Calendar Calls

- **Settlement**: If both sides have reached a settlement by the time there case is called, that settlement can be entered during the calendar call.

Review of Large Cases Decided by Special Trial Judges

- A controversy erupted over the process whereby opinions drafted by Special Trial Judges were reviewed and adopted by the Tax Court as its opinion
- Special Trial Judges are n/ empowered to enter decisions in cases involving *over $50K in dispute for any tax year*

Review of Large Cases Decided by Special Trial Judges

- However, if a Tax Court judge assigned a large case to a Special Trial Judge, that Special Trial Judge would hear the testimony, review the exhibits, and conduct the trial.
- Then the Special Trial Judge would *draft an opinion* for review by a regular judge of the U.S. Tax Court. That opinion would contain the Special Trial Judge's recommended findings of fact and conclusions of law.
- The regular Tax Court judge might adopt the Special Trial Judge's opinion or make substantial revisions to it.

Review of Large Cases Decided by Special Trial Judges

- The Tax Court treated the Special Trial Judges' opinions as advisory and n/ as public documents.
- In other words, the parties in the case were n/ allowed to see them. The result is that the public would n/ know if the final opinion entered by the Tax Court contained any *changes* by the Tax Court regular judge

Review of Large Cases Decided by Special Trial Judges

- Facts from *Ballard*: Civil fraud was an issue. The Tax Court Judge who did n/ hear any witness testimony made credibility fact findings *different* than the Special Trial Judge who did hear the witnesses. The STJ heard the witnesses (e.g., taxpayer, accountants and lawyers who advised T) and made a finding that TP's return reporting position *was n/ attributable to fraud*.

Review of Large Cases Decided by Special Trial Judges

- The Tax Court Judge reviewed the bare record (including a transcript of the testimony which, of course, excluded demeanor testimony which is so important in the truth finding process) and determined that TP's return reporting position was *fraudulent*. The Tax Court Judge *changed* the STJ's draft opinion to include the finding of fraud.

Review of Large Cases Decided by Special Trial Judges

- Holding: The Tax Court may n/ exclude the Special Trial Judge's draft opinion from the record on appeal
- Reasoning: One cannot tell whether the final decision reflects due regard for the special trial judge's opportunity to evaluate the credibility of the witnesses
- Effect: Parties will now know what changes, if any, are made by the regular Tax Court Judge

Review of Large Cases Decided by Special Trial Judges

- Tax Court has changed its practice: STJ's report is served on the parties and they have an opportunity to file objections to it. The report is also included in the record on appeal

Equity in the Tax Court

- Congress amended the Code to allow Tax Court to apply the doctrine of equitable recoupment to the same extent that it is available in civil tax cases in federal district courts

Burden of Proof

- General Tax Rule – TP bears the burdens
  - TP bears the burden of persuasion as to fact issues that must be resolved in deciding a civil tax case.
  - The burden of persuasion in a civil tax case means that the trier of fact (judge or jury) must find the fact in issue to be *more likely than not*, otherwise the party that bears the burden of persuasion loses

Burden of Proof

- Two categories of tax litigation
  - Tax Court litigation (e.g. prepayment litigation): In tax court litigation, the IRS seeks to have the Tax Court enter a decision for a deficiency so that the IRS can assess that deficiency amount against the TP. So, the IRS seeks a judgment against TP so that it can collect the amount of the judgment from TP
  - Refund litigation: Where TP seeks a judgment against the United States so that TP can get money from the United States. Refund suits assert that the Gov't has TP's money and is n/ entitled to it b/c TP does n/ owe the tax

Burden of Proof

- The Presumption of Correctness: Judicial opinions routinely pronounce that the notice of deficiency in a tax court proceeding has a *presumption of correctness*

Burden of Proof

- There are exceptions to the general rule. Various constitutional requirements, statutes or court rules assign the burden of proof differently for various policy reasons

Burden of Proof

- **Criminal Cases**: The Government must prove its case *beyond a reasonable doubt*.
- **Civil Fraud**: IRS must prove fraud by *clear and convincing evidence*. Trial judge may direct a verdict for TP if he determines that *no jury could find fraud by clear and convincing evidence*.

Burden of Proof

- **Omitted Income** (unreported income)
  - IRS argues that TP had income; TP says that he didn't. The problem is that TP has to prove a *negative*.
  - Some cases hold that once TP meets some production burden which can be a simple denial that is reasonable, the IRS must then meet at least a production burden – described as a "minimal evidentiary foundation" – by introducing evidence that, if believed, indicates that TP had the unreported income. Under this line of cases, TP still bears the normal burdens of production and persuasion once the IRS makes the required showing.

