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TAX LAW

ATTORNEY'S FEES FOR PREVAILING TAXPAYERS

I. INTRODUCTION

In *Sliwa v. Commissioner*,[1] the Ninth Circuit held that the IRS' unreasonable conduct, even before litigation in court actually starts, may be grounds permitting a taxpayer to recover attorney's fees.[2] Internal Revenue Code section 7430[3] provided

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1. 839 F.2d 602 (9th Cir. 1988) (per Poole, J.; the other panel members were Dimmick, J. and Boochever, J., concurring and dissenting.)

2. *Id.* at 607.

3. I.R.C. § 7430 (1983) (prior to 1986 amendments) provided in pertinent part:

> SECTION. 7430. AWARDING OF COSTS AND CERTAIN FEES.
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> (a) In General.— In the case of any civil proceeding which is—
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> (1) brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, and
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> (2) brought in a court of the United States (including the Tax Court and the United States Claims Court), the prevailing party may be awarded a judgment for reasonable litigation costs incurred in such proceeding.
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> (c) Definitions.—For purposes of this section—
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> . . .
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> (2)Prevailing Party.—
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> (A) In general—The term "prevailing party" means any party to any proceeding described in subsection (a) (other than the United States or any creditor of the taxpayer involved) which—
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> (i) establishes that the position of the United States in the civil proceeding was unreasonable, and
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> (ii)(I) has substantially prevailed with respect to the amount in controversy, or
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> (II) has substantially prevailed with respect to the most significant issue or set of issues presented.
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> (B) Determination as to the prevailing party. —Any de-

that a taxpayer may recover reasonable litigation costs if the IRS[4] had taken an unreasonable position in a civil proceeding.[5] As part of the Tax Reform Act of 1986[6] Congress revised section 7430 to provide that the term "position of the United States"

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termination under subparagraph (A) as to whether a party is a prevailing party shall be made—

(i) by the court, or

(ii) by agreement of the parties.

(3) Civil actions.—The term "civil proceeding" includes a civil action.

Section 7430 was subsequently amended by the TRA '86. *See infra* note 6 and accompanying text.

Section 7430 as originally enacted and under the 1986 amendments applies only to attorney fees incurred *after* litigation has commenced, even though IRS conduct *before* litigation commenced has been considered by the Ninth Circuit and other courts in awarding post-complaint fees.

Section 7430 has again been substantially amended by the Omnibus Taxpayer Bill of Rights which was enacted on November 11, 1988 as part of the Technical and Miscellaneous Revenue Act of 1988, Pub. L. No. 100-647 § 6239(a) 102 Stat. 3342, 3743-3746 (1988) *reprinted in* [1988] 55 Stand. Fed. Tax Rep. Extra Edition (CCH) par. 5439. The new law applies to proceedings commencing after November 10, 1988 and is outside the scope of this note.

Because of the large backlog of cases before the Tax Court the impact of this new legislation will not be felt in many cases for several years. At the end of 1987 there were 82,000 cases pending before the Tax Court. Nelson & Keightley, *Managing the Tax Court Inventory*, 7 VA. TAX L. REV. 451, 454 (1989). As of April 1987, 47.5% of pending Tax Court cases had been docketed for less that one year, 37.7% were within a one to three year range and 15.3% had been pending for more than three years. *Id.* at 453-54. Thus, § 7430 as codified prior to the enactment of the new 1988 amendments, and which gave rise to the issues litigated in *Sliwa*, will continue to govern many cases for the next few years.

Under the new law § 7430 has been expanded to allow taxpayers to recover reasonable administrative costs (including attorneys fees) incurred in certain administrative proceedings before the IRS as well as reasonable litigation costs. I.R.C. § 7430(a) (1988). In addition, the definition of the "position of the United States" has been revised. For recovery of litigation costs in court proceedings the position of the United States means the position taken by the Government in that proceeding. I.R.C. § 7430(c)(7)(A)(1988). For recovery of administrative costs the position of the United States means the position taken by the Government as of the earlier of (1) the date of the receipt by the taxpayer of the notice of decision of the IRS Appeals Office, or (2) the date of the notice of deficiency. I.R.C. § 7430(c)(7)(B)(1988).

4. The terms "IRS," (Internal Revenue Service) "Government," and "Commissioner" are hereafter used interchangeably.

5. The procedure for filing a motion for litigation costs under section 7430 in the Tax Court is described in Rule 231, U.S. TAX CT. R. PRACT. & PROC. The motion must be filed within 30 days after the court issues its opinion in a case that has gone to trial. If the taxpayer "substantially prevails" in a settlement without trial, the section 7430 motion must be filed at the same time as the stipulated decision. *Id.*(1988) 9 Stand. Fed. Tax Rep. (CCH) ¶ 5825m.

6. Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2752 (1986) [hereinafter TRA '86].

includes both the position taken in the civil proceeding as well as "[a]ny administrative action or inaction by the District Counsel[7] of the Internal Revenue Service . . . upon which such a proceeding is based."[8]

Although *Sliwa* was decided under the prior statute, the court took note of the revised statute. The Ninth Circuit viewed the language added by Congress as "shedding light on Congress' mandate that section 7430 provide attorney's fees to a prevailing party in cases where litigation is necessitated by the Government's unreasonable conduct at the administrative level.[9]

The court in *Sliwa* held for a broad reading of the statute in favor of the taxpayer and examined both the reasonableness of the position taken by the IRS during litigation as well as the reasonableness of its pre-litigation conduct.[10] However, the Ninth Circuit found in this case that the Government had acted

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7. *See* (1988) 9 Stand. Fed. Tax Rep. (CCH) par. 5975.05. The District Counsel is the division of the IRS whose responsibilities include handling litigation of cases before the Tax Court. In most cases, it is only after the taxpayer files a petition in Tax Court that the IRS attorneys of the District Counsel review the case and take whatever actions necessary to defend the Government.

8. 26 U.S.C. § 7430 (c)(4)(B)(1987). The TRA '86 at § 1551 modified some of the provisions of § 7430, effective for litigation costs incurred after 9/30/86 in civil actions or proceedings commenced after 1985.

Under the original 1982 statute the taxpayer had to show that the Government's position had been "unreasonable". The 1986 amendments changed that standard to "not substantially justified". I.R.C. § 7430(c)(2)(i)(1987). Most courts have held that the two terms are synonymous. Sher v. Commissioner, 89 T.C. 79, 84 (1987). In *Sher*, the taxpayer was assessed with what the IRS alleged was unreported dividend income from investments. *Id.* at 80. The taxpayer mailed evidence to an IRS agent verifying the income he had reported. *Id.* at 81. Nonetheless, the Commissioner issued a notice of deficiency to the taxpayer and the taxpayer was compelled to file a petition with the Tax Court. *Id.* at 82. Shortly after answering the petition the Government conceded that the IRS had erroneously included income earned in a tax free benefit plan as part of the taxpayer's taxable income. *Id.* at 87. The court denied the taxpayer's motion for attorney's fees holding that the pre-petition conduct of the IRS was irrelevant to whether the Government had acted unreasonably. *Id.* In addition, under TRA '86 a taxpayer whose net worth is in excess of $2 million does not qualify for attorney's fees. I.R.C. § 7430(c)(2)(A)(iii)(1987). Finally, the $25,000 ceiling on awards under the prior statute was replaced by a $75 per-hour limitation. I.R.C. § 7430(c)(1)(A)(ii)(III)(1987).

9. *Sliwa*, 839 F.2d 602 at 607 n.6. The court was implying that the amendment ought to be read broadly to include other administrative conduct of the IRS. *See* Devin, *Tax Court Review of IRS' Position: When May Taxpayers Recover Legal Fees?*, 68 J. TAX'N. 368, 370 n. 8 (1988) [hereafter Devin] (A discussion of the issue of what constitutes the "Government's position" and the "position of the District Counsel" under amended section 7430).

10. *Sliwa*, 839 F.2d at 607.

reasonably and did not allow the taxpayer to recover her attorney's fees.[11]

II. FACTS

From 1975 until 1977 Sylvia Sliwa's former husband, Kenneth Sliwa, embezzled money from his employer, Marriot Corporation, to cover accrued gambling debts.[12] During these years the Sliwas filed joint income tax returns.[13] None of Kenneth's illegal income from the embezzlement was reported to the IRS.[14] In 1978 the Sliwas divorced and entered into a separation agreement under which Kenneth conveyed his interest in the marital home to Sylvia.[15]

The IRS learned of the unreported gambling income and in 1981 issued a joint notice of deficiency[16] in income tax for tax years 1975, 1976 and 1977.[17] Since the Sliwas had filed joint returns during those years, Sylvia and Kenneth were jointly liable. The Commissioner mailed the notice to Kenneth at his new address, but did not send a notice to Sylvia at the old Sliwa residence.[18]

Tax assessments[19] were made against Kenneth in October and November of 1981.[20] Shortly afterwards, the IRS filed notice of federal tax liens[21] on the Sliwa Phoenix residence.[22] Even

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11. *Id.* at 608.

