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MATERIALS

ASPECTS OF U.S. TAX LITIGATION

**Omsk, Russia
October 27-30, 1998**

NATIONAL JUDICIAL COLLEGE

**with the participation of
Georgia State University
Russian Federation Fiscal Reform Project and
the United States Department of Treasury**

_____ **Sponsored by United States Agency for International Development (USAID)** _____

RUSSIA COMMERCIAL COURT WORKSHOP

**TAX LAW, PRE-TRIAL PROCEDURES AND
SETTLEMENT CONFERENCES**

**RUSSIAN-AMERICAN JUDICIAL PARTNERSHIP
(RAJP)**

**GEORGIA STATE UNIVERSITY
RUSSIAN FEDERATION FISCAL REFORM PROJECT**

UNITED STATES DEPARTMENT OF TREASURY

**Omsk, Russia
October 27 - October 30, 1998**

Sponsored by USAID

DAY 1

TAX COURT

- 8 30 - 9 00 Registration
- 9 00 - 9 30 **Welcomes and Opening Remarks**
**Justice Oleg Boikov, Deputy Chairman of Supreme Commercial
Court of the Russian Federation**
Judge Betty Barteau, Chief of Party, RAJP
Sharon Hester, Georgia State University
Rick Chewning, US Department of Treasury
- 9 30 - 10 30 **Fundamentals of Russian Tax Law**
**Presentation by Justice Oleg Boikov, Supreme Commercial Court
of the RF**
- 10 30 - 10 45 Coffee Break
- 10 45 - 12 00 **Prepayment Forum**
**Presentations by Judge Stephen Swift of the United States Tax
Court and Kristine Roth of the Office of the General Counsel,
United States Internal Revenue Service**
This session will focus on prepayment litigation, Internal Revenue
Service collection authority and jeopardy situations
- 12 00 - 13 00 Lunch

13 00 - 14 30 **Trials**
Presentations by Judge Stephen Swift of the United States Tax Court and Kristine Roth of the Office of the General Counsel, United States Internal Revenue Service
This presentation will address the role of the judge, lawyer and witnesses, as well as issues related to burden of proof and record-keeping requirements

14 30 - 14 45 Coffee Break

14 45 - 16 00 **Decision-Making**
Presentations by Judge Stephen Swift of the United States Tax Court and Kristine Roth of the Office of the General Counsel, United States Internal Revenue Service
This session will focus on bench opinions, the different types of written opinions, publication, staff (law clerks), the appeals process and standards of review

16 00 Adjourn

DAY 2

TAX COURT (CONTINUED)

9 00 - 10 30 **Comparison with Other Courts**
Presentations by Judge Stephen Swift of the United States Tax Court and Kristine Roth of the Office of the General Counsel, United States Internal Revenue Service
This presentation will explore the differences between the US Tax Court and other US Federal Courts

10 30 - 10 45 Coffee Break

10 45 - 12 00 **Resolution of Tax Disputes in Russian Judicial Practice**
Presentation by Judge Vyshniak N G , Chair of Judicial Panel of Supreme Commercial Court of the RF

12 00 - 13 00 Lunch

13 00 - 14 30 **Mock Trial**

14 30 - 14 45 Coffee Break

14 45 - 16 00 **Appellate and Supreme Court Arguments**

16 00 Adjourn

DAY 3

PRE-TRIAL PROCEDURES AND SETTLEMENT CONFERENCES

- 9 00 - 10 30 **Pre-trial Procedures and Settlement Conferences**
Presentation by Judge V Sue Shields, United States Federal Magistrate, Southern District of Indiana
This presentation will focus on pre-trial conferencing, including a discussion of case management planning
- 10 30 - 10 45 Coffee Break
- 10 45 - 12 00 **Pre-trial Procedures and Settlement Conferences (Continued)**
- 12 00 - 13 00 Lunch
- 13 00 - 14 30 **Pre-Trial Procedures in State Courts**
Presentation by Judge Brent Adams, Superior Court of the State of Nevada
This session will address the variety of pre-trial procedures used in state court systems
- 14 30 - 14 45 Coffee Break
- 14 45 - 16 00 **Workshop**
Participants will explore settlement conferencing through a role playing exercise to gain a better understanding of pre-trial procedures. Following the demonstrations, a panel discussion will be led by Judge Shields, Judge Adams and Judge Plotkin
- 16 00 Adjourn

DAY 4

PRE-TRIAL PROCEDURES AND SETTLEMENT CONFERENCES (CONTINUED)

- 9 00 - 10 30 **Summary Judgements, Default Judgements, and other Pre-trial Disposal Techniques**
Presentation by Judge Steven Plotkin, Louisiana Court of Appeals
This presentation will cover summary judgements, default judgements, and other pre-trial disposal techniques used in the United States
- 10 30 - 10 45 Coffee Break
- 10 45 - 12 00 **Summary Judgements, Default Judgements, and other Pre-Trial Disposal Techniques (Continued)**

12 00 - 13 00 Lunch

13 00 - 14 30 **Pre-trial procedures in the Russian Federation**
Presentation by Professor Sherstyuk V M , Law Academy

14 30 - 14 45 Coffee Break

14 45 - 16 00 **Improvement of Russian Tax Legislation**
**Presentation by Judge Andreeva T K , Head of Legislation
Development Department**

16 00 - 16 30 **International Association of Judges**
**Presentation by Justice Ernst Markel of the Supreme Court of
Austria and the International Association of Judges**

16 30 **Closing Remarks**

Tax Court Seminar Outline
October 27-28 and November 5-6, 1998

Prepayment Forum

- A Prepayment litigation
- B Freeze on IRS collection authority
- C Jeopardy situations

I Trials

- A No jury, judge is sole decision-maker
- B Judge's status, appointment, background
- C Witnesses, transcripts, perjury oath
- D Subpoena authority of taxpayer and IRS
- E Record-keeping requirements
- F Burden of proof
- G Types of witnesses—fact, expert, documents (business, banks, contracts, correspondence)
- H Privileges--lawyer/client, accountant/client

II Decision-making process

- A Bench opinions
- B Written opinions and publication
- C Reviewed opinions
- D Use in subsequent cases of written opinions by taxpayers, by lawyers, and by judges
- E Staff law clerks
- F Written briefs arguing facts and law
- G Different types of written opinions memo versus Tax Court published opinions, Orders
- H Court reviewed opinions
- I Appeals to Courts of Appeal, standards of review

V Comparison of U S Tax Court with other U S Federal Courts

Tax Court	Other Federal Courts
No prepayment	Full prepayment
No jury trials	Jury trials
Judges tax specialists	Judges generalists
Less formal procedures	Formal procedures
IRS in-house lawyers	Justice Department lawyers
Discovery limited	Broad discovery
Small claims division	No small claims division
Court review	No court review
Limited jurisdiction	General jurisdiction

V Materials Supplied

Copies of Branerton v Commissioner, Ash v Commissioner

CURRICULUM VITAE

Stephen J. Swift

May 15, 1998

Age 54 years

Address Office United States Tax Court Home
400 Second Street N W
Washington, D C 20217
(202) 606-8731

Employment

1983 to Present Judge, U S Tax Court, Washington, D C Appointed by President Ronald Reagan on August 16, 1983 Responsible for pretrial, trial, and resolution by written opinion of individual partnership trust and corporate income, gift and estate tax cases Conduct trials in all 50 States Have decided cases involving up to \$5MM in contested tax liabilities

1988 to Present Adjunct Professor, University of Baltimore School of Law Baltimore, MD One semester a year, teach a class on Federal tax controversy and litigation to LLM and MS candidates in taxation 1976 to 1983 Same title and responsibility at Golden Gate University School of Law San Francisco CA

1997 Conducted seminars in Moscow Russia and Washington D C for Russian tax and judicial officials regarding the United States tax dispute resolution system

1977 to 1983 Vice President and Senior Tax Counsel Bank of America N T & S A San Francisco CA Responsible for tax disputes throughout the World involving the bank BankAmerica Corporation (the parent holding company) and other B of A banking and nonbanking subsidiaries Managed group of 20 lawyers and accountants

1974 to 1977 Assistant United States Attorney United States Attorney s Office San Francisco CA Responsible for litigation in Federal District Court in Northern California of civil and criminal individual partnership trust and corporate income employment gift and estate tax cases and for litigation in California State courts involving the collection of Federal taxes

1970 to 1974 Trial Attorney, Honor s Program Tax Division United States Department of Justice Washington D C Responsible for litigation in Federal district courts in Arizona Colorado Kansas Missouri Nebraska Nevada and Utah of civil individual partnership trust and corporate income employment gift and estate tax refund cases

Education 1970 J D with Honors George Washington University Washington D C

1967 B S Brigham Young University Provo Utah

Additional Recognition, Leadership and Awards

1983 Outstanding Faculty Award Golden Gate University School of Law Graduate Tax Program San Francisco CA

1987 to Present Executive Advisor Tax Section State Bar of California

Kristine Roth

PROFESSIONAL EXPERIENCE

Office of Chief Counsel, Internal Revenue Service (1978 to present)

National Office Special Counsel to Assistant Chief Counsel, International (May 1997 to present) Coordinates between trial attorneys and attorneys specializing in technical areas of U S taxation of international income to develop litigating positions and strategies in cases with international tax issues

Field Offices As a Trial Attorney (1978 to 1990) in field offices in Cleveland, Foreign Operations and Washington, D C , prepared and tried cases before the U S Tax Court, and assisted in developing and reviewing collections suits and criminal prosecutions As an Assistant District Counsel, Washington, D C (November 1990 to May 1997), managed a group of senior litigators in their trial preparation of cases before the Tax Court as well as the quality of advice rendered during examination of the taxpayers whose cases presented the most significant or novel issues Developed and supervised a regional program to coordinate handling of international tax issues, including Advanced Pricing Agreements, in October 1994

Cornell Law School, Ithaca, New York, Visiting Professor (1989-1990), Taught Partnership Taxation, International Taxation, and Tax Practice and Procedure Also previously taught at Antioch Law School, Washington, D C , as an Adjunct Professor (Fall 1984) and at The Ohio State University College of Law, as a Teaching Assistant (Fall Quarter, 1977)

EDUCATION

LL M (Taxation) 1985, Georgetown University Law Center

J D , with Honors, December 1977, The Ohio State University College of Law

B A (History) 1973, The Ohio State University

BAR MEMBERSHIP

Admitted District of Columbia (active) and Ohio (inactive)

Barrister member of J Edgar Murdoch Inn of Court for the United States Tax Court, member of Court Procedure Committee, Tax Section of the American Bar Association

ASPECTS OF U S TAX LITIGATION

DAY 1 COMMENCEMENT OF A CASE

I IRS's Determination of a Deficiency & Notice of Deficiency

A Limited Jurisdiction of the U S Tax Court

The U S Tax Court has subject matter jurisdiction generally only over "deficiencies" (alleged underpayments) in Federal income, estate, gift, and some excise taxes, and interest and penalties relating thereto Sections 6214 & 7422(e)

If a taxpayer has a complaint against the IRS and wishes to sue the IRS over matters of conduct of IRS representatives, the Tax Court normally does not have subject matter jurisdiction over such matters. Lawsuits involving such matters typically occur in the Federal district courts. See generally sections 7421 and 7424-7433.

Also, if a taxpayer claims to have overpaid Federal taxes, and if the IRS is not attempting to "assess" additional taxes against the taxpayer, the taxpayer may sue the IRS (actually the United States) by filing a "complaint" for refund in the Federal district court with jurisdiction over the city in which the taxpayer resides or in the United States Court of Federal Claims, based in Washington, D C. See section 7422(a) & (e).

B "Ticket to the Tax Court"

Litigation in the Tax Court is typically predicated on the IRS making a "determination" of an alleged "deficiency" in the payment by a taxpayer of its correct Federal income, estate, gift, or certain excise tax liabilities. The IRS sets forth or asserts that "determination" of an alleged deficiency in a "notice of deficiency" and mails the notice of deficiency to the taxpayer. The IRS's notice of deficiency is commonly referred to as the "Ticket to the Tax Court" Section 6213(a).

Without receipt of a notice of deficiency from the IRS, a taxpayer generally has no right to file a "petition" nor to litigate substantive tax issues before the Tax Court. The filing of a Tax Court petition without the IRS's having mailed a notice of deficiency to the taxpayer is regarded as premature and will normally cause the IRS to seek an immediate dismissal and the Tax Court's granting such dismissal.

C Effect of Filing a Timely Tax Court Petition

The effect of filing a timely Tax Court petition upon the IRS's ability to assess an alleged tax deficiency is significant. Where a timely Tax Court petition is filed by a taxpayer, under section 6215(a), respondent is, by law, generally precluded from assessing and attempting to collect any portion of the proposed tax deficiency until, and only to the extent that, the Tax Court approves of respondent's determination.

In effect, the Tax Court takes over the matter of determining the taxpayer's correct tax liability for each year put in issue by the taxpayer's petition. Section 6215. Typically, the final document entered in the Tax Court proceeding (namely, the "decision document") sets forth that determination by the Tax Court of the taxpayer's correct tax liability and of any "deficiencies" in the payment of that amount for each of the years in dispute and controls the amount of additional tax interest, and penalties that respondent can assess and collect from the taxpayer with regard to each year litigated.

In spite of some limited exceptions, it is the above pre-payment feature of litigation in the Tax Court (or automatic freeze on the IRS's ability to assess and collect the alleged taxes, interest, and penalties owed) that explains the Tax Court's overwhelming preference among taxpayers for the forum in which to litigate Federal tax disputes. The ability of taxpayers to stop the IRS cold in its assessment and collection efforts, and to litigate the disputed additional tax liability before an independent judicial tribunal without being required to pay a single dollar of the additional tax liability alleged by the IRS, explains the Tax Court's popularity. Approximately, 95% of all Federal tax litigation occurs in the Tax Court.

Requirements of and issues relating to the IRS' "mailing" of notices of deficiency, to the "filing" of petitions, and to the "contents" of petitions and answers thereto (see the outline) will be discussed over the course of the next few days.

II "Naked Assessments"

Because an automatic "presumption of correctness" generally attaches to the IRS's adjustments to a taxpayer's items of income and expense as set forth in the IRS's notice of deficiency (see *Helvering v. Taylor*, 293 U.S. 507, 515 (1935)) it is often quite difficult in the Tax Court and in the other courts for a taxpayer to rebut this presumption of correctness by any probative evidence.

This burden on taxpayers to overcome the presumption of correctness in favor of the IRS's notice of deficiency has been recognized by the courts to present taxpayers with particularly difficult and what has been described as an unfair burden in situations where the IRS's notice of deficiency charges the taxpayer with unreported (especially "illegal" unreported) income

In *Weimerskirch v Commissioner*, 596 F 2d 358 (9th Cir 1979), the IRS notice of deficiency charged the taxpayer with additional unreported income from the sale of heroin. At the trial, the IRS offered no evidence that the taxpayer had engaged in the sale of heroin and relied solely on the presumption of correctness that generally attaches to its notice of deficiency. Also at the trial the taxpayer offered no substantive witnesses or evidence that tended to prove or disprove the taxpayer's sale of heroin. The taxpayer argued that it was impossible for him to prove a negative -- namely, the nonexistence of alleged income for which the IRS had offered no corroborative evidence.

The Tax Court at 67 T C 672 held for the IRS on the basis of the presumption of correctness of the notice of deficiency. The Ninth Circuit reversed and held that where additional unreported income, particularly unreported illegal income, is charged to a taxpayer, it is incumbent on the IRS to show some minimal evidentiary foundation in support of its determination in the notice of deficiency of the additional income charged to the taxpayer before the presumption of correctness will attach thereto.

In *Weimerskirch* the Ninth Circuit at 596 F 2d 361 n 6 quoted the following colorful language from the opinion of the 5th Circuit in *Carson v United States* 560 F 2d 693 696 as follows:

"The tax collector's presumption of correctness has a herculean muscularity of Goliathlike reach but we strike an Achilles' heel when we find no muscles no tendons no ligaments of fact.

In *Portillo v Commissioner* 932 F 2d 1128 (5th Cir 1991), the taxpayer succeeded before the 5th Circuit in extending the above reasoning to income reported by a payor on a Form 1099. The IRS had received from a general contractor a Form 1099 indicating payments to the taxpayer a painting subcontractor. The IRS matched the payments reflected on the Form 1099 with the taxpayer's return for the relevant year. Because the payments reflected on the Form 1099 were not reported on the taxpayer's tax return the IRS issued a notice of deficiency and charged the taxpayer with the additional 1099 income. At trial the IRS relied only on the presumption of correctness of the notice of deficiency to support its adjustment.

Significantly the taxpayer in Portillo did offer some evidence indicating that the Form 1099 on which the IRS was relying might well be inaccurate. On these facts the 5th Circuit concluded that the IRS's notice of deficiency was arbitrary and not entitled to the usual presumption of correctness and that the Tax Court's decision in favor of the IRS on the basis of the presumption of correctness of the notice of deficiency was reversed. The 5th Circuit explained as follows (932 F.2d 1133)

Justification for the presumption of correctness lies in the government's strong need to accomplish swift collection of revenue and in the need to encourage taxpayer recordkeeping. * * * the need for tax collection does not serve to excuse the government, however, from providing some factual foundation for its assessments. * * *

* * * the presumption of correctness does not apply when the government's assessment falls within a narrow but important category of "naked" assessment without any foundation whatsoever. * * * Several courts including this one have noted that a court need not give effect to the presumption of correctness in a case involving unreported income if the [IRS] cannot present some predicate evidence supporting its determination. * * * Although a number of these cases involved unreported illegal income, given the obvious difficulties in proving the non-receipt of income, we agree with the Third Circuit that this principle should apply whether the unreported income was allegedly obtained legally or illegally. [Citations and footnotes omitted.]

Subsequent cases involving the above proposition have applied this proposition fairly narrowly and tend to apply the traditional rule that respondent's notice of deficiency is to be presumed correct whenever there is any credible evidence linking the taxpayer to the income or to the activity which allegedly produced the income.

III Section 7522

The taxpayer Bill of Rights legislation that was passed in 1989 added an interesting requirement that relates to the content of respondent's notices of deficiency and that relates to the above discussion. Section 7522(a) provides that respondent's notices of deficiency now must explain the "basis for" each adjustment.

But section 7522(a) also expressly provides that failure of respondent's notice of deficiency to provide an explanation of the basis for the adjustments set forth in the notice of deficiency "shall not invalidate" the notice of deficiency. This last statutory mandate which seems to take much of the teeth out of section 7522 raises an interesting question not yet addressed by any court (namely, whether there is any consequence or effect on the notice of deficiency when respondent fails to provide in the notice of deficiency the explanation called for by section 7522).

IV - IRS NOTICE OF DEFICIENCY (continued)

The next aspect of the IRS' notice of deficiency involves certain delivery requirements pertaining to the IRS's notice of deficiency, as set forth in section 6212(a) and (b), and two recent cases that apply this statutory requirement. Also discussed briefly is the effect on running of the assessment statute of limitations on the issuance by respondent of a notice of deficiency.

A Delivery Requirements of sec 6212(a) & (b) "Last known address", *Abeles v Commissioner* 91 T.C. 10219 (1988) *Gaw v Commissioner*, 45 F.3d 461 (D.C. Cir. 1995)

Generally, the IRS is required to mail a notice of deficiency to a taxpayer by certified or registered mail to the taxpayer's "last known" address. See section 6212(a) and (b). This statutory requirement on the IRS represents a type of due process notification imposed on the IRS by section 6212 before the IRS generally may assess and collect from taxpayers the tax deficiency asserted. Upon mailing of the notice of deficiency, the 90-day period that the taxpayer is given to file a petition in the Tax Court (see section 6213(a)) starts to run against the taxpayer and if the taxpayer does not file a Tax Court petition, the IRS is authorized to proceed immediately to assess and to collect the tax deficiency reflected in the IRS's notice of deficiency for each year, with penalties as reflected in the notice of deficiency plus statutory accrued interest.

Note that there is no statutory requirement in section 6212 that the taxpayer actually "receive" the notice of deficiency for the notice of deficiency to be effective and to start the 90-day period running. Where the IRS satisfies the statutory requirement of mailing the notice of deficiency to the taxpayer's last known address but the taxpayer does not actually receive the notice of deficiency, the notice of deficiency is still fully valid and effective. The 90-day period to file the Tax Court petition 90 days has run, the IRS will be allowed to assess and collect the tax.

This rule (making validity of the IRS's notice of deficiency turn on proper "mailing" and not on actual "receipt" by the taxpayer of the notice of deficiency) may seem harsh but is based on the policy that our tax collection process is too critical to be subject to manipulation by taxpayers who could refuse to accept or pick up their mail when they expect a letter from the IRS

Even though the last-known-address rule was drafted to minimize manipulation and disputes, it has kept the Tax Court busy. Many cases are filed late in the Tax Court (after 90 days from the mailing date on the notice of deficiency) in which cases taxpayers seek (by means of a motion to dismiss the case with prejudice against the IRS) to have the notice of deficiency declared invalid. Taxpayers typically argue that they had moved, that the IRS knew or should have known of their new address, that the IRS therefore did not properly mail the notice of deficiency to their "last known address," and that the IRS's notice of deficiency should be held to be invalid.

Two trends have influenced this type of litigation -- (1) the increase in the number of marital divorces and separations, resulting in different addresses for taxpayers who in earlier years had filed joint tax returns with a single address, and (2) improved computer technology (or at least multi-million dollar expenditures by the IRS of taxpayers' money therefor). As a result, the courts have been willing to impose more stringent standards on the IRS' mailing of notices of deficiency.

In *Abeles v. Commissioner*, 91 T.C. 1019 (1988), the relevant dates are as follows:

Oct 15, 1980 Mailing Date of joint IRS Notice of Deficiency for taxpayers' 1976 year

June 15 1982 W filed separate return re 1981 showing a new address

Nov 30 1982 Mailing date of IRS's joint notice of deficiency for W's and H's 1975 & 1977 years. Though the 1981 return mailed by W to the IRS reflected the fact that W and H were using separate addresses, W did not receive actual notice of the deficiency for any of the years until 1986 when IRS levied on her bank accounts and put a lien on her house.

