

Choice of Forum¹

By Richard J. Sideman and Steven M. Katz

Richard Sideman and Steven Katz suggest factors that tax practitioners should consider when determining where to bring a tax case.

Overview—Choice of Forum

After an audit, the Internal Revenue Service (IRS) may propose a deficiency, refund, or “no change.” If the taxpayer does not agree with the auditor’s determination, the taxpayer has the opportunity for an administrative appeal to the IRS Appeals Division. If the case is not appealed, or it is appealed but not settled with the Appeals Officer, then the IRS will issue a statutory notice of deficiency under Code Sec. 6212. At that point, the taxpayer has two choices: (1) default (in which case the deficiency will be automatically assessed), make the payment, and pursue a refund action in the United States Court of Federal Claims (“Claims Court” or “Court of Federal Claims”) or the appropriate United States District Court; or (2) file a timely action in the U.S. Tax Court. A taxpayer that chooses to exercise its right to file a petition in the Tax Court need not pay the deficiency determined by the IRS as a prerequisite to bringing its case. A taxpayer is not permitted to try the same case in two different courts.

Thus, an early decision that the practitioner and his or her client face in most civil tax matters is where to litigate the taxpayer’s case. (Certain disputes may be litigated only in the district courts, such as summons enforcement cases, cases challenging jeopardy assessments, and certain other collection cases.) The decision should be made with great care since the choice of forum may determine the ultimate outcome of the case. In addition to important distinctions in the precedents followed by

these courts, there are a variety of other procedural differences that may weigh for or against a particular forum. This chapter discusses the considerations that should go into selecting the forum for civil tax litigation.

The IRS may assert additional deficiencies after a petition is filed in the Tax Court. In refund litigation, however, new adjustments may be used only as a setoff against the amount of the claimed refund if the statute of limitations has expired.

The relevant precedent in each available forum is also an important factor in choosing a forum.

Either the taxpayer or the government may demand a jury in the district courts. In the Tax Court and the Court of Federal Claims, a jury is not available.

Government attorneys in Tax Court proceedings work with the IRS, work only on tax cases, and are knowledgeable about substantive tax issues. In refund litigation, government attorneys are usually from the Tax Division of the Department of Justice and tend to be involved in a broader array of cases.

Each forum for tax litigation has its own set of procedural rules. The various rules differ most with regard to discovery, and these differences may affect the choice of forum.

In all three forums, a taxpayer has the opportunity to litigate its case close to its residence or, for a corporation, its principal place of business.

The amount of time it takes to litigate a case also affects the choice of forum.

Settlement of a refund case can be more difficult and involve greater delay than settlement of Tax Court cases due to the rules governing approval of refund case settlements.

Payment of Deficiency

Perhaps the most important difference between litigating in the Tax Court versus litigating either in

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the district courts or in the Court of Federal Claims concerns pre-payment of the deficiency. A taxpayer that chooses to exercise its right to file a petition in the Tax Court need not pay the deficiency determined by the IRS as a prerequisite to bringing its case. Section 6213(a) provides that, except in the case of a jeopardy or termination assessment, once a petition is filed in the Tax Court, the IRS may not make an assessment of the tax determined in the deficiency notice, or proceed to collect the tax, until the decision of the Tax Court becomes final. As a practical matter, the ability to dispute a deficiency without having to prepay the tax will compel many if not most taxpayers to litigate in the Tax Court rather than in forums which handle refund litigation.

By inflating the amount of the determined deficiency, the IRS agent often wields the power to maneuver a taxpayer into Tax Court, depriving it of a refund forum. For example, assume that an IRS agent suggests the she would probably be willing to settle the entire examination in return for taxpayer's offer to settle for a \$5,000 deficiency. This "offer to favorably consider a taxpayer offer" is presented in this roundabout way in order to preserve a fiction that the IRS agent merely determines the correct tax. Assume that the taxpayer does not agree to the \$5,000 deficiency and the agent submits her official report determining a total deficiency of \$100,000. The taxpayer appeals this determination to the Appeals Division. If the Appeals Officer refuses to revise the proposed deficiency downward, the taxpayer has two choices: (1) pay the entire \$100,000 deficiency and file a claim for refund (leading toward district court or Court of Claims litigation), or (2) litigate the controversy in Tax Court. If the taxpayer cannot, as a practical matter, raise the entire \$100,000, then it has no real choice of forum.

