

THE TAX CASES OF THE FEDERAL CIRCUIT: 1990

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INTRODUCTION

The thirteen tax-related cases decided by the Court of Appeals for the Federal Circuit during its 1990 term did not disturb existing precedents.¹ For the most part, these decisions followed estab-

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1. See *Akutowicz v. United States*, No. 90-5109 (Fed. Cir. Nov. 3, 1990) (WESTLAW, Fed. library, Fed. Cir. file) (affirming dismissal for lack of jurisdiction over tort claim arising from application of tax laws); *Murray v. United States*, No. 90-5068 (Fed. Cir. Oct. 2, 1990) (LEXIS, Genfed library, CAFC file) (reversing *sua sponte* dismissal of taxpayer's pro se suit for refund of tax, penalties, and interest, and remanding for determination of whether taxpayer properly paid full assessment at time complaint filed); *Taylor v. United States*, No. 90-5050 (Fed. Cir. Sept. 25, 1990) (LEXIS, Genfed library, CAFC file) (upholding dismissal for lack of jurisdiction where taxpayer failed to file refund request before bringing suit for years 1985, 1986, and 1987 and remanding for determination of whether refund request filed for 1982 was within statutory period); *Schiff v. United States*, No. 90-5025 (Fed. Cir. Aug. 21, 1990)

lished legal principles² or addressed relatively narrow issues that will not affect most taxpayers.³ Nonetheless, four of these cases addressed very technical tax questions that deserve further analysis.

First, in *Texas Eastern Corp. v. United States*,⁴ the court examined the issue of interest payments on income tax overpayments when overpayments result from paying a mistaken tax deficiency in an Internal Revenue Service (IRS) settlement.⁵ Second, in *Gradow v. United States*,⁶ the court addressed the meaning of the phrase "adequate and full consideration" in the context of the estate tax.⁷ Third, in

(LEXIS, Genfed library, CAFC file) (upholding dismissal of refund claim and assessing penalty for frivolous appeal); *Tenneco, Inc. v. United States*, No. 89-1699 (Fed. Cir. Mar. 8, 1990) (LEXIS, Genfed library, CAFC file) (denying claim for recovery of partially paid excise taxes and finding taxpayer liable as importer); *Pesko v. United States*, 918 F.2d 1581 (Fed. Cir. 1990) (supporting timeliness of deficiency assessment and dismissing taxpayers' refund suit on basis of untimely assessment); *Schultz v. United States*, 918 F.2d 164 (Fed. Cir. 1990) (upholding award of costs to government on basis of taxpayer's liability refund suit for partial penalty payment); *Carter v. United States*, 909 F.2d 1452 (Fed. Cir.) (upholding dismissal for lack of jurisdiction over IRS employees' overtime pay dispute covered by collective bargaining agreement grievance procedure), *cert. denied*, 111 S. Ct. 46 (1990); *Texas E. Corp. v. United States*, 907 F.2d 138 (Fed. Cir. 1990) (upholding denial of additional statutory interest and affirming IRS offset of earlier overassessments against subsequent tax deficiencies); *Transamerica Corp. v. United States*, 902 F.2d 1540 (Fed. Cir. 1990) (upholding disallowance of corporate taxpayer's charitable deduction claim where taxpayer retained rights in transferred property and expected substantial benefits in return for transfer); *Terry Haggerty Tire Co. v. United States*, 899 F.2d 1199 (Fed. Cir. 1990) (upholding denial of claim for recovery of partially paid excise taxes finding taxpayer liable as importer); *Danville Plywood Corp. v. United States*, 899 F.2d 3 (Fed. Cir. 1990) (disallowing corporate taxpayer's entertainment expense deduction because neither ordinary nor necessary); *Gradow v. United States*, 897 F.2d 516 (Fed. Cir. 1990) (contemplating statutory requirement for bona fide sale in consideration of gross estate).

2. *See, e.g., Akutowicz v. United States*, No. 90-5109, slip op. at 4 (Fed. Cir. Nov. 3, 1990) (WESTLAW, Fed. Cir. file) (following jurisdiction principles in dismissing tort claim); *Carter v. United States*, 909 F.2d 1452, 1458 (Fed. Cir.) (upholding jurisdiction principles in dismissing IRS employee overtime pay dispute for lack of jurisdiction), *cert. denied*, 111 S. Ct. 46 (1990); *Transamerica Corp. v. United States*, 902 F.2d 1540, 1546 (Fed. Cir. 1990) (relying on general principle that when taxpayer makes donation with expectation of receipt of substantial benefits, no deductible charitable contribution is permitted under § 170); *Danville Plywood Corp. v. United States*, 899 F.2d 3, 5 (Fed. Cir. 1990) (applying ordinary and necessary standard to entertainment expenses in determining deductibility as business expenses).

3. *See, e.g., Murray v. United States*, No. 90-5068, slip op. at 3 (Fed. Cir. Oct. 2, 1990) (LEXIS, Genfed library, CAFC file) (requiring fact-finding process on remand to determine whether taxpayer properly paid full assessment at time that taxpayer filed complaint); *Taylor v. United States*, No. 90-5050, slip op. at 1 (Fed. Cir. Sept. 25, 1990) (LEXIS, Genfed library, CAFC file) (finding no jurisdiction where taxpayer failed to comply with pre-litigation filing requirement); *Schiff v. United States*, No. 90-5025, slip op. at 4 (Fed. Cir. Aug. 21, 1990) (LEXIS, Genfed library, CAFC file) (finding appeal untimely); *Schultz v. United States*, 918 F.2d 164, 166 (Fed. Cir. 1990) (affirming Claims Court rules governing litigation expense reimbursement).

4. 907 F.2d 138 (Fed. Cir. 1990).

5. *Texas E. Corp. v. United States*, 907 F.2d 138, 141 (Fed. Cir. 1990); *see infra* notes 15-38 and accompanying text (analyzing court's opinion in detail).

6. 897 F.2d 516 (Fed. Cir. 1990).

7. *Gradow v. United States*, 897 F.2d 516, 519 (Fed. Cir. 1990); *see infra* notes 39-73 and accompanying text (analyzing court's opinion in detail).

Terry Haggerty Tire Co. v. United States,⁸ the court interpreted the term "importer" under the federal excise tax statute.⁹ Fourth, in *Danville Plywood Corp. v. United States*¹⁰ the court distinguished between business expenses that are and are not deductible.¹¹

The Federal Circuit generally affirmed Claims Court decisions,¹² often quoting passages from the lower court's opinions.¹³ The Federal Circuit appeared unwilling to adopt equitable or novel approaches to solving tax law problems.¹⁴ Consequently, the 1990 term decisions neither spark the types of controversies that legal scholars relish nor lead to erroneous legal conclusions or misguided legal interpretations that practitioners despise.

I. INTEREST ON DEFICIENCIES AND OVERPAYMENTS

The Internal Revenue Code (IRC or Code) generally provides for the accrual of interest on tax underpayments and overpayments.¹⁵ IRS audits often result in adjustments to the taxpayer's taxable income. As a result, tax deficiencies and overpayments may be determined for the audited periods. The amount of accrued interest on each underpayment and overpayment over several years is often difficult to track and the obfuscatory statutory language only makes this determination more difficult. The Federal Circuit confronted such a problem in *Texas Eastern Corp. v. United States*.¹⁶ The court in *Texas Eastern* held that the IRS need not pay interest on overassessments where the overassessment did not result in additional pay-

8. 899 F.2d 1199 (Fed. Cir. 1990).

9. *Terry Haggerty Tire Co., Inc. v. United States*, 899 F.2d 1199, 1203 (Fed. Cir. 1990); see *infra* notes 74-109 and accompanying text (analyzing court's opinion in detail).

10. 899 F.2d 3 (Fed. Cir. 1990).

11. *Danville Plywood Corp. v. United States*, 899 F.2d 3, 9 (Fed. Cir. 1990); see *infra* notes 110-28 and accompanying text (analyzing court's opinion in detail).

12. See, e.g., *Schiff v. United States*, No. 90-5025, slip op. at 7 (Fed. Cir. Aug. 21, 1990) (LEXIS, Genfed library, CACF file) (affirming Claims Court on procedural issue relating to statute of limitations); *Texas E. Corp. v. United States*, 907 F.2d 138, 141 (Fed. Cir. 1990) (affirming issue of interest payments on tax payments), *aff'g* 18 Cl. Ct. 387 (1989); *Gradow v. United States*, 897 F.2d 516, 519 (Fed. Cir. 1990) (affirming Claims Court on estate tax issue), *aff'g* 11 Cl. Ct. 808 (1987).