12. Sliwa v. Commissioner, 839 F.2d 602, 603 (9th Cir. 1988).

13. *Id.* at 603.

14. *Id.*

15. *Id.* Kenneth executed and recorded a quitclaim deed conveying his interest in the property to Sylvia. *Id.*

16. A notice of deficiency (also referred to as a "90 day letter") is a letter mailed to the taxpayer by the IRS which is a prerequisite to jurisdiction by the Tax Court. I.R.C. § 6212 (1987). The deficiency is the amount by which the tax determined by the IRS exceeds the amount calculated by the taxpayer on his or her return. I.R.C. § 6211 (1987).

17. *Sliwa*, 839 F.2d at 603.

18. *Id.* The Commissioner later conceded that this notice was ineffective as to Sylvia. *Id.*

19. Assessment is the term used when the IRS imposes an additional tax liability. BLACK'S LAW DICTIONARY 107 (5th ed. 1979). For example, if after an audit the IRS finds the taxpayer's gross income understated or deductions overstated, it will assess a deficiency in the amount of the tax that should have been paid. *Id.*

20. *Sliwa*, 839 F.2d at 603.

21. A tax lien as defined by Internal Revenue Code § 6321 (1987) arises "[i]f any person liable for any tax neglects or refuses to pay the same after demand, then the

though the Phoenix home had been conveyed to Sylvia in the separation agreement, the Government's position was that Kenneth had not effectively conveyed his interest in the house to Sylvia until after the tax liens had attached since the notary public had failed to sign the verification on Kenneth's 1978 quitclaim deed.[23]

In November of 1983, at the request of the IRS, Sylvia met with a revenue agent. The purpose of the meeting was to discuss Sylvia's knowledge of Kenneth's illegal income and her claimed exemption from liability as an "innocent spouse" under I.R.C. section 6013(e).[24] Sylvia provided the agent with a sworn statement by Kenneth which stated that at no time had Sylvia been aware of his embezzlement activities, and that she had received no benefits from the illegal income.[25]

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amount. . . shall be a lien in favor of the United States upon all property and rights of property, whether real or personal, belonging to such person." The Code further provides that the Government may seize and sell (levy) any property which is subject to a lien. I.R.C. § 6331 (1987).

22. *Sliwa*, 839 F.2d at 603.

23. *Id.* The notary public did not sign the verification on the quitclaim deed, although a notary's seal was placed below Kenneth's signature. *Id.* at 604 n.1. In Arizona, the law requires the signature of a notary public for an acknowledgement to be valid. *Id.* Kenneth and Sylvia corrected this defect by executing a warranty deed recorded on August 17, 1981, in which they conveyed the property at the office of the title company. *Id.* The officer of the title company executed a joint tenancy deed, recorded on the same day, conveying the property back to Sylvia and Kenneth. *Id.* On February 19, 1982, Kenneth executed a quitclaim deed conveying the house back to Sylvia. *Id.*

24. *Id.* at 604. I.R.C. § 6013(e) (1987) provides in pertinent part:

> (e) Spouse relieved of liability in certain cases.—
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> (1) In General.— Under regulations prescribed by the secretary, if—
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> (A) a joint return has been made under this section for a taxable year,
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> (B) on such return there is a substantial understatement of tax attributable to grossly erroneous items of one spouse,
>
> (C) the other spouse establishes that in signing the return he or she did not know, and had no reason to know, that there was such substantial understatement, and
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> (D) taking into account all the facts and circumstances, it is inequitable to hold the other spouse liable for the deficiency in tax for such taxable year attributable to such substantial understatement,
>
> then the other spouse shall be relieved of liability for the tax (including interest, penalties, and other amounts) for such taxable year to the extent such liability is attributable to such substantial understatement.

25. *Sliwa*, 839 F.2d at 604.

One month later Sylvia filed an action against the United States in the Arizona district court to quiet title to her residence.[26] The district court ruled that the original 1978 conveyance was a completed transfer and quieted title to the residence in favor of Sylvia.[27]

The Commissioner, in July of 1984, issued Sylvia a second notice of deficiency similar to the joint notice in 1981, again claiming the deficiencies in Sylvia's income for 1975, 1976, and 1977.[28] In response, Sylvia filed a Tax Court[29] petition on September 27, 1984, in which she contended that she was an "innocent spouse" and therefore relieved from liability for the tax due.[30]

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26. *Id.*

27. *Id.* The district court in Arizona awarded attorney's fees to Sylvia pursuant to section 7430 in this action. *Id.* at 604, n.2.

28. *Id.* at 604.

29. CCH, FINDING THE ANSWERS TO FEDERAL TAX QUESTIONS, at 45-46. (1987), provides the following information concerning the Tax Court

> The Tax Court was established in 1942 as an independent agency in the Executive Branch succeeding the Board of Tax Appeals created in 1924. The 1969 Tax Reform Act gave the Tax Court the status of a Constitutional court, making it part of the Legislative Branch of Government. . . .The Tax Court now has the same power as a U.S. District Court to punish contempt and to enforce its orders.
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> . . .There are nineteen Tax Court Judges, each of whom travels around the country to hear cases at a point convenient to the taxpayer. . . . A Tax Court decision may be appealed to the federal Court of Appeals for the appropriate circuit.

The "Golsen Rule" requires the Tax Court to follow a U.S. Court of Appeals decision within that circuit that is squarely on point. Thus, the when the Tax Court sits in the Ninth Circuit it is bound by its precedent where the only appeal from its decision is to that court of appeals. Golsen v. Commissioner, 54 T.C. 742, 757 (1970), *aff'd on other grounds*, 445 F.2d 985 (10th Cir. 1971), *cert. denied*, 404 U.S. 940 (1971). In other words, the Tax Court is bound by the precedent of its reviewing court. *Id.*

If a taxpayer's return is audited and the taxpayer and the examining agent cannot agree on one or more items, there are opportunities for review at higher levels of the IRS. CCH, FINDING THE ANSWERS TO FEDERAL TAX QUESTIONS 51 (1987). The taxpayer will receive a "30-day letter allowing him or her 30 days in which to file a request for an Appeals Office conference. *Id.* at 52. If the taxpayer ignores the "30-day letter," he/she will receive a deficiency notice called a "90 day letter." The taxpayer then has 90 days to in which to file a petition for review with the Tax Court. *Id.* Alternatively, the taxpayer can pay the tax due and sue for a refund in the federal district court where the taxpayer resides or in the United States Claims Court. W. KLEIN, B. BITTKER, L. STONE, FEDERAL INCOME TAXATION 49 (1987).

30. *Sliwa*, 839 F.2d at 604. The filing of a petition with the Tax Court action is the demarcation point between administrative conduct and litigation conduct of the IRS. Kaufman v. Egger, 758 F.2d 1, 3-4 (1st Cir. 1985). *See infra* note 68.

Following IRS procedure, Sylvia met with an Appeals Officer to try to settle the case.[31] The Appeals Officer suggested that Sylvia's bank records would be useful to establish her status as an "innocent spouse".[32] Sylvia's attorney subpoenaed the records from the bank. Upon receipt he informed the Appeals Officer that the documents were available for his inspection. The officer never responded or requested to see the subpoenaed documents.[33]

In June 1985, as the trial date approached, Sylvia served formal discovery requests on the Commissioner.[34] The Commissioner responded asserting that formal requests for discovery were premature because the parties had not yet had an opportunity to exchange information on an informal basis. The Government moved for a protective order.[35]

Sylvia moved for summary judgment and shortly thereafter the Tax Court took the motions under advisement at a hearing.[36] Before the Tax Court could rule, the Commissioner conceded all the issues in the case and stipulated to a dismissal.[37]

One month later Sylvia moved for litigation costs pursuant to I.R.C. section 7430.[38] The Tax Court decided the motion examining only the conduct of the IRS after Sylvia had filed her petition.[39] The Tax Court found that the Commissioner's posi-

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31. *Sliwa*, 839 F.2d at 604. IRS procedure calls for a referral of the taxpayer's file to the appeal division for possible settlement after the Commissioner has answered the petition. (1988) 9 Stand. Fed. Tax Rep. (CCH) ¶ 67,015.

32. *Id.* The bank records were one way in which Sylvia's claim that she had received none of Kenneth's illegal income could be independently verified by the IRS. *See infra* note 101.