At that time, in 1986, W filed in Tax Court a petition seeking to invalidate the notice of deficiency for 1975, 1976, and 1977, and asking the Tax Court to re-determine her tax liability for 1978. The IRS asked the Tax Court to dismiss W's petition for each of the years 1975-1977 as untimely and for 1978 because no notice of deficiency had been issued for that year.

With regard to 1976, Tax Court held that IRS's Oct 15, 1980, notice of deficiency was properly mailed to W's and H's joint "last known" address and W's petition was dismissed with prejudice against W as untimely for 1976

With regard to 1975 and 1977, Tax Court held that IRS's Nov 30, 1982, notice of deficiency for 1975 and 1977 was invalid as to W because it was not mailed to W's separate "last known address", as of the date of mailing, and W's petition was dismissed with prejudice against respondent (precluding respondent from making any assessment or collection based thereon) and, because the normal assessment period was otherwise expired as to W for 1975 and 1977, precluding respondent from mailing a new notice of assessment, dismissed W's petition because respondent had not mailed a notice of deficiency to W for that year (i.e., the taxpayer had no ticket to the Tax Court for 1978)

With regard to its basis for holding that the "old" address used for W on the notice of deficiency for 1975 and 1977 did not constitute W's "last known address" for purposes of section 6212(a) the Tax Court wrote

[In prior years] the computer capabilities of the IRS were such that an agent of respondent responsible for issuing a notice of deficiency did not have the ability to conduct, within a reasonable time, a search of the IRS's computer files for a more recent address for the taxpayer Today, however, the state of the IRS's computer capabilities is such that a computer search of the information retained with respect to a certain taxpayer, including his or her last known address may be performed by respondent's agent without unreasonable effort or delay See *Crum v Commissioner*, 635 F.2d 895, 900 (D.C. Cir. 1980), rev'd, an unreported order of [the Tax Court], wherein the District of Columbia Circuit Court of Appeals recognized that "a search of the computer files for a taxpayer's most recent address would take less than a minute today [whereas] that same task would have taken approximately six weeks in 1972 " [91 T.C. 1032-1033]

In *Gaw v Commissioner* 45 F.3d 461 (D.C. Cir. 1995) near the end of a difficult audit taxpayers through 3 separate letters notified IRS representatives in January of 1991 that they did not yet know precisely where they would be traveling and where they would be able to receive mail and that their lawyer whose name and address they disclosed to the IRS (but for whom they had not yet filed with IRS a power of attorney form) would know how to get in touch with them

On Oct 8 1991 the last day of the statute of limitations for assessment with regard to the Gaw's 1987 tax liability respondent mailed a notice of deficiency for 1987 to the Gaws at the California address that the Gaws had used on their 1988 tax return and also at the Hong Kong address

that the Gaws had used on their 1989 return. No copy of the notice of deficiency was mailed by respondent to Gaw's lawyer. The Gaws apparently did not actually receive actual notice of respondent's notice of deficiency until after respondent had assessed the tax deficiency and had begun collection activity. The Gaws filed a petition in the Tax Court within 2 weeks of receiving such actual notice.

Respondent moved to dismiss the Gaw's petition as being untimely filed beyond the 90-day period. In rejecting respondent's motion to dismiss, the Circuit Court explained as follows:

The taxpayer has the obligation in the first instance to give the IRS "clear and concise notification" of an address change. * * * In the absence of the taxpayer's "clear and concise notification" of an address change, the IRS generally is allowed to treat the address on the taxpayer's most recently filed return as the last known address. * * * But if before mailing the deficiency notice the IRS becomes aware that the address on the return is incorrect, then the IRS has an equitable obligation which courts will enforce, to use "reasonable diligence" to ascertain the correct address.

Concluding that respondent did not exercise reasonable diligence to ascertain the Gaw's correct current address, the Circuit concluded that the 90-day period for filing the petition to the Tax Court did not begin to run, in the Gaw's situation, until they received actual notice of respondent's notice of deficiency and that their petition was timely filed within 2 weeks of receiving such actual notice. The Circuit Court remanded the Gaw's case back to the Tax Court for consideration of the Gaw's tax liability on the merits.

Issues like those reflected in the above two cases relating to the proper mailing of respondent's notice of deficiency and to the taxpayer's last known address are common and underscore a point I made yesterday – the importance to many taxpayers of the "prepayment" feature of litigation in the Tax Court.

Note that if a taxpayer's petition is dismissed by the Tax Court as untimely, and if the Court of Appeals sustains that dismissal, the taxpayer's day in court is not over, as the taxpayer still has the option, after paying the full tax deficiency asserted by respondent, of filing with respondent a claim for refund and, if the claim for refund is denied, of then suing in the Federal district courts or in the U.S. Court of Federal Claims for a refund of allegedly overpaid taxes. See secs. 6511, 6532, 7422.

"Late" filing, however, of a petition in the Tax Court may be much preferable to the taxpayer (because of the absence of the full payment requirement) than suing for a refund and may be allowed if the taxpayer

can establish failure of respondent to mail the notice of deficiency to, or lack of due diligence on the part of respondent in ascertaining, the last known address of the taxpayer, as per the above and many other cases dealing with this issue

V Effect of Notice of Deficiency on Running of Statute of Limitation on Assessment Sections 6213(a), 6501(1), 6503

A tricky aspect of the 3-year and 6-year statute of limitations that, under section 6501(a) and (e), runs against the IRS's ability to assess a tax deficiency against a taxpayer for a particular year, is the manner in which respondent's mailing of a notice of deficiency to a taxpayer "interrupts" or "suspends" the running of that 3 or 6-year statute of limitation

Under section 6503, the text of which you may want to look at, as soon as the notice of deficiency is mailed by the IRS, because the IRS under section 6213 is automatically barred for a time being from continuing to assess and collect the tax deficiency alleged and determined by the IRS in the notice of deficiency, a corresponding interruption or suspension to the running of the 3 and 6-year assessment statute of limitations is triggered

This suspension on the running of the assessment statute of limitations lasts for at least the 90-day period during which the taxpayer has a right to file a petition in the Tax Court and, if the taxpayer does not file such petition, for 60 days thereafter, at which point in time the statute of limitations starts to run again for whatever time remained on the original 3 or 6-year statute of limitations when the suspension first started

If the taxpayer does file a petition in the Tax Court within the 90-day period following mailing of a notice of deficiency, then under section 6503, the assessment statute of limitations is suspended for the entire duration of the litigation, plus 60 days. At the end of the litigation, including appeals thereof, the assessment statute of limitations then starts up again for whatever time remained on the original 3 or 6-year statute of limitations at the time the suspension first was triggered upon mailing of the notice of deficiency

Applying the above statutory suspension rule, perhaps the following example may be helpful and illustrate how this suspension works during litigation

On April 15, 1991 individual taxpayer files 1990 Federal income tax return,

On April 1, 1994 IRS mails a notice of deficiency for 1990

Taxpayer does not file a petition in Tax Court,

By what date must IRS "assess" the tax deficiency reflected in the above notice of deficiency for the assessment to be timely under section 6501(a)?

What is the correct date and why?

DAY 2 PRETRIAL PROCEDURE

I Tax Court Petition and Answer Rule 34 and 36

A Contents of Pleadings

The 2 key pleadings that are filed in the Tax Court are the petition (filed by taxpayers) and the answer (filed by the IRS)

Rule 31 makes it clear that the purpose of the pleadings in the Tax Court is to provide fair "notice" to the other side of the items in dispute. This "notice" type pleading is similar to the notice pleading that is called for under the Federal Rules of Civil Procedure with regard to litigation in the Federal district courts.

Sufficient detail, however, should be provided in the taxpayer's petition filed with the Tax Court to give the IRS and the Tax Court enough information to identify which of the proposed tax adjustments reflected in respondent's notice of deficiency the taxpayer disputes and wishes to have the Court review, as well as the basis for contesting each adjustment. See Rule 34(b)(4) & (5), 36(b), and Rule 40. This typically is done by the lawyer for the taxpayer attaching to the petition an actual copy of respondent's notice of deficiency and then, in the body of the petition, by referring specifically to the attached notice of deficiency and the specific adjustments, as described in the notice of deficiency, that are being contested, with a brief explanation of the basis for the contest of each separate adjustment.

Although Rule 31(b) makes it clear that no particular form for the petition is required, Form 1 and 2, attached to the Tax Court's Rules, are copies of sample petitions in the format of which may be followed.

B Reply Rule 37

Where the IRS raises in its answer new affirmative issues on which the

IRS has the burden of proof (see Rule 142(a)), or an issue on which the IRS by statute has the burden of proof (such as the fraud addition to tax see section 7454(a)), the taxpayer may file a "reply" to the IRS's answer in which the taxpayer admits or denies affirmative allegations raised in the IRS's answer. Unless the IRS moves to require a reply, the filing of a reply is optional, and, where no reply is filed, the taxpayer will be deemed to have denied each of the material allegations made in the answer by the IRS, including those relating to new issues that were not raised in the IRS's notice of deficiency.

C Year-by-Year Deficiency Determinations

Note the importance of reflecting in the petition each year for which adjustments are disputed.

The IRS's determinations of tax deficiencies and taxpayers' contests thereof in the Tax Court are treated for court jurisdictional purposes, separately for each year. Thus, although a taxpayer may receive only one notice of deficiency form from the IRS, that notice of deficiency form may relate to a number of years and in fact may constitute a determination of a deficiency in the taxpayer's Federal income tax for each of those years. For example, a single notice of deficiency from respondent to a taxpayer may actually constitute a notice of deficiency for 3 years (e.g., 1990, 1991, and 1992) and the taxpayer may file 1 or 3 separate Tax Court petitions with regard thereto.

In whatever form the taxpayer receives notice of respondent's determination of tax deficiencies for a number of years (e.g., in a single document or in 3 separate notices of deficiency) the taxpayer's petition or petitions that are filed with regard thereto must specifically allege the taxpayer's contest of each of respondent's deficiency determinations for each separate year. If respondent's single notice of deficiency determines a deficiency for each of 3 years, and the taxpayer's single petition filed with respect thereto only refers to 2 of those years, and even though the same major tax adjustment was made for each of the 3 years, respondent's deficiency determination for the 3d year that is not mentioned in the petition will be deemed conceded by the taxpayer.

II 90-day Filing Period

As explained previously, if a taxpayer, upon receipt of a notice of deficiency, fails to file a petition with the Tax Court within 90 days of the date the notice of deficiency is mailed, the IRS is authorized to proceed to assess and collect the tax as set forth in the notice of deficiency. Section 6213(a) and (c). To stop -- for the time being -- such assessment and collection activity by the IRS, upon receipt of a notice of deficiency, the taxpayer must file a petition in the Tax Court.

withing the 90-day period. A 150-day period is provided for taxpayers who are outside the United States at the time of mailing the notice of deficiency, and a 180-day period is provided for certain members of the U.S. armed forces. Section 6213(a) and 7508.

The date of mailing the notice of deficiency, which starts the running of the 90-day period, usually is reflected by the date typed on the notice of deficiency, but where disputed the date of actual mailing date of the notice of deficiency will control, which is usually ascertainable from the postal mark on the envelop in which the notice of deficiency was mailed or from the postal certification or registry number that is retained by the IRS.

Rule 25 provides certain computational rules for computing the 90-day period to take into account nonbusiness days. At this time, the Tax Court does not accept electronic mailing or faxing of petitions to the Tax Court.

The 90-day time limit on the taxpayer's right to file a Tax Court petition and to stop the IRS's proposed assessment raises an important frequently litigated issue concerning timely "filing" of a taxpayer's petition.

Generally, all petitions, with a filing fee of \$60, must be filed at the headquarters office of the Tax Court located at 400 Second St. N.W., Wash., D.C. 20217.

Delivery of the actual hard copy of the petition document to the Tax Court may occur by any means as long as the petitions arrive at the Tax Court within the 90-day period.

Even though received by the Tax Court after the expiration of the 90-day period, if they satisfy the special, statutory "timely mailing/timely filing" rule of section 7502(a), petitions will be deemed to be filed timely with the Tax Court within the 90-day period. Under this rule, petitions will be considered timely "filed" with the Tax Court if they are mailed by the taxpayer in a properly addressed and stamped envelope and postmarked by the U.S. Postal Service before the end of the 90-day period. In this case, the postmark date is considered the "filing" date. Where the envelope containing the petition is sent U.S. registered mail, the date of registration is treated as the filing date. Certified envelopes containing petitions are considered "filed" on the date indicated on the certified receipt.

Where only a private postmark is reflected on the envelope and the envelope with the petition is received by the Tax Court after the end of the 90-day period, the petition will be treated as timely filed with the

Tax Court only if the taxpayer can prove actual timely mailing by U S mail within the 90-day period, and the envelope is received by the Tax Court within the time it normally takes mail to be mailed to Wash , D C from the city of mailing Treas Reg section 301 7502-1(c)(1)(iii)(b)

Petitions delivered to the Tax Court via private carriers such as Federal Express are not given the benefit of the timely mailing/timely filing rule, and are treated as filed only when actually received by the Tax Court

The facts of *Petrulis v Commissioner*, 938 F 2d 78 (7th Cir 1991), affg a memo opinion of the Tax Court, illustrate the importance of paying close attention to this rule In that case, taxpayer's petition was held to be untimely where on 90th day after mailing of notice of deficiency by respondent taxpayer delivered the petition to a private air express service for overnight express delivery to the Tax Court The taxpayer's petition was actually received by the Tax Court on the next day, a number of days before it would have been actually received had the taxpayer mailed it on the 90th day via the U S mail Both the Tax Court and the 7th Circuit held that the petition was late and dismissed the case against the taxpayer on the grounds that the timely mailing/timely filing rule of section 7502 does not apply to private delivery companies

Because of the above varying rules and potential for mismailing and misdelivery the recommended practice is to mail the petitions to the Tax Court using certified or registered U S mail return receipt requested, with the taxpayer or representative retaining a postmarked copy of the receipt attached to a retained copy of the petition

III New Issues – Rule 142(a) & (b)

As discussed yesterday the Tax Court Rules require that the taxpayer identify in the petition and thereby put in issue each adjustment that was made by respondent in the notice of deficiency that the taxpayer contests as well as any new item of income, deduction, or credit that the taxpayer wishes to claim

In the answer, the IRS is required to indicate its agreement or disagreement with each adjustment contested or each item raised in the petition by the taxpayer and to raise any additional adjustments or new items or issues that respondent wishes to raise at that time even items that may increase the taxpayer's deficiency over the amount of the deficiency as it was asserted in respondent's notice of deficiency

This ability or "right" to raise new items and new adjustments in the petition and answer is somewhat unique to the Tax Court and is based on

the fact that the statutes of limitations has been frozen and is still open for both claims for refund by the taxpayer and assessments by respondent

When a taxpayer files for a year a refund suit in the district courts or in the U S Court of Federal Claims and assuming the statute of limitations on filing a new claim for refund for that year has expired (see section 6511), new items or issues cannot be raised by the taxpayer. New adjustments can be raised in the government's answer but in a more limited manner than in the Tax Court. In a refund suit for a year (assuming the statute of limitations on making an assessment for that year has lapsed which it usually will have), the government's total dollar recovery relating to new adjustments raised by the government in its answer (assuming the court rules in favor of the government with respect to the new issue) can only be used to offset the amount of the refund to which the taxpayer would otherwise be entitled on the original adjustments put in issue by the taxpayer.

In other words, if respondent does raise in its answer in a refund suit a new issue or adjustment, its use of that issue is limited to act only as an offset or reduction to the amount of money the taxpayer would have been entitled to have refunded based on the original issues raised by the taxpayer in the claim for refund.

If respondent, in a refund suit, does raise a new issue by way of an offset, a taxpayer may be allowed to raise an untimely new issue in a refund suit solely as an offset to the government's offset.

Practically, at the time they must file the government's answer, respondent's lawyers in both Tax Court cases and in refund suits rarely know enough about the case to raise new adjustments or issues. Thus, new adjustments or issues are very, very rarely raised by the IRS in the answer that is due to be filed in the Tax Court within 60 days of service of the taxpayer's petition.

When new adjustments and new issues are raised in the Tax Court, the district courts, and the U S Court of Federal Claims, they typically are raised after the original pleadings have been filed and after the lawyers have gotten into the matter and "discover" new issues. In this situation (unless the very limited time is still open to amend their original pleadings as a matter of right, see Rule 41(a)), in none of the courts do the parties still have the "right" to raise new items or new adjustments. They must file a motion with the Court and seek to obtain the Court's permission or order authorizing such new issue, to which motion the other party may file an objection. The Tax Court and the other courts are often reluctant to allow new issues to be raised in late amended pleadings due to the prejudice it causes to the opposing party and to the court's efforts to get the case disposed of.

Where new issues and adjustments are allowed to be raised in the Tax Court, the distinction mentioned earlier is still applicable (i.e. a new issue allowed to be raised late in the Tax Court may involve new money or an increase in the total tax deficiency asserted by the IRS, but new issues allowed in refund suits in the district courts or in the U.S. Court of Federal Claims can be used only as offsets to reduce the amount to which the taxpayer otherwise would be entitled based on the original issues in dispute)

Also, with regard to new issues raised in the Tax Court, whether raised timely in the original petition or original answer, or by motion in a late amended petition or late amended answer, note that the party raising the new issue has the burden of proof with regard thereto (i.e. the IRS will have the burden of proof on any new issue that it raises in the answer or by motion that the court allows) Rule 142

The fear of new issues being raised in the Tax Court involving additional dollars -- over that asserted by the IRS in the notice of deficiency -- is often of great concern to lawyers representing taxpayers. It is often cited as a reason not to go to the Tax Court. Certainly there is some risk in that regard and for that reason I have discussed this matter at some length. Also for that reason Steve Salch is correct that before filing a petition in the Tax Court, a well-advised thoughtful lawyer will spend some time with the client discussing, and some time reviewing, the client's tax return and situation for the years involved to ascertain what exposure the client might have if the IRS lawyer should start looking around for new issues.

As a practical matter however new issues are seldom raised by the IRS in the Tax Court and often where the IRS attempts by motion to raise the issues late the Tax Court judge does not grant the IRS's motion.

IV Perfect an Imperfect Petition

Often pro se taxpayers and even on occasion lawyers do not file as their petitions documents that satisfy all of the pleading requirements of Rules 31-34. The Tax Court tends to be flexible and almost always will recognize an imperfect petition for purposes of satisfying the 90-day jurisdictional requirement of section 6213. The Tax Court Clerk's office ((202) 606-8754) will then notify the taxpayer or the representative of the defects in the petition and ask that the defects be perfect by way of an amended petition. For examples of defective petitions that have been recognized for jurisdictional purposes. See *Diviaio v. Commissioner*, 539 F.2d 231, see n. 3 at 233 (D.C. Cir. 1976) a written timely request for rules and forms for filing a petition was recognized for jurisdictional purposes where taxpayer was in prison.

The above ability to perfect an imperfect petition pertains to defects in the contents of the document that is received by the Tax Court. The limitations on the "timely mailing/timely filing" rule of section 7502 (namely, put the document in the U.S. Mail on or before the end of the 90 days from mailing by IRS of notice of deficiency, make sure it is postmarked, or use certified or registered mail, and retain receipts thereof attached to copy of the petition). As stated earlier, the delivery of an imperfect or a perfect petition to the Tax Court by facsimile or electronic mail will not be accepted by the Tax Court. See Rule 34(a)(1) and *Blum v. Commissioner*, 86 T.C. 1228 (1986).

V Pretrial Stipulations and Discovery

A Background of the Tax Court

The current U.S. Tax Court was not established as an independent Federal Court until 1969. Prior thereto, it was preceded (1942-1969) by the Tax Court of the United States (a court in name but more accurately viewed as an administrative review agency within the Executive Branch of the Federal Government) and (1924-1942) by the Board of Tax Appeals (not even a court in name and also an administrative review agency within the Executive Branch of the Federal Government).

The two predecessors to the current U.S. Tax Court – both of which for many years maintained their offices within the walls of the IRS headquarters building on 10th & Constitution Ave. Wash., D.C. – were highly regarded but were not perceived as having a sufficiently judicial status to perform the desired independent review of IRS determinations of tax deficiencies against taxpayers.

When the current U.S. Tax Court was established as a Federal court in 1969, a concerted effort was made to preserve much of the informality in the practice and proceedings that had developed over the many years by its two predecessor organizations. Of particular note was the informality in the exchange between the parties of information about the issues in the case that occurred at the pretrial stage of the proceedings.

Formal discovery by either party was very limited. The parties were expected to get together prior to the trial or hearing and (1) to share with each other the names of expected witnesses, what the testimony would relate to, and the substance thereof, (2) to provide the other side with copies of all exhibits to be used at trial, and (3) to exchange other relevant information relating to the issues in the case.

Much of this informality in Tax Court proceedings and litigation at the

pretrial stage carried over to the trial itself, and a trial in the Tax Court was generally expected to be quicker, more predictable, less costly, less intimidating, and essentially in all aspects "easier" than a trial in the Federal district courts or the Claims Court (the predecessor to the present U S Court of Federal Claims)

(As an important footnote, allow me to emphasize that this procedural difference that I am explaining in the historical practice of tax litigation before the respective courts is not intended to suggest that there was any significant perception that the bottom-line outcome of the litigation would generally be any different in the different courts)

As the U S Tax Court in 1974 adopted its first formal discovery rules (only interrogatories, requests for production of documents , and requests for admissions no party or third-party depositions were provided for) a real effort was made to not let the new discovery rules eliminate or change significantly the above informality and culture of the practice and proceedings in the U S Tax Court Continued informality in the pretrial and trial proceedings (and its perceived attendant important benefits) was regarded as an asset and was sought to be preserved

B Branerton v Commissioner 61 T C 691 (1974), illustrates well the emphasis in the Tax Court on informality and cooperation between the parties, particularly at the pretrial stage of the proceedings

The case involved a variety of fact intensive issues On January 2, 1974 one day after the Tax Court's first limited formal discovery rules (mentioned above) became effective the taxpayer's lawyer filed detailed and extensive written interrogatories under Rule 71 The IRS objected and asked in a motion for a protective order that it be relieved of answering any of the formal discovery requests until after the parties had had an opportunity to informally exchange information and to limit the taxpayer's formal discovery requests only to that material that the parties were not able to exchange informally

In a short but still leading case on the nature of pretrial proceedings in the Tax Court, the Court explained as follows

* * * in seeking a protective order [the IRS] specifically cites the second sentence of Rule 70(a)(1) which provides

However the Court expects the parties to attempt to attain the objectives of discovery through informal consultation or communication before utilizing the discovery procedures provided in these rules

It is plain that this provision in Rule 70(a)(1) means exactly what it says. The discovery procedures should be used only after the parties have made reasonable informal efforts to obtain needed information voluntarily. For many years the bedrock of Tax Court practice has been the stipulation process, now embodied in Rule 91. Essential to that process is the voluntary exchange of necessary facts, documents, and other data between the parties as an aid to the more expeditious trial of cases as well as for settlement purposes. The recently adopted discovery procedures were not intended in any way to weaken the stipulation process. See Rule 91(a)(2).