13. See *Texas E. Corp.*, 907 F.2d at 138, 140 (adopting conclusions of Claims Court); *Gradow*, 897 F.2d at 518 (relying on Claims Court's analysis of whether taxpayer's transfer was for full and adequate consideration within meaning of section 2036(a)).

14. *Texas E. Corp.*, 907 F.2d at 140 (refusing to apply regulation allowing statutory interest on erroneously paid deficiency interest).

15. See I.R.C. § 6601(a) (1986) (setting forth rules regarding interest on underpayments); *id.* § 6611 (setting forth rules regarding interest on overpayments). These interest rates are established each January, April, July, and October for the following calendar quarter and are based on the average market yield during the first month of the preceding quarter of outstanding United States obligations with a remaining term of three years or less. See *id.* §§ 6621(a), (b)(1), 1274(d)(1)(C)(i) (explaining how Commissioner sets interest rates).

16. 907 F.2d 138 (Fed. Cir. 1990).

ments by the taxpayer, but rather only delayed the refund of an overpayment made following an audit.¹⁷

The IRS audited Texas Eastern's income tax returns for the years 1970 through 1974 and, in 1979, determined that the taxpayer owed additional taxes for 1970, 1973, and 1974 and also found that Texas Eastern had overpaid its 1971 and 1972 taxes.¹⁸ The IRS applied the taxpayer's 1971 and 1972 overpayments to the 1970, 1973, and 1974 deficiencies.¹⁹ Thus, the taxpayer owed the government

17. *Texas E. Corp. v. United States*, 907 F.2d 138, 140 (Fed. Cir. 1990), *aff'g* 18 Cl. Ct. 387 (1989).

18. *See id.* at 139 n.3 (disclosing amount of 1971 and 1972 overpayments and 1970, 1973, and 1974 deficiencies). The taxes overpaid and owed for the years at issue were:

	<u>Deficiency</u>	<u>Overpayments</u>
1970	\$ 943,214.65	
1971		\$ 9,916,143.21
1972		10,208,623.06
1973	6,264,347.14	
1974	10,553,859.77	

Id.

19. *Id.* at 139 (recounting facts). The Code provides that deficiency interest be assessed on underpayments, and that statutory interest be levied on overpayments. *See* I.R.C. § 6601 (1986) (providing for deficiency interest); *id.* § 6611 (providing for statutory interest). In general, the taxpayer pays deficiency interest for the period commencing on the date that a tax liability is due and ending on the date that the taxpayer ultimately pays the tax in full. *Id.* § 6601(a). In addition, the government pays statutory interest to the taxpayer which accrues from the date an overpayment arises to the date that the service credits the overpayment to another taxpayer liability, or (if the amount is refunded) to a date shortly before the IRS issues the refund check. *Id.* § 6611(b)(1)-(2).

The Code authorizes the IRS to apply overpayments from one tax year against any outstanding deficiency from another tax year and allows the Service to refund any excess to the taxpayer. *Id.* § 6402(a). In the case of an underpayment where the taxpayer owes deficiency interest, such interest is abated when the IRS can credit an overpayment to the amount owed. *See id.* § 6601(f) (providing for satisfaction by credits). In addition, an overpayment from one tax year may offset not only a tax deficiency from another year, but interest on such deficiency as well. *See id.* § 6601(g) (maintaining that interest is to be assessed and collected as if it were tax); *see also* *Texas E. Corp. v. United States*, 907 F.2d 138, 140 n.7 (Fed. Cir. 1990) (noting that for years at issue in case, § 6601(f) was designated 6601(g) and 6601(g) was designated 6601(h)). Interest is denied during the period in which interest would have accrued had the credit not been made. *See* S. REP. NO. 1983, 85th Cong., 2d Sess. 99 (1958), *reprinted in* 1958 U.S. CODE CONG. & ADMIN. NEWS 4791, 4888, *and in* 1958-3 C.B. 1155, 1156, 1177 (explaining congressional attempt to eliminate erratic effects on taxpayers when both overpayments and underpayments exist by terminating interest as to both during period in which they offset one another, except deficiency interest will be charged for any period in which overpayment interest would not have been allowed if overpayment was not credited against deficiency). Thus, if any portion of a tax is satisfied by credit of an overpayment, no interest is imposed on the portion of the tax satisfied for any period during which interest would have been allowable both on the underpayment and on the overpayment if the overpayment had been refunded. *See* Treas. Reg. § 301.6601-1(b)(1) (as amended in 1983) (prohibiting interest imposition on tax for any period in which overpayment interest would have been permitted had overpayment been refunded rather than used to satisfy tax liability).

The following examples illustrate these complex rules:

Example 1: A 1989 overpayment is credited against a 1988 deficiency. No interest is payable on the overpayment because the due date of the 1988 deficiency precedes the date of the 1989 overpayment, *i.e.*, because tax is generally due at the same time as the required filing date for that tax. I.R.C. § 6151 (1986).

interest for 1970 and the government owed the taxpayer interest for 1971 and 1972, offset by the deficiencies in 1973 and 1974. This netting process resulted in a refund to the taxpayer of \$5,425,690.47, consisting of \$2,363,344.71 in overassessments for 1972 and \$3,062,345.76 in statutory interest.²⁰

Subsequent to an agreement reached in 1979, Texas Eastern pursued claims relating to depreciation deductions for the 1970 through 1974 tax years. In 1983, the taxpayer and the IRS reached a further agreement that resulted in a recomputation of the taxpayer's liabilities for 1970 through 1974.²¹ The IRS paid interest on the tax overpayments from the dates the tax payments were made to the date that the Service issued the refunds. The taxpayer alleged, however, that when computing the taxpayer's refund in the 1979 agreement, the interest computation should include a statutory interest payment on the deficiency interest deemed paid on the 1970, 1973, and 1974 deficiencies.²²

Example 2: If a 1989 overpayment is credited against a 1990 deficiency, interest is allowed on the overpayment from the date of the overpayment to the due date of the payment of the tax in the subsequent year, i.e., the due date of the 1990 tax return.

20. *Texas E. Corp.*, 907 F.2d at 139 (reviewing IRS actions taken following results of 1970 audit).

21. *Id.* at 140. The taxpayer's recomputed tax liability is as follows:

	<u>Deficiency</u>	<u>Overassessment</u>
1970		\$ 589,773.11
1971		12,020,372.23
1972		11,473,928.12
1973		7,482,468.75
1974	\$5,557,478.84	

Id. at 139 n.5. These redeterminations, coupled with the 1979 determinations, resulted in the following refund amounts:

	<u>Overassessed Taxes</u>	1983 <u>Overpayment/ Deficiency</u>	1979 <u>Overpayment/ Deficiency</u>
1970	\$1,532,987.76	(\$ 589,773.11 +	\$ 943,214.65)
1971	2,104,229.02	(12,020,372.23 -	9,916,143.21)
1972	1,265,305.06	(11,473,928.12 -	10,208,623.06)
1973	13,746,815.89	(7,482,468.75 +	6,264,347.14)
1974	(4,996,380.93)	(5,557,478.84 -	10,553,859.77)

Id. at 140 n.6.

22. See Brief for Appellant at 14-15, *Texas E. Corp. v. United States*, 907 F.2d 138 (Fed. Cir. 1990) (No. 90-5029) (setting forth taxpayer's allegations). The essence of the dispute may be illustrated as follows:

Example 1: Taxpayer overpays taxes by \$500 in year 1. In year 5, the IRS agrees to the refund; the applicable interest rate is 10%.

	<u>Refund</u>
Overpayment	\$500
Statutory Interest (\$500 × 4 yrs. × 10%)	200
Refund	\$700

Example 2: Rather than grant the refund, the IRS in year 5, assesses a \$200 deficiency with respect to Year 2 and offsets it against the \$500 overpayment.

The taxpayer asserted that statutory interest was due as part of the 1983 refund on the deemed deficiency interest payment assessed in 1979 and urged the court to look to the equities of the statutory interest rule.²³ A taxpayer is generally entitled to statutory interest with respect to any overpayment.²⁴ The regulations mandate that the payment of deficiency interest may constitute part of an overpayment.²⁵ The taxpayer alleged that adoption of the IRS approach would result in the IRS having use of deficiency interest that is subsequently refunded without the payment of statutory interest on those funds.²⁶

These arguments did not persuade the court. Instead, the court advocated the general rule that interest can be collected from the United States only where its payment has been authorized, regardless of whether the government controlled the taxpayer's funds.²⁷

	<u>Refund</u>
Overpayment	\$500
Less: Deficiency Offset	200
	<u>300</u>
Statutory Interest:	
Pre-Offset ($\$500 \times 10\% \times 1 \text{ yr.}$)	\$ 50
Post-Offset ($\$300 \times 10\% \times 3 \text{ yrs.}$)	90
Refund	<u>\$440</u>

Example 3: In year 7, the IRS concedes that the \$200 deficiency should not have been made. The taxpayer's position is that the refund should be \$260 ($\$700 - \440) plus interest from the time that the IRS wrongfully assessed the \$200 deficiency.

