TAXPAYER PROTECTION AND REIMBURSEMENT ACT

HEARING

BEFORE THE

SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE

OF THE

COMMITTEE ON FINANCE

UNITED STATES SENATE

NINETY-SIXTH CONGRESS

FIRST SESSION

ON

S. 1444

A BILL TO AMEND THE INTERNAL REVENUE CODE OF 1954 AND TITLE 28 OF THE UNITED STATES CODE TO PROVIDE FOR THE AWARD OF REASONABLE COURT COSTS, INCLUDING ATTORNEY'S FEES, TO PREVAILING PARTIES IN CIVIL TAX ACTIONS, AND FOR OTHER PURPOSES

JULY 19, 1979

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TAXPAYER PROTECTION AND REIMBURSEMENT ACT

THURSDAY, JULY 19, 1979

U.S. SENATE,
COMMITTEE ON FINANCE,
SUBCOMMITTEE ON OVERSIGHT OF THE
INTERNAL REVENUE SERVICE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:10 p.m., in room 1224, Dirksen Senate Office Building, Hon. Max Baucus, chairman of the subcommittee, presiding.

Present: Senators Baucus and Byrd.

[The press release announcing this hearing and the bill S. 1444 and floor statement follow:]

[Press Release, July 12, 1979]

COMMITTEE ON FINANCE, U.S. SENATE,
SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE.

FINANCE SUBCOMMITTEE ON OVERSIGHT OF THE INTERNAL REVENUE SERVICE SETS HEARING ON S. 1444

Senator Max Baucus (D.-Mont.), Chairman of the Subcommittee on Oversight of the Internal Revenue Service of the Senate Committee on Finance, announced today that the Subcommittee will hold a hearing on Thursday, July 19, 1979, on S. 1444, the Taxpayer Protection and Reimbursement Act. This bill would permit the awarding of reasonable court costs, including attorney's fees, to prevailing parties in civil tax actions.

The hearing will be held in Room 1224, Dirksen Senate Office Building and will begin at 2:00 p.m.

In announcing the hearing, Senator Baucus pointed out that, "There are certain situations where taxpayers not only must assess themselves and pay Federal income tax, but then must defend themselves against the Government's claim that they owe additional tax. When it is clear that the IRS (or Justice Department when it conducts the litigation) is maintaining an unreasonable position which results in real harm to a taxpayer, the availability of a judicial determination must never be an empty promise, expecially one caused by the burden of high litigation costs. To alleviate some of the financial burden for taxpayers who win in court against an unreasonable IRS position and to protect taxpayers at the outset from unreasonable IRS actions, I offer this legislation," Baucus added.

The following witnesses have been scheduled to testify before the Subcommittee:

The Honorable Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy.

The Honorable Jerome Kurtz, Commissioner of Internal Revenue.

John S. Murray, Acting Deputy Assistant Attorney General (Tax Division), Department of Justice.

The Honorable Moxley Featherston, Chief Judge, U.S. Tax Court.

Lipman Redman, Chairman, Section on Taxation, American Bar Association; accompanied by Steven Salch, Special Advisor to ABA Tax Section's Committee on Court Procedures.

Johnnie M. Walters, former Commissioner of Internal Revenue and former Assistant Attorney General (Tax Division), Department of Justice.

Stuart E. Seigel, former Chief Counsel, Internal Revenue Service.
Daniel Lewolt, Executive Director, National Taxpayers Legal Fund.
John Fitch, Director of Government Affairs, National Society of Public Accountants.

Legislative Reorganization Act.—Senator Baucus stated that the Legislative Reorganization Act of 1946, as amended, requires all witnesses appearing before the Committees of Congress, "to file in advance written statements of their proposed testimony, and to limit their oral presentations to brief summaries of their argument."

Witnesses scheduled to testify should comply with the following rules:

(1) A copy of the statement must be filed by noon the day before the day the witness is scheduled to testify.

(2) All witnesses must include with their written statement a summary of the principal points included in the statement.

(3) The written statements must be typed on letter-size paper (not legal size) and at least *100 copies* must be submitted by the close of business the day before the witness is scheduled to testify.

(4) Witnesses are not to read their written statements to the Committee, but are to confine their ten-minute oral presentations to a summary of the points included in the statement.

(5) Not more than ten minutes will be allowed for oral presentation.

Written testimony.—Senator Baucus stated that the Subcommittee would be pleased to receive written testimony from those persons or organizations who wish to submit statements for the record. Statements submitted for inclusion in the record should be typewritten, not more than 25 double-spaced pages in length and mailed with five (5) copies by July 30, 1979, to Michael Stern, Staff Director, Committee on Finance, Room 2227 Dirksen Senate Office Building, Washington, D.C. 20510.

II

96TH CONGRESS
1ST SESSION

S. 1444

To amend the Internal Revenue Code of 1954 and title 28 of the United States Code to provide for the award of reasonable court costs, including attorney's fees, to prevailing parties in civil tax actions, and for other purposes.

IN THE SENATE OF THE UNITED STATES

JUNE 27 (legislative day, JUNE 21), 1979

Mr. BAUCUS (for himself, Mr. LONG, Mr. BENTSEN, and Mr. BRADLEY) introduced the following bill; which was read twice and referred to the Committee on Finance with instructions that if and when reported, it then be referred to the Committee on the Judiciary for not to exceed 45 days to consider title II

A BILL

To amend the Internal Revenue Code of 1954 and title 28 of the United States Code to provide for the award of reasonable court costs, including attorney's fees, to prevailing parties in civil tax actions, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Taxpayer Protection and Reimbursement Act".

TITLE I—AMENDMENTS TO INTERNAL REVENUE CODE OF 1954

SEC. 101. (a) Subchapter B of chapter 76 of the Internal Revenue Code of 1954 is amended by redesignating section 7430 as section 7431 and by inserting after section 7429 the following new section:

"SEC. 7430. AWARD OF COURT COSTS, INCLUDING ATTORNEY'S FEES.

"(a) IN GENERAL.—In the case of any civil action or proceeding in a court of the United States, including the Tax Court, which is brought by or against the United States for the determination, collection, or refund of any tax, interest, or penalty under this title, the prevailing party (other than the United States or any creditor of the taxpayer involved) may be awarded a judgment for reasonable court costs, including attorney's fees, incurred in such action or proceeding but only to the extent such costs are allocable to the United States and not any other party to such action or proceeding.

"(b) LIMITATION ON COSTS.—In no event shall an award for reasonable court costs, including attorney's fees, exceed $20,000 for any one civil action or proceeding.

"(c) DEFINITIONS.—For purposes of this section—

"(1) ATTORNEY'S FEES.—The term 'attorney's fees' includes, with respect to any proceeding in the Tax Court, fees for the services of an individual, not

an attorney, who is authorized to practice before that court.

"(2) PREVAILING PARTY.—A party (other than the United States or any creditor of the taxpayer involved) shall be deemed to have prevailed in any such civil action or proceeding, only if such party, as determined by taking into account the entire record of the case as well as any other relevant evidence—

"(A)(i) is sustained (whether by judicial determination or agreement of the parties) as to all, or all but an insignificant portion, of the amount in controversy, or

"(ii) if no amount is in controversy, is sustained (whether by judicial determination or agreement of the parties) as to all, or all but an insignificant portion, of the issue or issues presented, and

"(B) establishes that the position of the United States in the civil action or proceeding was unreasonable.

"(d) EXCLUSION OF CERTAIN CIVIL ACTIONS OR PROCEEDINGS.—No award for reasonable court costs, including attorney's fees, may be awarded under subsection (a) with respect to any civil action or proceeding brought under—

"(1) section 7428 (relating to declaratory judgments with respect to status and classification of organizations under section 501(c)(3), etc.), unless such action or proceeding involves the revocation of the tax-exempt status of an organization described in section 501(c)(3),

"(2) section 7476 (relating to declaratory judgments with respect to qualification of certain retirement plans),

"(3) section 7477 (relating to declaratory judgments with respect to transfers of property from the United States), or

"(4) section 7478 (relating to declaratory judgments with respect to status of certain governmental obligations).

"(e) MULTIPLE ACTIONS.—For purposes of this section, in the case of—

"(1) multiple actions which could have been joined or consolidated, or

"(2) a case or cases involving a return or returns of the same taxpayer (including joint returns of married individuals) which could have been joined in a single proceeding in the same court,

such actions or cases shall be treated as one civil action or proceeding regardless of whether such joinder or consolida-

tion actually occurs, unless the court in which such action or proceeding is brought determines, in its discretion, that it would be inappropriate to treat such actions or cases as joined or consolidated for purposes of this section.

"(f) RIGHT OF APPEAL.—An order granting or denying such award, in whole or in part, shall be incorporated as a part of the decision or judgment in the case and shall be subject to appeal in the same manner and to the same extent as the decision or judgment.

"(g) SOURCE OF PAYMENT.—Payment of such award shall be made out of the general appropriations of the agency conducting the civil action or proceeding.".

(b) The table of sections for such subchapter is amended by striking out the item relating to section 7430 and inserting the following new items:

"Sec. 7430. Award of costs, including attorney's fees.
"Sec. 7431. Cross references.".

SEC. 102. Section 722 of the Revised Statutes (42 U.S.C. 1988) is amended by striking out immediately after "Public Law 92-318" the clause "or in any civil action or proceeding, by or on behalf of the United States of America, to enforce, or charging a violation of, the United States Internal Revenue Code,".

SEC. 103. The amendments made by this title shall apply to civil actions or proceedings filed after December 31, 1978, and before January 1, 1983.

TITLE II—AMENDMENTS TO TITLE 28

SEC. 201. Section 2412 of title 28, United States Code, is amended—

(1) by inserting "or subsection (b)" after "statute", and

(2) by adding at the end thereof the following:

"(b)(1) In the case of any civil action or proceeding in a court of the United States which is brought by or against the United States for the determination, collection, or refund of any tax, interest, or penalty under the Internal Revenue Code of 1954, the prevailing party (other than the United States or a creditor of the taxpayer involved) may be awarded a judgment for reasonable court costs, including attorney's fees, incurred in such action or proceeding but only to the extent such costs are allocable to the United States and not any other party to such action or proceeding.

"(2) In no event shall an award for reasonable court costs, including attorney's fees, exceed $20,000 for any one civil action or proceeding.

"(3) For purposes of this subsection, a party (other than the United States or a creditor of the taxpayer involved) shall be deemed to have prevailed in any such civil action or proceeding, only if such party, as determined by taking into account the entire record of the case as well as any other relevant evidence—

"(A)(i) is sustained (whether by judicial determination or agreement of the parties) as to all, or all but an insignificant portion, of the amount in controversy, or

"(ii) if no amount is in controversy, is sustained (whether by judicial determination or agreement of the parties) as to all, or all but an insignificant portion, of the issue or issues presented, and

"(B) establishes that the position of the United States in the civil action or proceeding was unreasonable.

"(4) No award for reasonable court costs, including attorney's fees, may be awarded under paragraph (1) with respect to any civil action or proceeding brought under—

"(A) section 7428 of the Internal Revenue Code of 1954 (relating to declaratory judgments with respect to status and classification of organizations under section 501(c)(3), etc.), unless such action or proceeding involves the revocation of the tax-exempt status of an organization described in section 501(c)(3) of such Code,

"(B) section 7476 of such Code (relating to declaratory judgments with respect to qualification of certain retirement plans),

"(C) section 7477 of such Code (relating to declaratory judgments with respect to transfers of property from the United States), or

"(D) section 7478 of such Code (relating to declaratory judgments with respect to status of certain governmental obligations).

"(5) For purposes of this subsection, in the case of—

"(A) multiple actions which could have been joined or consolidated, or

"(B) a case or cases involving a return or returns of the same taxpayer (including joint returns of married individuals) which could have been joined in a single proceeding in the same court,

such actions or cases shall be treated as one civil action or proceeding regardless of whether such joinder or consolidation actually occurs, unless the court in which such action or proceeding is brought determines, in its discretion, that it would be inappropriate to treat such actions or cases as joined or consolidated for purposes of this section.

"(6) An order granting or denying such award, in whole or in part, shall be incorporated as a part of the decision or judgment in the case and shall be subject to appeal in the same manner and to the same extent as the decision or judgment.

"(7) Payment of such award shall be made out of the general appropriations of the agency conducting the civil action or proceeding.".

SEC. 202. Section 722 of the Revised Statutes (42 U.S.C. 1988) is amended by striking out immediately after "Public Law 92–318" the clause "or in any civil action or proceeding, by or on behalf of the United States of America, to enforce, or charging a violation of, the United States Internal Revenue Code,".

SEC. 203. The amendments made by this title shall apply to civil actions or proceedings filed after December 31, 1978, and before January 1, 1983.

TAXPAYER PROTECTION AND REIMBURSEMENT ACT

Mr. BAUCUS. Mr. President, I am today introducing legislation which will reduce the inherent disadvantages now faced by taxpayers entangled in civil tax actions instituted by or against the Internal Revenue Service. My bill, the "Taxpayer Protection and Reimbursement Act," will allow Federal courts and the Tax Court to reimburse taxpayers who prevail against the IRS, in virtually all types of tax cases where the position of the IRS was unreasonable, for reasonable court costs, and attorneys' fees.

The successful functioning of our tax system depends upon voluntary compliance—that ability and willingness of taxpayers to accurately assess themselves and pay their taxes. In order to insure that this willingness to cooperate does not falter, taxpayers must have confidence that they are being treated fairly by IRS in its administration and enforcement of the tax laws. For the most part, IRS does perform its statutory duties of administering and enforcing tax laws reasonably and equitably.

To a large extent taxpayers are afforded ample occasions through IRS administrative appeals process to contest or voluntarily to settle their tax liability. Furthermore, even if a taxpayer must seek judicial resolution of a controversy that cannot be settled administratively, the Tax Court does provide a simplified procedure for small tax cases—those cases involving $5,000 or less for any one taxable year. However, even this small tax case procedure does not mean that taxpayers can always grapple with complicated tax laws in the Tax Court without the assistance or advice of an attorney or other authorized representative.

While recognizing that IRS generally exercises its authority justly and with restraint, the fact remains that in an organization as large and complex as IRS, which must administer a myriad of complicated tax laws, errors are bound to occur. There are instances where IRS has acted arbitrarily, where certain taxpayers may feel subjected to IRS harassment or abuse. Taxpayers are quite vulnerable to the power of IRS. The fact that taxpayers can go into court to get a judicial resolution of a dispute with IRS is small comfort to those taxpayers who must bear the expense of court costs and substantial attorney's fees. And consider how much worse this predicament is for taxpayers who, even though they are actually in full compliance with the law, are forced into court by an IRS position which is unreasonable in light of either its interpretation of a tax law or its application of that law to the particular taxpayer. Such taxpayers, who have to endure the turmoils of litigation through no fault of their own, must still pay the legal expenses incurred in the course of the court action. Often the litigation expenses can be almost as much—and may very well exceed—the actual amount of money that was in controversy. It takes little imagination to see how easily legal expenses for a $500 refund action in a Federal district court could quickly approach and then exceed $500. It is this reality which causes some taxpayers with meritorious claims not to seek judicial relief. In such circumstances, the expense of litigation often makes a court victory meaningless for taxpayers.

In a 1974 Law Review article on awards of attorneys' fees generally, this dilemma, which seems particularly harsh when encountered by taxpayers, was explained in this way:

"Current practice tends to alter prosecution of even clearly meritorious claims by litigants who could at best recover less than the often high expenses of counsel. . . . And what is true for plaintiffs also holds true for defendants: the cost of defending against an unjust small claim may easily exceed simply paying what is demanded. The result is distasteful, for it ranks legal rights by dollar value. . . . *(Court Awarded Attorneys' Fees and Equal Access to the Courts,* 122 University of Pennsylvania Law Review, 636, 650)"

Our tax laws are complex oftentimes vague and open to numerous interpretations. The courts perform a particularly invaluable service in tax cases by providing an impartial, final decision on the correct interpretation of the tax laws and how such laws should be applied to a particular taxpayer. In most court actions IRS must be there in order to carry out its statutory mandate to enforce tax laws, and it generally does so in a rational and responsible manner. I certainly do not intend to penalize IRS or impair the performance of its duties when it is acting reaonably and fairly—when IRS is in fact serving the public interest by seeking judicial resolutions of complex tax issues, thereby providing greater certainty in the laws upon which taxpayers may rely. However, when it is clear that IRS (or the Justice Department when it conducts the litigation) is maintaining an unreasonable position which results in real harm to a taxpayer, the availability of a judicial resolution of the problem for such a taxpayer must never be an empty promise, especially one caused

by the burden of high litigation costs. As Donald C. Lubick, Treasury Assistant Secretary for Tax Policy, said during Senate testimony over a year ago:

"The voluntary assessment plan system must be viewed as fair and evenhanded. Taxpayers without significant resources must not feel incapable of obtaining a redress of their grievances against the Internal Revenue Service where the Service has acted unreasonably. (March 13, 1978 statement before the Senate Judiciary Subcommittee on Improvements in Judiciary Machinery)."

It is to alleviate the financial burdens for taxpayers who win in court against an unreasonable IRS position and to protect taxpayers at the outset from unreasonable IRS actions that I offer this legislation.

Current law does little to remedy the problems I have just described. Under the "American Rule," ordinarily prevailing parties are not—absent express congressional intent—entitled to collect reasonable court costs, including attorney's fees, from the Government when it is the losing party. Congress has enacted numerous exceptions to this general rule. Yet the particular problem faced by taxpayer litigants was not specifically addressed until the Civil Rights Attorneys' Fees Awards Act of 1976 (Public Law 94-559). This act permits an award for attorney's fees, as part of court costs, to the prevailing party, other than the United States, in any civil action or proceeding brought by or on behalf of the United States to enforce, or charging a violation of, the Internal Revenue Code. However, as a result of substantial judicial interpretation of this provision, this statute has had minimal impact on most civil tax litigation for two basic reasons:

First of all, courts have been in virtual agreement that reimbursement for attorneys' fees may only be made where the taxpayer is the defendant. This interpretation results in the statute applying to very few tax cases, because in most civil tax actions the taxpayer is the party who brings a claim against the Government. (In general, civil tax cases are heard in the Tax Court where the taxpayer is the petitioner in a deficiency proceeding or in the Federal district court where the taxpayer is the plaintiff suing for a refund).

Second, courts have held that even if the taxpayer is the defendant in a civil tax litigation and prevails against the Government, that taxpayer nevertheless may recover attorney's fees from the Government only if the Government acted in bad faith, for purposes of harassment or vexatiously or frivolously. Few taxpayers are able to meet such a highly restrictive burden of proof, even though they prevail in the litigation.

Mr. President, my bill would put an end to the unintended and undesired restrictions now placed upon reimbursement of litigation expenses to taxpayers who prevail in most Federal civil tax actions against an unreasonable Government position. This Taxpayer Protection and Reimbursement Act bill has the following basic elements:

First. Federal courts and the Tax Court are given the discretion to reimburse prevailing parties, other than the United States, for reasonable court costs, including attorneys' fees, incurred in civil tax actions or proceedings in which the United States is a party.

Second. Reimbursement can be granted in a civil action or proceeding in which the United States is a party, which is brought for the determination, collection, or refund of any tax, interest or penalty, brought by or against the United States under the Internal Revenue Code, except those relating to certain declaratory judgments.

Third. Reimbursement of court costs, including attorney's fees, is available to plaintiffs/petitioners and defendants who prevail against the United States.

Thus, under my bill, reimbursements would be available in most types of Federal civil tax cases in which the United States is the losing party, such as refund actions, deficiency proceedings, collection and enforcement suits, summons proceedings, and wrongful levy actions. Moreover, permitting prevailing plaintiffs and defendants alike to receive such awards encourages meritorious suits to vindicate private harm and foster the public interest, and discourages the Government from instituting reasonable suits.

Fourth. Such reimbursement for reasonable court costs, including attorney's fees, may not exceed $20,000 for any one civil action or proceeding.

Such a ceiling is likely to provide sufficient relief for taxpayers in the ordinary types of civil tax cases, yet not encourage an excessive amount of additional litigation which could overwhelm already burdened courts.

Fifth. In order to be eligible for reimbursement of these litigation expenses, the prevailing party must satisfy two requirements, as determined by taking into account the court record as well as any other relevant evidence: The party must be sustained, either by judicial determination or agreement of the parties, as to all, or

all but an insignificant portion, of the amount in controversy or of the issues in controversy, in instances where no actual sum is involved; and, the party must establish that the position of the Government in the civil action or proceeding was unreasonable.

This "prevailing party" standard is both reasonable and equitable since, in determining whether its two requirements are met, the court must focus not merely on the formal record before it, but also on the totality of the relevant circumstances surrounding the case. Such circumstances would include the necessity for bringing the action, whether the party succeeds as to the central matter in dispute, and the conduct of the Government with regard to the particular taxpayer. For example, a court should consider whether even though IRS's desire to litigate a tax issue may very well be for the public benefit and its legal position may be reasonable, the position of IRS has nonetheless become unreasonable due to its application of that law to a particular taxpayer which wrongfully and unnecessarily forces that taxpayer into court. Furthermore, the rule that a party can be sustained either by judicial determination or settlement of the parties encourage the parties to settle thereby lessening court congestion, yet prevents the Government from escaping liability for litigation expenses merely by conceding the case before final judgment.

Sixth. For purposes of this reimbursement provision, the term "attorney's fees" include fees for the services of any person, not an attorney, who is authorized to practice before the Tax Court, with respect to such actions or proceedings.

Thus, litigation fees of tax court authorized representatives of the prevailing party, as well as the fees of attorneys, are covered under my bill.

Seventh. Any order granting or denying the reimbursement, in whole or in part, shall be incorporated as part of the court's decision or judgment in the case and subject to appeal in the same way as the decision or judgment.

Eighth. Payment of the reimbursements shall be made by the agency who conducts the civil action or proceeding out of its own general funds.

This requirement most certainly would provide an impetus for such governmental agency (IRS, in particular, and also the Justice Department) to exercise more caution and reason in all its dealings with taxpayers.

Ninth. The provisions of the bill will apply to civil tax actions or proceedings instituted after December 31, 1978, and before January 1, 1983.

This sunset provision compels the Congress and IRS to evaluate the success of this type of reimbursement and determine whether such law has had its intended effect.

In conclusion, this legislation provides much needed improvements to the present law granting awards of reasonable court costs, including attorney's fees, in Federal civil tax cases. It provides needed protection and assistance to those parties who become embroiled in court disputes with IRS through no fault of their own, but does not penalize IRS for fair, responsible, and reasonable performance of its duties. Our tax system must be fair and reasonable—and must be perceived as such by all taxpayers. Taxpayers must not feel at a complete disadvantage in the event of a dispute with the IRS. Taxpayers must not feel that a judicial resolution of a dispute with IRS in their favor is a hollow victory, because of the high litigation expenses which they nevertheless must bear—a burden which becomes especially outrageous to bear, as victors, when the IRS position was in fact unreasonable. The Taxpayer Protection and Reimbursement Act will help restore taxpayers' confidence in the fairness of tax administration by placing them on a more equal footing with IRS. I urge speedy consideration by the Senate of this essential legislation.

Mr. President, I ask unanimous consent that the text of the bill be printed in the Record.

Senator BAUCUS. The Subcommittee on Oversight of the Internal Revenue Service will come to order. We are here this afternoon to begin hearings on S. 1444, which I recently introduced, along with my distinguished colleagues, Senators Long, Kennedy, Dole, Bentsen, and Bradley. And, I am delighted that Senator DeConcini and Nelson have also joined as cosponsor.

This bill would permit Federal courts and the tax court, in most civil tax actions in which the Government is a party, to reimburse private parties who prevail against an unreasonable Government position for reasonable court costs, including attorney's fees.

The issue of awarding attorney's fees in Federal court cases in which the Government is a party has been the subject of intensive hearings in both the House and the Senate during the past few

years. However, today marks the first time that a provision permitting the awarding of court costs, including attorney's fees, which is designed exclusively for civil tax litigation in which the Government is the losing party, will be addressed.

We are all quite aware of—and certainly are concerned about—the deepening mood of dissatisfaction and even pessimism in our Nation's future which is growing throughout our country today. Nowhere is this mood more apparent than in our citizens' view of our tax system.

We hear more and more exasperated expressions of taxpayer frustration, distrust and even helplessness as they struggle to comply with a myriad of complex tax laws and pay their taxes. We hear that taxes are too high, that the tax laws are too complicated, and that tax forms and reporting requirements are excessively burdensome.

We hear that IRS is too big, powerful and awesome for an individual taxpayer to be able to stand up against and successfully vindicate legal rights—even in those instances where a taxpayer is confronted with an unreasonable IRS position. These comments take on a very high degree of credibility when you consider that in 1978 IRS employed over 85,000 persons. And further, in the 1978 annual report of the Chief Counsel of IRS—whose office handles IRS litigation—this statement was made: "The office of Chief Counsel employs over 900 attorneys, making it—next to the Department of Justice—the largest law firm in the country."

We must assure confidence in the fair administration and enforcement of our tax laws—especially since our tax system actually depends upon the ability and willingness of all taxpayers to accurately assess themselves and voluntarily pay their taxes. Taxpayers must not feel at a complete disadvantage in the event of a dispute with IRS. Nor should we penalize IRS when it performs its statutory duties of administering and enforcing the tax laws reasonably, responsibly and equitably—as it, for the most part, does. But when IRS acts unreasonably, taxpayers must not view a court victory as an empty promise because of the high litigation expenses which they must bear—litigation expenses that may approximate and very well surpass the actual amount of money at stake. Faced with this harsh fact of life, some taxpayers decide to swallow their legal rights and settle with IRS, rather than having to pay substantial litigation expenses in addition to engaging in a court confrontation with IRS.

This is the reality facing taxpayers today. We must not tolerate its existence any longer. The price of justice in our tax system must not be beyond the reach of any taxpayer. The ability to vindicate one's legal rights under our tax laws must not depend upon the size of a taxpayer's wallet—especially not when such a taxpayer is being treated unreasonably by IRS, and has not been able to get relief through IES's administrative appeals process. And so I offer this legislation for the following reasons:

One, to alleviate this financial burden, occasioned by high litigation expenses, for taxpayers who win in court against an unreasonable IRS position.

Two, to protect taxpayers at the outset from unreasonable IRS actions by making IRS more cautious and responsible in all its dealings with taxpayers.

And three, to restore confidence in the fairness of our tax system by placing taxpayers on a more equal footing with IRS.

This bill addresses only one of the problems taxpayers now face. Taxpayers should not have to go to court in order to find relief from unreasonable IRS actions. The administrative proceedings and appeals process within IRS must be fair, responsible and accessible. These proceedings must provide ample opportunity for taxpayers to resolve their disputes within IRS. Several bills have already been introduced which establish a taxpayers' bill of rights to govern IRS's administrative dealings with taxpayers. I, too, am presently working on similar legislation and certainly intend to address this issue within this subcommittee.

Issues raised by S. 1444 are fundamental to the direction our Nation will take in the next few years. I hope this hearing will enable us to better understand the need for such a limited departure in tax cases from the "American rule" under which parties must bear the costs of their own litigation and to strike an appropriate balance.

While there are numerous exceptions to the "American rule," an exception for tax cases has been considered only recently. The only time this particular subject has been addressed by a statute was in the Civil Rights Attorneys' Fees Awards Act of 1976—due in large measure to the exceptional efforts of the late Senator Allen. Regrettably, this provision has had a very limited impact in the tax area because it appears to apply only where taxpayers are defendants in the civil actions and when the Government has acted in bad faith, for purposes of harassment or vexatiously or frivolously.

I welcome all of you. And I want to express my appreciation to our witnesses for giving up their time to be with us today and give us the benefit of their learned views.

Before we begin the testimony, I would ask that S. 1444 and my accompanying statement be included in the hearing record.

First, this afternoon, we have the honor of hearing two Senators from the Southwest. The first Senator will be Senator Domenici.

Welcome to the hearing and proceed in any way you wish.

STATEMENT OF HON. PETE V. DOMENICI, A U.S. SENATOR FROM THE STATE OF NEW MEXICO

Senator DOMENICI. Thank you very much, Mr. Chairman.

First, I want to commend you for the oversight hearings you are having today and for your bill, Senate bill 1444. I also want to say to you, it is a privilege to be here with Senator DeConcini, my neighbor.

As you know, we have pending before the Judiciary Committee—I understand it is ready to be reported out—Senate bill 265 that Senator DeConcini has guided, equal access to justice. You are aware of that bill and I thank you for your support there.

The award of reasonable attorney's fees in tax cases which Americans litigate against the Internal Revenue Service and prevail is the best way to guard against capricious and arbitrary agency decisions. It provides an incentive to the taxpayer to fight

when he knows he is right. It restores tension to the delicate balance between the citizenry and their Government.

I commend Senator Baucus in his efforts to readjust the relative positions of taxpayers and the IRS when examining or auditing tax statements. Often the individual is intimidated or cannot afford to contest an IRS decision because of the cost and is forced to buckle under to the overwhelming weight of the bureaucracy.

As author of similar legislation which was recently reported from the Judiciary Committee, I feel that the universal role of the Internal Revenue Service in collecting each Americans proportionate share of the cost of Government must be reassessed. Too much frustration, too much anxiety exists. This approach of reassuring taxpayers that they will be able to defend their actions without incurring large costs, is the best way to restore their confidence that they can "fight city hall and win."

Substantively, I concur with the language of S. 1444 with one minor recommendation. From my experience I would suggest that the standard for the award of attorney's fees should be that the Federal Government must be able to substantially justify its position rather than reasonably justify its position, or pay fees.

This standard gives the taxpayer the benefit that the burden is on the Government to establish the reasonableness of its actions without an undue chilling effect on the agency.

I thank the Chair for this opportunity to state my views for the record and would finally request my name be added as a cosponsor of S. 1444.

Thank you.

Senator BAUCUS. I am very happy to have your name, and have you, Senator, as a cosponsor of the bill. I know you have been very active in this area. I appreciate your help.

Senator DOMENICI. Thank you very much, Mr. Chairman.

Senator BAUCUS. We are also very fortunate to have with us this afternoon Senator DeConcini from the State of Arizona.

Senator, we welcome you this afternoon.

STATEMENT OF SENATOR DENNIS DeCONCINI, A U.S. SENATOR FROM THE STATE OF ARIZONA

Senator DECONCINI. Mr. Chairman, I want to join Senator Domenici in my appreciation and accommodations to you for introducing and tackling the problem of S. 1444, or at least the problem that it addresses, known as the Taxpayers Protection and Reimbursement Act.

I think it is most commendable that you would tackle those important issues. Recent conversations with my constituents have strongly reinforced my belief that this is an area that needs immediate legislative attention.

As you know, and as Senator Domenici has pointed out, we have been working for some time with the Senator from New Mexico and Senator Nelson on legislation that creates the general exception to the American rule in litigation with the Government.

It has been a long process of evaluation, revision, and refinement. I believe the result of the bill is both fair and effective, under S. 265, fees would be awarded and agency adjudications and

civil actions could not be brought by the United States unless the Government could show the action was substantially justified.

During hearings on our bill, there was considerable discussion whether or not to cover tax cases against the bill's general standards.

You have, however, given us the opportunity to evaluate separate legislation which was intended to treat the special problems of IRS cases.

I very much appreciate this opportunity.

I believe that S. 1444 will cover a greater number of tax cases. Since this expressly includes tax court cases, I also think that it is a good idea to specify, as you have done, that the fee determination requires the court to take into account the entire record in the case, which I assume would include the fairness of the negotiations and the conference process.

My own concern is that the standard for awarding fees under S. 1444 may be too restrictive. As I understand the bill, the taxpayer must satisfy a two-pronged test.

First, the taxpayer must prove that "He has prevailed on all or all but an insignificant portion" of the issues or amount in controversy.

Then the burden is still on the taxpayer to prove that the Internal Revenue Service was unreasonable. While I understand that this is an attempt, in part, to address the problem of multiple issues which pervades tax litigation, I nevertheless believe that the task may be unnecessarily restrictive.

Given the complexity of the tax laws, I think it is unrealistic to expect taxpayers to meet the test except in rare cases. I believe the test could be modified somewhat without jeopardizing the functioning of our tax collection system.

Perhaps you might require the party to prevail on a substantial portion of the issues or amount in controversy, or perhaps you might require them to prove that they had prevailed on all issues, but then shift the burden to the Internal Revenue Service to demonstrate the reasonableness of its position.

Mr. Chairman, before I close, I would simply like to emphasize my belief in the importance of this legislation. In order for the voluntary self-assessment system to function properly, it must enjoy the confidence of the taxpayers.

As you and others have pointed out, the process must be fair and it must be perceived by the public to be fair.

One of the most disturbing facts to arise out of the hearings in Arizona and New Mexico on S. 265 was the overwhelming lack of confidence in the fairness of the process.

Citizens expressed their beliefs that the IRS uses oppressive and intimidating tactics to coerce compliance with its position. These people are what we call good Americans. They believe in the country. They believe in paying their taxes. But they also believe that they are not being treated fairly. They condemn the IRS for abusing its power more than any other agency, even OSHA, and that is quite an indictment.

The record on S. 265 demonstrates the kind of situation which have undermined the credibility of the IRS. One businessman testi-

fied that he had been audited 7 years in a row and had never been assessed an extra penny of taxes.

His vindication, however, had, for several years, cost him a substantial amount of time and money and Treasury itself testified that it is not unusual to find that where the Government has lost on a legal issue in five circuits it will still pursue the issue in a sixth circuit.

I am not sure that either S. 1445 or S. 265 completely addresses all of these problems. We might also need to look at other problems, such as S. 326 sponsored by Senator Bumpers, and S. 995, sponsored by Senators Helms and Leahy and the legislation that you indicated today that you were working on.

But I do believe that making an award of fees available in tax litigation will go a long way toward restoring a measure of confidence in the tax collection process.

I thank the Chairman for his indulgence.

Senator BAUCUS. I want to thank you very much, Senator. You have done a lot to try to redress some of the imbalance that presently exists because individual citizens do not have the resources, or are unable to defend themselves.

I want to commend you for introducing and pushing so assiduously S. 265. Both of you have worked very effectively in that area.

One question I have, though, is the degree to which either of you feel that attorney's fees and costs should be awarded not only in judicial cases, Tax Court and Federal district court tax cases, but also the degree to which they should be awarded for administrative hearings.

Could either of you address that question? I ask it because I sense that the taxpayer you talked about who was audited at least seven times may not have gone to court. I do not know.

Maybe he was simply audited seven times, and if that is the case and he did not go to court, this bill would not have helped him.

Senator DECONCINI. He did not go to court, and in a number of the cases, the witnesses have testified on the IRS flatly said that the far majority—I am sorry that I do not have the numbers—said they did not go to court, even when they were assessed an additional tax or penalty because of the cost involved.

That was constantly the complaint about going to the Tax Court—having to pay the tax and bring the suit or go to the district court.

The other areas that we found substantial complaint included the EEOC, OSHA, the Federal Trade Commission, and many other agencies that would bring action either administratively by their courts or even in the district court. This should not be a bill or legislation that is fearful to governmental agencies. I do not think that the bulk of IRS agents, or any other agents, are purposefully going out and harrassing people. I think they think that they are doing their job and as they approach this job, it appears to me that they ought to give more time and concern about the ability to prove their case before they make the allegations against the citizen.

So in respect to your question as to administrative courts, it seems to me while it applies also to them and should apply short of the litigation process, I think that one of the difficulties in the IRS

area that I came across—and you undoubtedly will address—where is threshold to apply the attorneys' fees?

Do you have to have the suit filed, or do you just have to have the audit filed?

I do not know the answer because the costs go up a great deal and how do you substantiate the costs?

Senator BAUCUS. I ask the question partly—it is somewhat a technical question—because if the end of the matter is at the administrative level, under this provision, I assume that a prevailing taxpayer would not be awarded fees. He would have to go to court to be entitled to any reimbursement of fees.

Maybe there is some way to avoid that problem.

Senator DOMENICI. If I may address that issue. Both your bill and S. 265 are experiments; both have a rather short sunset provision. Yours is 3 years and the reported bill has a 3-year sunset also.

I think that if you can figure out a way to manage it and make sure that it can be administered reasonably, you should go down as far as you can in the direction of administrative costs.

I do not know whether you should go to the first audit, the simplest kind of expenses, but if you can get more than court costs in the bill for a 3-year experiment it would be worthwhile.

Senator BAUCUS. Let me ask you another general question which I find somewhat bothersome, which is, whether you would think that the problems in administrative proceedings would be better solved through an award provision or through a taxpayers' bill of rights, which would give taxpayers a little more clout?

In other words, in dealing with the IRS, which of those two approaches, if either, seems to make more sense, in your judgment?

Senator DOMENICI. I have seen some of the bills and I would suggest that the most significant redress will come when a citizen feels free to adjudicate.

I would offer as broad a reimbursement for fighting with one's government as possible. Over the long run, it is going to bring citizens' rights more into focus than anything else and, on the other hand, it will bring less arbitrary and capricious decisions in substantive matters than most other provisions I have seen in taxpayers bills of rights.

I think that we ought to go with this broader based reimbursement as far as possible because it enables the average American citizen to fight. That is how we are going to get citizen redress. Citizens must not be afraid to fight.

I know that it is the same as tax matters as any others, but in the hearings on S. 265, the record is just rampant with citizens who say, "Well, I just had to go ahead and pay the fine because I could not afford to fight."

Or, "I went ahead and paid the fee because I could not afford an attorney's fee."

When that occurs, and it occurs many times in the American system of big government versus the citizen, the imbalance is enormous and you have to have something rather unusual to undue imbalance. I assume that much the same exists with IRS versus the American citizen.

Senator DECONCINI. I associate myself completely with the statements made by the Senator from New Mexico. It seems to me the Bill of Rights should be pursued and have hearings held on it.

If this bill, 1444, and/or 265 or a combination of anything of substance is enacted into law, I think you will have a far less need for a bill of rights. It will be a definite message for Federal agencies, but they have to proceed with more caution before bringing in their complaints, whether they are administrative complaints or the litigation.

What is important is for the people to feel if they want to contest their government, they have an opportunity, just like the government does now to convince the court that they are entitled to not have to pay the penalty, then not out of pocket on top of it.

This would be a great step forward.

After, as your bill sets forth, 3 years, we will have some kind of test on it, and that would be the time to really assess the total bill of rights, whether we ought to expand or contract, or where we should be going.

Senator BAUCUS. Let me ask a quick question, because I know you are busy and I appreciate your appearance this afternoon, and that is whether, in your judgment, the award of attorneys' fees and court costs should be taken out of, in this case, the IRS budget, or should the reimbursement be from the general treasury?

Senator DECONCINI. We opt to take it out of the agency, that the award is not awarded against, or the agency that does not prevail in the litigation. And I realize that that will come back to haunt us in the sense that we will have to appropriate for those losses, assuming that they are substantial.

This imposes a severe burden again on the agency directors to supervise their people that they are bringing good people.

When the budget comes up here for authorization, how much are you losing? You are losing attorneys' fees and costs in court.

That is how we are up for it, and I think it is a very reasonable position and one that is going to be extremely effective.

Senator DOMENICI. Mr. Chairman, I introduced S. 265 which is going to be reported to the Floor that my good friend Senator DeConcini has carried thru committee. In its introduction, I did not assess the fees against the agencies.

I am not going to object on the Floor. It appears to me that there is some logic and rationale on the other side. We do not want to be part of causing agencies not to do their work. We want them to do their work. We are passing laws for them to enforce, we ought to give them the money to enforce them.

It seems to me that the only advantages to charging the agency is that you will know how much they have cost the Government by being arbitrary in the enforcement of our laws.

I think we can do it the way that S. 265 does or do it by just pointing it out each year at budget time. In that way we will know what they have cost our Government without putting an agency director in the position of saying we are losing so much, we ought to stop enforcing this law or that law.

What we want is for enforcement not chilling the work of the agencies.

Senator BAUCUS. I want to thank you both very much for testifying. I apologize to you, Senator Domenici. I did not realize that you were the original sponsor of 265.

Senator DOMENICI. We passed it on the Senate Floor because nobody would give us a hearing.

Senator DECONCINI. Senator Domenici has been extremely effective in bringing this to the attention of many Senators.

Senator BAUCUS. Senator Byrd may have a cogent statement before you leave.

Senator BYRD. Thank you, Mr. Chairman. I was most interested in the testimony of both Senator DeConcini and Senator Domenici. I think that this legislation has some very important points. It has a good bit of appeal to the Senator.

Senator BAUCUS. Thank you very much.

Next, we will hear from a panel consisting of Donald C. Lubick, Assistant Secretary of the Treasury for Tax Policy; the Hon. Jerome Kurtz, Commissioner of Internal Revenue; and John Murray, Acting Deputy Assistant Attorney General for the Department of Justice.

Before you proceed, gentlemen, I would like to announce that Senator Bradley, a cosponsor of the bill regrets that he is unable to attend today, although he very much wanted to, but was detained. He has a written statement which without objection, we will include in the record.

[The statement of Senator Bradley follows:]

STATEMENT OF BILL BRADLEY, A U.S. SENATOR FROM THE STATE OF NEW JERSEY

Mr. BRADLEY. Mr. Chairman. As a member of this Subcommittee on Oversight of the Internal Revenue Service, I am pleased to join my colleagues, Senator Baucus, Senator Long, Senator Kennedy, Senator Dole, Senator Bentsen, and Senator DeConcini in sponsoring the Taxpayers Protection and Reimbursement Act.

I would also like to commend the distinguished chairman of this Subcommittee, Senator Baucus, for the leadership he has shown by introducing this bill, obtaining a well-rounded selection of cosponsors, and by quickly holding hearings on this matter.

This legislation promises to be a significant contribution to the rights of ordinary citizens who contest against the Internal Revenue Service and the government on tax questions, and at the same time, promises equal benefits to the government as well. It is no small accomplishment for one piece of legislation to benefit both sides in what certainly is a very delicate and controversial area—the collection of income taxes. The legislation does this by assuring small taxpayers that they will have protection against any possible overreaching from the Internal Revenue Service. This is accomplished by allowing the award of attorney's fees and costs when the taxpayer prevails against the government in cases where the IRS truly had no business in bringing the case in the first place.

The Service has elaborate provisions to guard against harassment and overreaching by its agents and lawyers. The Service rightly views this as a most important principle because confidence in the quality and even-handedness of our internal revenue system is the key to its success. I know that the Commissioner, Jerome Kurtz, regards the building of this confidence as one of this highest priorities.

But even with the best of intentions, and even with the best of administrative operation, there are cases which are brought which shouldn't be. And more important, there are circumstances in which taxpayers will believe that they are being sued simply because the government has the greater resources and legal assistance to go after them. This legislation will go far towards reassuring the ordinary taxpayer that Congress intends the collection of taxes to be administered fairly and equitably. It is designed to help the small taxpayer who cannot easily afford the kind of legal assistance to which larger taxpayers and corporations have access. Thus this bill, even if not one penny is ever awarded under it, will vastly increase citizen confidence in the tax collection system.

It is for these reasons that I am pleased to find the Treasury Department and the Service have changed from their prior opposition to the legislation of this kind. I know that it is largely because of the interest, support, and hard work of the Department, and especially the late Assistant Secretary, Laurence Woodworth, and his successor Don Lubick, that we have reached the stage where this bill can be introduced with the support of the Treasury.

This is a significant step forward over previous efforts to provide government reimbursement for taxpayers who prevail in litigation with the government over taxes. It carefully avoids the twin pitfalls of needlessly encouraging litigation, while still not making unreasonably difficult taxpayer recovery when the government's case is without justification.

Again, I want to compliment especially Senator Baucus for being able to bridge the previously large gap that existed between the interests of the Internal Revenue Service and the interests of the small taxpayer. I look forward to working with him and the chairman and the other sponsors towards speedy enactment of the legislation.

Senator BAUCUS. I am personally delighted to have each of you here this afternoon, gentlemen. You are very well known in each of your areas. I have respected your work very much. You certainly know the area much better than do I. Therefore, I am happy to have the benefit of your knowledge. You may proceed in any way that you wish.

I do not care which one wants to go first. It is up to the three of you.

STATEMENTS OF DONALD C. LUBICK, ASSISTANT SECRETARY OF THE TREASURY FOR TAX POLICY, AND JEROME KURTZ, COMMISSIONER OF THE INTERNAL REVENUE SERVICE

Mr. LUBICK. Mr. Chairman, Senator Byrd. I ask that my statement be inserted in the record and, on behalf of the Treasury Department, I would like to touch on a few of the main points. After we hear from the Justice Department, we would be delighted to answer questions.

Senator BAUCUS. It would be best to proceed in that way. Let's hear from each of you first. I encourage each of you, if you so desire, to comment on any testimony you have heard preceding yours so we can get some interchange here, and a better reaction.

Mr. LUBICK. As you have pointed out in your opening remarks, generally under the American system of jurisprudence, we do not award attorney's fees to victorious litigants. The general policy of the American legal system is to encourage access to the courts, unlike the English system where attorneys' fees in heavy amounts may be awarded, which stifles access to the courts.

A number of persons have argued that in particular situations attorney's fees ought to be awarded on a one-way basis to redress Government abuses, or to accomplish some public interest which transcends the interest of the litigating parties, and that this is the situation in tax cases.

We have to recognize, as I believe you have, Senator Baucus, in your statement, that one-sided awards may discourage settlement and encourage and prolong litigation. Ultimately, this is at the expense of all taxpayers, not only with respect to the specific amounts of attorney's fees awarded, but also with respect to the congestion in the court system which causes delays in justice as well as the additional expense of maintaining the system.

Yet, we have come to the conclusion at the Treasury Department that where there is overreaching and abuse it may be appropriate

that the taxpayer, for the sake of fairness, be protected through the award of fees.

I think that we have to recognize that the Internal Revenue Service by and large is a responsible Government agency. My own personal experience in private practice is that the agents of the Internal Revenue Service, in doing their job, are the most responsible civil servants of any agency of Government. We have to be sure that the Internal Revenue Service is not deterred, in any way, from doing a reasonable job of insuring compliance with the tax laws.

As taxpayers who normally are not audited and meet voluntarily our tax burdens, we all feel somewhat put upon when we hear cases of taxpayers who do not pay their share of the tax burden. Therefore, as taxpayers, even though we want to be sure that the Government acts responsibly, we also want to be sure that all of us are shouldering our fair burden of taxes.

We also want to take into account the fact that the court system is very crowded. It is very difficult and time-consuming for taxpayers who need to get swift redress of their particular problems in litigation to get hearings.

At the present time, the number of cases in the Tax Court is over 24,000. Recently you enacted legislation to introduce a small case procedure in the Tax Court in order to help reduce this burden on the courts and to allow expeditious treatment of taxpayer claims. If we introduce a system whereby attorney's fees are paid for, and whereby we subsidize litigation, it would undermine this expeditious procedure.

We think, Senator Baucus, that you have done an excellent job of balancing these various interests in S. 1444 and that you have dealt with the situation of the taxpayer who, in some situations, may feel helpless.

Before you have referred to, what may appear to be the overwhelming might of the Internal Revenue Service. However, if you divide the number of Government attorneys which you have referred to into the number of cases and you compare that average case load with your own experience as a lawyer, you would come to the conclusion that it might be difficult for any lawyer to be overpowering if he had a case load that large.

Be that as it may, there is, in many instances, an inertia that is involved simply because the Government can continue and delay the litigation. Very frequently, that is very painful to the litigant on the receiving end. To the Government, it is one more matter and time becomes of less concern.

By balancing all of these considerations, your bill makes a constructive step forward. We are particularly pleased that you have chosen to do this on a trial basis for a limited period of time so we can evaluate the experience under this procedure and see whether, indeed, we have struck a balance between curbing abuses and allowing use, without encouraging overuse, of the judicial process.

I think that your requirement that the taxpayer must show that the Government's position in the litigation is unreasonable is a satisfactory test. We had a test that was essentially the same in legislation that we proposed last year.