33. *Id.* The court later held that Sylvia had the burden of proof with respect to her claim to "innocent spouse" status and should have produced the records independent of any request by the IRS. *See infra* note 100 and accompanying text.

34. *Id.*

35. *Id.* U.S. TAX CT. R. PRACT. & PROC 70(a)(1) 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."

A protective order is an order of a court the purpose of which is to protect a person from further harassment or discovery. *See* FED. R. CIV. P. 26(c).

36. *Sliwa*, 839 F.2d at 604.

37. *Id.* The IRS stipulated to a dismissal of its notice of deficiency in November of 1985.

38. *Id.*

39. *Id.* at 603.

tion in litigation had not been unreasonable and denied Sylvia attorney's fees.[40] Sylvia appealed to the Ninth Circuit Court of Appeals.[41]

III. BACKGROUND

A. Application of Attorney's Fee Statutes Prior to *Sliwa*.

The traditional rule in the United States has been that in the absence of legislation providing otherwise, litigants must pay their own attorney's fees.[42]

The first federal statute providing for an award of attorney's fees against the Government in taxpayer litigation was the Civil Rights Attorney's Fees Awards Act of 1976.[43] This statute was interpreted by the courts to apply only to prevailing defendants and allowed awards only if the Government's position was frivolous, vexatious, or in bad faith.[44] In addition, the statute was held not to apply to cases brought in Tax Court.[45]

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40. *Id.*

41. *Id. See infra* note 29.

42. Christiansburg Garment Co. v. EEOC, 434 U.S. 412, 415 (1978). In *Christiansburg Garment Co.* the Equal Employment Opportunity Commission sued the company on a charge of racial discrimination. *Id.* at 414. The district court granted summary judgment for the company. *Id.* The company then petitioned for an allowance of attorney's fees under § 706(k) of Title VII. *Id.* at 415. The U.S. Supreme Court held that a prevailing defendant is to be awarded fees in a Title VII proceeding only when the court in the exercise of its discretion has found "that the plaintiff's action was frivolous, unreasonable, or without foundation." *Id.* at 421.

43. Civil Rights Attorney's Fees Awards Act of 1976, Pub. L. No. 94-559, 90 Stat. 2641 (1976). For a discussion of the history of legislative provisions providing for attorneys fees in tax cases see: Knight & Knight, *The Awarding of Attorney's Fees: The Impact of TRA '86 and Recent Judicial Developments.* 66 Taxes 123 (1988). [hereafter Knight and Knight.]

44. *In re* Kline, 429 F. Supp. 1025, 1027 (1977). (After bankruptcy judge disallowed claims by IRS against a bankrupt estate, the trustee moved for attorney's fees against the IRS alleging that the Government had known at the outset that its claim was without merit. *Id.* at 1026. The court held that the IRS had not acted in bad faith, for purposes of harassment, or vexatiously or frivolously in asserting its claims. *Id.* at 1027.)

45. Key Buick Co. v. Commissioner, 68 T.C. 178 (1977). When the taxpayer filed a motion for allowance of attorney's fees, the Tax Court held that the Civil Rights Attorney's Fees Awards Act did not apply to the case. *Id.* at 184. The court reasoned that the statute on its face referred to "any civil action or proceeding, by or on behalf of the United States of America" and that in all cases brought in Tax Court the taxpayer was the petitioner. *Id.* at 179. Thus, an action in Tax Court was " 'by or on behalf of' the taxpayer, not the United States" and not covered by the statute. *Id.* This was a significant limitation since most tax cases are heard before the United States Tax Court. Knight & Knight, *supra* note 43 at 127. Most taxpayers opt for the Tax Court because

In 1980, Congress expanded the concept of statutory recovery of attorney's fees through the enactment of the Equal Access to Justice Act (EAJA).[46] This statute authorizes reasonable fees and other expenses to a prevailing party other than the United States in any civil action brought by or against the United States.[47] However, like the Civil Rights Attorney's Fees Awards Act, EAJA was not applicable to cases brought in the United States Tax Court.[48]

The Tax Equity and Fiscal Responsibility Act of 1982[49] (TEFRA) amended EAJA to codify a new attorney's fees award provision in section 7430[50] of the Internal Revenue Code which applied to all tax litigation after February 28, 1983.[51] The House Report on the bill[52] stated the reasons for the enactment of new section 7430:

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they do not have to pay the contested fee until after settlement or judgement. In other federal courts the taxpayer must pay the tax and sue for a refund. *See generally* Mcqueen, *Tax Litigation and Attorney's Fees: Still a Win-Lose Dichotomy*, 57 S. CAL. L. REV. 471 (1984) (discussing obstacles to prevailing taxpayer's recovery of attorney's fees under § 7430).

46. Equal Access to Justice Act, Pub. L. No. 96-481, 94 Stat. 2327-2330 (1980).

47. 28 U.S.C. § 2412(d) (1982). The prevailing party could not recover fees if the court found that the position of the Government was "substantially justified". *Id.*

48. Adopted as part of Title 28 of the United States Code, the EAJA applies only to courts created under Article III such as the Supreme Court, federal courts of appeal and the district courts. The Tax Court was established under Article I of the Constitution. *See* McQuiston v. Commissioner, 78 T.C. 807, 811 (1982) In *Mcquiston*, the taxpayers were involved in a dispute with the IRS regarding proper allocation of income averaging and net operating loss provisions. *Id.* at 808. After the taxpayers prevailed on these issues the court denied attorneys fees, holding that EAJA doesn't apply to Tax Court since it is an Article I court. *Id.* at 812.

49. Tax Equity and Fiscal Responsibility Act, Pub. L. No. 97-248, 96 Stat. 324, 572 (1982) (hereafter TEFRA).

50. *See supra* note 3. This section authorizes (but does not mandate) an award of "reasonable litigation costs" to the "prevailing party" in any civil tax litigation brought in federal court. I.R.C. § 7430(a)(2)(amended 1983). In order to qualify as a "prevailing party" the taxpayer had to meet two requirements: (1) the taxpayer must first have "substantially prevailed" with respect to the amount in controversy; or (2) with respect to the most significant legal issues involved." I.R.C. § 7430(c)(2)(A)(ii)(I-II)(amended 1983)(whether or not the taxpayer has substantially prevailed is up to the court to decide or, alternatively, the parties can decide by agreement. I.R.C. § 7430(c)(2)(B)(ii)(amended 1983). Ordinarily, if the Government concedes the case before trial, the taxpayer by definition has substantially prevailed; (2) The taxpayer must establish: "that the position of the United States in the civil proceeding was unreasonable." I.R.C. § 7430(c)(2)(A)(i)(amended 1983).

51. TEFRA *supra* note 49 at 574.

52. H.R. REP. No. 404, 97th Cong., 2nd Sess. 11 (1982).

> The committee believes that taxpayers who prevail in civil tax actions should be entitled to awards for litigation costs and attorney's fees up to $50,000 when the United States has acted unreasonably in pursuing the case. Fee awards in such tax cases will deter abusive actions or overreaching by the Internal Revenue Service and will enable individual taxpayers to vindicate their rights regardless of their economic circumstances.
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> Moreover, the committee is concerned because the Equal Access to Justice Act, . . . does not apply to proceedings in the U.S. Tax Court. Since most tax litigation occurs in the U.S. Tax Court, few taxpayers will be able to obtain awards. In addition, the availability of awards in only these [district] courts encourages a taxpayer to choose the forum in which to pursue litigation based on whether awards of litigation costs are available.[53]

The joint committee print explaining new section 7430 reiterated the House Report's rationale for the enactment of the new provision.[54]

Section 7430 was amended by the Tax Reform Act of 1986.[55] The amendments were intended to conform section 7430 more closely to the Equal Access to Justice Act.[56] Under original section 7430 the taxpayer had to show that the Government's position was "unreasonable".[57] Under the amended statute the taxpayer is awarded attorney's fees if he or she proves that the Government's position was "not substantially justified".[58]

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53. *Id.*

54. STAFF OF JOINT COMM. ON TAXATION, 97TH CONG., 2ND SESS., GENERAL EXPLANATION OF THE REVENUE PROVISIONS OF THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982. (Comm. Print 1982).

55. TRA '86, *supra* note 6, § 1551.

56. *See* S. REP. No. 313, 99th Cong., 2d Sess. (1986) ("The bill modifies section 7430 to conform it more closely to the Equal Access to Justice Act.")

