St. Mary's Law Journal

Volume 17 | Number 2 Article 4

1-1-1986

Collecting Attorney Fees from the Government in Tax Litigation: An Analysis of the Winners and Prospects for the Future.

Craig J. Langstraat

COLLECTING ATTORNEY FEES FROM THE GOVERNMENT IN TAX LITIGATION: AN ANALYSIS OF THE WINNERS AND PROSPECTS FOR THE FUTURE

CRAIG J. LANGSTRAAT*

I. INTRODUCTION

A taxpayer who has endured an IRS audit and the administrative appeals process, without restitution of all tax issues involved, is faced with the prospect of litigation to resolve the dispute. The decision of whether to litigate will certainly involve a careful analysis of the tax issues involved. However, another important factor will be the costs extracted by the legal system to pursue the fight. The realistic prospect of collecting attorney fees from the government in tax litigation may be the deciding factor in the decision to pursue the court battle.

For cases filed after February 28, 1983, litigants are bound by the provisions of Internal Revenue Code (IRC) section 7430[1] when at-

* Associate Professor of Accounting/Law & Taxation. Edwin L. Cox School of Business, Southern Methodist University, Dallas, Tex.; J.D., Arizona State University; L.L.M. Taxation, University of San Diego, San Diego, Ca.; C.P.A.; member of the Arizona and California Bars.

1. *See* I.R.C. § 7430 (Supp. 1985) (awarding of court costs and certain fees). This section provides:

§ 7430. Awarding of court costs and certain fees

(a) In general.—In the case of any civic proceeding which is—

tempting to collect attorney fees from the federal government in tax

---

(1) brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under this title, and
(2) brought in a court of the United States (including the Tax Court and the United States Claims Court), the prevailing party may be awarded a judgment for reasonable litigation costs incurred in such proceeding.

(b) Limitations.—
(1) Maximum dollar amount.—The amount of reasonable litigation costs which may be awarded under subsection (a) with respect to any prevailing party in any civil proceeding shall not exceed $25,000.
(2) Requirement that administrative remedies be exhausted.—A judgment for reasonable litigation costs shall not be awarded under subsection (a) unless the court determines that the prevailing party has exhausted the administrative remedies available to such party within the Internal Revenue Service.
(3) Only costs allocable to the United States.—An award under subsection (a) shall be made only for reasonable litigation costs which are allocable to the United States and not to any other party to the action or proceeding.
(4) Exclusion of declaratory judgment proceedings.—
(A) In general.—No award for reasonable litigation costs may be made under subsection (a) with respect to any declaratory judgment proceeding.
(B) Exception for section 501(c)(3) determination revocation proceedings.—Subparagraph (A) shall not apply to any proceeding which involves the revocation of a determination that the organization is described in section 501(c)(3).

(c) Definitions.—For purposes of this section—
(1) Reasonable litigation costs.—
(A) In general.—The term "reasonable litigation costs" includes—
(i) reasonable court costs,
(ii) the reasonable expenses of expert witnesses in connection with the civil proceeding,
(iii) the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the party's case, and
(iv) reasonable fees paid or incurred for the services of attorneys in connection with the civil proceeding.
(B) Attorney's fees.—In case of any proceeding in the Tax Court, fees for the services of an individual (whether or not an attorney) who is authorized to practice before the Tax Court shall be treated as fees for the services of an attorney.
(2) Prevailing party.—
(A) In general.—The term "prevailing party" means any party to any proceeding described in subsection (a) (other than the United States or any creditor of the taxpayer involved) which—
(i) establishes that the position of the United States in the civil proceeding was unreasonable, and
(ii) (I) has substantially prevailed with respect to the amount in controversy, or
(II) has substantially prevailed with respect to the most significant issue or set of issues presented.
(B) Determination as to prevailing party.—Any determination under subparagraph (A) as to whether a party is a prevailing party shall be made—

litigation cases. This change made by the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA)[2] took tax litigation out from under the provisions of the Equal Access to Justice Act (EAJA)[3] with regard to the collection of attorney fees from the government.[4]

While tax cases filed prior to March 1, 1983, continue to be covered by the EAJA, this article will deal solely with the rules existing for cases filed after February 28, 1983. First, this article will examine the provisions of section 7430 of the Internal Revenue Code. Second, cases where the taxpayer was actually awarded attorney fees against the government will be analyzed to provide clues for potentially successful tactics. Finally, in light of the sunset provision contained in

---

(i) by the court, or
(ii) by agreement of the parties.

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

(d) 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 proceeding regardless of whether such joinder or consolidation actually occurs, unless the court in which such action 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.

(e) Right of appeal.—An order granting or denying an award for reasonable litigation costs under subsection (a), 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 as the decision or judgment.

(f) Termination.—This section shall not apply to any proceeding commenced after December 31, 1985.

Id. § 7430.

2. *See* Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 STAT. 324, 572 (1982) (codified as amended at I.R.C. § 7430 (Supp. 1985)).

3. *See* Equal Access to Justice Act, Pub. L. No. 96-481, 94 STAT. 2325 (1980) (codified in various United States Code sections including titles 5, 28, and 48). For a discussion on the requirements and provisions of the Equal Access to Justice Act, see generally Jones, *The Equal Access to Justice Act: When Will It Permit Attorneys' Fees,* 56 J. TAX'N 164 (1982); Robertson & Fowler, *Recovering Attorneys' Fees From the Government Under the Equal Access to Justice Act,* 56 TULSA L. REV. 903 (1982); Note, *Attorney's Fees in Tax Cases After the Tax Equity and Fiscal Responsibility Act of 1982,* 36 TAX LAW. 123, 134-47 (1982).

4. *See* Tax Equity and Fiscal Responsibility Act, Pub. L. No. 97-248, 96 STAT. 324, 572 (1982) (codified as amended at I.R.C. § 7430 (Supp. 1985)). For a discussion on the historical development of collecting attorney's fees from the federal government in tax litigation, see generally Comment, *Tax Litigation and Attorney's Fees: Still A Win-Lose Dichotomy,* 57 S. CAL. L. REV. 471 (1984); Note, *Attorney's Fees In Tax Cases After the Tax Equity and Fiscal Responsibility Act of 1982,* 36 TAX LAW. 123 (1982); Note, *Award of Attorney Fees in Tax Litigation,* 19 VAL. U. L. REV. 153, 157-80 (1984).

section 7430,[5] the desirability and likelihood of continuing this type of statute will be discussed.

II. REQUIREMENTS OF IRC SECTION 7430

The basic requirements of section 7430 appear fairly simple on first reading. As with many statutes, however, interpretation of words inherently difficult to define, such as "substantial" and "unreasonable," complicate understanding of the statute. Section 7430 authorizes, but does not mandate, the award of "reasonable litigation costs" to the "prevailing party" in any civil (not criminal) tax litigation brought in a federal court.[6] To better understand the situations where the taxpayer has the possibility of collecting attorney fees from the government, each portion of the preceding summary sentence must be clarified.