We think, in cases where the Government acts reasonably, it is not appropriate to award attorney's fees. In trying to get at the

abuse cases while maintaining the integrity of the compliance process, it is necessary that there be no inhibiting factors where the Government acts reasonably.

You have taken into account the entire record as well as intrinsic evidence in determining whether fees should be awarded. We think that is appropriate.

Your use of an objective test, as opposed to the question of bad faith that turns on subjectivity, we think, is also appropriate. If courts are at issue with this question, we think that they ought to be able to deal with it on the basis of objective factors.

We also agree that one test of reasonableness is who wins, and the fact that the Government prevails on any significant part of the proceeding certainly is evidence that the Government position was reasonable.

I think that one knows when one goes to litigation, one does not tend to drop out any of the issues. You leave them all in there for resolution, for bargaining purposes.

Therefore, the fact that the Government wins on one significant issue ought to be sufficient protection.

I would like to suggest one thing if I may, and that is in order to maintain the inducement for settlement, we ought to add a provision to the bill that requires the taxpayer to exhaust his administrative remedies rather than a taxpayer going directly from the audit stage to court, in order to obtain attorney's fees. I think it would expedite the settlement of cases if we went in that direction.

Senator BAUCUS. Thank you very much, Mr. Lubick.

In hearing so much administration support of the bill, I'm beginning to think there might be something wrong with S. 1444.

Senator Byrd has a 3 o'clock commitment that he must make and he would like to ask a couple of questions and make a couple of observations.

Senator Byrd, I welcome you to the hearing and look forward to your observations.

Senator BYRD. Thank you, Mr. Chairman.

Mr. Secretary, I listened to your testimony and also read your detailed statement. It seems to me that it is reasonable and balanced.

I like your approach to this matter, with one exception, the way it was handled.

You say that the Government relies upon individual taxpayers to assess themselves and bear their share of the tax burden. I think the American people have a right to be proud of the overall record that the American people collectively have made over a period of years as you recognize.

You say in return, taxpayers expect the Government to administer the system fairly and evenhandedly. I think that is also the case.

You say that the Internal Revenue Service generally administers tax laws reasonably and equitably and I concur in that also.

Then you say in this instance, that when the Government overreaches, a taxpayer must not feel incapable of defending his interest and I think that that is an equally important point—a point to which this legislation is addressed.

And you mentioned in your closing part of your remarks:

We recommend that the bill allows attorneys' fees to be recovered only in those instances where a taxpayer has exhausted his administrative remedies before instituting court proceedings.

Offhand, without thinking it through, the thought seemed to me a reasonable proposal also.

Now, the only aspect of your testimony that I am not in substantial agreement with was the final, next-to-the-last paragraph:

Contrary to most other forms of litigation, the complexity of a tax case is generally related to the relative affluence of a taxpayer. Most persons with modest resources can litigate their tax cases without incurring the legal fees that might be incurred by a large, multinational company.

I do not disagree with what you say. I question the philosophy.

In the first place, bringing in multinational companies seems to me to be trying to prejudice the case, because most of the taxpayers who would be involved are not multinational companies at all.

Then you recommend a cap of $20,000. I do not take exception to that. However, I do not know whether or not it is an appropriate figure.

The only thing, I suppose, I take exception to is what appears to me to be the philosophy, namely that we must be fair with the small taxpayers but we do not have to give the same regard in the case of the larger taxpayers.

I have always thought that the Government is obligated to be fair to all individuals, regardless of whether they are a large taxpayer or a small taxpayer.

Mr. LUBICK. We certainly agree with that, Senator Byrd. We were not expressing any contrary philosophy, simply saying that if indeed you had no cap whatsoever, an allowance of unlimited attorney's fees, you would be going beyond the particular problem of dealing with those persons who are not able adequately to defend themselves.

We are concerned with those citzens who do not normally litigate and who would not normally go to court. Such persons do not normally get involved in litigation involving many complex issues.

We do not want this necessarily to subsidize to payments of $500,000 legal fees in litigation where the taxpayers are pretty capable of taking care of themselves.

Certainly no one wants to suggest that we do not treat all taxpayers fairly. Indeed, in my experience in representing large corporate clients as well as small clients from relatively small communities is that the agents do give fair treatment both ways.

Senator BYRD. Your idea of a cap is not an idea that I oppose at all. It may be appropriate—not only appropriate, but desirable.

I must say, now, until I read the reference to multinational corporations in your testimony, I really was not thinking of this legislation as affecting corporations and companies. I was thinking about it in the way it affected individual citizens.

In reflecting upon your testimony, I think it is appropriate that the legislation should apply to companies. As I say, I just feel that in enacting legislation we want to be sure that we are protecting all taxpayers fairly from the problem. Generally speaking the Service does a good job. But mistakes are made in an organization that size, and there are cases that could be considered inappropriate harrassment. The courts can judge that.

If it is so judged, it seems to me the taxpayer should be permitted to have the court costs paid regardless of whether they are a small or large taxpayer.

Mr. LUBICK. The bill so provides, up to $20,000. It does not matter whether you happen to be a multinational company. The multinational company would get the same relief as well.

Senator BYRD. Thank you. Basically, it is a good statement.

Mr. LUBICK. Thank you.

Senator BYRD. Thank you, Mr. Chairman.

Senator BAUCUS. Thank you very much, Senator; also, Mr. Lubick.

Who wants to proceed next?

Commissioner Kurtz?

Mr. KURTZ. I have no separate statement. I associate myself with Mr. Lubick.

Senator BAUCUS. Mr. Murray.

STATEMENT OF JOHN S. MURRAY, ACTING DEPUTY ASSISTANT ATTORNEY GENERAL, TAX DIVISION, U.S. TREASURY

Mr. MURRAY. Thank you, Mr. Chairman.

We have submitted, on behalf of the Tax Division of the Justice Department, and speaking for the Justice Department, a statement in the record.

The tenor of the statement is along the lines that you heard with respect to the Treasury Department. The proposed law should assist in giving our taxing system an appearance as well as a reality for fairness in our statement. We attempted to point out some concerns that we had with certain provisions which we hoped would be clarified, or at least fleshed out, in the legislative history that will ultimately accompany the enactment of making such provision.

One of the points, although it would not be an important one, a very important one, is that the amount of the fees to be awarded to a prevailing taxpayer should, in our opinion, be equal to the amounts actually expended. This is a standard which has been used in other acts, notably the Privacy Act and the Freedom of Information Act, because the intent of the legislation, as we perceive it, is to make the taxpayers whole from their battle with the Internal Revenue Service or the Justice Department, not to reward them and punish the offending agency.

Perhaps the legislative history will cover this situation of pro se taxpayers, taxpayers who represent themselves, and the extent, if any, that they would be entitled to remuneration under this provision; taxpayers represented by in-house counsel; taxpayers who have prepaid legal plans which, in effect, insure the expenditures that they incur in any such suit or contingent fee arrangements.

We, of course, would be pleased to work with your staff to the extent that we could have any input to that.

The point I intend to make here, the statute is to insure reimbursement and not reward, as we read the standards set forth therein.

I would like to, Mr. Chairman, if I may, focus in on the comments of Senator Domenici concerning the proper standard to be

used, the standard set forth in S. 1444, vis-a-vis the standard set forth in S. 265. Would that be appropriate for me to address it?

Senator BAUCUS. Yes. That is a question I was going to ask.

Mr. MURRAY. All right, sir.

S. 1444, as you are well aware, provides that prevailing taxpayers must establish that the position of the United States was unreasonable.

This has two aspects to it. On its face, it places a burden on the taxpayer. This, I submit, is appropriate and is a standard part of our American jurisprudence, that the party attempting to obtain something in a lawsuit bears the burden of the proof.

So that the attempt to obtain attorneys' fees here are not on the plaint of simply the plaintiff taxpayer should bear the burden of proving entitlement to the attorneys' fee.

In the various exceptions that the case law has cut out of the normal American rule that no attorneys' fees are allowed, they have all been clear that the burden is on the party seeking the fees.

The second facet of this S. 1444 standard is that the position of the United States is unreasonable. Unreasonable or reasonable is an accepted term of art in American jurisprudence.

The reasonable man standard has existed throughout common law.

While it is subjective in and of itself as to what is reasonable, it does have a cornerstone for a foundation in the law and we believe that the use of that term can arrive at a just result in any given situation.

When the court, faced with the award of attorneys' fees can view the totality of all the facts, but then state that the law and the precedent, the extent to which the Government was trying to swim upstream against six circuits, judging the identical issue against it, I would submit, on behalf of the Justice Department, we could live with and we believe the courts could live with and be comfortable with the standards set forth in S. 1444.

I respectfully submit that the standard in S. 265 not only reverses the normally accepted burden of proof and takes it from the party seeking the award, the plaintiff, and places it on the party from whom the award is sought—an unusual result—but it also injects a term—I will stand corrected—a term that has no real underpinnings in the law, substantially justified.

The fees will be awarded unless the Government shows such action was substantially justified.

I would submit that that term does not give much guidance to the courts or show them the way in which to frame a particular factual situation within that, because I would submit it was not a recognized term within common law.

So we would endorse most strongly the S. 1444 standard vis-a-vis the S. 265 standard.

I would be available to answer any other questions that the chairman would have.

Senator BAUCUS. I thank you, Mr. Murray.

Commissioner, do you have a separate statement?

Mr. KURTZ. I have no separate statement.

Senator BAUCUS. Let us focus more on the burden, since that was the last point raised here.

As I understand it, one of your main reasons why the burden of proof standard in the bill is so preferable to the S. 265 standard, is because normally the burden of proof should be upon the person seeking relief rather than upon the person from whom relief would be granted.

Do you have any other reasons why you feel that the burden should not be shifted to the Government—that is, besides the historical reason?

Mr. MURRAY. None that come readily to mind, Mr. Chairman.

Mr. LUBICK. I think, Mr. Chairman, what you are trying to do here is to deal with questions of harassment or abuse where the individual is overwhelmed by the system. You are not trying generally to introduce the concept of the payment of attorneys' fees. You are trying to get at the rare and unusual case.

You do not want to encourage any more litigation than you have to. You do not want people to hang on and litigate instead of settling cases, and it seems to us that a standard that indicates that it is the unusual case, the case where the taxpayer has gotten raw treatment, unreasonable treatment, that you are trying to get at.

It is consistent with that approach to require that the Government be found unreasonable, that the taxpayer show that he has been this sort of victim.

I think it is because of the fact that you are dealing with the unusual situation to prevent abuse that both the burdens should be on the taxpayer and the standard ought to be that the Government has not acted reasonably.

Where the system is operating as it should, where the Government has a reasonable position and the taxpayer has a reasonable position when they go to court, there is no need to intervene.

I believe that is justification for the approach you have adopted in your bill.

Senator BAUCUS. How much more of a chilling effect would there be if the standard were shifted? I assume IRS would be somewhat less inclined to prosecute or commence a judicial action. How much less?

Mr. KURTZ. It is very hard to say. I do not think we are talking about a large number of cases.

Just to start the process from the beginning, during the last fiscal year, we audited over 2 million tax returns. Agreement was reached on audit with the taxpayer in all but about 65,000 cases, a small percentage of 2 million returns audited.

Unagreed cases then generally go through an appeals function—a simplified, informal, across-the-table kind of settlement procedure. During the last fiscal year, about 59,000 cases were settled at the administrative appeals level. Most of the remaining unagreed cases go to court, and a substantial majority of these cases are docketed in the Tax Court.

These are very rounded numbers. Of the cases docketed in the Tax Court, about 90 percent are then settled prior to trial. The Tax Court would render opinions in only about 1,000 cases a year. Of that total——

Senator BAUCUS. 1,000 out of roughly what?

Mr. KURTZ. We start out with 65,000 disputes after the audit. Of course, we are talking about different fiscal years as they flow through the process. But in any given year when the Tax Court decides the case, only about 10 percent of the cases involve decisions wholly favorable to the taxpayer. The balance were either wins for the government or were split.

So in only about 10 percent of the cases decided by the Tax Court, a total of perhaps 100 cases, would the taxpayer satisfy S. 1444's requirement that the taxpayer prevail as to all or all but an insignificant portion of the amount or issues in controversy.

The problem is determining to what extent attorneys' fees provisions would encourage further litigation rather than settlement. That is an imponderable. That is why it is very difficult to measure the impact or cost of the provision.

If the proposed legislation would not effect the way taxpayers now proceed and the way the Government now proceeds, it is a relatively small number of cases.

To the extent that the proposed legislation changes the way taxpayers and the Government resolve controversies, then the problem may become greater.

Senator BAUCUS. Part of the problem, too, some taxpayers would say, that such a large number are settled and so few go to trial is because of the court costs, and so forth, and that is an imponderable, too.

I understand that it is difficult to pin this down in any way, but could you give me a little more precision that would state it somewhat more exactly? How many fewer cases might be brought if the standard were shifted as it is in S. 265?

Mr. KURTZ. If the standard were changed one way or the other?

Senator BAUCUS. Shifted from the present provisions in S. 1444 to the standard in S. 265 where Uncle Sam has to show that he was not acting unreasonably.

Mr. KURTZ. It would just be a wild guess. I just could not guess what the difference would be.

Senator BAUCUS. No way of guessing at all?

Mr. KURTZ. No.

Mr. MURRAY. You do know, as an attorney, if you have a shot to get your fees paid, you are going to hang in there, litigate. There is going to be some effect.

I agree with Jerry that it is not possible.

Senator BAUCUS. Which has the greater chilling effect, shifting the standard or requiring that all reimbursement come out of IRS rather than the general treasury?

Mr. LUBICK. I would say shifting the standard is more serious than from whose budget it comes, because we are very confident that the number of cases in which it would be demonstrated that the IRS has acted unreasonably is going to be small.

Mr. KURTZ. Let me say my estimate would be that the cost of our litigating the fee issue and the cost of litigating the additional cases that would be brought because of the potential for fee reimbursement will in my judgment far exceed the amount of reimbursement paid. I do not anticipate the actual amounts to be reimbursed to be significant.

Mr. LUBICK. That is the problem of removing the standard. If you have an easier standard to satisfy, you are going to have more people who are going to take a crack at it.

Again, the final result is not going to be the payment of a large number of fees. The diversion of lawyer time and court time to this type of issue is going to be the real cost to the IRS, the judicial system, and to all of us taxpayers.

Senator BAUCUS. It seems to me that the more you find shifting the standard objectionable, the more you should be able to, in some way, quantify the difficulties, the fewer number of cases brought, or the other problems such as litigating the amount of fees, and so forth.

I understand it is an imponderable.

If I make myself clear, if you object fairly strongly, you must in some way be able to identify somewhat precisely the reasons for the objection.

Mr. LUBICK. It would take the analysis, for example, of all cases in which the Government did not prevail. We would have to go back and look at every one of those cases, go into it and see whether or not it was a situation where the Government had a reasonable position or not.

Senator BAUCUS. You mean there are some? I did not know there were any.

Mr. KURTZ. If we looked, we would not find many.

Mr. LUBICK. That is what you would have to do. That would be a rather onerous task. That is why we cannot give you a number. We can speak from our own personal experiences. Other than cases where the Government was arguing with me, they are rarely unreasonable.

In practice, I have had illustrations where I think the fact that the Government was unreasonable ultimately prevailed. By and large, in practice, it is the rare case where there is not a reasonable basis for some sort of Government position.

Mr. MURRAY. Mr. Chairman, if I may volunteer something, I think that the use of the phrase "substantially justifies" impacts two ways: first it would impact, as I think you have been directing your thoughts, on the number of actions that the IRS would authorize to be commenced in court—basically collection-type actions over which we in the IRS have some control.

Second, the presence of that language in that statute would impact at the administrative level on the willingness of the IRS auditing agents to set up positions that they believe serve judicial scrutiny and development of a body of law. As a result, it would impact on the generation of the revenue, the testing of the various provisions of the Tax Code that need testing.

Senator BAUCUS. Let me shift just a little bit to the $20,000 ceiling. Do any of you have any reactions as to whether that is too high or low? Perhaps it should be indexed?

Mr. LUBICK. The limit in our bill originally was $10,000, which is a pretty good fee where I come from for handling a Tax Court case, if it is not extremely complex with a lot of factual and legal issues. So we think $20,000 is more than adequate.

I think since you have a relatively short trial period, there is no particular need to index it. When you go back to look at it at the end of that period, you can review that question.

Senator BAUCUS. We have 4 years and since inflation rises pretty quickly in 4 years, do you have any figures or indications on what the average attorneys' fees in tax cases are?

Mr. KURTZ. No, I do not have those figures, but one indication of what they are likely to be would be the indication of the size of the amount in controversy in the Tax Court cases that are decided. For fiscal year 1978, the Tax Court disposed—this does not include settlements—of 1,028 cases by either opinion or by court decisions.

Senator BAUCUS. One year?

Mr. KURTZ. One fiscal year, just the Tax Court. The district court has another set of figures. Perhaps we can just focus on these for the moment.

Of those 1,028 cases 581 involved amounts in controversy under $1,500.

Another 155 involved amounts in controversy between $1,500 and $5,000, and another 53 were between $5,000 and $10,000. Yet another 113 were between $10,000 and $50,000.

My guess would be that in none of those cases—where the amount in controversy is $50,000 or less, would the legal fees exceed $20,000.

Senator BAUCUS. And court costs?

Mr. KURTZ. That is just a guess, but certainly with up to $10,000 in dispute, you would not get $20,000 in fees. Out of 1,028 cases, only about 130 exceeded $50,000 in controversy.

Senator BAUCUS. Do you have any reason for thinking that the situation is any different in district court cases?

Mr. KURTZ. The district court cases generally involve larger sums of money, but they generally involve larger taxpayers.

The difference, of course, is that one must pay the tax before going into the district court, so you tend to be dealing with more affluent taxpayers.

Senator BAUCUS. Mr. Murray?

Mr. MURRAY. Of course, the cases brought in district courts can vary from $50 to $30 or $40 million. Obviously a $20,000 attorney's fee is not going to be, as we pointed out in our statement, of much help to Exxon or Slumber J or other major corporations that we currently have in litigation.

If the tenor of the legislation is to make them whole then, of course, no cap would be appropriate. But I would firmly urge that $20,000 would certainly cover the vast majority of our cases. We have no statistics on that.

Again, on the amount in controversy in district court cases that I can give you, it breaks down in almost the same way. You have about 18 percent of the cases over $50,000 in controversy in District Court.

Senator BAUCUS. What about the vast majority?

Mr. KURTZ. About 82 percent of the cases involve amounts in controversy of less than $50,000; about 24 percent are under $1,000.

Mr. LUBICK. I would like to point out one thing, Mr. Chairman. At one time, when we were developing proposals of this sort, we had suggested that the amount of fees be fixed as a percentage of

the amount in controversy. It was argued very strenuously by the congressional persons with whom we worked that they did not want that, because they wanted to protect the fellow who had a $500 matter on which, as a matter of principle, he wanted to resist the Government. Indeed, I think that is perhaps one of the cases where you are most concerned about Government overwhelming the small taxpayer.

There is a little bit at stake. It is a matter of principle. Darn it all, he wants to show the Government that he is right. The attorney's fees might, indeed, exceed the amount in question.

Senator BAUCUS. That raises another question that is fundamental. I have spoken to small businessmen—I mean very small with five or six employees—in Montana and one in particular told me he was quite upset—this was a few years ago.

He said that IRS auditors came in and combed his books time and time again until they could finally find something. In fact, he talked with them and they admitted they were going to keep looking, doggone it, until they found some discrepancy, regardless of how small it was. Sure enough, they found a discrepancy. It was not very large; it did not amount to much. But the IRS investigators and auditors were satisfied.

That reminds me, too, of the example that Senator DeConcini mentioned where somebody in his State apparently was audited seven times. Cases of that nature are not going to be taken care of by this bill, because they are basically administrative actions. Nevertheless, there are a significant number of taxpayers who feel, I think with some justification, that they are being harassed.

Certainly if the person I spoke with was speaking accurately—I have no reason to think he was not—that type of IRS conduct during audits is a harassment. How do we deal with those cases that are more prevalent and more numerous than the kinds of judicial harassment?

Your figures show most disputes are resolved before they go to court.

Mr. KURTZ. We now have a system in place and taxpayers are told if they are selected for audit and if they were audited within the preceding 2 years, on the issues in question and there was no change in the preceding audit, that absent extraordinary circumstances, the audit will be canceled.

Senator BAUCUS. When did you begin that?

Mr. KURTZ. That procedure has been in effect for at least a couple of years, several years, I think.

Frequently there are newspaper reports of that kind of thing that someone claims they have been audited a great number of times over a period of years, and I am sure it is possible for that to happen out of 136 million returns filed.

When we see that kind of report in the newspaper, we do look into the case, because it is not supposed to happen. We find invariably that that was not the case. That is, in many cases, it is not clear to people what is an audit.

For example, we match information documents—documents reporting payments of interest and dividends—against tax returns. If we find that someone has been paid interest and has not included it on their tax return, we send them a bill. That is not an audit.

If there is a mathematical error on a return filed, and we send back a correction notice, that is not an audit.

An audit is almost always a face-to-face meeting with an auditor or revenue agent. When we find these articles that appear about repetitive audits we find that they have been other kinds of contacts, not audits, because, as I said, the audits will not repeat unless there are repetitive changes.

If there is an audit that results in a significant change, that would not cause a cancellation of a subsequent audit the next year. But if there are prior no change audits, this will in the normal course cause the audit to be canceled.

An agent saying I am going to find something before I leave here is a matter that should be reported to the IRS Inspection Service.

I must say that my view of the situation is that, just as everyone has a duty under law to file a tax return, they have an obligation to cooperate if their return is selected for audit. That is a cost of living in this country under our self assessment tax system. We only audit 2 percent of returns that are filed in a particular year.

We could provide that we would reimburse taxpayers for the cost of every audit, but it would be very expensive and it seems to me that there are better ways to spend money. If there are disagreements on audits there is a very simple, inexpensive, convenient appeals system available to settle those disputes.

Senator BAUCUS. Why not modify the bill to allow some reimbursement at some stage in the administrative process? Would that meet any objection?

Mr. KURTZ. It is simply a question of how much money the Government wants to spend in this area and how much time should be taken.

Again, it seems to me that that is a basic cost of living under a voluntary compliance type of income tax system. I think your bill strikes the right mark—going only to the more extraordinary situation where the case is not resolved in the normal course.

With 18,000 agents and auditors in the field, obviously mistakes will be made, but we have a mechanism to correct them in a reasonably efficient way. It seems to me that taxpayers are entitled to reimbursement when that system breaks down, but when that system works, it seems to me that it is just a part of living under the income tax.

Senator BAUCUS. I want to thank you all very much. Unfortunately, we only have an afternoon to examine this question. There are several other panels of witnesses. I wish we could go into this more deeply.

I will be submitting some questions that I hope you will answer for the record.

Thank you Commissioner, Mr. Lubick and Mr. Murray. We appreciate your testimony very much.

[The material to be furnished follows:]

QUESTIONS SUBMITTED BY SENATOR BAUCUS AND THE TREASURY DEPARTMENT'S RESPONSES TO THEM

Question 1. Over a year ago, in testimony before the Seante Judiciary Subcommittee on Improvements in Judicial Machinery, you presented the Treasury Draft Bill permitting, in certain circumstances, awards of attorneys fees in civil tax litigation. Would you describe the major differences between this 1978 Treasury Draft Bill and

S. 1444, as well as the significance of these differences? Do you believe that S. 1444 would allow more taxpayers to recover fees than under the Treasury Draft?

Answer. Differences between S. 1444 and the Treasury draft bill include the following:

The standard for recovery is stated differently. The Treasury proposal would have required that the Government's position be "without any reasonable grounds." S. 1444 would require that the Government's position be "unreasonable." Both proposals would include a requirement that the taxpayer be sustained as to all, or all but an insignificant portion, of the amount in controversy.

The S. 1444 standard might be construed to be somewhat more liberal in permitting attorney fee recoveries.

The scope of covered cases would be broader under S. 1444 than under the Treasury draft bill. S. 1444 would apply to most collection actions whereas the Treasury draft was limited to cases involving a determination of correct Federal tax liabilities, litigation arising out of the revocation of status as a section 501(c)(3) organization, or judicial review of jeopardy assessment procedures.

By virtue of this broader case coverage, S. 1444 could be expected to permit more taxpayers to recover fees than would be permitted under the Treasury draft.

The ceiling on the recovery of attorney fees in any one proceeding would be $10,000 under the Treasury draft and $20,000 under S. 1444.

S. 1444 would terminate after 4 years, rather than after the 3-year trial period proposed in the Treasury draft.

Under S. 1444, attorney fees would be recovered from the budget of the agency conducting the litigation. The Treasury draft would have provided for recovery out of the general fund of the United States.

Question 2. How would you interpret the phrase "which is brought by or against the United States for the determination, collection, or refund of any tax, interest or penalty" in S. 1444? Do you believe this language would cover such actions as summons proceedings and wrongful levy actions?

Answer. The bill excludes criminal actions, State court proceedings, most declaratory judgment actions, and suits involving the competing claims of the United States and other creditors of the taxpayers (such as lien foreclosures and bankruptcy proceedings). Subject to these specific exclusions, we believe that the bill is intended to be read broadly to include such litigation as summons enforcement proceedings, wrongful levy actions, and enforcement of return preparer penalties, as well as suits to determine correct Federal tax liability.

Question 3. Would you give some specific examples of what you would consider, under the terms of this bill, an unreasonable Government position for which reimbursement of fees may be made?

Answer. The following are examples of instances where, under the terms of S. 1444, the Government's position in a tax matter might be found to be unreasonable:

The Government has lost a particular tax issue in several Circuit Courts. However, the issue is litigated in still another Curcuit.

The taxpayer establishes that the IRS received a payment from him as an officer of a delinquent employer and applied it to the employer rather than the employee portion of employment taxes in contravention of both an agreement with the taxpayer and the provisions of the Internal Revenue manual. The Service then asserted a 100 percent penalty against the officer.

The Service makes a jeopardy assessment calculation of illegal income from sale of narcotics; the amount of the assessment bears no rationale relationship to the facts and is held to be inappropriate in an action under Code section 7429 for review of jeopardy assessment procedures.

Question 4. S. 1444 provides that a party must be sustained as to all, or all but an insignificant portion, of the amount, or issues, involved. How would you interpret the word "insignificant?" How would you apply this requirement to cases (1) where there are split decisions; (2) where there are multiple issues of varying importance; and (3) where the actual magnitude of the tax liability involved in any single issue might be substantially greater than the amount in controversy in a single year because the issue is a reoccurring issue?

Answer. A dual purpose of S. 1444 should be borne in mind when interpreting the requirements that a party be sustained as to all, or all but an insignificant portion, of the amount (or issues) involved. We believe that the bill promotes the principle that taxpayers should not have to bear the cost of defending themselves against abusive governmental action. At the same time, it recognizes that the public would be ill served by a proposal that penalizes responsible tax administration and impairs the ability of taxpayers to obtain expeditious judicial decisions on tax controversies.

Within this framework, the standard for recovery is not a rigid one. The bill clearly indicates that attorney fees reimbursement should not be permitted in those cases where there is no clear-cut winner. But to define the term "insignificant" in exact percentage terms would seem to be undesirable. Application of the standard might take account of such factors as the presence of a recurring issue or, where no amount is in controversy, the relative importance of multiple issues. We believe that the court should retain some discretion in applying the standards for recovery; however, we endorse the effort of S. 1444 to limit that discretion through sensible legislative guidelines.

Question 5. Under the terms of S. 1444, do you agree that the date of filing the petition or complaint in court begins the period for which reimbursement may be provided?

Answer. A possible reading of the bill would limit recovery to those fees incurred after the taxpayer files a petition in Tax Court or a complaint for refund in District Court. The filing of the initial pleading formally commences the "civil action or proceeding" mentioned in the bill.

However, we would not object to a recovery for the fees incurred in preparing the initial pleading. In our view, the bill can be read to include such expenses directly attributable to the judicial proceeding. Perhaps the intent in this regard could be clarified, either through an amendment to the bill or through appropriate language in the Committee report.

Question 6. You have proposed that the bill should make it clear that in order to be eligible for reimbursement, a taxpayer must exhaust all administrative remedies before instituting a civil action. Why should a taxpayer have to go through additional delay and expense when it is clear, e.g., in prime issue cases, that further administrative appeal would be pointless? Would it be better just to leave that entire issue to the discretion of the court in determining the appropriateness of any award?

Answer. We believe that the administrative appeals process is vitally important to the smooth functioning of the tax system. Appeal to an IRS regional office is available to the taxpayer in the event he disagrees with the findings of an examining agent. Through the administrative process, about 85 percent of tax cases are settled without being docketed in the Tax Court, and over 95 percent of all controversies are resolved without trial.

In the absence of an administrative exhaustion requirement, S. 1444 might induce many taxpayers to circumvent the appeals procedure and to initiate needless litigation. The prospect of recovering attorney fees for court action would encourage some persons to file a Tax Court petition before discussing the disputed issues with the IRS. The Court docket could thereby be congested with cases that could have been resolved easily at an administrative stage if the parties has been willing to confer.

There will, of course, be some issues that cannot be reconciled at the administrative stage. However, many issues that may appear initially to be intractable can be resolved through a discussion by the parties of the facts and law involved in a particular situation. With the new, one-stage administrative appeal process, there should not be protracted prelitigation proceedings on those issues where a stalemate has clearly developed between the IRS and a taxpayer.

Question 7. You have stated your opposition to shifting the burden to the Government to show that it acted reasonably once the taxpayer prevails on the merits. Please give specific reasons for your opposition. Specifically then, how would taxpayers really be able to obtain evidence necessary to prove that the Government acted unreasonably?

Answer. S. 1444 takes a sensible approach to the attorney fees issue. It seeks to distinguish between abusive and responsible governmental actions. It recognizes that reasonable pursuit of debatable tax issues might be discouraged by enactment of an attorney fees bill that applies broadly to all prevailing taxpayers.

Our tax system could not function effectively if the Government conceded all close cases to taxpayers. Accordingly, we believe that, even in those cases where the taxpayer has prevailed, the Government has generally acted in a reasonable manner in litigating the issues. To place the burden on the Government to show reasonable action would be inconsistent with this presumption.

The question implies that taxpayers would be required to produce substantial evidence beyond the information elicited on the merits of the controversy. We do not believe that such additional evidentiary burdens would be required. It is our understanding that S. 1444 seeks to apply an objective standard in assessing the Government's position. The relative strength or weakness of the Government's case and the particular fact situation of the taxpayer could usually be determined from

the record of the case. The bill does not require that a taxpayer prove subjective malice or "bad faith" of IRS officials—a requirement that might involve presentation of substantial evidence unrelated to the substantive merits of the tax controversy.

Question 8. Would you agree that the bill should include expert fees as reimbursable expenses?

Answer. We do not object to the inclusion of expert fees as reimbursable expenses, as long as such fees are included in computing the $20,000 expense ceiling and the standard for awarding fees remains unchanged.

Questions Submitted by Senator Baucus and the Internal Revenue Service's Response to Them

Question 1. IRS Manual Supplement 42G-369, which was issued on September 26, 1977, refers to the possibility that attorneys fees may be awarded under the Civil Rights Attorneys Fees Award Act of 1976 where a taxpayer is "able to prove harassment or bad faith on the part of the IRS." This supplement then states that "all employees will strictly adhere" to the principles set forth in Revenue Procedure 64-22 "so as to avoid the application of" this Act. Revenue Procedure 64-22 sets forth the governing principles of IRS:

"The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by the examining officers when they have merit, never arbitrarily or for trading purposes."

"Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and consideration. It should never try to overreach and should be reasonably within the bounds of law and sound administration . . . ."

If S. 1444 is enacted, how would this directive be changed? Would you take additional steps to ensure that IRS' employees do in fact act reasonably, fairly, and responsibly in all dealings with taxpayers?

Answer. If S. 1444 is enacted, the IRS Manual will be updated in order to advise all IRS personnel of the provisions of the new law and how it should affect their work. I expect that the revised portion of the manual will continue to refer to Revenue Procedure 64-22 and will continue to require each employee to strictly adhere to its principles. I believe that the principles set forth in Revenue Procedure 64-22 constitute a proper description of the conduct we can and should expect of all IRS employees. I do not believe that the enactment of S. 1444 would change this.

I believe that IRS employees have a very good record in acting in a reasonable, fair, and responsible manner in their dealings with the public. Nevertheless there is always room for improvement. Regardless of whether S. 1444 is enacted, the IRS will do its utmost to take all steps which may become necessary to insure that its employees act in an appropriate manner.

Question 2. Should the bill make it clear that in order to be eligible for reimbursement, a taxpayer must exhaust all administrative remedies before instituting a civil action? Why should a taxpayer have to go through additional delay and expense when it is clear, e.g. in prime issue cases, that further administrative appeal would be pointless? Would it be better just to leave that entire issue to the discretion of the court in determining the appropriateness of the award?

S. 1444 should make it clear that in order to be eligible for reimbursement a taxpayer must exhaust all admistrative must exhaust all administrative remedies before instituting a court proceeding. The IRS' administrative appeals procedure has recently been streamlined in order to provide all parties with an effective means of settling disputes with a minimum burden to the taxpayer in terms of time and expense. Taxpayers are not required to participate in the appeals process before going to court. However, I feel that in the overwhelming number of cases the appeals process proves to be beneficial to all parties concerned and I think its use should be encouraged. The appeals process is generally an informal across-the-table settlement procedure. During fiscal year 1978, approximately 59,000 cases were settled in the administrative appeals process.

This benefits the court because it enables it to focus its limited time on the issues actually in dispute. It also saves time and money for all the parties because it enables them to concentrate on the precise areas in which they disagree.

I favor an administrative exhaustion requirement even though certain issues cannot be resolved at the administrative level. Often issues which initially appear to be of a nature which cannot be resolved turn out to be otherwise. Sometimes after all the facts are at hand the government relaizes that the issue in dispute is not what it first appeared to be and in fact can be settled. Sometimes after further discussion the taxpayer agrees that the government's position is correct. If the

administrative appeal results in a real stalemate the notice of deficiency can be issued expeditiously.

In the absence of an exhaustion of administrative remedies requirement, S. 1444 might induce many taxpayers to initiate needless litigation. The prospect of recovering attorney's fees would encourage some persons to file a petition with the Tax Court before discussing the issues in dispute with the IRS. The Court docket could thereby become congested with cases that could have been resolved at an administrative stage if the parties had been willing to confer.

I think it is important to note that in recent years when Congress has expanded the rights of taxpayers versus the government in court proceedings, it has often required that the taxpayers first exhaust their administrative remedies. Section 7428 (b)(2), 7476 (b)(3), 7477 (b)(2) and 7478 (b)(2) of the Internal Revenue Code are all examples of this. They all require an exhaustion of administrative remedies and were all enacted within the last six years.

The voluntary settlement process is dealt with in detail in response to your sixth question. For now I would like to stress that the IRS has only one level of administrative appeal. I think when one considers the role of the administrative appeal process in resolving disputes, requiring taxpayers to participate in a single level of administrative appeal can be easily justified.

Question 3. Under the terms of S. 1444, would you agree that the date of filing the petition or complaint in court begins the period for which reimbursement may be provided?

Answer. I would not be so restrictive. With respect to proceedings in the Tax Court I believe that reimbursement may begin to be provided for fees incurred after the date on which the taxpayer receives a notice of deficiency. However, I would recommend this only if coupled with a requirement that the taxpayer exhaust his administrative remedies. Otherwise, there is a significant incentive to ignore the appeals process and the overextended Tax Court would have yet a larger docket. With respect to proceedings in other courts where the amount of tax liability is at issue, I believe that reimbursement may begin to be provided for fees incurred after the date on which the taxpayer receives a notice of disallowance of a claim for refund or six months after the claim for refund is filed, whichever occurs first. In proceedings where the amount of tax liability is not at issue I think that reimbursement should begin with expenses directly related to the preparation of the complaint.

Question 4. Should litigation expenses incurred by taxpayers who represent themselves in pro se proceedings be reimbursable?

Answer. I do not think that taxpayers who represent themselves should be eligible to be reimbursed for attorney fees they would have incurred had they not represented themselves. One purpose of S. 1444 is to permit taxpayers to seek redress against unreasonable action on the part of the government without being deterred due to the high cost of adequate legal representation. That is, concern over the high cost of legal fees should not prevent taxpayers from taking legal action in such instances. Taxpayers who choose to represent themselves do not incur attorneys' fees. The high cost of attorneys' fees does not deter these people from bringing legal action. Permitting people who represent themselves to collect the equivalent of attorneys' fees would be reimbursing them for their time spent rather than for the expenses they incurrred. Reimbursement for time spent is a very different concept from reimbursement for expenses incurred and should be the subject of far more scrutiny and consideration than it has been up to this time.

On the other hand, I do believe the bill should permit reimbursement of related expenses actually incurred by persons who represent themselves to the extent the expenses are reasonable and would have gone into the fee an attorney would have charged. In addition, to the extent the bill permits reimbursement of court costs, persons representing themselves should be entitled to such costs.

Question 5. Would you agree that the bill should include expert fees as reimbursable expenses?

Answer. I would not object to a provision in S. 1444 which would include expert fees as reimbursable expenses provided that these fees are among those limited by the $20,000 ceiling and the standard for awarding fees remains unchanged.

Question 6. Would you describe the voluntary settlement process? What specific guidance is given IRS agents in settling cases? What information is provided taxpayers to ensure that they are aware of their rights in this process? What does IRS do to ensure that taxpayers will be fairly treated during this process and that the settlement will be equitable? Under what circumstances does IRS refuse to settle a case?

Answer. The attached Publication 556, "Examination of Returns, Appeal Rights, and Claims for Refund," describes the returns examination process and a taxpayer's appeal rights where the taxpayer does not agree with the results of an examination. The Service furnishes this pamphlet and other information to taxpayers at appropriate points in the tax administration process. For example, under present examination procedures, the initial contact letter explains IRS procedures and the taxpayer's appeal rights and advises the taxpayer of the availability of Publication 556. If agreement is not reached during examination, a written communication, Publication 5, is furnished the taxpayer explaining appeal rights and the preparation of protests in unagreed cases. In addition, Service examining officers are required to ask taxpayers whether they have any questions regarding the audit process, audit case selection procedures and appeal rights, and are instructed to answer those questions and furnish Publication 556 to any interested taxpayer.

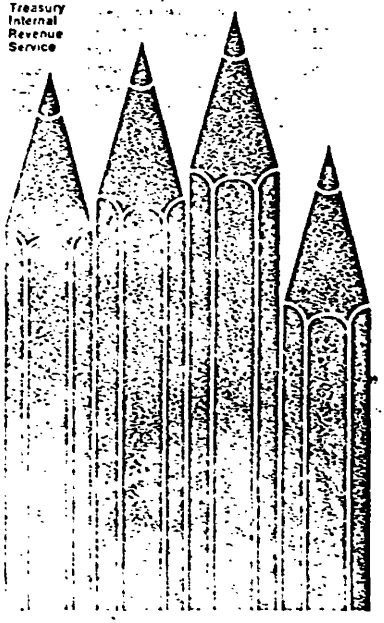
The examination process is aimed at determining the correct tax liability of a taxpayer. After the examination, the taxpayer may either agree or disagree with the results of the examination. "Settlement" beyond agreeing or disagreeing with the results of an examination can take place at the appeals level. Attached are Internal Revenue Service policy statements and a portion of the Internal Revenue Manual which describe the appeals function and its settlement practice and procedure.

Publication 556

Examination of Returns, Appeal Rights, and Claims for Refund

1979 Edition

Department of the Treasury Internal Revenue Service



Examination of Returns

Why Returns Are Selected for Examination

The usual reason for selecting a tax return for examination is to verify the correctness of income, exemptions, or deductions that have been reported on the return. Returns are primarily selected for examination by use of a computer program known as the Discriminant Function System (DIF). The DIF process is a mathematically based system that involves the assignment of weights to the entries on returns and the production by computer of a score for each return. The higher the score, the greater the probability of error in a return. Returns identified by DIF are then screened manually and those confirmed as having the highest error potential are selected for examination.

Returns may also be selected as part of the random sample under the Taxpayer Compliance Measurement Program (TCMP), which is the Service's long-range research program designed to measure and evaluate taxpayer compliance characteristics. Information obtained from TCMP is used to update and improve DIF.

The remaining returns are selected by other established selection methods, such as screening claims for refund of previously paid taxes and matching information documents (Forms W-2, 1099, and 1087).

The vast majority of taxpayers are honest and have nothing to fear from an examination of their tax returns. An examination of such a taxpayer's return does not suggest a suspicion of dishonesty or criminal liability. It may not even result in more tax. Many cases are closed without change in reported tax liability and in many others the taxpayer receives a refund.

Confidentiality of Tax Matters

You have the right to have your tax case kept confidential. The IRS has a duty under the law to protect the confidentiality of your tax information. However, if a lien or a lawsuit is filed, certain aspects of your tax case will become public knowledge.

The Internal Revenue Service has exchange agreements with state tax agencies under which information about any increase or decrease in tax liability on your state or federal return is shared with the other agency. If a federal tax return you have filed is changed, either by filing an amended return or as a result of being examined, it may affect your state income tax liability. It may be to your advantage to file an amended state tax return. Similarly, any change on your state income

tax return may affect your federal return. Contact your state tax agency or the Internal Revenue Service for more information.

If Your Return Is Examined

The examination may be conducted by correspondence, or it may take place in your home or place of business, an Internal Revenue Service office, or the office of your attorney or accountant. The place and method of examination is determined by the Internal Revenue Service, but we try to select the place and method that is most appropriate under the circumstances, taking into account the complexity of your return. If the method is not convenient for you, we will attempt to work out something more suitable.

Whatever method of examination is used, you may act on your own behalf or you may have someone represent you or accompany you. An attorney, a certified public accountant, an individual enrolled to practice before the Internal Revenue Service, or the person who prepared the return and signed it as the preparer, may represent or accompany you.

If you prefer, you do not have to be present at a routine examination if you have authorized one of these persons to represent you. Authorization may be made on Form 2848-D, *Tax Information Authorization and Declaration of Representative*, which is available at any Internal Revenue Service office, or by means of any other properly written authorization.

If you filed a joint return, either you or your spouse, or both, may meet with us.

Transfers to Another District

As a general rule, the examination of a tax return is made in the Internal Revenue Service District where the taxpayer files. However, in any case where the examination of your return can be completed more quickly and conveniently in another district, you may request that the case be transferred to that district. Transfers are usually based on circumstances such as:

1) Your place of residence is changed before or during the examination; or
2) Your books and records are kept in another district.

The Examination

The examination normally begins when we notify you by mail that your return has been selected for examination. You will also be notified of the method of examination and the records you will need to assemble in order to clarify or prove items reported on your return. By assembling your records beforehand, you may be able to clear up questionable items or arrive at the correct tax with the least trouble.

Upon completion of the examination, our examiner will explain to you, or your authorized representative, any proposed change in your tax liability. The examiner will also explain the reasons for the change. It is important that you understand any proposed change, so please don't hesitate to ask questions about anything that is not clear to you. Most individual examinations are agreed to and closed at this level, but you don't have to agree and you may appeal any proposed change.

Repetitive Examinations

We try to avoid unnecessary repetitive examinations of the same items, but this occasionally happens. Therefore, if your tax return was examined in either of the 2 previous years for the same items and the examination resulted in no change to your tax liability, please contact the person whose name and telephone number are shown in the heading of the letter you received as soon as possible. The examination of your return will then be suspended pending a review of our files to determine whether it should proceed. However, if your return was selected for examination as part of the random sample for TCMP, discussed earlier, this procedure for exemption from examination will not apply and your return must be examined.

If You Agree

If you agree with the findings of the examiner, you will be asked to sign an agreement form. By signing, you will indicate your agreement to the amount shown on the form.

If you owe any additional tax, you may pay it when you sign the agreement. Interest is charged on the additional tax from the due date of your return to the date you pay.

If you do not pay the additional tax when you sign the agreement, you will be mailed a bill for the additional tax. Interest is charged on the additional tax from the due date of your return to the billing date. However, you will not be billed for more than 30 days interest from the date you sign the agreement. No further interest or penalties will be charged if you pay the amount you owe within 10 days after the billing date.

If the examination results in a refund, the Internal Revenue Service can refund your money more promptly if you sign the agreement form. You will receive interest at the applicable rate on the amount of the refund.

Appeal Rights

If You Don't Agree

If you don't agree with the changes proposed by the examiner, and if the examination was made in an Internal Revenue Service office, you may request an immediate meeting with a supervisor to explain your position. If agreement is reached, your case will be closed.

If agreement is not reached at this meeting, or if the unagreed examination was made outside of an Internal Revenue Service office, we will send you (1) a transmittal letter notifying you of your right to appeal the proposed adjustments within 30 days, (2) a copy of the examination report explaining the proposed adjustments, (3) an agreement or waiver form, and (4) a copy of Publication 5, *Appeal Rights and Preparation of Protests for Unagreed Cases.*

If after receiving the examination report you decide to agree with the examiner's findings, you should sign the agreement or waiver form. You may pay any additional amount you owe without waiting for a bill. Make your check or money order payable to the Internal Revenue Service. Include interest on the additional tax, but not on penalties, at the applicable rate from the due date of the return to the date of payment. Please do not send cash through the mail.

If after receiving the examination report you decide not to agree with the examiner's findings, we urge you to first appeal your case within the Service before you go to court.

Because people sometimes disagree on tax matters, the Service maintains an appeals system. Most differences can be settled within this system without having to go to court.

If you do not want to appeal your case in the Service, however, you can take it directly to court.

The following general rules tell you how to appeal your case.

Appeal Within the Service

We now have a single appeal level within the Service. Your appeal from the findings of the examiner is to the Appeals Office in the Region. Conferences are conducted on as informal a basis as is possible.

If you want an appeals conference, address your request to your District Director in accordance with our transmittal letter to you. Your District Director will forward your request to the appeals office, which will arrange for a conference at a convenient time and place and will discuss the disputed issues fully with you or your representative. You or your representative should be prepared to discuss all disputed issues and to present your views at this meeting in order to save the time and expense of additional conferences. Most differences are resolved at this level.

If agreement is not reached at your appeals conference, you may, at any stage of the procedures, take your case to court. See *Appeals to the Courts,* later.

Written Protests

So that your case may get prompt and full consideration by the appeals officer, you may need to file a written protest with the District Director. You don't have to file a written protest, however, if:

1) The proposed increase or decrease in tax, or claimed refund, does not exceed $2,500 for any of the tax periods involved in field examination cases; or
2) Your examination was conducted by correspondence or by an interview at our office.

If a written protest is required, it must be submitted within the 30-day period granted in the letter transmitting the report of examination and should contain:

1) A statement that you want to appeal the findings of the examining officer to the Regional Director of Appeals;
2) Your name and address;
3) The date and symbols from the letter transmitting the proposed adjustments and findings you are protesting;
4) The tax periods or years involved;
5) An itemized schedule of the adjustments with which you do not agree;
6) A statement of facts supporting your position in any contested factual issue; and
7) A statement outlining the law or other authority upon which you rely.

The statement of facts under (6) must be declared true under penalties of perjury. This may be done by adding to the protest the following signed declaration:

"Under the penalties of perjury, I declare that I have examined the statement of facts presented in this protest and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

If your representative submits the protest for you, he or she may substitute a declaration stating:

1) That he or she prepared the protest and accompanying documents; and

2) Whether he or she knows personally that the statements of fact contained in the protest and accompanying documents are true and correct.

Representation

You may represent yourself at your appeals conference, or you may be represented by an attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service.

If your representative attends a conference without you, he or she may receive or inspect confidential information only in accordance with a properly filed power of attorney or a tax information authorization. Form 2848, *Power of Attorney and Declaration of Representative*, or Form 2848-D, *Tax Information Authorization and Declaration of Representative*, available from any Internal Revenue Service office, or any other properly written power of attorney or authorization may be used for this purpose.

You may also bring witnesses to support your position.

Appeals to the Courts

If you and the Service still disagree after your conference, or if you skipped our appeals system, you may take your case to the United States Tax Court, the United States Court of Claims, or your United States District Court. These courts are independent judicial bodies and have no connection with the Internal Revenue Service.

