

Executive's Tax & Management Report

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DEALING WITH THE IRS

Court Options Available After Appeals

By Ray Moore

In the April and May issues of EXECUTIVE'S TAX & MANAGEMENT REPORT, we discussed what to do in preparation for and during an audit and how to contest an auditor's findings through the IRS' appeals process. As you read in last month's issue, most taxpayers successfully resolve their issues at Appeals. But what can you do if you don't reach a conclusion that you consider satisfactory through Appeals?

Review your situation and determine if the cost of going further is warranted based on the potential tax and/or penalty savings. If you decide it is, then you can contest the IRS' findings in court. An experienced advisor can help you weigh your options and evaluate your chance of successfully contesting the proposed assessment.

If you choose to go to court, then there are two different routes available: Tax Court and federal district court. The benefits and drawbacks of each, as well as subsequent courses of action, are discussed in the remainder of this article.

Tax Court

The Internal Revenue Code ("the Code") sets up a special court, called the Tax Court, to hear only tax cases. All Tax Court

cases are heard by judges of the Tax Court. There are no jury trials; each case is presided over by one of 19 Tax Court judges. Since these judges only hear tax cases, they are considered specialists in tax matters. As such, the Tax Court tends to understand the complexities of the tax law better than judges who are more generalist in nature.

If you believe your position is supported in the Code or other relevant tax authority, you should file your case in Tax Court (as opposed to a District Court as discussed below).

There are several benefits of filing with the Tax Court:

- **Deferral of payment for contested taxes.** You do not have to pay the tax until after the court has reached its decision.
- **Self-representation.** If qualified, you can represent yourself before the Tax Court. While most taxpayers choose to be represented by an attorney, you do have a right to self-representation in Tax Court.
- **Opportunity to go back to Appeals.** Once a case is filed in Tax Court, the court often sends the case back to Appeals, and a taxpayer can even request this. Of the Tax Court cases that I have personally been involved in, all

were sent back to Appeals by the Tax Court and were successfully settled there. The decision entered in the Tax Court was simply a stipulated decision as agreed to by the taxpayer and the Appeals Officer. One of the primary charges for Appeals is to settle cases that have been docketed if at all possible. Knowing that you are willing to take your case to court and recognizing the potential hazards involved in litigation, the IRS may be more willing to settle your case in Appeals, even if it was unwilling to do so the first time.

In general, you should *not* go to Tax Court under either of the following circumstances:

- The Tax Court has already ruled contrarily to your position on a similar case. In such a situation, the chances of its ruling in your favor are minimal.
- You are seeking equitable application of the tax law. The Tax Court is generally viewed as being a strict constructionist of the tax law. If it's equity you are looking for—if you're looking for "fair" treatment because it's the right thing to do in your

situation—the Tax Court is not the place to find it. Go to the Tax Court only if you feel that the law is on your side—that the IRS’ interpretation of the law is incorrect.

District Court

The main alternative to taking a case to the Tax Court is to take it to a federal district court. (A taxpayer can also file with the Court of Federal Claims under similar procedures and conditions, but that route is much less used than it once was.)

Before you can file with a district court, however, all of the following criteria must be met:

- You must pay the tax as assessed by the IRS.
- You must file a timely claim for a refund.
- The refund claim must have been denied.

Exception. If you have not received either the refund or a specific denial of the claim within six months of filing, then you can file with the district court.

You must file in the federal district in which you live (or, in the case of a business, in which the business is located).

In general, you should file a claim in a federal district court under the following circumstances:

- The case is more a case of fact than law (*i.e.*, the law is clear, but how your facts line up with the law and/or the correct application of the law to your facts is unclear).
- You are looking for equitable treatment rather than a pure application of the tax law to the facts of the case.
- You want a jury trial.

Because district courts hear many types of cases, the district

court judge is often not a tax specialist. While this may work to your advantage if you believe that an equitable application of the tax law to your situation will result in a favorable decision, it also means that many district courts will tend to follow the precedents set by the Tax Court in similar cases. That’s why it is important, even if your case is being tried in a district court, to distinguish your situation from any relevant Tax Court findings that do not support your case.

Appeals Court

Regardless of the “court of original jurisdiction” (*i.e.*, the court that first hears your case), any appeal of your case from the Tax Court or a district court will be to the Circuit Court of Appeals for the circuit in which you are located. (The exception to this is cases argued in the Court of Federal Claims, which are appealable to the Federal Circuit Court of Appeals.)

The Tax Court and district court are bound to follow the precedent set by cases decided in your circuit. The Tax Court has adopted a rule, called the *Golsen* rule (after a case, *J.E. Golsen*, 54 TC 742), which it applies to try to ensure consistent treatment of the cases it hears. This rule states that if a circuit has already ruled on a particular issue and the case before it is appealable to that circuit, the Tax Court will follow that circuit’s ruling. This can result in strange results where two circuits have come down on different sides of an issue. For example, the exact same situation, covering two partners in a partnership, tried by the Tax Court can result in ruling one way for one taxpayer and a different way for the other if the partners’ cases are appealable to different circuits.

It is critical that your advisor be aware of the rulings by the circuit court to which your case is appealable. For example, it might be preferable to file with the Court of Federal Claims, rather than with a district court, if the Court of Appeals for the Federal Circuit has ruled favorably on your issue and the Court of Appeals for the circuit in which you reside has ruled unfavorably. If you go the district court route, the district court will follow the ruling of your circuit; but if you go to the Court of Federal Claims, that court will follow the ruling of the Federal Circuit Court.

Supreme Court

No matter which circuit court your case is appealable to, the only level of appeal from there is to the U.S. Supreme Court. The Supreme Court does not hear many tax cases, however. Usually, it will hear a tax case only if there is a split between the circuits. That makes it even more critical to analyze your position and the relative benefits of the Tax Court versus a district court route and/or the circuit to which your case is appealable. Rarely will you be able to have your case tried at a level higher than your circuit court.

Summary

Before going to court, it is imperative that you review your case and realistically analyze its potential. If you are unable to settle your case at Appeals the first time and would like a second chance, then you can file with the Tax Court and ask that the case be remanded to Appeals. Tax Court might also be the best route for you to take if you feel that the law is clear and the IRS is misapplying it.

However, if you feel that the law is generating an unfair result, and you think that equity and/or a more reasonable approach (as opposed to a strict reading of the law) is on your side, then the district court (possibly with a jury trial) probably offers you more potential than the Tax Court.

It is impossible to overstate the importance of having your tax advisor help you make these decisions. A good case, strongly presented, usually results in a favorable result for the taxpayer. Conversely, a poor case, or even a good case poorly presented, usually results in an

unfavorable decision for a taxpayer.

Ray Moore, CPA, of O'Sullivan Creel, LLP (Pensacola, FL), is a member of the Editorial Advisory Board for EXECUTIVE'S TAX & MANAGEMENT REPORT. He can be reached at rmoore@osullivancreel.com. ■