Contrary to [the taxpayer's] assertion that there is no "practical and substantial reason" for granting a protective order in these circumstances, we find good cause for doing so. [Taxpayers] have failed to comply with the letter and spirit of the discovery rules. The attempted use of written interrogatories at this stage of the proceedings sharply conflicts with the intent and purpose of Rule 70(a)(1) and constitutes an abuse of the Court's procedures.

Accordingly, we conclude that [the IRS's] motion for a protective order should be granted and [the IRS is] relieved from taking any action with respect to these written interrogatories. The parties will be directed to have informal conferences during the next 90 days for the purpose of making good faith efforts to exchange facts, documents, and other information. Since the cases have not been scheduled for trial, there is sufficient time for the parties to confer and try informally to secure the evidence before resorting to formal discovery procedures. If such process does not meet the needs of the parties, they may then proceed with discovery to the extent permitted by the rules.

In summary, it is important for practitioners to realize that Branerton still reflects the primary mode of operation: informality and spirit of cooperation that is sought and expected in Tax Court practice and litigation. Certainly, we have a significant number of multi-million, even multi-billion dollar cases in the Tax Court, and informality and cooperation is difficult when such numbers are at stake.

In my opinion, however, in the smallest and even in the largest cases, the Tax Court still expects the basic principles reflected in Branerton to be attempted first and applied before either party goes after the other with elaborate and cumbersome formal discovery. For a discussion of the continued viability of the Branerton principles in the context of large-dollar tax cases, the Tax Court's reviewed opinion in *Mary Kay Ash v. Commissioner*, 96 T.C. 459 (1991) is noteworthy (see particularly my concurring opinion at 476). It will surely be on the final exam.

We will next talk more about the formal discovery rules that are

We will next talk more about the formal discovery rules that are presently available in the Tax Court, how they compare with the formal discovery rules of the Federal Rules of Civil Procedure, and how the rules in recent years have moved somewhat significantly in the direction of the Tax Court's Branerton procedure

Formal Tax Court Discovery—Rules 70-75

As explained, assuming the parties have complied with Branerton and have informally exchanged basic facts and documents, the Tax Court does have in place formal discovery rules that the parties in the Tax Court can turn to and utilize to obtain additional information from the opposing side

These Tax Court rules are similar to, but do have a few significant differences from, the formal discovery rules of the Federal district courts. After reiterating the basic Branerton policy of a strong preference for informal discovery, Rule 70 provides basic guidance on how to conduct formal discovery in the Tax Court.

Rule 71 provides for "interrogatories" which are simply written questions, authored by the lawyer for one party that are propounded on the opposing party, answers to which are written by the lawyer for and signed by the opposing party. Interrogatories are generally good for asking the opposing party to identify witnesses and relevant documents, and for asking general background facts, all of which should have been turned over informally under Branerton. They are generally not good for asking tough, pointed questions on key aspects of the case. Lawyers responding in writing to interrogatories find it too easy to "misunderstand" the questions, to hedge or be ambiguous, or to evade the most damaging aspect of the questions.

Rule 72 provides for requests for production of documents. Again, under Branerton, all relevant documents should have been turned over. There should be little use for either interrogatories or requests for production of documents in the Tax Court, if the parties are complying with the mandate for informal discovery. Sometimes, however, interrogatories are useful just to pin the opposing party down in writing on some basic facts that the propounding party already knows.

What is the preferred recourse if, in the Tax Court, one party does not comply with the informal discovery rule, does not exchange information informally, and may even refuse to meet? Should you proceed, at that point, to serve on the uncooperating party formal discovery? Generally, no. It is my preference that in such a situation, the lawyer first notify my office and request of my secretary that a conference call be set up to discuss with me the breakdown of informal discovery. We will together usually reach a quick agreement as to the level of

informal discovery that is to occur or as to type and timing of formal discovery that is appropriate

Also, if after informal and formal discovery is completed, the effort to stipulate basic facts and documents under Rule 91 breaks down, I prefer that the parties notify my office of that fact and request a conference call to discuss the problem, rather than file a written motion under Rule 91(f) to compel the other party to stipulate. Such a motion is always difficult and time consuming to write, painful for me to read, and inconclusive when the other side responds in kind (namely, by submitting a response that blames all the difficulties on the other party)

Going back to the formal discovery rules of the Tax Court, Rule 74 provides for “consensual” discovery depositions under oath of the taxpayer, or of other key witnesses that both parties agree should be deposed and put under oath. Depositions are very useful. Often the best tactic for a lawyer to take who has a particularly credible witness is to make that witness available before trial to the other side via a deposition. The case may be settled soon thereafter.

As indicated, in the Federal district courts, depositions by government lawyers for the IRS of the taxpayer are common, and commonly allowed over the objection of the taxpayer and his or her lawyer. Rule 75 of the Tax Court, however, provides that when the IRS seeks to take a deposition of the taxpayer and the taxpayer objects, the Tax Court has no authority to order that the taxpayer submit to the deposition. Rule 75 only provides that when a deposition is not agreed to by the other side, the party seeking the deposition may file a motion with the Court for an order permitting the deposition to be taken, but only of a non-party witness.

Thus, in the Tax Court, we have, in my opinion, the rather odd and unfortunate situation that in a multi-million dollar, large and complex case, the IRS wishes to depose the taxpayer, or the president of the taxpayer corporation, who knows all of the intimate details of the transaction and of the issue (e.g., a hobby-loss or a for-profit activity issue), the taxpayer can veto the deposition and force the IRS lawyer to wait until the time of trial to eyeball and question the taxpayer for the first time.

Theoretically, the Tax Court judge might try to order the deposition of the taxpayer under some other general rule of case management, but to my knowledge that has never been done, and it would be contrary to the wording and understanding of Rule 75.

DAY 3

Trials in the Tax Court

I BASIC PRINCIPLES

Federal tax litigation in general has long been regarded as the most "civil" of all Federal court litigation, and litigation in the Tax Court is regarded as perhaps the most "civil" of all tax litigation. By "civil" I mean somewhat forgiving, less rigid, more informal, less intimidating, less costly, minimal formal discovery, and rather loose interpretation of Federal Rules of Evidence, particularly the hearsay rule and business records exception thereto.

Many tax lawyers who are tax planners would be quite reluctant to litigate a tax refund case in the Federal district courts, and they would likely hire a litigator to "first chair" the case. Many tax planners, however, with little if any litigation experience, would not be too hesitant to litigate their client's case in the Tax Court.

This basic and significant difference between litigation and a trial in the Federal district courts versus a trial in the Tax Court is attributable to various factors -- the early history of the Tax Court as an Executive Branch administrative hearing agency, the fact that the Tax Court does not have criminal jurisdiction nor jury trials, and the fact that many of the judges that have been appointed to the Tax Court over the years had a tax planning background, not a litigation background.

As a result of the above, in the Tax Court the rules of evidence are more loosely applied. The judges tend to be more interested in technical tax aspects of the case, rather than probing into the "ins and outs" of the Rules of Evidence. Also, and unfortunately, judges of the Tax Court receive little formal CLE training in the Rules of Evidence.

Awareness of the above factors will help you in litigating in the Tax Court. If you have a knotty evidentiary problem that you anticipate at trial, prepare well, have the cases in support of your position at hand, and don't assume the judge will be up to speed on the niceties of the Rules of Evidence. You may even want to bring the evidentiary problem to the judge's attention before trial and brief the question in advance of the trial.

Keep in mind that in the Tax Court the judge will decide the case -- no jury. All of your arguments -- legal, equitable, procedural, evidentiary -- will be decided by the judge before you. From your very first oral or written communication with the judge in the case, you are talking to the sole person who will make the decision (barring Court review, which we will talk about later in the week, or appeal), and that in each

communication with the judge you are establishing your credibility and rapport with the judge

Always, especially in every oral communication with the judge about the case -- in person or on the phone -- make sure you know and can explain three basic pieces of information about the case

(1) What is the total \$ amount involved in the case,

(2) What are the key issues in the case, and

(3) What years are involved

The above 3 pieces of information a judge always wants to know in order to resolve a discovery dispute prior to trial, to rule on a matter of relevancy to discuss any aspect of the case Why? Because these 3 pieces of information allow the judge to have a sense of what the case is about, of its magnitude, of its scope, of what might be relevant to resolution of the case and the issues, and how the case might be prepared for trial and be tried

So often the lawyers raise pretrial problems that they allege is critical I will interrupt them and ask "First tell me this about the case, what years are involved and what are the key issues?"

The response I too often get is, "Well, let's see the files are in the next office It will take me a minute or two to get that information More often than not in written motions to compel discovery or to compel stipulations the lawyers do not provide this information In those cases my secretary must then pull out the file and we have to wade through other documents to get that information

Always be prepared, at any point in a case to answer the above 3 questions!

One other basic principle Remember the judge is not your opponent The judge is not your enemy, nor your impediment to justice and victory The judge is suppose to be and likely is your only "vehicle" through which you are going to obtain justice if at all

Accordingly do not view questions from the judge as "interruptions" to the "script" of your opening statement or of the questions you have prepared for your witness or for cross examination of another witness Every interruption or question from the judge -- of you or of a witness -- is a signal as to where the judge is, what the judge is thinking about what the judge thinks is important View it as an opportunity to turn your attention your statements your questions your time directly to the matters that the judge is thinking about Deal with that question

Don't go back to your scripted questions or statement until you are sure the judge is ready to do so

Even better, know your case so well, that you don't need to use a script
This all comes with experience I also used a script the first few trials, and I also lost my moot court trial in Law School

II Tax Court Rules

As you have noticed from my repeated reference thereto, the Tax Court has its own set of pretrial and trial rules that govern many aspects of a Tax Court trial Just above every court has its own set of local rules Always check those local rules before filing and before trying a case in any court with which you are not familiar

The particular rules of the Tax Court that apply to the conduct of actual trials in the Tax Court are found in Tax Court Rules 132-152 Many of the other Tax Court rules will, of course also come into play at different stages of your case

As Steve Salch has already explained most of the Tax Court trials are set on General Trial Calendars on which perhaps 50 to 100 cases will be set for trial on the same 1 or 2 week trial calendar Many of the cases will settle and the judge usually end up actually trying 5 to 10 cases

After the trial the judge may render an immediate "bench" opinion or more typically ask for post trial briefs from the parties, and then decide the case by written memorandum or division opinion explaining in detail the findings of fact and law upon which the judge's decision is based I will explain later in the week the Court Review and Conference procedure of the Tax Court

If your case has some unique aspect to it or if you anticipate that the trial of your case will take more than a few days you should notify the judge a number of months before the trial calendar is to begin to explain that the case will take a number of days and at least give the judge the opportunity to set the case for trial on specific days of that calendar

If your case is particularly complex or large and is going to involve an unusually complex pretrial proceedings and/or an unusually long trial you should seriously consider filing a motion to have the case specially assigned to a judge long before it is put on a general trial calendar Usually the Chief Judge grants such a request particularly if it comes into the court as a joint request from both the taxpayer and the IRS

The Federal Rules of Evidence apply in the Tax Court although as

stated, not as strictly as in the other Federal courts. Certainly, any Federal court decision interpreting and applying a Federal Rule of Evidence is good authority for any evidentiary problem you may have in the Tax Court. Note that the Tax Court's Rule 143(a) states that these Federal Rules of Evidence shall apply in the Tax Court as they are interpreted by the U.S. District Court for the District of Columbia. If a particular rule of evidence, however, is interpreted differently by the 9th Circuit Court of Appeals, and if the Tax Court trial is being conducted in San Francisco and is appealable to the 9th Circuit, the Tax Court likely would defer to the 9th Circuit's interpretation.

I will explain more this rule of deference by the Tax Court to the law of the applicable court of appeals -- known as the Golsen rule -- later in the week.

With the notice of setting of a case on a general trial calendar, you will receive from the Tax Court a Standard Pretrial Order. A typical such order is set forth below. This is my order for my trial calendar beginning next March in San Francisco. Note that this order includes an explanation of an experimental settlement judge or mediation experiment that the Tax Court is piloting in San Francisco and Los Angeles.

At the beginning of a Tax Court trial, each lawyer should be able to explain what has been stipulated, what exhibits can be admitted into evidence, and each lawyer will then be expected to make a brief opening statement. Please do not read your opening statement.

An opening statement should briefly (in 5 to 15 minutes) summarize the evidence you anticipate will be offered to prove up your side of each of the main issues in the case. It should give the judge some advance signal of what you think your key evidence is that you think entitles your client to win.

Another important strategy in every case, which should be disclosed and explained in your opening statement, is whether you are relying on alternative arguments. If so, each alternative argument should be explained. This takes some careful thought. Many lawyers do not think through alternative arguments and can not explain them well. For each alternative argument, you should be able to explain:

- (1) what is the argument and why is it being made in the alternative?
- (2) is the alternative argument consistent or inconsistent with other arguments?
- (3) what triggers the argument?
- (4) what moots the argument?

Remember that in the Tax Court the taxpayer generally has the burden of proof. The taxpayer should subpoena for trial testimony all witnesses that the taxpayer needs to make their case and all custodian of records that the taxpayer needs to have produce records at the trial.

Generally, records should have been obtained from the opposing party informally under Branerton and from third parties by deposition subpoena, if necessary, prior to the trial via a consensual deposition under Rule 74.

The Tax Court's subpoena power is nationwide, and the Tax Court Clerk's Office can provide subpoenas for service on the witnesses. The Tax Court has authority to enforce the subpoenas and to imprison witnesses for not honoring a trial subpoena.

Usually, because of the burden of proof, the taxpayer proceeds first to call witnesses, followed by cross examination by the IRS lawyer. If the fraud addition to tax is involved, the IRS will often, by agreement or by direction of the court, be expected to go first with its witnesses.

Occasionally, the parties will be expected to make closing arguments at the end of the trial. Here, the lawyers should attempt to summarize the key evidence that actually has come into evidence and that they believe would support a decision in their client's favor on each issue. Thereafter, unless a bench opinion is rendered, the judge will set a post-trial briefing schedule.

Below please see a sample Standard Pretrial Order, the attached explanation of the experimental settlement judge procedure, and a form that can be used for the pretrial brief that the Standard Pretrial Order requires be served on the opposing party and filed before the trial.

UNITED STATES TAX COURT WASHINGTON, D.C.

STANDING PRE-TRIAL ORDER

To the parties in the Notice of Trial to which this Order is attached

Policies

You are expected to begin discussions as soon as practicable for purposes

of settlement and/or preparation of a stipulation of facts. Valuation cases and reasonable compensation cases are generally susceptible of settlement and the Court expects the parties to negotiate in good faith with this objective in mind. All minor issues should be settled so that the Court can focus on the issue(s) needing a Court decision.

If difficulties are encountered in communicating with another party, or in complying with this Order, you should promptly advise the Court in writing with copy to each other party, or in a conference call among the parties and the trial judge.

Continuances will be granted only in exceptional circumstances. See Rule 134, Tax Court Rules of Practice and Procedure. Even joint motions for continuance will not routinely be granted.

If any unexcused failure to comply with this Order adversely affects the timing or conduct of the trial, the Court may impose appropriate sanctions, including dismissal, to prevent prejudice to the other party or imposition on the Court. Such failure may also be considered in relation to disciplinary proceedings involving counsel. See Rule 202(a).

An experimental Settlement Judge Procedure will be available on this trial calendar. See attached notice explaining this procedure.

Requirements

To effectuate the foregoing policies and an orderly and efficient disposition of all cases on the trial calendar, it is hereby

ORDERED that all facts shall be stipulated to the maximum extent possible. All documentary and written evidence shall be marked and stipulated in accordance with Rule 91(b) unless the evidence is to be used to impeach the credibility of a witness. Objections may be preserved in the stipulation. If a complete stipulation of facts is not ready for submission at trial, and if the Court determines that this is the result of either party's failure to fully cooperate in the preparation thereof, the Court may order sanctions against the uncooperative party. Any documents or materials which a party expects to utilize in the event of trial (except for impeachment) but which are not stipulated shall be identified in writing and exchanged by the parties at least 15 days before the first day of the trial session. The Court may refuse to receive in evidence any document or material not so stipulated or exchanged unless otherwise agreed by the parties or allowed by the Court for good cause shown. It is further

ORDERED that unless a basis of settlement has been reached, each party shall prepare a Trial Memorandum substantially in the form attached hereto and shall submit it directly to the undersigned and to the

opposing party not less than thirty (30) days before the first day of the trial session. It is further

ORDERED that witnesses shall be identified in the Trial Memorandum with a brief summary of the anticipated testimony of such witnesses. Witnesses who are not identified will not be permitted to testify at the trial without leave of the Court upon sufficient showing of cause. Unless otherwise permitted by the Court upon timely request, expert witnesses shall prepare a written report which shall be submitted directly to the undersigned and served upon each other party at least 30 days before the first day of the trial session. An expert witness' testimony may be excluded for failure to comply with this Order and the provisions of Rule 143(f). It is further

ORDERED that, where a basis of settlement has been reached, stipulated decisions shall be submitted to the Court prior to the first day of the trial session. Additional time for filing of settlement documents will be granted only where it is clear that settlement has been approved by both parties, and the parties shall be prepared to state for the record the basis of settlement and the reasons for delay in filing documents. The Court will specify the date by which settlement documents will be due and expect proposed decisions to be submitted by such date. It is further

ORDERED that all parties shall be prepared for trial at any time during the term of the trial session unless a specific date has been previously set by the Court. It is further

ORDERED that every pleading, motion, letter or other document submitted to the Court by any party subsequent to the date of the notice of trial shall be served upon every other party or counsel for a party and shall contain a certificate of service as specified in Rule 21(b).

Dated: Judge

NOTICE OF EXPERIMENTAL SETTLEMENT JUDGE PROCEDURE

Consistent with the increased utilization by Federal courts of various alternative dispute resolution techniques, during the San Francisco trial calendar beginning March 17, 1997 on which this case is calendared for trial, the Tax Court, as an experiment only will have available a judicial officer, other than the trial judge, to act as a confidential settlement judge or confidential mediator. It is expected that this experimental procedure would be available in those cases that do not settle in the normal course of pre-trial settlement negotiations between the parties and where the parties or the Court believe that use of a settlement judge would be of assistance to the expedited resolution of the case.

It is intended that the settlement judge generally would not be asked to assist in mediating issues in a case until after the parties have participated fully and in good faith in settlement negotiations between themselves.

Under this experimental settlement judge procedure any party in a case may submit a written request to the Court to discuss the case with the settlement judge. Such request should be accompanied by a representation that the party making the request has already participated in good faith settlement negotiations with representatives of the opposing party in the case. The request should also include a representation that a copy of the request has been sent to the opposing party and a representation as to whether the opposing party agrees with the proposal that the matter be referred to a settlement judge.

Also unless an agreement for the settlement of your case has already been reached in your Trial Memorandum which should be filed no later than February 14, 1997 please indicate whether mediation of the issues in your case by the settlement judge would in your opinion be appropriate.

Use of the experimental procedure described herein will generally not justify a continuance in a case.

It should be noted that a change has been made to the STANDING PRE-TRIAL ORDER to accommodate this experimental procedure (namely your Trial Memorandum is due not less than thirty (30) days before the first day of the trial session).

Trial Calendar SAN FRANCISCO, CALIFORNIA Date MARCH 17, 1997

TRIAL MEMORANDUM FOR (Petitioner/Respondent) Please type or print legibly (This form may be expanded as necessary)

NAME OF CASE DOCKET NO (S)

ATTORNEYS Petitioner _____ Respondent
_____ Tel No _____ Tel No

AMOUNTS IN DISPUTE Year(s) Deficiencies Additions Damages

STIPULATION OF FACTS Completed _____ In Process _____

ISSUES

WITNESS(ES) YOU EXPECT TO CALL (Name and brief summary of expected testimony)

CURRENT ESTIMATE OF TRIAL TIME _____

(Continued on back)

SUMMARY OF FACTS (Attach separate pages if necessary to inform Court of facts in chronological narrative form)

BRIEF SYNOPSIS OF LEGAL AUTHORITIES (Attach separate pages, if necessary, to discuss fully your legal position)

EVIDENTIARY PROBLEMS

DO YOU WISH TO DISCUSS THIS CASE WITH THE SETTLEMENT JUDGE?

DATE _____
Petitioner/Respondent

Return to Judge Stephen J. Swift United States Tax Court Room 316 400
Second Street N.W. Washington D.C. 20217 (202) 606-8731

III EXPERT WITNESSES

A majority of cases litigated in the Tax Court (as well as in the district courts and U S Court of Federal Claims) involve the tax statutes and regulations as mere background – important background to make one's arguments to decide the case and to understand the opinion that is reached. But at the core of most cases (i.e., most cases turn on) not some narrow or esoteric provision of tax law. Rather they turn on the facts!

Common fact issues litigated in the Tax Court involve tax fraud, the valuation of property, the "innocent spouse" status of one of a husband or wife, the allocation of income and expenses between related parties, taxpayers' liability for negligence or the other civil penalties, the legitimacy of a purported business activity or the for-profit objective of a taxpayers' activity, and substantiation of claimed business expenses. All of these issues and most others, are fact intensive. Frequently, positions taken in factually intensive trials involve unique expertise that is addressed by the parties via expert witness reports and expert witness testimony.

Rules 702 and 703 of the Federal Rules of Evidence allow experts to testify and to give opinion testimony (1) where such testimony is regarded as benefitting the trier of fact to understand the case and to decide issues of fact and (2) where the particular witness called is qualified to give an expert opinion on the matter.

