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COMMENTS

CAN THE INTERNAL REVENUE SERVICE BE HELD ACCOUNTABLE FOR ITS ADMINISTRATIVE CONDUCT? THE I.R.C. SECTION 7430 FEE RECOVERY CONTROVERSY

I. INTRODUCTION

When the Internal Revenue Service (IRS) takes an unreasonable position regarding liability for past income tax, a taxpayer may find him or herself in a double bind. He or she may find that it is less expensive to simply concede the alleged liability than to defend against it. The IRS has the power to set in motion draconian collection measures if the taxpayer fails to take immediate defensive action.¹ Therefore the taxpayer is forced to either concede or enter into the Internal Revenue Service's lengthy and expensive administrative appeals process.²

When a tax professional is hired to represent the taxpayer in the appeal, fees are added and costs continue to climb. Nevertheless, when the taxpayer finally files suit to resolve the disputed liability, he or she may find the result disillusioning. Depending upon the court and jurisdiction in which the suit is

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1. For an explanation of Internal Revenue Service collection measures see M. SALTZMAN, *IRS Practice And Procedure*, 14-1 - 14-45 (1981 & Supp. 1987). The Internal Revenue Service is the only creditor in the United States which may attach a putative debtor's property and begin collection without first obtaining a court order. Thus in the tax debt situation, payment comes before defense, and the burden of proof, ordinarily borne by the creditor, is shifted to the taxpayer/debtor. *Id.* at 14-4.

2. For an extensive discussion on Internal Revenue Service administrative appeals procedures, see M. SALTZMAN, *supra* note 1, at Chapters 8 (The Examination Function) and 9 (The Appeals Function) (1981 & Supp. 1987).

filed, the taxpayer may not be able to recover the fees and costs incurred in defending against any unreasonable position taken by the Service.³ In some jurisdictions, the courts have, in effect, held that the IRS can adopt an unreasonable position, force a taxpayer through the administrative appeals process and then concede without incurring liability for the taxpayer's fees and costs once a legal action is filed.⁴

This result is currently possible due to the controversy surrounding the interpretation of Internal Revenue Code section 7430 (hereinafter section 7430).⁵ As originally enacted in 1982,

3. The Eleventh and District of Columbia Circuit Courts of Appeals, as well as the Tax Court, have interpreted fee recovery statutes narrowly and have awarded few litigation costs to prevailing taxpayers. *See infra* text accompanying notes 118-155. *See also*, *Baker v. Commissioner*, 787 F.2d 637, 641-42 (D.C. Cir. 1986) (taxpayer's petition for fees pursuant to IRC section 7430 denied); *Ewing v. Heye*, 803 F.2d 613 (11th Cir. 1986) (same); *Walsh v. United States*, 56 A.F.T.R.2d (P-H) 5370 (D. Minn. 1985) (same); *Contini v. United States*, 55 A.F.T.R.2d (P-H) 419 (N.D. Cal. 1984) (same); *Brazil v. United States*, 54 A.F.T.R.2d (P-H) 5707 (D. Or. 1984) (same); *Zielinski v. United States*, 54 A.F.T.R.2d (P-H) 5132 (D. Minn. 1984) (same); *Eidson v. United States*, 53 A.F.T.R.2d (P-H) 841 (N.D. Ala. 1984) (same).

In contrast, the First and Fifth Circuit Courts of Appeal, as well as many of the district courts, have interpreted fee recovery statutes broadly and have been more inclined to award taxpayers fees in the face of the government's unreasonable conduct. *See infra* text accompanying notes 49-88. *See also*, *Powell v. Commissioner*, 791 F.2d 385 (5th Cir. 1986) (holding the administrative position immediately prior to litigation is subject to scrutiny for reasonableness); *Kaufman v. Egger*, 758 F.2d 1 (1st Cir. 1985) (holding that governmental conduct throughout the administrative process should be examined); *Finney v. Roddy*, 617 F.Supp. 997 (E.D. Va. 1985) (same); *Roggeman v. United States*, 85-2 U.S. Tax Cas. (CCH) ¶9473 (N.D. Ill. 1985) (same); *Rosenbaum v. Internal Revenue Service*, 615 F. Supp. 23 (E.D. Va. 1984) (same); *Penner v. United States*, 584 F.Supp. 1582 (S.D. Fla. 1984) (same); *Hallam v. Murphy*, 586 F.Supp. 1 (N.D. Ga. 1983) (same). For a general discussion of the "American Rule" of fee shifting and its progression in tax litigation, see Comment, *Award of Attorney Fees in Tax Litigation*, 19 VAL. U.L. Rev. 153 (1984).

4. *See infra* text accompanying notes 118-155. *See also* *Baker v. Commissioner*, 787 F.2d 637, 641-42 (D.C. Cir. 1986) (holding the court may only consider the reasonableness of the government's position in the civil proceeding, not in the underlying administrative procedure); *Ewing v. Heye* 803 F.2d at 613 (same); *Walsh*, 56 A.F.T.R.2d (P-H) at 5370 (same); *Contini*, 55 A.F.T.R.2d (P-H) at 419 (same); *Brazil*, 54 A.F.T.R.2d (P-H) at 5707 (same); *Zielinski*, 54 A.F.T.R.2d (P-H) at 5132 (same); *Eidson*, 53 A.F.T.R.2d (P-H) at 841 (same).

5. 26 U.S.C. § 7430 (amended by the Tax Reform Act (TRA) of 1986, Pub. L. No. 99-514, § 1551(a)-(g), 1152(a), 100 Stat. 2085, 2752-53) was passed as part of the Tax Equity and Fiscal Responsibility Act of 1982. Pub. L. No. 97-248, (codified at 26 U.S.C. § 7430 (Supp. 1985) (amended 1986)) and provided in pertinent part:

Awarding of court costs and certain fees.

In the case of any civil proceeding which is —

(1) brought by or against the United States in connection with the determination, collection or refund of any tax, inter-

section 7430 provided for the award of attorneys' fees and costs⁶ to a taxpayer in a case brought against the United States when the taxpayer had "substantially prevail[ed]"⁷ and the government's "position . . . in the civil proceeding was unreasonable, . . ."⁸ The difficulty in interpretation stems from the discrepancy between the statute's language and its legislative history.⁹

Prior to the passage of section 7430, a taxpayer who prevailed in a tax case in a district court could petition for fees and costs pursuant to 28 U.S.C. Section 2412(d)(1)(A), the Equal Access to Justice Act (hereinafter EAJA).¹⁰ EAJA mandated that

est 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.

. . . .

7430(c)(2)(A). The term "prevailing party" means any party to any proceeding described in [7430(a)] . . . 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 (emphasis added).

The first portion of this article deals with cases which were decided under § 7430 prior to its amendment by the Tax Reform Act of 1986. Therefore all references to § 7430 are to the prior statute unless otherwise indicated. For a discussion of the effects of this amendment, *see infra* text accompanying notes 182-194.