The potential remedy of attorney fees is available in all federal courts, including the Tax Court and the United States Claims Court.[7] The opportunity to recover attorney fees in the Tax Court under section 7430 is a significant advantage over EAJA, which was interpreted to prohibit an award of fees for cases filed in the Tax Court and other federal courts.[8] Since the largest number of original jurisdiction tax cases are tried in the Tax Court, section 7430 significantly broadens the availability of potential attorney fees.

Section 7430 provides that "reasonable litigation costs" incurred by

---

5. *See* I.R.C. § 7430(f). This section provides in the pertinent part: "This section shall not apply to any proceeding commenced after December 31, 1985." *Id.* § 7430.

6. *See id.* § 7430(a). This section states in the pertinent part: "[i]n the case of any civil proceeding . . . the prevailing party may be awarded a judgment for reasonable litigation costs incurred in such proceeding." *Id.* § 7430(a).

7. *See id.* § 7430(a)(2). This section provides for the awarding of court costs and certain fees "in the case of any civil proceeding which is . . . brought in a court of the United States (including the Tax Court and the United States Claims Court). . . ." *Id.* § 7430(a)(2).

8. *See, e.g.,* White v. Comm'r, 537 F. Supp. 679, 689 (D. Colo. 1982) (statute does not authorize award of attorney fees); Engles Coin Shop, Inc. v. Comm'r, 52 T.C.M. (P-H) ¶ 83,561 (T.C. 1983) (Tax Court without authority to award attorney fees under EAJA); Crock v. Comm'r, 52 T.C.M. (P-H) ¶ 83,351 (T.C. 1983) (Tax Court lacks jurisdiction to award attorney fees prior to the Tax Equity and Fiscal Responsibility Act); *see also* Jenny v. Comm'r, 52 T.C.M. (P-H) ¶ 83,001 (T.C. 1983) (Tax Court without authority to award attorney fees under Equal Access to Justice Act). The House Report accompanying the Act states that cases brought in the United States Tax Court are not within the provisions of the Equal Access to Justice Act. *See* H.R. Rep. No. 404, 97th Cong., 1st Sess. (1981). *See generally* Note, *Attorney's Fees in Tax Cases After the Tax Equity and Fiscal Responsibility Act of 1982,* 36 TAX LAW. 123, 144-47 (1982) (discussion of rationale for excluding United States Tax Court from provisions of EAJA).

the prevailing party may be awarded in a tax case brought by or against the United States.[9] "Reasonable litigation costs" include court costs,[10] expenses of expert witnesses,[11] costs associated with the preparation of studies, analyses, engineering reports, tests or projects,[12] and attorney fees.[13] Since the Tax Court allows qualified persons who are not attorneys to represent taxpayers before the court, fees paid to such persons qualify as attorney fees for possible reimbursement.[14] The statute further provides that the maximum award for "reasonable litigation costs" in any proceeding is $25,000;[15] however, no specific hourly attorney fee limit is imposed.[16] Finally, the definition of "reasonable" costs under the statute is left to the discretion of the court.[17]

Other statutory limitations also exist which make life difficult for taxpayers who try to get reimbursed for attorney fees in tax litigation cases. First, taxpayers are not eligible for an award of litigation costs unless all available administrative remedies within the Internal Reve-

---

9. *See* I.R.C. § 7430(a) (Supp. 1985).

10. *See id.* § 7430(c)(1)(A)(i). This section provides: " 'reasonable litigation costs' include . . . reasonable court costs." *Id.* § 7430(c)(1)(A)(i).

11. *See id.* § 7430(c)(1)(A)(ii). This section reads: " 'reasonable litigation costs' includes . . . the reasonable expense of expert witnesses in connection with the civil proceeding." *Id.* § 7430(c)(1)(A)(ii).

12. *See id.* § 7430(c)(1)(A)(iii). This section provides: " 'reasonable litigation costs' includes . . . the reasonable cost of any study, analysis, engineering report, test, or project which is found by the court to be necessary for the preparation of the party's case." *Id.* § 7430(c)(1)(A)(iii).

13. *See id.* § 7430(c)(1)(A)(iv). This section provides: " 'reasonable litigation costs' includes . . . reasonable fees paid or insured for the services of attorneys in connection with the civil proceedings." *Id.* § 7430(c)(1)(A)(iv).

14. *See id.* § 7430(c)(1)(B). The statute states: "in case of any proceeding in the Tax Court, fees for the services of an individual (whether or not an attorney) who is authorized to practice before the Tax Court shall be treated as fees for the service of an attorney". *Id.* § 7430(c)(1)(B).

15. *Id.* § 7430(b)(1). This provision provides that: "reasonable litigation costs . . . shall not exceed $25,000." *Id.* § 7430(b)(1).

16. *See id.* § 7430 (TEFRA sets no hourly limit); *see also* Note, *Award of Attorney Fees in Tax Litigation,* 19 VAL. U. L. REV. 153, 185 (1984) (TEFRA sets no hourly limit on amount of attorney fees). The EAJA, on the other hand, limited reasonable attorney fees to $75.00 per hour. *See* Equal Access to Justice Act, Pub. L. No. 96-481, § 204(a), 94 STAT. 2325 (1980), *codified* at 28 U.S.C. § 2412(d)(2)(A) (Supp. 1983). One writer has stated that current hourly rates being charged under TEFRA exceed the $75.00 hourly limit set by the EAJA. *See* Note, *Award of Attorney Fees in Tax Litigation,* 19 VAL. U. L. REV. 153, 185 n.210 (1984).

17. *See* I.R.C. § 7430(c)(2)(B)(i) (Supp. 1985). *But see* Penner v. United States, 584 F. Supp. 1582, 1584-85 (S.D. Fla. 1984) (limiting attorney fees under section 7430 to $90.00 per hour).

nue Service have first been exhausted.[18] Under treasury regulation 301.7430-1(b), the taxpayer is required to participate in good faith in a conference with the Appeals Office of the Internal Revenue Service.[19] This conference must be requested by the taxpayer prior to the issuance of the statutory notice of deficiency or the "90-day letter."[20] In situations where no appeals conference is available, however, the taxpayer must file a written claim for relief with the Internal Revenue

---

18. *See id.* § 7430(b)(2). This section requires that "a judgment for reasonable litigation costs shall not be awarded . . . unless . . . the prevailing party has exhausted the administrative remedies available to such party within the Internal Revenue Code." *Id.* § 7430(b)(2); *see also* Comment, *Tax Litigation and Attorney's Fees: Still A Win-Lose Dichotomy,* 57 S. CAL. L. REV. 471, 490 (1984) (all administrative remedies must be exhausted); Note, *Attorney's Fees in Tax Cases after the Tax Equity and Fiscal Responsibility Act of 1982,* 36 TAX LAW. 123, 149-50 (1982) (costs available only after all administrative remedies exhausted). An exception exists, however, when the IRS has indicated that the issue involved will be litigated in all cases. *See* H.R. REP. No. 404, 97th Cong., 1st Sess. 13 (1981) (when IRS litigates particular issue in every case; negates requirement to exhaust all administrative remedies); *see also* Comment, *Tax Litigation And Attorney's Fees: Still A Win-Lose Dichotomy,* 57 S. CAL. L. REV. 471, 490 (1984) (exception when issue is one litigated in all cases).