57. I.R.C. § 7430(c)(2)(A)(i) (1987).

58. I.R.C. § 7430(c)(2)(A)(i), as amended by TRA '86 *supra* note 6, § 1551(d)(1). The legislative history of EAJA which first applied the "substantial justification" in attorneys fee cases against the Government stated: "The test of whether or not a Government action is substantially justified is essentially one of reasonableness. Where the Government can show that its case had a reasonable basis both in law and fact, no award will

The Senate Committee Report to the amendments proposed but not adopted by the conference committee provided:

> The committee believes that the provision allowing awards of attorney's fees should be continued but must be modified to provide greater consistency between the laws governing the awards of attorney's fees in tax and nontax cases. Specifically, the committee believes that the Equal Access to Justice Act provides the appropriate standards for awarding attorneys fees.
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> . . . Furthermore, the "substantially justified" standard is applicable to prelitigation actions or inaction of the Government agents as well as the litigation position of the Government.[59]

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be made." H. REP. No. 1418 96th Cong., 2d Sess. 10 (1980). The adoption of this standard "balances the constitutional obligation of the executive branch to see that the laws are faithfully executed against the public interest in encouraging parties to vindicate their rights." *Id.* at 10.

In Rutana v. Commissioner, 88 T.C. 1329 (1987), following a Tax Court memorandum decision in their favor, the taxpayers moved for attorneys fees pursuant to section 7430. *Id.* at 1330. The court held that the IRS attorney who defended the case for the Government should have known from the facts available to him at trial that the Government could not clearly and convincingly establish fraud by the taxpayers. *Id.* at 1334. The court looked at the "substantially justified" standard under EAJA in determining whether the IRS attorney had been unreasonable. *Id.* at 1333 Following the Sixth Circuit's decision in Wyandotte Savings Bank v. NLRB, 682 F.2d 119 (6th Cir. 1982) ("substantially justified" standard equated with the reasonableness test of section 7430 in a dispute regarding an NLRB order) the court applied the considerations expressed in the legislative history of EAJA and evaluated the reasonableness of the IRS counsel's conduct on the basis of whether he "had a reasonable basis in law and fact for believing that he could prove fraud as to petitioner." *Id* at 1333. (quoting H. REP. No. 1418, *supra* this note).

In Sher v. Commissioner, 89 T.C. 79 (1987), the Tax Court held that the "substantial justification" standard of amended section 7430 is "not a departure from the 'reasonableness standard' " of the original statute. *Id.* at 84. The court stated that there is no significant difference between the "reasonableness" standard of the unamended section 7430 and the new "substantial justification" standard, reasoning that the change in language was in accordance with Congress' express intent to conform amended section 7430 more closely to EAJA. *Id.* Other amendments to original section 7430 include: (1) The $25,000 cap on the award of attorneys fees is eliminated and replaced with a $75 an hour cap. I.R.C. § 7430(c)(1)(A)(ii)(III)(1987). (2) Costs are denied for any period during which a prevailing party unreasonably protracts the proceedings. I.R.C. § 7430(b)(4)(1987). (3) The definition of "reasonable litigation costs" has been limited by a market rate ceiling. I.R.C. § 7430(c)(1)(A)(ii)(1987). (4) The amended section does not apply to individuals with a net worth of more than $2 million. I.R.C. § 7430(c)(2)(A)(iii)(1987).

59. S. REP. No. 313, 99th Cong., 2d Sess. (1986).

The '86 amendments, while clear on the standard of proof required in attorney's fees, cases did not as clearly define the exact point at which it applies. Amended section 7430 further provided that the Government's position includes its position taken during civil proceedings and *any administrative action (or inaction) by the IRS District Counsel.*[60]

The House Bill Report to the proposed amendments provided that the court should have discretion in tax cases

> to assess all or a portion of any award under section 7430 *against the IRS employee* if the court determines that the proceeding resulted from any arbitrary or capricious act of the employee. It is the intention of the committee that this provision apply to IRS attorneys as well as non-attorneys. Thus, all employees of the Office of Chief Counsel of the IRS, such as those in the tax litigation function, are subject to this provision.[61] (emphasis added)

The final Conference Agreement Report to the amendments as finally enacted made no explicit reference to any limitation on administrative conduct to be scrutinized in determining the "position of the United States."[62] However, the Conference Agreement did state:

> In addition to providing for attorney's fees with respect to litigation expenses, the conference agreement also provides that attorney's fees may be awarded with respect to the administrative action or inaction of the District Counsel of the IRS (and all subsequent administrative action or inaction) upon which the proceeding is based.[63]

This is the only explanation the Conference Committee made to its amendment of the phrase "the position of the United States" as finally enacted. The amended statute provides in pertinent part:

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60. I.R.C. § 7430(c)(4)(B) as added by TRA '86 *supra* note 6, § 1551(e).

61. H.R. REP. No. 426, 99th Cong., 1st Sess. 840 (1987).

62. H.R. CONF. REP. No. 841, 99th Cong., 2d Sess. II-802, *reprinted in* U.S. Code Cong. & Ad. News 4888-90.

63. *Id.* at II-802.

> (4) POSITION OF THE UNITED STATES.—The term "position of the United States" includes—
> (A) the position taken by the United States in a civil proceeding and
> (B) the administrative action or inaction by the District Counsel of the Internal Revenue Service (and all subsequent administrative action or inaction) upon which such a proceeding is based.[64]

Viewed with the Conference Committee's explanation in mind the amendment amplified the scope of the costs recoverable by the taxpayer to include those costs incurred as a result of the action or inaction of the IRS District Counsel.[65] Since neither the Senate nor the House proposals were adopted by the Conference Committee it is not clear what the legislative intent was with respect to the extent of IRS conduct to be evaluated under section 7430.

Prior to this amendment, a frequently litigated issue under section 7430[66] had been whether the court could scrutinize the conduct or position taken by the Government *before* a petition or complaint was filed by the taxpayer[67] or whether it was limited to examining only the conduct of the IRS after litigation commenced.[68]

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64. I.R.C. § 7430(c)(4)(A)and(B) as amended by TRA '86 *supra* note 6, § 1551(e).

65. *But see* Shifman v. Commissioner, 53 Tax Ct. Mem. Dec. (CCH) 1987-347 at 1337. In *Shifman*, The IRS erroneously assessed the taxpayer with tax upon annuity income that she had not received. *Id.* at 1337-1338. The court denied her motion for fees taking a narrow view of the Government's conduct in the case. *Id.* at 1339. The Tax Court used the comments of the Conference Committee (quoted above at note 63 in the text) to amended section 7430 as support for its position that the "Government's position" is to be defined narrowly as that of the Government after litigation commences and/or the position taken in any administrative action by the District Counsel. *Id.*

66. Barry, *Section 7430 and the Award of Litigation Costs: A Reasonable Position*, 39 TAX LAWYER 769, 770 (1986) [hereafter Barry].

67. This was one of the principal issues decided in *Sliwa* where the court adopted a broad reading of the statute and held that IRS conduct before the taxpayer files a petition with the Tax Court may be examined for unreasonableness. *Sliwa*, 839 F.2d 602, 607 (1988).

68. Two courts of appeal prior to *Sliwa* had taken a broad view of the conduct to be examined and included in their scrutiny IRS pre-litigation conduct, as well as its position during litigation. The Fifth Circuit decided the issue in Powell v. Commissioner, 791 F.2d 385 (5th Cir. 1986). In *Powell*, the taxpayers were disallowed deductions for losses on partnership returns. *Id.* at 386. After concessions by the Government the taxpayer moved for attorneys fees. *Id.* at 387. The court remanded the case to the Tax Court for a

The Tax Court subsequent to the 1986 amendment con-

determination of whether the IRS had been unreasonable at the administrative level. *Id.* at 392. The court reasoned that "[i]f the IRS takes an arbitrary position and forces a taxpayer to file suit, then, after the papers have been filed, becomes sweet reason, the taxpayer should be permitted to recover the cost of suing." *Id.* The First Circuit addressed the issue in Kaufman v. Egger, 758 F.2d 1 (1st Cir. 1985), *aff'g* 584 F. Supp. 872 (D. Me. 1984). In *Kaufman* the IRS sent a notice of deficiency to an address where the taxpayers no longer lived. *Id.* at 2. Three years later the taxpayers received notice that the IRS was seizing their refund as partial payment for the earlier deficiency (of which they had never received notice). *Id.* The IRS later acknowledged the defective notice and conceded the case. *Id.* The court allowed attorneys fees holding that it would frustrate the purpose of section 7430 "to interpret it in such a way that the IRS, after causing a taxpayer all kinds of bureaucratic grief at the administrative level, could escape attorney's fee liability by merely changing its tune after the initiation of the suit by the taxpayer." *Id.* at 4.