6. Section 7430 includes reasonable attorneys' fees within the term "costs." 26 U.S.C. § 7430(c)(1)(A)(iv) (Supp. 1986).

7. 26 U.S.C. § 7430(c)(2)(A)(i)(I) (Supp. 1986) (amended by the 1986 TRA *see supra* note 5). To be considered a "prevailing party" under the statute, the taxpayer must first have substantially prevailed with respect to the amount in controversy or as to the main issue in the suit. *Id.* Second, the taxpayer must prove that the government's position was unreasonable. *Id.* This two-pronged definition of "prevailing party" eliminates the presumption that the taxpayer is automatically eligible for recovery of costs if the United States loses the case. *See* H.R. REP. No. 404, 97th Cong., 1st Sess. 10, 11 (1981) ; 127 CONG. REC. 32070, 32077 (1981) [hereinafter cited as H.R. REP. No. 404]. Congress intended that the government "should not necessarily be penalized for the reasonable pursuit of debatable tax issues. Tax administration would be ineffective if the Government conceded all close cases to the taxpayer in order to avoid payment of fee awards." *Description of Law and Bills Relating to Awards of Attorney's Fees in Tax Cases*, Joint Comm. on Taxation, 97th Cong., 1st Sess. 11 (1984).

8. 26 U.S.C. § 7430 (c)(2)(A)(i) (Supp. 1985) (26 U.S.C. § 7430 is referred to hereinafter as I.R.C. § 7430).

9. *See infra* notes 23-35 and accompanying text.

10. Pub. L. No. 96-481, 94 Stat. 2325 (1980) (codified in scattered United States Code Sections, including Titles 5, 28, and 48). EAJA was enacted to expand the liability

courts award fees and costs to the prevailing taxpayer if the government's position was not "substantially justified."¹¹

When Congress passed the Tax Equity and Fiscal Responsibility Act of 1982, it added section 7430 intending it as the controlling statute for attorneys' fee awards in all tax cases, regardless of the forum chosen.¹² EAJA was never applicable to cases brought in the United States Tax Court because EAJA, as a Title 28 statute, pertained exclusively to courts established pursuant to Article III of the United States Constitution.¹³ The United States Tax Court was established under Article I of the Constitution.¹⁴ Therefore, a taxpayer who sued in a Federal district court or the United States Claims Court could recover fees pursuant to EAJA, but a taxpayer who sued in the Tax Court could not.¹⁵ Congress intended section 7430 to remedy this inequity and provide for "one set of rules [to] apply to awards of litigation costs in tax cases whether the action is brought in a U.S. district court, the Court of Claims, or the U.S. Tax Court."¹⁶

Section 7430 provides,¹⁷ in general, that in any civil tax proceeding against the United States, a prevailing party, other than

of the United States for attorneys' fees and other expenses in all governmental administrative proceedings and civil actions. In this way Congress intended to encourage citizens with legitimate causes of action to litigate against the United States regardless of their financial circumstances. Any citizen who prevails in a dispute with any official or agency of the government may petition the court for fees pursuant to 28 U.S.C. § 2412 (e)(2)(C). If the government cannot prove that its position was substantially justified, the court must award the fees unless special circumstances make the award unjust. H.R. REP. NO. 120, 99th Cong., 1st Sess. 3, 4-8 (1985).

11. 28 U.S.C. § 2412(d)(1)(A) (Supp. 1987). Amended Aug. 5 1985, Pub. L. No. 99-80, § 2(c)(2), 99 Stat. 183, 185 (codified at 28 U.S.C. § 2412(d)(2)(D)). See also H.R. REP. NO. 120, 99th Cong., 1st Sess. *supra* note 10, at 11.

12. See Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, 96 Stat. 324, 572-74 (1982) (codified as amended at I.R.C. § 7430 (Supp. 1985)); see also H.R. REP. NO. 404, *supra* note 7, at 11.

13. See, e.g., Northern Pipeline Co. v. Marathon Pipe Line Co., 458 U.S. 50, 87 (1982) (bankruptcy courts are non-Article III courts and therefore Title 28 is not applicable). See also Nash Miami Motors, Inc. v. Commissioner, 358 F.2d 636, 637 (5th Cir.), *cert denied*, 385 U.S. 918 (1966) (holding that the tax court is a non-Article III court and instead is a Article I legislative court). See also H.R. REP. NO. 404, *supra* note 7, at 11.

14. See H.R. REP. NO. 404, *supra* note 7, at 12 n.1.

15. See *supra* note 13.

16. H.R. REP. NO. 404, *supra* note 7, at 11.

17. I.R.C. § 7430 was amended by the Tax Reform Act of 1986. See *supra* note 5. The current dollar limitation for attorneys' fee awards under § 7430 is \$75.00 per hour. For a discussion of the changes made in § 7430 by the TRA, See *infra* note 183.

the United States, may be awarded reasonable litigation costs.¹⁸ A “prevailing party” as defined by section 7430, is a party who has substantially prevailed with respect to the amount in controversy¹⁹ or as to the most significant issue[s] presented.²⁰ Additionally, the prevailing party must have established that the “position of the United States in the civil proceeding was unreasonable.”²¹ A costs award under section 7430 includes reasonable court costs, attorneys’ fees, expert witness fees, and any necessary studies, engineering reports, tests or projects.²²

The section’s legislative history reveals that it was added to the tax code to “deter abusive actions or overreaching by the Internal Revenue Service and [to] enable individual taxpayers to vindicate their rights regardless of individual circumstances.”²³ This statement demonstrates a recognition of the power the IRS wields and its potential for abuse. It also demonstrates Congressional awareness of the comparatively ineffective position occupied by a taxpayer facing the IRS bureaucracy. The legislative history, however, makes it clear that section 7430 was not designed to open the floodgates for fee recovery from the IRS.²⁴ To provide some protection against a perceived flood of frivolous claims, Congress limited the awarding of fees under section 7430 to those cases where the government acted “unreasonably.”²⁵ In contrast, to recover fees under EAJA, the government’s conduct must be “not substantially justified.”²⁶ Additionally, Congress placed the taxpayer suing under section 7430 at a disadvantage by imposing the burden of proving the unreasonableness of the government’s position upon the taxpayer.²⁷ EAJA places on the government the affirmative burden of proving that its conduct was substantially justified.²⁸

18. I.R.C. § 7430(a). Awards under § 7430 before its 1986 amendment were limited to \$25,000. I.R.C. § 7430(B)(1).

19. I.R.C. § 7430(c)(2)(a)(ii)(I) (Supp. 1985).

20. I.R.C. § 7430(c)(2)(a)(ii)(II) (Supp. 1985).

21. I.R.C. § 7430(c)(2)(A)(i) (Supp. 1985). See H.R. REP. No. 404, *supra* note 7, at 11.

22. I.R.C. § 7430(c)(1) (Supp. 1985).

23. See H.R. REP. No. 404, *supra* note 7, at 11.

24. *Id.*

25. *Id.* See also I.R.C. § 7430(c)(2)(A)(i) (Supp. 1985).

26. 28 U.S.C. § 2412(e)(3) (Supp. 1987).

27. I.R.C. § 7430(c)(2)(A)(i) (Supp. 1985).

28. 28 U.S.C. § 2412(d)(1) (Supp. 1987).

