

Where Can You Litigate Your Federal Tax Case?

By David B. Porter

Historically, when a taxpayer had a controversy with the Internal Revenue Service that could not be resolved at the examination level, the taxpayer nearly always went to the Tax Court to seek relief. However, there have always been different options available to litigate a tax controversy. Today, those options are more important to examine and evaluate than in the past. This article explores the aspects of each of those options.

Before the taxpayer has to choose where to litigate a tax case, there will be an opportunity to settle the case at the administrative level. A revenue agent will audit (or examine) the tax return. The revenue agent will prepare a report, often recommending a deficiency in income tax (plus interest and penalties). If a revenue agent's report (sometimes called a 30-day letter) is issued, the taxpayer has the right (within 30 days) to file a protest and have an appeals conference with the IRS Appeals Division. Many cases are resolved at IRS Appeals for a percentage of the proposed deficiency.

If the case does not settle at this level, then the IRS will issue a Notice of Deficiency (90-day letter). The Notice of Deficiency commences a 90-day period (150 days if mailed to a taxpayer outside the U.S.) in which to file a petition in the Tax Court. If a petition is not filed within 90 days, then the only other way to contest the IRS determination and litigate the matter is to pay the tax and seek a refund.

Generally, all income taxes must be assessed within three years after the tax return is filed. However, if a tax return omits an amount in excess of 25 percent of the gross income stated on the return (or overstates deductions to this extent), then the statute of limitations is six years. (State statutes of limitations for income tax assessments must also be considered. The California statute of limitations, for example, is generally four years, giving California an extra year after the running of the normal three-year federal statute to make a California assessment.)

I. Alternatives for Tax Litigation

There are three places to litigate a tax controversy against the IRS: the U.S. Tax Court, U.S. District Court, and the Court of Federal Claims. Each has advantages and disadvantages.

A. U.S. Tax Court

Most tax disputes are resolved in the U.S. Tax Court. Located in Washington, it is composed of 19 judges, each appointed for a 15-year term. The judges hear only tax cases, and therefore they are presumed to be experts in the tax law.

The court rides a "circuit," and judges regularly travel to major cities throughout the country where they conduct their trials. The taxpayer has the opportunity to designate a place of trial in whatever major city he or she chooses. The court will then come to the

designated city and hold a trial session where a calendar of cases will be heard generally over a two-week period.

In Tax Court, you may contest the proposed adjustments to the tax made by the IRS *before* paying the tax. You must file a petition with the Tax Court within 90 days from the issuance of the Notice of Deficiency. The Notice of Deficiency will state the last day that the taxpayer can file a petition. If the taxpayer does not file a timely petition then the proposed adjustments in the Notice of Deficiency become an assessment.

The pretrial discovery procedures in Tax Court are rather informal, and depositions are extraordinary. Settlement of a Tax Court case is negotiated with an IRS Appeals Officer, or closer to trial with the Area Counsel trial lawyer. A Tax Court trial is held before one judge without a jury. Before trial, the court requires the parties to stipulate or agree to all facts not in dispute. This process speeds up the trial and assists in the settlement of many cases prior to trial.

The Tax Court follows the Federal Rules of Evidence (applicable to trials without a jury in the District of Columbia). Some Tax Court judges are lenient in enforcing the rules and allowing the admission of evidence, presumably because the judge, not a jury, is the decisionmaker regarding both the facts and the law. The judge may allow evidence into the record, yet later rule that the evidence does not have much weight or is not credible, and the judge may therefore choose not to rely on it in the court's determination.

After trial, the Tax Court sets a briefing schedule, usually 90 days, and requires the parties to file briefs containing proposed findings of fact with citations to the record, and a legal argument. Thereafter, the court usually issues an opinion within a year of the trial. The Tax Court attempts to apply the tax law consistently throughout the country, regardless of the circuit or region where the trial occurs or the taxpayer lives. The losing party has the right to appeal to the Court of Appeals for the circuit where the taxpayer resides. (Further, the *Golsen* rule requires the Tax Court to follow a Court of Appeals decision that is squarely on point and where the Tax Court decision will be appealed to that same Court of Appeals.)

B. U.S. District Court

As an alternative to filing in Tax Court, the taxpayer has the choice of suing in U.S. District Court. Significantly, the taxpayer must pay the tax first and then file a refund claim, while in Tax Court the tax need not be paid until after the case is concluded. This practical difference eliminates the U.S. District Court for many tax disputes.

The U.S. District Court is the general trial court for the federal judicial system. The district court is located in a certain geographic region and hears cases only from within that district. District judges are appointed to the bench for life. They hear a wide variety of cases that may range from civil employment law to criminal drug conspiracies. The district judge may or may not be a specialist in tax law.

Again, the taxpayer must pay the proposed tax deficiency first, before going to court. The taxpayer

pays the tax and files a refund claim. This payment and refund claim filing do not have to occur within 90 days of the issuance of the Notice of Deficiency. Once the IRS denies the refund claim, or six months passes, whichever occurs first, the taxpayer can file a refund lawsuit in district court.

Pretrial discovery is conducted pursuant to the Federal Rules of Civil Procedure. Depositions and other discovery tools, such as interrogatories and requests for admission, are common. Before trial there may be a summary judgment motion filed by either side that requests the court to rule as a matter of law that the claim should (or should not) be allowed. This motion is significant, as the case may be decided on this motion if the judge, considering all of the undisputed facts, determines that there can only be one outcome as a matter of law.

In a district court case, the IRS will be represented by the Tax Division of the Department of Justice in Washington or the Tax Division of the U.S. Attorney's Office in the few cities in the country that have such a division. Settlement authority is vested in the trial attorney assigned to the case.