Various district courts have held similarly. In Peavy v. United States, 625 F. Supp. 974 (D. Colo. 1986), an IRS attorney was fined for failing to appear at a settlement conference with the taxpayer. *Id.* at 976. In addition, the IRS took 14 months to settle the case. *Id.* The court held that the conduct of the Government had not been unreasonable even considering that the "position of the United States" refers to position of the IRS in its administrative proceedings. *Id.* In Finny v. Roddy, 617 F. Supp. 997 (E.D. Va. 1985), liens were placed on the taxpayer's property to satisfy the tax deficiency of a third person who the IRS believed was the true owner. *Id.* at 998. The court concluded that " 'position of the United States' in. . .26 U.S.C. § 7430(c)(2)(A)(i) refers to the position of the IRS in its administrative proceedings as well as to the Government's position following the filing a complaint in . . . court[,] . . ." and granted the taxpayer attorneys fees. *Id.* at 1002. In Penner v. United States, 584 F. Supp. 1582 (S.D. Fla. 1984), the IRS initiated a jeopardy assessment against the taxpayer without ever asking for an explanation of the taxpayer's large bank accounts. *Id.* at 1584. The Court was not persuaded by the Government to accept a "narrow reading . . . . If the Government's position in initiating the jeopardy assessment was found to be unreasonable . . . it is hard to fathom how the Government's position (in defending an unreasonable action) would be reasonable." *Id.* at 1583. The court granted the motion for attorneys fees. *Id.* at 1584. In Kaufman v. Egger, 584 F. Supp. 872 (D. Me. 1984), a notice of deficiency was sent to an address where the taxpayers no longer lived. *Id.* at 874. The court granted the taxpayer's motion for fees and held that the " 'position of the United States' that it [the court] shall examine for the purposes of determining the reasonableness shall be their [the Government's] prelitigation conduct which engendered the civil proceeding." *Id.* at 878. In Hallam, Jr. v. Murphy, 586 F. Supp. 1 (D. Ga. 1983), *aff'd*, 758 F.2d 1 (1st Cir. 1985), the IRS continued to seek collection of alleged tax deficiencies even though it knew that the taxpayers had never received proper notice. *Id.* at 1. The court granted the taxpayers' motion for fees and held that the proper time frame to view the defendant's [Government's] conduct is throughout the entire tax proceeding, not just the time frame after the plaintiffs filed their lawsuit. *Id.* at 3.

On the other hand, some federal courts of appeal have adopted a narrow interpretation and holding that the court may examine only the reasonableness of the Government's position after litigation commences. The Eighth Circuit in Wickert v. Commissioner, 842 F.2d 1005 (8th Cir. 1988), *aff'g* 51 T.C.M. 1373, held that IRS administrative conduct could not be considered in an action for attorneys fees against the Government. *Id.* at 1008. In *Wickert*, the taxpayer was assessed with a deficiency on the grounds that she had received income in the form of alimony from her former husband. *Id.* at 1006. The taxpayer had excluded the income asserting that the payments were not income but rather represented a property settlement. *Id.* After filing a petition with the Tax Court,

strued the "position of the United States" as limited to (1)the

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Ms. Wickert met with an appeals officer who conceded the case. *Id.* The taxpayer sought attorneys fees on the grounds that the Commissioner had no legal basis in fact to assess the deficiency and that the actions of the IRS had been unreasonable. *Id.* at 1007. The IRS argued that its position had not been unreasonable because after the petition was filed it had promptly conceded the case. *Id.* The Eighth Circuit affirmed the decision of the Tax Court which had held that only the IRS' in-court litigation conduct could be considered in assessing the unreasonableness of its conduct. *Id.* at 1008. The court reasoned that because the recent 1986 amendments to section 7430 provided that the " 'position of the United States' includes the government's administrative action or inaction as well as its in-court litigating position, Congress has made it clear that the pre-amendment phrase at issue does not include administrative action or inaction." *Id.* at 1008. In Ewing & Thomas, P.A. v. Heye, 803 F.2d 613 (11th Cir. 1986), the taxpayer was forced to file a complaint to obtain a release from an IRS lien after he had satisfied the obligation secured by the lien. *Id.* at 614. The government attorneys promptly conceded the case, and the court denied the taxpayer's motion for fees. *Id.* at 616. The court held that the "position of the United states" that must be examined is the Government's in-court litigating position *Id.* at 615. In Baker v. Commissioner, 787 F.2d 637 (D.C. Cir. 1986), *vacated*, 83 T.C. 822 (1984), the IRS insisted on an assessment against the taxpayer even though the taxpayer's similarly situated co-workers had obtained a favorable disposition on the same tax issue. *Id.* at 638. After the Government finally conceded the case the court denied the taxpayer fees, taking a narrow view of the conduct of the Government and stating that the "relevant *position* of the United States is the one taken *in the civil proceeding*." *Id.* at 641. In United States v. Balanced Financial Management, 769 F.2d 1440 (10th Cir. 1985), the taxpayers failed to comply with an IRS summons. *Id.* at 1442. The Government sought an order to show cause why the taxpayers should not be held in contempt. *Id.* The IRS attorney handling the case failed to show up at the hearing. *Id.* at 1443. The court held that the conduct of the IRS in the contempt proceeding was not unreasonable and reversed the lower courts order granting an award of attorneys fees. *Id* at 1451. The court asserted that the "position of the United States means the arguments relied upon by the Government in litigation." *Id.* at 1450.

Lower courts holding the same have been: Walsh v. United States, 85-1 U.S. Tax Cas. (CCH) ¶ 9411 (D. Minn. 1985) where the taxpayer's estranged wife forged his signature on a joint return. *Id.* at 88,117. The IRS denied his claim for a refund of his taxes and failed to answer his letter asserting that his wife had forged his signature on their joint return. *Id.* The court ruled for the taxpayer on the forged return issue, but denied his motion for attorneys fees holding that the " 'position of the United States' is specifically limited to that taken in civil proceedings brought in a court of the United States." *Id.* at 88,118. In Eidson v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 9182, (N.D. Ala. 1984) the taxpayers were forced to file suit to obtain a refund of taxes overassessed by the IRS. *Id.* at 83,274. The court refused to allow the taxpayer attorneys fees and held that "to consider the Government's administrative position in determining whether to award fees and costs to plaintiffs [taxpayers] would be clearly contrary to the specific wording of section 7430." *Id.* In Brazil v. United States, 84-2 U.S. Tax Cas. (CCH) ¶ 9596,(D. Ore. 1984) the IRS assessed taxes against the taxpayers without having first sent the statutorily required notice of deficiency. *Id.* at 84,702. The taxpayers were forced to file a complaint in order to enjoin tax levies on their bank accounts. *Id.* at 84,703. After the IRS conceded the case, the court allowed no recovery of attorneys fees "so long as the United States' position is reasonable from the point in time when litigation commenced." *Id.* In Zielinski v. United States, 84-1 U.S. Tax Cas. ¶ 9514, (D. Minn. 1984) the IRS assessed a $500 penalty against the taxpayer for writing on her return that she refused to waive her fifth amendment rights. *Id.* at 84,356. After the taxpayer was forced to sue for a refund the IRS conceded the case. *Id.* The court denied a motion for

Government's position *after* litigation commences and/or (2)the *position of the District Counsel* before litigation commences and thus maintained its pre-amendment narrow reading of the statute.[69]

District Counsel, the IRS's legal staff, often does not become involved in a case until after the taxpayer has filed a petition with the Tax Court. Thus, under the Tax Court's interpretation of this portion of the amended statute judicial scrutiny is limited to the Government's position after the commencement of litigation in most cases.[70] Consequently, other administrative activity that prejudices the taxpayer (such as improper notices of deficiency issued by lower echelons of the IRS) in the Tax Court's view is not relevant in deciding whether the "position of the United States" has been "substantially justified".

The Second Circuit, the only circuit court to consider this issue under revised section 7430 to date has adopted a broad reading of the amended statute, as compared to the narrow construction given the statute by the Tax Court[71].

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fees stating that "Congress . . . did not intend to compensate claimants for unsustainable positions in the administrative proceeding." *Id.* at 84,357. For a comprehensive discussion of this issue, *see* Barry, *supra* note 66.

69. *See, e.g.*, Sher v. Commissioner, 89 T.C. 79 (1987), *supra* note 58 (pre-petition actions of the IRS are not relevant, the court limited reasonableness inquiry to actions taken by District Council and Appeals Division); Shifman v. Commissioner, Tax Ct. Mem. Dec.(CCH) 1987-347, *supra* note 65 (appeals officer rather than district counsel involved in case, therefore issuance of notice of deficiency did not constitute "position of the United States"); Weiss v. Commissioner, 89 T.C. 779 (1987) (Tax Court denied taxpayer's motion for fees asserting that the District Counsel's involvement at the level of tax shelter project did not constitute action or inaction by the District Counsel for purposes of section 7430); Harris v. Commissioner, 55 Tax Ct. Mem. Dec 907 (CCH) (1988) (Court acknowledged that IRS Examination Division's refusal to rescind the deficiency notice was unreasonable as the IRS had issued a notice of deficiency after the statute of limitations had expired but held that since the Examination division's conduct was prior to District Counsel becoming involved in the case section 7430 did not apply. *Id.* at 909.)