As another safeguard to keep claims from proliferating, the legislation requires that a taxpayer suing for fees must have "exhausted the administrative remedies" available before he or she is eligible for recovery.²⁹ This requirement is designed to encourage taxpayers to resolve tax disputes without litigation.³⁰ The administrative appeals process, however, is lengthy, complicated and vulnerable to abuse by IRS agents.³¹ Because of the complexity and intimidating nature of the appeals procedure, many taxpayers obtain professional assistance. Nevertheless, the Ways and Means Committee, in its report on section 7430, stated that:

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 recoverable under an award of litigation costs.³²

Given the committee's stated intent that section 7430 "deter abus[e] [and] overreaching"³³ by the IRS, it is difficult to understand this apparent prohibition against awarding attorneys' fees for services performed while in the administrative appeals process.³⁴ The abuse and harassment which section 7430 was enacted to deter is more likely to occur during the administrative process³⁵ and, may be what ultimately causes taxpayers

29. I.R.C. § 7430(b)(2) (Supp. 1985). See also H.R. REP. No. 404, *supra* note 7, at 13.

30. See H.R. REP. No. 404, *supra* note 7, at 11.

31. *Id.*

32. *Id.* at 14.

33. *Id.* at 11.

34. See I.R.C. § 7430 (b)(2) (Supp. 1985); H.R. REP. No. 404, *supra* note 7, at 11.

35. The committee implicitly recognized this fact when it presented the factors to be taken into account when a court is considering awarding fees:

(1) whether the government used the costs and expenses of litigation against its position to extract concessions from the taxpayer that were not justified under the circumstances of the case, (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.

H.R. REP. No. 404 *supra* note 7, at 12.

While these particular abuses could conceivably occur after the filing of the civil action, the most likely time the IRS is going to "extract concessions" or unreasonably

to file suit. Given a literal reading of the committee report, either the only abuses which can be punished are those occurring after an action is filed, or there are contradictions in the intent, goals and requirements of section 7430.

II. THE SPLIT AMONG THE CIRCUITS

The ambiguities present in section 7430's legislative history have made judicial interpretation a difficult task. Therefore, no consistent interpretation has occurred to date.³⁶ The First, Fifth and Ninth Circuit Courts of Appeals³⁷ have rejected the notion that the IRS is not accountable for unreasonable conduct which occurs prior to "litigation." They have found it to be unacceptable and contrary to legislative intent.³⁸ Thus, some courts have held that the prelitigation conduct of the IRS can be considered in fee awards.³⁹ This approach is consistent with the legislative intent to deter abuse, because abuses can occur at the administrative level.⁴⁰

In contrast, the Eleventh and the District of Columbia Circuit Courts of Appeals have held that prelitigation conduct may not be considered when awarding fees.⁴¹ These courts support their position with a strict interpretation of the statutory language and the above-quoted passage from the committee

"pursue" the litigation for harassment purposes, is during settlement negotiations, prior to the filing of the suit. See Comment, *Tax Litigation and Attorney's Fees: Still a Win-Lose Dichotomy*, 57 S. CAL. L. REV. 471, 486 (1984) (discussing the committee's suggested factors to be taken in account when awarding fees). Such actions would force taxpayers to settle their dispute at the administrative level to avoid the cost and aggravation or embarrassment of litigating against the government. H.R. REP. No. 404 *supra* note 7, at 12.

36. See *supra* note 3 and accompanying text. See *infra* text accompanying notes 37-42.

37. *Powell v. Commissioner*, 791 F.2d 385 (5th Cir. 1986) (holding the administrative position immediately prior to litigation is subject to scrutiny for reasonableness); *Kaufman v. Egger*, 758 F.2d 1 (1st Cir. 1985) (holding that governmental conduct throughout the administrative process should be examined); *Sliwa v. Commissioner*, 839 F.2d 602 (9th Cir. 1988) (holding that prelitigation administrative conduct should be examined for reasonableness).

38. *Id.* See *infra* text accompanying notes 49-88.

39. See *supra* note 37.

40. See *supra* note 35 and accompanying text.

41. See *Baker v. Commissioner*, 787 F.2d 637 (D.C. Cir. 1985); *Ewing v. Heye*, 803 F.2d 613 (11th Cir. 1986). See also *supra* note 3.

report.⁴²

The area which may generate the most controversy when dealing with section 7430 is the "last known address" case scenario.⁴³ The last known address situation appears when the IRS attempts to notify a taxpayer of an alleged deficiency by mailing a statutory deficiency notice to an address where the taxpayer neither lives nor receives mail.⁴⁴ The taxpayer never receives the notice and the statutory time to respond runs out.⁴⁵ Thus in last known address cases the statutory notices fail to reach the taxpayer and the IRS begins collection without the taxpayer ever being notified of the alleged deficiency.⁴⁶ When the taxpayer learns of the alleged deficiency, collection efforts have already begun, and the taxpayer's only options are to file suit asking for an injunction to halt the collection procedures or to file a Tax Court petition.⁴⁷ Because the taxpayer never knew about the administrative proceedings, he or she never attempted to exhaust the administrative remedies. Therefore, the taxpayer cannot comply with the technical requirements of section 7430.⁴⁸

A. FIRST CIRCUIT COURT OF APPEALS

The First Circuit, in *Kaufman v. Egger*,⁴⁹ held that prelitigation conduct may be considered by the court when assessing the reasonableness of the government's conduct.⁵⁰ The court found that the government's conduct in dealing with the Kaufmans was unreasonable by any standard.⁵¹

The government's initial contact with the Kaufmans was to send an audit notice to a former address approximately one year

42. See *supra* text accompanying note 32.

43. See *infra* text accompanying notes 52-56.

44. I.R.C. § 6212 (1986) requires that the Statutory Notice of Deficiency be sent to the taxpayer's last known address. See also M. SALTZMAN, *IRS PRACTICE AND PROCEDURE*, 10-12 - 10-13 (1981 & Supp. 1987).

45. See *generally* text accompanying notes 52-56.

46. *Id.*

47. See *infra* notes 55-59 and accompanying text.

48. I.R.C. § 7430(b)(2) (1986) requires that administrative remedies be exhausted before a taxpayer is eligible to recover costs under the section.

49. 758 F.2d 1 (1st Cir. 1985).

50. *Id.* at 4.

51. *Id.*

after they had moved.⁵² When the Kaufmans failed to appear at the audit, the IRS assessed a tax of \$14,380.⁵³ The IRS mailed both a Notice of Proposed Adjustment and the Statutory Notice of Deficiency to an address where the Kaufmans had never lived.⁵⁴ In 1983, the IRS notified the Kaufmans that their 1982 tax refund had been seized to pay some of the prior tax liability.⁵⁵ Subsequently, they received a notice instructing them to contact the local IRS to arrange for installment payments on their remaining liability.⁵⁶

Thereafter, the Kaufmans filed suit in the United States district court for injunctive relief and for the return of their 1982 refund.⁵⁷ Two months after the Kaufmans filed their suit, the IRS stipulated to the issuance of a permanent injunction prohibiting it from any further collection activity based on the invalidly issued Deficiency Notice.⁵⁸ The district court awarded the Kaufmans attorneys' fees and the IRS appealed.⁵⁹

The First Circuit stated that the Kaufmans' situation was an example of the "unnecessary tribulations that can be brought to bear upon the unsuspecting citizenry by today's computerized bureaucracy."⁶⁰ The court went on to make it clear that taxpayers need not absorb the costs of initiating a suit that, but for the unreasonable conduct of the IRS, they would never have filed.⁶¹

52. *Id.* at 2.

53. *Id.*

54. *Id.* Eleven days later the IRS acknowledged its error and noted in the Kaufmans' file that the Statutory Deficiency Notice had been sent to the wrong address. During this same time, the IRS was corresponding with the Kaufmans at their correct address, on another unrelated tax matter. *Id.* at 2 n.2. This situation typifies the "last known address" case. *See supra* text accompanying notes 43-48.