Tax Court

If your case involves a disagreement over whether you owe additional income tax, or estate or gift tax, or certain excise taxes of private foundations, public charities, and qualified pension plans, you may go to the United States Tax Court. To do this, ask the Service to issue a formal letter, called a ***statutory notice of deficiency.*** You have 90 days from the date this notice is mailed to you to file a petition with the Tax Court (150 days if addressed to you outside the United States).

The Tax Court hears cases only if the tax has not been assessed or paid. Therefore, you must be sure that your petition to the Court is timely filed. If it is not, the proposed liability will be automatically assessed against you. Once the tax is assessed, a notice of tax due (a bill) will be sent to you and you may no longer take your case to the Tax Court. You are then required by law to make payment within 10 days. If the tax remains unpaid after the 10-day period, the amount due will become subject to immediate collection. You should be aware that once the assessment has been made, collection of the full amount due may proceed notwithstanding your belief that the assessment was excessive. Publication 586A, *The Collection Process*, is available at your local Internal Revenue Service office to explain our collection procedures.

If you filed your petition on a timely basis, the Court will schedule your case for trial at a location convenient to you. You may represent yourself before the Tax Court, or you may be represented by anyone admitted to practice before that Court.

If your case involves a dispute of $1,500 or less ($5,000 or less starting June 1, 1979) for any one taxable year, a simplified alternative procedure is provided by the Tax Court. Upon your request, and with the approval of the Tax Court, your case may be handled under the Small Tax Case procedures. At little cost to you in time or money, you can present your own case to the Tax Court for a binding decision. If your case is handled under this procedure, the decision of the Tax Court is final and cannot be appealed. You can obtain more information regarding the Small Tax Case procedures and other Tax Court matters from the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

District Court and Court of Claims

Generally, the District Court and the Court of Claims hear tax cases only after you have paid the tax and have filed a claim for refund. As explained later under *Claims for Refund*, you may file a claim for refund if, after having paid your tax, you believe the tax is erroneous or excessive. If your claim is rejected, you will receive a statutory notice of disallowance of the claim. If we have not acted on your claim within 6 months from the date you filed it, you can then file suit for refund. A suit for refund must be filed not later than 2 years after we have disallowed your claim.

You may file your refund suit in your United States District Court or in the United States Court of Claims. You can obtain information about procedures for filing suit in either court by contacting the clerk of your District Court or the Clerk of the Court of Claims, 717 Madison Place, N.W., Washington, D.C. 20005.

Claims for Refund

How to Claim a Refund

Once you have paid your tax you have the right to file a claim for refund if you believe the tax is erroneous or excessive. You may claim a refund by filing Form 1040X, *Amended U.S. Individual*

Income Tax Return. You can obtain this form and information about filing it at any Internal Revenue Service office. You should file your claim by mailing it to the Internal Revenue Service Center where the original return was filed. Corporations should use Form 1120X or such other form as is appropriate for the type of refund claimed.

A separate form must be filed for each tax year involved. You should attach to such form a statement supporting your claim, including an explanation of each item of income, deduction, or credit on which you are basing your claim.

Time for Filing a Claim for Refund

A claim for refund must be filed within 3 years from the date the return was filed (returns filed before the due date are considered to have been filed on the due date) or within 2 years from the date the tax was paid, whichever date is later.

Limit on Amount of Refund

If you file your claim within 3 years of the date your return was filed, the credit or refund may not exceed the portion of the tax paid within a period, immediately preceding the filing of your claim, equal to 3 years plus any extension of time for filing your return.

If you do not file your claim within this 3-year period, the credit or refund may not exceed the portion of the tax paid during the 2 years immediately preceding the filing of your claim.

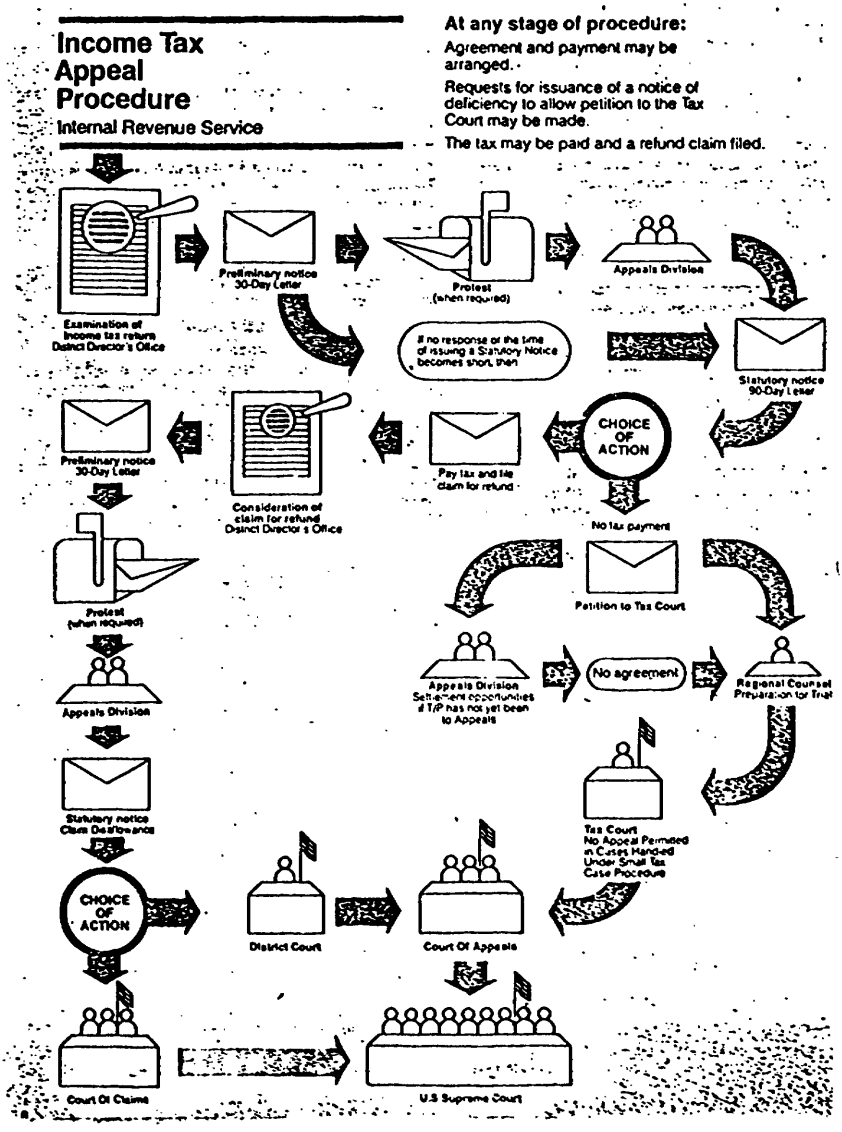
This general rule is subject to the following exception.

Exception for Special Types of Refunds

If your claim for credit or refund is based on a bad debt, worthless security, net operating loss carryback, capital loss carryback, foreign tax credit, or an investment credit carryback, or if you have entered into an agreement with the Internal Revenue Service extending the period for assessment of tax, you may be entitled to file your claim at a date later than stated under *Time for Filing a Claim for Refund*, and the limit on amount may not apply. In such cases, you should consult your Internal Revenue Service office for further information.

Processing Claims for Refund

Claims are usually processed shortly after they are filed. Your claim may be accepted as filed or may be subject to examination. If a claim is examined, the procedures are the same as in the examination of a tax return. However, if you are filing a claim for refund based solely on contested income tax or on estate or gift tax issues considered in previously examined returns and do not wish to appeal within the IRS, you should request in writing that the claim be immediately rejected. A notice of claim disallowance will then be promptly sent to you. Upon receipt of the disallowance you have 2 years to file a refund suit in the United States District Court having jurisdiction or in the United States Court of Claims.



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Appeal Rights and Preparation of Protests for Unagreed Cases

Department of the Treasury Internal Revenue Service

Publication 5 (Rev. 9-78)

Instructions

If You Agree

If you decide to agree with the examiner's findings in the enclosed examination report, please sign and return to that examiner the agreement form enclosed with our transmittal letter. By signing you will indicate your agreement to the amount shown on the form; and if you owe additional tax, you will stop an interest charge 30 days after filing the form.

Through June 30, 1975, interest is figured at the rate of 6 percent a year; from July 1, 1975, through January 31, 1976, interest is figured at 9 percent a year; from February 1, 1976, through January 31, 1978, interest is figured at 7 percent a year; and beginning February 1, 1978, interest is figured at 6 percent a year. No further interest (or penalties) will be charged unless you fail to pay the amount you owe within 10 days after the date of the notice you receive showing such amount. However, if you pay the tax when you sign the agreement form, interest stops immediately.

If you wish to pay, make your check or money order payable to the Internal Revenue Service. Include interest figured as explained above, on the additional tax (but not on penalties) from the due date of the return to the date of payment. Please do not send cash through the mail. If the examination results in a refund, the Internal Revenue Service can have your money refunded more promptly if you sign the agreement form. You will receive interest, figured as explained above, on the amount of the refund.

If You Don't Agree

If you decide not to agree with the examiner's findings, we urge you to first appeal your case with the Service before you go to court.

Because people sometimes disagree on tax matters, the Service maintains a system of appeals. Most differences can be settled in these appeals without expensive and time-consuming court trials.

If you do not want to appeal your case in the Service, however, you can take it directly to court.

The following general rules tell you how to appeal your case.

Appeal Within The Service

Appeals within the Service are handled by the Office of Regional Director of Appeals. If you decide to appeal, address your request for a hearing to your District Director in accordance with our letter to you enclosing these instructions. Your District Director will forward your request to the Appeals Office which will arrange for a hearing at a convenient time and place.

If agreement is not reached at the Appeals hearing, you may, at any stage of these procedures, take your case to court. See the last headings in this publication concerning appeals to the courts.

Written Protests

So that your case may get prompt and full consideration by the Appeals Officer, you need to file a written protest with the District Director. However, you don't have to file a written protest if:

(1) the proposed increase of decrease in tax, or claimed refund, does not exceed $2,500 for any of the tax periods involved; or

(2) your examination was conducted by correspondence or by an interview at our office.

If a written protest is required, it should be submitted within the 30-day period granted in the letter transmitting the report of examination and should contain:

1. A statement that you want to appeal the findings of the examiner to the Appeals Office;
2. Your name and address;
3. The date and symbols from the letter transmitting the proposed adjustments and findings you are protesting;
4. The tax periods or years involved;
5. An itemized schedule of the adjustments with which you do not agree;
6. A statement of facts supporting your position in any contested factual issue; and
7. A statement outlining the law or other authority upon which you rely.

A statement of facts, under 6 above, must be declared true under penalties of perjury. This may be done by adding to the protest the following signed declaration:

"Under the penalties of perjury, I declare that I have examined the statement of facts presented in this protest and in any accompanying schedules and statements and, to the best of my knowledge and belief, they are true, correct, and complete."

If your representative submits the protest for you, he or she may substitute a declaration stating

(1) That he or she prepared the protest and accompanying documents, and
(2) Whether he or she knows personally that the statements of fact contained in the protest and accompanying documents are true and correct.

Representation

You may represent yourself at your Appeals hearing, or you may be represented by an attorney, certified public accountant, or an individual enrolled to practice before the Internal Revenue Service. Your representative must be qualified to practice before the Internal Revenue Service. If your representative attends a hearing without you, he or she must file a power of attorney or a tax information authorization before receiving or inspecting confidential information. Form 2848, Power of Attorney, or Form 2848-D, Authorization and Declaration (or any other properly written power of attorney or authorization) may be used for this purpose. Copies of these forms may be obtained from any Internal Revenue Service office.

You may also bring witnesses to support your position.

Appeals To The Courts

If you and the Service disagree after your hearing, or if you skipped our appeals system, you may take your case to the United States Tax Court, the United States Court of Claims, or your United States District Court.

(However, if you are a nonresident alien taxpayer, you cannot take your case to a United States District Court.) These courts are independent judicial bodies and have no connection with the Internal Revenue Service.

Tax Court

If your case involves a disagreement over whether you owe additional income tax, estate or gift tax, or certain excise taxes of private foundations, public charities, and qualified pension plans, you may go to the United States Tax Court. To do this, ask the Service to issue a formal letter, called a notice of deficiency. You have 90 days from the date this notice is mailed to you to file a petition with the Tax Court (150 days if addressed to you outside the United States). If you do not file the petition within the 90-day period (or 150 days, as the case may be) the law requires that we assess and bill you for the deficiency.

The Court will schedule your case for trial at a location convenient to you. You may represent yourself before the Tax Court, or you may be represented by anyone admitted to practice before that Court.

In cases involving tax disputes of $1,500 or less for any year, there are simplified procedures. Information regarding these procedures and other matters relating to the Court may be obtained from the Clerk of the Tax Court, 400 Second St. N.W., Washington, D.C. 20217.

District Court and Court of Claims

You may take your case to your United States District Court or to the United States Court of Claims. Certain types of cases, such as those involving manufacturers' excise taxes, can be heard only by these courts. Generally, your District Court and the Court of Claims hear tax cases only after you have paid the tax and have filed a claim for refund. You can obtain information about procedures for filing suit in either court by contacting the Clerk of your District Court, or the Clerk of the Court of Claims. If we haven't acted on your claim within 6 months from the date you filed it, you can then file suit for refund. If we have disallowed your claim, a suit for refund must be filed no later than 2 years from the date of our disallowance.

8700
Settlement Practice and Procedure

8710
Appeals Settlement Function

8711
Settlement Objective

(1) The Appeals mission is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service (policy statement P–8–1). This policy is Appeals' general contribution towards achieving the Service mission ". . . to encourage and achieve the highest possible degree of voluntary compliance with the tax laws and regulations and to conduct itself so as to warrant the highest degree of public confidence in its integrity and efficiency." (Policy statement P–1–1.) In further support of the Service mission, Appeals may defer action on or decline to settle some cases, under policy statement P–8–47, where:

(a) required by other National Office-issued internal management documents, such as those suspending action on cases or those requiring coordination or control of identified matters with widespread impact; or

(b) such action would produce a greater positive effect on voluntary compliance than would be derived from settlement or other action on the case.

(2) A fair and impartial resolution is one which reflects on an issue-by-issue basis the probable result in event of litigation, or one which reflects mutual concessions for the purpose of settlement based on relative strength of the opposing positions where there is substantial uncertainty of the result in event of litigation.

(3) It is the experience of Appeals that thorough, reasonable, and objective consideration of all elements of a controversy will lead, in a large majority of cases, to resolution of the controversy on a basis agreeable to both the taxpayer and the Government. Agreement is not possible in all cases, however. A taxpayer may not agree with the Appeals conclusion as to the probable result in event of litigation, or to the extent of mutual concessions required where there is substantial uncertainty of litigating result, or may prefer to litigate for other reasons.

8712
Mutual-Concession Settlements

Case dispositions involving concessions by both the Government and the taxpayer for the purpose of settlement where there is substantial uncertainty in event of litigation as to how the courts would interpret and apply the law, or as to what facts the courts would find, are designated as mutual-concession settlements. Appeals is expressly authorized by policy statement P–8–47 to enter into such settlements. In such a case there is substantial strength to the position of both parties, so that neither party with justification, is willing to concede in full the unresolved area of disagreement. A resolution of the dispute involves concessions for the purpose of settlement by both parties based on the relative strength of the opposing positions. Forms 870–AD, Offer of Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and of Acceptance of Overassessment, type of agreement is generally used in mutual-concession settlements.

8713
Split-Issue Settlements

(1) Policy statement P–8–48 provides that Appeals may enter into settlements based on a percentage or stipulated amount of the tax in controversy, but that such settlement, identified as a "split-issue" settlement, should be used only where no other method of settlement is appropriate.

(2) A split-issue settlement is a form of mutual-concession settlement of an issue which, if litigated, would result in a decision completely for the Government or the taxpayer. The distinguishing feature of a split-issue settlement is that the agreed result would not be reached if tried.

(3) In deciding a split-issue settlement should be made, consider whether it has some effect upon later years, particularly in a carryover or carryback situation, and in most gift tax cases. If so, it is preferable that the split-issue settlement be expressed in terms of an adjustment of taxable income rather than in a percentage or an amount of tax.

(4) It is important that the taxpayer have a clear understanding of the effect of the split-issue settlement in terms of tax liability and taxable income. Either a closing agreement or a collateral agreement may be advisable.

8714
Nuisance Value Settlements

Policy statement P–8–47 provides that no settlement will be made if based on nuisance value to either party. Nuisance value is any concession that is made solely to eliminate the inconvenience or cost of further negotiations or litigation and is unrelated to the merits of the issues. Appeals neither exacts a concession nor grants a concession solely to relieve either party of such inconvenience or cost.

8720
Settlement Attitude and Approach

8721
Judicial Attitude Toward Settlement

(1) The judicial attitude is one which reasonably appraises the facts, law, and litigating prospects; uses sound judgment and ability to see both sides of a question; and is objective and impartial. Any approach which contemplates a maximum possible result in favor of the Government or a deficiency in every case is incompatible with a judicial attitude and the Appeals mission.

8721
Judicial Attitude Toward
Settlement—Cont.

(2) Advantage is not taken of a taxpayer's lack of technical knowledge. The Appeals Officer assists the pro se taxpayer in every way possible. In the absence of agreement, an explanation of further appeal rights is made.

8722
Case Evaluation for Settlement Purposes

(1) The settlement approach and elements of evaluation are not affected by the status of the case. An unacceptable settlement in nondocketed status does not become acceptable solely because it is reconsidered in docketed status; nor does it become more acceptable in a trial calendar period than it was in a prior period. This, of course, does not preclude recognition of changes in judicial interpretation of the law and changes in Service position. It is also recognized that in reconsideration of a case or trial preparation, additional facts may arise which could affect evaluation of the case.

(2) If the Appeals Officer would not recommend trial of an issue, such issue is conceded even though it may have some merit.

(3) Minor concessions are not made or accepted on the basis that the outcome of litigation is never absolutely predictable.

(4) Occasionally the Appeals Officer is faced with an issue where the "Golsen Rule" is applicable. The "Golsen Rule" originated with the case of *Jack E. Golsen*, 54 T.C. 742, (1970). In this case, the Tax Court held that it would follow the rule of law laid down by the Court of Appeals to which an appeal in the case before it would lie. Problems will arise in instances when the rule of law laid down by the local circuit conflicts with a Revenue Ruling, Revenue Procedure, or other announcement of Service position in regard to the same issue(s). In cases where the "Golsen Rule" is applicable, the Appeals Officer should consult with District Counsel as promptly as possible to determine the amount of litigation activity in other circuits and other relevant information on the Service's posture on the issue(s) involved.

8723
Partial Settlements

Negotiations should aim toward resolution of all issues in a case. If this cannot be done, the Appeals Officer should attempt to reach agreement with the taxpayer on all issues susceptible of resolution.

8730
Issues Which May Not be Appealed or Conceded

Appeals procedures are not available in the case of failure or refusal to comply with tax laws because of moral, religious, political, constitutional, conscientious or similar grounds. Such issues may not be conceded or given weight in settlement.

8740
New Issues and Reopening Closed Issues

8741
Introduction
[Supplemented by MS CR 87G-15]

(1) Policy statement P–8–49 provides that an issue on which the taxpayer and the District Director are in agreement should not be reopened by Appeals. A new issue should not be raised unless the ground for such action is substantial and the potential effect upon the tax liability is material.

(2) It is both the duty and responsibility of the Appeals Officer to conduct settlement negotiations in a manner which will foster confidence of taxpayers and their representatives in the fairness of the Service. There is no greater need for diplomacy, caution and exercise of sound judgment in appeals than in the raising of a new issue, or in reopening an issue where the taxpayer and the District Director are in agreement.

8742
Definitions

(1) Restrictions of policy statement P–8–49 do not apply to new issues raised by or for taxpayers. Therefore, the term "new issue" as used herein refers only to those new issues raised by Appeals for the Government.

(2) The reopening by Appeals of a previously agreed issue and the raising of a new issue by Appeals have the same implications and are, for all practical purposes, one and the same thing. Therefore, for purposes of this Section, reopening an agreed issue will be treated as the raising of a new issue.

(3) Tax Litigation Division defines an affirmative issue as, generally, an issue raised in the answer or amended answer which was not one of the adjustments in the notice of deficiency. For purposes of this Section and for consistency, Appeals will consider and treat such an affirmative issue as a "new issue."

(4) A new issue generally is anything "new" concerning a taxpayer's return, the examiner's report, or the notice of deficiency which the taxpayer did not cover in the protest or petition and which is being discussed by the Appeals Officer. A new issue in a nondocketed case is any possible adjustment to or change in the taxpayer's return or the district's report of examination which was not in contest when the case was received by Appeals and is raised or discussed by the Appeals Officer. A new issue in a docketed case is any possible adjustment to or change in an item affecting the taxpayer's tax liability which was not included in the notice of deficiency and is raised or discussed by the Appeals Officer after the petition is filed.

(5) The term "issue" is used in the broadest sense. It is not limited to a point in debate in which the parties take affirmative and negative positions. It is not limited to a point or matter in dispute. It includes any matter where

8742
Definitions—Cont.

the Appeals Officer injects a position contrary to the position originally or previously taken by the taxpayer or any Government representative. This does not mean that the taxpayer must dispute the Appeals Officer's position since there may be agreement at the time the matter is injected into the proceedings. Nonetheless, this matter would be an "issue" when injected into the proceedings. Moreover, merely commenting on or asking a question about an item on the return or in prior reports which is not an issue before Appeals constitutes the raising of new issue.

8743
General Guidelines

(1) New issues are not raised casually, indiscriminately, or haphazardly, and are never, under any circumstances, raised for bargaining purposes. To do so may cause extreme irritation to the taxpayer and result in a feeling that the Appeals Officer is interested solely in exacting revenue. It is likely that a taxpayer who has good

chance on the merits of the issues already raised would feel somewhat irked to have to face a new issue, even if it is a good one for the Government, and could be justifiably irritated with a situation where inquiries concerning new issues were more in the nature of a "fishing expedition" or "threat." When new issues are raised, taxpayers or representatives are to be so advised regardless of the stage of Appellate consideration.

(2) When a case has reached the Appellate Division, it is late in the administrative process to raise new issues. Appellate consideration is not an extension of the examination process. Further, the return has been audited by a Revenue Agent; a report has been reviewed by supervisors; and, in many instances, it has been considered by the district Conference Staff function. After such consideration of the return, the taxpayer has every right to expect that the differences have been identified.

(3) The Commissioner exercises administrative prerogatives provided by the Internal Revenue Code and the Secretary of the Treasury in administering the tax laws. Many circumstances require exercise of administrative prerogative. Audit Division cannot and does not examine all tax returns filed. Every possible adjustment is not always made to those returns which are examined. District Appellate Appeals Officers exercise mature judgment about whether to make adjustments not made by the Revenue Agent. For many reasons the Commissioner has established the policy under which Appellate will not raise new issues except under certain circumstances. Therefore, if a possible adjustment to a taxpayer's return or to prior reports is discovered by the Appellate Division but not made because such action would not be within the spirit of policy statement P-8-49, this would not constitute a serious administrative omission because it would be within the Commissioner's discretion in the administration of tax laws.

(4) Grounds for raising new issues are listed below.

(a) A new issue is not raised by Appellate to the taxpayer's detriment unless grounds for such action are substantial (strong, possessing real merit) and potential effect on tax liability is material (having real importance and great consequence). See policy statements P-8-1 and P-8-49. "Substantial" applies to the reason for raising the issue and means that there must be a strong reason, possessing real merit, for raising it. "Substantial" does not apply to the grounds for later making an adjustment. There must be some good, sound, substantial reason already existing in the record or known to the Appellate Appeals Officer to raise the issue. Mere suspicion or guess that something might be wrong with the item is not substantial. For example, if the District Director disallowed a claimed farm loss solely on the ground that it was a hobby and made no comment concerning the items making up the loss, there would not be substantial grounds for raising a new issue concerning the amount of loss, amount of any item making up the loss, or nature of any item making up the loss simply because the Appellate Appeals Officer merely suspected or guessed that the items had not been verified. On the other hand, if the examiner had indicated in the report that these items had not been verified, there would be good reason for the Appellate Appeals Officer, if he/she believed such action was necessary, to refer the case back to the District Director for such verification. If, in discussion of reasons for disallowance of the claimed farm loss, the District Director stated that some of the items of claimed expense were personal in nature, this would constitute substantial ground for the Appellate Appeals Officer either raising a new issue or referring the case back to the District Director for further information and investigation.

(b) "Substantial grounds" are those which cause an Appellate Appeals Officer to be quite certain, at the time a new issue (other than an alternative issue) is raised, that the Government will prevail if the issue is litigated. "Quite certain" does not necessarily mean 100 percent certain, but it does mean a very high degree of certainty. If an alternative issue or position represents the real issue which should be in controversy, certainly the Government's best position should be set forth even though it does not meet the "quite certain" test. If a new issue is an alternative issue or alternative position, grounds are substantial if it strengthens the Government's position over that relied upon by the District Director or if it represents correct legal theory and position of the Service on the transaction involved. However, if an alternative issue or position is quite weak, even though it strengthens the Government's position, it should not be raised.

(5) The burden of proof is upon the Government when it raises a new (affirmative) issue in a docketed case. Therefore, except in unusual circumstances, the issue should not be raised unless necessary provable facts to sustain the issue are readily available. Merely because the burden of proof is not immediately upon the Government when a new issue is raised in a nondocketed case does not mean that the standards for raising it should be less restrictive than the standards for raising a new issue in a docketed case.

(6) A new issue will not be raised unless the potential effect upon the tax liability is material. "Material" refers to amount of tax which would result from the adjustment for the new issue. Mature judgment must always be exercised in determining what is material just as in weighing all aspects of a case. Whether amount of tax is material depends upon whether it is material to the Government.

(7) A small amount of tax is never material regardless of the economic size of the taxpayer and even though the amount of tax may be large when compared to total tax liability shown on the return or change in tax liability previously proposed, the tax resulting from a new issue will rarely, if ever, be material in the usual office audit type case. On the other hand, if the amount of tax resulting from the adjustment is only a small percentage of tax liability shown on the return or change in tax liability previously proposed, it may be material if the amount is quite large.

(8) There may be instances when failure to correct an error will have an adverse effect on voluntary compliance

8743
General Guidelines—Cont. (2)

or may cause the burden of proof before the court to shift to the Government. In such cases, the error should be corrected because the effect on tax liability is material to the Government.

(9) IRM 8200 and 8600 emphasize importance of preconference preparation so that facts to be relied upon and issues, court decisions, and authorities to be discussed are known by the participants prior to the first conference. This avoids the element of surprise to participants at the conference. Therefore, it is important that any new issue to be discussed should be raised before the first conference if at all possible. In any event, taxpayer or representative should be advised on the raising of a new issue and offered an opportunity for discussion prior to taking any formal action such as the issuance of a statutory notice of deficiency.

(10) Policy statement P-8-49 puts limitations on raising new issues. Conversely, however, it does not require that a new issue which meets the tests of substantiality and materiality shall necessarily be raised by Appellate. The conclusion to raise or not to raise the new issue must take into account not only these policy criteria but also all surrounding facts and circumstances involved in the case, including compatibility with the Appellate mission and objectives. On the other hand, Appellate should not hesitate to raise a new issue when it is warranted. This is particularly applicable in situations in which the raising of a new issue may actually be conducive to an agreed disposition or may discourage misuse of the appeals process (e.g., purposely withholding important information for the Revenue Agent). The determination as to whether there has been a misuse or manipulation of the appeals process is based on strong evidence and not mere suspicion.

8744
Effect of District Action

In the examination of tax returns, there are no set rules which are inflexibly followed. Examiners must exercise a great deal of judgment in deciding the extent to which items on tax returns will or will not be verified. Also, practices will vary among examiners as to disclosure in workpapers or reports the extent to which items on the return were or were not verified. Therefore, a reviewed and approved report of examination can thereafter be accepted as correct and any item on the return not changed or commented upon in the report can be accepted as correct. But see IRM 8900 regarding Joint Committee cases. Unchanged items should never be questioned unless there is a substantial reason for such action.

8745
New Issues Raised by Taxpayer

The Appellate Division always gives full, fair and impartial consideration to a new issue raised by the taxpayer. If such an issue is based upon important evidence, such evidence should ordinarily be referred to the District Director for verification.

8750
Settlement of Related Cases

8751 [Supplied by DISC 2 876-167]
General Guidelines

(1) The best overall utilization of Service resources and the avoidance of whipsaw situations will be the primary considerations in deciding whether interrelated cases should be assembled and considered concurrently. See IRM 8252. Interrelated cases are those in which a determination with respect to an issue in one case has a direct tax effect on another case.

(2) A small related or interrelated case should ordinarily be considered on the basis of the record and requests should not be made that Audit develop further evidence or examine other returns. The fact that the Appellate Appeals Officer's determination is inconsistent with action taken in another small case should not influence the Appellate Appeals Officer. Any further action in a related case would be a function of the Audit Division.

(3) Settlements in related cases should not be made whereby a party clearly not liable under the facts agrees to a deficiency of a related taxpayer.

8752
Settlement Procedure in Whipsaw Cases

(1) A whipsaw situation may develop where a settlement in one case could have a contrary tax effect in another case and one of the taxpayers may later, when the period of limitations applicable to the other case has expired or is about to expire, file a claim on a basis inconsistent with the prior closing.

(2) Additional action may be necessary in order to protect the Government's interest in a whipsaw situation.

(a) If a material amount of tax is involved and there are litigating uncertainties, the use of a closing agreement is ordinarily warranted.

(b) In the absence of circumstances stated in (a) above, a collateral agreement may be obtained if it is considered useful to express in writing the understanding of the parties. However, a collateral agreement does not have the legal effect of a closing agreement.

(c) For use of closing agreements and collateral agreements in related cases, see text 122:(2)(j), 123, 523, and 611:(3) of IRM 8(13)10, Closing Agreement Handbook.

8753
Settlement Procedure—Interrelated 100-Percent Penalty Cases

(1) Generally, the Government may compromise the liability of one responsible person without prejudicing its rights against others. This is believed to be true whether the assessment is made against one person or the assessment names more than one responsible person; however, in the event of a multiple assessment, to avoid potential litigation a legal opinion as to the effect of the settlement on other named responsible persons should be requested.

(It is the practice of the Service to make separate assessments against responsible persons and it is unlikely that a multiple assessment work unit will be encountered.)

(2) One hundred percent penalty cases should be evaluated for settlement using the same criteria as any other case.

(3) To make effective use of the 100-percent penalty as a collection device, the Department of Justice may sometimes interplead all potential responsible persons in 100-percent penalty refund suits. Therefore, in multiple-person cases where agreement and payment of the total correct outstanding liability cannot be secured, closing agreements shall not be used. The responsible person signing agreement Form 2751, Proposed Offer of Agreement to Assessment, etc., should be informed of the potential reopening of the case, and the closing letter should be modified to state that settlement is subject to reopening at the request of the Department of Justice. The total correct outstanding liability is the proposed outstanding liability as modified by meritorious argument as to the amount in question.

(4) The use of closing agreements or Form 2751-AD, 100% Penalty—Offer of Agreement to Assessment and Collection, etc., may be appropriate in multiple-person cases where payment of the total correct outstanding liability is secured, and in intermediate settlements with single responsible persons.

(5) In cases where there is doubt as to collectability as well as doubt as to liability, an appropriate offer in compromise may be filed with the District Director. If there is no substantial doubt as to liability but there is doubt as to collectability, an offer in compromise based solely on doubt as to collectability may be filed with the District Director. For procedures in such cases, see IRM 8(12)30.

8760
Settlement in Fraud Cases

(1) If the period of limitations for assessment has expired except for fraud, and it is concluded that the evidence of fraud is insufficient to warrant litigation, the deficiency in tax as well as the fraud penalty should be conceded in full.

(2) If the period of limitations for assessment has expired except for fraud, and it is concluded that the evidence warrants litigating the penalty in a nondocketed fraud case, a closing agreement should be executed where a mutual concession settlement is worked out for a deficiency with no fraud penalty or a fraud penalty representing less than 50 percent of the underpayment but greater than zero. The closing agreement determining tax liability provides legality of assessment and finality of settlement. Also see IRM 8246.

(3) In such a mutual concession settlement with a closing agreement, tax liability should not be converted to fraud penalty solely to reflect the penalty in the settlement; and fraud penalty should not be converted into tax solely to avoid the appearance of penalty.

(4) For special provisions in cases involving recommendation for criminal prosecution, see IRM 8(15)00. For requirement of Counsel concurrence in the elimination of fraud penalty in connection with a case involving recommendation for criminal prosecution, see IRM 8246 and Delegation Order No. 66, as revised, (Exhibit 8100-5).

8770
Settlements That Affect Later Taxable Years

(1) Issues such as reasonableness of salaries, capital gain v. ordinary income on recurring sales of property, hobby losses, etc., are resolved on the basis of the facts and circumstances applicable to each year separately. In such cases settlement has no effect on later years in which a similar issue may arise. The Appeals Officer should be sure that the taxpayer understands this.

(2) Where settlement involves issues such as basis of property, category of income, or amount of income from installment collections, it may be desirable to incorporate the effect on later years into the settlement by use of a closing agreement or collateral agreement.

(a) Where the disposition involves mutual concessions and the subsequent tax effect is material, a closing agreement should be executed. Where there are no mutual concessions or where the tax effect is not material, a closing agreement is not required, but it may be executed if in the judgment of Appeals it is desirable or the taxpayer requests a closing agreement.

(b) Where a closing agreement is not required, a collateral agreement may be obtained since it will express in writing the understanding of the parties as to the tax effect in later years.

8780
Reopening Closed Cases

(1) Policy statement P-8-50 states the policy of the Service concerning the reopening of cases previously closed by Appeals. The reference in the policy statement to a case closed on a basis of concessions made by both Appeals and the taxpayer refers to a nondocketed case closed by Form 870-AD type of agreement. The reference in the policy statement to a case closed on a basis not involving concessions made by both Appeals and the taxpayer refers to a nondocketed case closed by other than a Form 870-AD type of agreement; for example, a case closed by Form 870 or similar forms described in IRM 8800, or closed by reason of failure of the taxpayer to file a timely petition with the United States Tax Court following issuance of a statutory notice of deficiency by Appeals, or an excise or employment tax case closed without agreement as to assessment.

(2) Under policy statement P-8-50, approval is not required to reopen previously closed cases as follows:

8780
Reopening Closed Cases—Cont.

(a) To allow carrybacks provided by law which were not taken into account in a prior closing.

(b) To assess excessive portion of a tentative allowance.

(3) Further, approval is not necessary to adjust matters previously reserved by the Government or by the taxpayer in an agreement.

(4) Under policy statement P–8–50, the Director, Appeals Division, may authorize, in advance, reopenings of similar classes of cases. Such advance approval has been given to redetermine tax liability under former IRC 270 where deductions attributable to a trade or business exceed gross income by $50,000 for each of five consecutive years. This is in accord with Rev. Rul. 66–270, 1966–2 C.B. 106.

8790
Disagreements to Appeals Determinations

Disagreements with Appeals determinations by district offices are subject to regional procedures. If, at the discretion of the Regional Director of Appeals, it is considered necessary to obtain the assistance of the Appeals Division, National Office, concerning any such disagreement, the matter may be referred to the National Office, Attention: CP:AP:SS, under a memorandum setting forth the information desired as precisely as possible to assist in obtaining a prompt reply.

P-8-48 *(Approved 12-23-60)*
"Split-Issue" settlements considered under certain circumstances

Appeals may consider and accept proposals for settlement which are based on a percentage or on a stipulated amount of the tax in controversy. However, this type of settlement, identified as a "split-issue" settlement, should be used only in those cases in which no other method of settlement is appropriate.

P-8-49 *(Approved 12-23-60)*
New issues not to be raised unless material

An issue, on which the taxpayer and the office of the District Director are in agreement, should neither be reopened by Appeals nor should a new issue be raised, unless the ground for such action is a substantial one and the potential effect upon the tax liability is material.

P-8-50 *(Approved 4-13-73)*
Mutual concession cases closed by Appeals will not be reopened by Service except under certain circumstances

A case closed by Appeals on the basis of concessions made by both Appeals and the taxpayer will not be reopened by action initiated by the Service unless the disposition involved fraud, malfeasance, concealment or misrepresentation of material fact, or an important mistake in mathematical calculation, and then only with the approval of the Regional Director of Appeals.

Requirements for reopening mutual concession cases at taxpayer's request

Under certain unusual circumstances favorable to the taxpayer, such as retroactive legislation, a case closed by Appeals on the basis of concessions made by both Appeals and the taxpayer may be reopened upon written application from the taxpayer, and only with the approval of the Regional Director of Appeals. The processing of an application for a tentative carryback adjustment or of a claim for refund or credit for an overassessment (for a year involved in the prior closing) attributed to a claimed deduction or credit for a carryback provided by law, and not included in a previous Appeals determination, shall not be considered a reopening requiring approval. A subsequent assessment of an excessive tentative allowance shall likewise not be considered such a reopening. The Director, Appeals Division, may authorize, in advance, the reopening of similar classes of cases where legislative enactments or compelling administrative reasons require such advance approval.

Non-mutual concession cases will not be reopened by Service except under certain circumstances

A case closed by Appeals on a basis not involving concessions made by both Appeals and the taxpayer will not be reopened by action initiated by the Service unless the prior disposition involved fraud, malfeasance, concealment or misrepresentation of material fact, an important mistake in mathematical calculation, or such other circumstances that indicates that failure to take such action would be a serious administrative omission, and then only with the approval of the Regional Director of Appeals.

Requirements for reopening non-mutual concession cases at taxpayer's request

A case closed by Appeals on a basis not involving concessions made by both Appeals and the taxpayer may be reopened by the taxpayer by any appropriate means, such as by the filing of a timely claim for refund.

(P-8-51—P-8-60 are reserved)

TRANSFER OF CASE FILES AND SETTLEMENT JURISDICTION

P-8-61 *(Approved 12-23-60)*
Transfer of nondocketed cases

An Appeals official is authorized to transfer settlement jurisdiction in a nondocketed case or in an excise or employment tax case to another region, if the taxpayer resides in and his/her books and records are located (or can be made available) in such other region. Otherwise, transfer to another region requires the approval of the Director, Appeals Division.

P-8-62 *(Approved 12-23-60)*
Transfer of docketed cases

An Appeals official is authorized to transfer settlement jurisdiction in a docketed case to another region if the location for the hearing by the United States Tax Court has been set in such other region, except that if the place of hearing is Washington, D.C., settlement jurisdiction shall not be transferred to the region in which Washington, D.C., is located unless the petitioner resides in and his/her books and records are located (or can be made available) in that region. Otherwise, transfer to another region requires the approval of the Director, Appeals Division.

APPEALS FUNCTION

P-8-1 *(Approved 3-26-79)*
Appeals mission

The Appeals mission is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer and in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service.

(P-8-2—P-8-11 are reserved)

PRE-90-DAY AND PROTESTED EXCISE AND EMPLOYMENT TAX CASES

P-8-12 *(Approved 12-23-60)*
Consideration of new evidence by District Director

If a taxpayer submits evidence for the first time while the case is under consideration by Appeals, such activity in the reasonable exercise of its discretion may transmit same to the District Director for his/her consideration and comment.

P-8-13 *(Approved 12-23-60)*
Unnecessary consents not to be secured

Consents extending the statutory period for assessment on tax returns under jurisdiction of the Appeals Office shall be secured only when they are necessary to protect the Government's interest. Extension of the statutory period in such consents shall be limited to the additional time required for completion of closing action.

(P-8-14—P-8-23 are reserved)

90-DAY CASES

P-8-24 *(Approved 12-23-60)*
Conferences not granted in 90-day cases in absence of unusual circumstances

If a taxpayer had an Appeals conference in the prestatutory notice status, or if the opportunity for such a conference was accorded but not availed of, there will be no Appeals conference granted in the 90-day status after the mailing of the statutory notice of deficiency, in the absence of unusual circumstances.

(P-8-25—P-8-34 are reserved)

PRACTICE AND CONFERENCE PROCEDURE

P-8-35 *(Approved 8-29-77)*
Requirements for Appeals consideration in non-docketed cases: exceptions provided

In order to bring an unagreed case before Appeals, the taxpayer or the representative should generally first file with the district office, service center or Office of International Operations a written protest setting forth specifically the reasons for refusal to accept the findings. If the protest includes a statement of facts upon which the taxpayer relies, such statement should be declared to be true under the penalties of perjury. The protest and any new facts, law, or arguments presented therewith will be reviewed for the purpose of deciding whether further development or action is required prior to referring the case to Appeals. Where Appeals has an issue under consideration it may, with the concurrence of the taxpayer, assume jurisdiction in a related case, after the office having original jurisdiction has completed any necessary action. The Director, Appeals Division, may authorize the regional Appeals Office to accept jurisdiction (after any necessary action by office having original jurisdiction) in specified classes of cases without written protests provided written or oral requests for Appeals consideration are submitted by or for each taxpayer.

P-8-36 *(Approved 12-23-60)*
Conference rights of taxpayer with reviewing officer

Where the Appeals representative recommends acceptance of the taxpayer's proposal of settlement, or, in the absence of a proposal, recommends action favorable to the taxpayer, and said recommendation is disapproved in whole or in part by reviewing officer in Appeals, the taxpayer shall be so advised by such reviewing officer and upon written request shall be accorded a rehearing before such reviewing officer. The Appeals Office may disregard this rule where in the interests of the Government would be injured by delay, as for example, a case involving the imminent expiration of the statute of limitations, dissipation of assets, etc.

(P-8-37—P-8-46 are reserved)

SETTLEMENT PRACTICE AND PROCEDURE

P-8-47 *(Approved 3-26-79)*

Appeals will ordinarily give serious consideration to an offer to settle a tax controversy on a basis which fairly reflects the relative merits of the opposing views in the light of the hazards which would exist if the case were litigated. However, no settlement will be made based upon nuisance value of the case to either party. If the taxpayer makes an unacceptable proposal of settlement under circumstances indicating a good-faith attempt to reach an agreed disposition of the case on a basis fair both to the Government and the taxpayer, the Appeals official generally should give an evaluation of the case in such a manner as to enable the taxpayer to ascertain the kind of settlement that would be recommended for acceptance. Appeals may defer action on or decline to settle some cases or issues (for example, issues on which action has been suspended nationwide) in order to achieve greater uniformity and enhance overall voluntary compliance with the tax laws.

QUESTIONS SUBMITTED BY SENATOR BAUCUS AND THE DEPARTMENT OF JUSTICE'S RESPONSES TO THEM

Question 1. Would you briefly describe the procedures involved when a civil tax case is referred by IRS to the Justice Department? What consideration does Justice make in determining whether or not the Government should litigate a particular case? In other words, if IRS changes its mind, decides that the taxpayer was right and that the case should be dropped, can Justice still go ahead and litigate the case?

Answer. The Department of Justice receives a suit letter requesting the commencement of litigation when the Internal Revenue Service desires to institute a suit, for example to reduce a tax assessment to judgment or to foreclose a tax lien. When the action consists of a suit against the Government, such as a refund case, the Internal Revenue Service is notified of the case immediately and it prepares a letter in which it outlines its recommendations concerning defense. In either instance, the Department of Justice reviews the available files and the Service's recommendation in deciding whether to commence or defend the litigation. The review encompasses both the legal and factual aspects of the case, while taking into account that factual issues can and will be further developed during the course of the litigation.

After a case is referred to the Department of Justice, the Department is responsible for prosecuting or defending the litigation and is by law not bound by the recommendations of the Internal Revenue Service. However, under an agrement between the Department and the Service, no case will be conceded unless the views of the Service are sought and the Service's views concerning settlement are also sought, except in refund suits as to which the Service's defense letter advises us that the Department can settle the case on the best terms obtainable.

If the Service decides that a particular case should be conceded, the likelihood is that the case will be conceded. The Department carefully reviews such cases, however, especially to insure that issues that could have been raised in defense have not been overlooked. Although the Department has the authority to continue such litigation, that authority is rarely exercised. A much more frequent occurrence is that the Service desires continued prosecution or defense when our attorneys believe that the case should be conceded. In those situations, we will try to convince the Service that its position is erroneous. If the Service remains steadfast in its views, we will generally resolve the question in accordance with our client's wishes.

Question 2. How is the "unreasonable" standard in S. 1444 different from the *Christianberg Garment Company* Supreme Court language that the action must be "frivolous, unreasonable, or without foundation," "meritless or vexatious?"

Answer. In our view, the standard contained in S. 1444 would permit a somewhat more liberal allowance of attorneys' fee awards than the *Christianberg Garment* standard. Although both standards utilize the term "unreasonable," the meaning of the term as used in *Christianberg* is colored by the associated terms and phrases of the *Christianberg* test. The terms "frivolous," "without foundation," and "meritless or vexatious" would seem to require a degree of irresponsibility that would not be required if the term "unreasonable" stood alone, such as in S. 1444. Thus, for example, continued litigation of an issue as to which adverse precedent existed in several circuits would not likely meet the *Christianberg* test where the Government was attempting to get a vehicle for Supreme Court review. Nonetheless, continued litigation of the issue might be viewed as "unreasonable" under S. 1444 on the grounds that the Government should subsidize the costs incurred by a losing taxpayer in that situation. In our view, the standard contained in S. 1444 would provide a lower and more easily met threshold than the *Christianberg* standard.

Question 3. Under the provisions of S. 1444, do you believe that, if unreasonableness is not shown, a taxpayer would, in the alternative, still be entitled to award of court costs under the general provisions of Title 28 of the United States Code?

Answer. The bill is ambiguous on this point, but could be read to supplant the provisions of 28 U.S.C. § 2412 which S. 1444 would designate as Section 2412(a). The ambiguity could and should be cured perhaps by inserting into proposed Section 2412(b) the phrase "Except to the extent provided by subsection (a)."

Question 4. Would you comment in more detail on the provision in S. 1444 which requires that the payment of such awards be made out of the general appropriations of the agency conducting the civil action or proceeding?

Answer. The Administration supports the concept that attorneys' fee awards be satisfied by agency appropriations, rather than by the judgment fund. S. 1444 would apparently require, however, that the award be satisfied out of the appropriations of the agency conducting the litigation. Leaving aside the difference in the applicable standard, the Department prefers the approach that was taken in its draft attorneys' fee legislation under which: Any award of fees and other expenses * * * shall

be paid by the department or agency of the United States whose position has been found to be arbitrary, frivolous, unreasonable, or groundless * * *.

Question 5. Should litigation expenses incurred by taxpayers who represent themselves in pro se proceedings be reimbursable?

Answer. Actual expenses incurred *pro se* taxpayers should be reimbursed.

Question 6. With respect to the burden of proof set forth in the bill, how would taxpayers really be able to obtain evidence necessary to prove that the Government acted unreasonably?

Answer. We believe that in cases that are actually litigated the trial record would generally provide an adequate basis upon which the court could make a determination concerning whether the position taken in the litigation by the United States was unreasonable. Indeed, although there have been a few instances in which the courts have required an evidenciary hearing on this point in cases governed by the Allen amendment, most of the courts that have encountered the problem has proceeded to a decision based entirely on the trial record. Since S. 1444 would encompass cases that are settled, as well as those actually litigated, evidenciary hearings would be necessary in those cases should S. 1444 be enacted. The courts can, of course, permit discovery through interrogatories, or by other means, of evidence concerning this issue.

[The prepared statements of the preceding panel follow:]

STATEMENT OF THE HONORABLE DONALD C. LUBICK
ASSISTANT SECRETARY (TAX POLICY)

Mr. Chairman and members of the Subcommittee:

I am pleased to present today the views of the Department of the Treasury with respect to S. 1444, "the Taxpayer Protection and Reimbursement Act." This bill provides for the reimbursement of attorney fees to prevailing parties in tax cases where the Government's position in the litigation is found to be unreasonable. The Treasury Department supports S. 1444.