These decisions are consistent with the Tax Court's earlier view of the statute before the 1986 amendments. *See* Baker v. Commissioner, 787 F.2d 637 (D.C. Cir. 1986), *supra* at note 68. In *Baker*, When the taxpayer complained about disadvantageous treatment he had received in comparison to identically situated taxpayers, no effort was made by the IRS officials to determine the merits of his claims. *Id.* at 643-44. The Court Appeals for the Fifth Circuit affirmed the Tax Court's application of section 7430's unreasonable standard solely to IRS conduct that occurred "in the civil proceeding." *Id.* at 641.

70. *See supra* note 7. Under the "Golsen rule", *supra* note 29, a decision in the Federal Circuit Court of Appeals binds all subsequent Tax Court decisions in that circuit. *See generally*, Devin *supra* note 9.

71. Weiss v. Commissioner, 850 F.2d 111 (2d Cir. 1988), *rev'g* 89 T.C. 779 (1987). In

B. The Reasonableness Standard Prior to Sliwa.

The House Report accompanying TEFRA concerning the

Weiss, the taxpayers purchased an interest in a limited partnership drilling venture. *Id.* at 112. In 1982 the taxpayers claimed their distributive share of the losses sustained by the venture on their tax return. *Id.* In 1986 the IRS sent a statutory notice of deficiency to the taxpayers claiming that they had not established their entitlement to the loss claimed by them in 1982. *Id.* The taxpayers filed a petition with the Tax Court alleging that the Tax Court lacked jurisdiction because the IRS had not followed the rules requiring an audit at the partnership level before issuing a deficiency notice. *Id.* at 112-113 The IRS District Counsel conceded the case to the taxpayers. *Id.* at 113.

The taxpayers filed a motion for litigation costs pursuant to section 7430. They alleged that the conduct of the IRS in issuing the notice of deficiency was unjustified. *Id.* The IRS contended that the time for determining whether the Commissioners's position was substantially justified was subsequent to the filing of the taxpayer's petition in court and not at the time of the issuance of the notice of deficiency. *Id.* at 114. The Tax Court held that the 1986 amendments to section 7430 did not reach IRS's prelitigation actions or inactions. *Id.* The Second Circuit rejected the Tax Court's reasoning and held that "once the Commissioner takes a position that leaves the taxpayer no alternative other than a judicial remedy, regardless of whether the stance is a final administrative position or a position in litigation, the IRS has taken a position which constitutes a 'position of the United States' within the meaning of section 7430." *Id.* at 115. The court reasoned that since both the 1982 version of statute and the 1986 enactment provide that the court is to examine the "position of the United States" in the civil proceeding "we believe that they are not materially different for purposes of determining the circumstances that constitute a position of the United States." *Id.* at 116. Thus, the court aligned itself with those circuit courts that had held for a broader reading of the statute citing, among others, the Ninth Circuit's holding in *Sliwa*.

In addition, the Second Circuit found that the legislative history of section 7430 indicated that Congress had intended to make the standards for recovery of litigation costs in tax cases the same as those applied to other civil actions against the Government under the Equal Access to Justice Act (EAJA). *Id.* Under EAJA the court observed "the question of whether the Government's position in a litigated matter is substantially justified is answered by examining both the Government's in-court litigation conduct and any 'action or failure to act taken by the agency upon which the civil action is based.' " *Id.*

The court found nothing in the legislative history of the amended version of section 7430 "to suggest that Congress intended to narrow the pre-1986 amendments view of section 7430 or to limit strictly an examination of the government's position solely to that taken in court." *Id.* Furthermore, the court noted that the language of the amended statute was almost identical to that used in the corresponding section of the EAJA statute except for the words "District Counsel". *Id.* The court reasoned that "this further suggests to us that agency action that directly results in litigation, such as the Commissioner's issuance of a deficiency notice in this case, should be considered in assessing the government's conduct." *Id.*

The court concluded by citing *Sliwa*, where the Ninth Circuit expressed its view that the 1986 amendments to section 7430 did not alter the original purpose of the section to award attorneys fees where the Government's unreasonable conduct at the administrative level compels the taxpayer to litigation. *Id.* The only district court case to date where the revised statute has been read broadly is Bailey v. United States, U.S. Tax Cas. (CCH) ¶ 9353 (D.C. Del 1988) The *Bailey* court said, "It is clear from the statute itself that in determining whether the position of the United States was substantially

unreasonableness of the Government's position in section 7430 states that the unreasonableness of the IRS it is to be determined upon: "the facts and legal precedents relating to the case as revealed by the record."[72] Other factors to be considered in evaluating the Government's position are: "(1)Whether the government used the costs and expenses of litigation against its position to extract concessions from the taxpayer that were not justified under the circumstances of the case, [and] (2) whether the government [sic] pursued the litigation against the taxpayer for purposes of harassment or embarrassment, or out of political motivation."[73]

The reasonableness standard has been held to encompass situations where the Government continues to litigate a case which it knows is without merit either on the facts or on the law.[74] However, if prior administrative conduct is excluded, the likelihood of recovery by a prevailing taxpayer is greatly reduced and the limitation on IRS conduct afforded by the statute may be meaningless.[75]

As a result of the Tax Court's restrictive holding in *Baker v. Commissioner*,[76] that the "position of the United States" did not include any of the IRS' underlying administrative positions, it has been difficult for taxpayers to recover attorney's fees in Tax Court proceedings under section 7430.[77] However, some federal

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justified, the Court must consider not only the position taken in this action but also the position the Government adopted in the underlying administrative action." *Id.* at 83,937.

72. H.R. REP. No. 404, 97th Cong., 2nd Sess. 12 (1982).

73. *Id.*

74. *See* Hallam Jr. v. Murphy, 84-1 U.S. Tax Cas. par. 9320, 83,437 (N.D. Ga. 1983) ("The continued assertion of a position with knowledge that position is based upon an erroneous assumption is per se unreasonable." *Id.* at 83,437); Kaufman v. Egger, 758 F.2d 1, 4 (1st Cir. 1985), *supra* note 68 (the IRS seizure of a taxpayer's tax refund and attempts to collect on a tax deficiency where it had never effectively notified the taxpayer of the alleged deficiency "was unreasonable by any standard.")

But see, eg., Ewing & Thomas, P.A. v. Heye, 803 F.2d 613 (Eleventh Cir. 1986) (no recovery of attorneys fees when taxpayer was unable to secure release of a lien through IRS administrative processes despite having satisfied the underlying obligation.)

75. *See supra* note 68.

76. 787 F.2d 637 (D.C. Cir. 1986).

77. Former Commissioner of Internal Revenue Roscoe Egger testified before the Committee of Ways and Means of the House of Representatives in 1985, *Awards of Attorney's Fees in Tax Cases, 1985: Hearings on I.R.C. section 7430 Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means*, 99th Cong., 1st Sess. 13 (1985) (statement of Roscoe Egger, Commissioner of Internal Revenue). The committee was convened to consider the advisability of extending section 7430 which

district courts and the the United States Claims Court which are not bound by the Tax Court have found the Government's in-court litigation position unreasonable and allowed recovery.[78]

IV. THE COURT'S ANALYSIS

A. INTERPRETATION OF SECTION 7430(C): "POSITION OF THE UNITED STATES".

The Ninth Circuit first considered Ms. Sliwa's contention that section 7430 would be rendered ineffective if the court could not consider the IRS' pre-litigation conduct.[79] The Government, however, argued that the phrase "in the civil proceeding" limited scrutiny by the court to conduct after the taxpayer filed a petition. This issue was critical to Sylvia's case since for all practical purposes the *only* conduct of the IRS after the complaint was filed included a meeting with an Appeals Officer and a motion for a protective order.[80]

The Ninth Circuit aligned itself with the First and Fifth Circuits.[81] Observing that while only litigation costs (costs in-

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was due to expire at the end of that year. *Id.* at 1. Commissioner Egger presented information regarding the impact of section 7430 in Tax Court proceedings: in 20 out of 60 cases (within 26 months) where the issue of attorneys fees had been raised, fees had been awarded to a taxpayer. Of these 20 awards, 13 were for amounts less than $5,000. *Id.* at 13-14, 18. *See* Langstraat, *Collecting Attorney Fees From the Government in Tax Litigation: An Analysis of the Winners and Prospects for the Future*, 17 ST. MARY'S L.J. 395, 411-413 (1985)(an analysis of Tax Court decisions where taxpayers have attempted to claim attorney's fees under section 7430.)