55. *Kaufman*, 759 F.2d at 2.

56. *Id.*

57. *Id.* The government argued that the Kaufmans had failed to exhaust the administrative remedies provided by the IRS as required by § 7430(b)(2) (Supp. 1985) because they had immediately filed suit. *Id.* The court held that the Kaufmans were not precluded from receiving an award of costs, because the alleged deficiency had already been referred to collections. *Id.* at 3. Moreover, the court found that the Kaufmans fell within an exception to that requirement set forth in a treasury regulation (26 C.F.R. § 301.7430-1-f(3)(ii)(1986)), and therefore the IRS, through its own regulations, exempted the Kaufmans from that requirement. *Kaufman*, 758 F.2d at 2-3.

58. *Id.* at 2.

59. *Id.*

60. *Id.* at 1.

61. *Id.* at 1-2. "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

The court stated that the intent of Congress in passing section 7430 was, an attempt to “grant the public some relief from such bungling.”⁶²

The main issue before the court was whether the government’s behavior prior to the institution of litigation could be considered in determining the unreasonableness of its behavior in the section 7430 context. After acknowledging the split on the issue in the opinions to date, the First Circuit held that prelitigation conduct may be considered because “it is in keeping with Congress’ remedial bias in enacting this statute.”⁶³ The court concluded that the district court did not err in scrutinizing the government’s prelitigation conduct to determine its reasonableness.⁶⁴ While stating that the conduct of the IRS in the *Kaufman* case was “unreasonable by any standard,”⁶⁵ the court did not articulate any definitive test for unreasonableness. Instead, the court simply stated that interpreting section 7430 in any other way would frustrate Congressional intent.⁶⁶ Thus, the controlling interpretation of section 7430 in the First Circuit is that taxpayer entitlement to fees is triggered by unreasonable IRS conduct, regardless of the stage in the proceedings.⁶⁷

B. FIFTH CIRCUIT COURT OF APPEALS

The Fifth Circuit’s entry into the section 7430 controversy came with *Powell v. Commissioner*.⁶⁸ In *Powell*, the taxpayer received an assessment on an uncontested 1976 liability with the understanding that collection would be curtailed until the audit of an underlying tax shelter was completed.⁶⁹ To protect its position for the 1977 year, the IRS issued a statutory notice using an alternate theory with respect to the indebtedness connected with the tax shelter.⁷⁰ Taxpayer filed a petition for the 1977 year. Ultimately the parties settled the dispute for both the 1977

bureaucracy.” *Kaufman*, 758 F2d. at 1.

62. *Id.* at 1-2.

63. *Id.* at 4.

64. *Id.* at 3.

65. *Id.* at 4.

66. *Id.*

67. *Id.*

68. 791 F.2d 385 (5th Cir. 1986).

69. *Id.* at 386-87.

70. *Id.* at 387.

and 1976 years by stipulating to a \$15,000 deficiency for the 1976 year and a dismissal of the 1977 case.⁷¹ Powell's position in seeking attorneys' fees was that the government was unreasonable in issuing the 1977 statutory notice before he had an opportunity to address the 1976 settlement offer.⁷²

The Fifth Circuit, analyzing section 7430 and analogizing its parallel EAJA provisions,⁷³ held that the conduct of the IRS at the time the suit was filed should be examined to ascertain the reasonableness of the government's conduct.⁷⁴ The test is in the nature of a proximate cause test.⁷⁵ The court reasoned that if unreasonable IRS conduct proximately caused the taxpayer to file suit and if the other prerequisites of section 7430 were met, the taxpayer could recover fees.⁷⁶ The court went on to justify this perspective by stating that "[t]his reading of section 7430 allows tax litigants to recover the costs of a civil proceeding they never should have been required to initiate."⁷⁷

The most intriguing part of the Fifth Circuit's opinion is its use of EAJA as an interpretative guide. The court began its comparison by noting that section 7430 "by and large places taxpayers at a disadvantage."⁷⁸ The opinion went on to directly analogize to EAJA, despite its much lighter burden of proof on the citizen litigating against the government.⁷⁹ The court reasoned that the shifting of the burden of proof to the taxpayer was enough of a disadvantage, making the additional disadvantage of narrowly interpreting the language of the statute unnecessary.⁸⁰

In acknowledging the parallels between EAJA and section 7430, the court reasoned that the legislative intent behind them was similar.⁸¹ It held that "Congress' retroactive interpretation

71. *Id.*

72. *Id.* at 387-88.

73. 28 U.S.C. § 2412(d)(1)(A) (1982) (repealed 1984).

74. *Powell*, 791 F.2d at 391-92.

75. *Id.* at 388.

76. *Id.* at 391-92.

77. *Id.* at 392.

78. *Id.* at 390.

79. *Id.* at 390-91.

80. *Id.* at 390.

81. *Id.* at 390-91.

of the phrase ['position of the United States'] in EAJA should be equally applicable to section 7430, even though Congress amended only EAJA"⁸²

The Fifth Circuit formulated an appealing rationale for examining prelitigation conduct when awarding fees. It reasoned that if an administrative position adopted by the IRS forced a taxpayer to file an action, it would be incongruous for section 7430 to require courts to ignore the unreasonable position underlying the taxpayer's action.⁸³

The Fifth Circuit's decision in *Powell* is not as broad as the First Circuit's opinion in *Kaufman*. The *Powell* court saw a need to examine only the highest administrative position adopted by the government immediately prior to the filing of the taxpayer's suit.⁸⁴ If that administrative position was unreasonable and proximately caused the litigation, then a court may award fees and costs.⁸⁵

In contrast, the *Kaufman* court examined the conduct of the IRS throughout the administrative proceedings.⁸⁶ It held that if the government's conduct was unreasonable, regardless of the stage in the proceedings, the taxpayer could recover fees.⁸⁷ This holding ignores the legislature's obvious concern regarding the case load of the Tax Court.⁸⁸ It also places an additional burden on the judiciary. Instead of merely scrutinizing the government's position immediately prior to the filing of the taxpayer's action, courts in the First Circuit must study the administrative conduct of the IRS throughout the proceedings.

82. *Id.* In 1985, Congress amended EAJA to make it clear that the "position of the United States" included "the action or failure to act by the agency upon which the civil action is based." Act of Aug. 5, 1985, Pub. L. No. 99-80, § 2(c)(2), 99 Stat. 183, 185 (codified at 28 U.S.C. § 2412(d)(2)(D)(1987)).

83. *Powell*, 791 F.2d at 391.

84. *Id.* at 392.

85. *Id.*

86. *See supra* text accompanying note 67.

87. *See supra* text accompanying notes 65-67.

88. *See* H.R. REP. No. 404, *supra* note 7, at 11.