	<u>Refund</u>
Amount Deprived Taxpayer	\$260
Statutory Interest ($\$260 \times 10\% \times 2 \text{ yrs.}$)	52
Refund	<u>\$312</u>

The IRS, on the other hand, determined the refund to be \$200 plus interest from Year 2.

	<u>Refund</u>
Overpayment	\$200
Statutory Interest ($\$200 \times 10\% \times 5 \text{ yrs.}$)	100
Refund	<u>\$300</u>

The difference between the taxpayer's and government's positions represents the statutory interest that accrued on the deficiency interest paid on the erroneous \$200 deficiency from the end of Year 2 to the end of Year 5 ($\$200 \times 10\% \times 3 \text{ yrs.} \times 10\% \times 2 \text{ yrs.}$). See *Texas E. Corp. v. United States*, 18 Cl. Ct. 387, 390, 391 n.8 (1989) (offering example to illustrate taxpayer's contention that interest owed taxpayer credited by IRS to pay deficiency should accrue overpayment interest).

23. *Texas E. Corp.*, 907 F.2d at 140 (rejecting taxpayer's claim for additional interest on interest it claims should be deemed to have been paid).

24. See *supra* note 19 (discussing taxpayer's entitlement to statutory interest).

25. See Treas. Reg. § 301.6611-1(c) Ex. 2 as amended in 1976 (explaining through example that in addition to taxes overpaid, deficiency interest paid to government on tax overpaid is considered part of tax overpayment for purposes of computing overpayment interest).

26. See Brief for Appellant at 14-15, *Texas E. Corp. v. United States*, 907 F.2d 138, 140 (Fed. Cir. 1990) (No. 90-5029) (contending entitlement to overpayment interest on interest deemed paid).

27. See *United States ex rel. Angarica v. Bayard*, 127 U.S. 251, 260 (1888) (expressing general rule that government need not pay interest claims absent statutory provision).

Thus, to collect overpayment interest, the taxpayer must show specific statutory authority for the collection. In contrast, the general rule regarding tax underpayments is that underpayment interest accrues from the date the taxes are due to the date the taxes are paid in full.²⁸ In cases where an underpayment offsets an overpayment, deficiency interest does not accrue on the portion of the tax so satisfied by credit for any period during which, if the credit had not been made, interest would have been allowed with respect to such overpayment.²⁹ Thus, the court found that the crediting of the 1971 overpayment against the 1970 deficiency precluded, as a matter of law, the imposition of additional deficiency interest as well as the imposition of deficiency interest on the 1973, and 1974 deficiencies.³⁰ Consequently, the taxpayer never paid any deficiency interest with respect to the 1970, 1973 and 1974 deficiencies except for interest on the 1970 deficiency that had accrued prior to the date the 1971 overpayment was made.³¹ The court concluded, therefore, that the taxpayer was not entitled to statutory interest on any deficiency interest.³²

Texas Eastern argued that section 6601(f) should not govern the facts of the case and claimed that the statutory rule for crediting interest does not apply to an offset involving erroneous deficiencies.³³ Using the legislative history as support, the taxpayer contended that section 6601(f) should operate only when actual, mutual indebtedness exists.³⁴ The taxpayer relied on *Fruehauf Corp. v.*

28. See *supra* note 19 (discussing 6601(a) provision which provides general rule).

29. See *id.* (explaining section 6601(f) which sets out rules regarding accrual of deficiency interest when underpayment exceeds overpayment).

30. *Texas E. Corp.*, 907 F.2d at 140.

31. *Id.*

32. *Id.*

33. *Id.* (noting taxpayer's argument that erroneous deficiency without mutuality of interest due from government and taxpayer precludes application of provision).

34. *Id.* at 141; see also S. REP. NO. 1983, 85th Cong., 2d Sess. 235, reprinted in 1958 U.S. CODE & CONG. & ADMIN. NEWS 4791, 5023, and in 1958-3 C.B. 1155, 1158 (providing legislative history). The legislative commentary explained that interest will be denied to the government on "any portion of an underpayment satisfied by the crediting against it of an overpayment for the period during which interest would run on the overpayment so credited if the credit had not been made, e.g., if it had instead been refunded." *Id.* In addition, the legislative history expressed Congress' intent to "remove the distinction now existing in the running of interest where the overpayment is credited against an underpayment of original tax and where it is credited against an additional assessment." *Id.* The legislative history called for interest on a credited overpayment to:

run only from the date of the overpayment to the original due date of the amount against which it is credited. Thus, if it is credited against an underpayment antedating the overpayment, no interest would run on the overpayment at all. Since interest would otherwise run on the overpayment from the date of overpayment to the date of refund, interest on the underpayment will stop running as of the date of the overpayment; that is, *when the mutuality of indebtedness arises*. Similarly, in the case of an overpayment which antedates the due date of an underpayment, interest will run on

*United States*³⁵ to support its position.³⁶ The court in *Texas Eastern* stated that it did not see how *Fruehauf* applied to the taxpayer's situation. In *Fruehauf*, the taxpayer underpaid its 1960 taxes, but a 1963 net operating loss created a carryback that eliminated the 1960 underpayment. The government assessed deficiency interest in 1969 and the taxpayer's right to interest on the refund of the net operating loss commenced in 1963. The *Fruehauf* court concluded that the taxpayer's right to statutory interest from 1963 through 1969 should be offset by the 1969 deficiency interest.³⁷

Thus, the court characterized *Texas Eastern's* case as one where the IRS had delayed refunding the correct tax until 1983 and not one where the taxpayer had overpaid its 1979 taxes. Accordingly, the court held that the taxpayer was not entitled to statutory interest on any alleged deficiency interest because no such deficiency interest had been paid.³⁸

II. ESTATE TAXATION

Estate taxation involves an initial determination of a gross estate's value. The value of a gross estate generally includes the value of all property transferred in which a decedent has retained a life interest.³⁹ A transfer of property with a retained life interest may be excluded from the gross estate, however, if it is deemed a "bona fide sale for an adequate and full consideration."⁴⁰ The court considered the meaning of that phrase in *Gradow v. United States*.⁴¹ The case concerned Betty and Alexander Gradow who at all times resided in California, a community property state.⁴² Alexander, who

the overpayment only until such due date, that is, *when the mutuality of indebtedness arises*.

Id. (emphasis added).

35. 477 F.2d 568 (Ct. Cl. 1973).

36. *Fruehauf Corp. v. United States*, 477 F.2d 568, 569 (Ct. Cl. 1973) (holding taxpayers not liable for interest on potential deficiency and finding no mutuality of indebtedness where operating loss was carried back, extinguishing potential deficiency and creating overassessment).

37. *Id.* at 573 (applying Code consistent with congressional intent to eliminate inequities in operation of interest requirements on taxpayer and government for deficiency and overpayment interest charges).

38. *Texas E. Corp. v. United States*, 907 F.2d 138, 140 (Fed. Cir. 1990) (expressing court's holding).

39. See I.R.C. § 2036(a) (1986) (excluding from value of decedent's gross estate amount of any property which has been transferred by way of "bona fide sale for an adequate and full consideration").

40. See *id.* (noting exception to property included in gross estate's value).

41. 897 F.2d 516 (Fed. Cir. 1990).

42. See *Gradow v. United States*, 11 Cl. Ct. 808, 809 (1987) (providing factual background), *aff'd*, 897 F.2d 516 (Fed. Cir. 1990); see also BLACK'S LAW DICTIONARY 280 (6th ed. 1990) (noting that California is community property state). The difference between a common law property state and a community property state focuses on married persons' property

died in 1977, bequeathed his interest in the couple's community property to a trust for Betty for life with the remainder to their son, but only if Betty affirmatively elected not to claim her "widow's share" under California's community property law.⁴³ Betty refrained from making a "widow's share" election and instead elected to transfer her own share in the community property to a trust from which she would receive the income for life.⁴⁴

Betty died less than sixteen months after making the election.⁴⁵ Her executor excluded the value of the trust property from her gross estate for federal estate tax purposes.⁴⁶ The IRS, on audit, reasoned that Betty had made a "testamentary transfer" with a reserved life estate that would subject the transferred amount to estate tax under section 2036.⁴⁷ In essence, the IRS treated Betty's election to have her share of the community property pass to a trust for her lifetime benefit as a section 2036(a) transfer.⁴⁸ The IRS conceded that in exchange for the transfer of her community property interest to the trust, Betty received consideration in the form of a life estate in both her own and Alexander's community property.⁴⁹ The parties stipulated the value of this life estate to be \$234,767.⁵⁰

rights. *Id.* In essence, community property law considers one-half of each spouse's earnings as owned by the other spouse. *Id.*

43. *Gradow*, 11 Cl. Ct. at 809.