78. *See* Sharpe v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 13,574 (E.D. Va. 1984). In *Sharp*, the Government's litigation position was unreasonable where it ignored the express provisions of a trust instrument and asserted that the trust was income to the decedent taxpayer's estate. *Id.* at 84,483. Moreover, the IRS previously had advised the Justice Department to concede the case. *Id.* at 84,484; Columbus Fruit and Vegetable Coop. v. United States, 85-2 U.S. Tax Cas. (CCH) ¶ 9518 (Cl. Ct. 1985) In *Columbus Fruit* the IRS disallowed deductions claimed by the taxpayer for patronage dividends paid to its members. *Id.* at 89,268. The court awarded attorneys fees holding that the litigation position of the Government was unreasonable where it pursued a case in which it had seriously mischaracterized the relevant case law and rulings applicable to the taxpayer's case. *Id.* at 89,271); Giesecke v. United States, 637 F. Supp. 309, 312 (W.D. Tex. 1986) In *Giesecke*, the taxpayer sought successfully to deduct expenses he incurred to promote a singer. *Id.* at 309. The court allowed the taxpayer attorneys fees holding that the IRS's litigation position was unreasonable where it "failed to follow clear precedent on points that it had acquiesced to more than 25 years ago." *Id.* at 312.

79. Sliwa v. Commissioner, 839 F.2d 602, 605 (9th Cir. 1988).

80. *Sliwa*, at 604.

81. *See supra* note 68 and accompanying text.

curred in and after the filing and preparing of the Tax Court petition as opposed to all costs, including pre-litigation attorney's fees) may be recovered under the statute, it did not follow that only the Government's litigation conduct could be considered: "If the conduct of the Government at later administrative levels is unreasonable, it stands to reason that the position of the Government in defending in the civil proceeding in the first place may be unreasonable as well if based upon that conduct."[82] The court observed that a narrow reading allows the IRS to effectively coerce the taxpayer into settling their case:

> The commissioner therefore has at his disposal a powerful tool—and incentive for taxpayer settlement—in keeping the taxpayer out of court for as long as possible and then settling the case when his bluff is called. If the statute is to have any bite at all, courts must be permitted to look at earlier conduct to determine whether the initial filing of a tax petition was provoked by unreasonable conduct.[83]

The court in support of its position referred to the 1986 amendments[84] which it argued had expanded the conduct that the court could scrutinize to determine whether the IRS had been unreasonable. Besides conduct in the civil proceeding, the 1986 amendments added "any administrative action or inaction by the District Counsel of the Internal Revenue Service (and all subsequent administrative action or inaction) upon which such proceeding is based.' "[85] The Ninth Circuit stated: "[W]e view these amendments as shedding light on Congress' mandate that section 7430 provide attorney's fees to a prevailing party in cases where litigation is necessitated by the government's unreasonable conduct at the administrative level."[86] The court reversed

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82. *Sliwa*, 839 F.2d at 607.

83. *Id.* at 607.

84. *Id.* at 607 n.6.

85. *Id.*

86. *Id.* By using the amended definition of the "position of the United States" which includes the action (or inaction) of the IRS District Counsel to support its holding, the Ninth Circuit is reading the amendment broadly. Recent Tax Court cases interpreting the amended definition have construed the same language to limit the examination of the Government's position to actions of the IRS District Counsel exclusive of administrative actions of any other divisions of the IRS. (*See infra* note 115 and accompanying text). As the Ninth Circuit examined the conduct of the Commissioner before

the holding of the Tax Court on this issue.[87]

B. THE REASONABLENESS OF THE GOVERNMENT'S POSITION IN *Sliwa*.

On appeal Sylvia argued that the Government position had been unreasonable because: (1) She had put the Commissioner on notice of her "innocent spouse" status before he issued the second notice of deficiency;[88] (2) In the first meeting with the IRS examining agent before she filed her petition with the Tax Court, the agent had " 'led [her] to believe that she was relieved from liability. . . under section 6013(e);' "[89] and (3) The Commissioner's litigating position was unreasonable because it was calculated to "obstruct and delay."[90]

The court first noted that the summary judgement granted to Sylvia by the Arizona State district court quieting title to the residence in her favor did not resolve the issue of her "innocent spouse" status.[91] Second, since she was advised at the conclusion of her meeting with the examining agent to produce her bank records, the court reasoned that the second deficiency noticed was issued: "in part because Appellant had failed at the meeting with Hartley [the IRS agent] to substantiate her innocent spouse claims."[92] Thus, concluded the court, the Commissioner was not unreasonable in later asserting the deficiency in the second notice.[93]

Ms. Sliwa filed her petition and before the IRS District Counsel (legal staff) was involved, it is not reading the amendment as limiting the administrative conduct to be examined merely to the conduct of the IRS District Counsel and thereafter.

87. *Sliwa*, 839 F.2d at 607.

88. *Sliwa*, 839 F.2d at 608. Sylvia supported her assertion citing Hallam, Jr. v. Murphy, 586 F. Supp. 1, (N.D. GA. 1983). In that case the court had held that the IRS's prelitigation position was unreasonable where it continued to seek collection of a tax deficiency even though it knew that the taxpayer had never been properly notified.

89. *Sliwa*, 839 F.2d at 608.

90. *Id.*

91. *Id.* The summary judgment resolved only the issue of Kenneth Sliwa's interest in the property. *Id.* at 609.

92. *Id.*

93. *Id.* In Adams v. Commissioner, 60 T.C. 300, 303 (1973) the taxpayer's wife prepared joint returns but did not disclose her separate income to the IRS or her husband. Wife made substantial omissions of income on return, the court held that taxpayer was not a innocent spouse because he was put on notice of the omissions by his wife's nondisclosure to him of her income and he failed to prove that he had not significantly benefited from the omitted income. *Id.* at 302-03. The *Sliwa* court cited *Adams* for the pro-

Finally, the court dealt with Sylvia's argument that the Commissioner's failure to respond to her discovery requests and his motion for a protective order[94] exhibited the Government's obstructive tactics. The court dismissed this argument noting that discovery procedures should only be used "after the parties have made reasonable informal efforts to obtain the needed information voluntarily."[95] Since the informal discovery requirement came into play only after litigation commenced with the filing of the petition in Tax Court, Sylvia's informal efforts to provide records earlier on did not satisfy the rule.[96] Thus, the court concluded that the Commissioner's motion for a protective order was reasonable in light of his concern about the use and timing of formal discovery.[97]

The court went on to observe that the bank records, which contained information that the Government needed in order to concede the case, were not in the Commissioner's hands until after Sylvia filed her petition.[98] Sylvia argued that the Government could not have relied on the bank records when it conceded the case because it had refused to subpoena them.[99] The court rejected this argument noting again that the burden of proof is on the taxpayer to prove an entitlement to a benefit under the Internal Revenue Code.[100] Since Sylvia admitted that

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position that the it was the burden of the taxpayer to prove her innocent spouse status. The court rejected Sylvia's arguments that the Commissioner had been put on notice of her "innocent spouse" status: "we cannot say that the Government was unreasonable . . . in requiring at least some independent corroboration of those assertions [that she was an innocent spouse] which ultimately came in the form of the bank records." *Sliwa*, 839 F.2d at 608.

94. *See supra* note 35.

95. *Sliwa*, 839 F.2d at 609. The court cited Branerton Corp. v. Commissioner, 61 T.C. 691, 692 (1974). In *Branerton*, the taxpayer served interrogatories on the IRS one day after the Government attorney had answered the petition. *Id.* at 691. The court granted a protective order to the IRS for a reasonable period of time to allow the parties to obtain discovery through informal communication. *Id.* at 692.

In addition, the court cited TAX CT. R. 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."

96. *Sliwa*, 839 F.2d at 609.

97. *Id.*

98. *Id.*

99. *Id.*

100. *Id.* The burden of proof is on the taxpayer for most purposes in Tax Court proceedings. A presumption of correctness attaches to the Commissioner's determination of a deficiency. *See* TAX COURT R. 142.

the Commissioner examined the bank records for the first time at the hearing before the Tax Court on her motion for summary judgement, the court inferred that the records had been relied upon by the Government in making its subsequent concession.[101]

The court concluded that the Commissioner was not "unreasonable in waiting to concede the case until someone from the IRS had a chance to review the records,"[102] especially since the Commissioner had conceded the case soon after the bank records had been examined.