C. NINTH CIRCUIT COURT OF APPEALS

The Ninth Circuit recently took the opportunity to interpret section 7430 in the case of *Sliwa v. Commissioner*.⁸⁹ *Sliwa* was a last known address case⁹⁰ where there was substantial legal activity between the issuance of a first invalid notice of deficiency, the issuance of a second, valid, notice of deficiency and the filing of a Tax Court petition.⁹¹

After the petition was filed the case went to the Appeals Division for settlement negotiations.⁹² At a hearing in September of 1985 the Tax Court took *Sliwa's* request for formal discovery under advisement.⁹³ Thereafter the Commissioner conceded all the issues in the case and, in November of 1985, stipulated to a dismissal of the Notice of Deficiency.⁹⁴ Petitioner then requested that the court award litigation costs under section 7430.⁹⁵ The Tax Court denied the motion and *Sliwa* appealed.⁹⁶ The Ninth Circuit reviewed the case de novo, as a case of first impression regarding statutory interpretation.⁹⁷

The Ninth Circuit began its discussion with an overview of the other circuits' interpretations of the statute.⁹⁸ After comparing the reasoning behind the differing interpretations of the statute, the Ninth Circuit stated that a restrictive interpretation of the phrase "in the civil proceeding" would "undermin[e] the legislative intent . . ."⁹⁹ of the statute.

The Ninth Circuit, like the *Powell* and *Kaufman* courts, held that prelitigation administrative conduct could be scrutinized for unreasonableness when determining whether or not to award fees against the government.¹⁰⁰ It reasoned that "[i]f the

89. 839 F.2d 602 (9th Cir. 1988).

90. *Id.* at 603.

91. *Id.* at 603-604.

92. *Id.* at 604.

93. *Id.*

94. *Id.*

95. *Id.* at 604-605.

96. *Id.* at 605.

97. *Id.*

98. *Id.* at 606-607.

99. *Id.* at 607.

100. *Id.*

conduct of the government at later administrative levels is unreasonable, it stands to reason that the position of the government in defending in the civil proceeding in the first place may be unreasonable as well if based upon that conduct."¹⁰¹ Significantly, the Ninth Circuit echoed the *Powell* court's analysis regarding unreasonable administrative positions at higher levels.¹⁰² The statement above largely paraphrases the "proximate cause" analysis utilized in *Powell*.¹⁰³ If the government's unreasonable conduct causes a taxpayer to file suit, the government should be liable for the costs the taxpayer incurred in bringing that suit.¹⁰⁴

An important distinction between the Ninth Circuit's decision in *Sliwa* and the decisions in *Kaufman* and *Powell* is that the Ninth Circuit bifurcated the issues of reasonableness and fee recovery.¹⁰⁵ The Ninth Circuit held that unreasonable conduct triggered the provisions of section 7430, regardless of the stage in the proceedings.¹⁰⁶ However, the court also held that only the "costs and fees actually incurred in and after preparing and filing the petition in the tax court, were recoverable under the statute."¹⁰⁷ This distinction is significant, first, because it fulfills the goals set out in the legislative history¹⁰⁸ and second, because it maintains the narrow focus of section 7430's statutory language.¹⁰⁹

In a footnote,¹¹⁰ the Ninth Circuit indicated that they believed that this interpretation of section 7430 was in accord with the amendment of section 7430 by the Tax Reform Act of 1986.¹¹¹ The court conceded that the 1986 amendment of section 7430 did not control in *Sliwa* but stated that it "shed light" on the intent of Congress in passing the statute.¹¹² Thus, the Ninth

101. *Id.*

102. *Id.* See *supra* text accompanying notes 84-85.

103. See *supra* notes 73-77 and accompanying text.

104. *Id.* See also *Sliwa*, 839 F.2d at 607.

105. *Sliwa*, 839 F.2d at 607. The court held that unreasonable administrative behavior triggered cost recovery, but that only costs incurred in and after preparing the petition could be recovered. *Id.*

106. *Id.*

107. *Id.*

108. See *supra* text accompanying note 23.

109. See *supra* text accompanying notes 24-32.

110. *Sliwa*, 839 F.2d at 607 n.6.

111. *Id.* See also *infra* notes 182-189 and accompanying text.

112. *Sliwa*, 839 F.2d at 607 n.6.

Circuit's interpretation of section 7430 should not change dramatically when applying the amended statute.¹¹³

In contrast, the *Kaufman* and *Powell* courts did not delineate the point at which taxpayers could recover fees for representation during the administrative process, if the position of the IRS was unreasonable.¹¹⁴ Both courts treated the reasonableness and threshold of recovery issues as a single issue.¹¹⁵ In doing so, they interpreted the statute very broadly, and failed to take into consideration the narrow focus of the statute's language.¹¹⁶ The Ninth Circuit's decision adopts the analytical approach presented by the Fifth Circuit in *Powell* and refines it in an attempt to comport with the statute's narrow language.¹¹⁷

D. DISTRICT OF COLUMBIA CIRCUIT COURT OF APPEALS

The District of Columbia interpreted section 7430 much more narrowly when it decided *Baker v. Commissioner*.¹¹⁸ In *Baker*, the taxpayer, who worked in Saudi Arabia, was required to live in restricted quarters.¹¹⁹ Baker took an exclusion from his gross income for those quarters, as allowed by section 911 of the Internal Revenue Code.¹²⁰

In 1982, the IRS audited Baker's returns, along with those of two taxpayers in identical situations.¹²¹ The IRS disallowed Baker's exclusion, while dismissing the cases against the others.¹²² Baker informed the IRS of the identical cases and of their results.¹²³ The Appeals Office denied that the outcome of the other identical cases had any bearing upon Baker's situation.¹²⁴ Soon after Baker hired an attorney and filed a petition in

113. *Id.*

114. *See*, *Kaufman v. Egger*, 758 F.2d 1, 4 (1st Cir. 1985) and *Powell v. Commissioner*, 791 F.2d 385, 391-392 (5th Cir. 1986).

115. *See supra* text accompanying notes 63-67 and 83-85.

116. *See supra* text accompanying notes 24-32.

117. *Sliwa* 839 F.2d at 607.

118. 787 F.2d 637 (D.C. Cir. 1986).

119. *Id.* at 638-39.

120. *Id.* at 639.

121. *Id.*

122. *Id.* at 639-40.

123. *Id.*

124. *Id.* at 640.

Tax Court, the IRS signed a stipulation which acknowledged that its disallowance of Baker's exclusion was wrong.¹²⁵ Baker then requested, pursuant to section 7430, that the Tax Court award him the costs he incurred in bringing his suit.¹²⁶

The District of Columbia (D.C.) Circuit Court held that only the reasonableness of the "position of the United States in the civil proceeding [commenced by Baker's petition]" should be considered when deciding whether or not to award costs.¹²⁷ The court concluded that the language and legislative history of section 7430 both mandated that recovery of costs begin only after litigation had begun.¹²⁸

In reaching its conclusion the D.C. Circuit looked to EAJA for guidance in interpreting section 7430.¹²⁹ Unlike the Fifth Circuit, however, this court distinguished EAJA, stating that the congressional amendment of EAJA in 1985, which broadened the language,¹³⁰ evidenced the congressional intent that section 7430 have "a focus narrower than EAJA's."¹³¹ The court then stated that it believed the test articulated in *Spencer v. NLRB*,¹³² ironically, an EAJA case, should guide the disposition of fees under section 7430.¹³³ The *Spencer* test provides that when a petitioner has been subjected to atypically harsh treatment, the government must produce a particularly strong justification for its position.¹³⁴

This test ignores the burden of proof requirement of section 7430, which clearly places the taxpayer in the position of proving that the government's position was unreasonable.¹³⁵ Thus in the D.C. Circuit, courts addressing fee awards in tax cases must determine whether the taxpayer has been subjected to "atypically harsh treatment."¹³⁶ If the court is satisfied that the IRS has

125. *Id.*

126. *Id.*

127. *Id.* at 644.