Significantly, the district court is the only court for tax matters in which a jury is available. The facts of the case will be decided by laypersons, not tax experts. The rules of evidence are governed by the Federal Rules of Evidence and strictly enforced since a jury is present. Once the jury returns a verdict, the case is completed. There is no further delay with a briefing schedule or decision by the court.

The district courts are bound by the decisions of the court of appeals for the circuit in which the district is located and by the U.S. Supreme Court. Following a verdict by the jury, and possibly post-trial motions, the case is concluded. Decisions of the district court are appealed to the court of appeals where the district is located.

C. United States Court of Federal Claims

The third choice for litigating federal tax disputes is the U.S. Court of Federal Claims. The U.S. Court of Federal Claims, like the Tax Court, sits in Washington and travels on a circuit to various cities to hold its trials. The court consists of 16 judges appointed for 15-year terms like Tax Court judges, and the court hears various claims brought against governmental agencies. The court has equitable jurisdiction, since it was founded in 1982 (from 1982 to 1992 the court was named the Claims Court) and hears primarily money cases founded upon the Constitution, federal statutes, or contracts with the U.S.

As in district court, the taxpayer must pay the tax deficiency and file a claim for refund before the tax assessment may be contested in court. The discovery procedures available in the Court of Federal Claims are almost the same as those in the district court, as the rules were patterned after the Federal Rules of Civil Procedure. The government in such cases is represented by the Tax Division of the Department of Justice, Claims Court Section, in Washington. The attorney will have settlement authority, but will consult on all matters with the client, the IRS.

A trial is held before one judge without a jury. Following a trial, the court will issue a briefing schedule like the Tax Court for the parties to submit proposed findings of fact and legal argument. Thereafter, the court will render an opinion months later. An appeal from a Court of Federal Claims decision is taken to the Court of Appeals for the Federal Circuit, not the circuit where the taxpayer resides, as in the other two courts.

II. The Bond Procedure

One practical problem with choosing to go to Tax Court is that if the deficiency is upheld, then interest will have run on the tax during the entire controversy. Interest is always a large factor to consider. (Sometimes it reaches the same amount as the deficiency itself after five or six years.) A procedure that is not used often (I've only used it once), as an alternative to either paying or not paying the tax, is to make a remittance to the IRS under the cash bond procedure.

Revenue Procedures 84-58, 1984-2 C.B. 501, and 82-51, 1982-2 C.B. 839, both provide procedures for taxpayers to make remittances to stop the running of interest on deficiencies. A deposit in the nature of a cash bond is not a payment of tax, is not subject to a claim for credit or refund, and, if returned to the taxpayer, does not bear interest. A remittance made before the mailing of the notice of deficiency designated in writing as a deposit in the nature of a cash bond will be treated as such by the IRS and not treated as a payment of tax. The deposit stops the running of interest on the amount of the deposit. The taxpayer may request the return of all or part of the deposit any time up until the assessment, and the amount will be returned without interest (unless the IRS determines the assessment due would be in jeopardy or should be applied against another liability).

On completion of an examination, the taxpayer still has the right to petition the Tax Court. An assessment would be made for the portion of the deposit not in excess of the deficiency and such amount would be applied as a payment of tax. The taxpayer can ask for the excess to be returned (without interest). Revenue Procedure 84-58 makes it clear that a deposit in the nature of a cash bond stops the running of interest at the time the remittance is received.

III. Weighing Alternatives

An emerging consensus among some tax practitioners today is that if a taxpayer has the ability to pay the tax, the district court is frequently the best choice. The Tax Court has acquired a reputation for being pro-government. Furthermore, paying the tax assessment will stop the running of interest on the deficiency.

There is also a difference in personnel depending on where the case is pursued. The revenue agent, Appeals Officer, and Area Counsel Attorney are all IRS personnel. If the taxpayer files a refund suit he or she will be dealing with a U.S. Department of Justice Tax Division Trial Attorney or an Assistant United States Attorney (Tax Division). Most cases in district court also settle prior to trial, just as in Tax Court. The vast majority of

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cases in both Tax Court and district court settle for a percentage of the proposed deficiency prior to trial.

An advantage to district court is that a jury is available, while a Tax Court case is decided by a judge. A Tax Court judge is, by definition, trained in the tax law, which can be helpful or hurtful, depending on the case. A disadvantage in the district court is that motions for summary judgment are common. It is likely that the government would file such a motion before trial, and ask the judge to rule that the taxpayer cannot prevail as a matter of law.

If the government's motion is successful, then judgment is entered in its favor. However, if the government's motion is denied, then the likelihood of settlement increases dramatically. The government may not wish to risk allowing the case to go to a jury, especially a case that may generate significant sympathy and feelings of injustice about the tax system.

Another advantage to the district court is that the resolution is much swifter than in Tax Court. In district court, the jury returns a verdict and a judgment is entered. In Tax Court, following the trial the parties must file post-trial briefs (opening and answering briefs) citing the trial transcript and record.

A significant factor in selecting the forum for a tax case is whether the substantive law on the particular tax question involved is different in each of the trial courts and appellate courts. In some cases, this can be a determining factor.

As with so many things these days, much of this comes down to a question of money. If the taxpayer has the financial resources, then litigating a tax case in district court (or the Court of Federal Claims) is a real option. A jury will be the trier of fact in the district court (but not the Court of Federal Claims) and may be more sympathetic to the taxpayer than a judge. Furthermore, there will be no delay in issuing a final determination at the end of the trial, while in Tax Court the delay can be up to one or two years. These delays bring to mind the adage about justice delayed is justice denied. Today, more than ever, a taxpayer must carefully consider all alternatives before automatically going straight to Tax Court.

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