A taxpayer may want to proceed in the Tax Court, which does not require prepayment of the deficiency, and yet have good reason to prepay. For example, paying the deficiency stops the accrual of interest that will be owed if the deficiency is eventually sustained.² And the taxpayer is free to prepay, but must carefully avoid depriving the Tax Court of jurisdiction.

Although many district courts employ various alternative dispute resolution techniques, the Justice Department has not eagerly embraced them in tax cases.

Caution. Specifically, if a deficiency proposed by the IRS is paid prior to issuance of the deficiency notice, technically there is no deficiency. Consequently, no statutory notice of deficiency could be issued pursuant to Code Sec. 6212. Without a notice of deficiency, the Tax Court would be deprived of jurisdiction.³

Example. Assume that an individual income tax return reports total tax (after all tax credits) of \$75,000 offset by income tax withholding of \$60,000, with a

\$15,000 balance due with the return. The return is examined and the revenue agent redetermines a total tax in the amount of \$100,000. It follows that the deficiency, for purposes of the statutory notice, is computed as shown in Table 1.

Table 1

Total tax determined by IRS	\$100,000
Less: tax assessed per return, plus additional assessments and less rebates	<u>\$75,000</u>
Deficiency per statutory notice	\$25,000

If the taxpayer signs the waiver enclosed with the revenue agent's report (which authorizes assessment of \$25,000) or, alternatively, submits full payment (which similarly authorizes the IRS to assess the deficiency), then there is no remaining deficiency as defined by Code Sec. 6211. Absent a deficiency, the Tax Court will have no jurisdiction and the taxpayer will have deprived itself of the right to litigate there. The only avenue of appeal, then, would be to file a claim for refund and, if the claim is denied by the IRS, to litigate in district court or the Court of Claims.

To avoid this jurisdictional problem, but still make payment and stop the accrual of interest, the taxpayer has two options. The taxpayer may either (1) make a "deposit in the nature of a cash bond," specifically designated as such, before or after the deficiency notice is issued, pursuant to Code Sec. 6603 and Rev. Proc. 2005-18, 2005-13 IRB, or (2) pay the tax in full or in part after the deficiency notice is issued.⁴

In contrast to the Tax Court, which does not require prepayment, refund litigation, as the name implies, whether in a federal district court or in the Court of

Federal Claims, requires a taxpayer to pay the full amount of the disputed tax.⁵ The taxpayer need not pay the determined penalties and interest. Moreover, in certain cases involving so-called “divisible” taxes (e.g., employment tax cases), it is sufficient to make only a partial payment of the total tax for the period in issue. For example, a taxpayer could limit its payment of a disputed employment tax by paying only the portion relating to a single employee for one tax period.

Possibility of Additional Deficiency

After a petition is filed in the Tax Court, the IRS has the right to assert a greater deficiency amount.⁶ The Service does, however, assume the burden of proof on any increase over the deficiency notice (assuming the IRS did not already have the burden of proof).⁷ The right to assert a greater deficiency is a critical exception to the restriction against additional deficiency notices under Code Sec 6212(c)(1).

Planning Note. Assume that a revenue agent raises an issue which results in a proposed \$50,000 deficiency. The taxpayer’s representative is convinced that the adjustment is incorrect and that the Tax Court would surely rule in favor of the taxpayer. What should the representative do before recommending that the taxpayer file in Tax Court? The authors suggest that the representative should review the entire return looking for other potential issues. The representative should warn the client that the Tax Court decision can include deficiency amounts for new issues raised by the government during trial. While the government would have the burden of proof on such issues, as a practical matter, the government can often carry that burden of proof. It would certainly be a disaster if in this example the Tax Court decision determined a deficiency of \$1 million. Therefore, a prudent representative would carefully explain this possibility to the taxpayer so that the taxpayer can make an informed decision.

In contrast, in refund litigation new adjustments may be applied by the government only as a setoff against the amount of the claimed refund. But this restriction applies only if the statute of limitations has expired; otherwise, the IRS is free to issue a statutory notice of deficiency. Thus, if a taxpayer is concerned about the possibility of increased deficiencies, it should avoid the Tax Court and instead wait to file its claim for

refund until the statute of limitations on assessments by the IRS (generally three years from the filing of the return) is about to expire, and then proceed with a refund action in either the district court or the Claims Court. By doing this, the taxpayer effectively precludes the IRS from asserting additional deficiencies.