19. *See* Treas. Reg. § 301.7430-1(b)(1985).

20. *Id.* § 301.7430-1(g). The following examples are provided in regulation 301.7430-1 (g) to illustrate the provisions of section 7430:

> *Example(1).* Taxpayer A exchanges property held for investment for similar property and claims that the gain on the exchange is not recognized under section 1031. The Internal Revenue Service conducts a field examination and determines that there has not been a like-kind exchange. No agreement is reached on the matter and a preliminary notice of proposed deficiency (30-day letter) is sent to A. A does not file a request for an Appeals Office conference. A pays the amount of the proposed deficiency and files a claim for refund. A preliminary notice of proposed disallowance is issued by the Internal Revenue Service. A does not request an Appeals Office conference and instead files a civil action for refund in a United States District Court. A has not exhausted the administrative remedies available within the Internal Revenue Service.
>
> *Example (2).* Assume the same facts as in example (1) except that, after receiving the preliminary notice of proposed deficiency (30-day letter) A files a request for an Appeals Office conference. No agreement is reached at the conference. A pays the amount of the proposed deficiency and files a claim for refund. A preliminary notice of proposed disallowance is issued by the Internal Revenue Service. A does not request an Appeals Office conference and files a civil action for refund in a United States District Court. A has exhausted the administrative remedies available within the Internal Revenue Service. . . .
>
> *Example (12).* Taxpayer H receives a preliminary notice of proposed deficiency (30-day letter) and neither requests nor participates in an Appeals Office conference. The Service then issues a statutory notice of deficiency (90-day letter). Upon receiving the statutory notice, H requests an Appeals Office conference. The Appeals Office informs H that an Appeals Office conference will not be granted. H files a petition in the Tax Court after receiving notice of the denial of a conference. H has not exhausted the administrative remedies available within the Internal Revenue Service because the request for an Appeals Office conference was made after the issuance of the statutory notice.

Id. § 301.7430-1(g) (examples 1, 2, 12).

Service.[21]

Requiring taxpayers to first utilize all administrative remedies limits the discretion of the tax advisor representing the taxpayer. For example, in some situations the preferable strategy may be to bypass the appeals conference and proceed directly to litigation. This may save fees for the client and/or limit the issues to be litigated. By using this strategy, however, the tax advisor would be relinquishing the opportunity to collect attorney fees from the government for the litigation. The tax advisor's evaluation of whether to request an appeals conference, therefore, is colored by the possibility of collecting attorney fees from the government in subsequent litigation.

Another limitation contained in section 7430 relates to the subject matter of the tax litigation. The general rule is that litigation costs cannot be awarded in declaratory judgment proceedings.[22] This provision, therefore, excludes retirement plan qualifications[23] and determinations of the tax-exempt status of governmental obligations.[24] A specific exception is provided which allows litigation costs to be awarded in declaratory judgment proceedings involving the revocation of tax-exempt status for a section 501(c)(3) charity or foundation.[25]

After avoiding or overcoming all these statutory obstacles, the taxpayer still must qualify as a "prevailing party" in the litigation.[26] To qualify as a prevailing party, the taxpayer must satisfy a two-pronged test. First, the taxpayer must have substantially prevailed with regard to the amount in dispute,[27] *or* substantially prevailed with regard to the most important issue or sets of issues presented.[28] The standard

---

21. *See id.* § 301.7430-1(d)(1)(1985). Situations where no appeals conference is available include actions involving liens, levies, summonses and termination and jeopardy assessments. *See id.* § 301.7430-1(d).

22. *See* I.R.C. § 7430(b)(4)(A) (Supp. 1985). This section provides that "no award for reasonable litigation costs may be made . . . with respect to any declaratory judgment proceeding." *Id.* § 7430(b)(4)(A).

23. *See id.* § 7476 (declaratory judgments relating to qualification of certain retirement plans prohibited).

24. *See id.* § 7478 (declaratory judgments relating to status of governmental obligations).

25. *See id.* § 7430(b)(4)(B). This section states that the exclusion of declaratory judgment proceedings "shall not apply to proceedings which involves the revocation of a determination that the organization is described in section 501(c)(3)." *Id.* § 7430(b)(4)(B).

26. *See id.* § 7430(a). This provision states that "the prevailing party may be awarded a judgment for reasonable litigation costs. . . ." *Id.* § 7430(a).

27. *See id.* § 7430(c)(2)(A)(ii)(I).

28. *See id.* § 7430(c)(2)(A)(ii)(II).

of "substantially prevailed" is not set by statute and is subject to varying judicial interpretations. The second prong requires the prevailing party to establish that the position of the United States was unreasonable.[29] Unlike the standard in the EAJA,[30] the burden of proof is on the taxpayer to prove that the government's position was unreasonable.[31] As discussed below, this unreasonableness requirement is the major stumbling block for taxpayers attempting to collect attorney fees from the government in tax litigation. As with the "substantially prevailed" test, the exact parameters of an "unreasonble" government position are being defined by judicial decisions.[32]

---

29. *See id.* § 7430(c)(2)(A)(i).

30. *See* 28 U.S.C. § 2412(d)(1)(A) (Supp. 1985). EAJA provides that attorney fees shall be awarded to a prevailing party unless the United States can prove its position was substantially justified or that special circumstances make the award unjust. *See id.* § 2412(d)(1)(A); *see also* Williamson v. United States, 573 F. Supp. 11, 11 (N.D. Ga. 1983) (government has burden of showing award should not be made under EAJA).

31. *See* I.R.C. § 7430(c)(2)(A); *see also* Randazzo v. United States Dep't of Treas., 581 F. Supp. 1235, 1237 (W.D. Pa. 1984) (party must establish two conditions before possibility of being awarded attorney fees). *See generally* Rubin, *Report on TEFRA Provisions With Respect to Award of Litigation Costs to Taxpayers and Increased Damages to the Government,* 62 TAXES 381, 384 (1984) (under section 7430 taxpayer has burden whereas EAJA placed burden on government); Note, *Attorney's Fees in Tax Court After the Tax Equity and Fiscal Responsibility Act of 1982,* 36 TAX LAW. 123, 155 (1982) (TEFRA shifts burden of proof to taxpayer). The Senate committee report on TEFRA states: "[t]he committee has explicitly placed the burden of establishing the unreasonableness of the position of the United States on the taxpayer." S. REP. NO. 530, 97th Cong., 2d Sess. 687 (1982).

32. *See* I.R.C. § 7430(c)(2)(B) (Supp. 1985). This section provides that the "determination . . . as to whether a party is a prevailing party shall be made . . . by the court." *Id.* § 7430(c)(2)(B); *see also* Kaufman v. Egger, 584 F. Supp. 872, 878 (D. Me. 1984) (court determines reasonableness of government's position), *aff'd,* 758 F.2d 1 (1st Cir. 1985); Randazzo v. United States Dep't of Treas., 581 F. Supp. 1235, 1237 (W.D. Pa. 1984) (court determines reasonableness from facts and circumstances surrounding proceeding). *See generally* Rubin, *Report on TEFRA Provisions With Respect to Award of Litigation Costs to Taxpayers and Increased Damages to the Government,* 62 TAXES 381, 384 (1984) (determination of government's reasonableness is made by the court). Specific criteria has been set forth by the House Ways and Means Committee, however, informing both parties and courts as to facts that indicate unreasonableness on the part of the government. *See* H.R. REP. NO. 404, 97th Cong. 1st Sess. 12 (1981). The factors include:

> (1) whether the government used the costs and expenses of litigation against its position to extract concessions for the taxpayer that were not justified under the circumstances of the case; (2) whether the government pursued the litigation against the taxpayer for purposes of harassment or embarrassment, or out of political motivation; and (3) such other factors as the court finds relevant.