CURRENT LAW

We recognize at the outset that S. 1444 departs from the general procedures for payment of attorney fees in our court system. Under the so-called "American rule," each party in litigation ordinarily pays his own legal fees whether the case involves private litigants or the Government. Congress has created a few statutory exceptions to the "American rule." For example, a victorious party can recover attorney fees under the Civil Rights Act of 1964, the Freedom of Information Act, and the Consumer Product Safety Act. But most provisions for fee shifting are designed to encourage private citizens to enforce rights that transcend the interests of the litigating parties -- a rationale that rarely applies in tax cases.

Current law does contain an ambiguous provision for awarding attorney fees in tax litigation. The Civil Rights Attorneys' Fees Awards Act of 1976 provides judicial discretion to grant attorney fees to a prevailing party (other than the United States):

> "...in any civil action or proceeding, by or on behalf of the United States of America, to enforce, or charging a violation of, a provision of the United States Internal Revenue Code...."

Interpretation of this quoted language has been the subject of controversy in Congress and the courts.

With respect to two basic issues, the courts have determined that the statute has a narrow application. First, virtually all the cases have held that attorney fees can be awarded only if the taxpayer is the defendant. This interpretation results in the statute being applied to very few cases; most tax litigation occurs in the Tax Court where the taxpayer is the petitioner or in a District Court where the taxpayer is the plantiff suing for a refund. Second, the courts have cited legislative history to conclude that taxpayers must demonstrate that the Government has acted "in bad faith, for purposes of harassment or vexatiously or frivolously."

In our view, current law is unacceptable. The ambiguities in the 1976 Act are troubling, and the Act has been held to apply to such an arbitrarily narrow category of cases that it provides more confusion than protection for taxpayers. The tax provision of the Civil Rights Attorneys' Fees Awards Act should be repealed.

OBJECTIVES OF NEW LEGISLATION

Some persons may argue that this Subcommittee should take no action beyond repeal of the tax provision in the Civil Rights Attorneys' Fees Awards Act. As we have noted, a Federal tax case is not, in general, the type of litigation in which attorney fees historically have been awarded; tax litigation seldom involves a "private attorney general" seeking to establish social principles for the public at large. In fact, an attorney fees statute presents the danger of impairing the interests of the vast majority of taxpayers. A recent comment by the Tax Section of the New York State Bar Association is instructive:

"...[I]t must be recognized that in legal disputes right and wrong are often matters of degree, or of fact; that a system that encourages the settlement of cases may be as desirable as one that pushes cases to trial; that the allowance of attorneys' fees may induce either more litigation or more prolonged litigation; and that any increased litigation expenses of the Government will ultimately be borne by all taxpayers." Tax Section, New York State Bar Association, Report of the Committee on Practice and Procedure, "Awards of Attorneys' Fees in Federal Tax Cases," January 18, 1978.

However, in spite of the potential problems with awarding attorney fees in tax cases, we favor a provision for fee shifting in certain instances. The issue must be faced squarely: when should the legal fees of one taxpayer be paid by all taxpayers? In addressing this question, we believe that legislation should be designed with several general objectives in mind.

Protection of Taxpayers Against Government Abuses

Any attorney fee proposal should be examined in the context of our self-assessment method of taxation. The American tax system is unique in the extent to which it depends upon voluntary compliance. The Government relies upon individual taxpayers to assess themselves and to pay their share of the tax burden. In return, taxpayers expect the Government to administer the system fairly and even-handedly.

We believe that the Government usually lives up to its end of the bargain. The Internal Revenue Service generally administers the tax laws reasonably and equitably. But in any institution as large as the IRS, some mistakes are made. In those instances where the Government overreaches, a taxpayer must not feel incapable of defending his interests. The awarding of attorney fees in appropriate cases can help to preserve the principle of fairness that is central to the voluntary assessment system.

Encouragement of Responsible Government Action

The attitudes and actions of Government employees, as well as taxpayers, may be affected by attorney fees legislation. Proponents of such legislation usually suggest the

need to restrain the Federal bureaucracy. Accordingly, an attorney fees bill is advanced as a deterrent to heavy-handed actions by the Internal Revenue Service.

In order to achieve this deterrent objective, legislation should distinguish between abusive and responsible governmental actions. Tax administration would obviously be ineffective if the Government conceded all close cases to taxpayers. Reasonable pursuit of debatable tax issues should not be discouraged by enactment of an attorney fees bill that applies broadly to all prevailing taxpayers.

Concern for Tax Court Congestion

Moreover, a bill that is drafted too broadly would encourage litigation and increase substantially a volume of tax cases that is already alarming. The current Tax Court inventory is at an all-time high of over 24,000 cases. Such a huge case load places a strain upon the Government's ability to dispose effectively of a case and impairs the ability of a taxpayer to obtain prompt judicial resolution of a dispute.

Congress has acted recently in an effort to alleviate this court congestion and to assist small taxpayers. The Revenue Act of 1978 expands a special Tax Court small case procedure, originally created in 1969. Effective June 1, 1979, the Act permits an informal, expedited process for handling disputes where $5,000 or less is at issue; the prior jurisdictional ceiling was $1,500. Nearly all of these cases are handled by the taxpayers themselves, without the need to hire counsel. In describing this recent amendment, the General Explanation of the Revenue Act of 1978 states:

> "[M]ore taxpayers will be able to take advantage of that expeditious and simplified procedure for handling tax disputes. In addition, it will provide a means of relieving the regular judges of part of an extremely heavy workload."

If attorney fees were to be awarded routinely to prevailing taxpayers, we fear that use of the simple small case mechanism would be discouraged. Attempts to streamline Tax Court procedures would be undermined. And in the process, the ultimate losers would be the thousands of taxpayers who desire swift judicial decisions on tax controversies.

APPROACH OF S. 1444

Measured by the objectives I have outlined, S. 1444 is a good bill. Its scope is more expansive and rational than current law. Yet, its language is well tailored to accommodate the unique characteristics of tax cases.

To recover attorney fees under S. 1444, a litigant must show that the position of the Government in the litigation is unreasonable. This standard promotes the sound principle that taxpayers should not have to bear the cost of defending themselves against abusive governmental action. But at the same time, it recognizes the interest of all taxpayers in responsible tax administration by the IRS and in having an expeditious judicial remedy for cases not settled at an administrative level.

The "reasonableness" test is to be applied by "taking into account the entire record of the case as well as any other relevant evidence." Under this standard, the attorney fees issue should be viewed in the context of the history of litigation on a particular tax question. For example, a court might award attorney fees where the Government continues to litigate a legal issue after losing in several Circuit Courts. On the other hand, attorney fees should not ordinarily be granted where a decision invalidates an IRS ruling that had previously been upheld by other courts.

In outlining the requirements for recovering attorney fees, the bill recognizes that tax cases, compared to other forms of civil litigation, typically involve many differing issues of fact and law as well as several taxable years. There is likely to be no clear-cut winner in such a multi-faceted proceeding; approximately 40 percent of all Tax Court cases result in decisions that are split between the taxpayer and the Government. Accordingly, S. 1444 describes with some precision the extent to which a party must prevail in order to qualify for an award. Under the bill, a party must prevail with respect to all, or all but an insignificant portion portion of, the amount in controversy. If no amount is in controversy, the taxpayer must prevail with respect to all, or all but an insignificant portion of, the issues involved.

We believe that the definition of "prevailing party" in S. 1444 -- a definition that incorporates the "reasonableness" standard and the specific treatment of multiple issue proceedings -- should allay many of the concerns about exacerbating court congestion in tax cases. But to discourage unnecessary litigation, the Subcommittee may wish to consider an additional refinement of the requirements for recovery of legal expenses. Under current practices, a taxpayer typically appeals to an IRS regional office in the event he disagrees with the findings of an examining agent; over 95 percent of all disputed cases are resolved without trial. If the bill is enacted as drafted, there is a danger that a taxpayer will circumvent the administrative process and have his case docketed in court solely because of the prospect of recovering attorney fees and other court costs. As a safeguard against such unintended results, we recommend that the bill allow attorney fees to be recovered only in those instances where a taxpayer has exhausted his administrative remedies before instituting court proceedings.

Finally, we would like to note another provision in the bill that reflects the unique aspects of tax cases. Contrary to most other forms of litigation, the complexity of a tax case is generally related to the relative affluence of the taxpayer. Most persons with modest resources can litigate their tax issues without incurring the legal fees that might be paid by a large, multinational company. Therefore, to target relief to those most in need, H.R. 1444 places a ceiling of $20,000 on the amount of costs and attorney fees that can be awarded in any one proceeding. This cap is a workable limitation that focuses the bill on small taxpayers without requiring a judicial determination of asset size -- a determination that could itself raise difficult fact questions for a court.

S. 1444 takes a reasonable, balanced approach to the special problems of awarding attorney fees in tax litigation. The bill is scheduled to be effective for a 4-year period, so that its impact can be carefully evaluated before permanent legislation is adopted. This experiment should be undertaken. We urge enactment of S. 1444.

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STATEMENT OF JOHN F. MURRAY, ACTING DEPUTY ASSISTANT ATTORNEY GENERAL, TAX DIVISION

Mr. Chairman:

Thank you for inviting me to share with you the views of the Department of Justice on S. 1444, the "Taxpayer Protection and Reimbursement Act."

The courts in the United States apply the so-called "American Rule" in connection with attorneys' fee awards. Under the American Rule the prevailing litigant is not generally entitled to reimbursement of his legal fees from the losing litigant. Although a few common law exceptions to this general rule exist, attorneys' fees cannot be awarded against the United States, in any event, absent a statutory authorization.

In recent years, the Congress has enacted a number of such statutory authorizations for the award of attorneys' fees. Among these recent enactments are Titles II and VII of the Civil Rights Act of 1964 (42 U.S.C. Secs. 2000a-3(b); 2000e-5(k); Title III of the Organized Crime Control Act (18 U.S.C. Sec. 2520); the Freedom of Information Act (5 U.S.C. Sec. 552(a)(4)(E); the Privacy Act (5 U.S.C. Sec. 552a(g)); the Consumer Product Safety Act (15 U.S.C. Secs. 2059(e)(4), 2060, 2072(a), 2073); and, most recently, the Allen amendment to the Civil Rights Attorneys' Fees Awards Act of 1976 (42 U.S.C. Sec. 1988).

The rationale for authorizing award of attorneys' fees against the Government was explained in the Report of the House Government Operations Committee on the 1974 amendments to the Freedom of Information Act in the following terms (H. Rep. 93-876, 93d Cong. 2d Sess. pp. 6-7):

> The allowance of a reasonable attorneys' fee out of government funds to prevailing parties in litigation has been considered desirable when the suit advances a strong congressional policy.

The Department of Justice believes that the American Rule is generally sound and that the burden of attorneys' fees should be shifted only in order to effectuate specific and compelling public interests, and only if the monetary and other costs of fee shifting are reasonable. The converse side of this proposition is that such fees should not be shifted indiscriminately or as a matter of course to the Government when it is the nonprevailing party. Any other approach as to the award of fees against the Government would have a chilling effect on the quality of efforts to enforce the law. As Senator Kennedy said during debate on the Allen Amendment to the Civil Rights Act of 1976 (122 Cong. Rec. S. 17051 (daily ed., Sept. 29, 1976)):

> [The legislation] is not, however, intended * * * to deter the Government from instituting legitimate tax cases by threatening it with the prospect of having to pay the defendant's counsel fees should it lose. Were the Congress or the courts to provide otherwise, it would have a substantial chilling effect on the bringing of genuinely meritorious actions. I am sure that none of us would want to inhibit responsible lawsuits brought by the United States to enforce the tax laws of our country.

Aside from the prospect that attorneys' fee legislation could have the effect of inhibiting legitimate enforcement of the tax laws, such legislation also poses other dangers. For example, the prospect of obtaining an award of attorneys' fees would likely inhibit administrative settlement of tax controversies and thereby increase the caseload of

the courts, although to what extent that will happen is admittedly speculative. Even as to cases that would have been filed without regard to award of attorneys' fees, the courts will face additional work since counsel can be expected aggressively to seek reimbursement of fees from the court. As a result, the settlement of cases after institution of suit is also likely to be more difficult.

Our system of taxation is based upon self-assessment and, accordingly, every effort must be made to maintain the appearance and reality of fairness. Small taxpayers sometimes perceive that the Internal Revenue Service has acted unreasonably, but find that the cost to challenge that action would exceed the amount in controversy. That type of situation is unfortunate, undermines the credibility of the system, and calls for a legislative solution. On balance we agree that an effort should be made to solve that problem, even though from a policy standpoint it can be argued that the taxpaying public as a whole should not be asked to underwrite what is essentially an expense of recovering or preserving the private property of a single taxpayer. The solution, however, should be confined to the problem at which it is addressed and should not be viewed as a relief act for attorneys.

The Allen amendment to the Civil Rights Attorney's Fees Awards Act of 1976 (P.L. 94-559) is the only legislation enacted to date which allows the award of attorneys' fees against the Government in a tax case. The purpose of that legislation, like the purpose of S. 1444, is to permit small taxpayers to obtain reimbursement of their court costs, including attorneys' fees, when the Government has acted unreasonably.

S. 1444, unlike the Allen amendment, would permit the award of fees against the Government whether the suit was instituted by the Government or against the Government. The Allen amendment permits no redress in the latter situation. Also in contrast to the Allen amendment (which contains no limitation), S. 1444 would permit a maximum award of $20,000.

An obvious pressure point in terms of litigation concerning the legislation is the manner in which the term "unreasonable" will be interpreted and applied. It clearly would not require that bad faith in a subjective sense be demonstrated. The statement of Chairman Bacus upon introduction of S. 1444 states that the totality of circumstances must be taken into account, not merely the formal record of the trial, and then suggests that—

> a court should consider whether even though IRS' desire to litigate a tax issue may well be for the public benefit and its legal position may be reasonable, the position of IRS has nonetheless become unreasonable due to its application of that particular law to a particular taxpayer which wrongfully and unnecessarily forces that taxpayer into court.

We understand this analysis merely to exemplify that the Service can act unreasonably either in its adoption of a legal position or application of that legal position to the facts of a particular case, and that the legislation would apply in either event. In light of this understanding we have no difficulty with the analysis. The basic thrust of

the "unreasonable" conduct concept is for the courts to determine whether the Service has overreached.

One troubling aspect of the legislation is that it would permit the recovery of "court costs," but neither the statute nor the floor statement defines the breadth of that term. At the present time the United States Tax Court has no power whatever to award court costs, while the district courts may award the costs enumerated in 28 U.S.C. Sec. 1920. We would be pleased to work with your staff on this aspect of the legislation because absent some guidance for the courts a great deal of litigation, and no doubt some inconsistent decisions, will result.

Another issue which the legislation should address is the manner in which "reasonable attorneys' fees" will be computed. The courts have given us guidance in connection with the computation of attorneys' fees when the services are performed by private law firms. However, how should the computation be made when the legal services are performed by in-house counsel? Should the amount of the fees in that situation be based upon the salary of that attorney allocable to services performed in connection with the case, or should the award be based upon what it would have cost the taxpayer had private counsel be hired? Similarly, some courts in connection with Freedom of Information Act cases have actually made "attorneys' fee" awards to litigants who instituted and tried the suit without the benefit of counsel. In keeping with the

purpose of S. 1444, to allow reimbursement of expenditures in tax cases caused by improper action on the part of the Internal Revenue Service, we believe that awards under S. 1444 should be limited to reimbursement of the amount actually expended. The American Bar Association's proposed statute for the award of attorneys' fees in tax cases includes such a limitation. 30 Tax Lawyer 1292 (1977).

We would also feel more comfortable if the legislative history indicated that in determining the reasonableness of the award, the court could reduce, or even deny, the claimed award to the extent that the prevailing party's conduct unduly and unreasonably protracted the controversy. The federal government should clearly not be viewed as a "deep pocket" for the recovery of unwarranted fees.

Another matter that should be addressed in the legislative history concerns the procedure for determining the allowability of an award. One difficulty in the trial of tax cases has always been a tendency on the part of taxpayers to put the Internal Revenue Service or the auditing agent on trial, rather than concentrating on the factual and legal issues involved. Legislation to authorize attorneys' fee awards should not be viewed or used as a vehicle to encourage such trial tactics, but rather the parties should be required to supplement the record concerning allowability and the amount of any claimed award after the case is decided on the merits. Moreover, it should not be necessary in all instances to have a second trial on the attorneys' fee issue. Instead, the parties should be expected to raise the matter by motion and affidavit

in order to facilitate a determination by the court of the need for an actual hearing. In order to resolve any doubt as to the procedure to be followed, that issue should be addressed in the legislative history.

As to the maximum amount to be awarded, S. 1444 imposes a limitation of $20,000, in keeping with its focus on suits instituted by small taxpayers. Other witnesses will no doubt contend that the limitation should be removed, although removal of that limitation would change the entire thrust of the proposal. Assuming arguendo that the other requisites of S. 1444 could be met, we have no doubt that $20,000 would not be completely compensatory in certain civil tax cases, such as the cases the Department of Justice is presently conducting with Exxon, Mobil Oil Company, Shell Oil Company, Getty Oil Company, General Motors Corporation, International Harvestor Company, Inland Steel Corporation or the Xerox Corporation. We submit, however, that based upon the awards made to date against the Government under the Allen amendment that the proposed maximum amount awardable will be adequate in most cases involving small taxpayers.

The last issue upon which I would like to comment is the source of payment provision contained in S. 1444, which presently states that the award should be paid out of "the general appropriations of the agency conducting the action or proceeding." In light the role of the Department of Justice in tax cases, to act as legal representative for the Internal Revenue Service, we are not convinced that the source of payment rule properly allocates the burden of compensating taxpayers

who would recover awards under S. 1444. Thus, we would like to pursue this matter with your staff in subsequent discussions.

In conclusion, I would like to commend Chairman Baucus for introducing S. 1444, and for conducting these hearings. The legislation takes a balanced approach and its enactment would be beneficial.

I would be pleased to respond to any questions that you may have.

Senator Baucus: The next witness will be Hon. C. Moxley Featherston, Chief Judge, U.S. Tax Court.

Judge Featherston, I am very happy to have you here.

STATEMENT OF HON. C. MOXLEY FEATHERSTON, CHIEF JUDGE, U.S. TAX COURT

Judge FEATHERSTON. Thank you, Mr. Chairman.

I welcome this opportunity to discuss S. 1444.

With me are Judge Leo Irwin of our court and Mr. Charles S. Casazza who is the clerk of our court.

We have filed a formal statement and we understand that statement will be made a part of the record of this proceeding, and permit me, just briefly, to give you the highlights of this statement.

The Tax Court takes no position on the ultimate determination of basic policy with respect to this proposed legislation. As a court, we feel that this is a policy decision that is to be made by the Congress.

We certainly agree with the views that you have expressed, Mr. Chairman, that it is important that the administration of the Internal Revenue laws be fair and that they give the appearance of fairness. Certainly, that is also true with respect of the handling of litigation in the courts.

We do have some concerns about the effect of the proposal on tax litigation. Let me briefly summarize three of those concerns that we have described in our statement.

I think in the course of the testimony of the witnesses who just preceded me, that every one of those concerns have been touched on, but from the standpoint of the court, we have a little bit of a different problem, perhaps, than the administrators have.

First, we are concerned about the possible effect of the bill on the settlement of tax cases. When I came to the Tax Court in 1967, approximately 6,000 cases were filed in that year. During the last fiscal year, the fiscal year ended September 30, 1978, 13,750 cases were filed. Approximately 75 percent of the cases, as we make the computation, are disposed of by settlement. Any substantial increase in the number of cases which have to be litigated would create a burden upon the court which would be beyond the present capabilities of the court to handle. We are, therefore, concerned that the legislation, as it is finally framed, take into account its possible effects upon settlements.

After the facts are known, the Government concedes some cases completely. This bill, as I understand it, would provide for costs in such cases if the Government's position was unreasonable, and the

decisions as to whether costs are to be allowed must be made in the light of the record as a whole.

In a case which has been disposed of by a complete concession by the Government, there, of course, is no trial record. This presumably means that the court may have to take testimony to ascertain what the evidence would have been if the case had gone to trial, and possibly whether the taxpayer has withheld information from the Internal Revenue Service during the audit process.

Faced with the possible claim for attorneys' fees in these cases, the Government may tend to litigate rather than to concede a case. Similarly, a taxpayer may tend to decline to make a give-and-take settlement in the hope that he will be able to prevail completely and be entitled to costs.

The second concern that I would mention was one that you alluded to a few minutes ago, Mr. Chairman. We are not certain whether the phrase "reasonable court costs including attorneys' fees," as used in the bill, is intended to cover the expenses incurred by the taxpayer at the administrative or audit level.

If the language is not intended to cover costs incurred at the administrative level, the tendency may be to shortcut the administrative process and to file a suit in the hope of recovering costs which otherwise would not be reimbursable, thus increasing the amount of the litigation in the courts.

On the other hand, if the bill is intended to allow reimbursement for costs incurred at the administrative level, the court may find itself in a position of having to hear testimony concerning the entire administrative process. Under the law as it now stands, the Commissioner's determination is treated as having what the courts refer to as a presumption of correctness. The courts ordinarily do not hear testimony that goes behind the statutory notice.

We think it is important to preserve this rule. This is a problem which will have to be dealt with, hopefully, in the statute on legislative history of this provision.

The third consideration is that the bill, as it now stands, gives no guidance as to how reasonable attorneys' fees are to be determined. Tax Court litigation, as suggested a few minutes ago by Commissioner Kurtz, presents a special problem in this respect.

Approximately 34 percent of the Tax Court cases involve less than $1,500 and 51 percent involve less than $5,000. It is true that, at this time, most of these small cases are handled by taxpayers who do not have attorneys, but of course the bill would open up the possibility for these taxpayers to obtain reimbursement for attorneys' fees.

One of the problems which I think might be dealt with in the statute on legislative history is whether, and to what extent, pro se taxpayers—that is, taxpayers who do not have attorneys—will be entitled to recover fees.

With respect to the amount in private litigation, one of the important factors in determining the reasonableness of attorneys' fees is, of course, the amount involved, or the amount which has been saved, or recovered by the litigant. If the amount involved is to be a criterion for the amount of the attorneys' fees allowable in these small tax cases, the amount of the fees may not be sufficient to attract an attorney. On the other hand, if the amount in litiga-

tion is not a factor to be taken into account, the court may find itself with claims for attorneys' fees that exceed the amount of the deficiency determined by the Commissioner.

We would urge that the statutory language or the committee report give the court some guidance on this type of case.

Mr. Chairman, these are three points which are covered in more detail in our statement. If we can be of any assistance in providing any further information, we would be pleased to do so.

Senator BAUCUS. Thank you very much, Judge.

Let me ask you a few questions on your last point. I guess the basic question I have is how much more guidance do you want as a judge, or you think other Tax Court judges or district court Judges would like, in determining some of the answers to the questions you raised?

I guess my basic question is, on the one hand, the degree to which you feel these issues should be addressed in the statute or in the legislative history, and on the other, the degree to which judges should be able to have more flexibility?

Should individual taxpayers appearing on their own behalf be entitled to reasonable fees, what are reasonable fees in those cases, and what kinds of limits should there be, for example?

Could you address that basic question, please?

Judge FEATHERSTON. Yes.

As I understand it, the use of the term "reasonable" and "unreasonable" that appear in the bill are designed to give the courts a great deal of latitude and discretion in deciding when attorneys' fees are to be allowed, and in what amount. I think that is basically a good solution to the problem.

I do have this concern that I expressed, however, concerning the small tax cases in the Tax Court. As I indicated, some of them involve very small amounts of money. The legal issue presented is not always easy in these small cases and if an attorney is going to be employed in those cases to prepare them for trial in a way that would be of any help to the taxpayer, he is going to spend a great deal of time and we simply are not sure as to how the court should proceed under the legislation.

Senator BAUCUS. I understand. I guess I am asking, would you, as a judge, prefer fairly definite, clear guidelines, which, as a practical matter, might be somewhat rigid and inflexible or would you prefer it if we were to err in the other direction, to give the judiciary more flexibility?

I am trying to get a feel for how far you believe we should go?

Judge FEATHERSTON. I would prefer flexibility.

Senator BAUCUS. But you would still like a little more guidance?

Judge FEATHERSTON. Particularly in the small cases.

Senator BAUCUS. You raised the concern about the degree to which this bill may discourage settlements. I am wondering if you could give the committee a little bit of guidance, based on your experience, on the degree to which you think providing for attorneys' fees and costs for prevailing plaintiffs and defendants would discourage settlements, and the degree to which settlements may be further discouraged if the burden of proof were shifted to the Government.

Judge FEATHERSTON. I am not sure I can give you any helpful information because we have absolutely no experience, so we would be dealing entirely in terms of speculation as to its possible effect.

I would think, as a practical matter, that in the vast majority of cases, if the taxpayer, let us say, is able to settle the case on a very favorable basis, that it would not stand in the way.

There may be situations, however, where taxpayers will be very reluctant to settle, or the Government will be reluctant to settle, for fear that they would be subjected to the payment of attorneys' fees. This is an extremely difficult question for me to answer because we simply have no experience on which to base an answer.

Senator BAUCUS. I suppose the same problem occurs with your second point, whether taxpayers might shortcut the administrative process and immediately go to court because of the possibility that they might also be awarded attorneys' fees and costs.

As you heard in some of the earlier testimony, some of the witnesses suggested that taxpayers must first exhaust their administative remedies before going to court. If that provision were written into the bill, would you still be worried about whether taxpayers would unnecessarily shortcut the process and go to court because of the possibility of getting fees?

Judge FEATHERSTON. Mr. Chairman, I would think that a proposal requiring taxpayers to exhaust administrative remedies should be given very careful consideration as a separate piece of legislation. That would be my feeling about it.

I think that the present procedures available are quite flexible. It may be that there are some definite advantages in that respect to taxpayers.

Here, again, we are dealing with a matter of judgment. I should think that that should be given very careful study.

Senator BAUCUS. Would section 6673 be helpful here in preventing taxpayers from unjustifiably short circuiting the process and going to the Tax Court. That section enables the Tax Court to award damages, not to exceed $500, against taxpayers who bring proceedings unnecessarily.

Judge FEATHERSTON. That section, as you indicated, authorizes the Tax Court to award damages to the Government to the extent of $500 if the taxpayer files the action merely for delay. So that the factual standard, the factual issue that has to be answered in those cases is whether the action was filed merely for delay. Other statutes give similar authority to the courts of appeals and the Supreme Court.

Senator BAUCUS. Should we modify that statute?

Judge FEATHERSTON. I have no suggestions in that respect.

Senator BAUCUS. Judge, I appreciate your appearance this afternoon. You have been very helpful, and I thank you.

[The prepared statement of Judge Featherston follows:]

STATEMENT BY CHIEF JUDGE C. MOXLEY FEATHERSTON, U.S. TAX COURT, ON S. 1444

I welcome this opportunity to submit the views of the United States Tax Court with respect to S. 1444, known as the Taxpayer Protection and Reimbursement Act. The Bill would provide for the award of reasonable court costs, including attorney's fees, to prevailing parties in Tax Court and other civil tax litigation.

GENERAL COMMENTS

At the outset, I wish to make it clear that the Court takes no position on the ultimate determination of basic policy in respect of this proposed legislation. We think this is a matter for the Congress to decide. Our concern is with respect to the impact which certain provisions of the proposal may have on tax litigation and the consequent burden on the courts. I trust that our statement of these concerns will not be interpreted as opposition to the Bill.

Tax litigation poses some special problems. It deals with the duty and power of the Federal Government to collect the revenue necessary for its proper functioning. In the context of the need for revenue, we believe that any legislation authorizing the award of costs in tax cases requires a careful balancing. The right of a taxpayer not to be imposed upon with respect to efforts to collect taxes alleged to be due from him must be weighed against the obvious undesirability of encouraging taxpayers to delay payment of taxes they justifiably owe in the hope, however small, that they may be able to convince a court that they do not owe such taxes and, in addition, can obtain reimbursement for the costs of litigation.

There is also a need, in striking such a balance, to take into account that the prospect that the award of court costs and attorney's fees will add to the already heavy load of tax cases with which the judicial system has to contend. One striking example of what we have in mind, both in terms of revenue collection and adding to the burden of the judiciary, is reflected in the provision for the award of costs where cases are settled. In many instances, after all the facts become known, cases are settled on the basis that there are no additional taxes due. It would seem that the prospect of the Government's being required to pay costs in such cases may inhibit the resolution in favor of the taxpayer of issues in pending cases where any real doubt exists and thus encourage litigation which would otherwise not take place. In a similar vein, taxpayers may be hesitant to concede issues where there is any doubt, because to do so will militate against the possibility of being awarded costs, again encouraging litigation.

We are certain that Congress does not intend that this Bill become the engine to fuel additional litigation. As we understand its objectives, the purpose is to confine the award of costs to situations where the Government has clearly abused the exercise of its power and duty to collect needed revenue. To achieve this objective we think it essential that, if legislation is enacted, it contain precise language (either in the statute itself or in the legislative history) expressing the intention of the Congress to confine the benefits conferred only to taxpayers who have been imposed upon.

UNREASONABLE POSITION AND REASONABLE COSTS

In this connection there are two provisions in the Bill which cause us concern: (1) the provision (new sec. 7430(c)(2)(B) that fees may be allowed if the prevailing party establishes, among other things, that "the position of the United States in the civil action or proceeding was unreasonable"; and (2) the provision (new sec. 7430(a)) that the prevailing party may be awarded "reasonable court costs, including attorney's fees, incurred in such action or proceeding." The terms "unreasonable" and "reasonable" when used in the context of Tax Court litigation without more definite guidelines lack the precision we think is needed to avoid further extensive litigation problems.

We assume that the objectives in using these general terms to a large extent is to avoid a second trial on whether fees are allowable and in what amounts, and to leave those decisions to the sound discretion of the court. We endorse those objectives, but we believe that, if they are to be achieved in Tax Court litigation, more precise language in the Bill or the Committee report is needed.

CASES CONCEDED BY THE GOVERNMENT

I have referred to the possible reluctance of the Government to concede cases completely lest the petitioner claim court costs and attorney's fees. There is another problem in this type of case which may lead to further litigation. Where the Government has conceded the case entirely or except for an "insignificant portion" and the taxpayer claims costs, the decision as to whether costs will be allowed must be made, as in other cases, "by taking into account the entire record of the case as well as any other relevant evidence." (New sec. 7430(c)(2.) Since there is no trial record in such cases, this provision apparently means that the Court will be required to take testimony and other evidence to ascertain whether the Government's position was "reasonable"—in other words, to hear the evidence that would have been offered had the case gone to trial. In other conceded cases, evidence may be

needed to ascertain whether the Commissioner's "unreasonable" position was attributable to the taxpayer's failure to furnish complete information during the audit of his return.

The Tax Court is particularly concerned about any provision which would in any way impede settlements. Over the last 12 years, the annual filings of new Tax Court cases has more than doubled. During the fiscal year ended September 30, 1978, we received 13,740 new cases and closed 12,062 cases. Our judicial manpower has been severely stretched to handle this heavy workload. Any appreciable decrease in the settlement rate would cast a load on the Court beyond its capacity to carry.

We are not suggesting that injustices, if they exist, should continue without attention merely because of the additional work. We are asking only that the prospect of obtaining reimbursement for court costs and attorney's fees not be made an inducement to the refusal of reasonable settlements.

INSIGNIFICANT AMOUNT IN CONTROVERSY

The provisions that the taxpayer must prevail "as to all, or all but an insignificant portion of the amount in controversy" (new sec. 7430(c)(2)(A)(i)) or "as to all, or all but an insignificant portion, of the issue or issues presented" (new sec. 7430(c)(2)(A)(ii)) have the seeds of litigation problems in certain tax cases. Many issues litigated in tax cases are of a continuing nature. In the year in suit, the amount at stake or an individual issue may be "insignificant" when compared with the total deficiency. Yet in other years large amounts may turn on the same legal or factual issue. The decision in the year before the court may form a basis for collateral estoppel for other years or provide a precedent controlling liabilities in later years. Without further guidance in the language of the statute or in the Committee report, we may be faced with the necessity of exploring through testimony the tax consequences of our decision in later years, thus increasing litigation.

DETERMINATION OF COURT COSTS

The determination of the amount of the court costs and attorney's fees to be allowed in individual cases may be extremely difficult under the standard of "reasonable court costs" without further guidance. We interpret this language to mean that "court costs" other than attorney's fees are not limited to the precise items now allowable in the district courts under sections 1920 and 2412 of Title 28 of the Code.[1] The only limitation on court costs under the Bill appears to be the provision that allowable court costs may not exceed $20,000 for any one civil action or proceeding.

As the Committee knows, much of the time spent in handling tax litigation is expended at the various administrative levels within the Internal Revenue Service. In many cases, taxpayers incur expenses for the services of attorneys, accountants, and experts during the audit stage. Whether the language "reasonable court costs, including attorney's fees" is intended to cover such expenses at the administrative level needs to be made clear. And that provision presents a dilemma: If the language is not intended to cover costs incurred at the administrative level prior to the Tax Court suit, the temptation to the taxpayer will be to file suit and then obtain such costly assistance, thus increasing litigation. If the Bill is intended to cover such costs at the administrative level, the Tax Court may be faced with the necessity for permitting testimony (at the trial itself or at a second trial) describing the whole administrative process.

Involved in this prospect of permitting testimony on the administrative process is the general principle in tax litigation that, except in extreme cases where, for example, violations of constitutional rights may have occurred, the courts do not allow the testimony to go back of the statutory notice of deficiency. The courts accord to the Commissioner's determination in the notice of deficiency what is referred to as a "presumption of correctness," and the taxpayer generally has the burden of showing error in the Commissioner's determination. We would urge that

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[1] Section 1920 of Title 28 of the U.S. Code is as follows: "Sec. 1920. Taxation of costs. A judge or clerk of any court of the United States may tax as costs the following: (1) Fees of the clerk and marshal; (2) Fees of the court reporter for all or any part of the stenographic transcript necessarily obtained for use in the case; (3) Fees and disbursements for printing and witnesses; (4) Fees for exemplification and copies of papers necessarily obtained for use in the case; (5) Docket fees under section 1923 of this title. A bill of costs shall be filed in the case and, upon allowance, included in the judgment or decree." This section does not apply to the Tax Court because the meaning of the term "court of the United States" is restricted by 28 U.S.C. 451 to courts created under Article III, whereas the Tax Court was created under Article I of the Constitution.

it be made clear that nothing in the proposed legislation should be interpreted to impair or restrict this long-standing rule.

ALLOWANCE OF FEES IN CASES INVOLVING SMALL AMOUNTS

The amounts in dispute in Tax Court cases vary widely. The following table shows by categories such amounts in stated percentages of the 16,758 groups of Tax Court cases pending on May 31, 1979:

Category	Number of groups [a]	Percent in each category
$0 to $1,500	5,654	34
$1,501 to $5,000	2,892	17
$5,000 to $10,000	1,355	8
$10,000 to $50,000	3,111	19
$50,000 to $100,000	1,104	7
$100,000 to $200,000	840	5
$200,000 to $500,000	886	5
$500,000 to $1,000,000	371	2
Over $1,000,000	545	3
Total	16,758	100

[a] Included in a group of cases are those cases identified as having been brought by the same or a related taxpayer or having a common issue. Ordinarily, such cases can be consolidated for trial.

The Bill as it now stands gives no guidance as to how we are to determine the amounts of "reasonable" attorney's fees. In private litigation, the amount at issue is a factor of primary significance. If primary significance is to be attached to that factor under the Bill, the amount involved in the 34 percent of the groups of cases involving less than $1,500 or even the 17 percent involving less than $5,000 is so small that the fees would hardly be sufficient to obtain the services of competent attorneys. On the other hand, if the amount involved is not to be a limiting factor, the Court may find itself required to allow attorney's fees which exceed the amount in dispute. We urge the Committee to provide us with guidance on this point. Another consideration, though at the other end of this spectrum, is the need for guidance in cases handled by "in-house" lawyers of corporate taxpayers. If fees are not to be awarded for the services of "in-house" counsel, measured perhaps by a portion of their salaries, it would appear to penalize the use of staff attorneys to handle litigation.

CONCLUSION

The Court appreciates the opportunity your Committee has given it to comment on S. 1444.

If the Committee has any questions, I will be happy to provide you with any further information available to the Court. We will also welcome the opportunity to work with your staff if you should desire us to do so.

Senator BAUCUS. The next panel will include: Lipman Redman, chairman, section on taxation, American Bar Association; accompanied by Steven Salch, special advisor to ABA tax section's Committee on Court Procedures. Johnnie M. Walters, former Commissioner of the Internal Revenue Service and former Assistant Attorney General, Tax Division of the Department of Justice and Stuart E. Seigel, former Chief Counsel, Internal Revenue Service.

Gentlemen, I am very happy to have you here. You have heard earlier testimony. I encourage you to summarize whatever written statements you might have and also to respond to any statements you have heard this afternoon with which you agree or disagree.

Gentlemen, proceed in any manner that you wish.

[The prepared statement of Lipman Redman follows:]

STATEMENT OF LIPMAN REDMAN, CHAIRMAN, SECTION ON TAXATION, AMERICAN BAR ASSOCIATION, ACCOMPANIED BY STEVEN SALCH, SPECIAL ADVISOR, ABA TAX SECTION COMMITTEE ON COURT PROCEDURES

Mr. REDMAN. Mr. Chairman, we have made no arrangements as to what order to proceed. Since my name is listed first and I am the oldest one at the table, maybe that entitles me to start.

We thank you very much for the chance to be here, because this is an area of considerable concern. Mr. Salch and I speak for the American Bar Association and we are entitled to do so, because after the Senate Finance Committee paid its first attention to the subject in the 1976 act, we decided it was time for us to take a serious look at the question .

As a result, our appropriate committee on court procedure chaired by Mr. Salch offered a resolution that went through all required processes.

The section on taxation approved it in the summer of 1977 and the House of Delegates of the American Bar Association ratified it in the following February.

A number of points have been made and questions asked and, as the Chairman suggested, it might be most helpful if we addressed those directly.

Preliminarily, I think it is important to say what a number of the witnesses have said, and what is implicit in everybody's testimony, I believe, that our self-assessment tax system is clearly the best in the world, far and away. It works very well in most instances, and we do not countenance any severe changes in the system, because of the inevitable number of horror stories, of which there will be an unending supply, no matter what kind of rules are written, whether by statute or Treasury regulations or revenue procedures or revenue rulings of the Internal Revenue Service.

Nonetheless, there is an increasing perception on the part of taxpayers across the country that the Internal Revenue Service is the big bad wolf in the picture and it is just too expensive to fight them. In that setting, we accept and agree with the principle that underlies S. 1444, namely the provision in appropriate situations for award of attorneys' fees in civil tax litigation where the taxpayer prevails.

I do not think anybody disputes that around the room today.

In that context, with all the problems—the first one raised this afternoon is the question as to whether or not the proposal should extend to fees incurred in administrative processing of cases through the Internal Revenue Service before litigation; whether, as a part of that, there should be a requirement that taxpayers exhaust their administrative remedies.

We say no to both of those propositions.

It is true that there are horror stories that indicate that the Revenue Service is putting some taxpayers to undue expense in the administrative process. We do not think that happens often enough, however, to warrant all of the problems inherent in trying to define the process and to set a standard that would apply.

The Revenue Service is trying to do its job of applying the Revenue Code throughout the country. It is inevitable, in many

instances, in a self-assessment system, and there is nothing wrong with the Revenue Service picking up a return for examination perhaps even large numbers of returns, even though it finally decides that no adjustment is appropriate in many of those cases.

It is nonetheless an important part of the system that taxpayers understand that. Their returns are subject to examination as an important element of our self-assessment system. The fact that a return is examined and is not changed does not, by itself, in our judgment, warrant the imposition of any penalty, if you will, on the Revenue Service for having done its job.

With regard to a requirement to exhaust administrative remedies, there are many instances where, wholly apart from a question of award of legal fees ultimately, it is in the taxpayers' best interests not to exhaust his administrative remedies. It saves time, it saves money, in a number of situations, for a counsel to advise his clients, do not bother with going to the Appellate Division; go right to court.

That will occur in situations in which it is known that the Revenue Service is litigating certain issues because they are so-called prime issues. They are not settling those cases, because they want judicial guidance.

There is no point in going through the administrative process in that situation, yet that taxpayer would be deemed not to have exhausted his administrative remedies and not entitled to an award of legal fees that might otherwise be appropriate.

We think the definitional problems in trying to define what constitutes exhausting such remedies simply are not worth it, and that the proper balance has been struck in the Chairman's bill of requiring litigation as the point beyond which legal fees are appropriate.

A second area that has been discussed is the question of how do you determine the amount of the award? Should there be a requirement, as this bill has, that the Government must be deemed to have been unreasonable and a related provision of a maximum of $25,000 for any case or controversy?

As you know, the ABA proposal does not require either of those standards.

We think the question of reasonableness will simply unduly complicate the whole process the way the bill is written. It will be a threshold question that the court would have to decide before reaching this second question of whether or not to award any fee at all.

What is reasonable may be very difficult to establish. Is it unreasonable because the Commissioner and the Chief Counsel operating through their various regions have determined that the Revenue Service wants judicial guidance in this matter, even though they have lost four, five, or six cases? One court may say yes and another court may say no.

Does it matter? Is it not sufficient simply to leave it to the court to decide whether or not the litigating position adopted by the Government in a particular case is unreasonable as far as the taxpayer is concerned? We think the court should be free to do so.

And we think it would unduly complicate matters if we adopted a threshold standard of unreasonableness.

Furthermore, the burden of showing unreasonableness is on the taxpayer—and that is where I think it probably belongs, but it would be very difficult to carry because of the whole complex and myriad processes through which the Revenue Service must function in reaching a decision on whether or not to litigate a particular case.

In the administrative processing of a case, the Government's decisions are made by and large throughout the field offices. Decisions and mistakes are likely to be made. When you go to the question of whether to litigate, actually to go to court, whether the Government is going to insist that you go to court, you are now at the point where the decision is made by a higher level person.

It seems to me that that is an appropriate cutoff point beyond which fees should be made available in the right circumstance.

In terms of requiring a threshold finding of unreasonableness, I think you are imposing an undue burden on the court as well as the taxpayer who may think he is entitled, if this bill were law, to recoupment of legal fees.

Why not avoid those problems and leave it to the discretion of the court? It has been done before in many other areas of law.

Senator BAUCUS. What examples can you give me? Where has it been before?

Mr. REDMAN. In many areas of the law such as civil rights awards, there is a list of situations where awards for legal fees are made available in the discretion of the court.

In other words, we do not find any case, at last that we know of, where, indeed, there is a threshold requirement of this kind. Reasonableness is frequently one of the elements used by the court—reasonableness on the part of the Government action is one of the factors used in determining the fee.

Mr. SALCH. Mr. Chairman, most of the existing Federal legislation that speaks to the question of recoupment of attorneys' fees will have a standard of either prevailing party, or of substantially prevailing.

There are some exceptions in the patent area which essentially use an exceptional case language. For attorneys' fee recoupment, that has traditionally been interpreted to mean the same thing as bad faith, taxation unwarranted, or harrasment, which, of course, is the Civil Rights Fees and Awards Act of 1976 brought and ties in with what the Federal district court said was their inherent equity power to award attorneys' fees in exceptional cases.

Senator BAUCUS. Regrettably there is a vote going on. I have approximately 7 minutes to get over to vote. We will temporarily recess for about 10 minutes.

Thank you.

[A brief recess was taken.]

Senator BAUCUS. The subcommittee will come to order.

Mr. Redman, you were telling us not to include a standard of reasonableness.

Mr. REDMAN. Yes.

There are two aspects to it: One, it is a difficult matter to resolve. We might well have all sorts of litigation on that issue alone and we just do not think it warrants that, especially in light of our second point which is that reasonableness, or lack of it, on

the part of the Government would clearly be, that one of the elements to be considered by the court in exercising its discretion with regard to either the question of any award and, if so its amount. We suggest that the committee ought to make that clear in its report.

We are relying upon the experience gained in other areas of the law where legal fees are allowed to be awarded, largely on the basis of the court's discretion. There may well be some excesses, but indeed the taxpayer has to be a prevailing body to start with, and the amount of the award has to be a reasonable amount before we think those two constraints should operate to avoid excesses.

That takes me to the one point I did not mention so far, the definition of the prevailing party as it now appears in the bill. We have a concern, which we expressed in our formal statement—which we gather will be included in the record—that the definition will not cover every instance which I think the bill should cover.

We offer the example in the statement where there are two issues perhaps involved in one case, one involving $500 and another involving $750.

The taxpayer wins on the $500 issue and it is very important because it affects matters that recur in subsequent years—life for depreciation purposes, and things of that sort. He might lose on the $750 issue and under the definition of the bill, that means that he is not a prevailing party.

We do not think that should follow and, in view of the basic purpose of the bill, we doubt that that is your intent.

We prefer to leave it to the definition now in various statutes, to be determined by the court. The United States Code now contains that term in fixing a party's entitlement to recover. We suggest that same definition should probably apply here.

We recognize that the bottom line, we are putting an awful lot of power and discretion in the court, but we think that is where it belongs. Subject to this question of requiring a finding at the threshold of unreasonableness and a ceiling on the amount of the award, both of which we oppose because they should be left to the discretion of the court, we agree with the direction of the bill and urge the Senators and Chairman to proceed with it. We would be glad to help in any way that we can.

Senator BAUCUS. Thank you very much, Mr. Redman.

Mr. REDMAN. Thank you, Mr. Chairman.

Senator BAUCUS. Our next witness will be Mr. Stuart E. Seigel. Mr. Seigel?

STATEMENT OF STUART E. SEIGEL, FORMER CHIEF COUNSEL, INTERNAL REVENUE SERVICE

Mr. SEIGEL. Mr. Chairman, thank you very much for the opportunity of appearing here today. I have submitted a statement that I understand will be included in the record and I would like merely to highlight my statement.

Senator BAUCUS. To avoid any confusion, all your full statements will be made a part of the record.

Mr. SEIGEL. As you know, Mr. Chairman, I recently served as chief counsel for the Internal Revenue Service. I am presently a

partner in the Washington, D.C. law firm of Williams & Connolly and I am appearing here today in my individual capacity.

I would like to say at the outset that I agree that where the position of the Government in tax matters goes beyond the bounds of reasonable administration of the law, it is appropriate to consider a system for compensating a taxpayer for the legal costs involved in contesting the position of the Government.

At the same time, there are problems involved in responding to that need, problems which I believe should be carefully considered and evaluated as you move forward to fashion a remedy.

First, I think it is important that obstacles should not be created to the assertion of positions taken, in good faith, by Revenue officials that they believe reasonably reflect the law and congressional intent.

Second, in providing the award of attorneys' fees you will create collateral proceedings in the courts. Not only would the court have to determine the jurisdictional, procedural, and substantive issues involved in the litigation, it would then be required to proceed to a supplementary inquiry to determine whether an award of attorneys' fees is appropriate and, if so, the amount to be granted.

Courts already are struggling with increasing dockets should not be overburdened further with collateral proceedings that are unnecessary.

This is particularly true in the case of the Tax Court where the overwhelming majority of the volume of civil tax disputes are lodged.

Any program providing for an award of attorneys' fees in civil tax litigation must, in my view, be structured to avoid creating an incentive for the habitual assertion of the claim.

A third objective should be to avoid creating an awards system that could operate to disturb settlements that taxpayers would otherwise agree to in the hope that further pursuit of the proceedings would yield recovery of all, or some portion, of attorneys' fees.

Disincentives to fair and just settlements would only increase administrative and judicial costs and burdens and lead to negative impressions of the efficiency of the system.

Fourth, while there are undoubtedly cases in which Service officials may act unreasonably, the nature of the tax system is such that individuals may have a perception of unfairness which may not be attributable to the actions of the Service, but rather reflect dissatisfaction with the tax laws generally or the unease and concern which taxpayers typically experience when subjected to an IRS audit. Therefore, the standard against which awards would be authorized should be articulated in a way that will be responsive to legitimate cases and not authorize recovery in situations where the Service's actions are appropriate, even though determined ultimately to be incorrect.