Example. Tina Payton, an individual taxpayer, files her calendar year 2002 return on April 12, 2003. The IRS examines the return during 2004 and determines a deficiency of \$5,000. Payton is convinced that the IRS adjustment is completely erroneous. However, concerning another controversial issue, future disallowance of a particular 2002 deduction could result in an additional \$30,000 deficiency. How should Payton proceed? The authors suggest that Payton wait until the period for assessing a deficiency regarding the 2002 return has almost expired before she files a claim for refund. Assuming that there is no applicable authority for a longer statute date, the statute of limitations on the 2002 return will expire on April 15, 2006. It would be prudent for Payton to file her claim for refund several weeks earlier. After April 15, 2006, the IRS may raise the deduction issue only as an offset to the \$5,000 claimed refund, but there is no risk that the taxpayer will be required to pay the additional \$30,000 potential deficiency.

Precedent

Another factor that the taxpayer and its representative should carefully review in selecting the forum for tax litigation is the relevant precedent in each available forum.

All courts follow decisions of the United States Supreme Court. The Tax Court follows its own decisions unless there is a contrary decision of the appellate court to which an appeal would lie in that case.⁸ This is often called “the Golsen Rule.” For individuals, an appeal from a Tax Court decision goes to the Circuit Court of Appeals in which the individual resided at the time of filing the petition. An appeal of a decision involving a corporation is to the Court of Appeals for the Circuit in which the corporation has its principal place of business or principal office. District courts follow decisions of their respective court of appeals. Finally, appeals from decisions of the Court of Federal Claims go to the Court of Appeals for the Federal Circuit.

Given the rules regarding controlling authority, the representative must carefully study the case law in the

various courts on the pertinent issues and evaluate whether one forum offers more favorable authority. In a case where the authority in the different courts varies (*i.e.*, one forum has more favorable authority than another, or one forum has no authority on the issue and another has negative authority), precedent may be determinative in selecting the forum.

Planning Note. The choice among forums with differing precedent may be effectively decided as follows:

1. First, the taxpayer should review the precedent in the court of appeals for its circuit (which controls in Tax Court and district court cases) and also review the precedent in the Federal Circuit (which controls in Claims Court cases). If precedent of the court of appeals for the taxpayer's circuit is more favorable than the Federal Circuit, then the taxpayer needs to choose between the district court and the Tax Court (and avoid the Court of Federal Claims). This last decision should be made upon evaluation of factors other than precedent.
2. Conversely, if the applicable court of appeals precedent is contrary to the taxpayer's position, or if the precedent in the Federal Circuit is more favorable, then the taxpayer should consider precedents, if any, in the Court of Federal Claims.
3. If the courts of appeals have no precedent on the issue, then the taxpayer would look to the Tax Court, its district court, and the Claims Court for precedent. The taxpayer should proceed in whichever court has the most favorable precedent (assuming none of the other factors discussed in this chapter outweigh this consideration).
4. Finally, if there is no precedent in the applicable court of appeals, Court of Claims, or Tax Court, then the analysis would turn to which of the three courts is most likely to sustain the taxpayer's position.

Judges and the Availability of a Jury

A jury is not available in either the Tax Court or the Court of Federal Claims. In the district courts, however, either the taxpayer or the government may demand a jury.⁹ A jury is particularly appropriate in

cases involving valuation, penalties (especially the trust fund recovery penalty, also called the "100 percent penalty"),¹⁰ or in cases where the taxpayer is an unusually sympathetic figure for whom a jury would be more likely to rule than a judge. The practitioner should therefore carefully consider the advantages and disadvantages of having the case tried before a jury rather than a judge.

Similar consideration should be given to the kind of judge who will hear the case in the different forums available. Judges in the Tax Court are tax specialists who hear only tax-related cases. In contrast, district court and to some extent Claims Court judges do not generally have a tax expertise and hear a wide variety of cases. Although outcomes are difficult to predict, the practitioner may feel that his or her case has a better chance of success in front of a tax expert, or alternatively, in front of a judge who is not a tax expert. A highly technical issue, for instance, is better tried before a Tax Court judge. In contrast, an issue where the law is relatively straightforward but equitable considerations exist (*e.g.*, whether penalties apply) may be better tried before a district court jury.