Id. at 12. *See generally* Rubin, *Report on TEFRA Provisions With Respect to Award of Litigation Costs to Taxpayers and Increased Damages to the Government,* 62 TAXES 381, 384 (1984) (listing factors to consider when determining reasonableness); Note, *Attorney's Fees in Tax Cases After the Tax Equity and Fiscal Responsibility Act of 1982,* 36 TAX LAW. 123, 153 (1982)

III. THE WINNERS

While something can presumably be learned by analyzing cases in which the taxpayer was denied an award of attorney fees,[33] this article's analysis will concentrate on cases in which the taxpayer has been successful in obtaining an award of attorney fees. Through examining successful actions brought by taxpayers, the author hopes to illuminate special problems and tactics to ensure similar results for other taxpayers and their tax counselors.

A. *Circuit Court Decisions*

Due to the relatively recent effective date of section 7430, only two cases in which the taxpayer ultimately prevailed in an award of attorney fees have been decided at the United States Circuit Court of Appeals level. The only reported case is *Kaufman v. Egger,*[34] decided by the First Circuit. The facts in *Kaufman* are fairly straightforward and were not in dispute.

The Internal Revenue Service (IRS) sent an audit notice to the Kaufmans' address as listed on their 1978 return approximately two years after the return was filed.[35] The taxpayers had moved to a different state and did not receive the notice. When the IRS did not receive a response, it mailed a notice of adjustment and the statutory notice of deficiency to another address where the Kaufmans never lived. Three years later, the IRS seized the taxpayers' refund from a more current tax return and informed the Kaufmans of the local Service authority they could contact to make arrangements to pay the amount due.[36] The Kaufmans, upon learning about this matter, con-

---

(discussion of factors courts are to consider when determining reasonableness of governmental action).

33. *See, e.g.,* Jenny v. United States, 581 F. Supp. 1309, 1311 (C.D. Cal. 1984) (award of litigation costs not authorized), *rev'd on other grounds,* 755 F.2d 1384 (9th Cir. 1985); Brazil v. United States, 84-2 U.S. Tax Cas. (CCH) ¶ 9596 (D.Or. 1984) (plaintiffs' motion for attorneys' fees denied); Eidson v. United States, 84-1 U.S. Tax Cas. ¶ 9182 (N.D. Ala. 1984) (motion for attorneys' fees denied). For a discussion on unsuccessful attempts to recover attorney fees under TEFRA, see generally, Note, *Award of Attorney Fees in Tax Litigation,* 19 VAL. U. L. REV. 153, 188-90 (1984).

34. 758 F.2d 1 (1st Cir. 1985).

35. *See id.* at 2. The IRS mailed the tax liability notice in October, 1980. The notice, however, was sent to an address of another couple also named Kaufman. *See id.* at 2 n.2.

36. *See id.* at 2. The IRS seized the Kaufman's $606 tax refund as a partial payment for the alleged deficiency. The original assessment was $14,380, however, with the addition of interest and penalties, the IRS claimed that the Kaufman's owed $23,857. *See id.* at 2.

tacted their tax accountant. The accountant contacted the IRS and was informed that the taxpayers' account had been transferred to the Taxpayers Delinquent Account Section for collection. The Kaufmans brought suit in the United States District Court for Maine for injunctive relief and for the return of their seized tax refund.[37] At the end of this litigation, the district court awarded attorney and expert fees to the taxpayers, and the IRS agreed to the entry of a permanent injunction prohibiting it from taking any steps to collect taxes due based on the subject notice of deficiency.[38]

The IRS appealed the award of attorney and expert fees to the First Circuit.[39] The opening paragraph of the First Circuit's opinion clearly indicates the court's attitude in affirming the district court's award:

> The present case zeros in on one of many unnecessary tribulations that can be brought to bear upon the unsuspecting citizenry by today's computerized bureaucracy. It also requires our interpreting one Congressional attempt to grant the public some relief from such bungling.[40]

Two arguments were advanced by the IRS in its attempt to avoid an award of attorney fees under section 7430. The first contention was that the Kaufmans had failed to exhaust all administrative remedies as required in section 7430(b)(2).[41] The IRS argued that the taxpayers should have tried to resolve the matter internally with the IRS before filing suit. The court rejected this IRS argument for two reasons. First, since the "draconian collection procedures" of the Taxpayer Delinquency Account Section were threatening the taxpayers, they should not be faulted for seeking timely judicial relief.[42] Second,

---

37. Kaufman v. Eggar, 584 F. Supp. 872, 872 (D. Me. 1984), *aff'd,* 758 F.2d 1 (1st Cir. 1985).

38. *See id.* at 873.

39. *See* Kaufman v. Egger, 758 F.2d 1 (1st Cir. 1985).

40. *Id.* at 1-2.

41. *See id.* at 2-3; *see also* I.R.C. § 7430(b)(2) (Supp. 1985) (prevailing party must exhaust available administrative remedies). For a discussion on the requirement that all administrative remedies be exhausted, see generally Comment, *Tax Litigation And Attorney's Fees: Still A Win-Lose Dichotomy,* 57 S. CAL. L. REV. 471, 490 (1984) (all administrative remedies must be exhausted); Note, *Attorney's Fees in Tax Cases After the Tax Equity and Fiscal Responsibility Act of 1982,* 36 TAX LAW. 123, 149-50 (1982) (attorney fees available only after all administrative remedies exhausted).

42. *See* Kaufman v. Egger, 758 F.2d 1, 3 (1st Cir. 1985); *see also* I.R.C. §§ 6331-44 (1967 & Supp. 1985) (property seized for collection of taxes); *id.* § 7403 (action to subject property or enforce lien for payment of tax).

the court cited a treasury regulation which excuses the taxpayer's failure to exhaust administrative remedies where the taxpayer, without fault on his part, does not receive notice of IRS action.[43]

The second argument advanced by the IRS was more substantial. The position of the IRS was that the language of section 7430(c)(2)(A)[44] excludes pre-litigation behavior from consideration in determining whether the government behavior was unreasonable for purposes of an award of attorney fees. The position excluding pre-litigation behavior from consideration has been adopted by several district courts.[45] Other district courts, on the other hand, have permitted consideration of pre-litigation behavior.[46]

The First Circuit in *Kaufman* adopted the position that pre-litiga-

---

43. *See* Kaufman v. Egger, 758 F.2d 1, 3 (1st Cir. 1985) (citing Treas. Reg. 301.7430-1 (f) (1985)). Regulation 7430-1(f)(ii)provides in the pertinent part:

> A party's administrative remedies within the Internal Revenue Service are considered exhausted for purposes of section 7430 if . . . in the case of a civil action for refund . . . the party . . . did not receive a preliminary notice of proposed disallowance prior to issuance of a statutory notice of disallowance and the failure to receive such notice was not due to actions of the party (such as the failure to supply requested information or a current mailing address) . . . .