44. *Id.*

45. *Id.*

46. *Id.*

47. A decedent's gross estate includes "the value of all property to the extent of any interest therein of the decedent at the time of his death." I.R.C. § 2033 (1986). Because this rule may be easily avoided unless it also reaches property that a decedent gives away during his life by an essentially testamentary transfer that makes a gift of property with a reserved life estate, section 2036 provides in pertinent part:

(a) *General Rule.* The value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which he has retained for his life, or for any period not ascertainable without reference to his death, or for any period which does not in fact end before his death:

(1) the possession or enjoyment of, or the right to the income from, the property,
or

(2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Id. § 2036. Thus, this provision extends the estate tax to any property that the decedent gives away for less than adequate and full consideration during his life while retaining a life estate in the property. *Gradow v. United States*, 897 F.2d 516, 518 (Fed. Cir. 1990) (noting this proposition). This rule also applies where the decedent does not have such power at death but did have such power at any time within three years of death. I.R.C. § 2035(a), (d)(1)-(2) (1986) (stating rule).

48. *Gradow*, 897 F.2d at 517 (asserting that failure to include contributed property's value created deficiency in estate taxes).

49. *Id.* (noting that by transferring her portion of community property into trust of both spouses, she would receive all income for life).

50. *Id.* at 518 n.6 (reciting net consideration received).

The IRS subtracted this value (\$234,767) from the value of the property contributed to the trust (\$444,641).⁵¹

On appeal, the dispute focused on the value of the property transferred into the trust, and consequently, whether that value was "adequate and full" in return for the \$234,767 life estate.⁵² The government contended the value of the transferred property was \$444,641, the stipulated value of Betty's entire community property interest at the time of Alexander's death, and, under section 2036, assessed additional estate tax on the difference.⁵³ The estate, however, contended that the value of the transfer equalled only the value of the remainder interest in the trust passing to the remainder person at the death of Betty, stipulated to be less than \$234,767.⁵⁴

The Circuit Court, like the Claims Court, relied on three prior decisions for its adoption of the government's position. The first case relied on by the court was *United States v. Allen*.⁵⁵ In *Allen*, the decedent created an *inter vivos* trust reserving the income for life with the remainder to her children.⁵⁶ Shortly before her death, she

51. *Id.* at 518 (allowing credit against amount of transfer).

52. *Id.* (noting both executor's and government's positions).

53. *Id.* (stating that consideration equalled half of community property).

54. *Id.* (noting consideration was value of remainder interest in half of community property).

This dispute may be explained by a simple example. Assume husband (H) and wife (W) own \$200,000 of community property. H's will provides that W may take her one-half interest in the property at H's death or may permit the couple's entire property of \$200,000 to pass to a trust in which she is given a life estate. By choosing to receive the life estate, W performs two actions: (1) she elects to waive her statutory right to one-half of the community property, and (2) she transfers her one-half property interest to the trust. In return for these transfers, W acquires a life estate in the entire \$200,000. If the value of the life estate is worth \$60,000 based on mortality tables then in effect, see Treas. Reg. § 20.2031-10, Table A(2) (1989) (providing present worth of annuity, life interest, and remainder interest of single female), the government's position would be that W transferred her statutory \$100,000 property interest for \$60,000 consideration, and therefore, no bona fide sale for adequate and full consideration occurred for section 2036 purposes. The estate, however, could contend that W transferred \$40,000 (the beneficiary's remainder interest) for \$60,000 consideration, resulting in adequate and full consideration. For commentary on this issue prior to the *Gradow* decision, see, Johnson, *Revocable Trusts, Widow's Election Wills, and Community Property: The Tax Problems*, 47 TEX. L. REV. 1247, 1282 (1969) (recognizing that case law allows wife's gross estate to be offset by electing life estate in husband's community share); Lowndes, *Consideration and the Federal Estate and Gift Taxes: Transfers for Partial Consideration, Relinquishment of Marital Rights, Family Annuities, the Widow's Election, and Reciprocal Trusts*, 35 GEO. WASH. L. REV. 50, 76 (1966) (proclaiming unsoundness of widow's election because it offers opportunities for tax avoidance in community property states); Miller & Martin, *Voluntary Widow's Election: Nationwide Planning for the Million Dollar Estate*, 1 CAL. W.L. REV. 63, 81 (1965) (noting major purpose of transfer is to avoid inclusion in gross estate of property interests transferred by wife by requiring transfer be made for "full and adequate consideration in money or money's worth"); Morrison, *The Widow's Election: The Issue of Consideration*, 44 TEX. L. REV. 223, 242 (1965) (recommending adoption of general value rather than dollar amount, to measure consideration received as fraction of property interest transferred by wife).

55. 293 F.2d 916 (10th Cir. 1961).

56. *United States v. Allen*, 293 F.2d 916, 916 (10th Cir.), *cert. denied*, 368 U.S. 944 (1961).

sold her life estate for slightly more than its actuarial value.⁵⁷ Representatives of the estate argued that the trust property could not be brought back into the estate under section 2036 because the decedent's life interest was transferred for adequate and full consideration.⁵⁸ The Tenth Circuit held that the sale of the life estate was not made for adequate and full consideration.⁵⁹ The court reasoned that the measure of the consideration for the life estate transfer was not the value of the decedent's life interest, but was instead the value of the trust corpus, that is, the property that would have been included in the gross estate had the decedent not made the transfer.⁶⁰ Thus, the decedent was treated as having transferred not the life estate, but the full value of the trust corpus.⁶¹

The second case relied on by the *Gradow* court was *Estate of Gregory v. Commissioner*.⁶² In *Estate of Gregory*, the decedent, prior to her death, did not exercise her widow's election.⁶³ This resulted in her community property, worth approximately \$70,000, passing to a trust established by her husband's will. In exchange she received a life interest in the trust with an actuarial value of approximately \$12,000.⁶⁴ The Tax Court held that, under section 2036, the transfer was not for "adequate and full consideration."⁶⁵ The *Gregory* court ruled that "[t]he statute excepts only those *bona fide* sales where the consideration received was of comparable value which would be includable in the transferor's gross estate."⁶⁶ In addition, the Tax Court rejected the estate's argument that the decedent's retained life interest in her own share of the community property should be counted as consideration for the transfer.⁶⁷

Finally, the *Gradow* court relied on *United States v. Past*.⁶⁸ In *Past*,

57. *Id.*

58. *Id.* at 917. Section 2035(d) provides that if a decedent releases or transfers for less than adequate and full consideration, a power under section 2036 within three years of death, the power is considered as if held at death under section 2036. I.R.C. § 2035(d) (1986). This rule prevents "gifts in contemplation of death" whereby the decedent, in anticipation of his death, depletes his estate by transferring assets out of his estate with the intent to minimize estate tax. See H.R. REP. NO. 1380, 94th Cong., 2d Sess. 14 (1976) (setting forth legislative history of § 2035(d)).

59. See *Allen*, 293 F.2d at 917 (recognizing that consideration exceeded life estate's value).

60. See *id.* at 918 (noting Congress' intent).

61. *Id.*

62. 39 T.C. 1012 (1963).

63. *Estate of Gregory v. Commissioner*, 39 T.C. 1012, 1013 (1963).

64. *Id.*

65. *Id.* at 1016.

66. *Id.*

67. *Id.* at 1017 (reasoning that retained life estate in one's own property cannot serve as consideration for adequate and full consideration requirement of section 2036 because decedent retains that property interest rather than transfers it to trust).