128. *Id.* at 641.

129. *Id.* at 641-42.

130. *See supra* note 82.

131. *Baker*, 787 F.2d at 641-42 n.8.

132. 712 F.2d 539 (D.C. Cir. 1983), *cert denied*, 466 U.S. 936 (1984).

133. *Baker*, 787 F.2d at 643.

134. *Id.* (citing *Spencer*, 712 F.2d at 561).

135. *Baker*, 787 F.2d at 643. *See also*, I.R.C. § 7430(c)(2)(A)(i) (Supp. 1985).

136. *Baker*, 787 F.2d at 643 (citing *Spencer*, 712 F.2d at 561).

sufficiently abused the taxpayer, the burden to produce a “particularly strong” justification for its actions shifts to the government.¹³⁷ This analysis is quite unlike that used in any other jurisdiction for section 7430 questions.

E. ELEVENTH CIRCUIT COURT OF APPEALS

In *Ewing v. Heye*,¹³⁸ the Eleventh Circuit decided the case of a taxpayer who could not convince the IRS to release a lien.¹³⁹ The taxpayer had satisfied the obligation secured by the lien, but the government had not released it, despite the statutory requirement that such a lien be released within thirty days of satisfaction.¹⁴⁰ When the taxpayer filed suit, the government investigated its case and promptly conceded.¹⁴¹

The taxpayer then requested reimbursement for the costs incurred in both the administrative proceedings and in bringing its suit in the district court.¹⁴² The district court denied the taxpayer’s request because the government had acted reasonably since the petitioner filed his complaint.¹⁴³ It conceded its case.¹⁴⁴ The district court held that administrative proceedings were not the civil proceedings referenced by section 7430.¹⁴⁵

On appeal to the Eleventh Circuit, the taxpayer conceded that “costs and attorneys [sic] fees may not be awarded for pre-litigation administrative proceedings.”¹⁴⁶ Therefore, the main issue before the court of appeals should have been whether the district court properly found the in-court litigating posture of the IRS to be reasonable.¹⁴⁷ Instead, the court stated, “[t]he sole question before the court is whether the district judge correctly

137. *Id.*

138. 803 F.2d 613 (11th Cir. 1986)

139. *Id.* at 614.

140. 26 U.S.C. § 6325(a)(1) (1967 and Supp. 1987) (requiring that IRS liens be released within thirty days of satisfaction).

141. *Ewing*, 803 F.2d at 614.

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.*

146. *Id.* at 614 n.1 (citing Appellant’s Reply Brief at 3-4).

147. *Id.*

determined that the government's position in the administrative proceedings could not be examined to determine the reasonableness of the government's position 'in the civil proceeding.'"¹⁴⁸

The court went on to discuss the differences in interpretation of section 7430 among the circuits. It concluded that "the denial of attorneys' fees and costs in the instant case may well be 'unfair,'"¹⁴⁹ but that nevertheless section "7430 as drafted by Congress, does not allow for such an award."¹⁵⁰ The court held that they could not scrutinize administrative conduct occurring prior to the filing of a legal action or award fees incurred during such an administrative proceeding.¹⁵¹ While this holding was unnecessary to determine the issues presented in the case, it is nevertheless the controlling precedent for the Eleventh Circuit.

The *Ewing* court criticized the *Kaufman* and *Powell* decisions as attempts to judicially amend an imperfectly drafted statute.¹⁵² While sympathetic to the plight of taxpayers forced into administrative appeals proceedings, the opinion states that "Congress would have been explicit if it had intended to provide attorney fee relief for proceedings prior to the 'civil proceedings.'"¹⁵³ The opinion criticizes the analysis in *Powell*, stating that *Powell's* use of the 1985 amendment of EAJA to infer Congressional intent that section 7430 apply to administrative proceedings was "totally unconvincing."¹⁵⁴ Yet, neither the Eleventh Circuit in *Ewing* nor the D.C. Circuit in *Baker* give a reasonable explanation as to how Congress expected to "deter abusive overreaching"¹⁵⁵ by the IRS, if it also intended to limit awards of fees and costs to cases of in-court unreasonableness.

III. ANALYSIS

The examples of unreasonable conduct outlined by Congress in its Committee Reports are much more likely to occur prior to

148. *Id.*

149. *Id.* at 616.

150. *Id.*

151. *Id.* 615-16.

152. *Id.* at 616.

153. *Id.* at 615 (citing the district court order at 2-3).

154. *Id.*

155. See H.R. REP. No. 404, *supra* note 7, at 11.

the filing of a suit.¹⁵⁶ Nevertheless, the Eleventh and D.C. Circuits have been willing to abandon the goal of vindicating taxpayers' rights and deterring IRS abuses¹⁵⁷ by adhering to a strict interpretation of section 7430.¹⁵⁸ They have largely ignored the factors the committee suggested be taken into account when considering awarding fees,¹⁵⁹ and have failed to explain how such factors might arise in an in-court proceeding.

An additional question not dealt with by the *Baker* and *Ewing* opinions is the language in the statute which immediately proceeds the controversial language "position of the United States in a civil proceeding."¹⁶⁰ Section 7430(c)(2)(B)(3) states: "The term 'civil proceeding' includes a civil action."¹⁶¹ Both the Eleventh¹⁶² and D.C.¹⁶³ Circuits seem to have assumed that "civil proceeding" was synonymous with "civil action." However, if the terms mean the same thing, it is somewhat odd for Congress to have included them both.

Another pertinent inquiry in this regard is, if a civil action is included within the term "civil proceeding," what else is included in the term?¹⁶⁴ Given the subsequent amendments to section 7430 to further conform it to EAJA,¹⁶⁵ a persuasive argument could be made that Congress intended administrative proceedings to be included within the term civil proceeding.

At the opposite extreme, the First and Fifth Circuits seem ready to ignore altogether the narrow language that Congress used to limit recovery under § 7430.¹⁶⁶ The Ninth Circuit in

156. *See supra* note 35.

157. *See supra* note 7 and accompanying text.

158. *See supra* text accompanying notes 127-131 and 148-151.

159. *See supra* note 35.

160. I.R.C. § 7430 (c)(2)(B)(4) (Supp. 1985).

161. I.R.C. § 7430 (c)(2)(B)(3) (Supp. 1985).

162. *Ewing*, 803 F.2d at 615.

163. *Baker*, 787 F.2d at 641-42.

164. The following factors support the conclusion that the legislature intended that courts consider administrative conduct when deciding whether or not to award fees under § 7430: (1) the legislative goals of deterring abuse and overreaching by the IRS (*see* H.R. REP. NO. 404, *supra* note 7, at 11); (2) the factors the committee suggested courts use when considering awarding fees under § 7430 (*see supra* note 35 and accompanying text); and (3) the subsequent amendment of section 7430 to bring its language closer to EAJA (*see infra* notes 183-190 and accompanying text).

165. *See supra* notes 183-190.

166. *See supra* text accompanying notes 63-67 and 73-82.