Treas. Reg. § 301.7430-1-f(3)(ii)(1985). The *Kaufman* court pointed out that all notices were either sent to an old address or an address where the taxpayer never lived. *See* Kaufman v. Egger, 758 F. 2d 1, 3 (1st Cir. 1985).

44. *See* Kaufman v. Egger, 758 F.2d 1, 2-3 (1st Cir. 1985); *see also* I.R.C. 7430(c)(2)(A) (Supp. 1985) (allowing award of attorney fees in cases where "the position of the United States in *the civil proceedings* was unreasonable") (emphasis added).

45. *See, e.g.,* Zielinski v. United States, 84-1 U.S. Tax. Cas. (CCH) ¶ 9514 (D. Minn. 1984) (compensation only allowed when government taxes unsupportable position in court action as opposed to administrative proceeding); Brazil v. United States, 84-2 U.S. Tax Cas. (CCH) ¶ 9596 (D. Or. 1984) (reasonableness of position only considered in litigation, not for events preceding litigation); Edison v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 9182 (N.D. Ala. 1984) (courts limited to awarding fees based on unreasonableness *"in the civil proceeding"); see also* Baker v. Comm'r, 83 T.C. 822, 827 (1984) (statute requires examination of reasonableness during litigation as opposed to administrative proceeding); Popham v. Comm'r, 53 T.C.M. (P-H) ¶ 84,652 (T.C. 1983) (reasonableness of government's position during litigation can only be considered). *See generally* Note, *Attorney's Fees in Tax Cases After the Tax Equity and Fiscal Responsibility Act of 1982,* 36 TAX LAW. 123, 152-54 (1982) (discussion on reasonableness standard applied to government's position).

46. *See, e.g.,* Penner v. United States, 584 F. Supp. 1582, 1583 (S.D. Fla. 1984) (government's initiation of jeopardy assessment considered unreasonable position); Sharpe v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 13,574 (E.D. Va. 1984) (recovery of attorney's fees allowed for both administrative and judicial level when government's position unreasonable); Hallam v. Murphy, 84-1 U.S. Tax Cas. (CCH) ¶ 9230 (N.D. Ga. 1983) (proper time frame to consider government's unreasonableness is throughout entire tax proceeding); *see also* Kaufman v. Egger, 584 F. Supp. 872, 877-78 (D. Me. 1984) (government's wrongful conduct included prelitigation conduct), *aff'd,* 758 F.2d 1 (1st Cir. 1985).

tion behavior can be considered in determining whether the government's behavior was unreasonable.[47] The court reasoned that this interpretation was consistent with congressional "remedial bias" in enacting section 7430.[48] The court also cited Senate committee language which stated that awards would be available "when the United States has acted unreasonably in *pursuing the case.*"[49] By applying this approach, the court found that the behavior of the IRS was, in fact, unreasonable. Notwithstanding the finding of unreasonableness, there was no real discussion of standards to determine "unreasonableness" in the opinion, but the court merely concluded that this particular bureaucratic mixup "was unreasonable by any standard."[50] While the First Circuit's decision failed to enunciate specific guidelines for determining unreasonable government behavior, it serves as the sole appellate analysis for future awards of attorney fees under section 7430. Furthermore, the *Kaufman* decision is important for its broad

---

47. *See* Kaufman v. Egger, 758 F.2d 1, 3-4 (1st Cir. 1985) (government's liability triggered by unreasonable position even if occurring in prelitigation conduct).

48. *See id.* at 4.

49. *Id.* at 4; *see also* Staff of Senate Committee on Finance, Technical Explanation of Committee Amend., 127 CONG. REC. §§ 15587, 15594 (Dec. 16, 1981). The *Kaufman* court pointed out that the intent of Congress in allowing an award of attorney fees is to "deter abusive actions and overreaching by the Internal Revenue Service and will enable taxpayers to vindicate their rights regardless of their economic circumstances." Kaufman v. Egger, 758 F.2d 1, 4 (1st Cir. 1985) (citing H.R. REP. NO. 97-404, 97th Cong., 2d Sess. 13 (1982); Staff of Senate Committee on Finance, Technical Explanation of Committee Amend., 127 CONG. REC. §§ 15587, 15594 (Dec. 16, 1981)).

50. *See* Kaufman v. Egger, 758 F.2d 1, 4 (1st Cir. 1985). In contrast, the lower court did enunciate several factors in its decision to award attorney fees to the Kaufmans. The district court found that the government seizure of the Kaufman's tax refund violated the procedures mandated by the Internal Revenue Code. *See* Kaufman v. Egger, 584 F. Supp. 872, 879 (D. Me. 1984), *aff'd,* 758 F.2d 1 (1st Cir. 1985). The district court further stated that the government knowingly violated the law, hoping the taxpayer would pay the additional tax monies without challenging the improper collection method. *See id.* at 879. The court concluded that the government attempted "to use the cost and expense of litigation against its position to extract concessions from the taxpayer that were not justified under the circumstances of the case." *Id.* at 879. A second factor the district court deemed relevant was that the government could have spared the court and the parties the time and expense of trial. The court stated that the conduct of the government "smacks of negligence at its best, bad faith at its worse." *Id.* at 879. A third factor relied on by the district court was the government's seizure of the Kaufman's tax refund. The court concluded that "the seizure amounted to a taking of plaintiff's property without according them due process of law." *Id.* at 879. Finally, the district court stated that a determination that the government's position was "reasonable merely because they stipulated to entry of judgment against them" would be an unrealistic view of the facts. *See id.* at 879. A practitioner, seeking attorney fees from the government would be well advised to preserve an accurate record of the entire pre-litigation relationship with the IRS so that it can be used in later court actions.

construction and application of the attorney fees remedy in tax litigation.

The Ninth Circuit recently issued a memorandum decision upholding an award of attorney fees to a taxpayer for tax litigation, but stated that its disposition was not appropriate for publication and that the decision could not be cited to or by the courts of the Ninth Circuit. The case of *Haynes v. United States*[51] involved a divorced taxpayer whose property was the subject of an IRS levy arising from a pre-divorce joint return tax liability. The taxpayer was not notified by the IRS as to any potential liability. When Haynes contacted the IRS after finding out that her assets were subject to tax liens, she was assured that the liens would be released. Since the IRS took no immediate action to release the liens, Haynes filed suit. The IRS still did not release the liens, claiming that the taxpayer's administrative file could not be located. Several months elapsed before the IRS finally did release the liens. The district court ultimately awarded attorney fees to the taxpayer.[52]

The Ninth Circuit, in undertaking its *de novo* review of the propriety of the district court's awarding of attorney fees, recognized the significance of whether IRS pre-litigation behavior could be considered in determining unreasonable government behavior.[53] The Ninth Circuit, however, did not decide that issue because they found the unreasonable litigation position taken by the government was sufficient to support the district court's award of attorney fees under section 7430.[54] While the *Haynes* decision does not resolve the pre-litigation behavior issue, it does provide a valuable lesson — when seeking attorney fees from the government, the tax attorney should use both pre- *and* post-litigation government behavior to establish unreasonableness.