Government Attorneys

In U.S. Tax Court proceedings, the IRS is represented by attorneys from the IRS's Office of Chief Counsel. Prior to the IRS's 2000 restructuring, the attorneys were typically from local offices known as District Counsel. With the abandonment of districts, attorneys are now assigned to various operating divisions. But while working now within a different structure, attorneys still work out of local offices. The attorneys representing the government in Tax Court proceedings work exclusively on tax cases and typically are familiar with substantive tax issues and Tax Court procedures.

In refund litigation, whether in district court or in the Court of Federal Claims, the government is generally represented by attorneys from the Tax Division of the Department of Justice. Since the Department of Justice is involved in all criminal tax prosecutions, the attorneys involved in refund cases are perhaps more sensitive to potential criminal issues than attorneys who litigate cases in the Tax Court.

Although both sets of attorneys are charged with representing the government's interests, they often take different approaches stemming from the fact that the attorneys from Chief Counsel are Treasury employees whereas the Department of Justice attorneys

are not. This distinction can result in a tendency for attorneys in Tax Court litigation to give considerable deference to the auditor's findings whereas attorneys in refund litigation may take a fresher look at what the IRS has concluded.

Procedural Rules

Each of the forums for tax litigation has its own set of procedural rules. Thus, there are the Tax Court Rules and the Court of Federal Claims Rules. Both sets of rules are similar to the Federal Rules of Civil Procedure, which are observed by the district courts. In addition to numerous minor distinctions, the various rules differ most with regard to discovery, and these differences may affect the choice of forum.

Discovery in the Tax Court is more limited than in the other courts. The Tax Court requires informal discovery before a party may resort to formal discovery. Depositions are rarely used in the Tax Court, and when they are used, it is generally only with the consent of the other party. The Tax Court also requires that the parties stipulate to as many facts as possible. Although this is often difficult to accomplish, it tends to streamline trials. In general, then, the Tax Court is not the place for "scorched earth" litigation.

On the other hand, if the parties can work cooperatively, the Tax Court is likely to be the least expensive way to try a tax case. This is particularly true if the case qualifies for small case procedures under Code Sec. 7463, which applies at the taxpayer's option to deficiencies of \$50,000 or less. If Code Sec. 7463 applies, the procedures are very flexible and informal, but the Tax Court decision is not appealable.

Place of Trial

All three forums allow a taxpayer to litigate its case relatively close to its residence or, for a corporation, its principal place of business. Although based in Washington D.C., the Tax Court's judges travel throughout the country and hear trials in over 70 cities. A list of the cities where the court holds trials appears in the court's rules at Appendix IV.¹¹ The court tries to accommodate taxpayers' requests and visits most cities at least once a year, and the more populous cities several times a year. The Court of Federal Claims follows a similar practice because it is authorized by statute to hear cases anywhere in the United States.¹² Federal district courts sit throughout the country.

Length of Case

Clients will be concerned about how long it will take to resolve their matter. While this will vary with its complexity, some facts are useful concerning the choice of forum.

Historically, approximately six to nine months after a petition was filed in the Tax Court, the case was assigned to a trial session in the city designated by the petitioner (or by the government, if the petitioner failed to designate a city). Recently, however, the Tax Court's docket has been reduced so that, depending on the city, cases are often set for a trial session within six months after the petition is filed.

The notice from the Tax Court setting the case for trial is typically issued five to six months prior to the trial session.

Assuming that the court requires post-trial briefs pursuant to the schedule prescribed in the court's rules, briefing will be complete approximately 120 days after the trial.

Historically, the court has taken as long as one year (and often more) to issue an opinion. Due to internal pressures to issue opinions sooner and the court's reduced docket, decisions are now often issued anywhere from six months to one year after the trial.

The length of time between initiating a case and receiving a decision in district court is difficult to generalize given the widely varying caseloads in each district across the country. Taxpayers should not expect anything less than one year from initiating an action to receiving a decision.

In both the Court of Federal Claims and the district courts, the length of time will vary depending on whether the court decides the case by motion for summary judgment or trial. In comparing forums, unless a particular district court has an unusually large or small caseload, there is generally no basis for choosing one forum over another with respect to length of litigation.