68. 347 F.2d 7 (9th Cir. 1965).

the community property of each spouse, pursuant to a divorce settlement, went to a trust in which the wife acquired a life interest.⁶⁹ The value of her share of the community property transferred to the trust was about \$244,000; the remainder interest in such property was valued at about \$101,000; and the value of her life estate in the whole trust corpus was approximately \$144,000.⁷⁰ The Ninth Circuit ruled that the transfer was not for "adequate and full consideration" under section 2036.⁷¹

Finding these cases controlling, the Federal Circuit in *Gradow* affirmed the Claims Court decision favoring the government's interpretation of the value of the property that was transferred into the trust.⁷² The court reiterated that for purposes of measuring whether "full and adequate consideration" was given for the life estate, the consideration consists of the decedent's half of the community property.⁷³

III. EXCISE TAXES

Tax cases frequently involve the problem of determining who, among several potential taxpayers, is the proper party to tax.⁷⁴ This issue, as well as the ancient adage *caveat emptor*,⁷⁵ was made painfully evident to the taxpayer in *Terry Haggerty Tire Co. v. United States*.⁷⁶ In *Haggerty Tire*, a divided court upheld a Claims Court summary judgment that found a United States buyer of tires liable for excise taxes on its purchases where the entity importing the tires, and otherwise liable for the tax, was a foreign corporation inaccessible to IRS collection procedures.⁷⁷

Terry Haggerty Tire Co. ("Haggerty"), a New York corporation engaged in the business of selling tires on both a retail and a wholesale basis was approached by representatives of Canada Tire Co.

69. *United States v. Past*, 347 F.2d 7, 10 (9th Cir. 1965).

70. *Id.* at 14.

71. *Id.* at 12 (stating that "value of what the decedent received under the trust [\$144,000] must be measured against the value of the property she transferred to the trust [\$244,000 and not \$101,000]").

72. *See Gradow v. United States*, 897 F.2d 516, 519 (Fed. Cir. 1990) (adopting Claims Court's analysis).

73. *See id.* at 518 (observing absence of full and adequate consideration under section 2036(a)).

74. *E.g.*, *Lucas v. Earl*, 281 U.S. 111, 115 (1930) (reporting Justice Holmes' famous "fruit and tree" analogy for determining who is taxed on income earned by one person but received by another person).

75. *See BLACK'S LAW DICTIONARY* 222 (6th ed. 1990) (expressing maxim "let the buyer beware" as summary for rule that purchaser must inspect for himself).

76. 899 F.2d 1199 (Fed. Cir. 1990).

77. *Terry Haggerty Tire Co. v. United States*, 899 F.2d 1199, 1201 (Fed. Cir. 1990), *aff'd* 16 Cl. Ct. 620 (1989).

("Canada Tire") to solicit orders for tires.⁷⁸ Canada Tire was a Canadian corporation with no business facilities in the United States.⁷⁹ Haggerty was aware that it was purchasing tires from a foreign manufacturer.⁸⁰ The companies negotiated the price of each order including: the cost of the tires, freight charges, brokerage fees, and customs duties.⁸¹ Haggerty and Canada Tire disagreed, however, over whether the payment of excise taxes was included in the price.⁸² No written agreements existed describing the business transactions.⁸³

After Haggerty placed an order, Canada Tire either shipped the tires from its warehouse in Canada or arranged to have the tires released from those held at a bonded customs warehouse in Vermont.⁸⁴ The tires stored in the bonded warehouse had not yet cleared customs, and therefore, they were treated as not yet having entered the United States.⁸⁵ Once a specific order was placed, Canada Tire paid the customs duty and caused the customs broker to ship the tires to the United States purchaser.⁸⁶ The tires were shipped to the taxpayer in New York with the taxpayer retaining the right to refuse shipment if the goods were defective.⁸⁷

The issue in this case hinged on the definition of "importer" for purposes of the assessment of an excise tax on tires.⁸⁸ Section 4071 imposes an excise tax on the importer of tires used on highway vehicles.⁸⁹ In defining the term "importer," the regulations provide that where an entity is the mere nominee of the beneficial owner, the beneficial owner is the "importer" of the article and will be liable for the excise tax.⁹⁰ The taxpayer argued that Canada Tire was not its nominee but was in fact the real owner of the goods until

78. *Id.* at 1199.

79. *Id.*

80. *Id.*

81. *Id.* at 1199-1200.

82. *Id.* at 1200.

83. *See id.* at 1199-1200 (noting that Haggerty placed orders either through representatives or over telephone).

84. *Id.* at 1200.

85. *Id.*

86. *Id.*

87. *Terry Haggerty Tire Co. v. United States*, 16 Cl. Ct. 620, 621 (1989).

88. *Terry Haggerty Tire Co. v. United States*, 899 F.2d 1199, 1200 (Fed. Cir. 1990) (observing importance of finding true meaning of "importer").

89. *See* I.R.C. § 4071 (1986) (imposing tire tax).

90. *See* Treas. Reg. § 48.0-2(a)(4)(i) (1988) (defining importer). The Treasury Regulation defines "importer" as any person bringing an article into the United States from outside the United States, "or who withdraws such an article from a customs bonded warehouse for sale or use in the United States." *Id.* If the article's named importer is not its beneficial owner, such as when the importer is a customs broker employed by the beneficial owner, the beneficial owner is the "importer" for federal tax purposes. *Id.*

they were delivered to the taxpayer. Haggerty, therefore, claimed it had no ownership interest in any specific tires until they were delivered and accepted.⁹¹ Thus, the taxpayer's position centered on the fact that Canada Tire was not a mere agent, but rather its own principal.⁹²

The majority chose to ignore the issue of whether Canada Tire was its own principal. In affirming the Claims Court ruling that Haggerty, and not Canada Tire, was the importer, the court held that the determination of who is the "importer" turns on who is "the inducing and efficient cause of the importation," that is, which party is "primarily responsible" for causing the tires to enter the United States.⁹³ Accordingly, technical rules involving place of sale and transfer of title are irrelevant.⁹⁴ The court reasoned that if such technical rules were adopted, it would be impossible to enforce collection of the tax if the taxpayer were a foreign corporation or resident with no contacts with the United States.⁹⁵

This holding, the court noted, had been the announced position of the IRS in several revenue rulings,⁹⁶ one of which presented facts virtually identical to *Terry Haggerty*. In Revenue Ruling 68-197,⁹⁷ a domestic corporation arranged to purchase goods, which were subject to a federal manufacturer's excise tax, from a foreign corpora-

91. See *Terry Haggerty Tire Co.*, 16 Cl. Ct. at 621-22 (declaring that Canada Tire should be "importer" liable for excise tax because it shipped tires to customs warehouse without existing order for tires from domestic company).

92. See *id.* at 622 (citing *Handley Motor Co. v. United States*, 338 F.2d 361, 364 (Ct. Cl. 1964) (pronouncing determination of who is "importer" depends on who arranges for shipment as principal and not as agent)).

93. See *Terry Haggerty Tire Co. v. United States*, 899 F.2d 1199, 1200 (Fed. Cir. 1990) (quoting *Import Wholesalers Corp. v. United States*, 368 F.2d 577, 585 (Ct. Cl. 1966)); see also *Corex Corp. v. United States*, 524 F.2d 1017, 1020-21 (9th Cir.) (holding that plaintiff was "importer" subject to tax because unincorporated association assumed functions of importer but did not perform substantial promotional activities, bear unusual risks, or earn significant profit), *cert. denied*, 425 U.S. 912 (1975); *Sony Corp. of Am. v. United States*, 428 F.2d 1258, 1265-66 (Ct. Cl. 1970) (asserting that plaintiff subdistributor was not "importer" where corporation retained initiative for introducing products into United States and engaged in promotional activities).

94. See *Terry Haggerty Tire Co.*, 899 F.2d at 1200 (citing *Import Wholesalers Corp. v. United States*, 368 F.2d 577, 583 (Ct. Cl. 1966) (noting determination of "importer" does not turn on technical rules such as sales law)).

95. See *Terry Haggerty Tire Co.*, 899 F.2d at 1201 (citing *Handley Motor Co. v. United States*, 338 F.2d 361, 364 (Ct. Cl. 1964) (remarking that persons or corporations in foreign country are inaccessible to collection procedures)).

96. See Rev. Rul. 69-393, 1969-2 C.B. 206 (noting necessity to look through transaction's form to its substance in determining whether nominal importer actually functions as typical import merchant or merely serves in representative capacity for bringing articles into United States); Rev. Rul. 67-209, 1967-1 C.B. 297 (stating that subsidiary in United States is considered "importer" of taxable articles when foreign company organizes subsidiary in United States to market certain articles).