---

51. No. 84-2626, slip op. (9th Cir. July 11, 1985).

52. *See id.* at 6.

53. *See id.* at 5.

54. *See id.* at 5-6. In determining that the government litigation position was unreasonable, the *Haynes* court noted that: (1) the IRS waited two months before filing an answer to the taypayer's complaint; (2) in its answer, the IRS denied the taxpayer's allegations due to an alleged lack of information; (3) the IRS had "ample opportunity to ascertain whether the liens placed on the taxpayer's property were procedurally defective;" and (4) the IRS opted to search for its lost administrative file for months rather than simply confirming the taxpayer's allegations by asking the agent who originally placed the liens. *See id.* at 6. Also, the court pointed out that the failure to properly notify the taxpayer of any potential liability violated both statutory duty and IRS policy. *See id.* at 2.

B. *District Court Decisions*

Several United States District Courts have awarded taxpayers attorney fees against the government under section 7430. In *Penner v. United States,*[55] the court abated an IRS jeopardy assessment exceeding $1,300,000 and also released all liens against the taxpayer's property. The basis for the court's actions was its conclusion that the making of the assessment and the amount demanded were not supported by substantial evidence.[56] In the court's opinion, the IRS had been neither thorough nor diligent in examining the taxpayer's assets or other required evidence.[57]

In arguing against an award of attorney fees to the taxpayer, the Internal Revenue Service took the position that its litigation behavior was reasonable, thereby disqualifying the taxpayer from the definition of a "prevailing party" under section 7430(c)(2).[58] Additionally, the government argued that its pre-litigation behavior, whether reasonable or not, could not be considered when awarding attorney fees.[59] The district court, however, held that the IRS pre-litigation behavior could be considered because the governmental proceeding was continuous from the initiation of the jeopardy assessment through the defense of that assessment.[60] Finally, the court determined that Congress would have specifically excluded pre-litigation behavior if that was its intent.[61]

---

55. 584 F. Supp. 1582 (S.D. Fla. 1984).

56. *See id.* at 1583.

57. *See id.* at 1583.

58. *See id.* at 1583.

59. *See id.* at 1583. The government contended that the defending of a civil suit should be evaluated independently from the government's initiation of the jeopardy assessment. *See id.* at 1583. The *Penner* court, however, stated that no rational basis could be recognized distinguishing between the initiating of the jeopardy assessment and the defending of that assessment. *See id.* at 1583. The court concluded that "if the government's position in initiating the jeopardy assessment was found to be unreasonable, . . . it is hard to fathom how the government's position (in defending an unreasonable action) would be reasonable." *Id.* at 1583. *But see* Edson v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 9182 (N.D. Ala. 1984) (such distinction is required).

60. *See* Penner v. United States, 584 F. Supp. 1582, 1583-84 (S.D. Fla. 1984).

61. *See id.* at 1584 (citing H.R. CONF. REP. NO. 97-760, 97th Cong., 2d Sess., at 686, *reprinted at* 1982 U. S. CODE CONG. & AD. NEWS 781, 1449). Interestingly, the district court reduced the attorney fees requested by the taxpayer's counselor, limiting the maximum hourly rate to $90.00 per atttorney hour, even though the statute does not require such a limitation. *See id.* at 1584.

A district court in *Hallam v. Murphy*[62] levied attorney fees against the government in a case in which the IRS had abated an assessment for lack of issuing the required notice to the taxpayers. The abatement occurred after the taxpayers filed suit to enjoin collection.[63] The government used the familiar arguments that the taxpayer had not exhausted all administrative remedies and that the government's position was reasonable. The government's contention that administrative remedies had not been exhausted was based on a letter sent to the taxpayers which directed the taxpayers to pay the tax and file for a refund. The IRS claimed that the taxpayer's failure to comply with the letter precluded an award of attorney fees.[64] In rejecting the government's argument, the court found that paying alleged tax deficiencies and filing a claim for refund were not within the definition of administrative remedies contemplated by section 7430(b)(2).[65]

As to the unreasonableness issue, the *Hallam* court concluded that the government behavior during the entire tax proceedings should be examined, not just the behavior after litigation had commenced.[66] The court also found that the government's continued assertion of its position against the Hallams was *per se* unreasonable, therefore, the award of attorney fees and costs were justified under section 7430.[67]

Sharpe v. United States,[68] demonstrates the availability of attorney fees in an estate tax litigation situation. In *Sharpe,* the IRS claimed that the estate was liable for tax on the value of property in a trust over which the decedent had allegedly been a co-trustee under the

---

62. 84-1 U.S. Tax Cas. (CCH) ¶ 9230 (N.D. Ga. 1983).

63. *See id.* ¶ 9230. On June 6, 1983, the Hallams filed suit seeking to permanently enjoin the government from collecting alleged tax deficiencies for the tax year 1977. The Hallams alleged that the government was not entitled to collect the alleged tax deficiency because the required notice was not issued. After the Hallam suit was filed, the government abated the tax assessment. Therefore, the only material issue before the court concerned the Hallam's motion for an award of attorney fees and costs. *See id.* ¶ 9230.

64. *See id.* ¶ 9230. The government claimed that "if the refund procedure is an adequate legal remedy prohibiting injunctive relief, it is entitled to recognition as an adequate administrative remedy under 26 U.S.C. § 7430." *Id.* ¶ 9230. The court held, however, that "an adequate remedy at law is a different question than whether the plaintiffs exhausted all available administrative remedies." *Id.* ¶ 9230.

65. *See id.* ¶ 9230.

66. *See id.* ¶ 9230. The *Hallam* court stated that the government knew, or should have known, that the Hallams never received the required notification. The court concluded, therefore, that the government's continued assertion of a known incorrect position was unreasonable *per se. See id.* ¶ 9230.

67. *See id.* ¶ 9230.

68. 84-1 U.S. Tax Cas. (CCH) ¶ 13,574 (E.D. Va. 1984).

provisions of sections 2041[69] and 2035 of the Internal Revenue Code.[70] Both the will and trust instrument provided that whenever the trustees were empowered to invade the corpus or allocate income for the benefit of the decedent, the decedent was disqualified from acting as a trustee in such situations. The government ultimately conceded the case after briefs were exchanged, but before the actual trial.

The government's only viable argument against the award of attorney fees in *Sharpe* was that its actions were reasonable. In holding for the taxpayer, the court provided two reasons for holding that the government's actions were unreasonable. First, the district court undertook a review of the statutory and case law in the general power of appointment area and found no support for the government's position.[71] Second, the court found that the IRS recommendation to the Department of Justice that an administrative refund for the full tax and interest claimed by the estate should be made, was a factor to be considered.[72] Again, attorney fees and costs for the litigation were awarded under section 7430.