Settlement

Settlement of Tax Court cases is the responsibility of the IRS's Appeals Division and the attorney assigned to the case. Generally, after a case is assigned to a Chief Counsel attorney, that attorney refers the case to Appeals, which then has authority over settlement.¹³ If a settlement is not reached while the case is in Appeals,¹⁴ settlement jurisdiction shifts to the assigned attorney. Despite the transfer of technical authority,

Appeals will often continue to play a critical role in settlement negotiations.

Code Sec. 7122(a) authorizes the Attorney General or his delegate to settle a tax refund case. Settlement negotiations in refund cases are handled by the Department of Justice attorneys assigned to the case. Note that the Justice Department does not provide for settlement negotiations with a person (e.g. an appeals officer) who is not charged with trying the case. The lack of this theoretically independent review may reduce the likelihood of settlement.

A complex set of rules governs who must approve the settlement of a refund case, depending upon the amount involved. Certain cases require the IRS's involvement and must proceed to higher levels within the government. In practice, settlement of a refund case can be more difficult and involve greater delay than settlement of Tax Court cases due to the rules governing approval of refund case settlements.

Although the Government has begun to encourage alternative dispute resolution, and it is used more and more frequently, these techniques have not taken hold in tax litigation, perhaps due to the general

success of regular settlement procedures. Indeed, it is the experience of the authors that roughly 85–90 percent of cases settle.

The Tax Court is the only forum in which a taxpayer will be allowed to proceed to binding arbitration.¹⁵ Government attorneys are prohibited from agreeing to binding arbitration in refund cases.¹⁶ The Tax Court has also approved the use of mediation. Although many district courts employ various alternative dispute resolution techniques, the Justice Department has not eagerly embraced them in tax cases. The Court of Federal Claims offers parties both a settlement judge and mini-trials as ways to resolve cases without a formal trial.¹⁷

The various procedures for alternative dispute resolution are detailed in Chapters 6 and 10 of CIVIL TAX LITIGATION.¹⁸ Given the infrequency of their use, they are generally not a reason to choose one forum over another.

The Practice Tool at ¶ 10,010 of the book¹⁹ contains a choice of forum decision tree that will help the practitioner choose the best forum in which to litigate.²⁰

ENDNOTES

¹ This article is excerpted from Chapter 1 of CCH's CIVIL TAX LITIGATION by Richard J. Sideman and Steven Katz. Internal cross-references are omitted. Order information is available at 800-344-3734 or at www.tax.cchgroup.com.

² Code Sec. 6601 and Code Sec. 6621

³ Code Sec. 6213(a) and Code Sec. 7442.

⁴ Code Sec. 6213(b)(4).

⁵ *W.W. Flora*, Sct, 60-1 USTC ¶9347, 362 US 145, 80 SCt 630.

⁶ Code Sec. 6214(a)

⁷ Tax Court Rule 142(a).

⁸ *J.E. Golsen*, 54 TC 742, CCH Dec. 30,049 (1970), *Aff'd*, CA-10, 71-2 USTC ¶9497, 445 F2d 985

⁹ 28 USC §2402; Fed. R. Civ. P. 38(b).

¹⁰ Code Sec. 6672.

¹¹ CCH's CIVIL TAX LITIGATION, *supra* note 1.

¹² 28 USC §173.

¹³ Rev. Proc. 87-24, 1987-1 CB 720.

¹⁴ Cases involving deficiencies (defined to include tax and penalties) of more than \$10,000 are to be promptly returned to counsel when no progress toward settlement of all or a part of a case is made, or when a case appears on a trial calendar, unless counsel agrees to extend the period of Appeals' consideration. Cases involving deficiencies of \$10,000 or less, including "S" cases, are referred to Appeals for a period of six months or until one month before the trial calendar call in regular cases or 15 days before the trial calendar

call in "S" cases, if earlier. At the end of this period or when Appeals determines the case is not susceptible of settlement, the case is returned to counsel. Where appropriate, the counsel and Appeals may agree to extend the period of Appeals' consideration, or return the case to Appeals if there is a likelihood of settlement. Rev. Proc. 87-24, 1987-1 CB 720.

¹⁵ Tax Court Rule 124.

¹⁶ Executive Order 12778 on Civil Justice Reform.

¹⁷ Court of Federal Claims General Order No. 13.

¹⁸ *See supra* note 1.

¹⁹ *Supra* note 1.

²⁰ *See supra* note 1.

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