Thus, although the Ninth Circuit in *Sliwa* established a broad reading of section 7430, the court nevertheless found that in this case neither the IRS's pre-litigation conduct nor its litigation conduct was unreasonable.[103]

C. The Dissent

Judge Boochever in dissent asserted that the Government's conduct was unreasonable.[104] He reasoned that if the bank records were indispensable to the Government's deciding the case, the IRS personnel should have requested them "rather than forcing the taxpayer to expensive litigation."[105]

In addition, Judge Boochever noted that if after litigation was initiated all the evidence weighed towards Sylvia being an innocent spouse, then "[t]he burden should have been on the government to undergo the expense of producing the records, rather than requiring Ms. Sliwa to subpoena them."[106] Moreover, the Government had unreasonably delayed examining the records even after Sylvia had obtained them "forcing Mrs. Sliwa

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101. *Sliwa*, 839 F.2d at 609. The court cited Church v. Commissioner, 37 Tax Ct. Mem. Dec. 1236, 1240 (CCH)(1978) as support for the relevance of the bank records to a determination of innocent spouse status under section 6013(e). In that case the taxpayer was assessed with additions to tax based on his failure to report income from the sale of stock. *Id.* at 1238. His wife was found not to be an "innocent spouse." *Id.* at 1240. The court, in reaching its conclusion, relied in part upon the wife's bank records showing substantial sums in her account. *Id.*

102. *Sliwa*, 839 F.2d at 609.

103. *Id.*

104. *Id.* at 610 (Boochever J., dissenting).

105. *Id.*

106. *Id.*

to commence discovery in view of the imminent trial setting."[107] Thus, in Judge Boochever's view, the Government "unnecessarily precipitated litigation and unreasonably added to the expenses once the suit was filed."[108] This result, argued the Judge, was contrary to Congress' intent to "partially compensate taxpayers for expenses and inconvenience caused by unreasonable conduct."[109]

V. CRITIQUE

A. Position of the United States

The Ninth Circuit's broad reading of section 7430 is in accord with legislative purpose.[110] The narrow reading of other courts renders ineffective the impact of section 7430 on abusive practices by the IRS.[111] The Government can exert great pressure by taking unreasonable positions.[112] As soon as the taxpayer files a complaint or petition in court the Government can concede the case, thus foreclosing any remedy for the pre-litigation abuse suffered by the taxpayer. This result is not only contrary to Congress' intent to deter overreaching by the I.R S. but it also undermines the other goal addressed by Congress in enacting section 7430, which was to decrease the number of cases that get litigated in Tax Court by encouraging settlement.[113] If the Taxpayer is forced to file a petition or complaint to obtain relief from I.R.S. abuse, the goal of early settlement of cases is

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107. *Id.* It is not clear in the facts whether the Government was put on notice that Sylvia had obtained the bank records. This fact could easily have been determined had either of the parties initiated informal discovery.

108. *Id.*

109. *Id.*

110. The congressional purpose behind awarding attorneys fees was to "deter abusive actions and overreaching by the Internal Revenue Service," and to "enable individual taxpayers to vindicate their rights regardless of their economic circumstances." H.R. REP. No. 404, 97th Cong., 2nd Sess. 11 (1982).

111. *See generally* Barry, *supra* note 66.

112. Because of the requirement that the taxpayer exhaust his/her administrative remedies, I.R.C. § 7430(b)(1) (1987), the taxpayer under most circumstances must request an appeals office conference if the taxpayer disagrees with the proposed deficiency determined by the examining agent. Thus, in most cases an unreasonable position adopted at the audit level will only be relevant to an award of attorneys fees if the same unreasonable position is adopted by the appeals officer thereby compelling the taxpayer to file a petition in Tax Court.

113. *See* H.R. REP. No. 404, 97th Cong., 2nd Sess. 13 (1982).

defeated.[114]

There is nothing in the legislative history of amended section 7430 to suggest that the reasonableness of the conduct of other IRS administrative divisions is to be excluded from review by the courts.[115] Instead, the amendment added by the Tax Reform Act of 1986 provides: "the term 'position of the United States' *includes* -—
. . . administrative action . . . by the District Counsel. . . ."(emphasis added)[116] is best read as a mandate from Congress to the courts to expand their inquiry to a consideration of IRS conduct at the administrative level.[117]

B. The Reasonableness of the Government's Position

In the majority's view, Sylvia's problem was that she failed to satisfy her burden of proof as to her innocent spouse status before she filed her petition with the Tax Court. If she had done so, the conduct of the IRS thereafter would have been unreason-

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114. The taxpayer is required by I.R.C. § 7430(b)(1)(1987) to exhaust his/her administrative remedies before becoming eligible for an award of attorneys fees. Thus, there is no incentive for the taxpayer to circumvent the IRS' administrative dispute resolution procedure.

115. The Tax Court decisions assume that if Congress had intended to include a broader scope of IRS administrative conduct to be examined that it would have specifically provided for it in the amended statute. *See, e.g.*, Russell v. U.S., 87-2 U.S. Tax Cas. (CCH) ¶ 9405, 89,119 (1987). In *Russell*, the IRS assessed taxes against taxpayers without first mailing to them the required notice of deficiency. The court denied their motion for attorney's fees after they prevailed in the case, holding that the prelitigation conduct was not relevant to a determination of the Government's unreasonableness. *Id.* at 89119-20.

Given the broad scope of the amendments originally proposed but not adopted in both the House Bill and Senate Amendments it is plausible to read the amended statute, as did the court here in *Sliwa*, as authorizing a broader inquiry into the reasonableness of the Governmental conduct involved in a particular case. *See supra* notes 85, 86 and accompanying text. The language at the beginning of the added subsection supports this interpretation: "The term 'position of the United States' *includes*— . . . (B) any administrative action . . . by the District Counsel . . . ." (emphasis added) I.R.C. § 7430(c)(4)(1987). There is nothing in the language of the statute or the legislative history to indicate that the definition of the term "position of the United States" does not also include other unreasonable IRS administrative conduct. Congress could have easily made an explicit limitation by defining the "position of the United States" to mean *only* its position in the civil proceeding and that of the IRS District Counsel and not other administrative divisions of the IRS.

116. I.R.C. § 7430(c)(4)(B) (1987).

117. For a good discussion of the policies supporting a broad interpretation of the "position of the United States" see Barry, *supra* note 66, at 782-85.

able. This result is fair considering that Sylvia bore the burden of proof on this issue.

The dissent argued that "If bank records were important to the Government's decision it should have requested them rather than forcing the taxpayer to expensive litigation."[118] While it appears that the Appeals Officer failed to immediately follow through after Sylvia's attorney notified him that he had the records,[119] this bureaucratic blunder does not rise to the level of "abusive actions and overreaching by the Internal Revenue Service."[120] Thus, the majority's conclusion that "we cannot say that the Government was unreasonable in requiring better proof than Sliwa's mere assertions of innocence. . ."[121] is appropriate in this case.

The dissent's position would result in the burden of proof shifting to the Government. This view would require the Government to prove that the taxpayer was *not* entitled to the benefit claimed. Since the taxpayer is the party in the best position to produce the proof necessary to establish the claimed benefit (the taxpayer is most likely to have the relevant records) it makes little sense to place this burden on the Government.

VI. CONCLUSION

The Ninth Circuit's holding in *Sliwa*, that the reasonableness of the IRS' administrative conduct should be considered when a court decides whether to allow a prevailing taxpayer attorney's fees is commendable. In so holding, the court has remained faithful to the underlying purpose and rationale of section 7430 which is to "deter abusive actions and overreaching by the IRS and . . . enable individual taxpayers to vindicate their rights regardless of their economic circumstances."[122]

Even after the 1986 amendments to section 7430 the Tax Court outside the Ninth Circuit has continued to apply its earlier view that the IRS conduct to be examined for reasonable-

118. *Sliwa*, 839 F.2d 602, 610 (9th Cir. 1988) (Boochever, J., dissenting).
119. *Id.* at 604.
120. H.R. REP. No. 404, 97th Cong., 2nd Sess. 13 (1982).
121. *Sliwa*, 839 F.2d at 608.
122. H.R. REP. No. 404, 97th Cong., 2nd Sess. 11 (1982).

ness is limited to conduct occurring subsequent to the taxpayer filing a petition.[123] The Ninth Circuit however, will likely apply the broader approach articulated in *Sliwa* in future cases arising under amended section 7430 and scrutinize IRS administrative pre-litigation conduct as well as the Government's conduct after litigation has commenced.[124]

*James Thurston**

123. *See supra* note 115.

124. The Tax Court, because of the "Golsen Rule", will be bound to follow the Ninth Circuit's resolution of this issue in all decisions it makes within the Ninth Circuit's appellate jurisdiction. *Golsen*, 54 T.C. 742, 757 (1970). *See supra* note 29 for a full discussion of the case.

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