A third party not directly involved as a taxpayer in tax litigation has also been awarded attorney fees under section 7430. In *Prudential-Bache Securities, Inc. v. Tranakos,*[73] a securities firm was holding assets for a taxpayer in the taxpayer's capacity as a trustee. The IRS levied on accounts held by Prudential-Bache relating to the potential personal tax liability of the trustee-taxpayer. Both the taxpayer and the IRS demanded that Prudential-Bache distribute the assets to them. The securities firm brought an interpleader action to have the district court decide the legal owner of the funds. The government ultimately released its levies after determining that the taxpayer had no personal interest in the assets. The court found that the securities firm was indeed a "prevailing party" in the tax-related interpleader action.[74] In the court's opinion, the attempt by the IRS to enforce its

69. *See id.* ¶ 13,574. The IRS characterized the co-trusteeship as a general power of appointment. The *Sharpe* court, however, held that the government's position that a general power of appointment should be imputed to the plaintiff was unreasonable. *See id.* ¶ 13,574.

70. *See id.* ¶ 13,574. The decedent had resigned from his co-trusteeship, however, it was within three years of his death. Therefore, under section 2035, the trust assets are includable as part of his taxable estate. *See id.* ¶ 13,574.

71. *See id.* ¶ 13,574.

72. *See id.* ¶ 13,574.

73. 593 F. Supp. 783 (N.D. Ga. 1984).

74. *See id.* at 787. The court held that Prudential-Bache qualified as a prevailing party because (1) it established that the position of the United States in the interpleader action was

levies once it had knowledge that the taxpayer held the subject assets in a fiduciary capacity was unreasonable behavior.[75] The court therefore awarded attorney fees and costs to Prudential-Bache under section 7430.

C. *Tax Court Decisions*

Because of the limited success enjoyed by taxpayers in the United States District Courts and Circuit Courts, one might also expect taxpayers would enjoy limited success in the Tax Court. However, from the effectiveness date of section 7430 through the date of writing of this article (well over two years), attorney fees have not been awarded to a taxpayer in a reported Tax Court decision under the provisions of section 7430.[76] The primary reason for this situation is a very restrictive interpretation of the statute by the full Tax Court in the case of *Baker v. Commissioner.*[77] Since *Baker,* subsequent taxpayer attempts for an award of attorney fees in the Tax Court have been dismissed by memorandum decisions.[78] Even though the taxpayer did not prevail in the *Baker* case, this case must be analyzed to evaluate the possibility of collecting attorney fees from the government in cases tried before the Tax Court.

The facts in *Baker* are straightforward. The IRS assessed deficiencies against the taxpayer based on four grounds: additional income from (1) disallowance of a foreign earned income exclusion; (2) for rental value of housing provided the taxpayer by his employer; (3) additional deductions from an increase in rental loss; and (4) allow-

---

unreasonable based on the clear impropriety of the levy notices issued, and (2) it substantially prevailed on the most significant issue in the interpleader action by avoiding multiple liability. *See id.* at 787.

75. *See id.* at 786. The court found that the United States did not make an effort to verify or controvert the taxpayer's claim that the assets were held in a fiduciary capacity. Although the levies were eventually released, the court found that the IRS "did not review the relevant documents within a reasonable time after . . . objections to the notices were presented to it." *Id.* at 787 n.4.

76. *Cf.* BNA DAILY TAX REPORT No. 81, April 26, 1985 Tax Court Judge Howard Dawson reported to the House Ways and Means Select Revenue Measures Subcommittee that the government had agreed to ten to fifteen out of court settlements for attorney fees in Tax Court cases with settlement amounts ranging between $500 and $1000. *See id.* at 81.

77. 83 T.C. 822 (1984).

78. *See* Apirtis v. Comm'r, T.C.M. (P-H) ¶ 85,044 (T.C. 1985) (relies on *Baker* as basis for denial of award of attorney fees); Popham v. Comm'r, T.C.M. (P-H) ¶ 84,652 (T.C. 1984) (*Baker* cited in denying award).

ance of a deduction for excess foreign living costs.[79] Several administrative hearings and litigation meetings later, the government conceded to the taxpayer on all issues. The taxpayer then brought an action to collect attorney fees from the government under section 7430.[80]

The taxpayer's claim was based on alleged unreasonable government behavior in promulgating the disputed income tax regulation and in determining the deficiencies.[81] Since this claim was based on pre-litigation behavior, the Tax Court first addressed the issue of whether pre-litigation behavior could be considered in determining a potential "unreasonable" classification under section 7430(c)(2)(A)(i).[82] The Tax Court concluded that pre-litigation behavior could *not* be considered.[83] The court decided that Congress had intended to distinguish administrative proceedings from litigation.[84] This distinction was evidenced by the requirement of exhausting administrative remedies as a prerequisite to an award, and of restricting collectible attorney fees to those incurred in litigation.[85] The court therefore considered only post-litigation behavior in addressing the award of attorney fees.[86]

The Tax Court's rejection of the government's pre-litigation behavior is the most significant reason for the unfavorable environment for

---

79. *See* Baker v. Comm'r, 83 T.C. 822, 824 (1984).

80. *See id.* at 824. The specifics of a motion for litigation costs in the Tax Court are contained in Rules 230-233 of the Tax Court Rules of Practice and Procedure. *See* TAX CT. R. PRACTICE 230-233.

81. *See* Baker v. Comm'r, 83 T.C. 822, 826 (1984). In *Baker,* one controversy concerned whether the taxpayer resided in "a camp", as defined by the regulations, to become eligible for the foreign earned income exclusion. *See id.* at 829; *see also* Treas. Reg. § 1.911-1(c)(1)(iv) (1985).

82. *See* Baker v. Comm'r, 83 T. C. 822, 826 (1984).

83. *See id.* at 826-27.

84. *See id.* at 826.

85. *See id.* at 827; *see also* I.R.C. § 7430(b)(2) (Supp. 1985) (before fees awarded in subsequent civil proceeding, all administrative remedies must first be exhausted). The court relied on the legislative history of section 7430(b)(2) as support for its conclusion. *See* Baker v. Comm'r, 83 T.C. 822, 827 (1984). The legislative history stated:

> Recoverable litigation costs include only the reasonable amount of costs which are incurred in the litigation of a civil tax action or proceeding. The committee intends that the *costs of preparing and filing the petition* or complaint *which commences a civil tax action be the first of any recoverable attorney's fees.* Fees paid or incurred for the services of an attorney during the administrative stages of the case could not be recovered under an award of litigation costs. [Emphasis added.]

Id. at 827 (citing H.R. REP. NO. 404, 97th Cong., 1st Sess. (1981)).