Sliwa adopted the proximate cause reasoning of the *Powell* decision and then refined it to accommodate the narrow language of section 7430.¹⁶⁷ By scrutinizing prelitigation conduct for reasonableness, the Ninth Circuit seeks to deter “abus[e] and overreaching” by the IRS.¹⁶⁸ By only allowing recovery for those fees incurred in and after preparing the petition, they limit recovery as mandated by the statute’s narrow language.¹⁶⁹

Congress passed section 7430 to give taxpayers a chance to vindicate their rights against the IRS¹⁷⁰ and to deter IRS abuses.¹⁷¹ However, they also drafted section 7430 in a way intended to deter spurious taxpayer suits¹⁷² and to force taxpayers to utilize fully the administrative appeals procedures of the IRS.¹⁷³ In so doing, Congress attempted to provide taxpayers who had been abused by the system, rather than merely inconvenienced, with a way to vindicate their rights. Section 7430 was intended to eliminate the situation in which an innocent taxpayer simply gives in and pays the deficiency because the expense of an appeal is more than the alleged deficiency.¹⁷⁴

It is unjust, regardless of the interpretation of section 7430, to allow the IRS to force a taxpayer to incur costs in the appeals process and then concede its case without liability immediately upon the filing of a legal action. Moreover, it is contrary to the stated legislative intent and the spirit of section 7430. Yet this is the conclusion reached by the Eleventh and D.C. Circuits. For courts to read section 7430 in such a restricted manner is to encourage the very abuse and overreaching which Congress sought to deter by enacting the statute.

The *Sliwa* opinion came the closest to balancing the section’s limiting language with its policy goals.¹⁷⁵ Unlike *Kaufman*,

167. *Sliwa v. Commissioner*, 839 F.2d 602, 607 (9th Cir. 1988).

168. *Id.* “If [§ 7430] is to have any bite at all, courts must be permitted to look to earlier conduct to determine whether the initial filing of a tax petition was provoked by unreasonable conduct.” *Id.*

169. *Id.*

170. See H.R. REP. NO. 404, *supra* note 7, at 11.

171. *Id.*

172. *Id.* at 15.

173. *Id.* at 13.

174. See Schmalbeck & Myers, *A Policy Analysis of Fee-Shifting Rules Under The Internal Revenue Code*, 1986 DUKE L.J. 970, 977-80 (1986).

175. *Sliwa v. Commissioner*, 839 F.2d 602, 607 (9th Cir. 1988); see *supra* text accom-

which broadly held that courts may consider all prelitigation administrative conduct when deciding cost awards,¹⁷⁶ the *Sliwa* opinion, like the *Powell* opinion, focuses on what caused the taxpayer to file suit.¹⁷⁷ Only the administrative conduct at the highest level, the level immediately prior to the filing of the suit, may be considered by the court.¹⁷⁸ If that conduct was unreasonable and proximately caused the taxpayer to file suit, fees and costs incurred in preparing and filing the petition may be recovered.¹⁷⁹

This analysis enables taxpayers who are subjected to unreasonable conduct to file suit.¹⁸⁰ The proximate cause test may also deter abusive conduct by administrative officers. They may be encouraged to behave reasonably throughout the administrative procedures because, in the event an innocent taxpayer does file suit, the courts will hold the IRS accountable for its conduct.¹⁸¹

IV. SECTION 7430 AS AMENDED BY THE 1986 TAX REFORM ACT

In the Tax Reform Act of 1986, Congress attempted to rectify section 7430's legislative shortcomings by amending those sub-sections which had been the subject of the most controversy.¹⁸² The first area of debate which Congress attempted to settle was the controversy surrounding the reasonableness

panying notes 99-109.

176. *Kaufman v. Egger*, 758 F.2d 1, 4 (1st Cir. 1985).

177. *Sliwa*, 839 F.2d at 607. See also *Powell*, 791 F.2d at 391-92.

178. *Sliwa*, 839 F.2d at 607. See also, *Powell*, 791 F.2d at 392.

179. *Sliwa*, 839 F.2d at 607. See also *Powell*, 791 F.2d at 392.

180. Thus, the taxpayer is allowed to approach the prospect of litigation with the IRS from a rational, moral aspect, rather than from a solely economic analysis. *Id.* at 392. See also Langsraat, *Collecting Attorney Fees From The Government In Tax Litigation: An Analysis of the Winners And Prospects For The Future*, 17 ST. MARY'S L.J. 395 (1986) (discussing § 7430's effectiveness in compensating prevailing taxpayers).

181. One criticism of the deterrent effects of § 7430 is that it does not hold individual agents, who abuse their administrative positions, economically liable for their actions. See *Award Of Attorney's Fees In Tax Cases, 1985: Hearings Before The Subcomm. On Select Revenue Measures of the House of Representatives Comm. On Ways And Means, 99th Cong., 1st Sess. 4 (1985)* (statement of Andy Jacobs Jr., Congressional Rep. from Indiana).

182. Pub. L. No. 99-514, § 1551, 100 Stat 2085, 2752-53 (codified as amended at 26 U.S.C. § 7430 (1987)).

test.¹⁸³ The test now, as provided in the amended section 7430(c)(2)(A)(i) is whether the government's conduct was "substantially justified."¹⁸⁴

The difference between the terms "substantially justified" and "unreasonable" is largely one of degree. The United States Court of Appeals for the Third Circuit defined what constitutes "substantial justification" in *Washington v. Heckler*.¹⁸⁵ The court stated, in the EAJA context, that to be substantially justified, one must prove: "(i) a reasonable basis in truth for the facts alleged; (2) a reasonable basis in law for the theory it propounds; and (3) a reasonable connection between the facts alleged and the legal theory advanced."¹⁸⁶ The legislative history of EAJA employs the same type of parallels when it states "The test of whether or not a Government action is substantially justified is essentially one of reasonableness."¹⁸⁷ The problem is that a position can be reasonable, and still not be substantially justified by the circumstances.

183. In the 1986 Tax Reform Act, Congress made four major changes in § 7430. First, Congress changed the standard by which the government's position is to be evaluated. The former § 7430's previous language focused on whether the government's position was reasonable, whereas the new provision focuses on whether the government's position was "substantially justified." I.R.C. § 7430(c)(2)(A)(i) (Supp. 1985) amended by Tax Reform Act of 1986, Pub. L. No. 99-514, § 1511(d)(1), 100 Stat. 2085, 2752 (1986). This language conforms with the corresponding language in EAJA, thus bolstering the arguments that § 7430 and EAJA are analogous and should be interpreted uniformly.

Second, the administrative position taken by the IRS is now included in the evaluation of whether the government's position was substantially justified. I.R.C. § 7430(c)(2)(A)(I) (1986). The statute's former language referred only to the government's "position . . . in the civil proceeding," thus causing the controversy discussed *supra*. I.R.C. § 7430(c)(2)(A)(i) (1985).

Third, the maximum award for attorneys' fees has been set at \$75 per hour and reimbursement for expert testimony and preparation of expert reports, tests, etc., must be based on market rates. I.R.C. § 7430(c)(1)(A)(ii)(I) (1986). The former maximum was set at \$25,000 in total costs. I.R.C. § 7430(c)(1)(A)(ii)(I) (Supp. 1985).

Finally, Congress imposed net worth limitations on the parties who are eligible for fee reimbursements. Individuals having a net worth of less than \$2,000,000 and entities having a net worth of less than \$7,000,000 are eligible for reimbursements. Taxpayers with net worths over these amounts are not eligible for reimbursements. I.R.C. § 7430(c)(2)(A)(iii) (1986).