97. Rev. Rul. 68-197, 1968-1 C.B. 455.

tion.⁹⁸ The foreign corporation shipped the goods directly to locations in the United States where the domestic corporation had offices, and the domestic corporation then distributed and sold the products.⁹⁹ The foreign corporation controlled the products through delivery, paid customs duties, and retained title until delivery.¹⁰⁰ In addition, the foreign corporation employed a customs broker in the United States to assist in clearing the goods through customs.¹⁰¹ The IRS concluded that because the foreign corporation was only a conduit, the domestic company was the true “importer” for purposes of determining who was responsible for paying the excise tax.¹⁰²

In a footnote, the majority dismissed Haggerty’s assertion that Canada Tire maintained a “permanent establishment” within the United States for purposes of the United States-Canada Income Tax Convention and was, therefore, the first United States resident purchaser of the tires.¹⁰³ Under Haggerty’s reasoning, as the first United States resident purchaser of the goods, Canada Tire, and not Haggerty, was liable for the excise tax.¹⁰⁴ The court noted, how-

98. *Id.* at 455.

99. *Id.* at 456.

100. *Id.*

101. *Id.*

102. *Id.* The ruling states in relevant part:

In the instant case, [the foreign corporation] is not engaged in selling articles in the United States. The technicalities of the import procedure, as a matter of fact, are subordinate to and geared to the needs and demands of [the domestic corporation]. Furthermore, the [foreign corporation’s] broker serves merely as a conduit through which the merchandise is cleared through customs for delivery to [the domestic corporation]. Thus, the fact that [the foreign corporation] agrees to incur and pay all expenses of transportation, customs clearance, and delivery or the fact that title does not pass to [the domestic corporation] until delivery does not give [the foreign corporation] any substance as an “importer” in the United States. Under such circumstances, [the domestic corporation] is the person in the United States who is the inducing and efficient cause of the articles being brought into the United States for his own sale or use.

Id.

103. See *Terry Haggerty Tire Co. v. United States*, 899 F.2d 1199, 1201 n.3 (Fed. Cir. 1990) (noting absence of cases or rulings in which nonresident foreign corporations have been held to be importers). Under Article VII of the Convention Between the United States of America and Canada with Respect to Taxes on Income and on Capital, a Canadian citizen is subject to United States federal income tax on all income earned in the United States that is derived from a “permanent establishment” in the United States. Convention Between the United States of America and Canada With Respect to Taxes on Income and on Capital, Sept. 26, 1980, United States-Canada, art. VII, para. 2, 1986-2 C.B. 258, 260. A permanent establishment in the United States includes a “person acting in the United States on behalf of a Canadian resident if such person has, and habitually exercises in the United States, an authority to conclude contracts in the name of the Canadian resident.” *Id.* at art. V, para. 5, 1986-2 C.B. 258, 259-60.

104. See *Handley Motor Co. v. United States*, 338 F.2d 361, 364 (Ct. Cl. 1966) (stating that “importer” for purposes of assessing excise tax is first purchaser resident in United States who arranges (as principal and not as agent) for goods to be brought into United States).

ever, that the treaty relates only to the reciprocal taxation of income and does not cover excise taxes.¹⁰⁵ Even if the court had been willing to extend the application of the treaty to excise taxes, it is unclear whether Canada Tire had a "permanent establishment" within the meaning of the treaty. The taxpayer would have had to show that Canada Tire had given its employees general authority to contract, as Canada Tire had no business facilities in the United States.¹⁰⁶ Given that the contracts in this case were oral, it is unlikely that Haggerty could have shown such authority, especially without Canada Tire's cooperation.

The dissent ignored the problem of whether the IRS could collect the tax from Canada Tire and found Canada Tire, and not Haggerty, liable for the tax.¹⁰⁷ The dissent emphasized that in summary judgment decisions, the court must construe the facts in the light most favorable to the non-moving party.¹⁰⁸ In this case, the possible absence of a principal/agent relationship between Haggerty and Canada Tire might make Canada Tire its own principal and "importer" for purposes of the excise tax. Consequently, when construing the facts in the light most favorable to Haggerty, the dissent believed the facts suggested a closer examination and thus would grant Haggerty a hearing on the merits.¹⁰⁹

Notwithstanding the dissent, it is unlikely that Haggerty could prove Canada Tire's permanent establishment in the United States. In spite of the dissent's assertion to the contrary, if Canada Tire were found liable for the tax, the IRS would be unable to collect the tax from Canada Tire. Whether courts should take such collection problems into consideration when determining who is liable for specific taxes is beyond the scope of this Article.

105. *Terry Haggerty Tire Co.*, 899 F.2d at 1201 n.3; see also Convention Between the United States of America and Canada With Respect to Taxes on Income and on Capital, Sept. 26, 1980, United States-Canada, art. II, 1986-2 C.B. 258 (setting forth taxes covered).

106. See United States-Canada Income Tax Convention, Jan. 1, 1941, United States-Canada, Protocol, para. 3(f), 1943 C.B. 526, 532 (maintaining that term "permanent establishment" includes cases where enterprise of one of contracting states carries on business in other contracting state through employee or agent in other state and that employee or agent has general authority to contract for employer or principal).

107. See *Terry Haggerty Tire Co.*, 899 F.2d at 1203 (Newman, J., dissenting) (suggesting that IRS could collect from Canada Tire).

108. *Id.* at 1201 (stating that Claims Court incorrectly resolved disputed material facts against non-movant); see also FED. R. CIV. P. 56 (providing for summary judgment in cases where pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any, show that there is no genuine issue as to any material fact and that moving party is entitled to judgment as matter of law).

109. See *Terry Haggerty Tire Co.*, 899 F.2d at 1203 (Newman, J., dissenting) (suggesting court should have vacated summary judgment to determine which party was importer).

IV. BUSINESS EXPENSES

The courts must often address the thorny issue of determining when an expenditure constitutes a deductible ordinary and necessary business expense.¹¹⁰ During the 1990 term, the Federal Circuit considered this issue in *Danville Plywood Corp. v. United States*.¹¹¹ The court in *Danville Plywood* upheld the Claims Court's finding that certain expenditures made during the taxpayer's 1980 and 1981 tax years were not deductible.¹¹²

Specifically, Danville Plywood Corporation (Danville) deducted sizeable amounts in connection with a sales seminar it conducted in New Orleans, Louisiana, that coincided with the 1981 Super Bowl.¹¹³ Danville paid all travel, hotel, and ticket expenses for approximately 120 persons ("attendees") primarily comprised of Danville customers, employees, spouses, and their children.¹¹⁴ After an exhaustive evidentiary examination, the Claims Court concluded that the taxpayer did not meet its threshold burden of showing that the Super Bowl expenses qualified as deductible ordinary and necessary business expenses.¹¹⁵ It further held that, even if the expenditures qualified as deductible business expenses, they would not be deductible because, as entertainment expenses, they were

110. See I.R.C. § 162 (1986) (setting forth rule that taxpayers may only deduct trade or business expenses that are ordinary and necessary).

111. 899 F.2d 3 (Fed. Cir. 1990).

112. *Danville Plywood Corp. v. United States*, 899 F.2d 3, 9 (Fed. Cir. 1990) (upholding Claims Court ruling that taxpayer failed to show claimed deductions ordinary and necessary), *aff'g* 16 Cl. Ct. 584 (1989).

113. See *id.* at 5 & n.2 (detailing expenses). These expenditures included \$27,151 paid for Super Bowl tickets, \$30,722 for air fares, \$45,300 for accommodations and services, and \$272 for the delivery/pick-up of the Super Bowl tickets. *Id.*

114. *Id.* at 5 (reviewing list of participants).

115. See I.R.C. § 162(a) (1986) (providing deduction only for "ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including . . . traveling expenses") (emphasis added).