Last, recognizing the problems inherent in striking a balance between the need for appropriate measures of relief and the risks of untoward disruption to existing procedures, any program should be viewed as a first effort, subject to review and evaluation to determine whether continuation as a permanent part of the law is warranted and, if so, what modifications would strengthen the program.

With these guides in mind, I believe S. 1444 presents a constructive approach to the problem.

I support the sunset provision of the bill, a mechanism within the statute to require review and re-evaluation is essential for fashioning an appropriate solution to the problem.

I would hope that, at the proper time, the intent of that provision would be realized by meaningful congressional reconsideration of the issue so that needed legislative actions can be instituted without undue delay.

S. 1444 would authorize award of attorneys' fees if the taxpayer can establish that the position of the Government is unreasonable. Conditioning recovery on a showing of unreasonableness on the part of the Government may provide too imprecise a standard to be susceptible to reasonably uniform application. The term could be interpreted to include not only the propriety of the Government's legal position, but any number of ancillary matters, such as the manner in which the case was handled and the Government's position presented.

The critical question in this regard, as I see it, is whether the Government had a reasonable basis in law for the position advanced in the case. That standard would more effectively separate out the cases in which awards are appropriate than the standard contained in the bill, and would provide better guidance to courts in making determinations.

I might add, at this point, that I disagree with Mr. Redman's view that even a standard of reasonableness ought not to be included in the bill. That approach would lead to a lack of uniformity among taxpayers; and to extended collateral proceedings in the courts, where almost any aspect of the proceeding would be relevant to the court's determination.

Viewing this as a first effort, it seems to me that you ought to strive to articulate a standard that is one that the courts are familiar with, that is responsive to the needs that the bill addresses, and that could be reviewed through the sunset process to determine whether changes are, in fact, necessary at a later time.

The $20,000 limitation on the maximum fees that can be awarded seems to me higher than necessary to further the bill's objectives. The maximum amounts appear to be greater than the amount of fees one would anticipate would be ordinarily associated with cases of the type that the bill seeks primarily to assist—taxpayers faced with proposed liabilities that are small in the relation to the legal costs that would be incurred to defend or prosecute the case.

The prospect of too generous a recovery could be an incentive for increased litigation. Recognizing this effort as an initial program, a limitation of $10,000 would seemingly serve to provide an appropriate level of relief in the types of situations to which the bill is predominately addressed, while avoiding the risk of undue stimulus to litigate. The level of maximum recovery can then be re-evaluated in the light of actual experience in the coming years.

In conclusion, a carefully drawn and balanced effort in the attorneys' fee area would be an appropriate step to take at this time. Given the uncertainty of some of the effects that such action might have on the administration of the tax system, I believe prudent

limitations and useful guidelines should be sought in the development of a final proposal in actual practice will afford important guidance for future action in this area.

I appreciate very much the attention and consideration of the subcommittee and would be pleased to answer any questions you may have.

Senator BAUCUS. Thank you very much, Mr. Seigel.

Mr. Walters?

STATEMENT OF JOHNNIE M. WALTERS, FORMER COMMISSIONER OF INTERNAL REVENUE AND FORMER ASSISTANT ATTORNEY GENERAL, TAX DIVISION, DEPARTMENT OF JUSTICE

Mr. WALTERS. Mr. Chairman, I am Johnnie M. Walters, a partner in the law firm of Leatherwood, Walker, Todd & Mann, Greenville, S.C.

From January 1969 to August 1971, I was Assistant Attorney General in charge of the Tax Division and from August 1971 to May 1973, I was at the IRS as a Commissioner. Before and after those times, I have spent my entire professional career working in the Federal tax system as an attorney.

After looking at this proposed legislation and thinking back on all the experiences I have had, I must disagree with my brothers. I do not believe the legislation should be adopted.

I say that for this reason. I think that our tax system as it is, as said earlier, is the best system in the world and we should strive to keep it so. I think, as several of the speakers have indicated today, there are extremely few cases where there is unreasonable action on the part of the Government.

I suspect in fact, that if the test is retained and the legislation passes, the legislation will be meaningless because how in the world can a taxpayer prove unreasonableness on the part of the Government?

If I know correctly the people with whom I have worked, they will be prepared to show that they acted reasonably in some way. It will be almost impossible to prove that they are wrong.

Senator BAUCUS. Maybe that will strengthen the public's confidence in the tax system.

Mr. WALTERS. It may.

Senator BAUCUS. It may if the judges rule that IRS always has been reasonable.

Mr. WALTERS. That is a possibility, but can we afford that?

What I am afraid this legislation will do is it will create additional tax legislation. Taxpayers naturally are going to say well, they acted unreasonably; let's sue, in cases where they would not otherwise sue.

So the tax legislation is going to be pursued further and, in addition, this legislation will present to the courts a very serious issue with which they have not heretofore had to deal—that is, did the Government act unreasonably?

I do not know how they will handle that.

Accordingly, I really believe that for the few cases we really want to deal with, what the Congress should consider doing is, within the structure we now have, let the Internal Revenue Service and the Department know that no Federal agency, particularly

them, should act unreasonably. Then through adequate oversight, see that that is done.

I do not know whether anybody has suggested it, but let me suggest that there has not been adequate oversight of the Internal Revenue Service. While I was there a few years ago, I suggested to the joint committee that I would like to have more oversight, that we needed it. The trouble is that the joint committee and its staff are so overwhelmed with the massive tax legislation almost annually that they do not have the time to do that.

I would suggest respectfully that you give consideration to adequate oversight to take care of the few cases where there is unreasonable action, which there is, in a very few cases. In that way, we can avoid the massive problems that I think this legislation will breed.

I think it will breed contempt, animosity and just bad relations generally, and that these will tend to erode our voluntary self-assessment system.

Senator BAUCUS. Thank you very much, gentlemen.

Mr. Walters, are you saying that you are just opposed to the way this particular bill is currently drafted because of the unnecessary complications, or are you saying that it is the general premise of the bill that is faulty—that it is never proper to award attorneys' fees to prevailing taxpayers even where, by definition, we all agree the Internal Revenue Service has acted very improperly.

Mr. WALTERS. Mr. Chairman, I think, as I have said in my statement, that it is difficult to argue that a taxpayer who litigates to get that to which he or she is entitled should not be made whole, so I think that premise may be sound.

But I think the problems that will be engendered by this legislation are going to be worse than the problems we now have.

Senator BAUCUS. Is one reason because it is difficult for a judge to determine reasonableness? Is that the basic problem?

Mr. WALTERS. That is part of it.

In addition, if you go out and talk with taxpayers who are in dispute with IRS—and I am sure you have talked to some and I have talked with many while in and out of IRS—all of them think they are reasonable.

What I am saying is it is going to multiply litigation and extend it. I think that is worse than the problem we are trying to cure.

Senator BAUCUS. You do not think that the bar will weed out those cases in talking to those clients that are potentially justifiable and those that are not potentially justifiable?

Mr. WALTERS. Some lawyers would. Some lawyers would try. Frankly, and unfortunately, there are many lawyers who would not, would not even try.

Senator BAUCUS. Mr. Seigel?

Mr. WALTERS. If I may say one further thing as an example, I have had a case pending now for 2 years and that client has insisted every time I have seen him that I should try to get attorneys' fees, and there is no way that it would be justified, but he thinks so.

Mr. SEIGEL. My understanding is that, after the tax provision in the Civil Rights Attorneys Act of 1976 was passed, many lawyers routinely included in their petitions in the Tax Courts a claim for

attorneys' fees, because their clients had some arguable grounds to make the claim. If you have a broad standard, lawyers would be concerned about omitting a claim for attorneys' fees and being subject to criticism or even malpratice claims for failing to assert the claim.

There is, in the system, an incentive for the lawyer to be certain that it is covered and to pursue it, unless the client disagrees and unless there is clearly no basis for the assertion of the claim.

Senator BAUCUS. Mr. Seigel, what has been the result of attorneys and their clients seeking reimbursement because of alleged unreasonable positions in civil rights cases? Do you have any idea?

Mr. SEIGEL. I am not familiar with the civil rights litigation.

Senator BAUCUS. Mr. Walters, if you can give us some guidance, what kind of oversight should we participate in? You suggested actions to the joint committee staff, but they were so busy they did not have a chance to do much. What would you suggest we do?

Mr. WALTERS. I think if they had someone on that staff who could devote some time discussing with the Commission and his staff, chief counsel and his staff, on a fairly regular basis the problem, the problem you see we have, Mr. Chairman, all of us—you and the media and all of us, as someone referred to them earlier today, the horror cases. We do not hear, and I vouch, sir, you do not hear from the millions of Americans who think IRS and the Department do a great job.

So I really think that here we are swatting at a gnat with a cannon.

Mr. REDMAN. Mr. Chairman, if I may, I do not disagree with what Mr. Walters suggests except to the extent that he offers it in lieu of the bill that you are now considering.Yes, indeed, there may be room for more oversight in certain areas between the Congress and the Internal Revenue Service, although if you look at the list of appearances that the Commissioner and chief counsel have made over the last several years, you begin to wonder about that, whether or not you do anything in that area.

I do not think that any increase in the amount of oversight will touch the problem, which I think is one of the most important that your bill addresses, namely the importance of the feeling by taxpayers that indeed, if they do consider themselves as having been dragged into court, at least the law allows them to recover all or part of their attorneys' fees as determined at the discretion of the court.

We recognize this as an experiment in a new and difficult area. We recognize that the claim for attorneys' fees may well cause some problems for the Revenue Service. It might well impose upon the courts another decision to make.

Given all those concerns, it is not an easy balance to strike. Nonetheless, we think on balance that the best approach is to say to the court, depending on a variety of circumstances, we ask you to exercise your judgment, if you consider it appropriate, to award reasonable attorneys' fees.

As a starting experiment, we think that is a good way to go, and with a sunset provision in the bill, there will be ample time to review the experience under it.

Senator BAUCUS. In your judgment, in what kinds of cases should a judge award reasonable attorneys' fees? You do not want us to enter into the threshold question, but could you tell us, in your personal view, when should a judge award reasonable fees?

Mr. REDMAN. Yes.

If you read some of the Tax Court and other district court decisions in tax cases, you find examples where the government's position on the legal issue involved is really off the wall, to use a current expression, and some opinions so describe it.

There may be no malice involved, there may be no vexacious harrassment involved, but just very poor judgment on the part of the government in having dragged a taxpayer into court.

Some instances involve a small taxpayer and a small amount of dollars, there is no principle involved and no precedent involved from the Government's point of view, but somebody made a bad mistake in making that taxpayer litigate. That is the kind of case where I think the court should have the discretionary power to award legal fees.

Senator BAUCUS. Are you not concerned that different judges will have vastly different standards? Mr. Seigel says that the standards should be tightened up a little bit. It seems to me that he certainly has a point in implying, anyway, that that would, to some extent, prevent a wide variety of standards being used by different judges in determining whether or not IRS has been reasonable.

Mr. REDMAN. Mr. Chairman, that is a difficult balance to draw. I respect Mr. Seigel for falling on his side of the line. After we considered this subject, we decided for the opening experiment that we ought to fall on the other side of the line.

Senator BAUCUS. Why are you not concerned about the point I am making? A taxpayer has no idea, and a lawyer has no idea how to advise his clients.

Some judges would say they apply very strict tests or very lenient tests. There would be no uniform standard.

Mr. REDMAN. I would hope that no responsible lawyer would make a decision as to how to handle his case on the basis of his concern for whether or not he might get a fee award.

Senator BAUCUS. I am talking about in advising his client as to how successful they will be getting a fees award.

Mr. REDMAN. It would be a simple enough procedure in most instances where the client decides to recoup his costs from the Government to file the application. It would not take a court that much time or effort to dispose of it one way or the other. We think an initial requirement as to unreasonableness will make it harder for the court.

Senator BAUCUS. I do not understand that point.

Correct me if I am wrong in understanding you. I am a little concerned, if we proceed with the bill—I am concerned with your approach not to have any standard in reaching the threshold question.

Mr. REDMAN. The standard of reasonableness is in our proposal, but as to amount, not as a separate qualification.

Senator BAUCUS. With respect to the amount of fees. You do not have a standard here with respect to the Government that is a judgment on the Government's action.

Mr. REDMAN. The standard of reasonableness as to the amount could take us down to zero. A court could easily award zero because he does not think any amount would be reasonable under the facts of that particular case.

Senator BAUCUS. You would have no criteria against which a judge would determine whether or not the Government's actions are reprehensible?

Mr. REDMAN. We suggest in our statement some judgments that easily could be written into the committee report, the difficulty of the case, the reason for the Government's position in that particular case, the amount of ingenuity required on the part of the taxpayer in prevailing, going for novel law, and things of that sort.

The various cases in other areas of the law that deal with reasonableness would be equally applicable here. We simply do not agree that that question should constitute an independent requirment.

Senator BAUCUS. Do you agree that there is some relationship in a tax case between the amount of money involved and the amount of fees?

Mr. REDMAN. We have rejected that in our thinking, because it is difficult to compute the amount involved. The amount in 1 year may not represent the true amount involved.

Senator BAUCUS. Could you give this committee any guidance, in your judgment, on what the average attorneys' fees are in cases brought?

Mr. REDMAN. If you are asking me about fees in big cities, the answer is that many people think they are atrociously high. If you are asking about other parts of the country, I have no idea, Mr. Chairman. I doubt that you could establish any kind of statistic in that regard.

Senator BAUCUS. What would your reaction be to the $20,000 ceiling?

Mr. REDMAN. In our statement, we suggest that there be more—$20,000 is a number. If there were to be a maximum, it is good a number as any. If there were going to be a maximum, I personally would not be suggesting a higher number, but our ABA position is that there be no maximum.

Senator BAUCUS. I will ask any of you, particularly Mr. Seigel, if you have had any experience with GAO audits of the IRS, and whether they amount to meaningful oversight.

Mr. SEIGEL. I was just going to say, Mr. Chairman, that there has been, in recent years, an increase of substantial proportions, in the availability of oversight.

There is this subcommittee of the Senate Finance Committee that did not exist a number of years ago. There is a comparable oversight subcommittee, as you know, at the Ways and Means Committee, that did not exist a number of years ago.

The General Accounting Office has now been authorized to audit various activities of the Internal Revenue Service and their oversight committees of the Treasury Department, such as the Government Operations Committee, where two subcommittees exercise oversight of the Internal Revenue Service.

My experience in the Service was that we devoted a good deal of time in responding to appearing before and dealing with a variety of oversight type inquiries and examinations.

I think the problem today may be sorting out those inquiries in those areas that warrant careful attention from some that may have a good deal of time devoted to them, but may not be terribly important in the overall scheme of the Service's activities.

Senator BAUCUS. Unfortunately, there is another vote going on. I think it probably would be most appropriate to conclude this panel.

I will have some more questions. I will submit them to be answered specifically for the record.

[The material referred to follows:]

SEPTEMBER 3, 1979.

LIPMAN REDMAN, Esq.,
Washington, D.C.

DEAR MR. REDMAN: I would like to thank you for testifying on July 19 before the Senate Finance Subcommittee on Oversight of the Internal Revenue Service on S. 1444, the "Taxpayer Protection and Reimbursement Act". Your comments will certainly be most helpful as the Senate Finance Committee continues its consideration of this bill.

And, I also want to express my appreciation to you for providing such meaningful assistance to my office during the preparation stages of S. 1444.

At the hearing I stated that I would have additional questions to be added to the record. Thus, I would appreciate your response to the following questions:

1. Do you have any concern that attorneys may, if S. 1444 is enacted, increase their fees realizing that their clients may be reimbursed for a portion of those fees?

2. You seem to be recommending that the only requirement for award is that the party prevail—and that the courts be given total discretion to determine what constitutes "prevailing".

(a) Are you saying that merely winning is enough?

(b) Under what specific circumstances do you believe taxpayers should be so reimbursed?

3. Would you describe the extent to which collateral proceedings in court would be necessary in order to determine the appropriateness of reimbursement under S. 1444?

(a) To what extent would these collateral proceedings be unnecessary under your proposal?

4. It has been suggested during this hearing that the bill should make it clear that in order to be eligible for reimbursement, a taxpayer must exhaust all administrative remedies before instituting a civil action. Do you agree?

5. Under the terms of S. 1444, do you believe that the date of filing the petition or complaint in court begins the period for which reimbursement may be provided?

6. Should expenses for pro se proceedings be reimbursable expenses under this bill?

7. Should expenses for expert assistance and witnesses be reimbursable?

8. How should litigation expenses for in-house counsel by computed?

Thank you in advance for your assistance.

With best personal regards, I am

Sincerely,

MAX BAUCUS.

AMERICAN BAR ASSOCIATION,
Washington, D.C., September 25, 1979.

Hon. MAX BAUCUS,
Dirksen Office Building,
U.S. Senate, Washington, D.C.

DEAR SENATOR BAUCUS: We appreciate the opportunity extended to us in your September 3, 1979, letter to Mr. Redman to comment further on S. 1444, the "Taxpayer Protection and Reimbursement Act." In addition, it has been our privilege to work with your staff on various questions raised by the initial draft of the bill.

Our responses to your questions are as follows (each numbered paragraph corresponds to the question number in your letter):

1. We do not believe that an increase in attorney's fees is likely if S. 1444 is enacted. The attorney will have to satisfy both his client and the court that his fee

is reasonable. He must satisfy his client because, if he does not prevail, the client will be paying the entire bill. He must satisfy the court, if he does prevail, because S. 1444 limits reimbursement to reasonable attorney's fees.

We should point out that the $20,000 limitation presents problems in this regard which would be avoided if S. 1444 adopted the ABA's position of allowing prevailing taxpayers to recover reasonable attorney's fees without limitation as to amount. The problem comes, for example, in a case in which the attorney has performed services reasonably worth $20,000 for which he submits a bill for $30,000 to his client, knowing that since the client won his case he will only have to pay $10,000. The question thus is whether the court should award reimbursement of $20,000 because the attorney's services were worth that much, if it knows that the attorney has billed the client for an additional $10,000 over and above what his services were reasonably worth. Presumably, the courts will use their discretion to reach an equitable result in this situation, but the best way to resolve this problem is to eliminate any limitation (other than the limitation of "reasonableness") on the prevailing taxpayer's recovery.

2. You have correctly interpreted the ABA's position on this issue. Since the "prevailing party" standard is frequently utilized in other federal statutes governing award of attorneys fees (notably the Civil Rights Attorney's Fees Awards Act of 1976), there is ample precedent to guide the courts in the exercise of discretion in awarding such fees.

(a) Under the "prevailing party" standard winning is usually enough; however, the court has discretion to deny or limit an award in appropriate circumstances. While the "prevailing party" standard does leave considerable discretion to the courts, for that very reason it also allows the fullest consideration of the specific facts and circumstances of each case in determining whether a fee award is appropriate. A taxpayer who has successfully prosecuted a deficiency redetermination or tax refund action through the often long and expensive course of litigation with the Government usually feels that characterizing his success as "merely winning" (the quoted words are from your letter) grossly understates his effort, expenditure, and commitment.

(b) While our position is, as stated, that the court should have discretion to award fees to the prevailing taxpayer, we suggest that if any of the following circumstances appear, a fee award is particularly appropriate:

(i) The Government has previously lost a final decision on the legal issue in another forum.

(ii) A reasonable investigation of the facts would have demonstrated to the Government that it was unlikely to prevail on the issue.

(iii) Existing law and precedent, while not directly controlling, made it unlikely that the Government would prevail.

(iv) The Government's position is contrary to a published administrative position or longstanding administrative practice.

(v) The facts and circumstances of the case demonstrate that the Government has attempted to use the costs of litigation to extract taxpayer concessions which would be unjustified by the facts of the case.

3. Under the existing definition of "prevailing party" in the bill, collateral proceedings would clearly be required to establish the "unreasonableness" of the Government's position. We believe that this is undesirable and suggest that the need for such a collateral proceeding would be eliminated in most cases if a simple "prevailing party" standard were adopted. We believe that the legislative language should permit the court to hold a collateral hearing when the court deems such a hearing necessary; however, such a hearing should not be required.

The determination of the amount of the fee will of course require some testimony to establish the reasonableness of the award sought. Such testimony could be given at time of trial. However, we believe that it would be wasteful of court time to require such proof at that time since better, more complete evidence is available at the conclusion of the proceeding, and there is no need to receive such evidence in the first place until the taxpayer has prevailed on the substantive issues. Both federal and state courts have long experience in awarding fees in cases ranging from complex anti-trust matters to relatively simple domestic relations cases. Few such cases produce significant collateral proceedings contesting the amount of the fee, and we believe that there will be few tax cases in which the reasonableness of the fee is seriously contested. In short, while a brief hearing on a motion to set fees will probably be required, in most cases we would not expect such hearings to produce significant disagreements.

4. We would oppose any provision which would require a taxpayer to exhaust administrative remedies.

Administrative proceedings are generally futile in cases which involve "prime issues" or announced contrary positions of the Internal Revenue Service. Moreover, there are no mandatory "administrative proceedings" before the Internal Revenue Service, and they do not involve a formal hearing process as is usually the case before other agencies. Instead they more closely resemble an informal conciliation process. The difficulties of such a requirement are illustrated by the following frequently-recurring fact pattern: a taxpayer requests a conference and discusses the facts of his case with an appeals officer. After several conferences, the taxpayer concludes that an acceptable settlement cannot be reached with the appeals officer and unilaterally determines that further conferences with the appeals officer would be futile and thereupon terminates administrative proceedings. If such termination were considered a failure to exhaust administrative remedies, the appeals officer could effectively prevent any taxpayer from exhausting his administrative remedies by simply failing to act.

5. S. 1444 as presently written does not make it clear when fee accrual begins. The complaint or petition date should be the date on which the accrual of reimbursable fees begins, so that fees allocable to legal services during the administrative process are not reimbursed.

6. While we have not previously considered the matter, those of us who now have done so in response to your letter individually do not favor payment to a *pro se* taxpayer for his own time. First, such time would not be compensated for taxpayers represented by an attorney. Second, unlike a reimbursement of attorneys fees which would be offset by a deduction for fees paid, the *pro se* taxpayer would apparently recognize income on any such award. Third, awards to *pro se* taxpayers might well encourage more taxpayers to appear *pro se*. The experience of the Tax Court, which handles more *pro se* cases than any other forum, suggests that the unrepresented taxpayer is not merly a burden on the system in that he frequently litigates hopeless positions which competent counsel would have advised him to abandon, but also a threat to himself since he often mishandles meritorious positions. Accordingly, we feel that the bill should not encourage *pro se* litigation. Indeed, a major advantage of the bill in our view is that it may encourage taxpayers to consult competent counsel rather than file *pro se* litigation.

7. We have not taken a position on expert witness fees, accounting fees, and other similar expenses in our prior testimony. Certainly to the extent that such expenditures are necessary to the litigation but not reimbursed, the bill falls short of its goal of making the taxpayer whole. We would not oppose inclusion of such costs in the bill.

8. Concerning the "in house" counsel matter, we again have not previously considered the matter but those of us who have now done so in response to your letter individually believe that fees for "in house" counsel should be allowed, based on time expended and set by reference to the hourly rates charged by attorneys in private practice with comprable skill and experience. We oppose as unwiedly and unnecessarily complicated any attempt to prorate corporate costs and overhead as a basis for setting "in house" counsel fees.

Finally, we would like to take this opportunity to comment on three aspects of S. 1444 as presently drafted.

First, S. 1444 now provides for an award of costs, including reasonable attorney's fees, if the Government's position in litigation is unreasonable. Under present law, 28 U.S.C. § 2412, a taxpayer in a civil tax action (other than in the Tax Court) is already entitled to an award of costs (not including attorney's fees) if he prevails in the action, without any further showing. Assuming that it was not your intention that S. 1444 cut back on rights already enjoyed by taxpayers, S. 1444 should be amended to make clear that, as under present law, the taxpayer need only prevail to be entitled to reimbursement of costs other than attorney's fees. (Note that the Government also has the right to reimbursement of costs under 28 U.S.C. § 2412 if it prevails in a civil tax action. Under S. 1444 as presented drafted, the Government would not have to do more than prevail to recover costs, whereas the taxpayer would have to both prevail and show that the Government's position was unreasonable).

Second, we of course feel that S. 1444 should give the courts discretion to award attorney's fees in any case in which the taxpayer prevails. If additional requirements are to be imposed on the taxpayer, however, such as a requirement that the Government's position be unreasonable, the burden of proof issure becomes very important. We think it only fair that, since by hypothesis the Government has lost the case, it should have the burden of showing why its position was not unreasonable, or substantially unjustified, or whatever standard may be selected. Further, proof of the justification for or reasonableness of the Government's position will

frequently involve facts best known to the Government. Placing the burden of proof on the taxpayer could lead to costly discovery proceedings, quite probably involving frequent assertions of governmental privilege. Indeed, under the present language of the bill, a taxpayer might find it more expensive to prove the unreasonableness of the government's position than to prove the merits of his case.

Third, we strongly urge that the provisions of the bill which would treat "multiple actions which could have been joined or consolidated" as a single action for purposes of applying the $20,000 limitation be deleted. Rules 20(a) and 42(a) of the Federal Rules of Civil Procedure permit consolidation of actions if any common questions of law or fact are involved. Under the present provisions of the bill, wholly unrelated taxpayers' actions which might have been consolidated under the permissive joinder rules would be regarded as a single action even though the taxpayers involved are completely unrelated and possibly even antagonistic. Moreover, determination of whether one tax case "could" have been consolidated with another might well involve the court in another unnecessary controversy. We do not oppose the consolidation rule for cases involving returns of the same taxpayer, although we note that even this provision could result in limiting taxpayers with adverse interests to a single fee award, as for example when divorced spouses take differing positions concerning a joint tax return filed while they were married.

Thank you for providing us with this opportunity to express the above views on S. 1444. We, of course, remain at your disposal if we may provide further assistance.

Very truly yours,

CHARLES M. WALKER.

SEPTEMBER 3, 1979.

STUART E. SEIGEL, Esq.,
Williams and Connolly, Washington, D.C.

DEAR MR. SEIGEL: I would like to thank you for testifying on July 19 before the Senate Finance Subcommittee on Oversight of the Internal Revenue Service on S. 1444, the "Taxpayer Protection and Reimbursement Act". Your comments will certainly be most helpful as the Senate Finance Committee continues its consideration of this bill. And, I also want to express my appreciation to you for providing such meaningful assistance to my office during the preparation stages of S. 1444.

At the hearing I said that I would have additional questions to be added to the record. Thus, I would appreciate your response to the following questions:

1. Do you feel S. 1444 would make IRS more cautious in all its dealings with taxpayers?
2. Could you give us some specific examples of instances of IRS actions in which you feel an award of attorney's fees should be given?
3. Do you believe that the bill should make it clear that in order to be eligible for reimbursement a taxpayer must exhaust all administrative remedies before instituting a civil action? Why should a taxpayer have to go through additional delay and expense when it is clear, i.e. in prime issue cases, that further administrative appeal would be pointless? Would it be better just to leave that entire issue to the discretion of the courts?
4. Under the terms of S. 1444, do you believe that the date of filling the petition or complaint in court begins the period for which reimbursement may be provided?
5. You have stated that you believe a ceiling of $10,000 would be more appropriate. Could you tell us specifically why you believe the $20,000 ceiling is too high?
6. Do you believe that the voluntary settlement process is really so equitable that we should ensure that it is in no way disturbed?
7. Should litigation expenses incurred by taxpayers who represent themselves in pro se proceedings be reimbursable?

Thank you in advance for your assistance.

With best personal regards, I am

Sincerely,

MAX BAUCUS.

LAW OFFICES,
WILLIAMS & CONNOLLY,
Washington, D.C., September 25, 1979.

Hon. MAX BAUCUS,
Dirksen Office Building,
U.S. Senate, Washington, D.C.

DEAR SENATOR BAUCUS: This has reference to your letter dated September 3, 1979, concerning S. 1444, the "Taxpayer Protection, Reimbursement Act," and to the additional questions contained therein which you have requested I respond to. There

follows a statement of each of the 7 questions set forth in your letter, and my response thereto.

Question 1. Do you feel S. 1444 would make IRS more cautious in all its dealings with taxpayers?

Answer. I do not believe that enactment of S. 1444 would have a significant impact overall on the day-to-day dealings of the IRS with taxpayers. There are, in my view, relatively few situations in which IRS officials would be influenced in their actions and decisions by prospective recovery of attorneys' fees by taxpayers. As I stated in my prepared testimony, compensation for legal costs incurred as a consequence of unreasonable IRS action could have a salutary effect on the very few within Government who may abuse their authority.

Question 2. Could you give us some specific examples of instances of IRS actions in which you feel an award of attorneys' fees should be given?

Answer. No specific examples come to mind although review of decided cases would likely yield some appropriate examples.

Question 3. Do you believe that the bill should make it clear that in order to be eligible for reimbursement a taxpayer must exhaust all administrative remedies before instituting a civil action? Why should a taxpayer have to go through additional delay and expense when it is clear, i.e. in prime issue cases, that further administrative appeal would be pointless? Would it be better just to leave that entire issue to the discretion of the courts?

Answer. I believe it is proper to require exhaustion of administrative remedies as a condition precedent to reimbursement since that process offers the potential for administrative self-correction without the necessity of litigation. Any other rule would tend to encourage needless litigation. The number of cases in which further administrative appeal would be "pointless" are few in number, and are not the type of cases where the Government's position is likely to be such as to warrant the award of attorneys' fees.

Question 4. Under the terms of S. 1444, do you believe that the date of filing the petition or complaint in court begins the period for which reimbursement may be provided?

Answer. Since legal representation may be sought in connection with a contested matter prior to commencement of a judicial proceeding, I believe reimbursement should cover legal fees incurred during administrative proceedings, but only subsequent to the time the Service's initial determination is made (usually by issuance of a revenue agent's report following completion of the examination).

Question 5. You have stated that you believe a ceiling of $10,000 would be more appropriate. Could you tell us specifically why you believe the $20,000 ceiling is too high?

Answer. An excessive reimbursement ceiling carries with it the danger that it will create an incentive for extended dispute and disagreement. It seems to me that the ceiling should be geared to an amount which would be sufficient to cover the bulk of the situations where relief is warranted and where, but for reimbursement, the costs would be unduly high in relation to the amount involved. $10,000 seems to be sufficient to accomplish that purpose without creating an undue stimulus to litigate.

Question 6. Do you believe that the voluntary settlement process is really so equitable that we should ensure that it is in no way disturbed?

Answer. The voluntary settlement process is the cornerstone of efficient administration of disputed tax matters. Any significant breakdown in that process would place an additional burden on already overworked courts with significant expense to taxpayers, the Service, and the courts. Even more important, perhaps, is the danger that negative attitudes on the part of taxpayers to the Government in general, and the Service in particular, will be enhanced by a proliferation of litigation to resolve disputes.

Question 7. Should litigation expenses incurred by taxpayers who represent themselves in *pro se* proceedings be reimbursable?

Answer. I believe it may be appropriate to provide for reimbursement of a *pro se* taxpayer's reasonable out-of-pocket costs. In such cases where no costs are incurred to secure representation, this measure of relief would serve to minimize the financial consequences incurred to contest inappropriate governmental action.

I trust the foregoing will be helpful to you and the Subcommittee in your further consideration of this matter.

Sincerely,

STUART E. SEIGEL.

Senator BAUCUS. Mr. Walters?

Mr. WALTERS. Mr. Chairman, I would appreciate the privilege of making a very brief statement. I do not want to leave with your thinking I am so obstreperous that I do not agree with anything. I concur in my brothers' approval of the sunset provision.

Senator BAUCUS. We will accommodate you there.

We will be sure that there is a sunset provision.

Thank you very much, gentlemen.

[The prepared statements of the preceding panel follow:]

STATEMENT OF

LIPMAN REDMAN

CHAIRMAN, SECTION OF TAXATION

and

STEVEN C. SALCH

SPECIAL ADVISOR TO THE COMMITTEE
ON COURT PROCEDURE OF THE SECTION OF TAXATION

ON BEHALF OF THE

AMERICAN BAR ASSOCIATION

Mr. Chairman, Members of the Subcommittee, we appreciate this opportunity to present the views of the American Bar Association on S.1444. I am Lipman Redman, Chairman of the Association's Section of Taxation and with me is Steven C. Salch, Special Advisor to the Committee on Court Procedure of the Section of Taxation.

As representatives of the Section of Taxation and of the American Bar Association, we are pleased to support the basic principle of S.1444: the establishment of judicial authority to award reasonable attorneys' fees to the litigating taxpayer who prevails in civil tax litigation with the Government. We are authorized to state that support because the same principle underlies the proposal which the Tax Section adopted at its Annual Meeting in August, 1977 and which the House of Delegates of the American Bar Association approved the following February. That resolution with appropriate explanation is attached as Exhibit A.[1/]

In his statement explaining the Bill, the Chairman expressed the same fundamental concern which prompted the Section to initiate its recommendation. We share that interest in

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1/ Exhibit B is a copy of the proposed implementing statutory language. This is part of the Section's position but under Association procedures, was not considered by the House of Delegates.

preserving the confidence of taxpayers in the fairness of our self-assessment tax system. That system is unique in the world and, by and large, it works well. Support for that system requires continued taxpayer confidence, and that in turn requires a perception of fairness. It is that perception which is damaged in the eyes of the small taxpayer who frequently can not afford to litigate with the Internal Revenue Service or with the Department of Justice. The same is true of many other taxpayers where the amount of tax involved may not justify the contest because of the high cost of litigation.

We think it would help this concern if the law provides a set of rules which will make taxpayers eligible to recover attorneys' fees in certain situations. At the same time we think it equally important to impose reasonable restraints on the rules of eligibility in an effort to avoid the creation of fee contests in the tax area as a whole new subject of litigation.

At the outset it may be appropriate to note the obvious: as lawyers, we will of course benefit from the proposed legislation, and as spokesmen on this subject for the American Bar Association, we speak for lawyers from all across the country who will indeed represent the many small taxpayers who constitute an important group of beneficiaries of the Bill. We acknowledge that but assure you that that is not our motivation. We have long been interested in this subject and were

prompted to move by other developments which indicated to us increasing evidence of general taxpayer dissatisfaction with an increasingly complex revenue code and tax return, more frequent public references to taxpayer revolt and the like. This in turn has heightened our concern for the need to take some logical and reasonable step to counteract that concern. We sincerely believe that the concept of S.1444 represents a sensible and workable approach to this one phase of the problem.2/

In substance therefore our position is the same as S.1444: the right in the court to award attorneys' fees to successful private litigants in civil tax cases with the Government.

Turning now to some of the particulars f the Bill.

2/ The need for legislation is established by Alyeska Pipeline Service Corp. v. Wilderness Society, 421 U.S. 240 (1975), where the Supreme Court held that federal courts do not have the power to award attorneys' fees and expenses to a prevailing party unless specifically authorized by statute. An effort to satisfy this requirement was approved by the Senate Finance Committee and adopted by the Senate (with a limit of $10,000) in the Tax Reform Act of 1976; the provision was deleted by action of the Senate-House Conference. The enactment thereafter of the Civil Rights Attorney's Fees Awards Act of 1976 (P.L. 94-559) appeared to be inadequate because it required a "civil action or proceeding, by or on behalf" of the Government and that did not appear to reach most civil tax cases where the taxpayer is either the plaintiff or the petitioner.

1. Types of litigation covered

The Bill applies to civil tax litigation in all federal courts - the U.S. Tax Court, the Federal District Court, and the U.S. Court of Claims - and therefore without regard to whether the taxpayer is a petitioner seeking to avoid assessment or a plaintiff who has paid the disputed tax and is seeking its refund. This would not however extend to declaratory judgment proceedings.

The Association's position is the same in this regard and for the same reasons: entitlement to recovery should not hinge on the particular forum or the technical status of the parties.

2. The limitation of entitlement to the "prevailing party"

Here again our position is basically the same as that set forth in the Bill: the taxpayer must prevail in the litigation in order to be eligible for recovery of attorney's fees. An argument can be made that at least some small taxpayers should be reimbursed their legal fees regardless of the outcome of the contest, on the theory that only in that way can those taxpayers have the feeling that they are in a position to "fight the system". We agree with the concept of the Bill, however, that that would indeed expose the system to too much fee litigation and is not warranted.

We do have some concern however with the definition of "prevailing party" in Section 201(3) of the Bill. It specifies that the taxpayer's position must be "sustained . . . as to all, or all but an insignificant portion, of the amount in controversy".

Quite often tax cases involve several issues and the actual magnitude of the tax liability involved in any single issue might be substantially greater than the amount in controversy in a single year because the issue is a recurring issue, such as inventory or bad debt tax accounting, allowable depreciation, eligibility of certain expenditures for tax credit or the like. If the taxpayer prevails on such an issue involving $500 of tax liability in the current year, but $10,000 of tax liability over all potentially affected years, yet does not prevail in another issue present in the instant case and involving $750 of tax liability, is the taxpayer the "prevailing party" under the Bill? We believe he should qualify under these facts but it is not clear that that result will follow under the Bill.

This illustrates the problem which complicates any effort to develop a suitable, all-encompassing definition of "prevailing party". It is for this reason that the Association's proposal leaves that decision to the sound discretion of the courts, as is the case under existing law in other areas.

Another argument sometimes made in this connection is to allow the Government to recover certain costs if it is the prevailing party. The rationale is to discourage specious and similarly ill-founded lawsuits by taxpayers, sometimes designed simply to delay the time of payment of tax clearly due. Here too we agree with the Bill's approach and invite the committee's attention to that part of the Section's report (page 1289 of Exhibit A) which outlines the reasons which we found to be persuasive.

We note too other phases of this particular facet of the subject on which the Bill and the ABA position coincide, namely appellate review of the trial court's award, the exclusion of legal fees attributable to the administrative aspects of the tax contest, i.e. prior to formal litigation, and the application of eligibility for recovery to situations where the litigation is settled by agreement rather than by court decree.

3. The requirement that the Government's position be "unreasonable"

This is one element of eligibility on which the Association's proposal differs from the Bill. At first blush, this condition appears to be sound: the Government should not have to pay the taxpayer's legal fees simply because the Government was doing its job, even though it lost a particular case. Closer analysis, however, discloses fundamental flaws in that analysis.

As a substantive matter, a determination of unreasonableness could present a very difficult question: is it unreasonable for the Internal Revenue Service to adopt a policy of litigating every case involving a particular issue (family partnerships and professional service corporations a number of years ago) as part of its effort to seek judicial guidance on ambiguous or complex code provisions - even after the Government has lost a significant number of those cases? Or is it unreasonable for the Internal Revenue Service to continue to litigate an issue in certain parts of the country in the face of clear defeat in one or more federal circuits? Certain judges might find such litigating policies quite reasonable, regardless of their application to particular parties in particular cases; others might be more persuaded by the facts of the particular case. This could easily produce an area of conflict which does not appear to be warranted.

We think it is preferable to include the matter of the Government's reasonableness or lack of it as one of the factors in fixing the amount of the fee. Since we propose to leave the amount to the court's discretion, we think the court can give due weight in that manner to the nature of the Government's actions. Expressed another way, if the Government did not act unreasonably, the fee award may well be small or even zero. By the same token, unreasonable actions by the Government are likely to prompt the court to award a higher amount.

An equally important consideration in this regard stems from the taxpayer's difficulty in establishing unreasonableness. Presumably he would have the burden of doing so, and this might require him to seek his proof from the Government's records of the process it followed in formulating its position. However, many such materials might be available only by discovery and a substantial portion of them may be privileged from discovery. This could produce additional litigation involving discovery requests for internal memoranda, communications, and depositions of, or interrogatories to, Government personnel and the Government's resistance (quite likely legitimate) against production of documents or other discovery by private litigants through assertions of privilege.

For these reasons our position does not condition recovery upon a showing that the Government's position is unreasonable.[3/] Rather, the Association recommends that entitlement to recoupment be conditioned only upon status as the prevailing party and be left to the discretion of the court.

4. The amount of the award

The Bill imposes a limit of $20,000 for any one action or proceeding. This follows from the belief that this maximum represents an appropriate balance between sufficient

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3/ We note that despite our opposition to this criterion, it is considerably preferable to the requirements of the Civil Rights Attorney's Fees Awards Act of 1976, P.L. 94-559, that the Government's actions be taken in "bad faith", or "vexatiously" or "frivolously".

relief in most cases and a concern for not making the recovery provision so attractive as to invite undesirable litigation.

We respectfully disagree, and in this regard as well, urge the rule involved in our proposal, namely the rule of reasonableness as determined by the court. It seems to us that the selection of a maximum in any amount requires a determination in a situation where every case is likely to be different and where numerous factors are relevant, with the result that any number has to be arbitrary. It may well be that $20,000 (or less) will suffice in many and even most cases, but we suggest that in those same cases, the court is quite likely to award substantially similar or equivalent amounts, and at least we think that the precedent established in other areas of the law warrants the same approach here: a reasonable amount as determined in the court's discretion. This would enable the court to consider all relevant factors as they might differ from case to case: the novelty of the issues presented, the extent to which the taxpayer's position is based on decided cases, rulings and other authorities, the extent to which the issues involve the public interest (e.g., an effort by the Government to establish a principle of general application), the taxpayer's financial status, the time required to litigate the issues, and the magnitude of the taxpayer's expenses - and as noted, whether the Government acted "unreasonably".

This list of considerations is by no means complete, but it is certainly adequate to demonstrate the difficulty of justifying a maximum in any amount. Given the primary impetus for the whole concept of the Bill, there does not appear to be any overriding reason to attempt an arbitrary limit when the court's discretion is readily available and is already established as a sound technique for judgmental matters of this sort - and any concern for excessive enthusiasm for taxpayers would of course be tempered by the limitation of reasonableness and be limited by the requirement that the taxpayer be the prevailing party.

In our judgment these factors constitute adequate safeguards against excess and against tax litigation motivated solely or primarily by the lawyer's interest in legal fees.

5. The requirement that any award be paid by a particular agency

The reasoning behind this section of the Bill is to provide a motivation for the particular agency involved not to be unreasonable or careless in selecting cases for litigation. Although it may not matter at all to taxpayers, we suggest some potential problems in this regard which may tend to cause inter-agency disputes and may be difficult to administer in practice due to the manner in which civil tax litigation and certain administrative refunds of tax are handled.

For example, administrative refunds, including those made incident to settlement of income, estate or gift tax litigation in excess of $200,000, (as a practical matter) require Joint Committee on Taxation approval and both the Internal Revenue Service and the Department of Justice are bound to follow the Joint Committee if the refund is not approved and the settlement is therefore not effected. If the taxpayer prevails at trial, under S.1444 whose funds are charged? S.1444 provides it would be the agency conducting the trial, yet the Joint Committee in essence caused the trial by rejecting a settlement proposed by the agency conducting the trial. Note, in this regard, that a refund action can be initiated because the Joint Committee has rejected an administrative recommendation for action on a refund claim and the same results as obtain in the preceding example can follow.

The Justice Department does not become involved in civil tax refund controversy until a refund complaint or petition has been filed and frequently is unable to evaluate a case preliminarily until the Internal Revenue Service's defense memorandum and administrative files are forwarded to it. If, upon receipt of such materials, the Justice Department determines that the Government's case lacks merit and should be conceded and the taxpayer is awarded attorneys' fees, should the Justice Department, as the agency conducting the trial, be charged with the award when it has done what S.1444 hopes to encourage it to do?

These are but a few examples of the type of complexities peculiar to tax litigation which cause us concern about the provisions of S.1444 dealing with the manner of payment of costs awards.

Mr. Chairman, we much appreciate the opportunity to participate in these hearings and trust that if we can be helpful in further consideration of this important question you will feel free to call upon us. Certainly we stand ready to work with you and the Subcommittee staff to any extent that you like.

EXHIBIT A

COMMITTEE ON COURT PROCEDURE

TAX SECTION RECOMMENDATION No. 1977-1

TO AMEND THE INTERNAL REVENUE CODE OF 1954 AND THE JUDICIAL CODE TO PERMIT THE AWARD OF COSTS, INCLUDING REASONABLE ATTORNEYS' FEES AND EXPENSES, TO THE PREVAILING PARTY (OTHER THAN THE GOVERNMENT) IN LITIGATION INVOLVING THE REDETERMINATION, RECOVERY, REFUND OR COLLECTION OF ANY INTERNAL REVENUE TAX.

RESOLVED that the following Resolutions be submitted by the Section of Taxation to the House of Delegates of the American Bar Association:

RESOLUTIONS

RESOLVED that the American Bar Association recommends to the Congress that the Internal Revenue Code of 1954 be amended to permit the United States Tax Court in deficiency proceedings to award the prevailing party (other than the Government) costs, including reasonable attorneys' fees and expenses;

FURTHER RESOLVED that the American Bar Association recommends to the Congress that Title 28 of the United States Code be amended to permit reasonable attorneys' fees and expenses to be included in the award of costs to the prevailing party (other than the Government) in litigation involving the recovery, refund or collection of any internal revenue tax;

FURTHER RESOLVED that the Section of Taxation is directed to urge on the proper committees of the Congress amendments which will achieve the foregoing results;

FURTHER RESOLVED that Recommendation No. 1959-10, which provides for the award of limited costs in tax refund actions, proposed by the Section of Taxation in August, 1959, 12 TAX LAWYER 30 (1959), and adopted by the Association in August, 1959, 84 A.B.A. REP. 145 (1959), be withdrawn.

REPORT

Summary

Taxpayers may be forced to incur substantial out-of-pocket expenses, including legal fees, to establish through litigation that they do not owe internal revenue taxes which the Government seeks to assess or retain. The Supreme Court has held that the federal courts do not have the power to award attorneys' fees to a prevailing party in the absence of an act of Congress expressly authorizing such award. Existing federal statutes authorize the award of costs other than attorneys' fees and expenses to the prevailing party in tax refund litigation, but not in United States Tax Court proceedings. The award of attorneys' fees and expenses is not authorized by statute in either tax refund actions or deficiency proceedings. Although it could be argued that the Civil Rights Attorney's Fees Awards Act of 1976, P.L. 94-559, authorizes such awards,

the relevant provision is ambiguous.

It is recommended that all federal courts, including the United States Tax Court, be authorized to award costs, including reasonable attorneys' fees and expenses, to a prevailing party (other than the Government) in litigation involving the redetermination, recovery, refund or collection of any internal revenue tax.

Discussion

At the present time, the federal courts may award certain costs, other than attorneys' fees and expenses, to the prevailing party in tax refund and appellate proceedings to the extent authorized in 28 U.S.C. §§ 1920 and 2412. Related provisions are contained in the rules of various federal courts, *e.g.*, Rule 54 of the Federal Rules of Civil Procedure and Rule 39 of the Federal Rules of Appellate Procedure. (No comparable rule has been promulgated by the Court of Claims.) There is no statutory provision authorizing the United States Tax Court to award any costs in deficiency proceedings.

In *Alyeska Pipeline Service Corp. v. Wilderness Society*, 421 U.S. 240 (1975), the United States Supreme Court held that the federal courts do not have the power to award attorneys' fees and expenses to a prevailing party unless an act of Congress expressly authorizes such award. The United States Code contains over 50 provisions authorizing the award of attorneys' fees in a wide range of cases. However, the only statutory provision authorizing the award of attorneys' fees in tax litigation is found at 42 U.S.C. § 1988. This provision, added by the Civil Rights Attorney's Fees Awards Act of 1976 (P.L. 94-559, October 19, 1976), permits the award of reasonable attorneys' fees to a prevailing party (other than the United States) "in any civil action or proceeding, by or on behalf of the United States of America, to enforce, or charging a violation of, a provision of the United States Internal Revenue Code . . . ." Senator Allen of Alabama, one of the sponsors of this legislation, stated several months after enactment that this provision was intended to apply to "any case involving a disputed tax . . . notwithstanding the formalistic characterization of the taxpayer as plaintiff or defendant or as appellant or appellee." 123 Cong. Rec. S732 (daily ed. Jan. 14, 1977). His comments were in response to the view expressed by others that the provision appears to be inapplicable to tax refund actions in the district courts and Court of Claims as well as deficiency actions in the United States Tax Court, since such proceedings are not "by or on behalf of" the Government. This basic question of statutory interpretation will, in time, be resolved by the courts. *See Key Buick Co. v. Commissioner*, 68 T.C. No. 17 (May 16, 1977). Until then, the ability of a taxpayer to obtain reimbursement of attorneys' fees and expenses will remain in doubt.