Rule 704 of the Federal Rules of Evidence allows experts to give opinions on ultimate issues in the case and too often experts attempt to do so just that and no more or to give opinions on subsidiary issues but without explaining the factual basis therefor.

Tax Court Rule 71(d) allowing interrogatories that ask for an expert witness's opinion and the specific basis and reasoning therefor. Rule 76 allowing formal depositions of experts to be taken and Rule 143(f), requiring expert witnesses to prepare written reports setting forth their opinions and the specific facts and reasoning in support thereof are all intended to give the parties in Tax Court cases the tools they need to force experts to disclose fully the facts, data, and reasoning on which they have and do rely in reaching their opinions.

In tax litigation, expert witness testimony often would clearly benefit the court. Too often, however, the particular expert witness testimony that is offered is so conclusory, so superficial, so one-sided and obviously biased in favor of the side who is paying the expert witness fee that the expert witness changes from an independent expert into a 'gun slinger' for the client.

In litigating many tax shelters during the 1980s, Tax Court judges saw

more "experts" than they knew existed. Many of these so-called experts probably started out as independent experts but became so "energetic" about their clients' case that they appeared to lose their independence and to take on the status of "advocates" for one side or the other -- just another "assistant" for the lawyer who hired the expert.

In such situations, courts are increasingly willing to call it as they see it, and to reject or ignore the so-called expert's testimony on the grounds of bias and lack of independence. As explained by one court of appeals judge on this point in the context of expert testimony submitted by way of an affidavit in support of a motion for summary judgment:

Rule 705 [of the Federal Rules of Evidence] allows experts to present naked opinions. Admissibility does not imply utility. [The expert] presented nothing but conclusions -- no facts, no hint of an inferential process, no discussion of hypotheses considered and rejected. *** An expert who supplies nothing but a bottom line supplies nothing of value to the judicial process.

Judges should not be buffaloed by unreasoned expert opinions. *** ukase in the guise of expertise is a plague in contemporary litigation. *** [The expert] cast aside his scholar's mantle and became a shill for [the client]. *** [Mid-State Fertilizer v. Exchange Nat. Bank, 877 F.2d 1333, 1339-1340 (7th Cir. 1989)] [Citations omitted.]

Tax Court Rule 143(f) anticipates that the expert witness will prepare and submit a written report and therein thoroughly explain the underlying facts and reasoning on which the conclusion is based. The Rule also makes it clear that such expert witness report will generally serve as the expert's direct trial testimony and that the limited oral testimony that will be heard from the expert will occur on cross examination or on rebuttal, not on direct examination. Most judges on the Tax Court probably approach expert witness testimony in that fashion and limit or allow no direct testimony from the expert witness once the expert's report has been admitted into evidence.

Personally, I prefer that after an expert's report is submitted into evidence the expert then spend a period of time on direct examination, personally explaining the key facts and the reasoning relied on in the report. I want to eye-ball the expert witness, hear the expert explain the report, evaluate the expert's credibility, professionalism, and objectivity. Otherwise, I have just the expert's cold written report to go on and the expert's defensive testimony on cross examination, and I do

not feel as comfortable evaluating the weight to be given one expert over another

In summary, in the Tax Court, it is my recommendation that qualified experts be used, where appropriate to assist the court on technical matter. The expert's written report should be submitted timely, in good form and style, and with complete explanations of the facts and reasoning relied on. The parties should be prepared to allow the experts to be deposed under Rule 76, and to meet informally with each other to attempt to come to a meeting of the experts' minds.

At trial, the parties should be prepared to ask, and the experts should be prepared to respond to, some key questions about the expert's report, and the facts and reasoning relied on. This should occur, in my opinion, not only on cross, but also on direct examination by the party offering the expert witness report. To clarify your particular judge's preference with regard to direct examination and testimony from the expert to personally explain his report before he is subject to cross examination check with your particular judge before the trial.

IV SMALL CASE PROCEDURES

For cases involving income or gift tax deficiencies alleged by respondent of no more than \$10,000 for each year, or no more than \$10,000 in estate taxes, taxpayers have the option of filing petitions in the Tax Court with respect thereto and of electing the "Small" or "S" case procedures described in IRC section 7463 and in Tax Court Rules 170-183.

For cases involving deficiencies of no more than \$10,000 per year the "S" case election or designation is generally at the option of the taxpayer and is generally made in the petition. The election also can be made later by the taxpayer at any time before trial. If the case is perceived by IRS or by the Court to be of particular significance or legal importance the IRS may object and may file a motion to have the "S" case designation removed from the case and to have the case treated as a regular case, or the Court may so order on its own initiative.

Form 2 in the Appendix to the Tax Court's Rules is a sample form petition that can be used for filing a case as an "S" case.

There are two primary consequences to "S" case designation.

(1) The trial of "S" cases by Special Trial Judges is to be conducted on a very informal basis. The rules of evidence are relaxed. "Any evidence deemed by the Court to have probative value shall be admissible. Rule 177(b) and

(2) No appeal from decisions of Special Trial Judges in 'S' cases is allowed. Neither the IRS nor taxpayers may appeal decisions rendered in "S" cases.

As a result of #1 above, taxpayers in the trial of "S" cases generally are pro se or not represented by lawyers, and Special Trial Judges often will provide some active assistance to taxpayers in the conduct of the trials. For example, Special Trial Judges may make a particular effort to ask questions of witnesses and to make suggestions to taxpayers that would not occur in the trial of regular cases.

The pretrial rules of informal discovery, stipulation, and formal discovery that we have already discussed in this seminar generally apply to "S" cases. Generally, pre-trial and post-trial briefs are not filed by the taxpayer nor by the IRS in "S" cases.

The objective of the "S" case procedure is to provide a forum in which legal technicalities are de-emphasized, the rules of evidence are not applied strictly, and the Special Trial Judge is expected to conduct the trial in a manner that makes it practicable for a pro se taxpayer to handle the case and still have some reasonable possibility of success.

As a result of #2 above, in deciding "S" cases Special Trial Judges have more ability to "do equity" and to make "estimates" of expenses and other items that are at issue but not documented or substantiated. A related aspect of "S" cases that allows Special Trial Judges to be more flexible do more equity, and to be less technical than in regular cases is the provision that "S" cases which are written up in what we refer as "Summary Opinions" are not treated as precedential, should not be cited as authority, and are not published. See section 7463(b).

A number of law schools have established law clinics and offer assistance and legal representation particularly to pro se taxpayers in 'S' cases.

Further, a number of State and local bar associations have established pro bono programs under which pro se taxpayers in both "S" cases and in regular cases are offered pro bono assistance at the calendar call.

Note that upon the filing of 'S' case petitions, the IRS is not required to file answers, and a taxpayer should contact the local IRS District Counsel office to determine whom to talk to about the case.

Special Trial Judges conduct 'S' case calendars in a number of small cities in which the Presidentially appointed judges do not sit for trial of regular cases. For example, "S" case trial calendars may be held in a city such as Fresno, CA, whereas the regular trial calendars in California are held only in Los Angeles, San Francisco, and San Diego.

When an "S" case calendar is put together, all cases requesting that city for its trial venue that involve tax deficiencies of no more than \$10,000 will likely be put on that calendar and tried by a Special Trial Judge, whether or not the "S" case election has been made. Cases so tried by Special Trial Judges in which the "S" case election has not been made are not tried as "S" cases, and the taxpayer and the IRS will have the right to appeal such a case. But the Special Trial Judge will preside at the trial and will write up the opinion and decide the case, but under the regular Tax Court rules.

Special Trial Judges also have authority to try cases involving amounts in dispute in excess of \$10,000, when assigned such a case by the Chief Judge. Those cases, of course, are not treated as "S" cases and both parties have full rights of appeal. See Rule 183. In such cases involving more than \$10,000, the proposed written opinions of Special Trial Judges must be reviewed and approved by a Presidentially appointed judge.

V Bench Opinions or Oral Findings of Fact and Oral Conclusions of Law

The Tax Court conducts no jury trials. All issues raised in cases that are tried must be decided by the Tax Court trial judge. Section 7460 makes it clear that decisions of the judges of the Tax Court are to be in written form.

Many of the opinions take an enormous amount of time to write up. At the same time, section 7459 specifies that our decisions are to be made "as quickly as practicable."

In recognition that many cases that are tried do not involve complex issues and that to require such decisions to be rendered in a formal written opinion might well be merely postponing the inevitable, section 7459(b) and Rule 152 provide that Tax Court judges and Special Trial Judges may, in appropriate cases, decide the case by "oral" findings of fact and conclusions of law—that is, by rendering a "bench" opinion immediately after the trial.

A bench opinion is simply an opinion that the judge, after the trial, reads or speaks into the record. The parties and the lawyers are typically still present and the judge renders quick justice. The bench opinion is then transcribed by the court reporter and a written copy of the bench opinion is served on the parties and available to be reviewed by an appellate court if it is appealed.

As a resource to use for bench opinions, judges will frequently look to the parties' pre-trial briefs. If you anticipate that your case may be suitable for a bench opinion (keep in mind that bench opinions are not

rendered just against taxpayers), prepare a more extensive pre-trial brief. Provide some good quotations and citations from the Tax Court and from your circuit court of appeals on the general principles of law that are applicable, and provide in your pre-trial brief some good factual background information on the issues in your case.

Where the above type of information is not readily available for the judge to use in a bench opinion, even though the case may be relatively simple and quite suitable for a bench opinion, the judge may decline to do so, and you may end up having to file post-trial briefs and waiting 6 months or more for your decision.

Can you ask for a bench opinion, and if so would you do so at the beginning of the trial or at the end of the trial? Yes, you can ask, but be tactful and suggest, rather than ask. Even better, discuss it in advance with your opposing lawyer, and perhaps you two can agree that either way it is decided, a bench opinion would be appropriate. Then, you might jointly represent to the court at the beginning of the trial that the case should not need post-trial briefing, that you have filed good pretrial briefs, that the trial evidence will cover the remaining factual matter, and that the court “may wish to consider rendering a bench opinion [in your favor, of course].”

Note that a judge in a bench opinion is still required to state orally the specific findings of fact that are essential to support the decision. Thus, you will still know what has been decided, why you have won or lost, and you should be able to fully evaluate whether an appeal is appropriate. As suggested earlier, each party has full rights of appeal from a bench opinion.

Are certain types of issues uniquely suited to bench opinions? It is not so much the type of issue but rather the lack of complexity—factually and legally—of the particular issue in your case that makes it suitable for a bench opinion. Some issues, however, do seem to be more susceptible to bench opinions than others. Substantiation issues, innocent spouse issues, for-profit issues, tax protestor issues, additions to tax, for example.

Sometimes judges are reluctant to render a bench opinion because they don't want to be there in the courtroom, however, most judges find that all parties seem quite relieved to receive the decision so quickly. How does the old saying go?—“Justice delayed is no justice at all.”

V Court Reviewed Opinions

The U.S. Tax Court's existence is based on the perceived need to have a

specialty "tax" court, with specialty "tax" judges, and a procedure for insuring that those judges interpret and apply the tax law to taxpayers throughout the Country in a uniform and thoughtful manner

The need for uniform and thoughtful application of the tax law and facts to tax disputes is addressed by way of the Tax Court's "court review" procedure. Every written opinion of a judge is submitted by the authoring judge to the Chief Judge's Office where it is reviewed by experience tax lawyers who work on the staff of the Chief Judge. Assuming it passes that "review" the proposed opinion is then circulated within the Court to all of the other judges. Assuming it is not questioned by any of the other judges, the opinion will be filed and served on the parties.

If, however, the opinion is questioned or challenged by the Chief Judge or by any two of the other judges of the Court during the above review process, the opinion will not be filed at that time. The authoring judge will have an opportunity to "negotiate" with the Chief Judge or with the other judges who have a problem with the opinion. If the questions can be worked out or if modifications to the opinion can satisfy the judges who have questioned it, it can then be filed and served on the parties.

If the questions or concerns can not be worked out, and the authoring judge stands on the opinion as written, the opinion as proposed will then be scheduled to be debated at a Court Conference of all 19 of the Presidentially appointed judges of the Tax Court. This Court review function of the Tax Court constitutes a quasi-appellate function of the judges of the Tax Court over proposed opinions of their colleagues. After the debate a vote is taken and a majority of the participating judges controls.

If the opinion is adopted as written, the dissenters can write dissenting opinions. If the opinion is voted down, the authoring judge can agree to rewrite it the other way, after which the revised opinion will usually come back to the Court Conference for another vote. If the authoring judge is voted down and refuses to rewrite it the other way, the case will be reassigned to another judge to rewrite it the other way, and the new opinion of the other judge will then eventually come back to the Court Conference for another debate and vote.

Certain informal guidelines exist for the type of cases that will be sent to Court Conference. For example, where the proposed opinion holds a Treasury Regulation invalid, where the opinion addresses an issue on which a recent Court of Appeals opinion has reversed an earlier Tax Court opinion, where the opinion would hold a section of the Internal Revenue Code unconstitutional, where the opinion holds that a Treaty provision trumps a section of the Internal Revenue Code, the opinions would in all likelihood automatically be sent to Court Conference.

If you have such a major issue, you should be aware of the likelihood of Court Conference review and write your briefs and try your case accordingly. Also, be aware that to win your case you actually will have to convince at least a majority of the judges voting on the case, not just the single judge sitting before you at the trial.

Occasionally, a case goes to Court Conference because of the unusual way it is written up, or because of particularly strong feelings within the Court that it is written up incorrectly. For example, an unusually large \$ case will attract attention within the Court and may generate some significant opposition because of the way it is written or the conclusion it reaches. If a number of judges officially request the Chief Judge to hold the opinion and to send it to Court Conference, that request will normally be honored.

The Court Conference review of important issues and cases is one of the most important and most challenging aspects of being a judge on the Tax Court. As I suggested earlier, it makes me not only a trial judge but also a quasi-appellate judge. The Tax Court's Court Conference review procedure is not well understood and not fully appreciated by many lawyers.

This concludes our material for this seminar on certain aspects of the litigation of Federal tax disputes in the U.S.

Paul Stephan (pbs@virginia.edu)
804-924-7098 fax 804-924-7536

Type of Action	Limitation Period	IRC §
Claim for refund of overpaid tax	On or before <i>later</i> of 3 years after return filed or 2 years after tax paid	6511(a)
	If statute of limitations was extended by consent on or before 6 months after expiration of extended period	6511(c)(2)
Filing suit for refund of overpaid tax	<i>Not before</i> 6 months from date of filing refund claim (with no response from IRS) or date of notice of disallowance	6532(a)(1)
	<i>Not after</i> 2 years from date notice of disallowance is sued or 2 yrs from date statutory notice of disallowance was waived	6532(a)(3)

CHAPTER 6

CHOICE OF FORUM IN CIVIL
TAX LITIGATION

§ 61 Introduction

When efforts to resolve a tax dispute administratively fail, the taxpayer must decide whether to pay the disputed tax (or abandon hopes of recovering a claimed refund), or instead to litigate the controversy. At this stage, the taxpayer enjoys an unusual and significant strategic advantage: the taxpayer in a civil tax controversy can select among three different courts, each with different procedures, precedents and levels of expertise. Although "forum shopping" is present in other aspects of our judicial system, in no other type of case is one party favored with such broad discretion to select among several courts the forum that is most likely to rule in his favor.

The three available forums are the United States Tax Court, the United States district courts, and the United States Claims Court (formerly the Court of Claims). To ensure that the proper forum is selected, one must be familiar with the most important features of each. For example, factors that may determine the appropriate selection include whether a jury trial is available, whether the taxpayer must first pay the disputed tax in order

to litigate in that forum, the apparent expertise of the judges, and the precedents governing decisions in the tribunal

The Tax Court is the forum chosen by most taxpayers. As of September 30, 1988, there were 70,815 petitions pending in the Tax Court involving deficiencies totaling more than \$22 billion. As of the same date, there were 2,679 complaints pending in the US district courts seeking refunds of \$526 million and 829 complaints pending in the Claims Court seeking refunds of \$885 million. 1988 IRS Annual Report, 35, 38.

Statistics show that the taxpayer loses more often in the Tax Court than in the other forums. The IRS Annual Report for fiscal 1988 shows taxpayer victories in the Tax Court in 47% of the cases, down from 52% for the previous year. 1988 IRS Annual Report at 39. For the same period, taxpayers won 11.3% of cases in US district courts and the Claims Court, down from 15.9% for the previous year. 1988 IRS Annual Report at 38. Of course, these statistics do not take into account the legal issues involved or the merits of the cases. Because the taxpayer need not pay the tax to litigate in the Tax Court, more frivolous cases are docketed in the Tax Court than in the other forums.

Examples of how important the choice of forum can be abound. One of the most famous is *Estate of Carter v Commissioner*, 453 F.2d 61 (2d Cir 1971), in which a widow appealed from a decision

of the Tax Court holding that payments made to her by her deceased husband's employer were taxable income to her, rather than a tax-free gift. The appellate court observed that if the widow had been able to pay the deficiency and thereby qualify to litigate the issue in United States district court, based on the precedents governing the court, she would have won. On the other hand, because she could not afford to pay the tax, her only choice was the US Tax Court, which took a much more restrictive view of what constituted a tax-free gift. The appellate court reversed the Tax Court, stating that "[w]e cannot believe . . . the result should depend on whether a widow could afford to pay the tax and sue for a refund rather than avail herself of the salutary remedy Congress intended to afford in establishing the Tax Court and permitting determination before payment." The *Golsen* rule, discussed at section 628 below, precludes a recurrence of this exact problem, but examples of the disastrous impact of improper or unlucky forum selection continue to occur and the best trial forum should be selected initially, if at all possible.

§ 62 United States Tax Court

§ 621 No Need to First Pay the Tax

The single most important feature of the US Tax Court is that it is the only forum that does not require that the taxpayer first pay the disputed tax in order to file suit. For this reason, it is some-

times referred to as the "poor man's court" As its name implies, the Tax Court hears only tax cases Tax Court judges are usually quite expert in tax matters, and taxpayers who have the most complicated and technical issues often select the Tax Court for its supposed expertise

§ 622 Article I Court

The Tax Court is an Article I "legislative" court, which means that it was established pursuant to Article I of the US Constitution, rather than Article III, which established many other federal courts IRC § 7441 This distinction has little practical effect in selecting the appropriate forum, except that the Tax Court's jurisdiction is strictly limited by statute See § 625 for a discussion of jurisdictional prerequisites The main impact of Article I status is on the compensation and tenure of the judges Tax Court judges serve for terms of 15 years, rather than for lifetime appointments (as do the US district judges, for example) IRC § 7443 Tax Court judges must retire at age 70, IRC § 7447, and they do not enjoy the protection that Article III judges have from reduction in their compensation during their tenure The Tax Court consists of 19 judges appointed by the President with the advice and consent of the US Senate IRC § 7443

The court was established in 1924 as the Board of Tax Appeals Decisions from the former Board of Tax Appeals are cited as "___ B T A ___" In 1942 its name was changed to the Tax Court of the

United States In 1969 the court's name was again changed, this time to United States Tax Court, and several significant changes were made the court's status was changed from an agency of the Executive Branch that had functioned as a *de facto* court to an official Article I "legislative" court, and Tax Court judges were given expanded powers to enforce their orders by fine or imprisonment Prior to 1969, Tax Court judges could not enforce their own contempt citations, but instead were required to petition the US district courts for an enforceable contempt order

§ 623 Where the Tax Court Trial Occurs

The Tax Court is based in Washington, DC, but its judges travel throughout the country to hear tax cases Thus, selection of the Tax Court is often equally as convenient for the taxpayer as selection of his US district court, and the taxpayer need not travel to Washington, DC for the trial of his case (although he may choose to have the trial in Washington, which some taxpayers do to avoid local publicity)

§ 624 No Jury Trials, Some Rules Relaxed

Trial by jury is *not* available in the Tax Court As a result, the Federal Rules of Evidence, which apply in Tax Court proceedings, are enforced much less stringently than in a jury trial in a US district court The Tax Court has its own rules of practice and procedure, which differ from the Federal Rules of Civil Procedure Tax Court rules

require the parties to cooperate generally to resolve factual disputes. For example, pretrial discovery is more limited by the Tax Court Rules than by the Federal Rules of Civil Procedure, and Tax Court Rules require that the parties first engage in informal communication to attempt to reach the objectives of discovery before utilizing formal discovery procedures. T C Rule 70(a)(1)

Unlike the other available courts, the Tax Court permits non-lawyers to represent taxpayers in cases before it. Under Tax Court Rule 24(b), a taxpayer may represent himself in a Tax Court proceeding, and Rule 200 permits accountants and others who pass an examination to practice before the Tax Court. For obvious reasons, however, including most non-lawyers' lack of familiarity with litigation procedures and tactics, the taxpayer usually should be represented by an attorney. The Tax Court has held that it does not have the power to appoint counsel for indigent taxpayers.

§ 625 Jurisdictional Requirements

§ 6251 Limited Jurisdiction. The Tax Court does not have jurisdiction over all controversies relating to federal taxes. Its jurisdiction is limited to specific statutory grants of jurisdiction, which include income, estate and gift tax cases, windfall profits tax and certain excise tax cases, and some declaratory judgment and disclosure cases. Even if subject matter jurisdiction exists, Tax Court jurisdiction is further dependent on exact compliance with several statutory prerequisites. The Commis-

sioner must "determine" that a tax "deficiency" exists, the IRS must mail a notice of deficiency to the taxpayer, and the taxpayer must file a petition in the Tax Court within 90 days of the mailing of the notice of deficiency.

§ 6252 Commissioner Must "Determine a Deficiency." There is no required form for the notice of deficiency, and any document that fairly informs the taxpayer that the Commissioner has "determined a deficiency" and that identifies the taxable year and the amount of the deficiency is usually upheld under IRC § 6212(a). Although it might seem that the mailing of a notice of deficiency would be proof enough that the Commissioner had "determined" a deficiency, two recent cases have held that a notice of deficiency that was vague and bore no relationship to the return filed by the taxpayer did not comply with IRC § 6212(a) because the Commissioner did not "determine" a deficiency as required by the statute. *Scar v Commissioner*, 814 F.2d 1363 (9th Cir. 1987), *rev'g* 81 T.C. 855 (1983), *Campbell v Commissioner*, T.C. Memo. 1988-105. In both cases the deficiency notices stated that they were being sent "in order to protect the government's interest." The effect of these decisions is to discourage the Service from mailing hasty, last minute notices based on little or no actual examination of taxpayers' returns.