Only traveling expenses incurred "while away from home in the pursuit of a trade or business" may be deducted. *Id.* In addition, the Regulations provide that only such travel expenses that are "reasonable and necessary in the conduct of the taxpayer's business and directly attributable to it may be deducted. If the trip is undertaken for other than business purposes, the travel fares and expenses incident to travel are personal expenses and the meals and lodging are living expenses." Treas. Reg. § 1.162-2(a) (as amended in 1958) (emphasis added). However, "[i]f the trip is solely on business, the reasonable and necessary traveling expenses, including travel fares, meals and lodging, and expenses incident to travel, are business expenses . . ." *Id.*

Where a taxpayer incurs travel expenses to and from a destination at which the taxpayer "engages in both business and personal activities, traveling expenses to and from such destinations are deductible only if the trip is related primarily to the taxpayer's trade or business." *Id.* § 1.162-2(b) (emphasis added). In contrast, where the trip is "primarily personal in nature," traveling expenses "to and from the destination are not deductible even though the taxpayer engages in business activities while at such destination." *Id.* Nevertheless, expenses incurred at the destination "properly allocable to the taxpayer's trade or business are deductible even though the traveling expenses to and from the destination are not deductible." *Id.*

not "directly related to"¹¹⁶ or "associated with"¹¹⁷ the active conduct of the taxpayer's trade or business.¹¹⁸

The Federal Circuit limited itself to a clearly erroneous standard of review of the Claims Court's factual determinations of whether the taxpayer met the above tests.¹¹⁹ The court found that the Claims Court's conclusions—that the expenditures were not ordinary and necessary business expenses—were not clearly erroneous; thus, it did not discuss whether the expenditure, if ordinary and necessary to the taxpayer's trade or business, would have satisfied the additional requirements of being either directly related to or associated with the trade or business.¹²⁰

Both the trial court and the Federal Circuit Court examined the relation of the employees, customer representatives, and their spouses to the corporation's business. As to spouses of employees or customers, the Federal Circuit focused on whether the presence of any spouse served a bona fide business purpose¹²¹ and whether such purpose constituted the "dominant purpose" for the spouse's attendance.¹²² The court found that the taxpayer simply did not present sufficient evidence to establish that the attendance of any spouses or relatives satisfied those tests.¹²³

116. See Treas. Reg. § 1.274-2(c)(3)(i)-(iv) (as amended in 1985) (defining instances where entertainment expenditures may be "directly related to" business). There are four requirements under the "directly related to" test: (1) the taxpayer must have a reasonable expectation of deriving some income or direct benefit (as opposed to goodwill) from the entertainment; (2) the taxpayer must actively engage in a *bona fide* business discussion or transaction during the entertainment; (3) the *bona fide* business discussion must constitute the principal activity; and (4) the taxpayer must allocate expenses between business and nonbusiness guests in attendance. *Id.*

117. See I.R.C. § 274(a)(1)(A) (1986) (allowing deduction for entertainment expenses "in the case of an item directly preceding or following a substantial and *bona fide* business discussion (including business meetings at a convention or otherwise), [where the taxpayer establishes] that such item was *associated with*, the active conduct of the taxpayer's trade or business") (emphasis added).

118. See *Danville Plywood Corp. v. United States*, 16 Cl. Ct. 584, 603-08 (1989) (discussing application of section 274 requirements, notwithstanding fact that court had already concluded that expenses were neither ordinary nor necessary).

119. *Danville Plywood Corp. v. United States*, 899 F.2d 3, 7 (Fed. Cir. 1990) (citing *FED. R. Civ. P.* 52(a) (discussing standard of review)).

120. *Id.* at 9 (affirming Claims Court on basis of section 162 requirements and finding unnecessary to reach section 274 requirements).

121. See Treas. Reg. § 1.162-2(c) (as amended in 1958) (stating that expenses attributable to travel of taxpayer's wife when accompanying spouse on business trip are not deductible unless taxpayer can demonstrate that "wife's presence on the trip ha[d] a bona fide business purpose"). The wife's expenses will not be deductible if she solely performs "some incidental service." *Id.* These rules also extend to "other members of the taxpayer's family who accompany him on such a trip." *Id.*

122. See *Danville Plywood Corp.*, 899 F.2d at 8 (citing *United States v. Disney*, 413 F.2d 783, 788 (9th Cir. 1969) (suggesting that focus should be whether spouse's presence was to serve business purpose and whether spouse's activities conformed to this purpose)).

123. *Danville Plywood Corp.*, 899 F.2d at 8 (finding that spouses did not serve dominant purpose of assisting with trip's business purpose).

As for the expenditures attributable to the taxpayer's employees and customers, the Federal Circuit conceded that the trip may have increased sales and generally promoted the taxpayer's business, but agreed that its central focus was entertainment.¹²⁴ The court adopted the established rule that expenditures must be "appropriate and helpful" to the development of the taxpayer's business to be considered "necessary."¹²⁵ The court also concluded that to qualify as "ordinary," an expenditure must be "normal, usual, or customary"¹²⁶ in order to properly distinguish it from an expenditure that must be capitalized and depreciated.¹²⁷ Applying these standards to the evidence presented to the Claims Court, the Federal Circuit could not overturn the lower court's findings as clearly erroneous.¹²⁸

V. STATUTE OF LIMITATIONS

Another major issue addressed by the Federal Circuit focused on the finality of Tax Court decisions. Section 6213(a) prohibits the IRS from commencing collection activity against a taxpayer until ninety days after the Service mails a notice of deficiency to the taxpayer.¹²⁹ If the taxpayer files a petition in the Tax Court, however, the normal three-year statute of limitations for assessing tax¹³⁰ is suspended until sixty days after the Tax Court's decision becomes final.¹³¹ Generally, the Tax Court's decision becomes final when the time allowed for filing a notice of appeal expires, that is, ninety days after the Tax Court's decision is entered.¹³²

The court in *Pesko v. United States*¹³³ interpreted the interaction of these rules to determine whether the ninety-day period of section

124. *Id.* at 9.

125. *Id.* at 6 (citing *Commissioner v. Tellier*, 383 U.S. 687, 689 (1966) (defining necessary business expenses as "appropriate" and "helpful" to business)).

126. *See Danville Plywood Corp. v. United States*, 899 F.2d 3, 6 (Fed. Cir. 1990) (citing *Deputy v. duPont*, 308 U.S. 488, 495 (1940) (examining what constitutes "normal" business expenditure)).

127. *See Danville Plywood Corp.*, 899 F.2d at 6 (citing *Welsh v. Helvering*, 290 U.S. 111, 113-14 (1933) (distinguishing ordinary expenses from other types of expenses)); *see also* I.R.C. § 167 (1986) (discussing depreciation of capitalized assets).

128. *Danville Plywood Corp.*, 899 F.2d at 9 (declaring court's finding in light of standard applied).

129. I.R.C. § 6213(a) (1986). The notice of deficiency informs the taxpayer that the IRS believes he or she owes additional tax and that the IRS will commence an action for collection 90 days after the date of the notice unless the taxpayer files a Tax Court petition or pays the tax. *Id.* § 6212(a).

130. Generally, tax must be assessed within three years after filing a return. *Id.* § 6501(a).

131. *See id.* § 6503(a)(1) (explaining suspension procedure).

132. *See id.* § 7481 (providing time when court decisions become final); *see also id.* § 7483 (setting expiration of period to file notice of appeal). Note that the 60-day period of § 6503(a)(1) and the 90 day period of § 7481(b) total to 150 days.

133. 918 F.2d 1581 (Fed. Cir. 1990).

6213(a) terminated upon entry of a stipulated Tax Court decision containing a waiver of restrictions on assessment.¹³⁴ During an audit of the taxpayers' 1970 individual income tax return, the taxpayers consented to extend the statute of limitation on assessment from April 15, 1974 to December 31, 1975.¹³⁵ On December 24, 1975, the IRS issued a notice of deficiency to the taxpayers, who subsequently filed a petition in the Tax Court to redetermine the proposed deficiency.¹³⁶ The parties eventually agreed to a stipulated settlement of the dispute.¹³⁷ Consequently, on April 29, 1985, the Tax Court entered a stipulated decision settling the amount the taxpayers owed.¹³⁸ The taxpayers also signed a waiver permitting the IRS to assess the agreed amount of tax upon entry of the Tax Court's decision without requiring the IRS to send a notice of deficiency.¹³⁹ On October 4, 1985, the IRS sent a notice to the taxpayer that demanded payment. The notice reflected an assessment date of September 24, 1985, 148 days after the April 29 Tax Court decision.¹⁴⁰

A dispute arose concerning when the Tax Court decision became final for purposes of section 6503(a)(1). If the decision became final ninety days after entry (*i.e.* July 29), then the assessment was timely because the IRS would have a total of 150 days from April 29 to make the assessment.¹⁴¹ The taxpayers contended that the waiver of restrictions on assessment under section 6213(a) finalized the Tax Court judgment immediately upon entry of the stipulated agreement on April 29, 1985, and not ninety days thereafter.¹⁴²

134. *Pesko v. United States*, 918 F.2d 1581, 1581 (6th Cir. 1990), *aff'g* 19 Cl. Ct. 687 (1990).

135. *Id.*; see also I.R.C. § 6213(c)(4) (1986) (explaining that taxpayer may voluntarily agree to extend statute of limitation by signing Form 872 (Consent Fixing Period of Limitation Upon Assessment of Income Tax)); see also IRS Form 872, *reprinted in* 1 IRS Forms 870.1 (BNA) (Sept. 24, 1990) (reprinting form used to extend statute of limitation).

136. *Pesko*, 918 F.2d at 1582.