184. I.R.C. § 7430(c)(2)(A)(i) (Supp. 1985) amended by Tax Reform Act of 1986, Pub. L. No. 99-514, § 1511(d)(1), 100 Stat. 2085, 2752 (1986).

185. 756 F.2d 959 (3d Cir. 1985).

186. *Id.* at 961.

187. See H.R. REP. NO. 1418, 96th Cong., 2d Sess. 10, reprinted in 1980 U.S. CODE CONG. & ADMIN. NEWS 4989.

The second area of confusion which Congress attempted to clarify was the meaning of the phrase "position of the United States in the civil proceeding."¹⁸⁸ The section was amended to state: "The term 'position of the United States' includes — (A) the position taken by the United States in the civil proceeding, and (B) any administrative action or inaction by the District Counsel of the Internal Revenue Service (and all subsequent administrative action or inaction) upon which such proceeding is based."¹⁸⁹

This language roughly corresponds with the parallel language in EAJA, which was amended in 1985 by Congress to clarify what it meant by the "position of the United States."¹⁹⁰ It appears that Congress believed that adding similar language in section 7430 would clarify what "position of the United States in the civil proceeding" meant. Unfortunately, the injection of subparagraph (B) and its language regarding the presence of the District Counsel clouds rather than clears the prelitigation conduct controversy.

Upon examination, a serious flaw in the amendment language becomes clear. Taxpayers, regardless of where they bring suit, must request fees and costs under section 7430.¹⁹¹ Yet, in district courts or the Claims Court, where taxpayers sue the government for refunds from the IRS, District Counsel never enters the case at all. The government is represented by the United States Attorneys Office. Therefore, a truly literal reading of section 7430 would completely preclude district or Claims Court judges from awarding litigation costs in tax cases.

It is, however, likely that Congress merely meant to use the presence of District Counsel as an example of the sort of prelitigation administrative conduct for which the IRS should be accountable. In that case the word "includes" would be interpreted to mean "including, but not limited to." If that is the case, an analogy may be made to the position taken by the Fifth Circuit in *Powell*.¹⁹² The Fifth Circuit held that the position adopted at

188. I.R.C. § 7430(c)(4) (1986).

189. I.R.C. § 7430(c)(4)(B) (1986).

190. 28 U.S.C. § 2412(d)(2)(D) (Supp. 1987).

191. See H.R. REP. No. 404, *supra* note 7, at 13.

192. *Powell v. Commissioner*, 791 F.2d 385, 391-92 (5th Cir. 1986).

the highest administrative level, the position which proximately caused the taxpayer to file the petition, was subject to scrutiny for reasonableness.¹⁹³ The actions of District Counsel in its final negotiations with the taxpayer are an excellent example of the sort of administrative conduct the Fifth Circuit describes in *Powell*.¹⁹⁴

V. CONCLUSION

When drafting section 7430, the legislature was attempting to balance two competing interests. First, the interest of taxpayers in knowing that, in the event the IRS takes an unreasonable position regarding their tax liability, they can recover the costs of defending themselves.¹⁹⁵ Second, the interest of the Tax Court and the IRS in discouraging spurious tax litigation and in encouraging taxpayers to utilize the administrative procedures of the IRS.¹⁹⁶ Because of these competing interests, Congress altered the language of EAJA, the model statute, to accommodate a narrower focus. Congress intended that it be more difficult for taxpayers to recover fees under section 7430 than it was under EAJA; it did not intend the narrower language to totally preclude taxpayers from ever receiving an award of litigation costs.¹⁹⁷ The D.C. and Eleventh Circuit Courts of Appeals' interpretation of section 7430 essentially allow such a result.

Section 7430's language allows taxpayer litigants to believe that they will receive fees and costs if they prevail under the statute. Nevertheless, a strict interpretation of the statute essentially precludes recovery. By allowing prelitigation administrative conduct to go unmonitored, this interpretation renders moot the important policy goals of allowing innocent taxpayers to vindicate their rights and of deterring governmental abuse and overreaching.¹⁹⁸

Congress, through drafting and amending section 7430 to correspond with EAJA, has consistently sought to implement

193. *Id.*

194. *Id.*

195. *See* H.R. REP. NO. 404, *supra* note 7, at 11.

196. *Id.*

197. *Id.* at 14.

198. *Id.* at 11.

them analogously.¹⁹⁹ The only discernible difference between the two is section 7430's narrower scope.²⁰⁰ While EAJA clearly favors the citizen litigant, section 7430 denies awards of litigation costs unless the taxpayer has exhausted administrative remedies and has been abused by the system. The analysis used by the Ninth Circuit in *Sliwa* best balances the goals of discouraging spurious tax litigation and allowing taxpayers an opportunity to vindicate their rights if they are not liable.

This is accomplished by first requiring that taxpayers exhaust the administrative appeals system of the IRS before initiating a formal legal action.²⁰¹ The second goal of allowing taxpayers to vindicate their rights is aided by requiring that the governmental position which caused the taxpayer to file suit be "substantially justified."²⁰² While requiring that governmental positions be substantially justified, rather than merely "reasonable" as was required prior to the 1986 amendment, puts an additional burden on the administrative agents of the IRS: the fact that the taxpayer must prove that the position was not substantially justified evens the balance.

The analysis used in *Sliwa* is consistent with legislative intent of section 7430 and with the spirit of the subsequent amendment of the statute. Additionally, it answers the question which the other Circuits left untouched. At what point in time after the government adopts a substantially unjustified position can a taxpayer rely on being awarded fees and costs under section 7430? The Ninth Circuit in *Sliwa* clearly stated that section 7430 mandated that only those costs incurred in and after preparing and filing the petition were recoverable under the statute.²⁰³

199. See H.R. REP. No. 841, 99th Cong., 2d Sess. 800-02, 799-802 (1986); S. REP. No. 313, 99th Cong., 2d Sess. 197-99 (1986).

200. See *supra* text accompanying notes 18-28.

201. See I.R.C. § 7430 (b)(1) (1986).

202. See I.R.C. § 7430 (c)(2)(A)(i) (1986).

203. *Sliwa*, 839 F.2d at 607. The Ninth Circuit heard the case of *Sponza v. Commissioner*, No. 86-7432 (9th Cir. filed October 27, 1986), argued March 11, 1987 and, as of this writing, has not delivered its opinion. *Sponza* is another last known address case in which the IRS, after prolonged prelitigation administrative procedures, conceded the case soon after the taxpayer filed a petition in Tax Court. The Ninth Circuit may use *Sponza* to broaden their interpretation of section 7430 and actually delineate what administrative conduct is unreasonable.

396 GOLDEN GATE UNIVERSITY LAW REVIEW [Vol. 18:371

The analysis proposed by the Ninth Circuit Court of Appeals in *Sliwa* comes closest to actually implementing both the letter of the law in section 7430 and the spirit in which the statute was drafted. This conclusion is strongly supported by the 1986 Tax Reform Act amendment of section 7430 which used the administrative actions of District Counsel as one example of administrative level conduct for which the IRS should be held accountable. The 1986 amendments lend credibility to the conclusion that the First, Fifth and Ninth Circuits were correct in interpreting section 7430 analogously with EAJA and in holding the IRS accountable for its administrative conduct.

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