In 1988 Congress enacted new IRC § 7521, which will require that all deficiency notices mailed after Jan. 1, 1990 describe the basis for and

identify the amounts sought as tax due, interest, penalties and additions to tax. Failure by the Service to comply with these requirements will not automatically invalidate the notice, however. In addition to notices of deficiency issued under I R C § 6212, new section 7521 also applies to the first notice of proposed deficiency (usually the "90-day letter," described in Section 4.2), as well as to notices of assessment and demand for payment of tax that must be sent within 60 days after the tax is assessed and before collection procedures can be instituted. See Chapter 9 for a discussion of assessment and collection procedures.

§ 6.2.5.3 *Petition Must Be Filed Within 90 Days of Mailing of Notice of Deficiency*. The taxpayer initiates a suit in the Tax Court by filing a petition seeking a "redetermination" of the tax deficiency computed by the Service. The Commissioner of the Internal Revenue Service is the named respondent. The Commissioner is represented by attorneys from the Appeals Division and the District Counsel. In the other two available forums, the Government is represented by trial lawyers from the Tax Division of the Justice Department.

The petition may not be filed until the Service has issued the taxpayer a statutory "notice of deficiency" (known as a "90-day letter"). The notice of deficiency is sometimes referred to as the "ticket to the Tax Court" because Tax Court jurisdiction depends on its issuance. The taxpayer has

90 days from the date the notice of deficiency is mailed to the taxpayer's "last known address" to file the petition or pay the tax. If the taxpayer does neither, the Service will assess the deficiency and begin collection proceedings. Actual assessment of the tax (meaning that the Service can institute collection procedures) is barred during the 90 days after issuance of the notice of deficiency. If the taxpayer files a petition with the Tax Court during this 90-day period, the statute of limitations on assessment of the tax is suspended during the pendency of the case. I R C § 6503(a)(1).

To summarize, the date of *mailing* of the notice of deficiency is important because mailing of the statutory notice (rather than the date the taxpayer receives the notice) triggers three separate but related statutory rules:

a. It suspends the statute of limitations on assessment of the deficiency. I R C § 6503(a)(1).

b. It begins the 90-day statute of limitations in which the Tax Court petition must be filed. I R C § 6213(a).

c. It bars the Service from any assessment or collection activity during the 90-day period and, if the taxpayer files a petition in the Tax Court during the 90-day period, it further bars assessment or collection activity until the decision of the Tax Court becomes final.

Because the Code focuses on the date of mailing of the notice of deficiency, rather than on the date the taxpayer actually receives it, it is important to

retain the envelope in which the notice was mailed. The date on the notice itself may be different from the date the notice is mailed.

§ 626 *The Taxpayer's "Last Known Address"*

What happens if the taxpayer never receives the statutory notice? Obviously, the taxpayer will not have had an opportunity to petition the Tax Court to review the deficiency, and often the taxpayer first learns of the problem when the Service begins collection activity by placing liens on the taxpayer's property and levying on his bank accounts. See Chapter 9 for a discussion of the tax collection process. The Code requires only that the Service mail the notice, and permits (but does not require) mailing by certified or registered mail. IRC § 6212(a). The Code also states that the notice "shall be sufficient" if it is "mailed to the taxpayer at his last known address." IRC § 6212(b). Because we live in such a highly mobile society, it is not surprising that many taxpayers receive notices of deficiency weeks after they are mailed, or never receive them at all.

If the taxpayer never receives the notice of deficiency, one course of action is to seek an injunction barring collection of the deficiency on the theory that the notice of deficiency was never mailed by the Service, and therefore that assessment and collection are barred under IRC § 6213(a). This Code section is an exception to the general bar on suits to restrain assessment or collection of taxes. Winning such an action is quite difficult, however,

because there are detailed procedures outlined in the *Internal Revenue Manual* for keeping records of mailings of deficiency notices, and compliance with these procedures is proof of mailing. See *Keado v United States*, 853 F.2d 1209 (5th Cir. 1988).

More frequently, taxpayers challenge the validity of the notice by claiming that it was not mailed to their "last known address." If the statute of limitations has not run, the Service may simply correct its error and reissue the notice to the correct address. If the statute of limitations has expired on the deficiency, then the taxpayer's success in challenging the validity of the notice depends on a number of factors. First, if the court finds that the notice was in fact mailed to the taxpayer's last known address, then the notice is valid despite the fact that the taxpayer never received it. In one case, for example, the notice was held valid despite evidence that there had been a fire in the post office that could have caused the taxpayer's alleged nonreceipt of the notice. *Harrison v Commissioner*, T.C. Memo. 1979-045.

Another factor that will affect the court's determination of whether the notice is valid is the taxpayer's actual receipt of the notice, despite the fact that it was not mailed to his "last known address." The Tax Court has held that if the taxpayer actually receives the notice without prejudicial delay, then the notice is valid even though it was not mailed to the taxpayer's last known

address *Frieling v Commissioner*, 81 TC 42 (1983) (taxpayers timely filed Tax Court petition, notice held valid even though not mailed to last known address), *Mulvania v Commissioner*, 81 TC 65 (1983) (notice actually received 16 days after it was mailed to former but not last known address held valid, petition filed more than 90 days after notice mailed dismissed for lack of jurisdiction) The court's reasoning in these cases was that mailing to the last known address is merely a "safe harbor" for the Government, and that the notice may still be valid even though it was not mailed to the last known address Receipt of actual notice of the deficiency determined by the Commissioner, without prejudicial delay, is all that is required, according to the Tax Court See *McKay v Commissioner*, 89 TC 1063 (1987), *aff'd*, 886 F 2d 1237 (9th Cir 1989)

Receipt of the notice of deficiency by the taxpayer's attorney or accountant, and the actions taken by the advisor, can also affect whether the notice is valid For example, in *Mulvania v Commissioner*, 769 F 2d 1376 (9th Cir 1985) (*aff'g* 1984-98 TCM), the court held that a notice of deficiency that was not mailed to the taxpayer's last known address, but a copy of which was received by the taxpayer's accountant, was invalid The accountant informed the taxpayer of the notice approximately 45 days after he received it The accountant had a limited power of attorney authorizing him only to receive copies of correspondence The Ninth Circuit held

that "where a notice of deficiency has been misaddressed to the taxpayer or sent only to an adviser who is merely authorized to receive a copy of such a notice, *actual notice is necessary but not sufficient to make the notice valid*" *Id* at 1380 (emphasis added) The court reasoned that the notice became "null and void" when it was returned to the IRS undelivered, and that "the taxpayer's actual knowledge did not transform the void notice into a valid one" *Id* at 1380-81

Subsequently, however, the Ninth Circuit has held that actual notice is the central goal of section 6212(b)(1) and that delivery to the taxpayer of an exact copy of the notice of deficiency by the taxpayer's attorney was sufficient *McKay v Commissioner*, 886 F 2d 1237 (9th Cir 1989) The *McKay* majority distinguished its earlier decision in *Mulvania* on the basis that the record in *Mulvania* contained no evidence that the taxpayer either received a copy of the notice or was informed of its contents Thus, a notice of deficiency that is not mailed to a taxpayer's last known address, but of which the taxpayer is informed by his attorney or accountant without prejudicial delay, will be valid so long as the taxpayer receives a copy of the notice or is fully informed of its contents

The dissenting judge in *McKay* argued that *Mulvania* was both correct and not distinguishable, and that the misaddressed notice should not be effective According to the dissent

Until today's decision, the lines were drawn with clarity, if the IRS did not itself provide actual notice to the taxpayer or mail the notice to the taxpayer's last known address, the notice was invalid. We now depart from that line, and hold that in some circumstances notice can be provided by the taxpayer's own attorney, rather than the IRS. The inquiry now must shift from what IRS records show, to the nature of communications between tax advisors and clients. This decision * * * provides a disincentive for accurate record keeping on the part of the IRS, and will impede communication between tax advisors and their clients. [886 F 2d at 1240, Schroeder, J., dissenting.]

The stakes in these cases can be quite high if the court finds that the Service properly mailed the notice to the taxpayer's last known address, or that the taxpayer received the notice in time to file a Tax Court petition, then the taxpayer cannot litigate in Tax Court unless he actually files the petition within the 90-day period following mailing of the notice, on the other hand, if the court finds that the Service did not properly mail the notice to the taxpayer's last known address, and that the taxpayer did not actually receive the notice in time to file a Tax Court petition, then the notice is not valid and, assuming it was issued just prior to the expiration of the statute of limitations (as is usually the case), then the Service will be time-barred from trying to assess and collect the tax.

Given these stakes, it is important to identify exactly what is a taxpayer's last known address. Unfortunately, there are no clear guidelines, and the courts are split concerning the effect of certain types of notice from the taxpayer. Although the Service generally may simply use the address shown on the return in question, that address may not be used if the taxpayer notifies the Service in a clear and concise manner that his address has changed. Filing a later return with a different address is at least highly relevant, according to several US Courts of Appeals, although the courts do not uniformly hold that it is enough to notify the Service of a change in address. See, e.g., *King v Commissioner*, 857 F 2d 676 (9th Cir 1988) (re-stating the rule in the Ninth Circuit that "a subsequently filed tax return with a new address does give the IRS notice" of the change of address). Filing a power of attorney directing the Service to send copies of all correspondence to the taxpayer's representative is not sufficient notice of change of address even though the form clearly indicates an address for the taxpayer that is different from the address shown on the return in question. Oral notice alone is sometimes held sufficient, but the best practice would be to notify the examining agent orally and confirm this in writing to the Office of the District Director where the return was filed.

§ 627 Small Tax Cases

Taxpayers with asserted tax deficiencies of \$10,000 or less for any taxable year have the option of electing the more informal procedures available under IRC § 7463. The purpose of this provision is to afford a less expensive alternative for taxpayers who do not have the funds or the desire to litigate their tax deficiency in a regular Tax Court trial. Tax Court Rule 177(b) requires that trial of small tax cases "be conducted as informally as possible consistent with orderly procedure," and further provides that any evidence deemed by the court "to have probative value" shall be admissible. Under Rule 177(c), neither briefs nor oral arguments are required in small tax cases.

Special trial judges, appointed by the Chief Judge of the Tax Court under Tax Court Rules 3(d) and 180-83, hear small tax cases. Under IRC § 7463(b), decisions of the trial judge in small tax cases are final and nonappealable, and are not treated as precedent for any other case. A taxpayer electing small tax case procedures, therefore, gains the advantage of informality but forfeits both the opportunity to have her case tried by a regular Tax Court judge and her right to appeal an adverse decision.

§ 628 Governing Precedent in Tax Court—the Golsen Rule

Appeals from Tax Court decisions are reviewed by the US Courts of Appeals (other than the Court of Appeals for the Federal Circuit, discussed in § 64), with venue generally determined by the taxpayer's residence. IRC § 7482. Because the Tax Court's jurisdiction is nationwide, and because it is inevitable that the various Courts of Appeals will resolve some issues differently, the question arises how the Tax Court should decide a case in which the Courts of Appeals differ. Should the Tax Court follow its own precedent, or the precedent of the majority of appellate courts, or the precedent of the Court of Appeals to which an appeal in the case before it would lie? After years of uncertainty, the Tax Court resolved this question in its 1970 decision in *Golsen v Commissioner*, 54 TC 742 (1970), in which it declared that henceforth it would follow the governing precedent in the Court of Appeals to which the case before it is appealable. Although the court recognized that its decision could adversely affect the federal interest in uniform application of the tax laws, it concluded that efficient judicial administration required that it adopt the rule and that the court could foster uniformity by explaining why it disagreed with precedent it felt constrained to follow.

The effect of the *Golsen* rule can be illustrated by the following example. Assume that the issue involved is whether certain purported "interest"

payments are deductible, and that the First, Second, Third and Tenth Circuits have held that such payments are *not* deductible, while the Fourth and Seventh Circuits have held that such payments *are* deductible. If an appeal in the case before the court would lie to the First, Second, Third or Tenth Circuit Court of Appeals, then the Tax Court must rule that the payment is not deductible. If appeal would lie to the Fourth or Seventh Circuit, the Tax Court would be required to hold such payments deductible. If appeal would lie to any other Circuit, the Tax Court could reach its own decision on the question because it would not be bound by any precedent in the Circuit.

§ 629 *"Reviewed," "Regular," and "Memorandum" Decisions of the Tax Court*

The precedential value of a Tax Court decision depends on whether the decision is reviewed by all 19 judges (a "reviewed" opinion, which has the greatest precedential value), or instead is issued as a "memorandum" decision or what is known as a "regular" decision. The Chief Judge reviews all opinions of the Tax Court judges before issuance. The Chief Judge then decides whether the issue should be decided by all the judges (resulting in a "reviewed" decision). Both reviewed and regular decisions are published by the Tax Court and printed by the Government Printing Office in bound volumes designated as The United States Tax Court Reports. Such decisions, in which the

Commissioner of Internal Revenue is the respondent, are cited as "___ TC ___"

Not all decisions of the Tax Court appear in the official Tax Court Reports, however. Decisions involving relatively settled legal principles are issued as "Memorandum Opinions" and are numbered serially each year in the form "TC Memo 1990-1". Memorandum decisions are not published in the official Tax Court Reports, but are printed by unofficial, commercial publishers. Memorandum opinions have little precedential value.

In between "reviewed" decisions and "memorandum" decisions are what are often referred to as "regular" Tax Court decisions: those that have been reviewed by the Chief Judge and are published in the official Tax Court Reports, but are not reviewed by all 19 judges of the Tax Court. Such decisions usually involve some legal interpretation, unlike many "memorandum" decisions, but the issue is often less controversial or significant than is involved in most "reviewed" decisions. "Regular" Tax Court decisions have less precedential value than "reviewed" decisions but more than "memorandum" decisions.

§ 63 United States District Court

§ 631 *Jury Trial Available*

The US district courts are the only forum in which a jury trial is available. This fact, coupled with the familiarity of the district court judges with local concerns, influences many taxpayers to

Mock Trial

Harvard Institute for International Development

Moscow Russia

April 23 & 25, 1997

Script

Following abbreviations shall apply

Clerk	Clerk of the United States Tax Court
Court	Presiding Judge of the United States Tax Court
PC	Petitioner's counsel
RC	Respondent's counsel
TP	Taxpayer
Agent	IRS Agent

The proceedings commenced at the United States Tax Court in Washington , D C on April 19, 1997 Judge David Laro presiding Also present were (name), the Court Bailiff, (name), the Court's Trial Clerk, (name), a representing attorney for the Commissioner of the Internal Revenue Service (IRS), and (name), an attorney representing the Petitioner, taxpayer

THE CLERK All rise All persons having business before the United States Tax Court will draw near and give their attention The Tax Court is now in session, God save the United States and this Honorable Court, Judge David Laro presiding

THE COURT Please be seated

THE CLERK Please state your appearances for the record

THE COURT You may have the stipulation marked by the Clerk
and filed The stipulation together with the exhibits are
now a part of the record

*(Respondent's counsel now approaches the Trial
Clerk and has the stipulation marked and submitted to
the Court The stipulation is identified as joint
exhibit No 1)*

THE COURT Any other preliminary matters?

RC No, Your Honor, we're ready to proceed

PC Your Honor, we are ready to proceed

THE COURT Who has the burden of proof in this case?

RC Both parties, Your Honor, Respondent is alleging
that the taxpayer fraudulently understated his income
Thus, petitioner bears the burden of disproving the
amount of the deficiency determined by respondent, and
respondent bears the burden of proving that petitioner is
liable for the addition to tax for fraud that respondent
also determined

PC We agree, Your Honor Petitioner has the burden
on the deficiency and the government has the burden on the
addition to tax

THE COURT Thank you. Respondent's counsel may proceed and
make an opening statement

*(Respondent's counsel then addresses the Court and
makes the following opening statement)*

RC Good morning, Your Honor This is a fraud case
The government examined the petitioner taxpayer last year
IRS Agent, George Bush, met with the taxpayer at his
business and later at his home The agent observed that
the taxpayer owned an expensive late model BMW 735 11 The
taxpayer's wife wore expensive jewelry The taxpayer's
apartment was lavishly furnished The agent also learned
that the taxpayer owned a dacha 50 miles outside of
Washington, D C The IRS agent made a calculation that
showed that the taxpayer's net worth was over \$250,000, yet
the taxpayer filed tax returns for the last three years
showing that he only made \$10,000 a year in earned income
When the taxpayer was asked how he was able to afford all
of the expensive things he owned, the taxpayer said that he
had received a gift of \$150,000 cash from his family in
Iran The taxpayer could not substantiate with written
documents any proof of the gift The government believes
that the taxpayer earned far greater money than he reported
on his tax return and we will prove that to the Court
Therefore, we will ask the Court to find that the taxpayer
underreported his income, and is liable, therefore for the

tax on additional income of \$200,000, plus a penalty for fraud

THE COURT Thank you Does Petitioner's counsel wish to make an opening statement?

PC Yes, Your Honor The taxpayer did not underreport his income He did, however, receive a gift from his family in Iran in the amount of \$150,000 There are no documents to prove this gift because exporting capital is a criminal offense in Iran, yet it happened and the gift accounts for how the taxpayer did afford various luxury items Thank you That is all

THE COURT Respondent may call her first witness

RC We call IRS Agent George Bush to the witness stand

(Mr Bush approaches the witness stand and is sworn in by the Clerk)

CLERK (Administers oath)

AGENT I do

THE COURT Please state your name and address for the record

RC- Did the taxpayer say anything about any gifts he
 may have received or other sources of income?

AGENT No

RC Based on your examination did you make a
 determination?

AGENT Yes We determined that the taxpayer
 underreported his income by an amount not less than
 \$200,000, since we valued the automobile at \$75,000, the
 furnishings and painting at \$50,000, the equity of the dacha
 at \$50,000, and the jewelry at \$25,000

RC Thank you I have no more questions

THE COURT The witness may now be examined by petitioner's
 counsel

(Petitioner's counsel now interrogates witness)

PC Did you specifically ask the taxpayer whether he
 had received any gift from his mother?

AGENT I asked him generally^{ly} about gifts but not
 specifically about any one gift

PC Are you aware that it would be a violation of Iranian law for one to acknowledge that money was gifted and exported from Iran?

AGENT. We didn't discuss it

PC. I have no further questions of this witness

THE COURT Any redirect examination from respondent?

RC Just one question, Your Honor When did you first learn that petitioner was claiming that a source of his wealth was due to an alleged gift from his mother in Iran?

AGENT After the examination I learned about a gift claim a few weeks before this trial started

RC That is all Your Honor

THE COURT Any re-cross?

PC None

RC We now call the petitioner, taxpayer as our next witness

THE COURT. Would you please take the witness stand and be
 sworn in

*(The taxpayer approaches the witness stand and is sworn
in by the Clerk)*

CLERK (Administers oath)

TP I do

THE COURT Please state your name and address for the record

TP Joe Taxpayer I live at 1414 Independence Avenue
Washington, DC

RC For the year in question, is the amount of income
stated on your tax return all of the income which you are
claiming in the year at issue?

TP Yes, I only received \$10,000 of income

RC What was your occupation during the year at issue?

TP I was a salesman for a used automobile business

RC You had no other income?

TP No

RC You had a wife to support?

TP Yes

RC Did she have a job?

TP No

RC Do you have three small children to support?

TP Yes

RC Do you own an expensive BMW car?

TP Yes

RC How much did it cost?

TP \$75,000

RC You also own a dacha and apartment in the city?

TP Yes

RC The apartment is lavishly furnished and has fine painting decorating the walls?

TP Yes

RC You paid for all of these things on your \$10,000 income?

TP No I also received a gift from my mother of \$150,000 She lives in Iran

RC Did you pay any gift taxes or file a gift tax return with respect to the alleged gift from your mother?

TP No I did not want to document the gift because it is a crime to take money out of Iran and I did not want to expose my mother to any criminal violation

RC When did you get the gift?

TP I can't recall precisely About two years ago

RC Was the amount paid to you in one lump sum? _____

TP No I was paid in various \$10 000 to \$15,000 amounts by friends who came to visit

RC What are their names and addresses?

TP I don't remember exactly I have a list, but I
 didn't bring it to Court today I am telling the truth

RC No further questions

THE COURT It is your witness

PC Why are you so certain that you remember receiving
 the money from your mother?

TP She wanted me to have it and told me on several
occasions that she would get it to me as soon as---

RC Objection The answer calls for hearsay

PC Your Honor, it is impossible for the petitioner's
 mother to be here and we ask that the Court make an
 exception to the hearsay rule

THE COURT Objection sustained

PC What makes you certain that the amount was a gift?

TP That is what she wanted

PC I have no further questions

RC Respondent rests

PC Petitioner's counsel rests

THE COURT Does either side desire to make a closing statement?

RC No

PC No

THE COURT The Court has decided to render Oral Findings of Fact and Opinion in this case. The following represents the Court's Oral Findings of Fact and Opinion. This bench opinion is made pursuant to the authority granted by section 7459(b) of the Internal Revenue code of 1986, as amended to date, and Rule 152 of the Tax Court Rules of Practice and Procedure. Section references are to the Internal Revenue Code in effect for the year at issue. Rule references are to the Tax Court Rules of Practice and Procedure. Respondent has issued a Notice of Deficiency to the effect that the petitioner understated his income at issue by \$200,000. The respondent has determined such understatement by examining petitioner's assets, further determining that

petitioner's net worth significantly exceeded the amount of income, less expenses, which petitioner reported on his tax return. The petitioner claims that his assets were acquired from monies from which his mother allegedly gave him, yet petitioner has no documents to support his testimony. The petitioner did not offer any written proof regarding the names and addresses of the persons who may have delivered the amounts involved and the dates involved. Petitioner asks us simply to believe him. While petitioner's story may seem reasonable, it simply is not sufficient for this Court to hold in his favor. The government has carried its burden of proof in the deficiency, and we hold for respondent with respect thereto. With respect to the addition to tax (fraud), however, the government has the burden of proof. The government relies solely on the agent's testimony and its allegation that the taxpayer's testimony is not persuasive. We do not find that this is enough for the government to sustain its heavy burden of proving fraud. We hold for petitioner on this issue.