Prior to enactment of P.L. 94-559 various bills were introduced in the Congress to authorize the award of attorneys' fees in tax refund and deficiency litigation, and on several occasions such legislation was passed by the Senate. Indeed, section 1212 of H.R. 10612 (Tax Reform Act of 1976) as reported by the Senate Finance Committee and adopted by the Senate contained such a provision (limited to fees not to exceed $10,000). This provision was, however, deleted in conference. These actions indicate Senate recognition that the public interest would be served by permitting reimbursement of prevailing parties in tax litigation.

When the Government forces a taxpayer to incur litigation expenses to

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establish an absence of tax liability, it imposes on the taxpayer an economic burden akin to the tax which the litigation establishes is not owed. While the tax laws permit a form of indirect reimbursement for such expenses by allowing them as deductions for federal income tax purposes, such reimbursement is only partial and is limited to those taxpayers who itemize their deductions. The increasing complexity of the tax laws and the dramatically rising costs of litigation establish the desirability of legislation which would permit a prevailing taxpayer to receive direct reimbursement of the costs of the litigation, including reasonable attorneys' fees and expenses. This is particularly important in smaller cases, where the costs of litigation might otherwise effectively prevent the taxpayer from litigating his liability.

The Recommendation would eliminate the present uncertainty in the tax law by specifically authorizing all courts having jurisdiction over tax deficiency, refund and collection actions to award to the prevailing party (but not the Government) the costs of such litigation, including reasonable attorneys' fees and expenses.

In formulating the Recommendation, various policy questions were considered, including those discussed below.

1. *Costs of the Government.* The Recommendation would not authorize the award of attorneys' fees and expenses to the Government when it prevails in the litigation. While arguments could be advanced to support uniform treatment, it was concluded that the considerations which favor the award of costs to prevailing taxpayers from the private sector do not support, at least to the same extent, the award of costs to the Government to cover expenses incurred by it in the course of administering the tax laws. This conclusion was based on several considerations: (a) the Government is currently able to obtain a certain measure of reimbursement through the imposition of the negligence penalty and, in more severe cases, fraud and other penalties, where the taxpayer acts without regard for established tax principles; (b) the taxpayer must generally bear the burden of proving an absence of tax liability; (c) taxpayers are often forced to litigate issues because of the "public interest" of the Government in establishing principles of law which will apply to all taxpayers generally (*e.g.*, the "prime issue" list promulgated by the Office of Chief Counsel of the Internal Revenue Service); and (d) the Government, as an institution with considerable financial resources, possesses potentially disproportionate bargaining power resulting from its ability to assume the financial burden of protracted litigation. The Recommendation is also based on the conviction that taxpayers should not be discouraged from having the Government's assertions of tax liability reviewed by a court of law. The principle of affording a taxpayer his day in court, so essential to the maintenance of taxpayer confidence in the tax system, might be seriously undermined if court review were effectively available only to those who could (or would) assume the financial risk of being ordered to pay the Government's costs if their position is not upheld.

2. *Prevailing Party.* The proposal would limit the award of costs, including attorneys' fees and expenses, to the "prevailing party." In this respect, the Recommendation follows the approach of similar acts of Congress in which the award of such fees is authorized or mandated. While a determination of whether a party is the "prevailing party" in tax litigation will occasionally require the exercise of judicial discretion, the "prevailing party" concept is one with which

the courts are now familiar. It is therefore believed that the courts will be able to apply the concept to tax litigation without significant difficulty.

3. *Discretionary Award.* The Recommendation would authorize the courts to award such costs in their discretion. This approach differs from other statutes which mandate the award of such costs, *e.g.*, 7 U.S.C. § 499Q(b) (Perishable Agricultural Commodities Act); 15 U.S.C. § 1640(a) (Truth-in-Lending Act). While the discretionary aspect of the Recommendation could result in an uneven exercise of discretion by the courts, it nevertheless seems desirable. Discretion will permit the court to take into account the extent to which the taxpayer is the "prevailing party" in determining whether to award costs as well as the amount to be awarded. It is intended that the discretion given should be all-encompassing. The Recommendation therefore does not include guidelines, restrictions, or other standards, on the assumption that the courts will exercise their discretion in a manner generally consistent with their practices in applying other federal legislation permitting similar reimbursement of such expenses. The courts can be expected to consider, among other factors, the novelty of the issues presented, the extent to which the taxpayer's position is based on decided cases, rulings and other authorities, the extent to which the issues involve the public interest (*e.g.*, an effort by the Government to establish a principle of general application), the taxpayer's financial status, the time required to litigate the issues, and the magnitude of the taxpayer's expenses. It is not intended that the court's discretion be exercised only in cases where alleged Government "harassment" is indicated. *See In re Joel Kline,* Bankruptcy No. 16086—T (D.C. Md., April 25, 1977).

4. *Reasonable Attorneys' Fees.* The Recommendation is similarly limited to "reasonable" attorneys' fees and costs. The concept of reasonableness is now well established in the courts, *e.g.*, *Johnson v. Georgia Highway Express, Inc.*, 488 F.2d 714 (5th Cir. 1974), listing those factors which should be taken into account. The inclusion of a flexible test of reasonableness seems desirable without addition of a limitation expressed as a specified dollar amount.

5. *Administrative Costs.* Consideration was given to expanding the Recommendation to permit the award of costs incurred during the course of administrative consideration of the case, in addition to the costs of subsequent litigation. Persuasive arguments could be advanced to support such an expansion. It is possible that P.L. 94-559 might be interpreted to authorize the award of administrative costs, as suggested by Senator Allen in remarks made after enactment of that legislation. 123 Cong. Rec. S732 (daily ed. Jan. 14, 1977). Nevertheless, it was concluded that the Recommendation should not be expanded to include administrative costs because the effect might be to restrain the Government from exercising its legitimate functions of auditing returns, requesting additional information, and, when appropriate, requiring that the taxpayer establish the validity of the tax treatment in administrative proceedings. However, if the Government ultimately decides to force the taxpayer to litigate the issue, the Government should be prepared to make the taxpayer whole for the costs of litigation if the court determines that the position taken by the Government is erroneous.

6. *Other Types of Actions.* The Recommendation is limited to tax deficiency, refund and collection actions. Valid arguments could be advanced to support extension of the Recommendation to all tax actions, such as declaratory

judgment actions in the Tax Court. Since reimbursement of costs in other actions raises somewhat different considerations and policy judgments, and since declaratory judgment actions in particular are new and untested, it was concluded that the Recommendation should be confined to those actions where the justification for reimbursement is strongest.

7. *Unnecessary Litigation.* The objection most frequently raised to the award of costs to successful litigants is that it encourages unnecessary litigation. It is believed that the discretionary aspect of the award, together with the "prevailing party" requirement, would satisfy any such objections.

8. *Fairness.* The Recommendation would inject a much-needed element of fairness into the administration of the tax laws at a time when taxpayers are questioning, as never before, the fairness of the system. As Senator Bellmon stated in support of similar legislation in the 94th Congress:

> Therefore, any action which the Congress can take to convince citizens of this country that they are getting a fair shake in their dealings with the IRS is greatly in the national interest. This amendment, when passed, will correct one of the main complaints taxpayers have against the present administration of the income tax; namely, that the IRS can at its discretion use the power of the Internal Revenue Service to oppress and harass taxpayers and that the taxpayer is helpless to defend himself against such a procedure without financial sacrifice. 122 Cong. Rec. S12,604 (daily ed. July 27, 1976).

Recommendation No. 1959-10, 12 TAX LAWYER 30 (1959), adopted by the American Bar Association, 84 A.B.A. REP. 145 (1959), would require that costs be awarded as a matter of right to "the prevailing party" in refund suits brought in a federal district court or the Court of Claims. That recommendation is limited to costs generally reimbursable in suits involving private litigants, which would exclude attorneys' fees and expenses. Subsequent to the adoption of that Recommendation, 28 U.S.C. § 2412 was amended to permit a court to award costs (excluding attorneys' fees and expenses) to the prevailing party even though the litigation was against the Government. The present Recommendation goes beyond Recommendation No. 1959-10 in that it (1) extends the award of costs to include attorneys' fees and expenses and (2) pertains to deficiency proceedings in the Tax Court as well as refund actions. It also differs from Recommendation No. 1959-10 in that it would authorize, not require, the award of such costs.

No member of the originating committee or of the Council of the Section of Taxation is known to have a material interest in the Recommendation by virtue of a specific employment or engagement to obtain the result of the Recommendation. It is recommended that the Recommendation be made applicable only to cases filed after the date of its enactment in order that pending litigation not be affected.

EXHIBIT B

PROPOSED STATUTORY LANGUAGE

RESOLVED that the Section of Taxation implement the foregoing by urging the following amendments, or their equivalent in purpose and effect, on the proper committees of the Congress:

Sec. 1. Part II of subchapter C of chapter 76 of the Internal Revenue Code is amended by adding a new section 7465 to read as follows (insert new matter in italics):

SEC. 7465. AWARD OF COSTS.

(a) IN GENERAL.—In any proceeding before the Tax Court for the redetermination of a deficiency, the prevailing party, unless the prevailing party is the Commissioner, may be awarded a judgment for costs to the same extent as is provided in section 2412 of title 28 of the United States Code for civil actions brought against the United States.

(b) JUDGMENT.—A judgment for costs entered by the Tax Court under subsection (a) in favor of the prevailing party shall be treated, for purposes of this subtitle, in the same manner as an overpayment of tax. No interest shall be awarded with respect to any judgment for costs.

Sec. 2. Section 2412 of Title 28 of the United States Code is amended to read as follows (eliminate matter struck through, insert new matter in italics):

§ 2412. Costs.

(a) Except as otherwise specifically provided by statute, a judgment for costs, as enumerated in section 1920 of this title ~~but not including the fees and expenses of attorneys~~ may be awarded to the prevailing party in any civil action brought by or against the United States or any agency *thereof* or official of the United States acting in his official capacity, in any court having jurisdiction of such action. *Except as otherwise specifically provided, such costs shall not include the fees and expenses of attorneys.*

(b) In any civil action described in subsection (a) of this section for the collection or recovery of any internal revenue tax, or of any penalty or other sum under the internal revenue laws, the judgment for costs awarded to the prevailing party may include reasonable attorneys' fees and expenses unless the prevailing party is the United States, or an agency thereof or official of the United States acting in his official capacity.

(c) A judgment for costs when taxed against the Government shall, in an amount established by statute or court rule or order, be limited to reimbursing in whole or in part the prevailing party for the costs incurred by him in the litigation. Payment of a judgment for costs shall be as provided in section 2414 and section 2517 of this title for the payment of judgments against the United States.

Sec. 3. The amendments made by sections 1 and 2 shall be effective with respect to civil actions and proceedings for the redetermination of deficiencies commenced after the date of the enactment thereof.

EXPLANATION OF PROPOSED STATUTORY LANGUAGE

The statutory language of the present Recommendation has been patterned after the language of section 1212 of H.R. 10612 (Tax Reform Act of 1976) as reported by the Senate Finance Committee and as approved by the Senate. It is believed desirable that both the Internal Revenue Code and Title 28 of the United States Code be amended, since the provisions would be applicable to proceedings before both the United States Tax Court and the federal courts subject to Title 28.

Conforming and clerical amendments have not been made.

STATEMENT OF

STUART E. SEIGEL

Mr. Chairman and Members of the Subcommittee:

I am pleased to have the opportunity to appear here today to present my views on S. 1444, the proposed "Taxpayer Protection and Reimbursement Act."

I am a partner in the Washington, D.C. law firm of Williams and Connolly and am appearing in my individual capacity. I have recently served as Chief Counsel for the Internal Revenue Service and prior to that time have engaged in the private practice of law and held positions with the Internal Revenue Service and the Tax Legislative Counsel's Office of the Treasury Department.

The issue concerning the award of attorneys' fees to prevailing taxpayers in civil tax litigation is of importance to the public, the courts, and to tax administration. The availability of this forum to interested persons and organizations should contribute to a better understanding of the problems and to a more effective and thoughtful legislative response.

It is difficult to argue with the proposition that a person who is put to legal expense by the unreasonable actions of another should be reimbursed for the costs incurred in defending the matter. Yet, the American judicial system has generally not functioned in accord with that approach. The allowance of attorneys fees is the exception to the rule under our tradition. This reflects a desire not to unduly encourage litigation by the prospective recovery of attorneys' fees, and at the same time, not to inhibit those with claims from prosecuting their causes of action for fear of incurring large obligations to the other party in the event they do not succeed.

This balanced approach has generally served our system well. However, as in the case of any general rule, exceptions will apply. Thus, several Federal statutes now provide for the recovery of attorneys' fees in situations where the public interest is served by affirmatively encouraging litigation; the so-called "private attorneys general" cases.

In addressing the issue of awarding attorneys' fees in tax cases, I take the existing practice in Federal litigation generally as a point of departure, and approach the problem with the belief that the policies underlying the American rule are generally sound, but flexible enough to accommodate exceptions if justification exists.

Federal taxation has a broad impact upon our citizens. The reach of the income tax is pervasive. Participation in the

system is involuntary in the sense that taxpayers are required by law to report and pay their correct liability. An integral part of the viability and success of the system is the confidence of the American taxpayer in the fairness of the tax laws and in the even-handed and impartial administration of the system by the Internal Revenue Service.

Taxpayers should have accessibility to effective and fair mechanisms to resolve their disputes with the Government. Where the position of the Government is beyond the bounds of reasonable administration of the law, it is appropriate to consider some system of compensation for the legal costs involved in contesting the unfounded position being asserted. This would serve several useful purposes. First, it would enhance public confidence in the overall fairness of the system. Second, it would remove financial barriers to taxpayer assertion of legitimate grievances. Third, it could have a salutary effect on the very few within Government who may abuse their authority.

On the other hand, there are problems involved in responding to that need, which must be carefully considered and evaluated as a remedy is fashioned.

First, administration of the tax laws should strive to treat similarly situated taxpayers uniformly. In seeking to attain that objective, obstacles should not be created to the assertion of positions taken in good faith by revenue officials which they believe reasonably reflects the law and Congressional intent.

Second, providing for awards of attorneys' fees inevitably creates collateral proceedings in the courts. Not only would the court determine the jurisdictional, procedural, and substantive issues which may be involved in any litigation, but it would then be required to proceed to a supplemental inquiry to determine whether an award of attorneys' fees is approriate, and if so, the amount to be granted. Courts already struggling with increasing dockets should not be overburdened further with collateral proceedings that are unnecessary. This is particularly true in the case of Tax Court where the overwhelming majority of the volume of civil tax disputes are lodged. The Tax Court's caseload has been increasing dramatically in recent years and a system which encouraged a large number of taxpayers to assert a claim for reimbursement of attorneys' fees could impact adversely on the court's continued ability to function efficiently and effectively. Any program providing for an award of attorneys' fees in civil tax litigation must, therefore, be structured to avoid creating an incentive for habitual assertion of the claim.

A third objective should be to avoid creating an award system which could operate to discourage settlements which taxpayers would otherwise agree to, in the hope that further pursuit of the proceedings would yield recovery of all or some portion of attorneys' fees. The Service has, over the years, been able to dispose of something on the order of 80 percent of disputed cases

by settlement. Disincentives to fair and just settlements would only increase administrative and judicial costs and burdens and lead to negative impressions of the efficiency of the system.

Fourth, while there are undoubtedly cases in which Service officials may act unreasonably, the nature of the tax system is such that individuals may have a perception of unfairness that may not be attributable to the actions of the Service, but rather reflect dissatisfaction with the tax laws generally or the unease and concern which taxpayers typically experience when subjected to an IRS audit. Therefore, the standard against which awards would be authorized should be articulated in a way that will be responsive to legitimate cases and not authorize recovery in situations where the Service's actions are appropriate, even though determined ultimately to be incorrect.

Last, recognizing the problems inherent in striking a balance between the need for appropriate measures of relief and the risks that untoward disruption to existing procedures may present, any program should be viewed as a first effort, subject to review and evaluation to determine whether continuation as a permanent part of the law is warranted and, if so, what modifications would strengthen the program.

With these guides in mind, I believe S. 1444 presents a constructive approach to the problem. Although I have suggestions to offer concerning some aspects of the bill, I believe

it presents a positive framework for testing, in practice, the actual need for legislation of this type in the tax area, and a comparison of the benefits achieved to the costs and burdens imposed.

For that reason I support the 4-year sunset provision of the bill. A mechanism within the statute to require review and re-evaluation is essential to fashioning an appropriate solution to the problem. I would hope that, at the proper time, the intent of that provision would be realized by a meaningful legislative reconsideration of the problem so that needed legislative actions can be instituted without undue delay.

S. 1444 would authorize award of attorneys' fees if the taxpayer prevails in the litigation and can establish that the position of the Government was "reasonable." Obviously, if the taxpayer does not prevail in the litigation, it is clear that the Government had reasonable cause for their actions and no basis would exist for the recovery of legal costs.

However, conditioning recovery on a showing of "unreasonableness" on the part of the Government may provide too imprecise a standard to be susceptible to reasonably uniform application. The term could be interpreted to include not only the propriety of the Government's legal position, but any number of ancillary matters, such as the manner in which the case was handled and the Government's position presented. The critical question in this regard, as I see it, is whether the Government had a reasonable

basis in law for the position advanced in the case. That standard would more effectively separate out the cases in which awards are appropriate than the standard contained in the bill, and would provide better guidance to courts in making determinations. Such an approach would limit the inquiry to whether, under the law, the Service had reasonable grounds to proceed, and would afford protection to taxpayers from unsupported Government action, which is the objective of the bill.

The $20,000 limitation on the maximum fees that can be awarded seems higher than necessary to further the bill's objectives. The maximum amount appears to be greater than the amount of fees one would anticipate would be ordinarily associated with cases of the type the bill seeks primarily to assist -- taxpayers faced with proposed liabilities that are small in relation to the legal costs that would be incurred to defend or prosecute the case. The prospect of too generous a recovery could be an incentive for increased litigation. Recognizing this effort as an initial program, a limitation of $10,000 would seemingly serve to provide an appropriate level of relief in the types of situations to which the bill is predominantly addressed, while avoiding the risk of undue stimulus to litigate. The level of maximum recovery can then be reevaluated in the light of actual experience in the coming years.

In conclusion, a carefully drawn and balanced effort in the attorneys' fee area would be an appropriate step to take at

this time. Given the uncertainty of some of the effects that such action might have on the administration of the tax system, I believe prudent limitations and useful guidelines should be sought in the development of a final proposal, and that the effect of such a proposal in actual practice will afford important guidance for future action in this area.

I appreciate very much the attention and consideration of the Subcommittee and would be pleased to answer any questions you may have.

Statement By
Johnnie M. Walters
of Greenville, South Carolina

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(1) Introduction

Our voluntary self-assessment income tax system has served the country well. If we are to continue our system of government and governmental programs, we must keep that system working well. That means that taxpayers generally must be treated equitably and fairly by the Internal Revenue Service and the Department of Justice in the administration of the internal revenue laws. It is the intention of those sponsoring S.1444 to strengthen our system by providing for payment of reasonable court costs to taxpayers who prevail against the United States in certain cases.

(2) S.1444

This legislation would authorize a court - Tax Court, Court of Claims, United States District Court - to award a judgment for reasonable costs incurred in the civil action or proceeding brought by or against the United States for the determination, collection, or refund of tax, interest, or penalty under our internal revenue laws. The award may not

exceed $20,000.00 for any one civil action or proceeding. To qualify for such an award, the taxpayer must prevail over the United States and must establish that the position of the United States in the civil action or proceeding was unreasonable.

(3) Comments

One can hardly argue against making a taxpayer whole when he or she must litigate to achieve that to which he or she is entitled. That being so, we should favor provision for reasonable court costs when a taxpayer prevails in tax litigation. Nevertheless, in making provision for that we should recognize that -

(a) The possibility of recovering court costs will encourage additional tax litigation; and

(b) Failure to receive awards to cover court costs will spawn new litigation.

In addition, if enacted as introduced, S.1444 will engender animosity and contempt between taxpayers and government agencies. To qualify for an award under S.1444, a taxpayer must establish "that the position of the United States in the civil action or proceeding was unreasonable." Sec. 7430(c)(2)(b). Even though in practically all cases it will be virtually impossible to establish that fact, the charges and countercharges nevertheless will poison the atmosphere, breed animosity and contempt, and further burden the courts with a new and very difficult issue.

Actually, the requirement that the taxpayer establish unreasonableness on the part of the United States may render the legislation virtually

meaningless. Only in very rare cases will taxpayers be able to establish unreasonableness. The solution to that problem is to provide for awarding reasonable court costs when the taxpayer is sustained as to all or substantially all of the amount or the issue or issues in controversy.

Awarding costs to taxpayers will be costly. Before enacting legislation to award costs, Congress should face up to that and decide whether it is prepared to authorize another costly program. And, I respectfully submit that payment of awards should not be made out of the appropriations of the agency conducting the civil action of proceeding. Payment should be out of the general funds. The potential awards might aggregate so much that an agency would be strapped in the performance of its assigned responsibilities. If the awards program is worthy of enactment, then Congress should provide the funds with which to make it effective. It should not take those funds from the agencies involved.

(4) Conclusion

Based on my experience at and exposure to the Internal Revenue Service and the Department of Justice, I am convinced of two things:

(a) In substantially all cases, the IRS and the Department act reasonably; and

(b) In rare cases they do act unreasonably.

If Congress is to initiate a program based on unreasonable action, are there not better ways to achieve the goal than an awards program? No government agency should act unreasonably. Would not an adequate oversight program by the Joint Committee on Internal Revenue solve the problem? Our courts already have more litigation than they can process

promptly. I question the soundness of intensifying that problem by adding a very difficult issue to be litigated. And I seriously question the wisdom of breeding arguments as to the reasonableness of agencies of government. I respectfully suggest that we ought to direct those agencies to act reasonably and then by adequate oversight see that they do.

Senator BAUCUS. The committee will recess for 10 to 15 minutes.

[A brief recess was taken.]

Senator BAUCUS. The subcommittee will come to order.

Our next panel will include Daniel Lewolt, executive director, National Taxpayers Legal Fund, accompanied by Philip and Susan Long.

Second, John Fitch, director of government affairs, National Society of Public Accountants.

Third, Edwin Davis who is representing CPA's.

I want to thank the panel for waiting. It has been somewhat of a long afternoon and I apologize for the disruptions occasioned by the voting.

You have been very patient. I do thank you very much for attending.

We will begin first with Mr. Lewolt.

STATEMENT OF DANIEL LEWOLT, EXECUTIVE DIRECTOR, NATIONAL TAXPAYERS LEGAL FUND

Mr. LEWOLT. I appreciate the opportunity to appear here today to present the views of the National Taxpayers' Legal Fund on this bill. We exist to help insure that citizens are treated fairly by Government agencies and we find that our major complaints come from people involved with the Internal Revenue Service.

We find difficulty in trying to locate attorneys for these people, attorneys willing and competent to represent the taxpayer through the administrative level proceedings and in court.

One reason for this is the perception on the part of many lawyers that the IRS is a force too powerful and threatening to be reckoned with. Another major cause of attorney reluctance to represent taxpayers is the great cost of litigation in the tax area from the first level administrative conference on up.

The final version of the Taxpayers Protection and Reimbursement Act should provide a strong assurance of attorney fee awards to prevailing taxpayers in conflicts with the Government. Otherwise, it will not serve to stimulate a pro bono public spirited attitude that is sadly lacking in the legal profession toward taxpayers in need.

With the subcommittee's permission, we will submit a written analysis of the bill so we do not take up time going into detail now.

I would like to mention one thing in regard to the comment made by several panel members about the excessive litigation that would arise if this bill is passed. I think that taxpayers will also be risking a great deal in bringing the proceedings further in making a determination of whether the IRS was acting reasonably. This, itself, will be a deterrent against excessive litigation.

If this bill is to be effective, it will have to apply to administrative proceedings. Most of the cases we hear of are settled before the case ever reaches court.

We caution against too much reliance on this legislation alone to foster needed improvements in the unequal relationship between the system and those who finance it. Radical changes are necessary not only to provide a clear avenue of justice in tax cases but also to prove to an increasingly cynical public that this Government is truly interested in restoring and protecting constitutional rights.

Now, I am privileged to introduce two taxpayers from the State of Washington. They have valuable testimony supporting the motives of this bill.

Susan Long, to my left, is a visiting scholar at the Bureau of Social Science Research in Washington, D.C. She has a National Science Foundation grant and supplemental funding from the U.S. Department of Justice Law Enforcement Assistance Administration, to conduct a study of IRS tax enforcement. She is also a research associate on an LEAA funded project on data sources of white collar crime including 30 agencies, including the IRS.

Her previous research has included analyses of FBI criminal history, effectiveness of programs treating Federal offenders, and the methodology for testing the deterrent effect of law enforcement actions.

Philip Long, also to my left, is a businessman in Seattle, Wash. In 1969, the family business of building, selling, and renting duplexes was audited by the IRS. Audit officials, alleging 33 separate claims, demanded substantial additional taxes. Further, in an effort to force him to agree not to contest these clouded claims, IRS threatened him with a jeopardy assessment.

Although unable to afford an attorney, the Longs ultimately prevailed in court on each of the IRS 33 charges. After nearly 9 years of time and effort and expense, the U.S. Court of Appeals for the Ninth Circuit ruled in December 1977, that IRS had been clearly erroneous and that the business had never owed IRS an additional dime in taxes.

Without further delay, Susan Long.

Thank you.

Senator BAUCUS. We are happy to have you here.

STATEMENT OF SUSAN B. LONG

Ms. LONG. Thank you very much.

I am happy and pleased to present my views concerning Senate 1444, along with my husband, Philip Long. We appear here individually, in our individual capacities, and not as representatives of any organizational group or business.

We have a prepared statement which, as I understand it, will be included as part of the record.

I will not attempt, given the lateness of this hour, to cover all the points. However, there is one major point.

Senator BAUCUS. Excuse me. We have a decision to make here.

The bell rang again which means either we succinctly get through the points here and conclude the hearing in about 8 minutes or, if you have testimony which you want to present, we can continue—that is perfectly fine with me. I do not want to inhibit

you in any way whatsoever. I will come back and begin again in about 15 minutes—after staying here a few minutes more—and continue the hearings as long as you wish.

It is entirely up to the panel. Your statements will be included in the record.

I just want you to know if you have to leave this afternoon, we will conclude the hearing quickly, but if you have a statement you want to make orally, I will come back.

Ms. LONG. If one of the other persons has to leave we would be glad to let them talk now, and I would like to come back afterward.

Senator BAUCUS. Fine.

Ms. LONG. Would somebody like to talk first? We will turn it over to somebody else.

Senator BAUCUS. Does anybody on the panel wish to make a short statement at this point?

Fine. Mrs. Long, why don't you proceed.

Ms. LONG. What I want to emphasize is the great need that exists today for some remedy for the taxpayers who wish to contest an IRS action. Lots of mention has been made today of the so-called horror stories of taxpayers treated improperly by IRS. The suggestion was that they were the exception, and not a significant number out there in America.

The University of Michigan conducted a survey of the population of the United States concerning their dealings with Government. That report, published in 1975, concluded that nationwide, people reported having more problems with Government income tax officials than any other Government officials.

We get many calls, letters, and other communications from taxpayers who are in the midst of having difficulty with the IRS. They are very unhappy taxpayers.

We try to tell them what some of their options may be—administratively, in the courts—and where they may get additional information. But we always have to ask them, not first, are you right, how good is your case, but how much money is at stake. Because the overriding decision they must make is how much is justice to them worth.

In the vast majority of cases, it is simply cheaper to pay up and shut up. I believe the settlement figures that have been quoted today as well as the small proportion of cases taken on administrative appeal represent, in part, the cost barrier. Today even an administrative appeal is expensive.

In most cases, those costs are going to exceed the actual amount of money at stake.

I also would like to bring out that the picture of IRS treatment is somewhat different when talking about treatment that well-represented taxpayers may receive as contrasted to unrepresented taxpayers.

When you speak to tax attorneys or CPA's who have represented clients, they, on the whole, may get one kind of treatment from IRS while the unrepresented taxpayer receives another form of treatment. We have found——

Senator BAUCUS. How do you distinguish between the treatments?

Ms. LONG. We have found, unfortunately, that IRS agents and other officials are much more willing to tell taxpayers that the law requires such and so when, in fact, the law does not require such and so, to threaten them, to try to get them to do what they want to do by using their power, and by using the taxpayer's ignorance of the law. As a result, because of threats or misrepresentation, many taxpayers simply give in.

That is why this law, this proposed bill, is very important in taking some small step in providing some remedy.

However, we see there is a big problem in terms of how actually this remedy would, in fact, be. Because of the heavy burden placed upon the taxpayer, a taxpayer must not only prevail by winning all but an insignificant proportion, but show that IRS has acted unreasonably.

This is a heavy standard to bear in terms of proof.

As to standards, we would suggest that alternative legislation discussed today, or bills pending in the House which we referred to in our prepared statement, that rely on a different prevailing standard would provide more adequate relief to taxpayers.

Should the requirement that IRS act unreasonably remain before the award is made, at least the burden should be shifted to the Government at this point. Since the Government is, in almost exclusive control of the facts as to why it took this particular action, it should, therefore, bear the burden of proof at this juncture in the case.

Senator BAUCUS. Thank you very much. We will recess for 10 minutes.

[A brief recess was taken.]

Senator BAUCUS. Mrs. Long, were you finished?

Ms. LONG. Yes.

STATEMENT OF PHILIP LONG

Mr. LONG. I am probably the only taxpayer here who has been through the mill and I would like to point out a couple of little things. I did not hear one of the lawyers here mention the term "hazards of litigation." In internal documents of the Internal Revenue Service when they are training their people, they quite often use the term "hazards of litigation." They also use the term "nuisance settlements."

A nuisance settlement is where they settle for 5 or 10 percent on the dollar.

We feel that where you had to tell a person that you owe $10,000 and you pay $1,000, those are the kinds of cases where if you had a lawyer or threatened to have a lawyer, IRS would step back up and you would not pay anything.

We have given quite a number of talks to various organizations, including Rotary Clubs and Kiwanis Clubs and what have you. I also ran for Lieutenant Governor in the State of Washington and won the Republican nomination. I got 400,000 votes and I only spent $1,000 in my campaign fund.

But I talked to a lot of people and one of the things I asked was how many people in this audience have had problems with the Internal Revenue—because the only ticket I ran on, I wanted to do something about Government.

And I would say if it were a business group, over half of the people would raise their hands that they had had audits by the Internal Revenue Service.

When I talked to those people individually afterward, I would say that at least half of them said that they felt they were unfairly treated in one way or the other.

Either they were threatened or coerced. Maybe they did not pay a dime, but they did not feel that they were handled like they should be—as a person who makes a reasonable effort to get along with the system. If you are audited, the auditors should treat you as if you made a reasonable effort, and that is the whole point of what is wrong with the Internal Revenue Service.

You talk about oversight. We have been to the schools where they train the agents. The agents are trained under a quota system—they do not call it a quota anymore; it is called the norm or a goal. Your promotions are based on how many dollars of claims you generate a year.

Now, if you have a system where the head of the school in San Francisco—whom I talked to for 2 hours. He said 99 percent of the people cheat on their income tax; our job is to draw them into line.

I will just close with the little comment that there was one on their staff, a young woman about 18 years old, who had worked there 2 or 3 months. She said, "Do you hate me?" I said, "I do not hate you." But she was taught that if you worked for the IRS as one of their field people, people will hate you, because tax collectors are hated.

But I have talked to people in the State of Oregon who have been audited by the agents for the State and those agents are instructed to make just as much effort to get a refund as an additional tax. They help them to understand the tax system.

The basic business of over half of the personnel in IRS is not to make taxes work better, but to generate additional revenue. That is the main area that is the big problem—audit compliance, which represents over half of the personnel, is out there to generate additional revenue.

I will close with that. I hope this bill will make it possible for the Joe Doaks who has the hassle with the Internal Revenue Service to get better legal representation and obtain a fair shake.

Thank you very much.

Senator BAUCUS. Mr. Long, could you or your wife at this point briefly summarize your legal battles with the IRS? Give us a little flavor.

Mr. LONG. In our own personal tax case, we won on all 33 issues. We got a $146 refund. They charged us $38,000 and they upped it to $42,000. We ended up winning on every issue and then we have won on nine freedom of information cases. We took the first freedom of information case against the IRS in 1972. We were the first ones to win that and we got some national publicity because of that.

Senator BAUCUS. What was the basis of your freedom of information suits?

Ms. LONG. Really, the origin of explaining what happened, why some things happened, goes back to the original audit. After the

audit, there was—we did not realize what it was called. It was called a closing conference and they wanted to close it.

This conference was with the agent, and the agent brought along his supervisor, unannounced, to the CPA firm that makes out the business returns. They were not getting anywhere as they discussed things back and forth. This was before any specific pieces of paper had been sent to my husband regarding the audit.

They wanted Phil to fill out and sign some forms agreeing to what had been discussed. He felt that the taxes, as far as he knew, had been correctly filled out and did not wish to sign them. He said, thinking this was the American system, he was perfectly happy to have this go to court and have a jury decide and abide by whatever the jury decided.

In response to that, the supervisor threatened Phil with a jeopardy assessment. We were stupid enough not to really know what a jeopardy assessment was. But we certainly found out very quickly and we saw the awesome powers of the IRS in the jeopardy assessment area. This was before the change in the 1976 Tax Reform Act. Virtually you had no judicial remedy, period. They could just seize everything with no court review and you were stuck. It did not matter whether you owed anything.

We had this sudden thirst for knowledge. One of the things we wished to see were administrative rules and procedures that the IRS went by as well as statistics regarding the outcome of different procedures.

We were not successful in getting those. We could not get them. We went through the administrative appeals procedures. It took about a year. We got nothing. We decided the next taxpayer would have exactly the same problem, so as a result, we took IRS to court hoping to break loose the Internal Revenue Manual and we won that case, the freedom of information case on that. Those manuals are now public and published by CCH and made available.

Second, regarding statistics concerning IRS enforcement actions.

Senator BAUCUS. Thank you very much.

The next witness is Mr. Davis. Mr. Davis?

STATEMENT OF EDWIN I. DAVIS, CPA

Mr. DAVIS. Mr. Chairman, I appreciate the opportunity of appearing before this subcommittee to try to briefly give a summary of my views on the pending legislation, S. 1444. I would like to say one thing, by way of clarifying my position.

I am appearing merely as a practicing CPA rather than as representing any professional society.

We agreed all around the table today, I think, the people who have been here before us and the people who are here now, that for the most part, taxpayers are treated fairly by the Internal Revenue Service. I know in many instances where they lean over backward to get the middle-of-the-road answer.

Other people do have some problems.

It is a huge, massive system. You cannot eliminate all the problems and satisfy everybody's requirements. It is a very complex area.

I would, however, have some suggestions for improving, or some goals for improving, the system that we now have.

First, as a matter of demonstrable fairness to the taxpayers, the Government should permit recovery of costs of successful defenses against IRS claims and in summary, also, the amount of these awards and the entitlement question should be decided by the courts.

Our system believes in the impartiality and integrity of the courts. This also would bring about what we think of as an internal, or independent, check and balance on the fairness of the IRS treatment, and this would be an important automatic procedure which has been discussed here today.

With respect to S. 1444, I support the primary thrust—namely, the recovery of costs of successful defense against the IRS claims under certain circumstances. I have concern about certain portions of the operations of the bill.

No. 1, the $20,000 limit on cost recovery for the taxpayers could itself be unfair. The Government is not limited to $20,000 in similar costs.

The Government has available its counsel, its engineers, all of its professional auditing agents, and so forth. The taxpayer should be placed on an equal footing with them, maybe having as a limitation a cost award not in excess of an amount spent by the Government.

No. 2, under the present bill on counsel fees, only counsel fees and costs may be recovered. I personally have worked with legal counsel in tax litigation. If the question is a sophisticated one, if it is complicated, counsel needs the support of other professionals, CPA's, engineers, if it is an evaluation question, appraisers if it is an estate tax question; expert testimony possibly from physicians or many professional people.

This should be covered in some way.

No. 3, the operation of the rule requiring the taxpayer to prevail as to all but an insignificant part of a case is unclear. It is just unclear as to what it means.

In my opinion, it is a rather difficult thing to administer and would put an additional burden on the taxpayer.

Again, this seems a little unnecessary because no recovery should be permitted except in the sound discretion of the Federal court.

Next, with respect to the life of the bill, I believe in its present form it will disappear after 4 years. I have talked to many of my lawyer friends who litigate tax cases all the time. I have kept up with some of them. I know the load on the courts nowadays. It is absolutely—it is a heavy burden.

My point is that within a period of 4 years it is questionable whether or not many cases could be litigated and adjudicated so as to form a pattern for analysis of the justification of the program or whether the program should be changed.

Now we also have the rule requiring the taxpayer to prove that the Government was unreasonable and that, I believe, is unclear. The definition of unreasonable is somewhat in an area that the court might not entertain the action in the first place.

Now, the question of administrative remedies has come up here today, whether or not people should exhaust their administrative remedies. I think possibly there may be a solution: provide that

administrative remedy pursuit expenses be reimbursed to the taxpayer on some basis.

In summary, I believe that S. 1444 represents progress toward assuring a fundamental fairness to taxpayers. The fundamental fairness is necessary to the integrity and effective function of the self-assessment system. That is the most important thing to note in the whole purpose of what this subcommittee is trying to do.

Mr. Chairman, I thank you very much, Mr. Davis.

Mr. Fitch?

STATEMENT OF JOHN H. FITCH, JR., DIRECTOR OF GOVERNMENT AFFAIRS, NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS

Mr. FITCH. One of the benefits of going last is that you can say that everything that has been said before you agree with in some form or another. However, I think there are some points that I would like to emphasize on the part of the National Society of Public Accountants.

First of all, I would like to tell you that NSPA is an individual membership professional association made up of 17,000 small independent accountants that provide auditing, accounting, tax, and management advisory services to 10 million taxpaying clients, and 3 million of those are small businesses.

We strongly support the intent and the effect of the legislation. As a society whose membership provides tax advice and consultation to individual as well as corporate taxpayers, we are keenly aware of and have experienced the frustration of one who lacks the financial resources to challenge an arbitary and unreasonable position taken by the IRS.

The specter of unlimited legal and financial resources is constantly raised and used as a lever by IRS to force the individual or small business taxpayer into a settlement on terms most favorable to the Government rather than in the best interest of justice.

I am not saying that those two are mutually exclusive, but in some cases, they seem to be.

I think S. 1444 is similar to the intervenor programs that are currently in existence in Federal agencies like the FTC, and in regulatory reform legislation before the Senate for consideration. I think from that standpoint it is a good way to provide some sort of test of the tax laws and the reasonableness of their interpretation by the IRS.

What seems to have been lacking in testimony today is the effect these kinds of regulations have on small business. We find that small business has been burdened particularly with paperwork, increasing costs and general frustration with seemingly frivilous regulations and guidelines.

More importantly, the small business community has found itself the object of increasing abuse by regulatory agencies that use their statutory authority to seek rulings against small firms which, unlike the large corporations, do not have adequate resources to sustain a protracted legal battle with the Government.

This statutory abuse by certain agencies not only establishes precedents for rulings against larger firms, but builds the batting

averages of the agency to justify its very existence and additional appropriations from Congress.

Thus, the agency, its staff and the regulatory process are further entrenched in the Government.

While S. 1444 relates specifically to tax cases, the tax laws seriously impact on small business and any arbitrary or unreasonable interpretation, ruling, et cetera, by IRS can have a disastrous effect on a small business.

Specifically, NSPA supports the prevailing party concept of S. 1444. However, we have some reservations about the burden placed upon the prevailing party to establish that the position of the Government was unreasonable. We can envision the litigation of a fact situation turning on the reasonableness or unreasonableness of a Government position rather than on the merits and facts of the case.

NSPA suggests that unreasonableness be a part of the evidence presented to substantiate the position of a taxpayer or a factual issue, but it should not be controlling in determining whether or not costs and attorney's fees are to be awarded. The fact that the taxpayer prevailed should be sufficient.

NSPA also notes the absence of any reference to expert witness fees as being a reasonable court cost. In many cases brought before the Tax Court or the U.S. district courts, the attorney for the taxpayer relies heavily on the expert testimony of the accountant or tax expert who advised the taxpayer, prepared his or her return or would serve as one who interprets a tax ruling, regulation or law reasonably, but not in the same manner as IRS. These experts are expensive but are a necessary and in many cases a crucial aspect of the taxpayer's case. Therefore, NSPA recommends that the bill specifically include a provision relating to the fees of expert witnesses of this nature.

Since some of our members are authorized to represent taxpayers before IRS and the Tax Court, we are pleased to see that the definition of attorney's fees includes their services in their capacity as an advocate for a taxpayer.

NSPA has some reservation about the increase in the budget of IRS if S. 1444 becomes law; however, we believe that the direct benefit to the taxpayer and small business in the form of reimbursement for their litigation expenses as well as the indirect benefit of forcing IRS to carefully evaluate the merits and reasonableness of their positions on tax matters far outweigh the costs and will provide a fairer, more equitable administration of the tax laws.

In this regard, NSPA would like to point out that while S. 1444 does not pertain to administrative proceedings, those proceedings can be as costly as court litigation and, the factors in deciding to administratively appeal an IRS decision are similar if not identical to those relating to filing a court action. It is not necessarily our position that S. 1444 be amended to include administrative proceedings; however, it is our intention to bring out the fact that most cases challenging an IRS position on a matter take place at the administative level and that is where IRS exerts its greatest influence and pressure. While it is hoped that S. 1444, if enacted, would have some positive effect on the IRS in the administrative arena,

further attention simliar to S. 1444 should be focused in that direction.

Finally, NSPA supports the sunset provision of S. 1444, however, we believe the dates suggested by the legislation are unrealistic. The budgets for those future fiscal years will have already been determined when the bill is passed and those cases currently in litigation should not necessarily reap a windfall from S. 1444 at the expense of IRS who would be unnecessarily penalized because the rules of the game were changed after it began.

In conclusion, the National Society of Public Accountants believes that legislation providing for the payment of attorneys fees to individuals and small businesses prevailing in civil tax cases against the IRS is a first step toward restraining arbitrary regulatory proceedings. Since many cases result from a bureaucratic or administrative denial of justice to those unable to afford the extraordinary legal costs involved, legislation providing for an attorney fee reimbursement would restore to those abused their right to seek legal redress for damages done.

Thank you for the opportunity to present our views on this legislation.

Senator BAUCUS. Thank you very much, Mr. Fitch.

I want to tell you I agree with you that one of the basic problems facing small business today is the paperwork and all the procedures that small businessmen have to put up with in dealing with IRS and other agencies—certainly as compared with larger entities. That is the kind of problem I am going to be addressing in subsequent legislation.

I agree that it is a whole separate question that has to be addressed. It is a bit difficult to address it in this particular legislation.

One thing intrigued me. You seemed to say that whenever a taxpayer prevails, then automatically, in your judgment, that taxpayer should be awarded attorneys' fees. I am wondering if that is a bit fair, really.

It seems to me an argument may be made that when two parties legitimately and reasonably are unable to resolve their problems, even though one party is a taxpayer and the other party is Uncle Sam, that when each position is reasonable in sum and it is just a matter of trying to resolve which party is right, then in those cases by definition there is no harassment. The Government is acting reasonably, et cetera. I am wondering whether in those cases you think the taxpayer who prevails should necessarily be awarded attorneys' fees and costs.

Mr. FITCH. I think primarily in litigation not involving the Government, in most cases the litigants are—I would venture to say—relatively equal in their ability to fund the litigation, I think that when you litigate against the Federal Government, particularly from an individual standpoint or a small businessman's standpoint there is no financial parity therefore their cause—and I disagree with previous testimony—should be rewarded if they prevail.

I do not think the reasonableness or unreasonableness Government acts should be the test. I am not saying it should not be a part of the burden of proof. I am saying that it should not be the

controlling test to determine the awarding of attorney's fees or other court costs.

Senator BAUCUS. As I understand it, you think court costs, including attorney's fees, should be awarded automatically if the taxpayer prevails?

Mr. FITCH. Yes.

Senator BAUCUS. Unreasonableness is irrelevant?

Mr. FITCH. Basically.

Senator BAUCUS. Do other members of the panel agree?

Mr. LEWOLT. We were complaining about overcrowded courts. It may take as long to determine whether the IRS is acting reasonably as it took to determine the original tax matter if the whole sphere of evidence is taken into consideration.

Senator BAUCUS. Does anyone on the panel disagree with that position?

Yes, sir?

Mr. DAVIS. Mr. Chairman, I disagree with that. Basically, I think we all agree that a tax case, or the administration of the tax laws, is a different segment of Government and I think, again, that the award of the fee should be left in the discretion of the court once it is justified. I do not think it should be an automatic thing.

The Internal Revenue Service has certain authority and responsibility legally to do their work and in doing it they are going to have controversies that arise. I think the taxpayer would be satisfied if he won his case, dollar for dollar, but if the court reviewed the circumstances and said, yes, Mr. Taxpayer, that is fine. We hate to see you pay out the money, but this Internal Revenue agent, the Chief Counsel's office or the Justice Department, they did exactly what they were supposed to do under the law. They thought they were doing what was right, and you are not entitled to any costs.

Senator BAUCUS. I take it, sir, that you would be more agreeable to placing the burden of proof on the Government to show that it was not acting unreasonably. Is that correct?

Mr. DAVIS. I am a layman, as far as the law is concerned.

Senator BAUCUS. Under the bill as presently drafted, the prevailing taxpayer must show, since he has the burden of proof, that the Government was acting unreasonably. Some people argue, the Senators earlier this afternoon for example, that the burden should be shifted, once the taxpayer prevails on the substantive issues, to the Government to show that the Government was not acting unreasonably—that such a shift would enhance the likelihood of prevailing taxpayers being reimbursed for attorney's fees.

You do not have any view on that?

Mr. DAVIS. I heard the testimony. It is a layman's view. I do not think the burden should be shifted. I think the burden should stay where it is. It is just an extra step in the proceeding.

Senator BAUCUS. What about additional expert fees, like engineering costs, CPA costs, et cetera? Basically some of you suggested that those should be included as reimbursable costs.

I am wondering, is it the normal course—let's confine it only to judicial proceedings, not administrative proceedings—in judicial proceedings, what are additional fees of this nature?

Can any of you give me any idea of how much is involved here?

Mr. LONG. In our own particular case, we could probably not justify any of our costs by any definition by experts because we spent them in unusual and unique ways, and I think in a big percentage of the tax cases, there is probably half the expenses at least that the taxpayer puts out that you would not recover.

Ms. LONG. The definition of costs presently in title 28 that this bill is amending is rather narrow. They are not out-of-pocket expenses. They are specific categories.

Senator BAUCUS. Right.

How much would engineering fees, expert witnesses——

Ms. LONG. They could be very, very substantial, if you have to fly somebody in. Often, you have to consult with them in the first place. They have to review the record. We believe that the $20,000 limit is really too low of a limit in recognition of the actual costs of litigation.

Senator BAUCUS. The thing that struck me as a little odd—maybe I am naive—is that the panel that preceded you included practicing tax attorneys who felt that perhaps we are giving taxpayers a little too much here. The general tone of the testimony seemed that well, perhaps the bill makes sense, but maybe it is going to encourage too many taxpayers to claim attorneys' fees and so forth; whereas the general tone of your testimony, this entire panel's, is in the opposite direction.