86. *See* Baker v. Comm'r, 83 T.C. 822, 827 (1984).

an award of attorney fees in Tax Court litigation. As discussed earlier, other federal courts which awarded the taxpayer attorney fees noted that the government's unreasonable position usually began with pre-litigation behavior and was a decisive factor in the final "unreasonable" determination required by section 7430.[87] As concluded in *Kaufman,* deciding this issue in the government's favor severely restricts the availability of recovery for taxpayers.[88] While the Tax Court presently maintains a pro-government position on the issue of pre-litigation behavior, it can be hoped that it will follow the *Kaufman* analysis in the near future — as it is obligated to do.[89]

While avoiding the issue of pre-litigation behavior, the Tax Court in *Baker* does set some standards for determining the reasonableness of the government's position in the post-litigation period. The opinion provides that an unreasonableness determination should be based on an analysis of all the facts and circumstances of the case after litigation has begun.[90] Also, the fact that the government loses the case is not determinative.[91] The court noted that the underlying controversy was one of first impression and was a factor favoring the government's actions.[92] Moreover, the Tax Court believed the government's timely and thorough investigation of the case should be considered.[93] It appears, therefore, that excessive delays or lack of effort to obtain dispositive evidence on the part of the government could be classified as an unreasonable position.[94]

---

87. *See* Kaufman v. Egger, 584 F. Supp. 872, 877-78 (D. Me. 1984) (government's wrongful conduct included pre-litigation conduct), *aff'd,* 758 F.2d 1 (1st Cir. 1985); *see also* Penner v. United States, 584 F. Supp. 1582, 1583 (S.D. Fla. 1984) (government's initiation of jeopardy assessment considered unreasonable position); Sharpe v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 13,574 (E.D. Va. 1984) (recovery of attorney's fees allowed for both administrative and judicial level when government's position unreasonable); Hallam v. Murphy, 84-1 U.S. Tax Cas. (CCH) ¶ 9230 (N.D. Ga. 1983) (prior time frame to consider government's unreasonableness is throughout entire tax proceeding).

88. *See* Kaufman v. Egger, 758 F.2d 1, 3 (1st Cir. 1985).

89. *See* Golsen v. Comm'r, 54 T.C. 742, 757 (1982) (judicial administration mandates Tax Court to follow decisions of court of appeals).

90. *See* Baker v. Comm'r, 83 T.C. 822, 829 (1984).

91. *See id.* at 828-29.

92. *See id.* at 829. It appears that the Tax Court would view a government position that is contrary to a significant published decision as unreasonable. *Cf. id.* at 829.

93. *See id.* at 829.

94. *Cf. id.* at 830. The district court in *Prudential-Bache Securities* held that delays in reviewing relevant documents within a reasonable time was unreasonable under section 7430. *See* Prudential-Bache Securities, Inc. v. Tranakos, 593 F. Supp. 783, 787 n.4 (N.D. Ga. 1984).

D. *United States Claims Court Decision*

One recent United States Claims Court decision deals with the section 7430 issue. In *Columbus Fruit and Vegetable Coop. v. United States,*[95] the IRS challenged a taxpayer deduction for patronage dividends. When the taxpayer requested a statutory notice of deficiency, the IRS issued that notice without first issuing a preliminary notice of disallowance as required by IRS procedure.[96] The IRS tried to argue that the taxpayer had not exhausted the administrative remedies as required by section 7430(b)(2) because the taxpayer neither filed a written protest or requested an appeals conference. However, the court disagreed because Treasury regulation 301.7430(f)(3)(ii) provides that the taxpayer need not exhaust administrative remedies if the IRS does not issue a preliminary notice of disallowance.[97]

On the issue of whether the government's position in the litigation was unreasonable, the court analyzed the statutory and case law underlying the patronage dividend deduction.[98] The court found that the government's litigation position was unreasonable in light of congressional intent to promote the business venture and methods of the plaintiff.[99] While recognizing that the issue of whether pre-litigation behavior could be considered in an "unreasonableness" determination was important, the United States Claims Court did not address the issue because it believed the government's litigation behavior justified an award of attorney fees to the taxpayer.[100]

III. THE FUTURE

Built into section 7430 was a sunset provision which terminates the availability of awards for attorney fees for actions commenced after December 31, 1985.[101] Even in the event that the coverage of this

---

95. 85-2 U.S. Tax. Cas. (CCH) ¶ 9518 (Cl. Ct. 1985).

96. *See id.* ¶ 9518.

97. *See id.* ¶ 9518 (citing Treas. Reg. § 7430-1(1985))

98. *See id.* ¶ 9518.

99. *See id.* ¶ 9518.

100. *See id.* ¶ 9518. The Court of Claims however did state, in dicta, that a taxpayer should recover only those costs incurred during litigation and not those costs arising from IRS administrative procedures. *See id.* ¶ 9518; *see also* Zielinski v. United States, 84-1 U.S. Tax Cas. (CCH) ¶ 9514 (D. Minn. 1984). The court also limited the taxpayer's attorney to a $75.00 hourly rate. *See* Columbus Fruit and Vegetable Coop. v. U.S., 85-2 U.S. Tax. Cas. (CCH) ¶ 9518 (Cl. Ct. 1985).

101. *See* I.R.C. § 7430(f). The sunset provision of section 7430 states in the pertinent

statute is not extended by Congress, the impact of the provisions of section 7430 will extend for several years until all tax litigation commenced prior to 1986 is finally concluded. Preliminary hearings by the House Ways and Means Select Revenue Measures Subcommittee indicate no opposition to the extension of section 7430 from any of the witnesses, which included, Tax Court judges, the IRS Commissioner, and the assistant attorney general for the tax division of the Department of Justice.[102] There was some disagreement, however, among the witnesses as to potential modifications in the statutory language, especially on the issues of pre-litigation behavior and burden of proof.[103].

In any extended version of section 7430, two matters must be addressed. First, due to the significant split in opinion demonstrated by the previous case analysis, Congress needs to address the issue of whether pre-litigation government behavior can be considered by the court in determining whether the government's position was unreasonable. It is the author's considered opinion that pre-litigation behavior should be considered by all courts in determining the unreasonableness of the government's position. As demonstrated in the *Baker* case, a provision eliminating pre-litigation behavior from consideration would severely restrict the availability of the remedy to taxpayers. Such a severe restriction is contrary to the purposes of providing the remedy. The second matter to be addressed must be funding for the awards. Due to an oversight in the original legislation, no revenue has been appropriated to fund the awards.[104]

IV. CONCLUSION

While section 7430 does provide for the possibility of collecting attorney fees from the government, the standards imposed by the statute and the judiciary make the likelihood of such an award far from certain, even if the taxpayer prevails in the litigation. A recovery is especially difficult in the Tax Court since the court does not consider the government's pre-litigation behavior as an element of the reasona-

---

part: "[t]his section shall not apply to any proceeding commenced after December 31, 1985." *Id.* § 7430(f).

102. *See* BNA DAILY TAX REPORT No. 81 at 2, April 26, 1985.

103. *See id.* at 2-3.

104. *See id.* at 2. House Ways and Means Select Revenue Measures Subcommittee chairman Charles Rangel of New York noted the need for revenue provisions and "promised this matter would be addressed in any extension." *Id.* at 2.

bleness of the government's position. Other federal courts, however, have made the availability of attorney fees more likely by properly considering both pre- and post-litigation government behavior. Tax practitioners should also expect section 7430's provisions to have a continuing impact, despite the section's sunset provision, since a consensus of government representatives, tax professionals, and academicians has agreed that this type of remedy is useful in compensating the few taxpayers who have suffered as a result of unreasonable government behavior. Tax professionals should therefore always keep the availability of this remedy in mind during all stages of confrontation with the government so that an adequate record is preserved in appropriate cases.