Case adjourned

BRANERTON CORP

THE BRANERTON CORPORATION, PETITIONER *v* COMMISSIONER OF
INTERNAL REVENUE, RESPONDENT

JACK LINDNER AND ANNE LINDNER, PETITIONERS *v* COMMISSIONER OF
INTERNAL REVENUE, RESPONDENT

Docket Nos 5040-73, 5042-73 Filed March 5, 1974

Rule 70(a)(1), Tax Court Rules of Practice and Procedure —
More than 30 days after joinder of issue but prior to any informal
consultation or communication between the parties petitioners
served written interrogatories (pursuant to Rule 71) upon respond-
ent. Respondent filed (pursuant to Rule 103) a motion for a protec-
tive order. *Held* a protective order will be granted for a reasonable
period of time with direction that the parties attempt to attain the
objectives of discovery through informal consultation or communi-
cation before utilizing the procedures provided by the rules

Stephen L Packard, for the petitioners
D Ronald Morello and *Barry D Gordon*, for the respondent

OPINION

Dawson, Judge This matter is before the Court on respondent's
motion for a protective order, pursuant to Rule 103(a)(2), Tax Court
Rules of Practice and Procedure, that respondent at this time need
not answer written interrogatories served upon him by petitioners in
these cases. Oral arguments on the motion were heard on February 20,
1974, and, in addition, a written statement in opposition to respond-
ent's motion was filed by the petitioners.

The sequence of events in these cases may be highlighted as follows.
The statutory notices or deficiencies were mailed to the respective
petitioners on April 20, 1973. As to the corporate petitioner, the ad-
justments relate to (1) additions to a reserve for bad debts, (2) travel,
entertainment, and miscellaneous expenses, (3) taxes, and (4) depre-
ciation. As to the individual petitioners, the adjustments relate to (1)
charitable contributions, (2) entertainment expenses, (3) dividend
income, and (4) medical expenses. Petitions in both cases were filed on
July 2, 1973, and, after an extension of time for answering, respondent
filed his answers on September 26, 1973. This Court's new Rules of
Practice and Procedure became effective January 1, 1974. The next
day petitioners' counsel served on respondent rather detailed and ex-
tensive written interrogatories pursuant to Rule 71. On January 11,
1974, respondent filed his motion for a protective order. The cases have
not yet been scheduled for trial.

Petitioners' counsel has never requested an informal conference with respondent's counsel in these cases, although respondent's counsel states that he is willing to have such discussions at any mutually convenient time. Consequently, in seeking a protective order, respondent specifically cites the second sentence of Rule 70(a)(1) which provides "However, the Court expects the parties to attempt to attain the objectives of discovery through informal consultation or communication before utilizing the discovery procedures provided in these Rules."

It is plain that this provision in Rule 70(a)(1) means exactly what it says. The discovery procedures should be used only after the parties have made reasonable informal efforts to obtain needed information voluntarily. For many years the bedrock of Tax Court practice has been the stipulation process, now embodied in Rule 91. Essential to that process is the voluntary exchange of necessary facts, documents, and other data between the parties as an aid to the more expeditious trial of cases as well as for settlement purposes.¹ The recently adopted discovery procedures were not intended in any way to weaken the stipulation process. See Rule 91(a)(2).

Contrary to petitioners' assertion that there is no "practical and substantial reason" for granting a protective order in these circumstances, we find good cause for doing so. Petitioners have failed to comply with the letter and spirit of the discovery rules. The attempted use of written interrogatories at this stage of the proceedings sharply conflicts with the intent and purpose of Rule 70(a)(1) and constitutes an abuse of the Court's procedures.

Accordingly, we conclude that respondent's motion for a protective order should be granted and he is relieved from taking any action with respect to these written interrogatories. The parties will be directed to have informal conferences during the next 90 days for the purpose of making good faith efforts to exchange facts, documents, and other information. Since the cases have not been scheduled for trial, there is sufficient time for the parties to confer and try informally to secure the evidence before resorting to formal discovery procedures. If such process does not meet the needs of the parties, they may then proceed with discovery to the extent permitted by the rules.

An appropriate order will be entered.

¹Part of the explanation of note to Rule 91 (60 T.C. 1113) states:—

The stipulation process is more flexible based on conference and negotiation between parties adaptable to situations on matters in varying degrees of dispute susceptible of discussion and narrowing areas of dispute and often as a means to settle matters.

ASH v COMMISSIONER

MARY KAY ASH, PETITIONER v COMMISSIONER OF
INTERNAL REVENUE, RESPONDENT

Docket No 30585 89 Filed March 11 1991

Held, with respect to the summonses issued both before and after petitioner filed her petition to this Court petitioner's motion for a protective order will be denied *Universal Manufacturing Co v Commissioner* 93 T C 589 (1989) and *Westreco, Inc v Commissioner* T C Memo 1990 501 (which relied on *Universal Manufacturing Co*) modified

J Phillip Adams, for the petitioner
Deborah A Butler and *John S Reptsis*, for the respondent

OPINION

WRIGHT, *Judge* This matter is before the Court on petitioner's motion for protective order filed on July 6, 1990 Petitioner seeks a protective order under Rule 103¹ to restrict respondent's use of information obtained through administrative summonses

By notices of deficiency dated October 10, 1989 respondent determined the following deficiencies in and additions to petitioner's Federal income tax

Year	Deficiency	Additions to tax		
		Sec 6653(a)(1)	Sec 6653(a)(2)	Sec 6661
1983	\$37 060	\$1 853	1	
1985	6 608 527	330 426	1	\$1 652 132

¹50 percent of the interest due on the deficiencies

In a petition filed on December 29 1989 petitioner seeks a redetermination of the deficiencies for both taxable years Petitioner resided in Dallas, Texas when she filed her petition In her petition petitioner states that on November 29 1985 petitioner, along with certain other individuals and trusts (the transferors), exchanged Mary Kay Cosmetics Inc, common stock for (1) Common or preferred stock of Mary Kay Holding Corp, and (2) long-term notes of Mary

¹All section references are to the Internal Revenue Code of 1954 as amended and in effect for the years in issue All Rule references are to the Tax Court Rules of Practice and Procedure unless otherwise indicated

Kay Holding Corp (this transaction will hereinafter be referred to as the exchange)

In the exchange, petitioner received 131,079 shares of Mary Kay Holding Corp common stock and \$10,669,951.10 of long-term notes for 1,399,230 shares of Mary Kay Cosmetics, Inc, common stock. Immediately after the exchange the transferors owned 100 percent of all common and preferred stock of Mary Kay Holding Corp. Petitioner reported on a schedule attached to her Federal income tax return for 1985 that the Mary Kay Holding Corp long term notes and common stock were received in a transaction qualifying for nonrecognition treatment under section 351.

On December 5, 1985, MKCI Acquisition Corp was merged into Mary Kay Cosmetics, Inc. MKCI Acquisition Corp was a wholly owned subsidiary of Mary Kay Corp, which in turn was a wholly owned subsidiary of Mary Kay Holding Corp. In the merger, the shareholders of Mary Kay Cosmetics, Inc, other than Mary Kay Holding Corp, received cash and debentures of Mary Kay Corp in exchange for their shares of Mary Kay Cosmetics Inc (this transaction will hereinafter be referred to as the leveraged buyout).

After the merger Mary Kay Cosmetics Inc was a wholly owned subsidiary of Mary Kay Corp, which in turn was a wholly owned subsidiary of Mary Kay Holding Corp. Approximately \$16,609,890 in expenses was incurred by Mary Kay Cosmetics, Inc in connection with the leveraged buyout.

During June of 1989, respondent began an examination of Mary Kay Corp's Federal income tax return for taxable year 1985. As of the date petitioner's motion for protective order was filed, no notice of deficiency had been issued to Mary Kay Corp.

During August of 1989, respondent began an examination of petitioner's Federal income tax return for taxable year 1985. In his notice of deficiency for taxable year 1985, respondent determined that petitioner had received dividends in the amount of the distributed Mary Kay Holding Corp notes, or \$10,669,951. Respondent also determined that petitioner had received constructive dividends with

respect to \$2,626,061 of the MKCI leveraged buyout expenses With respect to taxable year 1983, respondent determined that as a result of adjustments to taxable year 1985, there was no investment credit carryback to taxable year 1983 as claimed by petitioner on her Federal income tax return for that year

The Summonses

On September 20, 1989, respondent issued an administrative summons pursuant to section 7602 to Lawrence Cox, treasurer of Mary Kay Corp, seeking certain information, testimony, and documents (the MKC summons) The MKC summons relates to the 1985 and 1986 taxable years of Mary Kay Corp and its subsidiaries The return date of the summons was October 18, 1989

On October 3, 1989, respondent issued a third-party recordkeeper summons (see section 7609(a)) to Jack Morris a partner with the accounting firm of Ernst & Young, seeking certain information, testimony, and documents (the petitioner/Morris summons) The petitioner/Morris summons relates to petitioner's 1985 and 1986 taxable years The return date of the summons was November 3, 1989

Also on October 3, 1989, respondent issued another third party recordkeeper summons to Jack Morris (the Rogers/Morris summons) The Rogers/Morris summons relates to an examination of Richard R and Janice Z Rogers' 1985 and 1986 taxable years Richard R and Janice Z Rogers' Federal income tax returns for those taxable years were under examination in relation to the exchange The testimony, information, and documents sought through the Rogers/Morris summons are identical to those sought by the petitioner/Morris summons As did the petitioner/Morris summons, the Rogers/Morris summons had a return date of November 3, 1989

During May and June 1990 respondent issued third party recordkeeper summonses to officials of Morgan Stanley & Co Inc Merrill Lynch Capital Markets, and Rothchild Inc (the adviser summonses) seeking certain testimony, information and documents relating to Mary Kay Corp's 1985 and 1986 taxable years

On October 18, 1989, the return date of the MKC summons, the treasurer of MKC provided certain documents to respondent, but withheld other documents that MKC concluded are subject to the attorney-client privilege. On November 3, 1989, the return date of both the petitioner/Morris summons and the Rogers/Morris summons, Jack Morris provided to respondent the information requested in the summonses and some of the requested documents. Morris withheld other documents on advice of counsel that such documents are subject to the attorney-client privilege.

On April 12, 1990, respondent commenced an action in the U.S. District Court for the Northern District of Texas to enforce the petitioner/Morris summons and the MKC summons. As of the date of petitioner's motion, no action had been taken to enforce the Rogers/Morris summons or the adviser summonses.

In her motion for protective order petitioner seeks an order prohibiting respondent's attorneys, agents, and employees engaged in representing him before this Court from obtaining access to, reviewing, or using any testimony, documents, or other information obtained pursuant to the MKC summons, the petitioner/Morris summons, the Rogers/Morris summons, and the adviser summonses after December 29, 1989, the date her petition was filed.

Discussion

As a preliminary matter we note that the enforceability of the summonses is not at issue. The parties agree that the District Court, not this Court, has jurisdiction to decide such issue. Sec. 7604. We therefore do not address the issue of whether the summonses are enforceable.

I Tax Court Rules of Practice and Procedure

Section 7453 provides that proceedings of the Tax Court shall be conducted in accordance with such rules of practice and procedure as the Court may prescribe. Petitioner argues that respondent's use of administrative summonses to obtain information related to the case pending before this Court allows respondent to undermine the discovery rules contained in title VII of our Rules of Practice and Proce-

dure (Rules 70 through 76) and gives him an unfair advantage Title VII provides rules addressing interrogatories, production of documents and things, examination by transferees, depositions upon consent of the parties, depositions without the consent of the parties, and deposition of expert witnesses

The purpose of discovery in the Tax Court is to ascertain facts which have a direct bearing on the issues before the Court *Penn-Field Industries, Inc v Commissioner*, 74 T C 720, 722 (1980) Discovery is not as broad in the Tax Court as it is in the Federal District Courts *Estate of Woodard v Commissioner*, 64 T C 457, 459 (1975) The discovery procedures established by our Rules in essence follow the Federal Rules of Civil Procedure (Federal Rules), but are not identical See 60 T C 1097 (1973) (note accompanying Rule 70(a) (1974) which, for the first time, permitted interrogatories and requests for production and inspection of papers and other things) Thus, absent a Court order, discovery through depositions without the consent of the opposing party is not available under our Rules (with the exception of a deposition taken under Rule 75), as it is under the Federal Rules That limitation is intentional See 60 T C 1097 (1973) Unnecessarily broad discovery may cause extensive delays and jeopardize the administration, the integrity, and the effectiveness of the internal revenue laws *Penn-Field Industries, Inc v Commissioner, supra* at 724 The discovery procedures should be used only after the parties have made reasonable informal efforts to obtain needed information voluntarily Rule 70(a)(1) *Branerton Corp v Commissioner*, 61 T C 691 (1974) Under Rule 103 we may issue orders to protect persons from annoyance embarrassment oppression, or undue burden or expense resulting from discovery Rule 123 allows this Court to impose sanctions including the exclusion of evidence obtained in direct violation of an existing Court order or the Court's Rules Rule 1(a) provides that where in any instance there is no applicable rule of procedure the Court or the Judge before whom the matter is pending may prescribe the procedure giving particular weight to the Federal Rules of Civil Procedure to the extent that they are suitably adaptable to govern the matter at hand

II *Authorization to Issue Summonses*

Respondent is authorized by sections 7602 and 7609 to issue summonses and to utilize the information obtained through them. In relevant part section 7602(a) provides that for the purpose of determining the liability of any person for any internal revenue tax the Secretary is authorized (1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry, (2) to summon the person liable for tax, any officer or employee of such person, or the person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax, or any other person the Secretary may deem proper, to appear before the Secretary and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry, and (3) to take such testimony of the person concerned under oath, as may be relevant or material to such inquiry. Section 7609(a) provides for special procedures when a summons is served on any person who is a third party recordkeeper.

III *Prior Opinions of This Court*

A Universal Manufacturing Co v Commissioner

In arguing that the use of administrative summonses to obtain information relating to the pending case undermines our discovery rules, petitioner relies on *Universal Manufacturing Co v Commissioner*, 93 T C 589 (1989). In *Universal Manufacturing Co* the taxpayers were Universal Manufacturing Co, as the successor by merger of WNC Corp (WNC), and Delbert W Coleman the majority shareholder of WNC. In a petition filed with this Court on September 2, 1988, Universal Manufacturing Co alleged that the Commissioner erred in determining that net operating loss deductions reported for its taxable years ending September 30, 1984, and September 30, 1986 were not allowable under sections 172 and 269. In a petition filed with this Court on December 12, 1988, Coleman alleged that the Commissioner erred in determining that certain moneys which WNC had treated as loans or shareholder advances should have been treated as dividends from WNC.

In *Universal Manufacturing Co* an agent of the Commissioner's Criminal Investigation Division served summonses on or about January 10, 1989, on two employees of WNC and third party recordkeeper summonses upon two accountants for WNC. The testimony and documents sought by the Commissioner under those summonses were directly related to the matters at issue in the pending civil cases. The taxpayers moved for a protective order under Rule 103, asserting that the Commissioner's use of administrative summonses to obtain information directly related to the issues of civil cases pending before this Court allowed him to circumvent the discovery rules contained in title VII of our Rules of Practice and Procedure and gave him an unfair advantage in the prosecution of litigation before this Court. The taxpayers urged the Court to exercise its inherent authority over the proceedings to prevent the Commissioner from utilizing in the Tax Court proceedings any information obtained pursuant to those administrative summonses.

In *Universal Manufacturing Co*, respondent argued that he was entitled to free and unfettered use of information developed through the administrative summonses in question. We noted that respondent chose to issue the notices of deficiency at issue and, in effect, chose to give the taxpayers the opportunity to come to this Court and invoke our Rules before his criminal investigation was completed, even though his internal administrative guidelines seemed to provide that a notice of deficiency normally would not be issued in such a situation. *Universal Manufacturing Co v Commissioner, supra* at 594. We went on to reason that the subject motion required us to reconcile two competing considerations. First, this Court has no desire to interfere in any way with respondent's investigations into violations of the internal revenue laws. We noted that respondent has the obligation to initiate such investigations and to pursue them to completion. Second, respondent's use of administrative summonses in a criminal case to interview third-party witnesses and obtain relevant documents concerning the issues in civil cases pending before the Court circumvents our discovery rules. *Universal Manufacturing Co v Commissioner, supra* at 594.

After balancing both considerations, the Court found that the Commissioner's use of administrative summonses to interview third-party witnesses and obtain relevant documents concerning the issues in cases pending before the Court impermissibly undermined the Court's discovery rules. The Court held that this was so even if the Commissioner's motives were fully proper. The Court stated its objective in so holding was to "require respondent to present his position in the civil cases pending before us without utilizing any information obtained pursuant to an administrative summons served after the cases were docketed in this Court." 93 T.C. at 595. The Court issued an order providing that the Commissioner was not to "obtain or use any testimony, documents or other information obtained pursuant to an administrative summons served after September 2, 1988," the date the petition to this Court was filed. *Universal Manufacturing Co v Commissioner, supra* at 595.

B Westreco, Inc v Commissioner

In addition to *Universal Manufacturing Co v Commissioner, supra*, petitioner relies on *Westreco, Inc v Commissioner*, T.C. Memo 1990-501. In *Westreco* this Court held that it was justified in issuing a protective order that prevented the Commissioner's lead trial attorney in a docketed case from further participation in an examination of a corporation and its related parties for later years concerning the same issue the Court was set to decide. In addition, the protective order prevented the use of information obtained under administrative summonses in the later years' examination in the trial for the earlier tax years.

The taxpayer in *Westreco* was a second tier subsidiary of Nestle S.A. Those two corporations and their related corporations were before the Court concerning a section 482 adjustment to the fee for contract research services paid to the taxpayer by its foreign parent corporation for the years 1978 through 1982. As the taxpayer was preparing for trial the Commissioner was conducting an examination of the income tax returns of Nestle and its related corporations to determine if the section 482 adjustments should be made for the years 1983 through 1985.

In connection with the 1983-85 examination, the Commissioner issued a document request and administrative summonses to the taxpayer's employees. The lead attorney for the Commissioner for the trial concerning the earlier years' adjustments was actively participating in the later years' examination. The taxpayer requested a protective order from this Court, concerned that the summonses and document request might be used to gather information for use in the upcoming trial, thus undermining this Court's discovery rules.

After considering the arguments of both parties, this Court issued the requested order, applying the principles of *Universal Manufacturing Co v Commissioner, supra*. The protective order prevented the Commissioner's lead trial attorney from further participation in the later years' examination process and from using any information obtained in that examination in the case that was being readied for trial. The Commissioner was also required to maintain a list of all evidence obtained in the later years' examination so that the Court could protect the integrity of its discovery rules. The Commissioner asked the Court to reconsider its order.

Upon reconsideration the Court found that the summonses served on petitioner's employees to appear for interviews and deliver documents in the later years' audit were in the nature of discovery depositions. The Court reasoned that the participation of the Commissioner's lead trial attorney for the 1978-82 deficiencies in the 1983-85 examination would give the Commissioner an unfair advantage. The Court viewed the activities of the Commissioner's attorney and the use of later years' summonses as an attempt to undermine the Court's discovery rules.

The Commissioner argued that the Court lacked the power to prevent it from using the information obtained through the summonses and document request. The Court held that its authority came from two sources. One was necessarily implied from the power of the Court to prescribe rules of practice and procedure. The second source of the Court's power was inherent in its obligation as a judicial body to protect the integrity of its processes and to

regulate the proceedings and parties, or the representatives of parties, that appear before it

The Court made clear that it was not implying that all activities of a trial attorney of the Commissioner in an audit would justify the kind of protective order it had issued in that case. The compelling facts in the case, it said in conclusion, justified the protective order it had issued. The language of the opinion is to be interpreted only in that context.

IV Summonses Issued Prior to Filing of Petition

With regard to the summonses issued in the instant case before petitioner filed her petition with this Court (MKC summons, petitioner/Morris summons, and Rogers/Morris summons), we find that *Universal Manufacturing Co v Commissioner, supra*, is inapplicable. That case involved a summons issued *after* the filing of the petition.

Petitioner argues that we should extend our holding in *Universal Manufacturing Co* to information obtained after the filing of her petition through the MKC summons, petitioner/Morris summons, and Rogers/Morris summons, which were issued before her petition was filed, because respondent's purpose in issuing them was to undermine this Court's discovery rules. First, we note that relatively few notices of deficiency result in the filing of a petition in this Court. Respondent had no way of knowing whether petitioner would file a petition. In addition, until a petition is filed, we have no basis on which to impose the rules provided for in title VII of our Rules of Practice and Procedure and any administrative summonses issued by respondent prior thereto do not pose a threat to the integrity of our Rules. Nor will the summonses pose a threat to the administration or effectiveness of our Rules of Practice and Procedure. When the petition was filed the parties on whom summonses were served were already under an obligation to provide the information called for pursuant to sections 7602 and 7609. Therefore the competing considerations addressed in *Universal Manufacturing Co* are not present here. If the summonses are for any reason invalid, petitioner's remedy lies with the U.S. District Court, not here.

We deny petitioner's motion for protective order with respect to the MKC summons, petitioner/Morris summons, and Rogers/Morris summons, which were all served prior to the filing of the petition in this case

V Summonses Issued After Filing of Petition

With respect to the adviser summonses, petitioner asks that we grant her motion pursuant to Rule 103. Rule 103 authorizes this Court to restrict the use of discovery procedures or information obtained through discovery when required to protect a party or other person against "annoyance, embarrassment, oppression, or undue burden or expense." As an initial matter, we must address the issue of whether this Rule may be used to restrict a party's use of information which is obtained through means *other than* our discovery rules.