Why is it, in your judgment, that tax attorneys tend to feel that the bill might be going a little bit too far?

Mr. LEWOLT. I do not think they want to see competition from public-spirited attorneys. Most of our calls are from small businessmen and from retired people which involve large amounts of money, but they cannot find these large law firms to represent them. I think if this bill was passed it would encourage young attorneys, perhaps inexperienced, to get the expertise they need to defend these people and, in turn, they would be providing competition for the establishment.

I also think that tax attorneys are well-established, certainly work hand-in-hand with the Internal Revenue Service, and have, to some extent, an interest in protecting the status quo.

Senator BAUCUS. I wonder if some of you could also help me a little bit by describing a typical audit process. I am trying to get a feel for the various steps that are involved, looking towards at what administrative step the bill should be amended to include fees and costs for administrative proceedings.

It seems to me, certainly, that the IRS sends the first letter. Maybe that is not the appropriate administrative step.

Could you give me a sense of what the various steps are before, and including, going to court?

Mr. LONG. I might point out statistically—I am a nut on statistics, and so is Sue—they said there were only 1,000 cases last year in the Tax Court and only about 100 of those actually won, and if you pay $20,000 to those 100 cases, you would only be paying out a maximum of $2 million. If you had twice as many, a maximum of $4 million.

So actually if one of the points that you have to do is win the case, there are only going to be 200 or 300 of them per year for the

next 3 or 4 years, because I do not think the inertia of the legal profession to swing over into this area will change it.

Senator BAUCUS. Could one of you outline the various steps in the administrative procedures, please? Someone who has some experience?

Mr. LONG. You start off with the audit, then you have the district conference, sometimes technical advice, and the appellate conference. Then you go through your pretrial conferences, stipulation conference, and then go to trial in Tax Court.

Senator BAUCUS. Could somebody add a little?

Ms. LONG. The appeals procedure was changed last fall. You used to have two levels of appeal, a district and appellate conference level. It has been consolidated to one level.

Basically in most cases, there is an audit. There is an attempt to get the taxpayer to agree to it at some point. If the taxpayer does not agree, they get what is known as the 30-day letter. That gives them an opportunity to seek an administrative appeal.

If they do not appeal it, then they will get a statutory notice. Then they have 90 days to file in the Tax Court or that money is assessed. If they wish to seek review in the district court or the Court of Claims, they have to pay the entire amount that is involved, then file an administrative claim for refund. If that is denied, or, I believe, if 6 months go by, then they can file in the district court or the Court of Claims.

Senator BAUCUS. At what level do you think it makes sense to provide for administrative costs?

Ms. LONG. There is a sharp demarcation. There is an administrative appeal within the IRS. It would be logical to extend it to that level during the appeals process, the contesting, once IRS has issued a formal finding. However, most taxpayers give in and do not even get a 30-day letter. They just agree to it, with IRS's action.

Perhaps it would be helpful, therefore, for a taxpayer to be aware clearly of their rights before they gave into it—to be sure that they were aware that they had this opportunity of administrative appeal and that costs were not a barrier once provisions for recovery of expenses were made in that area.

Mr. FITCH. I would like to speak to that for a moment.

It has been the experience of our members, maybe Mr. Davis could amplify on that, who have clients, individual or small business clients, who as soon as they get their first notice that they are going to be audited by IRS immediately turn it over to their accountant or turn it over to their attorney to handle it from there on.

So the clock starts ticking in terms of expenses right there. They are being charged for the time it takes that accountant or that attorney to contact IRS, to set up the interview, to be there when the audit is conducted, to do all the mechanical things involved in the audit, even before it gets to any kind of stage, the early issues and discussing possible settlements or were they go from there.

So I think that from the time the letter is received by the taxpayer, that is when the clock starts as far as our people are concerned.

Senator BAUCUS. Let me ask a basic question of everybody. What are your experiences?

You already discussed this to some degree, but let me ask the question again. What is the basic problem that most taxpayers have with the IRS?

Mr. Fitch, you talked about the small businessman's harassment with paperwork and perceived harassment, et cetera. I wonder if any of you could tell me fundamentally what is the bottomline here? Is it insensitive agents, paperwork, laws that do not make sense, too many regulations?

I am just curious. What is it, fundamentally?

Mr. DAVIS. Mr. Chairman, my experience has been that a lot of the problem is that really they do not understand the Internal Revenue. They think it is a big maze of confusion, or something.

I have had many clients who say, well, they cannot do that, it is unconstitutional. You cannot do that and that. They do not understand it.

I often tell them the problem is not with that examining agent; it is with the people who made the law.

I think that is a big area of misunderstanding with them. They do not understand its functions and purposes and so forth.

Senator BAUCUS. The taxpayer does not understand. What do we do about that, then?

Mr. DAVIS. It is one of our forms of government. I do not know if I have a suggestion.

If I might say something on the administrative costs, again, getting back to facing the examining agent or auditor, I do not think I would recommend commencing the administrative costs at that level because the Government has a right to come out there and check your books.

What you cannot do is to insure him against ever having to spend any money to do it.

I think the proper commencement point would be where the controversy is really locked in—maybe even above the agent level, or when it leaves the agent level. It is going to take that agent anywhere from a day to weeks to get his recommendation made out.

Until that point, you really do not have any controversy. He was just doing what he was supposed to do in the first place.

At first, at a level beyond him somewhere, the administrative costs could begin to tick off.

Senator BAUCUS. Mr. Fitch?

Mr. FITCH. The basic problem involves the complexities of the tax law. I think the taxpayers are not aware of what their rights are. They are unsure, or uncertain, of what the tax law says or is, and I think when they are faced with an agent who says this is the way it is, and you owe us money, it scares the taxpayer. Without any sort of professional advice, the taxpayer thinks that he is wrong and he has no other recourse but to capitulate.

That would be my opinion. We have people here who have been involved in it. They may be able to elaborate on that.

Senator BAUCUS. Mr. Long?

Mr. LONG. I think I have talked to hundreds of taxpayers who have had problems because they have phoned us and written us

letters, and I feel that most of them have very limited knowledge of the tax laws, the tax code, and so forth.

But in our original suit under the Freedom of Information Act, we broke out the IRS handbook and manual. If you work for IRS as an agent, you go to their school, like the one in Seattle or San Francisco, they have 1,800 pages in the first primary instruction manual. Then they have a section that is in the handbook and manual which they follow which is the interpretation of the law that Congress passes.

If you are a taxpayer and you try to file the regulations or code and you do it religiously and have your CPA do it just like he says, then the agent is working from a different interpretation. Then you have a gray area, suddenly, and you have a controversy, and then you have to thrash your way through that and we went through 33 issues and won on all of them, because when it got down to the cases, my CPA was correct.

We feel that IRS in many cases, we could have probably compromised out for 10 to 20 percent of the dollar.

Senator BAUCUS. Mr. Fitch, is the problem, in your judgment, the fact that the complexity of the tax code itself overwhelms taxpayers, or is it rather that IRS agents when they contact taxpayers are unreasonable in the manner in which they proceed with the taxpayers? Which of those two is the greater problem?

Mr. FITCH. That is a very difficult question. I would say both are a problem. Which would be the greater of the problems, I would say that probably it would be the face-to-face sitdown with the agent.

Senator BAUCUS. What if an agent is very, very reasonable, very understanding and wants to help, in the proper sense? If all the agents were model agents like that, would some of the same problems still exist for small businessmen or taxpayers with moderate or lower incomes?

Mr. FITCH. Probably. Referring to President Carter's crisis of confidence, I think if there were some way the taxpayer could be reassured that the Internal Revenue Service and its agents are, in fact, as you say they ideally should be, there would be a sharp reduction in the underground economy. And, a sharp reduction in litigation.

I still think there would be matters in controversy; however, I do not think the litigation will be as it is now in many cases where people in this country are saying, "They can't get away with that. I am going to sue them."

Senator BAUCUS. What if the IRS provided services to the taxpayers, more services than they now have? Would that be a help?

Mr. LONG. We testified to the taxpayers assistance program 5 or 6 years ago and we got the manual for training for those taxpayer assistance people and it was a 1-week course. Therefore, the average tax accountant knew much more than the taxpayer assistance people.

And if you followed their suggestions, you would be liable for the errors that you made in the tax return.

We believe that the IRS should be helpful and have the person understand the Tax Code first. Generating additional revenues

should be second. At the present time, the priorities, I think, at the IRS, are the reverse of that.

Ms. LONG. In terms of the problems and whether or not assistance would solve some of the problems, as I see it, there are three major problems: One, the taxpayer cannot find out what the correct way to make out their taxpayer is beforehand. You simply cannot. You can go and ask IRS, but there is no assurance that they are going to get the right answer.

IRS has conducted a rather long and complicated study over the years using sophisticated techniques of sampling to determine what proportions of the returns would be in error if all returns were audited, and they found the vast majority would, whether or not you went to IRS, a CPA, a lawyer, or made out your own return.

The No. 1 problem—there is no way to find out what would be the correct answer before you file your return.

If you gave IRS the resources—and obviously, it is a very expensive kind of process to have IRS giving assistance where the people giving the assistance have enough technical training and take enough time so they can be sure they are giving correct answers and IRS takes responsibility for their answers.

If you did that, yes. That would be of some assistance.

Second, when you get to the audit process, it would be important to have some real remedy. Always you need some check to be sure the system is working. Right now, there is no real practical remedy because of the cost barrier for seeking real relief.

Mr. LEWOLT. I would like to agree that the bottom line problem is confusion. Unfortunately, the power is unfairly distributed between the taxpayer and agent. The agent is not willing to take the time and patience to explain the complex tax code in a way that does not alienate the taxpayer.

When you are treated rudely and treated like you are a liar right off the bat, many times it interferes with your ability to understand, even if you happen to be in the wrong.

I think, based on the calls and letters we have received over the last 2 years, a massive retraining program has to be held in the IRS as to taxpayers rights.

I think it is an attitude problem on the part of agents.

Ms. LONG. I would like to make one comment on that.

Unfortunately, if the IRS agents took more time and were reasonable and looked at both sides, it would just eat up more time for audit and there would be fewer audits. IRS sets goals as to how many audits they are going to produce in a year given the resources they have. The person in the field simply does not have the latitude to spend the time to look at both sides, to be thorough, to explain. He or she simply does not have the time. He would get in trouble with his or her supervisor.

There was a study in the past looking at how many taxpayers who were audited understood the nature of the claim and why they contested it or did not contest it. The vast majority really did not understand. They gave in for a variety of reasons. They were afraid to fight. They could not afford to fight. They were scared. They did not understand.

It is simply, really, counterproductive to run an examination program in that fashion.

Senator BAUCUS. I want to thank you all. You have all been very, very helpful.

I am new to this committee and you have certainly heightened my sensitivity to a lot of the problems.

I want to tell you also that this is an area that I am going to be spending a lot of time in because my intuition is it is necessary and important to all of us.

I want to personally thank each of you for your testimony today which confirms some of the basic feelings that I have had.

And thank you for being so patient this afternoon.

[The prepared statements of the preceding panel follow:]

TESTIMONY OF DANIEL LEWOLT, EXECUTIVE DIRECTOR,
NATIONAL TAXPAYERS LEGAL FUND

THE NATIONAL TAXPAYERS LEGAL FUND, WHICH I REPRESENT, IS GRATEFUL FOR THE OPPORTUNITY TO COMMENT ON S. 1444, THE TAXPAYERS PROTECTION AND REIMBURSEMENT ACT.

THE NTLF IS A NON-PARTISAN ORGANIZATION DEDICATED TO PROMOTING AND PROTECTING THE CONSTITUTIONAL LIBERTIES OF CITIZENS AS TAXPAYERS. WE LITIGATE TO HELP INSURE THAT FEDERAL AGENCIES TREAT CITIZENS FAIRLY, AND, WE SEEK BASIC REFORM IN THE ADMINISTRATION AND ENFORCEMENT OF THE TAX SYSTEM.

S. 1444 IS DESIGNED TO AWARD COURT COSTS, INCLUDING ATTORNEY FEES, TO TAXPAYERS WHO ULTIMATELY PREVAIL IN ACTIONS AGAINST UNREASONABLE GOVERNMENT POSITIONS. WE BELIEVE THE BILL, AS PRESENTLY WRITTEN, COULD BE SUBSTANTIALLY STRENGTHENED. WITH OR WITHOUT THE SUGGESTED CHANGES, HOWEVER, WE FEEL THAT THE PROPOSAL SHOULD BECOME LAW. PASSING MEASURES IN SUPPORT OF TAXPAYERS RIGHTS SHOULD BE AN EMERGENCY LEVEL PRIORITY FOR THIS CONGRESS.

THE NATIONAL TAXPAYERS LEGAL FUND, WITH OVER 8000 CONTRIBUTERS IN NEARLY EVERY STATE, IS IN A UNIQUE POSITION TO HEAR THE RUMBLINGS OF TAX REVOLT IN AMERICA. I AM SURE NOBODY IN CONGRESS WILL BE SURPRISED TO HEAR THAT MOST OF THE COMPLAINTS WE HEAR COME TO US FROM PEOPLE HELPLESSLY ENTANGLED IN DISPUTES WITH THE INTERNAL REVENUE SERVICE BUREAUCRACY. DUE TO THE EXTREME COSTS OF TAX LITIGATION, TOO-OFTEN ALL OUR NON-PROFIT LEGAL FOUNDATION CAN DO FOR MANY OF THESE PEOPLE IS TO ADVISE THEM ON THE CONSEQUENCES OF THEIR SITUATION. WE TOO, FEEL THEIR FRUSTRATION WITH A SYSTEM THAT PRESENTLY ALLOWS SUCH RESTRICTED RECOURSE AGAINST ITS OWN INJUSTICE.

IRS COMMISSIONER, JEROME KURTZ, ADMITTED IN HOUSE COMMITTEE TESTIMONY THIS SPRING THAT RESPECT FOR THE TAX SYSTEM IS RAPIDLY DECREASING. IT IS REPEATED OVER AND OVER AGAIN IN TESTIMONY BY TAX OFFICIALS, THAT AMERICA DEPENDS ON A SYSTEM OF

"VOLUNTARY COMPLIANCE" WITH THE TAX LAWS. YET POWERS HAVE BEEN GIVEN TO IRS AGENTS THAT LEAD TO OCCASIONAL BUT HIGHLY DISILLUSIONING CONSTITUTIONAL ABUSES. THE COMMISSIONER HAS VOWED TO RESTORE PEOPLES' CONFIDENCE IN THE IRS. THIS WILL BE AN IMPOSSIBLE TASK WITHOUT PASSAGE OF LEGISLATION PROVIDING A REMEDY AGAINST THE AGENCY'S ABUSES.

THE BIGGEST BARRIER TO JUSTICE WHEN CAUGHT IN AN UNFAIR DISPUTE WITH THE IRS, IS THE COST OF PROVING YOUR CASE IN COURT. THIS BILL, THOUGH TOO WEAK IN OUR OPINION, WILL NEVERTHELESS PROVIDE RELIEF TO TAXPAYERS IN THE POSITION OF FIGHTING UNREASONABLE TAX CHARGES.

S.1444 WILL MAKE THE IRS MORE OBJECTIVE AND SELECTIVE IN THE CASES IT CHOOSES FOR LITIGATION. IT WILL ALSO SERVE TO DETER OFFICIALS FROM BRINGING CHARGES THEY WERE PLANNING TO DROP FOR BARGAINING PURPOSES. UNDER THE BILL, IF THE GOVERNMENT PERSISTS WITH AN UNSUPPORTABLE POSITION, AT LEAST THE TAXPAYER CAN RECOVER PART OF WHAT IT COSTS TO ESTABLISH JUSTICE.

ANY JUDICIAL "CONFUSION" OR SO-CALLED "BURDEN" THAT MIGHT BE CREATED BY THIS LEGISLATION SHOULD STAND SECONDARY TO THE NEED FOR AN AVENUE OF LEGAL REDRESS WHEN UNWARRANTED INJURY HAS BEEN INFLICTED ON A CITIZEN BY GOVERNMENT.

THIS LEGISLATION COULD PROVIDE A PARTIAL INSURANCE POLICY FOR ANY AND ALL TAXPAYERS WHO MIGHT ONE DAY HAVE TO EXPERIENCE THE NECESSITY OF FINANCING A LAW-SUIT TO CLEAR THEMSELVES OF AN UNREASONABLE CHARGE MADE BY THE IRS. EACH TAXPAYER WHO WINS A TAX SUIT AND RECOVERS COURT EXPENSES UNDER THIS NEW LAW, WILL HELP IMPROVE THE SYSTEM FOR EVERYONE.

THE PROBLEM

THE TAXPAYERS PROTECTION AND REIMBURSEMENT ACT SEEKS TO ADDRESS A PROBLEM ORIGINATING IN THE EXISTING TAX CODE. ALMOST EVERYONE IS CONFUSED BY THE TAX SYSTEM. THE SYSTEM ITSELF AND THOSE WHO RUN IT ALSO SEEM TO BE CONFUSED. CONSEQUENTLY, THE IRS IS STUCK WITH THE JOB OF ENFORCING A VAST BODY OF LAW THAT IS INHUMANE BECAUSE FEW UNDERSTAND IT. NO WONDER PEOPLE HAVE A DIFFICULT TIME TRUSTING THE IRS.

MANY IRS FIELD AGENTS ARE FRUSTRATED WHEN THEY SEE WEALTHY TAXPAYERS DEFEAT THEIR AUDITS IN COURT, WITH THE HELP OF EXPENSIVE TAX LAWYERS. SINCE THE PRESSURE

FOR COLLECTIONS IS SO HEAVY, SOMETIMES AN AGENT FINDS THAT HARRASSMENT CAN SQUEEZE MONEY OUT OF TAXPAYERS QUICKER THAN A CAREFUL INVESTIGATION. THOUGH HARRASSMENT DOESN'T WORK WELL ON BIG TAXPAYERS, IT IS OFTEN SUCCESSFUL AGAINST MIDDLE AND LOW-INCOME TAXPAYERS WHO CAN'T TAKE THE HEAVY RISKS OF A COURT BATTLE WITH THE FEDERAL GOVERNMENT.

THE COMPLEXITY OF THE SYSTEM THE IRS TRIES TO ADMINISTER AND ENFORCE DEMANDS THAT AGENTS BE BETTER TRAINED TO ASSUME AN EDUCATOR'S ROLE, RATHER THAN A COMPETITIVE POSITION, IN THEIR DEALINGS WITH CITIZENS. AGENTS SHOULD ALSO RECIEVE MORE SENSITVITY TRAINING TO THE CONSTITUTIONAL RIGHTS OF TAXPAYERS. CONGRESS CAN DO ITS PART BY DEFINING THESE RIGHTS AND PROTECTING THEM BY STATUTE.

SPECIFIC BILL PROVISIONS

I. THE COST BAR TO JUSTICE IN TAX CASES

THOSE TAXPAYERS WHO MEET THE TERMS OF THE LEGISLATION WOULD BE ELIGIBLE FOR AN AWARD OF REASONABLE ATTORNEYS FEES AND COURT COSTS, UP TO $20,000. IT IS ESTIMATED IN THE BILL'S INTRODUCTION THAT THIS AMOUNT WOULD COVER THE ORDINARY CIVIL TAX CASE. IN FACT, ATTORNEY FEES AND COURT COSTS IN ORDINARY TAX CASES OFTEN REACH $20,000 BEFORE THE CASE EVEN GETS OUT OF THE ADMINISTRATIVE APPEALS PROCESS. TWENTY THOUSAND DOLLARS WILL NO DOUBT HELP CONSIDERABLY IN A FEW CASES, AND THE AMOUNT SHOULD BE ENOUGH TO PROVIDE SOME INCENTIVE TO TAXPAYERS TO TRY AND PROTECT THEMSELVES. HOWEVER, THE BILL MUST RECOGNIZE, AT LEAST IN ITS LEGISLATIVE HISTORY, THAT THE AVERAGE COSTS ASSOCIATED WITH TAX LITIGATION FAR EXCEED THE AWARD CEILING OF $20,000.

FURTHER, IN ITS AWARD OF ATTORNEY FEES AND COURT COSTS, THE BILL GIVES NO OTHER STANDARD BUT "REASONABLENESS" FOR USE IN DETERMINING A FAIR AMOUNT IN EACH CASE. THIS LEAVES ALOT TO JUDICIAL DISCRETION, BUT PERHAPS JUDGES CAN BE TRUSTED TO PERFORM THIS TASK JUSTLY, IN LINE WITH THE LEGISLATIVE INTENT. EVEN SO, IT WOULD BE SIMPLE TO LIST THE COMMON COSTS INVOLVED IN TAX LITIGATION. COSTS RECOVERABLE SHOULD INCLUDE THE EXPENSES OF A CPA, APPRAISERS, OTHER NECESSARY PROFESSIONALS AND FREEDOM OF INFORMATION SUITS TO GAIN INFORMATION FOR CASE PREPARATION.

AS FOR ATTORNEY FEES, ONE WAY OF ESTIMATING THEM IN CIVIL LAW IS TO BASE THE FEE ON THE AMOUNT OF MONEY IN CONTROVERSY. THIS WOULD NOT BE APPROPRIATE HERE BECAUSE COSTS AND ATTORNEY FEES IN TAX LITIGATION ARE WIDELY FOUND TO QUICKLY

EXCEED THE AMOUNT IN CONTROVERSY. THEREFORE, THE JUDGE MUST BE THE ONE TO DECIDE WHAT IS JUST COMPENSATION. IDEALLY, IN DETERMINING THE AWARD, JUDGES WOULD TAKE INTO ACCOUNT OTHER DAMAGES THE INDIVIDUAL HAD SUFFERED THROUGHOUT THE UNNECESSARY INVESTIGATION AND SUBSEQUENT LEGAL PROCEEDINGS.

SINCE AN AWARD OF TWENTY-THOUSAND DOLLARS ONLY BEGINS TO COVER EXPENSES IN MANY CASES, A PROVISION COULD BE ADDED TO THE BILL REQUIRING A PRELIMINARY DETERMINATION OF REASONABLENESS WHEN COSTS REACH THE $20,000 MARK. THE DETERMINATION COULD BE BASED ON THE FULL RECORD AND RELEVANT EVIDENCE TO THAT POINT IN THE ACTION.

II. COSTS OF ADMINISTRATIVE PROCEEDINGS ARE NOT COVERED BY BILL

TAXPAYERS MUST MEET A NEWLY DEFINED PREVAILING PARTY STANDARD TO RECIEVE AN AWARD UNDER THIS BILL. THE STANDARD THAT IS IN USE IN 28 U.S.C. 2412, HAS BEEN HELD TO DEMAND THAT THE TAXPAYER SUCCEED AS TO ALL BUT AN "INSUBSTANTIAL" PORTION OF THE ISSUES OR SUM IN CONTROVERSY, IN ORDER TO RECOVER COSTS. THE STANDARD IN EFFECT UNDER S. 1444 HAS A TWO-FOLD REQUIREMENT THAT MAKES IT MUCH TOUGHER TO QUALIFY AS A PREVAILING PARTY. THE TAXPAYER MUST WIN ON ALL BUT AN "INSIGNIFICANT" PORTION OF THE ISSUES OR THE AMOUNT IN CONTROVERSY. "INSIGNIFICANT" IS A HARDER TERM TO SATISFY THAN "INSUBSTANTIAL". ALSO, THERE IS A FURTHER REQUIREMENT THAT THE TAXPAYER PROVE THE IRS WAS "UNREASONABLE" IN THEIR PURSUIT OF THE CASE.

A. TAXPAYER MUST PREVAIL ON ALL ISSUES OR AMOUNTS IN CONTROVERSY

MULTIPLE CAUSES OF ACTION COULD PRESENT DIFFICULTY FOR TAXPAYERS WISHING TO QUALIFY AS PREVAILING PARTIES UNDER THIS BILL. THE BILL SAYS THAT DIFFERENT CAUSES OF ACTION CAN BE LUMPED TOGETHER AS ONE, FOR PURPOSES OF DETERMINING WHETHER THE TAXPAYER HAS ALL BUT "INSIGNIFICANTLY" PREVAILED IN THE ACTION. WHETHER OR NOT IT IS FAIR TO GROUP DIFFERENT CAUSES OF ACTION TOGETHER IN REACHING A PREVAILING PARTY DETERMINATION IS LEFT TO THE DISCRETION OF THE JUDGE. WE WOULD RATHER SEE THE BILL REQUIRE SEPERATE ACCOUNTINGS FOR EACH MAJOR CAUSE OF ACTION, SO THAT THE TAXPAYER CAN BE AWARDED FEES AND COSTS FOR EACH CAUSE OF ACTION THAT WAS BROUGHT UNREASONABLY.

SINCE THIS BILL RELIES SO HEAVILY ON JUDICIAL DISCRETION, IT MIGHT BE WISE TO ENCOURAGE A NEW JUDICIAL ATTITUDE WITH A WORD OR TWO IN THE LEGISLATIVE HISTORY. THE TAX COURTS USE A "PRESUMPTION OF CORRECTNESS" IN EXAMINING AN IRS DETERMINATION OF DEFICIENCY. THIS PRESUMPTION SHOULD BE SHIFTED SLIGHTLY IN FAVOR OF THE CONFUSED

TAXPAYER SO THE BILL CAN ACCOMPLISH ITS STATED PURPOSE, WHICH IS TO PROTECT AND REIMBURSE.

B. TAXPAYER MUST PROVE THAT THE CHARGES ARE UNREASONABLE

THE NATIONAL TAXPAYERS LEGAL FUND SUPPORTS S. 1444 BECAUSE IT REPRESENTS A STEP TOWARD FAIRNESS. WE HAVE DOUBTS CONCERNING ITS EFFECTIVENESS HOWEVER, IF IRS BEHAVIOR MUST BE JUDGED "UNREASONABLE" IN ORDER TO AWARD COSTS AND FEES TO THE WRONGED TAXPAYER.

IN THE ENVIRONMENT OF COMPLICATED LITIGATION, A TERM LIKE "REASONABLE" MIGHT BE TOO GENERAL FOR TAX JUDGES TO HANDLE. ON THE OTHER HAND, IF THIS LAW PASSES, JUDGES MIGHT BE MORE SENSITIVE TO UNREASONABLENESS ON THE PART OF THE IRS. THIS FACTOR COULD HASTEN LITIGATION CONSIDERABLY. GIVEN THE EXTRAORDINARY LENGTH OF SOME COMPLETELY UNREASONABLE CASES THE GOVERNMENT HAS BROUGHT, THIS IS A WELCOME EFFECT OF THE BILL. JUDGES WILL AUTOMATICALLY STARY ADMITTING AND ENCOURAGING TESTIMONY CONCERNING THE REASONABLENESS OF THE GOVERNMENT'S POSITION. THEY WILL DO SO IN ORDER TO MINIMIZE THE POSSIBILITY OF A LONG EXTRA HEARING ON REASONABLENESS AFTER THE MAIN ACTION HAS BEEN DETERMINED IN THE TAXPAYERS FAVOR. HEIGHTENING JUDICIAL SENSITIVITY TO UNREASONABLE GOVERNMENT BEHAVIOR IS A GOOD WAY TO HELP THE GOVERNMENT KEEP ITS CASES CLEAN FROM THE BEGINNING.

THE COMPLAINT HAS BEEN MADE THAT EXTRA TESTIMONY WILL CLOG PROCEEDINGS. BUT, THE ALLOWANCE OF THIS TESTIMONY IS ONE OF THE BILL'S MOST IMPORTANT FEATURES. A BIG CAUSE OF TAXPAYER FRUSTRATION IS THE INABILITY TO GET EVIDENCE OF UNREASONABLE IRS BEHAVIOR IN THE RECORD. THIS EVIDENCE IS OFTEN RULED IMMATERIAL, OR IT IS ADMITTED INTO THE RECORD, ONLY TO BE IGNORED BY THE JUDGE. THIS LEGISLATION COULD SERVE TO OPEN TAX FORUMS TO THE COMPLETE RANGE OF CIRCUSTANCES AND ABUSES EXPERIENCED BY THE TAXPAYER. IT WILL HELP PROVIDE A LEVEL OF REASONABLE RESPECT FOR TAXPAYER RIGHTS, AS WELL.

CONCLUSION - PREVAILING PARTY STANDARD:

THE ONLY REQUIREMENT FOR AN AWARD OF COURT EXPENSES UNDER THIS LEGISLATION SHOULD BE THAT THE TAXPAYER WINS A MAJOR CAUSE OF ACTION. THOSE WHO ENDURE THE TURMOILS AND EXPENSES OF LITIGATION, THROUGH NO FAULT OF THEIR OWN, SHOULD BE AWARDED.

IF THE REASONABLENESS REQUIREMENT IS MAINTAINED, THE BURDEN OF PROOF SHOULD BE SHIFTED TO THE GOVERNMENT TO PROVE ITSELF REASONABLE. THE FACT THAT THE GOVERNMENT

WAS PROVEN WRONG IN THE MAIN ACTION, SHOULD PROVIDE A PRESUMPTION OF UNREASONABLENESS ALSO, FOR PRACTICAL PURPOSES, THE GOVERNMENT OFTEN POSSESSES MOST OF THE EVIDENCE ON THE ISSUE OF REASONABLENESS ANYWAY. ONE HOPES THAT THE IRS WOULD COOPERATE IN THE SPIRIT OF TRUST AND VOLUNTARY COMPLIANCE BY PRESENTING THIS EVIDENCE.

IV. PROPOSED DATES OF APPLICATION

THE ACT CONTAINS A SUNSET PERIOD OF THREE YEARS. NTLF SUPPORTS THIS LIMITATION, DESPITE THE FACT THAT IT WORKS TO DISQUALIFY A SUBSTANTIAL NUMBER OF CASES THAT TAKE CONSIDERABLY LONGER THAN THREE YEARS TO LITIGATE. IDEALLY, WE WOULD LIKE TO SEE THE SUNSET DATE PUSHED UP TO 1985. HOWEVER, WE ACKNOWLEGE THE VALUE OF AN EARLY SUNSET INSPECTION, DUE TO THE AMOUNT OF SOUND JUDICIAL DISCRETION THE BILL REQUIRES FOR SUCCESS. WE TRUST THAT A REVIEW OF THE BILL'S TRACK RECORD AFTER THREE YEARS WILL REVEAL WHETHER OR NOT JUDGES ARE IN-LINE WITH THE LEGISLATIVE INTENT. AT THAT TIME, NECESSARY CHANGES IN THE LAW CAN BE MADE.

IT IS MOST UNFORTUNATE, HOWEVER, THAT THE LAW WILL ONLY APPLY TO CASES FILED AFTER DECEMBER 31, 1978; SINCE MOST OF THE SUITS WE HAVE DOCUMENTED OVER THE PAST YEAR WERE INITIATED WELL PRIOR TO THIS DATE. WHY NOT LET EVERYONE WHO IS STILL INVOLVED WITH THE EXPENSE OF HAVING TO PROTECT THEMSELVES AGAINST WRONG AND UNFAIR TAX CHARGES HAVE ACCESS TO THE ACT'S PROTECTION.

NTLF'S DIRECT INTEREST IN THE PASSAGE OF S. 1444

OTHER THAN REPRESENTING THE INTERESTS OF TAXPAYERS WHO SUFFER AT THE HANDS OF GOVERNMENT, THE NATIONAL TAXPAYERS LEGAL FUND IS TRYING TO ESTABLISH A RELIABLE NETWORK OF ATTORNEYS TO DEFEND TO DEFEND TAXPAYER RIGHTS. S. 1444 WOULD ASSIST THAT EFFORT, SOMEWHAT.

FACED WITH AN ALLEGED TAX DEFICIENCY, MOST PEOPLE ARE HELPLESS WITHOUT A COMPETENT AND WILLING ATTORNEY ON THEIR SIDE. THESE ATTORNEYS ARE GENERALLY THE MOST EXPENSIVE ON THE MARKET. IF YOU HAVE AN AVERAGE INCOME, YOU CAN'T AFFORD ONE.

THERE IS CURRENTLY VERY LITTLE ECONOMIC INCENTIVE FOR LAWYERS TO TAKE IRS ABUSE CASES. THIS BILL WOULD ALLOW AN ATTORNEY TO TAKE A PUBLIC-SPIRITED GAMBLE. IF THE ATTORNEY IS CORRECT AND ABLE TO PROVE THAT THE GOVERNMENT CHARGES ARE UNTRUE

AND UNREASONABLE, AT LEAST PART OF THE FEES WILL BE PAID ALONG WITH THE ADDED SATISFACTION OF SERVING JUSTICE.

WE DO NOT THINK THAT CASES COVERED BY S. 1444 WILL SUDDENLY FLOOD THE COURTS, BECAUSE THE IRS UNDOUBTABLY ACTS REASONABLY MOST OF THE TIME. WE DO BELIEVE HOWEVER, THAT RESPONSE TO THIS LEGISLATION WILL SPRING UP IN ALL OF THE TAXING DISTRICTS.

THE LEGAL ESTABLISHMENT SEEMS TO BE ENTRENCHED IN ITS TOLERANCE OF TAXPAYER RIGHTS ABUSES. PROVIDING INCENTIVES FOR IDEALISTIC ATTORNEYS TO BECOME COMPETENT AT TAX LAW, IS THE BEST WAY TO EXPOSE AND CORRECT INJUSTICE IN THE ADMINISTRATION AND ENFORCEMENT OF THE TAX SYSTEM.

ATTORNEYS WHO ARE WILLING TO DEFEND TAXPAYER RIGHTS NEED TO HAVE ADDITIONAL LEGISLATION DEFINING A LIBERALIZED SET OF RIGHTS FOR TAXPAYERS. A "TAXPAYERS BILL OF RIGHTS" IS YEARS OVERDUE AND THERE IS NO TIME MORE PERFECT FOR ITS ENACTMENT INTO LAW THAN NOW. THE ESTABLISHMENT OF A SYSTEM THAT RESPECTS THE RIGHTS OF THOSE WHO FINANCE IT WILL NEVER BE COMPLETE UNTIL THE FUNDAMENTAL RIGHTS OF TAXPAYERS ARE FINALLY DETERMINED BY STATUTE.

LASTLY, THE NATIONAL TAXPAYERS LEGAL FUND THANKS SENATOR BAUCUS, HIS STAFF AND OTHER SPONSORS OF THIS LEGISLATION FOR INTRODUCING SENATE BILL 1444, AND FOR CONDUCTING HEARINGS WITH AN EAR TOWARD THE BASIC PROBLEMS OF TAX ADMINISTRATION AND ENFORCEMENT. WE LOOK FORWARD TO FOLLOWING YOUR PROGRESS IN ENACTING LEGISLATION TO IMPROVE THE SYSTEM FOR TAXPAYERS.

STATEMENT BY
SUSAN B. LONG AND PHILIP H. LONG

Mr. Chairman and Members of the Subcommittee:

We are happy to appear at this Committee's invitation to present our views on S. 1444, the Taxpayer Protection and Reimbursement Act. On the whole, we believe that this measure would be a small step in rectifying what we view as a major area in need of procedural reform today -- the system for resolving disputes between taxpayers and the government on their taxes.

THE PROBLEM: CHEAPER TO 'PAY UP AND SHUT UP'

The costs of contesting I.R.S. enforcement claims are high. Worse, little of these costs are now recoverable even if the taxpayer takes the I.R.S. to court and proves s/he never owed a dime. Since in the vast majority of cases the costs of contesting I.R.S. claims quickly exceed the amount of tax in dispute, few taxpayers can afford the price of justice.

In fact, a few years ago, former I.R.S. Commissioner Mortimer Caplin who heads a major law firm in Washington, D. C. told us his firm could not afford to take on a tax case unless there was over $100,000 at stake. The costs of litigation were simply too high to justify handling smaller

claims. No doubt with inflation, the figure is even higher today. The story is the same when you talk with other experienced tax attorneys.

Few taxpayers make $100,000 a year, let along are liable for $100,000 in additional tax. Thus, for the average taxpayer it matters little whether s/he owes the tax, it is simply to costly to contest I.R.S. claims.

From our experience, the problem of being priced out of obtaining justice is all too commonplace. Indeed, we receive many calls and letters from taxpayers angry over what they feel is an unjust I.R.S. claim. While we can try to be helpful by explaining administrative and court remedies and where to obtain further information, we must be honest with them about the costs they face. The question that is uppermost is not whether or not they owe the money, but simply: How much money is at stake? While only they can decide how much "justice" is worth to them, as a purely monetary matter in most cases it is simply cheaper to "pay up and shut up."

SOURCE OF TAX DISPUTES: COMPLEXITY AND UNCERTAINTY IN THE LAW

The unfairness of this system is heightened because taxpayers have little way of avoiding many tax disputes. The laws are complex and are subject to differing interpretations. A taxpayer has no sure way of discovering before s/he files the return whether the calculations -- despite one's best efforts -- will pass muster if the return is selected for audit. They cannot even be assured of obtaining the correct answers from I.R.S. The Internal Revenue Service's own scientific studies under its Taxpayer Compliance Measurement Program indicate that whether the taxpayer consults I.R.S., a tax preparer, C.P.A., or attorney, fully two-thirds of the regular 1040 returns filed would -- if examined --

be challenged by an I.R.S. auditor and additional moneys demanded. Studies indicate answers and standards vary within I.R.S. itself -- from one office to the next, from one agent to another.

To tell taxpayers under these circumstances that they have little practical choice but to pay whatever I.R.S. may claim is owed, is clearly unjust. Congress should recognize that part of the costs of creating a complex tax code are the costs of providing taxpayers an adequate remedy to ensure that they pay only those moneys they actually owe.

MEETING THESE NEEDS: S. 1444

We commend the Chairman and other Senators who have joined with him in introducing this legislation. S. 1444 does offer some needed relief to taxpayers. However, we believe it does not move far enough. There are four areas in particular we wish to comment on:

(1) the availability of costs as distinguished from attorney fees;

(2) the adequacy of $20,000 as the upper limit on awards;

(3) the requirement taxpayers must not merely substantially prevail, but win on "all, or all but an insignificant portion";

(4) the requirement that I.R.S.'s position be shown not simply wrong, but "unreasonable."

(1) Availability of Costs. Currently, under 28 U.S.C. 2412 a taxpayer need not establish that the government acted unreasonably to obtain "a judgment for costs..in any civil action brought by or against the United States or any agency or official of the United States acting in his official capacity." We are concerned that S. 1444 in amending this provision might be construed as requiring proof of I.R.S. unreasonableness before an award of costs -- as distinguished from attorney fees -- could be made.

While undoubtedly this was not the intent of the bill, we suggest that the matter be clarified by explicitly stating that the act does not limit relief or remedies presently available.

(2) $20,000 Limit on Awards. While we have no objection to setting a reasonable upper limit on awards, the figure of $20,000 falls short of the expressed goal: "to provide sufficient relief for taxpayers in the ordinary types of civil tax cases" (Cong. Rec., June 27, 1979). Legal fees, particularly at today's prices, could easily run over $20,000 in many ordinary tax cases. We urge consideration of raising this limit. At minimum, express recognition of the high cost of litigation should be noted, so that the $20,000 figure is not viewed as justifiable only in cases of above average complexity.

(3) Prevailing on All But an Insignificant Portion. We again commend the sponsors of S. 1444 for providing awards for taxpayers who win not by a judicial determination, but by having the government concede the issues after litigation has begun. However, S. 1444's language adopts a more stringent test than the usual prevailing standard rule. The requirement that taxpayers must not merely substantially prevail, but win on "all, or all but an insignificant portion" of the money (or where there is no money at stake, the issues) involved seems unduly restrictive. Surely taxpayers subject to unreasonable I.R.S. action who substantially prevail should not be denied attorney fees simply because they did not prove they owed nothing or next to nothing. Yet this is how we fear the "insignificant portion" language would be construed.

(4) Not Simply Wrong, But Unreasonable. Perhaps the chief area of concern we see in S. 1444 is its resemblance to some insurance policies which give you everything on the face, and take it all away in the fine

print. This is what we are afraid the practical effect of requiring a showing of I.R.S. unreasonableness before an award may be given. We prefer the language in H.R. 3884 introduced May 2, 1979 in the House by Representative Mineta, who has been joined by 35 cosponsors including your colleague from Montana, Representative Williams. In that measure a taxpayer is awarded attorney fees when s/he prevails. S. 1444 could be strengthened if at page 3, line 17, "or" was substituted for "and."

If some unreasonableness standard remains in this bill, we suggest that at least where a taxpayer has prevailed by proving I.R.S. tax claims were wrong, the burden should shift to the government to show its actions were not unreasonable. Just as the taxpayer has in his or her possession the facts regarding the tax issues and must bear the burden of proof on these, it is the government who has exclusive control of the facts on the basis for its actions. It should therefore bear the burden of proof at this juncture in the case.

Further, some guidance should be provided as to unreasonable standards of action. Both the legal position and actions in the case should be covered under such standards. Badges of unreasonableness should include:

(a) strained interpretation -- adopting a strained interpretation, not reasonably flowing from the statute;

(b) inconsistent position -- taking a position inconsistent with the government's past position without clear evidence that prior to asserting these tax claims in the instant case, it had altered its position and was applying this new position to other taxpayers;

(c) inconsistent application -- applying inconsistent standards to taxpayers the statute treats the same;

(d) nuisance claims -- raising issues not because of their legal merit, but for their nuisance value; (Settlement for a small percent of the original tax claim without a clear justification for switching positions would be an example of bringing nuisance claims.)

(e) Improperly threatening, or making false statements to the taxpayer to obtain or attempt to obtain unfair advantage;

(f) refusing to provide some adequate explanation of the basis of the government tax claim, or the type of evidence the government would require to accept the taxpayer's return as filed.

We hope that further consideration will be given to strengthening S. 1444 in its practical applications, and appreciate the efforts of this Subcommittee in this area. Thank you.

STATEMENT OF EDWIN I. DAVIS

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to present my views 1/ to this Subcommittee on S.1444 in particular and the general matter of the recovery by taxpayers of their attorneys' fees if they prevail in tax litigation. This Subcommittee should be commended by the taxpaying public for its efforts toward assuring that our government's revenues are raised in a manner that is not only fair in principle, but is also actually and demonstrably fair to taxpayers.

I am a Certified Public Accountant and I have practiced public accounting since 1951, in Houston, Texas. Before that, from 1949 to 1951, I was employed as an examining U.S. Internal Revenue Agent. Currently, my office prepares about 125 tax returns per year and handles about 50 or so preliminary inquiries and full-scale tax audits by the IRS per year. Based on my 31 years of experience within and without the Internal Revenue Service, and having studied S.1444, I have reached several conclusions which I would like to relate to you:

1. As the IRS and Treasury will no doubt tell you, there is no question that most taxpayers have no

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1/ I expect to be compensated for my time by one or more of my clients, but the views expressed herein are my own.

significant difficulties with the IRS. However, it is also true that only a very small percentage of individuals' returns are ever audited.

2. There is no question that some taxpayers do have significant difficulties with the IRS. These difficulties usually relate to honest differences of opinion, and I know from first-hand experience that most IRS agents try very hard to be fair to both the taxpayers and the government. However, taxpayers' difficulties can also result from stubborness, lack of knowledge, lack of effort, and other less desirable personal characteristics of the individuals involved. Further, at times the areas of IRS inquiry may be outside matters pertinent to particular tax examinations. Often there is a lack of appreciation of the difficulty and expense that a taxpayer will be forced to incur to respond to IRS related proceedings.

3. No matter how hard the IRS tries to do its job well and fairly, it will never be able to assure you or the taxpaying public that every taxpayer has been treated reasonably and fairly. Therefore, some independent check and balance is needed, and some method is needed to compensate taxpayers for any unfair impositions on them by their own government's employees that may occur from time to time.

When you consider the desirability of S.1444, and any changes to it that may be suggested by these hearings or otherwise, I hope you will agree that a change in the law to permit recovery of attorney's fees should be designed to

produce an independent check and balance on the fairness of IRS practices. Merely because the taxpayer prevails against the IRS does not mean that the taxpayer's attorney's fees should be reimbursed. However, if the IRS position was not justifiable, the taxpayer who was unfairly treated should be made whole.

Let me address the specifics of S.1444 as I think it would work in practice and suggest some ideas about that for you to consider.

First, I think the bill overall offers an improvement over current law, and I support it. That is not to say parts of it could not be improved, in my view.

My first concern about the bill is with the limit of $20,000 for fees and costs (I.R.C. § 7430(b); 28 U.S.C. § 2412(b)(2)). Besides the obvious fact that inflation may make any number like this quickly out-of-date, 2/ it does not seem fair to impose a dollar limit in many cases. For example, if the government and the taxpayer each were to spend $50,000 preparing and litigating a case that the government should never have brought, why should the taxpayer's $30,000 of cost in excess of the artificial $20,000 limit go unreimbursed? In fact, the unfairness to the taxpayer in this example is really understated, because only

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2/ A $20,000 limit enacted five years ago would have declined in real terms to less than $13,600 by today, and, a $20,000 limit enacted 10 years ago would have declined in real terms to less than $10,200 by today, using a CPI price deflator.

litigation expenses are subject to recovery under the bill. Before a tax case gets to the litigation stage, thousands of dollars in fees and costs may be paid by the taxpayer in connection with the IRS audit and administrative appeals. If pre-litigation expenses are not to be covered, perhaps fairness then requires that there be no dollar limit on the amount of litigation expenses that can be recovered under this bill. At a minimum, fairness would seem to require discretionary recovery up to an amount equal to the costs incurred by the government in preparing and litigating the case. This would give the taxpayer an equal break with the government. Placing the award of fees and costs within the sound discretion of the courts would not discriminate in favor of large and expensive tax controversies. Large and small taxpayers alike would have to accept the burden of paying the litigation expenses in the first instance, subject to the risk that they could prevail on the merits of the litigation and then persuade the court to exercise its discretion in favor of reimbursing all or part of their litigation expense.

My second concern is that only lawyers' fees and limited types of costs, such as filing fees, are recoverable, except that a non-lawyer acting as the taxpayer's counsel in the Tax Court, as permitted by the Court's rules, is also covered (I.R.C. § 7430(a); 28 U.S.C. § 2312(b)(1)). This means that the taxpayer's accountant who supervised his record-keeping, gave him the tax advice, prepared his return,

handled the audit by the IRS and was indispensable to the lawyer who tried (and won) the case must be paid solely out of the taxpayer's pocket. It also means that the taxpayer's appraiser, if there was a valuation question, his engineer, if there was a depreciation question, or his economist, doctor, etc. who testified at the trial must also be paid solely from the taxpayer's pocket. If the government has its accountants, appraisers, engineers and so forth involved in the case paid from tax revenues, this seems unfair. Perhaps all fees and costs incurred by a taxpayer should be covered by the bill as a matter of fairness. At a minimum, permissive recovery for fees and costs of experts required to confront the government's similar type experts would seem required to achieve fairness.

My third concern is that no recovery is allowed unless the taxpayer recovers all but an insignificant part of the amount in controversy (I.R.C. § 7430(c)(2)(A)(i); 28 U.S.C. § (b)(3)(A)(i)). I don't know how much is or isn't regarded as insignificant, as there is no definition of the term in the bill. Further, the term, "insignificant" is not a term with a generally accepted meaning in the Internal Revenue Code. Even if I knew the term's definition, I am not certain it could be applied sensibly if there were more than one issue in the case. If, for example, there were two issues in the case, one a 50/50 issue for either side and the other a 100% issue for the taxpayer, and if the court were to divide the 50/50 issue equally between the government

and the taxpayer and decide the 100% issue for the taxpayer, would the test be satisfied or not? I think the taxpayer should be entitled to his fees and costs attributable to the 100% issue in this case. Perhaps if the bill merely gave a federal judge discretion to award fees to the prevailing party it would solve the definitional problem and still protect the government from an unwarranted fee recovery. Both the taxpayers and the government should be willing to trust in the integrity of the federal court to exercise this discretion wisely.