Burden of Proof

- *Portillo* facts: TP was a contractor who was hired by a general contractor. The general contractor issued TP a Form 1099 claiming an amount that was substantially *greater* than the amount the general contractor could produce checks made payable to TP. TP denied that he received income in excess of the amount of the checks

Burden of Proof

- Analysis: Court found that the determinations had no substance b/c the IRS had failed to do anything other than rely upon the 1099s in the face of TP's denial of receipt of the income. Instead, the IRS had to provide the court w/ some indicia that TP received unreported income.
- How could the IRS do that? By showing that TP had some income-producing source such as TP's net worth, bank deposits, cash expenditures, or source and application of funds.

Burden of Proof

- **S 7491: Real or Phantom Shift: ’98 Restructuring Act added S 7491 to provide three key shifts of the burden of proof to the IRS**

Burden of Proof

- TP has done what's right
- Statistical
- Penalties

Burden of Proof

- TP has done what's right
  - The burden of persuasion will be on the IRS if:
    - TP introduces credible evidence to support his position on the fact in issue;
    - TP has maintained the required records w/ respect to the matter and has cooperated during the audit; and
    - TP has complied w/ any specific requirements of the Code that he substantiate an item

Burden of Proof

- TP introduces credible evidence to support his position on the fact in issue;
  - Credible evidence: Evidence which a court would find sufficient to base a decision on the issue if *no contrary evidence were submitted*. TP has n/ produced credible evidence if he merely makes implausible factual assertions, frivolous claims, or tax protestor-type arguments.
  - Similarly, uncontradicted testimony which the trier of fact does n/ find credible is n/ the quality of evidence required to shift the burden of proof.

Burden of Proof

- TP has maintained the required records w/ respect to the matter and has cooperated during the audit
  - TP must have cooperated w/ reasonable requests by the IRS for meetings, interviews, witnesses, information, and documents (including providing access to and inspection of witnesses, information, and documents within TP's control)
  - TP must have exhausted his administrative remedies

Burden of Proof

- Statistical
  - IRS has the burden of proof w/ respect to income items which the IRS proves solely through the use of statistical data from unrelated taxpayers.

Burden of Proof

- Rule: Where there are no reasonably ascertainable indications of TP's income (usually b/c TP was in some form of cash business and did n/ maintain records), the IRS may resort to a *statistical method* designed to extrapolate some reasonable amount of income based on the income from similarly situated TPs or using industry statistics
- Example: If TP is a waiter at a certain type of club and the IRS has a regional statistic that shows the average tip for a particular type of restaurant, the IRS may attempt some extrapolation

Burden of Proof

- Penalties
  - IRS has an initial burden of production
  - IRS meets this burden by producing some reasonable evidence that it is appropriate to impose the relevant penalty
  - If the IRS meets the burden, TP then has the burden of persuading the Court that he is n/ liable for the penalty

Burden of Proof

- Comment: The shift is rarely outcome determinative b/c most cases are resolved by the judge making an affirmative finding (i.e., is persuaded) as to the existence or nonexistence of each key fact.
- In other words, judges are making their findings of fact based on affirmative persuasion and n/ based on burden of proof default rules!

Other Courts

- Federal District Court
- Court of Federal Claims
- Bankruptcy Court

Federal District Court

- Federal District Court
  - Typical tax cases heard by the District Court:
    - Refund suits involving the merits of whether TP owes the tax or penalty;
    - Summons enforcement actions; and
    - Collection suits when the IRS chooses to go beyond its administrative enforcement powers
    - E.g., Fraud cases, excise cases, jeopardy assessments

Federal District Court

- Refund Suits: In order to bring a refund suit, TP must pay the tax liability up front and then file a claim for refund. Once it is disallowed, TP has jurisdiction to file a suit for refund in the district court
- TP can get a jury trial in District Court
- District Court judges: Not well versed in tax law. In contrast, Tax Court judges are experts in tax procedure and tax law

Court of Federal Claims

- Authorized to hear tax refund suits
- Relatively informal court, and operates much like the Tax Court

Bankruptcy Court

- Federal tax issues may arise in a bankruptcy proceeding
- Bankruptcy courts have jurisdiction to determine tax issues, such as liability for the taxes (if liability has n/ previously been litigated) and dischargeability

Bankruptcy Court

- If debtor has a tax proceeding pending in another court (e.g., Tax Court), the automatic stay provisions of the bankruptcy court will give the bankruptcy court the opportunity to determine where the litigation of the tax liability will proceed.
- The bankruptcy court may allow the pending proceeding to continue in order to have the other court resolve the tax issue or may resolve the tax issue itself