Rule 103 is derived from, and for all practical purposes is identical to, Rule 26(c) of the Federal Rules 60 T.C. 1057, 1122 (1973). Accordingly, we look to cases construing Rule 26(c) of the Federal Rules for guidance on the breadth of application of Rule 103. *Willie Nelson Music Co v Commissioner*, 85 T.C. 914, 917 (1985). Those cases uniformly hold that Rule 26(c) provides no authority for the issuance of protective orders to regulate the use of information or documents obtained through means other than discovery in the proceedings before the Court. *Kirshner v Uniden Corp of America*, 842 F.2d 1074 (9th Cir. 1988) (power to control discovery under Rule 26(c) *does not extend* to the issuance of a protective order preventing a party from using material obtained in a separate action and requiring the party to return the material to the other party even though the parties to such other action are identical), *Whittaker Corp v Execuair Corp*, 736 F.2d 1341 (9th Cir. 1984) (Rule 26(c) does not give District Court power to exclude evidence discovered in a *separate* antitrust action, even when such discovery occurs after the District Court's own discovery cutoff date), *Bridge CAT Scan Associates v Technicare Corp*, 710 F.2d 940 (2d Cir. 1983) (where information alleged to contain trade secrets was compiled prior to commencement of lawsuit. Rule 26(c) did not give court authority to prohibit its disclosure). Thus based on these

cases we could conclude that this Court does not have the authority to issue protective orders under such Rule restricting the use of information *which was not obtained through the use of the Court's discovery procedures*, but was obtained through other legal procedures. To the extent that *Universal Manufacturing Co v Commissioner*, 93 T C 589 (1989), may be read as applying Rule 103 more broadly, we reject such a reading. Because a ruling under Rule 103 would not be definitive here, we do not express a conclusion as to the application of that Rule to the question before us.

That is not to say, however, that this Court is powerless to regulate the processes of this Court, viz, the use in this Court of information obtained by administrative summons. It is undisputed that courts have inherent powers vested in the courts upon their creation and not derived from any statute. *Eash v Riggins Trucking, Inc*, 757 F 2d 557, 561 (3d Cir 1985) (and cases cited thereat). The Supreme Court has upheld the inherent authority of a court to enter a protective order prohibiting dissemination of information obtained through discovery, *Seattle Times Co v Rinehart*, 467 U S 20, 35 (1984), to control the conduct of attorneys practicing before it, *Thread v United States*, 354 U S 278, 281 (1957) to correct that which has been wrongfully done by virtue of the court's process, *United States v Morgan*, 307 U S 183, 197 (1939), and, most pertinently, "over their own process, to prevent abuse, oppression and injustice" *Gumbel v Pitkin*, 124 U S 131, 146 (1888).

Moreover, our own rules contemplate questions of practice and procedure for which there is no applicable rule of procedure and direct the Judge before whom the matter is pending to prescribe an appropriate procedure. Rule 1(a)

As we have already stated *supra*, our Rules of discovery in essence follow the Federal Rules but are not identical. Rule 26(a) of the Federal Rules (Rule 26(a)) allows, generally nonconsensual discovery by deposition. Our Rules do not. To give respondent carte blanche with regard to the admission of evidence obtained by administrative summons would in effect, give him the full advantage of Rule 26(a) an advantage that we have withheld. We need not do so. We have the power to uphold the integrity of the Court's process by enforcing the limited discovery that by rule we

have adopted. Where litigation in this Court has commenced, and an administrative summons is issued with regard to the same taxpayer and taxable year, we will exercise our inherent power to enforce the limited discovery contained in our Rules. We will do so unless respondent can show that the summons has been issued for a sufficient reason, independent of that litigation. Where litigation in this Court has commenced, and an administrative summons is issued not with regard both to the same taxpayer and taxable year (for instance where the summons concerns another taxpayer or a different taxable year), normally we will not exercise our inherent power. We will exercise that power, however, when petitioner can show lack of an independent and sufficient reason for the summons. In the instant case, only the adviser summonses were issued after litigation commenced. Those summonses fall within that situation where normally we will not exercise our inherent power. Since petitioner has not shown a lack of independent and sufficient reason for the adviser summonses, we need not exercise our inherent power nor detail how that power could be exercised. Rule 1 authorizes the Judge before whom a matter is pending to prescribe an appropriate procedure. What would be appropriate would depend on how best to maintain control "over [our] own process, to prevent abuse, oppression and injustice." *Gumbul v Pitkin, supra* at 146.

Universal Manufacturing Co presents the first situation (post petition summons, same taxpayer, same year) and, we believe the Court there may have concluded that there was no real prospect of a criminal investigation although the Court did not make such a finding. *Westreco, Inc* presents a different situation. The Court there stated that it found compelling facts that justified its protective order but cautioned that no implication was to be drawn that all activities of respondent's trial counsel in an audit would justify a similar order. We note that *Westreco, Inc* is a memorandum opinion which followed *Universal Manufacturing Co*. While we have herein modified our opinions in *Universal Manufacturing Co* and *Westreco, Inc*, both cases are still pending and the summons issues involved in those cases were decided without the benefit of the standards

articulated herein. We therefore express no view on the outcome of such cases under the standards articulated herein, as such matters are best left to the discretion of the Judge before whom the matter is pending.

Finally, we repeat that the enforceability of the summonses is not here at issue. That is a question for the District Court, and the pendency of a Tax Court proceeding does not deprive the District Court of jurisdiction to determine such enforceability. See *United States v Gimbel*, 782 F.2d 89, 93 (7th Cir. 1986), *Bolch v Rubel*, 67 F.2d 894, 895 (2d Cir. 1933).

We next consider petitioner's argument that this Court's power to exclude the evidence in question is inherent in its obligation as a judicial body to protect the integrity of its processes and to regulate the proceedings and parties that appear before it. We already have discussed the circumstances that would allow us to regulate the proceedings as requested by petitioner and, based on the record before us, we find that the summonses *in issue* are not a threat to the integrity of this Court's processes. The development of additional evidence through the summonses *in issue* will in fact benefit this Court's processes because it will result in a more fully developed factual background in which to consider petitioner's case. The additional evidence may also lead to the settlement of the case.

We also find that we are not compelled to grant petitioner's motion in order to regulate the proceedings and parties that appear before us. Our holding in this case that a protective order is not appropriate involves legitimate and good faith summonses with respect to other years to related taxpayers and to related tax liabilities and involves the absence of any other underlying facts or circumstances that would justify the issuance of a protective order in this case. Petitioner has failed to show respondent's lack of an independent and sufficient reason for the summonses. The rule we announce herein in no way limits this Court's exercise of its power to issue protective orders or to impose other appropriate sanctions where the underlying facts and circumstances of a particular case establish an abusive or prejudicial situation that warrants relief. If, as we proceed, an abusive or prejudicial situation becomes apparent (which

petitioner has so far not shown), we will be able to regulate the proceedings regardless of the rule we announce herein.

We also note that while this Court must, of necessity, control the admission of all evidence in the pending proceeding, any proceedings regarding the enforceability of the administrative summonses will be brought before the Federal District Court, not this Court. On the other hand, if we were to grant petitioner's motion with respect to the adviser summonses, we would then have to supervise the administrative summons process, in order to insure that none of the evidence obtained through that process was introduced into the case. The necessity of such supervision may make the regulation of the case more difficult rather than more efficient.

In conclusion, we deny petitioner's motion for protective order. With regard to each of the summonses other than the adviser summonses, we do so since all were issued prior to commencement of the litigation herein. With regard to the adviser summonses, we do so since petitioner has not shown a lack of a sufficient, independent reason for their issuance.

In light of the foregoing,

An appropriate order will be issued.

Reviewed by the Court

NIMS, KÖRNER, SHIELDS, HAMBLÉN, COHEN, CLAPP
GERBER, JACOBS, PARR, WELLS, COLVIN, and HALPERN
JJ, agree with the majority opinion.

WHALEN, J, concurs in the result only.

CHABOT, J, concurring in the result. I agree with the majority's ruling denying petitioner's motion for a protective order regarding certain administrative summonses.

My concern is that there seems to be a search for reasons to exclude information developed through administrative summonses while at the same time courts accept information developed through violations of people's constitutional rights. Respectfully I suggest that we are standing public policy on its head when we approach the lawful statutory

administrative summons with as much or more, suspicion than we do violations of constitutional rights

In dealing with disputes about excludability of evidence obtained in violation of people's rights under the United States Constitution, the Supreme Court has frequently stressed the undesirability of excluding from evidence information that may be reliable and important in enabling the triers of fact to decide correctly the cases that are before them.¹ The Supreme Court has nevertheless concluded that it is desirable to exclude otherwise admissible, reliable, and persuasive evidence where such exclusion would serve to deter future violations of rights guaranteed by the United States Constitution. Even then, limitations have been placed on the circumstances in which such exclusions will be authorized (See, e.g., our recent discussion in *Houser v Commissioner*, 96 TC 184 (1991))

Another area in which evidence is excludable, even though it may be highly reliable and persuasive, is under Rule 6(e),

¹Justice Powell summarized many concerns in *Stone v Powell*, 428 U.S. 465, 489-491 (1976) as follows:

The costs of applying the exclusionary rule even at trial and on direct review are well known: the focus of the trial, and the attention of the participants therein, are diverted from the ultimate question of guilt or innocence that should be the central concern in a criminal proceeding. Moreover, the physical evidence sought to be excluded is typically reliable and often the most probative information bearing on the guilt or innocence of the defendant. As Mr. Justice Black emphasized in his dissent in *Kaufman*:

A claim of illegal search and seizure under the Fourth Amendment is crucially different from many other constitutional rights: ordinarily the evidence seized can in no way have been rendered untrustworthy by the means of its seizure, and indeed often this evidence alone establishes beyond virtually any shadow of a doubt that the defendant is guilty. 394 U.S. at 237.

Application of the rule thus deflects the truthfinding process and often frees the guilty. The disparity in particular cases between the error committed by the police officer and the windfall afforded a guilty defendant by application of the rule is contrary to the idea of proportionality that is essential to the concept of justice. Thus, although the rule is thought to deter unlawful police activity in part through the nurturing of respect for Fourth Amendment values, if applied indiscriminately it may well have the opposite effect of generating disrespect for the law and administration of justice.²⁰

[Some fn. refs. omitted.]

²⁰In a different context, Dallin H. Oaks has observed:

I am criticizing not our concern with procedures but our preoccupation in which we may lose sight of the fact that our procedures are not the ultimate goals of our legal system. Our goals are truth and justice, and procedures are but means to these ends.

Truth and justice are ultimate values, so understood by our people, and the law and the legal profession will not be worthy of public respect and loyalty if we allow our attention to be diverted from these goals. *Ethics, Morality and Professional Responsibility*, 1975 BYUL Rev. 591, 596.

Fed R Crim Proc In those situations, the greater benefit that is sought to be obtained is that which is understood to lie in the secrecy of the grand jury

When we get beyond these situations, we find another command This is the command in the Federal Rules of Evidence, as enacted by the Congress, that "All relevant evidence is admissible, except as otherwise provided by the Constitution of the United States, by Act of Congress, by these rules, or by other rules prescribed by the Supreme Court pursuant to statutory authority" Rule 402, Fed R Evid

Historically, this Court's approach to discovery has been to insist on the parties' exchanging the relevant information informally and agreeing to inclusions of evidence (where parties' disputes are not settled) by the stipulation process This Court has not been willing to institute the bulk of the formal discovery procedures that appear to cause such extraordinary expenses, gamesmanship, and injustices in some courts Accordingly, except for the procedures in titles VII and VIII of the Tax Court Rules of Practice & Procedure, this Court has not afforded the parties the right of Court-enforced nonconsensual discovery By the same token, this Court has not ordinarily sought to interfere with the opportunities of the parties to obtain information On the contrary, this Court's focus on the stipulation process has been designed to push the parties to voluntarily provide each other with information relevant to the case at hand

Accordingly, as I see it, it should be an unusual circumstance for this Court to forbid a party to acquire information or use information that it has acquired unless the information has come from constitutional violations, violations of grand jury secrecy, or violations of some other public policy which is of such importance that it overrides the importance of facilitating the presentation of reliable, persuasive and otherwise admissible evidence to the trier of fact

The administrative summons, the effects of which petitioner seeks to insulate herself from in the instant case is not a creature of court rules but is, rather authorized specifically by statute The Congress has prescribed respondent's statutory authority and has specified the tribunals in

which that statutory authority is to be tested Those tribunals do not include this Court

There may be circumstances in which we may conclude that there has been such an abuse with regard to an administrative summons that we might restrict the use of information obtained thereby However, the fact that the information was obtained by an administrative summons surely should not itself be a ground for restriction or even a ground for suspicion The administrative summons is a tool specifically authorized by the Congress The policy considerations of the administrative summons have been examined and reexamined by the Congress on many occasions The Congress has changed its mind on many occasions Whatever the policy balances may be at any particular time, they are for the Congress to determine I submit that, for our purposes, we are obligated to take the administrative summons as a fact of life, we should do so not because we agree with the Congress' policy but, rather, because the Congress has exercised its constitutional authority and we must follow it (just as we must follow the Congress' decisions as to inclusion of income, deductions of expenses, allowances of credits, and the 90-day period for petitioning the Tax Court)

Respectfully, I suggest that those who are concerned about "a level playing field" should take their legitimate concerns to a different forum—the US Congress In the meanwhile, I would approach respondent's use of the administrative summons with no more suspicion than any party's use of any method of gathering information that does not require this Court's compulsory process I would be vigilant to prevent abuse but I would require the complaining party to explain where the abuse lies especially if the complaining party seems to be reluctant to provide relevant information as part of this Court's stipulation process

PARKER, SWIFT, and RUWE, *JJ*, agree with this concurring opinion

SWIFT, *J* respectfully concurring I believe that further explanations are appropriate (1) of the reason the rule implicit in *Universal Manufacturing Co v Commissioner*,

93 TC 589 (1989), and *Westreco, Inc v Commissioner*, TC Memo 1990-501, for the issuance of protective orders needs to be modified, and (2) of how the Tax Court's traditional informal stipulation and discovery process should operate in the large cases

(1) The opinions in *Universal Manufacturing Co* and *Westreco* did not analyze or weigh the underlying facts and circumstances relevant to motions for protective orders. Rather, they weighed the principles and structure of tax audit and tax administration (particularly the IRS summons authority) against the principles and structure of tax litigation (particularly Tax Court discovery). Those opinions, erroneously in my view, concluded that the latter is preeminent (at least in the context of a pending court case) and that there exists a fundamental and per se unfairness when the IRS attempts to utilize its statutory authority under the audit rules with respect to related taxpayers, other years, or other liabilities, at the same time that a taxpayer is involved in a pending tax case.

In *Universal Manufacturing Co*, in *Westreco*, and in the instant case, we are faced with respondent's specific and express statutory authority and responsibility under sections 7602 and 7609 to conduct civil and criminal audits for any and all years and for all taxpayers. See, for example, sec 7602(c)(3).¹ That authority (which includes the summons power) is separate and distinct from the discovery rules of this Court, is not limited by the Rules of this Court, and unless that authority is clearly abused this Court, in my opinion, has no business directly or indirectly interfering with the manner or method by which respondent utilizes that authority.

The motions for protective orders in *Universal Manufacturing Co*, *Westreco*, and the instant case, are in my opinion premature. They ask us to rule on the use of information before we even know what the information is, what form it takes, and before it is offered into evidence.

Under Fed R Evid 402, all relevant evidence is generally admissible except as otherwise provided by the Constitu-

¹Sec. 7602(c)(3) provides as follows:

(3) TAXABLE YEARS ETC. TREATED SEPARATELY.—For purposes of this subsection each taxable period (or, if there is no taxable period, each taxable event) and each tax imposed by a separate chapter of this title shall be treated separately.

tion, statute, other provisions of the Rules of Evidence, or other rules prescribed by the Supreme Court. None of those exceptions apply to the facts of *Universal Manufacturing Co., Westreco*, or the instant case.

Section 6103(h) states that information obtained by the IRS through the use of administrative summonses is excepted from the general rules of nondisclosure where it is to be used in subsequent and related court litigation. If the per se rule set forth in *Universal Manufacturing Co.* and *Westreco* were correct, section 6103(h) would be rendered meaningless with regard to litigation in the Tax Court.

Further, the discovery rules of this Court were never intended to be used as a vehicle to limit the admissibility of otherwise relevant information. As discussed below, it is exactly this type of information (i.e., relevant information that has been lawfully obtained) that the Tax Court traditionally has required a party to produce informally under the *Branerton* rule and to include in a stipulation. See *Branerton Corp. v. Commissioner*, 61 T.C. 691 (1974), Rule 91(a).

Lastly, even if the use of a summons were to be viewed as a means of acquiring information not available under our rules, it does not necessarily follow that suppression of evidence is a proper remedy. Suppression of evidence, even if predicated on a court's supervisory powers, has been restricted to those areas where the remedial objective of suppressing evidence (namely, the deterrence of future illegal activity) is most efficaciously served and suppression must be balanced against the undesirable effect of impeding the fact finding process. *United States v. Payner*, 447 U.S. 727 (1980).

In this case, as in *Universal Manufacturing Co.* and *Westreco*, there has been no finding that respondent committed any illegal or wrongful act in serving the summonses. Also, most of the summonses in this case requested third parties to produce information. In *Payner*, the Supreme Court held that even information that was stolen from a third party in violation of the Fourth Amendment to the Constitution should not necessarily be excluded from evidence in a case in which the third party is not a participant. See *United States v. Payner*, 447 U.S. at 735 n

7, *Dixon v Commissioner*, 90 T C 237, 245 (1988), following *Payner* on this point

Assuming a protective order is justified in a case, a further significant question is raised by the broad protective orders that were issued in *Universal Manufacturing Co* and *Westreco*, and by the protective order requested in the instant case, concerning the proper nature, scope, and extent of protective orders. A discussion of that question is perhaps best left for another day, but the failure of the majority opinion herein to address that question, in my opinion, should in no way be construed as an implicit approval of the nature, scope, or extent of the particular protective orders issued in *Universal Manufacturing Co* and *Westreco*.

(2) The discovery issue involved in *Westreco Inc v Commissioner, supra*, in *Universal Manufacturing Co v Commissioner, supra*, and in the instant case, directly and significantly affects the litigation and resolution in the Tax Court of our largest and most complicated cases. Indeed, the cumulative deficiencies determined by respondent in just the three cases mentioned are approximately \$33 million (with millions more involved in other years). Taxpayers most interested in this issue are likely to be major international corporations that have entered into multi-issue, multi-year transactions. Recently published news and legal articles indicate that the significance of this issue, as it relates to litigation of the large tax cases, has not been lost on the Government, the private bar, the media, or the general public.

In light of the above, I respectfully suggest that it is especially appropriate to provide at this time to the litigants in this Court additional guidance concerning the continued viability or lack thereof of the Tax Court's traditional informal stipulation and discovery process in the context of the large cases that are now being filed and that will be filed in the years ahead.

Routinely and particularly with regard to major clients accountants and lawyers (in preparing tax returns, in giving accounting and legal advice, and certainly prior to litigating a case) investigate what information from related taxpayers and from other years of their clients is relevant

to the current year returns, or to the pending transaction, controversy, or litigation. It would thus appear to be prima facie fair and appropriate that respondent's agents and counsel, in the large complex tax cases also have a keen interest in investigating and obtaining information from related taxpayers and from other years that may be relevant to the issues in a pending case.

Similarly, to the extent information from related taxpayers and from other years of the same taxpayers, in fact, is relevant to issues pending before us, this Court in my opinion should have the same interest in such information.

How then, in the large cases, is relevant information from related taxpayers and from other years to be discovered for use in this Court?

I believe that even in the large cases counsel for both parties generally should continue to utilize this Court's informal stipulation and informal discovery process to develop such information. See *Branerton Corp v Commissioner*, 61 T C 691 (1974), Rule 91. Where an appropriate *Branerton* request has been made by either counsel for relevant information pertaining to related taxpayers or to other years, opposing counsel, if they already have the responsive information, should turn over such information informally and completely. If they do not have such information and do not know if it exists, opposing counsel should undertake an investigation to determine whether the information exists and whether it is in their client's custody or control, followed by an appropriate informal and complete disclosure of all information found.

Where—in large cases and in connection with a complete and thorough development of the relevant facts—counsel believes that there is a need to question certain key witnesses or potential witnesses of the opposing party, counsel should proceed under *Branerton* to request an informal meeting with such individuals and with opposing counsel. Where an informal meeting cannot be agreed to and where the individuals in question do indeed appear to be key witnesses and to have been in a position to have particular insight into the relevant information or transactions at issue in a pending case, I would normally expect both counsel to agree, in such situations, to consensual

depositions under Rule 74, thereby obviating the need for the Court to rule on a motion for nonconsensual depositions under Rule 75

Where consensual depositions under Rule 74 cannot be agreed to, counsel should contact the Court to discuss the appropriateness of formal depositions. I suggest that the Court, in the large cases, and in such situations, should not be as hesitant as it has been in the past to order third-party nonconsensual depositions under Rule 75

The approach suggested herein emphasizes the Tax Court's strong interest in deciding cases based on all relevant information, and it would provide guidance to counsel in the large cases regarding how that information generally is to be developed. It reaffirms the Tax Court's continued use and primary reliance on good faith, reciprocal, and complete informal discovery, even in the large, complex cases. It recognizes and suggests that some increase in the use of depositions under Rules 74 and 75 may be appropriate in the large cases, and it would appear to minimize potential abuses of respondent's summons authority in connection with pending cases.

PARKER, GERBER, and RUWE, *JJ*, agree with this concurring opinion

October 1998

Script For Appeal to 4th Circuit Court of Appeals

Sam Jones, Appellant v.
Commissioner of Internal Revenue,
Appellee and Cross Appellant
Dkt. # 112-97

The following abbreviations shall apply

Judges 1, 2, and 3. Judges of the United States Court of Appeals
for the Fourth Circuit
Clerk. Clerk of the Court of Appeals
Rptr. Court Reporter
PC Counsel for Appellant or Taxpayer
RC Counsel for Appellee and Cross Appellant or IRS

THE CLERK All rise All persons having business before the
United States Court of Appeals for the Fourth Circuit will draw
near and give their attention The Court is now in session, God
save the United States Court of Appeals, Judges _____,
_____, and _____,
presiding

Judge # 1: Please be seated

THE CLERK Calling from the calendar Sam Jones, Appellant v
Commissioner of Internal Revenue, Appellee and Cross Appellant
Dkt # 112-97 Please state your appearances

PC- _____, appearing for
the taxpayer and appellant, Sam Jones

RC- _____, appearing for
the IRS, appellee and cross appellant

Judge # 1 Are the parties prepared to proceed?