My fourth concern is that the bill's life, from January 1, 1979, to January 1, 1983 (Secs. 103 and 203 of the bill), is too short a period to evaluate the bill's effectiveness. Cases simply take too long to develop in court to expect any meaningful data for that period to be available by December 31, 1982, when the bill would expire. By the time the first cases subject to the bill have been decided by the appellate courts, the four year term of the legislation would have expired. Several more years of experience with the bill would be required for adequate evaluation. It seems to me there should be no substantial concern that the cost of the bill might be too great, or that courts might be flooded with new litigation. Presumably, the number of cases in which the IRS actions would justify a federal court in making a costs award to a taxpayer would be few, unless the IRS has more problems in this area

than they have indicated to Congress and the taxpaying public. Taxpayers would have limited incentive to file more suits because no new assurance would exist that they would win a case against the IRS or that a federal court would award costs. Taxpayers would, however, have assurance that any litigation would be costly and that they would be out-of-pocket substantial amounts for the number of years necessary to conclude the litigation even if they might ultimately prevail. In any event, any unexpected docket crowding or budget problems could be brought to the Congress' attention and solved promptly, one way or another. If some finite evaluation period is needed, it should be substantially longer than that provided in the bill if any meaningful review is to occur before the provision expires.

My final concern is that a court would potentially have to follow a trial on the merits with a trial of the taxpayer's contention that the Service's position was "unreasonable". I am not sure what is unreasonable in this context. The small taxpayer who has to engage in expensive litigation over a sensible but novel question probably believes the IRS is unreasonable, and Senator Baucus' statement introducing S.1444 so suggests. However, "unreasonable" is defined by Black's Law Dictionary as "irrational; foolish; unwise; absurd; silly; etc." I doubt the presentation to a court of a sensible, novel issue is ever unreasonable, according to the word's dictionary definition. However, I think that it would strike ordinary people as unfair if the

government chose to try the small taxpayer's novel case while settling the large taxpayer's novel case. Again, these definitional difficulties could be avoided by giving the federal judge hearing the case discretion in the award of fees. The trial judge could then decide on a case by case basis what would be necessary to be fair to both the taxpayer and the government.

In summary, I believe S.1444 represents an important step toward demonstrating to taxpayers that the government intends to treat them fairly. I believe this fundamental fairness is necessary for the integrity and effective functioning of our self-assessment system. I hope my concerns expressed to you today will be helpful to you as you go forward in your markup sessions.

Thank you Mr. Chairman and members of this Subcommittee for giving me the opportunity to present my views on these matters.

STATEMENT

OF THE

NATIONAL SOCIETY OF PUBLIC ACCOUNTANTS

Mr. Chairman and Members of the Subcommittee:

My name is John H. Fitch, Jr. I am Director of Government Affairs for the National Society of Public Accountants. NSPA is an individual membership professional association made up of 17,000 small, independent accountants in public practice throughout the nation. Our members perform auditing, accounting, tax and management advisory services to 10 million tax paying clients (3 million of which are small business entities).

NSPA strongly supports the intent and effect of S. 1444. As a Society whose membership provides tax advice and consultation to individual as well as corporate taxpayers, we are keenly aware of and have experienced the frustration of one who lacks the financial resources to challenge an arbitrary and unreasonable position taken by the IRS. The specter of unlimited legal and financial resources is constantly raised and used as a lever by IRS to force the individual or small business taxpayer into a settlement on terms most favorable to the Government rather than in the best interest of justice.

NSPA views the intent and philosophy of S. 1444 as being similar to the intervenor program instituted by certain federal regulatory agencies such as the Federal Trade Commission in its rulemaking process and proposed and strongly supported in various bills on regulatory reform currently being considered by both the Senate and the House. The intervenor program, a part of the regulatory process, provides monies and financial support to individuals and groups who would be affected by a proposed rule or regulation but are unable to effectively present their views and comments on its impact on their constituency. S. 1444 acts in the same manner. That is, it would assure the plaintiff (or defendent) in a civil tax case of financial reimbursement should his position prevail and that of the Government's is found to be unreasonable. Thus, it would provide a mechanism for a taxpayer to show the effect an IRS rule, regulation, interpretation or law has on a particular fact situation (similar to commenting on a proposed rule) and cause the government to take notice and seriously evaluate that position.

From a small business standpoint this bill is even more important. Federal regulation of the private sector has burdened small business in particular with paperwork, increasing costs, and general frustration with seemingly frivolous regulations and guidelines. More importantly, though, the small business community has found itself the object of increasing abuse by regulatory agencies which use their statutory authority to seek rulings against small firms which, unlike the large corporations, haven't adequate resources to sustain a protracted legal battle with the government. This statutory abuse by certain agencies not only establishes precedents for rulings against larger firms, but builds the "batting averages" of the agency to justify its very existence and additional appropriations from Congress. Thus, the agency, its staff, and the regulatory process are further entrenched in the government.

A decision, right or wrong, by an official of a regulatory agency has caused more than just a few companies to go out of business. And even if the ruling has been proven wrong, a bankrupt company has no recourse of suing the government or righting the case through the appellate procedures -- it simply cannot afford the cost.

While S. 1444 relates specifically to tax cases, the tax laws seriously impact on small business and any arbitrary or unreasonable interpretation, ruling, etc., by IRS can have a disastrous effect on a small business.

Specifically, NSPA supports the "prevailing party" concept of S. 1444. However, we have some reservations about the burden placed upon the prevailing party to establish that the position of the government was unreasonable. We can envision the litigation of a fact situation turning on the reasonableness or unreasonableness of a government position rather than on the merits and facts of the case. NSPA suggests that unreasonableness be a part of the evidence presented to substantiate the position of a taxpayer or a factual issue, but it should not be controlling in determining whether or not costs and attorney's fees are to be awarded. The fact that the taxpayer prevailed should be sufficient.

NSPA also notes the absence of any reference to expert witness fees as being a reasonable court cost. In many cases brought before the Tax Court or in the U.S. District Courts, the attorney for the taxpayer relies heavily on the expert testimony of the accountant or tax expert who advised the taxpayer, prepared his or her return or would serve as one who interprets a tax ruling, regulation or law reasonably, but not in the same manner as IRS. These experts are expensive but are a necessary and in many cases a crucial aspect of the taxpayer's case. Therefore, NSPA recommends that the bill specifically include a provision relating to the fees of expert witnesses of this nature.

Since some of our members are authorized to represent taxpayers before IRS and the Tax Court, we are pleased to see the definition of attorney's fees includes their services in their capacity as an advocate for a taxpayer.

NSPA has some reservation about the increase in the budget of IRS if S. 1444 becomes law; however, we believe that the direct benefit to the taxpayer and small business in the form of reimbursement for their litigation expenses as well as the indirect benefit of forcing IRS to carefully evaluate the merits and reasonableness of their positions on tax matters far outweigh the costs and will provide a fairer, more equitable administration of the tax laws.

In this regard, NSPA would like to point out that while S. 1444 does not pertain to administrative proceedings, those proceedings can be as costly as court litigation and, the factors in deciding to administratively appeal an IRS decision are similar if not identical to those relating to filing a court action. It is not necessarily our position that S. 1444 be amended to include administrative proceedings; however, it is our intention to bring out the fact that most cases challenging an IRS position

on a matter take place at the administrative level and that is where IRS exerts its greatest influence and pressure. While it is hoped that S. 1444 if enacted would have some positive effect on the IRS in the administrative arena, further attention similar to S. 1444 should be focused in that direction.

Finally, NSPA supports the sunset provision of S. 1444, however we believe the dates suggested by the legislation are unrealistic. The budgets for those future fiscal years will have already been determined when the bill is passed and those cases currently in litigation should not necessarily reap a windfall from S. 1444 at the expense of IRS, who would be unnecessarily penalized because the rules of the game were changed after it began.

In conclusion, the National Society of Public Accountants believes that legislation providing for the payment of attorneys' fees to individuals and small businesses prevailing in civil tax cases against the IRS is a first step toward restraining arbitrary regulatory proceedings. Since many cases result from a bureaucratic or administrative denial of justice to those unable to afford the extraordinary legal costs involved, legislation providing for attorney fee reimbursement would restore to those abused their right to seek legal redress for damages done.

Thank you for the opportunity to present our views on this legislation.

Senator BAUCUS. That concludes the hearing.

Thank you all very much.

The hearing will recess subject to the call of the Chair.

[Whereupon, at 6:05 p.m. the subcommittee recessed, to reconvene at the call of the Chair.]

[By direction of the chairman the following communications were made a part of the hearing record:]

325 PENNSYLVANIA AVENUE, SOUTHEAST WASHINGTON, DISTRICT OF COLUMBIA 20003 TELEPHONE (202) 543-1300

July 17, 1979

Senator Max Baucus
1107 DSOB
Washington, D.C. 20510

Dear Senator Baucus:

We were pleased to learn that you have introduced S.1444, the Taxpayer Protection and Reimbursement Act.

Enclosed is a statement on the National Taxpayer Union's position on S.1444. Would you please enter the statement into the official record at the hearings on S.1444?

We wish you every success with your efforts on S.1444.

Sincerely,

David Keating
Director of Legislative Policy

DK/dm

WASHINGTON, DISTRICT OF COLUMBIA 20003 TELEPHONE (202) 543-1300

The Taxpayer Protection and Reimbursement Act

The National Taxpayers Union fully supports the objectives of S.1444, the Taxpayer Protection and Reimbursement Act. It is an important step towards reducing the awesome disadvantages the taxpayer now faces in a dispute with the Internal Revenue Service. Currently, it is well known that the taxpayer faces extreme disadvantages when a dispute arises with the Internal Revenue Service. Compared to the individual taxpayer, the IRS has virtually unlimited resources. If the taxpayer loses the dispute, he loses time, wages, expenses, and can be assessed penalties. If he wins, he gets to keep his money minus court costs, time, wages and other expenses incurred. These costs frequently exceed the amount of money the taxpayer is allowed to keep. While we feel enactment of S.1444 in its present form would reduce the disadvantages the taxpayer faces in a dispute with the Internal Revenue Service, we recommend the following changes in S.1444 be considered:

1) The bill gives discretion to the Courts to reimburse the taxpayer for reasonable court costs, including attorney's fees, only when the taxpayer wins the case in dispute and proves the position of the United States was unreasonable. If the taxpayer wins the case we feel he should be reimbursed for reasonable court costs. If the position of the IRS and the United States is wrong, the taxpayer should not have to further prove that the position is "unreasonable" and then rely on the discretion of the court to reimburse court costs.

2) The bill limits reimbursement of court costs to $20,000. The bill already limits reimbursement of court costs to a "reasonable" amount. If the costs are reasonable, and over $20,000, there is no fair reason not to reimburse the taxpayer. This provision guarantees that the IRS regains the inherent advantages over the taxpayer in a major case.

3) The bill provides that payment for reimbursement of court costs come from the general funds of the agency which loses the case. This important provision will help to ensure caution and reason in governmental actions against taxpayers. If limitations on amounts to be reimbursed are to be included in the bill, we would recommend limiting the total reimbursement the agency can dispense in any given year, instead of limiting the amount for any one case. This limit, of course, should not be used by the agency or the court as grounds to deny reimbursement. This limitation would guarantee that an agency would not repeatedly pursue frivolous actions.

HOLMES F. CROUCH
Tax Practitioner
20484 Glen Brae Drive, Saratoga, California 95070
(408) 867-2628
ENROLLED TO PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

July 21, 1979

Mr. Michael Stern
Staff Director
Committee on Finance
Room 2227
Dirksen Senate Office Bldg.
Washington, D.C. 20510

Re: Hearing on S. 1444

Dear Mr. Stern:

I have received your Press Release #H-44 dated July 12, 1979. I wish to submit a written statement for the record, pertaining to S. 1444: Taxpayer Protection and Reimbursement Act.

As a professional tax preparer, eight years in practice, I have become increasingly concerned about the hard lined and constrained adversary position which the Internal Revenue Service too often takes against taxpayers. I have had some experience where reasonable and moderate positions have been taken, but by and large, unreasonableness is the rule rather than the exception.

I have given this matter serious and constructive thought, and I keep coming up with the idea of NEGATIVE PENALTIES against the Internal Revenue Service. In other words, in addition to reimbursement for costs and fees to a taxpayer, a "Negative Penalty" would be imposed on the IRS for each act of arbitrary overassessment. The key word here is "arbitrary" overassessment as there are erroneous overassessments which, in time, can be corrected via administrative and judicial processes.

I suggest a 50% negative penalty for each arbitrary overassessment. That is, for each $100 in arbitrary overassessment made initially by the

IRS, a $50 negative penalty would be imposed. This $50 negative penalty would go to the taxpayer, tax free. Determination of the negative penalty would be made by the Senate Finance Subcommittee on Oversight of the Internal Revenue Service.

To provide a specific current example of what I mean, attached herewith are copies of a current protest involving my clients, Mr. & Mrs. Willard D. Whitaker. The tax controversy arises from an arbitrary and unreasonable overinterpretation of IR Code Sec. 280A. This section pertains to limitations in business expenses when using an "office-in-home." This section was a 1976 enactment.

What the IRS is saying is that, because of Sec. 280A, if a taxpayer claims $1 in office-in-home expenses, in a bona fide business endeavor, he is disallowed all otherwise allowable business expenses, even though such otherwise allowable expenses might result in a bona fide business loss of $100,000. This is truly an arbitrary and far-reaching position. All business losses of a sole proprietorship are automatically adjusted to zero, if a taxpayer so much as claims $1 of office-in-home expenses. Congress surely did not have this in mind when it enacted Sect. 280A.

In the Whitaker case attached, the IRS arbitrarily adjusted the Schedule C business losses for 1976 and 1977 to zero. The additional tax deriving from this arbitrary adjustment amounts to $515.28 for 1976 and $384.00 for 1977.

If the Taxpayer Protection and Reimbursement Act were properly worded to include 50% NEGATIVE PENALTIES against the IRS, the Whitakers would be entitled to reimbursement of $258 for 1976 and $192 for 1977. In addition, they would also be entitled to reimbursement for the audit fees and appellate fees which they have paid. To date, their audit fees are $75 and their appellate fees are $225.

I feel strongly that, sooner or later, the concept of negative penalties must be considered by Congress as a disciplinary tool against the IRS. Sooner or later, this must come if we are ever to restore confidence of taxpayers in their government. I believe that the opportunity to introduce this concept exists in S. 1444.

Respectfully submitted,

Holmes F. Crouch
TAX PRACTITIONER

Courtesy Copy to
Chief, Appellate Branch
IRS San Francisco

HOLMES F. CROUCH
Tax Practitioner
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ENROLLED TO PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

July 21, 1979

Mr. Aubry Myrick
Chief, Appellate Branch
Internal Revenue Service
2 Embarcadero Center #800
San Francisco, CA 94111

Re: Albert Hill, Conferee
Willard Whitaker, Taxpayer
Interpretation of Sec. 280A

Dear Mr. Myrick:

The official Statement of Principles of the Internal Revenue Service is, in part --

> ". . .(T)o determine the reasonable meaning of various Code provisions in the light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view. At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction. . . ."

On Friday, July 20th, I met with your Mr. Albert Hill in the San Jose IRS office. We met for approximately one hour concerning the 1976 and 1977 tax returns of Mr. & Mrs. Willard D. Whitaker (567-40-7885). The sole and only issue was interpretation of Code Sec. 280A.

It was very obvious to me that your Mr. Hill was adopting a hard-lined and strained construction of Sec. 280A. He even went so far as to indicate that his strained interpretation would invalidate applicable prior-existing code sections, such as Sections 161 (business expenses), 163 (interest), 164 (taxes), 167 (depreciation), and 183(d) (activity engaged in for profit). Though he listened courteously to my position on the matter, as expressed in my letter of June 12, 1978 to Mr. John Stoeckl, Field Auditor, he clearly indicated that he (Hill)was going to rubber-stamp the auditor's position.

I submit that if your Appellate Branch is going to be nothing more than a rubber-stamp for the Examination (Audit) Branch of the IRS, then the Appellate Branch should be abolished entirely. In fact, I am urging that the Appellate Branch be abolished (as a budget-saving matter), by sending a copy of this letter to the Senate Finance Sub-committee on Oversight of the Internal Revenue Service.

My professional contention is that the underlying Congressional intent of Sec. 280A was to eliminate potential taxpayer abuses of converting otherwise non-allowable personal expenses into allowable business expenses via use of "office in home." It was not the purpose of Sec. 280A to automatically disallow otherwise allowable deductions of Sections 161, 163, 164, 167, and 183(d).

What Stoeckl and Hill are saying is that if a taxpayer claims $1 in office-in-home expenses, he shall not be allowed any business losses, even if his otherwise allowable business losses were $100,000. I submit that this is an arbitrary and unduly constrained interpretation of Sec. 280A. I reject such interpretation as not being in keeping with the Statement of Principles of the Service.

In view of the above, I specifically request that you, Mr. Myrick, provide me a clear and reasonable interpretation of Sec. 280A as it applies to taxpayers having a bona fide business, who, for economy and profit-making reasons, happen to use an office-in-home.

I explained my position carefully and systematically to your Mr. Hill. I do not believe he comprehended what I was saying. If he did, there would be no increase in Mr. & Mrs. Whitaker's tax for 1976 and 1977. The proposed tax increases derive solely from disallowing the Schedule C losses, and substituting "zero" for "Net profit or loss" from the business.

In other words, what Stoeckl and Hill are saying is that a sole proprietorship can never have a net operating loss (NOL) if $1 in office-in-home expenses is claimed. This is a far-reaching and unintended effect of Sec. 280A.

Please do not "play games" with my request for your interpretation of Sec. 280A. I want a responsible response signed by you, as Chief of the Appellate Branch. In addition to the Whitakers, I have numerous other tax clients where this issue is vital.

Very truly yours,

Holmes F. Crouch

Holmes F. Crouch
TAX PRACTITIONER

cc: 1. Senate Finance Subcommittee
on Oversight of the IRS
2. Willard D. Whitaker

HOLMES F. CROUCH
Tax Practitioner
20484 Glen Brae Drive, Saratoga, California 95070
(408) 867-2628

ENROLLED TO PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

June 12, 1978

Mr. John Stoeckl
Field Audit Group FA 1454
Internal Revenue Service
123 East Gish Road
San Jose, CA 95112

Re: Willard D. and Consuelo W. Whitaker
1976 Return 1040
Your Form 4549

Dear Mr. Stoeckl:

Thank you for forwarding me your proposed audit changes via your letter dated June 1, 1978.

On behalf of the taxpayers, I am protesting the proposed audit changes on the following grounds:

1. Violation of Legislative Intent

House Report No. 94-658 states very clearly that the overall objective of the Tax Reform Act of 1976 is

- "to improve substantially the equity of the income tax at all income levels,
- to continue for the calendar year 1976 the economic stimulus provided . . . by the Tax Reduction Act of 1975, ..."

The basic intent of Code Sec. 280A was to improve equity, eliminate abuses, and still provide economic stimulus, particularly to minority groups. The primary target of the office-in-home disallowance was fully employed persons, employed persons with a side business, or employed persons in two or more occupations. The objective was to stop tax abuses; it was not to stop economic incentives.

In the case here, Mrs. Consuelo W. Whitaker had previously left her prior employment to become self-employed. She engaged in retail sales, instructional activities, and manufacturing; she acquired inventory and capital equipment which served no personal-use benefit whatsoever. Her motivation for using her home, temporarily, was for economic reasons: not for tax reasons. She sought to become self-employed in a new business of her own.

2. Unauthorized Penalty Against Self-Employed

Under the provisions of Schedule C, any net earnings from self-employment (in excess of $400) are subject to the self-employment tax: Schedule SE. Mrs. Whitaker was aware of this, and this indeed was her objective. She

vanted to get a business going in her own right and pay her own social security tax.

By your application of Code Sec. 280A, you have penalized her in an unauthorized manner. You have denied her the Code Sec.183(d) presumption that if she can show a profit in 2 out of 5 consecutive (full) years, she is deemed to be self-employed, whereupon all expenses are deductible.

Furthermore, I contend that you have misinterpreted Sec. 280A(b) -- exception for taxes and interest. The Committee Report on P.L. 95-30 specifically states:

> "The deductions allowable for interest (Sec. 163), certain taxes (Sec. 164) and casualty losses (Sec. 165) may still be claimed as deductions without regard to their connection with the taxpayer's trade or business or income producing activities." (Underscoring supplied.)

Although you and I discussed these matters by phone at length, I could sense that I was not getting through to you. Now it is also obvious that your supervisor does not comprehend the above.

On behalf of the taxpayers, I hereby request that the case be assigned to a District Conferee, who has broader discretion in interpretation than at the audit level.

In summary, the taxpayers protest the entire amount of additional taxes imposed, namely:

1976	$515.28
1977	$384.00

as being erroneous and in violation of Legislative intent.

Very truly yours,

Holmes F. Crouch

Holmes F. Crouch
TAX PRACTITIONER

cc: Mr. & Mrs. Willard Whitaker
Congressman Don Edwards
1625 The Alameda, Room 709
San Jose, CA 95126

Page 1 of 9 pages

Form 4549-A (Rev. August 1968)	Department of the Treasury - Internal Revenue Service / **Income Tax Audit Changes**	Return Form No. 1040

Name and Address of Taxpayers	S.S. or E.I. Number	Filing Status
WHITAKER, Willard D. & Consuelo W. 2289 Pentland Way San Jose, Cal. 95122	567-40-7885	Joint

Person With Whom Audit Changes Were Discussed	Name and Title
	Mr. W. D. Whitaker, Taxpayer Mr. H. P. Crouch, Enrolled Agent

1. Adjustments to Income	Year	Year 7612	Year 7712
a. Schedule C Loss		$1,132.26	$ 736.59
b. Interest: Home Mortgage, Sch. A		$381.00	$371.00
c. Taxes: R.E. Sch. A.		$187.00	$197.00
d. Taxes: S.D.I.		($90.00)	($114.00)
e.			
f.			
g.			
2. Total Adjustments		$1,610.26	$1,190.59
3. Adjusted Gross or Taxable Income Shown on Return or as Previously Adjusted		$22,227.50	$28,981.39
4. Corrected Adjusted Gross or Taxable Income		$23,837.76	$30,171.98
5. Tax		$5,608.08	$5,472.00
6. Alternative Tax if Applicable (from Page ____)			
7. Tax Surcharge			
8. Corrected Tax Liability (lesser of line 5 or 6, plus line 7)		$5,608.08	$5,472.00
9. Less Credits (specify) a. General Tax Credit		$180.00	- 0 -
b.			
c.			
10. Balance (line 8 less total of lines 9a through 9c)		$5,428.08	$5,472.00
11. Plus: a. Tax from recomputing prior year investment credit			
b. Self-employment tax			
c.			
12. Total Corrected Income Tax Liability (line 10 plus total of lines 11a through 11c)		$5,428.08	$5,472.00
13. Total Tax Shown on Return or as Previously Adjusted		$4,912.80	$5,088.00
14. Increase or (decrease) in Tax (difference between lines 12 and 13)		$515.28	$384.00
15. Penalties			

Other Information

Examining Officer's Signature	District	Date
John Stivers	94	16 July 1978

GPO : 1975 O - 188-888

Form 4549-A (Rev. 8-74)

FORM 886-A FEBRUARY 1966	EXPLANATION OF ITEMS	SCHEDULE NO. OR EXHIBIT 5
NAME OF TAXPAYER WHITAKER, Willard D. & Consuelo W.		YEAR/PERIOD ENDED 7612, 7712

1a. Net Loss - Schedule C

FACTS:

In 1976 Mrs. Whitaker was the sole proprietor of House Of W., manufacturing of Ceramics and Student Instructions in the manufacturing and decorating of ceramics.

The operation is conducted out of the taxpayers residence and began in 1973. One bedroom is used exclusively for storage of paints and other supplies and materials used in the business. The major portion of the garage is also used for the business operation, including shelves, work table and an oven for firing. The laundry facilities, washer and dryer, would constitute the only personal use of the garage. A portion of the dining room area is occasionally used for student instructions and as a work area.

Mrs. Whitaker conducts classes on Tuesday and Thursday, mornings and evenings and occasionally gives 1 day seminars and workshops. The taxpayer also conducts Saturday morning classes during the summer months.

Mrs. Whitaker's monthly income summary shows receipts in June through July of 1976 of $161.65 and zero in August, September, November and December.

Mrs. Whitaker deducted losses of $1,132.26 in 1976 and $736.59 in 1977. The prorated expenses deducted on schedule C and contributing to the loss included 40% for telephone, 40% for P.G.&E., 20% for Water, Trash and Insurance and a 20% Cost basis in the residence with a 30 year life depreciated using the straight line method.

LAW:

Internal Revenue Code section 280A, effective for taxable years beginning after 1975, disallows certain expenses in connection with business use of home, Rental of Vacation Homes, etc.

The General Rule under section 280A(a) states that no deduction shall be allowed with respect to the use of a dwelling unit which is used by the taxpayer during the year as a residence.

However, section 280A(b) states that the General Rule above does not apply to Interest, Taxes, Casualty Losses etc. which would be allowed without regard to its connection with the taxpayers trade or business or income producing activity.

FORM 886-A FEBRUARY 1968	EXPLANATION OF ITEMS	SCHEDULE NO. OR EXHIBIT JUL 19 1979
NAME OF TAXPAYER WHITAKER, Willard D. & Consuelo W.		YEAR/PERIOD ENDED 7612, 7712

Section 280A(c)(1)(B) also makes an exception to the general rule to the extent such item is allocable to a portion of the dwelling unit which is exclusively used on a regular basis as a place of business which is used by patients, clients or customers in meeting or dealing with the taxpayer in the normal course of his trade or business.

Another exception to the general rule is made under section 280A(c)(2) for a space in the dwelling unit used for storage of inventory held for use in the taxpayers trade or business of selling products at retail or wholesale if the dwelling unit is the sole fixed location of such trade or business.

Although the use of a dwelling unit meets the exceptions to the general rule, which would disallow the deductions entirely except for interest, taxes etc., the deductions for other business expenses are limited by section 280A(c)(5) to the amount of gross income derived from such use over the deductions allocable to such use whether or not such unit was so used.

TAXPAYERS POSITION:

The application of Internal Revenue Code section 280A to the taxpayer is erroneous and in violation of legislative intent.

The proposed adjustments are in violation of the overall objectives of the Tax Reform Act of 1976 as stated in House Report No. 94-658 which are: " To improve substantially the equity of the income tax at all income levels, To continue for the calendar year 1976 the economic stimulus provided earlier this year by the Tax Reduction Act of 1975."

The objective of section 280A was to stop tax abuses, not to stop economic incentives.

The taxpayers motive for using her home temporarily was for economic reasons, not for tax reasons. With the objective of getting a business going and paying her own Social Security Tax.

The application of section 280A constitutes an unauthorized penalty by denying the taxpayer the Internal Revenue Code section 183(d) presumption of showing a profit in 2 out of 5 consecutive years and thereby deemed to be Self-Employed, and all expenses are deductible.

Governments Position:

The use of the residence meets the exceptions to the general rule under section 280A(c)(2) and therefore a portion of the expenses are deductible.

However the expenses are subject to section 280A(c)(5) limiting the deductions to the gross income derived from such use over the deductions allocable to such use whether or not such unit was so used.

FORM 886-A FEBRUARY 1968	EXPLANATION OF ITEMS	SCHEDULE NO. OR EXHIBIT ... 1977
NAME OF TAXPAYER WHITAKER, Willard D. & Consuelo W.		YEAR/PERIOD ENDED 7612, 7712

House Report No. 94-658 states that the general reason for Code Section 280A was to eliminate the allocation problem when personal living and family expenses attributable to the home and not deductible are converted to ordinary and necessary business expenses even though the expenses did not result in additional or incremental costs incurred as a result of the business use of the home.

Section 280A of the Internal Revenue Code does not penalize or prevent a taxpayer from reporting a profit and paying Social Security Tax as a self-employed individual. It does however limit the deductable expenses to the Gross Income derived from the use of the residence for that trade or business reduced by the deductions which are allowed without regard to their connection with the taxpayer's Trade or Business (e.g. interest and taxes) as stated in the Committee Reports on Public Law 95-30.

Section 280A(f)(3) states that if no deduction is allowed under section 280A(a) for the tax year, such year shall be taken into account in applying subsection (d) of section 183. The proposed adjustments were not made under section 183(a) as an activity not engaged in for profit nor were they made under section 280A subsection (a) disallowing the deductions entirely, therefore the 183(d) presumption is not applicable in this case.

CONCLUSION:

The operation conducted by Mrs. Whitaker from her residence meets the exception to the general rule, however it is subject to the limitations of Section 280A(c)(5). Therefore, the expenses claimed on schedule C for 1976 and 1977 are limited to the gross income derived from the use of the residence reducted by the deductions which are allowed without regard to their connection with the taxpayer's trade or business (e.g., interest, taxes).

The schedule C losses claimed in 1976 and 1977 have been adjusted as shown below.

FORM 886-A FEBRUARY 1968	EXPLANATION OF ITEMS	SCHEDULE NO. OR EXHIBIT
NAME OF TAXPAYER		YEAR/PERIOD ENDED
WHITAKER, Willard D. & Consuelo W.		7612, 7712

Schedule C. as adjusted: For tax year ending 31 Dec. 1976.

Gross Income		$2438.71
Less: Allocated Expenses		
Interest - R.E. ($1,907 X .20)	$381.00	
Taxes - R.E. ($936 X .20)	$187.00	
Total		568.00
Limit on business expenses per Sec. 280A(c)(5)		$1,870.71
Actual business expenses per return:		
Cost of Goods Sold	$1,205.00	
Other expenses	1,751.57	
Total	$2,956.57	
Limit on expenses per Sec. 280A(c)(5)		$1,870.71
Net Profit/Loss as adjusted		- 0 -
Amount claimed per return		- $1,132.26
Total adjustment for 1976		$1,132.26

FORM 886-A FEBRUARY 1960	EXPLANATION OF ITEMS	SCHEDULE NO. OR EXHIBIT JUL 1 9
NAME OF TAXPAYER		YEAR/PERIOD ENDED
WHITAKER, Willard D. & Consuelo W.		7612, 7712

Schedule C. as adjusted: For tax year ending 31 Dec. 1977.

Gross Income		$2,305.58
Less: Allocated Expenses		
Interest - R.E. ($1,856.72 X .20)	$371.00	
Taxes - R.E. ($982.92 X .20)	197.00	
Total		568.00
Limit on business expenses per Sec. 280A(c)(5)		$1,737.58
Actual business expenses per return:		
Cost of Goods Sold	$1,575.92	
Other expenses	946.75	
Total	$2,522.67	
Limit on expenses per Sec. 280A(c)(5)		1,737.58
Net Profit/Loss as adjusted		- 0 -
Amount claimed per return		- $736.59
Total adjustment for 1977		$736.59

FORM 886-A FEBRUARY 1968	EXPLANATION OF ITEMS	SCHEDULE NO. OR EXHIBIT
NAME OF TAXPAYER		YEAR/PERIOD ENDED
WHITAKER, Willard D. & Consuelo W.		7612, 7712

1b. Interest, Home Mortgage: Schedule A

1c. Taxes, Real Estate: Schedule A

FACTS:

The net losses reported on schedule C for 1976 and 1977 were determined without considering a percent of the expenses for interest and taxes allocable to such use of the residence.

The total amount of Real Estate Taxes and Home Mortgage Interest were deductod on schedule A.

LAW:

Section 280A(c)(5) of the Internal Revenue Code limits the exponses attributable to the use of a residence to the gross income derived from such use after being reduced by the deductions allowable without regard to the use of the residence (e.g. interest, taxes).

House Report No. 94-658, page 161-162 states "The allowable deductions attributable to the use of a residence for trade or business purposes may not exceed the amount of the gross income derived from the use of the residence for that trade or business reduced by the deductions which are allowed without regard to their connection with the taxpayer's trade or business (e.g., interest and taxes)".

Senate Report No. 94-938, page 149 states "The allowable deductions attributable to the use of a residence or separate unattached structure for trade or business purposes may not exceed the amount of the gross income derived from the use of the residence or separate unattached structure for that trade or business reduced by the deductions which are allowed without regard to their connection with the taxpayer's trade or business (e.g., interest and taxes)."

TAXPAYERS POSITION:

Internal Revenue Code Section 280A(b) Exception for Interest, Taxes, Casualty Losses, Etc. has been Misinterpreted.

The Committee Report on P.L. 95-30 specifically states: " The deductions allowable for interest (Sec. 163), certain taxes (Sec. 164) and casualty losses (Sec. 165) may still be claimed as deductions without regard to their connection with the taxpayer's trade or business or income producing activities."

FORM 886-A FEBRUARY 1968	EXPLANATION OF ITEMS	SCHEDULE NO. OR EXHIBIT JUL 18 1979
NAME OF TAXPAYER		YEAR/PERIOD ENDED
WHITAKER, Willard D. & Consuelo W.		7612, 7712

GOVERNMENTS POSITION:

Section 280A(b) of the Internal Revenue Code makes an exception for interest, taxes, casualty losses, etc. when no deduction is allowed under Section 280A subsection (a).

The paragraph quoted in the Taxpayers Position from the Committee Report on P.L. 95-30 begins by stating: "The general disallowance provision, however, does not apply with respect to certain expenses which are otherwise allowable as deductions; for example, - - - " (continued as quoted under the Taxpayers Position.) (underscoring supplied).

The deductions have not been disallowed under subsection (a) of Section 280A, the general disallowance provision.

The deductions for Interest and Taxes applicable to the business use must be allocated first in accordance with Internal Revenue Code Section 280A(c)(5)(B) and the Committee Reports on P.L. 95-30, House Report No. 95-65 and Senate Report 95-938, to arrive at the limitation on the other business expenses allowable under Section 280A(c)(5).

The Committee Reports on P.L. 95-30 state: "The Act also provides an overall limitation on the amount of deductions that a taxpayer may take for the business use of the home. The allowable deductions attributable to the use of a residence for trade or business purposes may not exceed the amount of the gross income derived from the use of the residence for that trade or business reduced by the deductions which are allowed without regard to their connection with the taxpayer's trade or business (e.g., interest and taxes)."

CONCLUSION:

The interest and taxes claimed as itemized deductions on schedule A have been reduced by the business portion and allocated to the business in order to compute the excess gross income limitation on the remaining business expenses as required by Internal Revenue Code Section 280A(c)(5).

1976 Adjustment:	Schedule A.		20 Percent bus. alloc.	Allowable on Sch. A.
Per Return:	Interest	$1,207.00	$386.00	$1,521.00
	Taxes	$936.00	$187.00	$749.00
1977 Adjustment:	Schedule A.			
Per Return:	Interest	$1,456.72	$371.00	$1,485.72
	Taxes	$982.92	$197.00	$785.92

HOLMES F. CROUCH
Tax Practitioner
20484 Glen Brae Drive, Saratoga, California 95070
(408) 867-2628
ENROLLED TO PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

July 24, 1979

Mr. Michael Stern
Staff Director
Committee on Finance
Room 2227
Dirksen Senate Office Bldg.
Washington, D C. 20510

Re: Hearing on S. 1444
Supplemental Statement

Dear Mr. Stern:

I note with dismay that Jerome Kurtz, Commissioner of Internal Revenue was one of the lead-off witnesses giving oral testimony on S. 1444. I caution the Finance Subcommittee to weigh Mr. Kurtz's comments very critically. In the past eight years, he has been the one commissioner who has gone out of his way to intensify the unreasonable positions of the Internal Revenue Service. He is an attorney, and by professional nature, views every taxpayer and every taxpreparer as his adversary. He asserts an abusive and hardened position behind his shield of bureaucracy.

I am aware that over 120,000 letters have condemned Commissioner Kurtz for his many interpretation abuses of the IR Code. Furthermore, Congress itself has specifically prohibited administration of his interpretation of some sections of the Code. He is the principal violater of the official "Statement of Principles" of the Internal Revenue Service.

One of Commissioner Kurtz's crusades against those who are paying his salary (including his vacation and welfare benefits) is his vendetta against tax preparers. For some unexplained reason, he has taken it upon himself to make professional tax preparers his whipping boys. He has been completely unreasonable with regard to preparer penalties, and has

wasted untold amounts of budget money in perpetuating gross errors of interpretation and gross inefficiencies in his administration.

I will cite a specific example on point, backed up with a documentary file some 5-1/2 inches thick.

The example here pertains to Kurtz's interpretation of IR Code Sec. 6109(a)(4): Preparer Identifying Number. The section, in part, requires that a professionally prepared tax return ". . . shall bear such identifying number for securing proper identification of such preparer, his employer, or both, as may be prescribed."

Kurtz, himself, has personally dictated through his bureaucracy that the Sec. 6109(a)(4) term "proper identification" shall be, in the case of a self-employed preparer, his social security number. No alternative is tolerated. This, of course, conflicts directly with the Privacy Act of 1974.

In July 1977, I commenced action in the Federal District Court, Northern California, to obtain a more reasonable interpretation of "proper identification" than just a preparer's social security number alone. I proposed using an alternate identification number, such as an IRS license number or an IRS employer number.

During the past three years of preparing tax returns for others, I have been harassed, intimidated, threatened with seizure, and assessed with repeated multitudes of $25 penalties, cumulatively totaling nearly $20,000. To date, after endless administrative appeals on my part, all of these preparer penalties have been abated. But I never know what the next course of IRS harassment will be.

On June 27, 1979, I sought voluntary dismissal (without prejudice) of my Federal Court action. Now, the IRS is fighting this dismissal on the

allegation that one $25 penalty has not been officially abated. I have evidence to the contrary, but this will not stop an abusive bureaucracy if it has one targeted for attack.

The attached papers exemplify what a tax preparer has to go through to remove a $25 preparer penalty, erroneously assessed by the IRS. The problem, of course, is magnified when the Department of Justice gets in the act.

The example here is just one of millions that take place throughout this country in attempting to deal reasonably with the IRS. No wonder there is such widespread contempt for government. No wonder there is a "Crisis of Confidence" that is destroying this nation.

In view of the foregoing, I cannot urge too strongly that a meaningful "Taxpayer Protection and Reimbursement Act" be enacted.

Respectfully submitted,

Holmes F. Crouch

Holmes F. Crouch
TAX PRACTITIONER

HOLMES F. CROUCH
Tax Practitioner
20484 Glen Brae Dr.
Saratoga, CA 95070
(408) 867-2628

In Propria Persona.

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HOLMES F. CROUCH Plaintiff-Appellant, vs. COMMISSIONER OF INTERNAL REVENUE Defendant-Appellee.	No. 78-2237 MOTION FOR VOLUNTARY DISMISSAL (WITHOUT PREJUDICE)

TO THE COURT ABOVE NAMED:

Pursuant to Rules 27(a) and 42(b), Appellate Procedure, appellant hereby moves the Court for voluntary dismissal of the action herein.

Said motion is made on the grounds that the tax preparer penalties of issue are moot at this point. The appellee has administratively abated all penalties outstanding upon transmittal of record to this Court. The legal points raised by this action, however, are still open, but they are deprived of practical significance at this time due to recently revised administrative appeals procedures.

Appellant requests the appellee to submit his Bill of Costs, and that these costs be taxed against the $250 bond previously posted by the appellant.

Appellant further requests that the action be dismissed without prejudice, inasmuch as the legal points are still unsettled and may be raised again if administrative processes prove fruitless.

Dated: 27 June 1979

Holmes F. Crouch
HOLMES F. CROUCH
In Propria Persona

HOLMES F. CROUCH
Tax Practitioner
20484 Glen Brae Drive
Saratoga, CA 95070
(408) 867-2628

In Propria Persona

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HOLMES F. CROUCH,
Plaintiff-Appellant.
vs.
COMMISSIONER OF INTERNAL REVENUE,
Defendant-Appellee.

No. 78-2237

APPELLANT'S OPPOSITION TO APPELLEE'S CROSS-MOTION FOR EXTENSION OF TIME

TO THE COURT ABOVE NAMED:

Appellant acknowledges receipt on July 10, 1979 of appellee's motion for an extension of time. Appellant hereby opposes said cross-motion on the grounds that it does not require 21 days to prepare a one-page Bill of Costs.

Furthermore, appellee has made inaccurate statements in his cross-motion, apparently designed to mislead the Court, namely:

(a) Appellee's affidavit, paragraph 3 thereof, refers to alleged "penalty taxes." There never was, nor is there now, any 1976 issue herein involving a "tax" due on appellant's income. A "penalty tax" is a penalty based upon a specified percentage of a tax on income. In the case herein the so-called "penalty" is nothing more than an administrative tool for disciplining the appellant for refusing to affix his own private social security number onto the 300 to 400 tax returns that he prepares for others. Congress never intended that any revenue be produced by this disciplinary tool.

(b) Appellee's affidavit, paragraph 4 thereof refers to appellant's "current tax payment file." This is inaccurate for reasons in (a) above,

as well as the fact that the disciplinary penalties at issue were for tax year 1976 only. These penalties have since been administratively abated.

(c) Appellee's proposed Order form has slipped in the word "with" prejudice, whereas appellant's motion specifically stated "without" prejudice. Appellee's proposed Order form is therefore inaccurate.

Previously, appellant moved the Court to include administrative penalties for tax year 1977. Appellee opposed that motion, and the Court sustained the appellee. Therefore, 1977 penalties are not included herein: only the 1976 penalties.

In view of the above, appellant urges the Court to voluntarily dismiss the case without prejudice, applying to the 1976 penalties only.

If appellee seeks to include the 1977 penalties, then appellant withdraws his motion for voluntary dismissal.

Dated: July 11, 1979

Holmes F. Crouch
HOLMES F. CROUCH
In Propria Persona

CERTIFICATE OF SERVICE BY MAIL

This is to certify that two copies of the foregoing APPELLANT'S OPPOSITION TO APPELLEE'S CROSS-MOTION FOR EXTENSION OF TIME were this 11th day of July, 1979, placed in the U. S. Mail, postage prepaid, and addressed to:

Gilbert E. Andrews
Attorney, Tax Division
Department of Justice
Washington, D.C. 20530

Holmes F. Crouch
HOLMES F. CROUCH
Tax Practitioner

49-968 254

HOLMES F. CROUCH
Tax Practitioner
20484 Glen Brae Drive
Saratoga, CA 95070
(408) 867-2628

In Propria Persona

IN THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

HOLMES F. CROUCH Plaintiff-Appellant. vs. COMMISSIONER OF INTERNAL REVENUE Defendant-Appellee.	No. 78-2237 APPELLANT'S REPLY TO APPELLEE'S OPPOSITION TO APPELLANT'S MOTION FOR VOLUNTARY DISMISSAL WITHOUT PREJUDICE

TO THE COURT ABOVE NAMED:

Appellant acknovledges receipt on July 18, 1979 of appellee's opposition to appellant's motion for voluntary dismissal without prejudice. Appellant hereby replies to said opposition in conformity with the time provisions of Rule 27(a), Federal Rules of Appellate Procedure.

Appellant respectfully requests the Court's indulgence in considering the following points before rendering its decision on the matter herein:

1. Appellant's motion for voluntary dismissal without prejudice is based directly upon the wording in Rule 41(b), Federal Rules of Appellate Procedure, to wit --

> "An appeal may be dismissed on motion of the appellant upon such terms as may be agreed upon by the parties or fixed by the court." (underscoring supplied)

There is nothing implied or stated in this rule to support the appellee's contention that the appellant's motion "comes too late." Indeed, the clear purpose of such rule is to allow the appellant to clear the court calendar of matters which could -- or should be -- handled administratively.

2. At the time the initial complaint herein was filed (July 7, 1977),

there were no established administrative appeal procedures for relief involving statutes 26 USC 6109(a)(4) and 6695(c). Thus, the only available avenue open then to the plaintiff was the judicial process. The then-absence of administrative appeal procedures was noted by the lower court and admitted by the defendant. The defendant gave the lower court assurance that such procedures would be worked out in the future. Based on this assurance, the lower court rendered its decision. Exception to the lower court's decision, and hence the basis for appeal herein, pertains to its erroneously classifying an administrative penalty as a "tax" on income for revenue purposes.

3. Commencing on June 1, 1978 and extending through February 26, 1979, upon plaintiff-appellant's request, defendant-appellee administratively abated a total of $2,650 in penalties via IRS Form 1331-B. A total of 25 separate penalty abatement forms 1331-B were issued. These totals exceed those recited by the appellee. Hence, it is obvious that information on the one $25 penalty alleged by the appellee to be unabated either was lost in the mail, or more likely lost in the bureaucracy of appellee's own files. Appellee, who has a long-standing position of "substance over form" is grasping for straws here. The penalties at issue in the Record on Appeal are now truly moot.

4. On June 25, 1979, a defendant-appellee's representative from the Penalty Adjustment Branch, Fresno Center, telephoned the appellant with notification that on and after July 1, 1979, entirely new administrative appeal procedures would take effect. And that all penalties assessed up to and through June 30, 1979 would be "automatically adjusted" (abated). Thereupon, on June 27, 1979 appellant filed his motion for voluntary dismissal without prejudice. The appellant's intention in doing so was to clear up his own files, now approximately 5-1/2 inches thick, and at the same time clear the court's calendar of purely administrative matters.

5. The appellee raises the oppositional defense that the Treasury

Department would be deprived of benefits of res judicata and collateral estoppel, if the appellant's motion were granted. This oppositional defense has no merit herein. Neither res judicata nor collateral estoppel apply where controlling facts are different in different years, even though the issues and parties may be identical. (Goldstein v. U.S., 227 F. (2d) 1; Howard v. U.S., 497 F. (2d) 1270; Rose, 55 T.C. 28; Com. v. Sunnen, 333 U.S. 591). The gist of these citations is that if any of the facts relating to the issue in the second action are new, or if there has been an intervening law change, then collateral estoppel does not apply. With this different-facts principle in mind, appellant contends that the nov availability of defined administrative appeal procedures, whereas none existed at the time of the initial action, constitutes a substantially different set of controlling facts, to properly bar appellee's reliance on collateral estoppel.

For these reasons, appellant's motion for voluntary dismissal of the action herein, without prejudice, should be granted. A proposed order to this effect is attached hereto.

Dated July 20, 1979

Holmes F. Crouch
HOLMES F. CROUCH
In Propria Persona

CERTIFICATE OF SERVICE BY MAIL

This is to certify that one copy of the foregoing APPELLANT'S REPLY TO APPELLEE'S OPPOSITIOn TO APPELLANT'S MOTION FOR VOLUNTARY DISMISSAL WITHOUT PREJUDICE was this 20th day of July, 1979, placed in the U. S. Mail, postage prepaid, and addressed to:

Gilbert E. Andrews
Attorney, Tax Division
Department of Justice
Washington, D.C. 20530

Holmes F. Crouch
HOLMES F. CROUCH
Tax Practitioner

AICPA

American Institute of Certified Public Accountants
1620 Eye Street, N.W., Washington, D.C. 20006 (202) 872-8190

Arthur J. Dixon, Chairman
Division of Federal Taxation

July 31, 1979

Senator Max Baucus
Room 5327
Dirksen Senate Office Building
1st Street, N.W.
Washington, D.C. 20510

Dear Senator Baucus:

I am pleased to inform you that the American Institute of CPAs supports the enactment of S.1444, "The Taxpayers Protection and Reimbursement Act." We believe that it is much fairer to taxpayers than the tax provision of the Civil Rights Attorneys' Fees Awards Act, while at the same time providing substantial limitations upon the situations in which court costs can be recovered.

We assume that the fees paid to CPAs for assistance by them to taxpayers' attorneys in connection with the civil action or proceeding described in the bill are encompassed within the provision for "reasonable court costs", and would not be reimbursable solely out of the judgement for attorney's fees. Because such services by CPAs are very frequently rendered, we recommend that the proposed amendments to the Internal Revenue Code be clarified accordingly, or that a committee report so state.

The AICPA welcomes the opportunity to support this legislation. It will, we firmly believe, contribute to taxpayer confidence in our self-assessment system, and we commend you and your colleagues for sponsoring it.

Sincerely,

Arthur J. Dixon

Arthur J. Dixon
Chairman
Federal Tax Division

cc: Ed Neef
Rusty Guritz

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