PC Appellant is ready

RC. Appellee is ready

Judge # 1 Please be advised that we have read your
exhaustive and thorough briefs on the issues raised on appeal,
and we anticipate deciding this case immediately following
argument Appellant please proceed You have 10 minutes for
opening argument and 5 minutes for rebuttal argument Appellee,
you also have 10 minutes for opening and 5 minutes for rebuttal
argument

PC Your honor, my client, Sam Jones, filed the initial appeal
in this matter

The Tax Court properly held in favor of my client, the
taxpayer, with regard to the civil fraud penalty, and in favor of
my client with respect to the IRS' effort to raise as a new issue
\$1 million in drug income. But, in our view, the Tax Court
erroneously held in favor of the IRS with regard to the \$100,000
tax deficiency for 1993. We appeal the Tax Court's decision in
favor of the IRS with regard to the \$100,000 tax deficiency for
1993.

We believe the Tax Court committed clear error in holding
for the IRS on this \$100,000 deficiency. The evidence supporting
the tax deficiency was so speculative and untrustworthy that we
believe the Tax Court decision should be reversed under the
clearly erroneous standard.

The dollar amount of the \$250,000 in additional income charged to petitioner by the IRS and by the Tax Court was not supported by documentation, by expert witnesses, or by any other valid evidence. We believe the IRS calculation of this additional income was arbitrary and capricious, and the Tax Court's decision sustaining the IRS' computation should be reversed.

We also believe that the evidence clearly established that the IRS revenue agent was so biased against the taxpayer that the revenue agent's calculations of the taxpayer's income should not be entitled to the normal presumption of correctness. The revenue agent's comment to his sister when he first met the taxpayer and coveted the BMWs indicates that there was no way the revenue agent could be objective in his audit and examination of the taxpayer.

Lastly, the IRS slipped into the trial evidence the testimony about possible drug income. This was highly prejudicial and made it impossible for the Tax Court Judge to be objective about the rest of the evidence. The IRS offered absolutely no further evidence that in any way suggests the taxpayer received drug income. Alleged evidence of drug income initially was intended to support the additional \$1 million that the IRS attempted to raise as a new issue just before the trial and that the Tax Court properly did not allow. IRS counsel clearly knew about this alleged drug income before the trial, knew that the Tax Court had ruled that the drug income was not to be raised, and therefore the drug income should not have been brought up.

To then introduce the drug income into this case through the back door -- that is through the sister of the revenue agent and through her hearsay testimony -- was unethical, improper, prejudicial, and the Tax Court committed reversible error in allowing such testimony or evidence of drug income to be admitted.

In summary, your Honors, we believe that the Tax Court should be reversed, as a matter of law for committing clear error in sustaining the IRS' determination of the \$250,000 income adjustment.

With regard to the cross appeal of the IRS, and the claim that the Tax Court erred in not sustaining the civil fraud penalty and in not allowing the new issue involving the additional \$1 million of drug income to be raised, we believe the IRS appeal is ludicrous and totally without merit.

With regard to the Tax Court's refusal to allow the new issue to be raised involving the \$1 million in alleged drug income, a trial judge has almost complete discretion with regard to such procedural matters. This new issue was not raised until just before the trial. It constituted the assertion of 10 times the amount of the original tax deficiency determined and that had been involved in the case up until that time (\$1 million as compared to \$100,000). To have allowed this new issue would have necessitated a continuation of the trial, significant additional costs and delay in the trial, the preparation of new evidence and witnesses, and additional time of the Court in addressing the new issue.

Extreme prejudice would have been caused to the taxpayer and to the Court if the new issue would have been allowed. The authorities and policies are clear and well established to the effect that the Courts of Appeal, including the 4th Circuit, should not attempt to second guess or micro manage the work of a Federal trial judge, but should defer to the trial judge on matters of procedural discretion. After all, the trial judge is closest to the parties, to the evidence, to what has happened in the pre-trial phase of the proceedings, and is in a much better position to rule on the propriety of allowing a new issue than is this Court of Appeals.

For the above reasons, the taxpayer strongly argues that no error was committed by the Tax Court in refusing to allow the IRS to raise a new issue involving the alleged \$1 million of drug income.

We will address further the civil fraud penalty in our rebuttal, your honors.

RC The appellant-taxpayer makes many arguments -- all without merit and bordering on the frivolous. The only issue worthy of an appeal in this case and of the time and attention of your Honors' attention today is our -- the IRS' -- cross appeal of the Tax Court's holding that the IRS' civil fraud penalty should not be sustained. But we will save that for later. First, to address the issues raised in the taxpayer's appeal.

As to the adjustment to the taxpayer's income of \$250,000 in income and the tax deficiency of \$100,000 that was upheld by the Tax Court, we emphasize that the Tax Court is a special national Federal trial court. Its judges are specialists in matters of

Federal taxation. It is well-established that the Tax Court is entitled to special deference by other Federal courts, including the Courts of Appeal, in matters of Federal income taxation. The IRS' notice of deficiency is entitled to special deference. It is to be presumed correct, and the taxpayer has the burden of proving it wrong.

The Tax Court's holding with regard to the \$250,000 income adjustment and the \$100,000 tax deficiency was correct, properly reflects the presumption of correctness given to the IRS' adjustments and the taxpayer's burden of proof on that issue. The appellant has not established any basis for reversal of that issue as sustained by the Tax Court, to which holding the Court of Appeals should give significant deference.

The appellant's arguments are without merit when he argues that IRS agent George Irwin was biased and that he could not and did not conduct a fair and objective examination of the taxpayer.

IRS agents are real people. They have real interests and preferences and normal biases that we all have. Nothing in the IRS manual says that an IRS agent must like a taxpayer he is auditing. Perhaps agent Irwin did not like the taxpayer. So what? That is totally irrelevant. Unless an IRS agent's conduct is so egregiously bad as to be outrageous and completely arbitrary, whether or not the IRS agent liked or disliked the taxpayer under examination is of no interest to the courts. Certainly, there is no evidence in this case of arbitrary conduct on the part of the revenue agent.

Further, the failure of the IRS to obtain an expert is not grounds for reversal. The court opinions are clear that an IRS notice of deficiency is entitled to a presumption of correctness whether or not the IRS uses an expert in calculating the income adjustments that are made in the notice of deficiency. The IRS adjustment need only have some rational basis therefor in order for the presumption of correctness to attach to a notice of deficiency, and that is certainly the case here. The expensive BMWs, the dacha, and the jewelry, the value of which, as determined by respondent's agent, is not even disputed, comes to over \$100,000, reflecting assets purchased by the taxpayer in 1993. During the audit, the taxpayer had no excuse or explanation for the source of the funds for these expenditures, and respondent's agent and respondent were reasonable in making the net worth calculation and treating the funds used to purchase these assets as income to the taxpayer.

Especially because the value of the assets and the amount of the income adjustments were not challenged or even questioned by the taxpayer prior to the trial, it would be anomalous if the taxpayer were now allowed to do so

We again emphasize the deference that the Courts of Appeal traditionally give to the U.S. Tax Court, as a national court for the resolution of tax cases. That deference is an important part of our tax litigation system and there is no reason for Your Honors not to apply that deference to the opinion of the Tax Court in this case.

With regard to the claim that the trial court judge was greatly and unfairly prejudiced against the taxpayer by the allegation of drug income, (particularly after the trial judge had ruled that no new issue as to the drug income would be allowed), we emphasize that there has always been an issue in this case as to the source of the original \$250,000 in income that the IRS charged to the taxpayer under the net worth method of proof. It is to that \$250,000 in income only that the vague evidence of drug income refers, which we emphasize came into evidence through the testimony of the taxpayer's own witness, not through the IRS' witness.

In this case, there never has been an explanation as to the likely source of the \$250,000 in additional income until the taxpayer's witness provided that testimony. Accordingly, the general evidence of drug income was appropriately allowed as evidence of a taxable source for the \$250,000 used by the taxpayer in 1993 for purchases. It does not relate to the \$1 million that the IRS sought to raise as a new issue and that the Tax Court did not allow.

We also emphasize that the Tax Court trial did not involve a jury trial. Therefore, there was no possibility that members of a jury, who are typically nonlawyers, would have been prejudiced by such evidence of drug income. A trial judge certainly has the expertise and experience not to be unduly prejudiced or influenced by the evidence of drug income.

Now, your Honors, we address our cross appeal.

We do believe that the Tax Court abused its discretion and erred in not allowing to be raised in this case the issue as to the alleged \$1 million in drug income. Such income the taxpayer should have been aware of all along. After all, it was the taxpayer's own witness to whom the taxpayer made statements about having received drug income. Your Honors, in light of the damage

done to our society by illegal drug activity, we believe the IRS and the courts should be aggressive and liberal in using the criminal and civil laws, in reaching out to stop such activity. The source of the \$250,000 original adjustment has always been in issue, and its likely relationship to drug income was established by the taxpayer through his own witness. We had very good evidence of additional drug income in the amount of \$1 million and it was contrary to good judicial and social policy not to allow that evidence to be used to establish the taxpayer's true income for 1963. To allow the taxpayer to escape tax on this illegal income constitutes a windfall for the taxpayer and does serious damage to our society.

We believe the Tax Court judge, as a matter of law, read respondent's original notice of deficiency too narrowly and should have allowed the \$ 1 million to be asserted by respondent, either as a supplement or amendment to the original notice of deficiency or as a new issue.

In our brief rebuttal argument, we will address the taxpayer's argument as to the standard of proof on civil fraud. Thank you, your Honors.

Judge #1 Appellant, you have just 5 minutes for rebuttal argument.

PC Your Honors, this Court of Appeals should not reverse the Tax Court on the civil fraud penalty, and it also should impose a new standard of proof or a new burden of proof on the IRS with respect to civil tax fraud. The new standard should require that the IRS prove civil tax fraud "beyond a reasonable doubt" not merely by "clear and convincing" evidence. This argument is based on the similarity between civil tax fraud and criminal tax fraud.

In reality, the 75% civil fraud penalty is punitive in nature and should be regarded as a criminal type penalty and therefore the level of the IRS burden of proof with respect thereto should be beyond a reasonable doubt.

Thank you your Honors.

RC- Very briefly, your Honors. In our rebuttal argument, we address only the taxpayer's argument with regard to the proper burden of proof on civil tax fraud. Numerous cases have applied the "clear and convincing" burden of proof against the IRS in civil tax fraud cases. There is no reason in this case to modify

that standard, and the taxpayer's counsel has not suggested a reason. We submit that this Court of Appeals should reverse the Tax Court and should sustain the civil fraud penalty because the evidence is overwhelmingly clear that respondent established, by clear and convincing evidence, that the taxpayer committed civil tax fraud in filing a false tax return.

HOLDING OF COURT OF APPEALS FOR THE FOURTH CIRCUIT

[The three appellate court judges confer briefly and then announce that they are ready to decide the case and that they will read the opinion from the bench.]

Judge #1 (the Senior Judge among the three) then reads into the record the opinion, as follows:

This Court of Appeals holds that the Tax Court committed no clear error of fact or law in sustaining the \$100,000 tax deficiency. The trial proceedings were not so tainted with bias or unfairness, nor of evidence of drug income as to be fatal to the fairness of the proceedings. The general evidence of drug income was relevant and admissible as to the possible source of the \$250,000 additional income charged to the taxpayer in the IRS' notice of deficiency.

The alleged bias of the revenue agent is illusory and speculative. The only basis for such allegation of bias is the agent's casual comment to his sister about the taxpayer and his envy for others who own BMWs. We regard this as relatively innocuous. The objectivity of the trial judge was in no way tainted or compromised by any of the evidence.

As the IRS points out and emphasizes, even without the paintings and furnishings, respondent's computation for 1993 of a significant increase in the taxpayer's net worth is supported by items about which there is no dispute (namely, the BMWs, the dacha, and the jewelry). We believe there is ample evidence of a significant increase in the taxpayer's net worth from unreported

income for 1993 and of the taxpayer's liability for the \$100,000 tax deficiency

1,000,000

With regard to the alibi of a ~~\$950,000~~ gift from Iran, this is a factual matter with respect to which we defer to the Tax Court unless clear error occurred. We believe the evidence is not sufficiently strong to require a reversal of the Tax Court's conclusion that the taxpayer had \$250,000 in additional taxable income. In particular, the taxpayer's failure to disclose this alleged nontaxable source of funds until just before the trial weakens greatly the credibility of the taxpayer's alibi.

The Tax Court correctly concluded that the normal presumption of correctness applies to the IRS' notice of deficiency and the taxpayer failed to overcome his burden of proof as to the tax deficiency.

We also sustain the decision of the Tax Court not to allow the IRS to raise a new issue regarding \$1 million in alleged drug income. We find respondent's effort to raise this issue just before the trial patently late and dilatory. We defer to the discretion of the Tax Court judge on this procedural question.

We also note that we agree with the Tax Court that this issue did constitute a new issue, not covered in the IRS original notice of deficiency.

The taxpayer's arguments regarding burden of proof and the civil fraud penalty are novel, thoughtful and cogent, and we have given them much thought.

We believe the Tax Court in this case, in rejecting the IRS' assertion of the civil fraud penalty, erroneously applied the clear and convincing burden of proof standard. Properly applied under that level of burden of proof, we believe that as a matter of law, the Tax Court erred and the taxpayer should be held liable for the civil fraud penalty.

However, we agree with the taxpayer's novel argument that the proper level of burden of proof on the IRS with regard to the civil fraud penalty should be "beyond a reasonable doubt", the same as for criminal tax evasion.

The civil tax fraud and the criminal tax fraud penalties have essentially the same elements. Only the punishment is different -- for the civil fraud penalty the punishment is an dollar increase in the tax deficiency by 75% for the criminal tax fraud penalty, also called tax evasion, the punishment for each year is a maximum of \$100,000 and imprisonment in jail for up to 5 years in jail. Because the underlying substantive elements of civil and criminal tax fraud are essentially the same (namely an affirmative attempt to defraud the IRS willful

intent to defraud the IRS, and a substantial tax due), we conclude that it is appropriate to apply in this and other cases to civil tax fraud adjustments sought by the IRS the same "beyond a reasonable doubt" standard that we apply to criminal tax fraud

We recognize that this change in the 4th Circuit Court of Appeals of the level of the IRS' burden of proof on civil tax fraud is contrary to the law of every other Court of Appeals. This conflict in the law should perhaps be addressed by the Supreme Court on certiorari. Normally, we would be reluctant to create this conflict among the Circuit Courts of Appeal. We are persuaded, however, that the new standard for the IRS burden of proof in civil tax fraud cases is appropriate and is necessary.

For the reason only that we apply a new, higher burden of proof on the IRS imposition of the fraud penalty, and because we do not believe that the evidence in this case would satisfy this higher standard, we do not reverse the Tax Court's failure to sustain the IRS imposition against the taxpayer of the civil fraud penalty.

This concludes our opinion. An appropriate order and decision will be entered within 30 days reflecting our disposition of the tax adjustments and penalties at issue.

October 1998

Script For Certiorari from 4th Circuit Court of Appeals to

U S Supreme Court

Commissioner of Internal Revenue,
Appellant v. Sam Jones, Appellee
Dkt. # 35-97

The following abbreviations shall apply.

CJ Chief Justice of the United States Supreme Court

Justices 2 through 9: Associate Justices of the United States
Supreme Court

Clerk Clerk of the Supreme Court

Rptr Court Reporter

PC: Counsel for Appellee or Taxpayer

SG Solicitor General of the United States and Counsel for
Appellant or IRS

THE CLERK. All rise All persons having business before the
United States Supreme Court will draw near and give their
attention The Court is now in session, God save the United
States Supreme Court, Chief Justice _____
presiding

Clerk: Calling Dkt # 35-97,

SG May it please the Court Your Honors it is a pleasure to be before you today. This case presents an important issue affecting the administration of the Federal income tax laws As the Court is aware, no Federal law impacts more people in the United States than our Federal income tax laws

The civil fraud penalty is one of the most important tools that the IRS has in order to maintain and encourage a high level of voluntary compliance with our Federal income tax laws It is well known that many other countries do not have a high level of voluntary tax compliance We believe that the level of compliance in the U S is, in part, attributable to the fact that the IRS vigorously asserts and imposes the civil fraud penalty and that the law is clear as to what the elements thereof are and how it is applied

We believe that the U S Court of Appeals for the 4th Circuit in this case below has rendered an opinion that establishes an unnecessarily and improperly high standard that the IRS must satisfy in order to impose the civil tax fraud penalty

For over 70 years, in the 4th Circuit and throughout the Nation the burden on the IRS to impose the civil tax fraud penalty has been "clear and convincing evidence" There is simply no justification for the 4th Circuit to establish a new, higher standard or burden of proof for tax fraud in conflict with all the other Circuit Courts of Appeal We see absolutely no justification for the IRS to have one uniform burden of proof on civil tax fraud that applies everywhere in the U S except those 5 States within the jurisdiction of the 4th Circuit (namely, Maryland Virginia West Virginia, North Carolina and South Carolina) Are taxpayers in those 5 States to be preferred, and is the IRS in those 5 States to be treated more harshly than taxpayers and the IRS in all of the other States? That is the effect of the rule adopted by the 4th Circuit in this case with regard to the IRS' burden of proof in civil tax fraud

The 4th Circuit's opinion in this case has simply caused confusion and made it more difficult for the IRS to do its job (that is, to collect taxes and to enforce penalties against those taxpayers who don't file their tax returns and pay their taxes honestly)

We believe that this Honorable Court should eliminate the conflict that the 4th Circuit has caused by its opinion in this case with regard to the level of the IRS burden of proof on

civil tax fraud We respectfully submit that the Supreme Court in this case should reverse the 4th Circuit and declare that the IRS has a single, nationwide, and uniform burden of proof to establish civil tax fraud by clear and convincing evidence

Also, after correctly stating the IRS' burden of proof on civil tax fraud, this Honorable Court should follow the dicta of the 4th Circuit and reinstate the civil fraud penalty against taxpayer-appellee Sam Jones We submit that the 4th Circuit correctly noted that if the burden of proof is one of "clear and convincing" evidence, then the Tax Court's conclusion that the IRS in this case had not met that burden is clearly erroneous

Thank you, your Honors

PC. May it please the Court We submit that the 4th Circuit correctly increased the IRS' burden on civil tax fraud to "beyond a reasonable doubt" In fact, we believe that that standard should apply nationwide There is little difference between civil and criminal tax fraud It doesn't make any sense to have a different standard and as between the two standards, it should be more difficult, not easier, for the IRS to impose the civil fraud penalty

If this Honorable Court decides to reverse the 4th Circuit as to the level of the IRS' burden of proof and reinstate the "clear and convincing" burden with regard to civil tax fraud then we believe this Court should ignore the 4th Circuit's dicta to the effect that the IRS satisfied that standard and that the Tax Court clearly erred in failing to sustain the civil fraud penalty under that burden of proof

Thank you your Honors

Chief Justice The Court has fully considered this matter and is now prepared to rule The following constitutes the unanimous opinion of the Supreme Court

Criminal tax fraud represents a crime that is so severe that it constitutes a crime against society itself. The punishment of imprisonment for up to 5 years reflects that fact It is appropriate that before Federal Courts sustain the IRS' imposition of the criminal tax fraud penalty, the IRS should be required to prove that the taxpayer committed such crime "beyond a reasonable doubt", the universal standard for essentially all Federal felony crimes

In contrast the civil fraud penalty is triggered when an error on a tax return is made that does not rise to the level of a crime against society. It represents a serious and intentional error but not one that harms society as a whole in a criminal manner. We believe the IRS, in order to effectively do its job and encourage voluntary tax compliance, needs to have available against taxpayers a tax fraud penalty that is civil, not criminal, in nature, that involves no imprisonment, only a dollar penalty, and that is easier to prove than criminal tax fraud.

In short, the 75% civil tax fraud penalty serves a viable purpose in our Federal tax system, separate and distinct from the purpose of the criminal tax fraud penalty. That separate purpose is to punish with a large dollar penalty those taxpayers who intentionally underreport and underpay their tax liability but whose conduct does not rise to the level of criminal conduct, and thereby to deter other taxpayers from underreporting and underpaying their taxes.

We reverse the 4th Circuit's statement of the IRS' burden of proof to establish civil tax fraud. In the 4th Circuit, consistent with the rest of the Nation, the IRS' burden of proof on civil tax fraud shall be "clear and convincing" evidence.

With regard to 4th Circuit's dicta to the effect that the IRS satisfied that standard and that the Tax Court clearly erred in failing to sustain the civil fraud penalty in this case under that burden of proof, we disagree. First of all, we note that as dicta that statement of the 4th Circuit is not precedential and has no legal effect.

Secondly, we believe that statement of the 4th Circuit fails to appreciate the proper and significant role of the U.S. Tax Court in our judicial system. As a special Federal trial court with limited subject matter jurisdiction over just Federal taxes, the Tax Court and its judges who are all specialists in Federal taxation serve an important role in developing a uniform interpretation of our tax laws. Without such a uniform court interpretation and application of our Federal tax laws, citizens and taxpayers who live in different parts of the U.S. would be treated differently, the tax system would be regarded as unfair and arbitrary, and the voluntary compliance of taxpayers in the filing of tax returns and the payment of their correct tax liabilities would be greatly reduced.

As other courts have repeatedly noted, because of its important and special role in our Federal tax system, appellate courts (including this the Supreme Court) are expected to give decisions of the Tax Court special deference on both findings of fact and questions of tax law interpretation.

Accordingly, reiterating and applying in this case the rule of special deference to the Tax Court, we conclude that the Tax Court got it right on both the legal question as to the IRS' burden of proof on civil tax fraud ("clear and convincing evidence") and on the fact question as to whether in this case the IRS satisfied that burden.

We reverse the 4th Circuit's conclusion as to what burden of proof applies to civil tax fraud. We ignore the 4th Circuit's dicta that the IRS failed to prove in the Tax Court by clear and convincing evidence the taxpayer's liability for the civil tax fraud penalty, and we remand this case to the 4th Circuit with the mandate that it reinstate in full the decision and judgment of the Tax Court.

This concludes the opinion and holding of the Court.