137. *Id.* (indicating settlement decision).

138. See *id.* (setting forth stipulated agreement). The agreement provided in part:

It is further stipulated that, effective upon the entry of the decision by the Court, [taxpayers] waive the restriction contained in [I.R.C. section 6213(a)] prohibiting assessment and collection of the deficiency (plus statutory interest) until the decision of the Tax Court has become final.

Id.

139. See *id.* at 1583 (explaining other waiver factors); see also I.R.C. § 6213(d) (1986) (permitting taxpayer to waive right to notice of deficiency provided for in section 6213(a) and allowing IRS to assess immediately tax deficiency).

140. See *Pesko v. United States*, 19 Cl. Ct. 687, 688 (1990) (discussing assessment period).

141. See I.R.C. § 7483 (1986) (providing 90 days to file appeal notice); see also *id.* § 6503(a)(1) (providing IRS additional 60 days to assess underpayment once Tax Court decision is final).

142. See *Pesko v. United States*, 918 F.2d 1581, 1582 (Fed. Cir. 1990) (setting forth taxpayer's claim of untimeliness).

Thus, the taxpayers argued, the assessment was not timely because the IRS had only sixty days from this date to make the assessment.

In rejecting this argument, the court found that the taxpayers' waiver simply accelerated assessment under section 6213(a) and did not change the date that the Tax Court's decision became final.¹⁴³ In affirming the government's position, the court looked to *Security Industrial Insurance Co. v. United States*¹⁴⁴ and *Sherry Frontenac, Inc. v. United States*,¹⁴⁵ cases in the Fifth and Eleventh Circuits, respectively, that considered this issue under similar facts.¹⁴⁶ The *Pesko* court, like the Fifth Circuit in *Security Industrial*, distinguished *United States v. Shepard's Estate*,¹⁴⁷ which suggested that a stipulated Tax Court decision became final upon date of entry rather than ninety days thereafter.¹⁴⁸ However, the direct issue of whether a stipulated decision becomes final upon entry rather than ninety days thereafter was not raised in *Shepard's Estate* as it had been in *Security Industrial* and *Sherry Frontenac, Inc.* The *Pesko* court, therefore, based its decision on the reasoning of those cases that had squarely faced the same issue.

The *Pesko* court also distinguished *Elizalde v. Commissioner*.¹⁴⁹ In *Elizalde*, the Tax Court indicated that a stipulated decision becomes final upon entry without regard to the ninety-day period provided

143. See *id.* at 1583 (explaining court's reasoning).

144. 830 F.2d 581 (5th Cir. 1987).

145. 868 F.2d 420 (11th Cir. 1989).

146. In *Security Industrial Insurance Co.*, the taxpayer contended that, because stipulated decisions cannot be appealed, a stipulated Tax Court decision that is not appealed is final on the date of entry, rather than 90 days thereafter. *Security Indus. Ins. Co. v. United States*, 830 F.2d 581, 585 (5th Cir. 1987) (setting out taxpayer's contention). The Fifth Circuit rejected this argument and held the final date of a stipulated decision is the same as for any Tax Court decision that is not appealed, *i.e.*, 90 days after the date of entry. *Id.* at 586. In so holding, the Fifth Circuit found that the date of finality provided in sections 7481 and 7483 encompasses all Tax Court cases, whether stipulated or not. Further, the court decided that the 90-day period of section 7483 must be included in the statute of limitation under section 6503 in stipulated Tax Court decisions because taxpayers do, in fact, appeal stipulated decisions. *Id.* For instance, the taxpayer might appeal under the belief that the Tax Court lacked subject matter jurisdiction. *Id.*

Similarly, in *Sherry Frontenac, Inc.*, under facts identical to those in *Pesko*, the Eleventh Circuit rejected the taxpayer's argument that the 90 day period established in sections 7481 and 7483 was inapplicable to a stipulated Tax Court decision. *Sherry Frontenac, Inc. v. United States*, 868 F.2d 420, 423 (11th Cir. 1989) (presenting facts and explaining inapplicability of 90-day provision to stipulated decisions); see also *Becker Bros., Inc. v. United States*, 88-1 U.S. Tax Cas. (CCH) ¶ 9262, at 83,600 (C.D. Ill. 1988) (finding that IRS is permitted 90 days from date on which stipulated Tax Court decision is entered along with 60-day period of § 6503 to assess tax).

147. 319 F.2d 699 (2d Cir. 1963).

148. *United States v. Shepard's Estate*, 319 F.2d 699, 700 (2d Cir. 1963) (making this suggestion); see also *Security Indus. Ins. Co. v. United States*, 830 F.2d 581, 584 n.7 (5th Cir. 1981) (distinguishing *Shepard's Estate*).

149. 48 T.C.M. (CCH) 28 (1984).

for in sections 7481(a)(1) and 7483.¹⁵⁰ As in *Shepard's Estate*, however, the primary issue in *Elizalde* concerned fraudulent transfers and was unrelated to the statute of limitation issue raised in *Pesko*. The litigants did not address the statute of limitation issue briefly mentioned in *Elizalde*, and the assessment in question was found timely.

The *Pesko* court also pointed out that the taxpayers' reliance on Revenue Ruling 66-17 was misplaced.¹⁵¹ Under the facts of this Ruling, a taxpayer received a notice of deficiency and promptly waived the ninety-day restriction on assessment under section 6213(a) without filing a Tax Court petition. The Service held that the suspension period of section 6503(a) terminated sixty days after receipt of the waiver.¹⁵² This ruling, however, never reached the central concern of the *Pesko* court—finality.

Finally, the *Pesko* court found ironic the taxpayers' claim that the assessment of the IRS violated some standard of fair play and decency when, in fact, the taxpayers were attempting to avoid an admitted liability through a legal technicality.¹⁵³ The taxpayers and the IRS entered into a compromise of the taxpayers' liability that the taxpayers knew would result in an assessment. Therefore, if this case were to be decided by the equities of the circumstances, the court noted that the IRS, not the taxpayers, should prevail.¹⁵⁴ The court's holding and its rejection of the taxpayers' arguments, when coupled with similar decisions in other circuits, should dissuade other taxpayers from raising this issue in other jurisdictions.

VI. PROCEDURAL ISSUES

During 1990, the Federal Circuit decided several cases that involved procedural issues, none of which dealt directly with tax issues.¹⁵⁵ Of these decisions, perhaps the most significant involved the meaning of the term "prevailing party" for purposes of awarding court costs to the government following a finding that the tax-

150. *Elizalde v. Commissioner*, 48 T.C.M. (CCH) 28, 35 (1984) (discussing finality of decision).

151. Rev. Rul. 66-17, 1966-1 C.B. 272, 272.

152. *Id.* at 274 (explaining finality).

153. See *Pesko v. United States*, 918 F.2d 1581, 1585 (Fed. Cir. 1990) (finding no sympathy for taxpayers who abuse system).

154. *Id.*

155. See, e.g., *Murray v. United States*, 918 F.2d 185 (Fed. Cir. 1990) (reversing lower court's decision based on question of subject matter jurisdiction); *Taylor v. United States*, 915 F.2d 1584 (Fed. Cir. 1990) (agreeing with Claims Court that it lacked jurisdiction); *Schiff v. United States*, 914 F.2d 271 (Fed. Cir. 1990) (affirming Claims Court's dismissal); *Carter v. United States*, 909 F.2d 1452 (Fed. Cir. 1990) (upholding lower court's ruling on subject matter jurisdiction).

payer was liable for section 6672 employment taxes. The others dealt generally with the issue of the Claims Court's jurisdiction over a tax dispute.

A. Prevailing Party

In *Schultz v. United States*,¹⁵⁶ the court upheld a Claims Court award of costs against appellant Schultz.¹⁵⁷ The lower court had ordered Schultz to pay the costs of his trial under Claims Court Rule 54(d).¹⁵⁸ The substantive legal issue considered by the Claims Court was whether the appellant was subject to the 100% penalty imposed by section 6672.¹⁵⁹ The Claims Court applied the "responsible person" standard of liability by applying a two-part test: (1) whether the taxpayer had a duty to collect and pay income and Federal Insurance Contributions Act (FICA) taxes to the federal government, and if so, (2) whether the failure to pay was willful.¹⁶⁰

The Claims Court, after weighing the evidence, concluded that Schultz was a corporate officer who was a "responsible person" within the meaning of section 6672 and that his failure to pay was willful.¹⁶¹ The Claims Court, however, abated the government's claim by \$4,776.88, which represented the amount paid by another former officer and responsible person of the corporation.¹⁶² Ultimately, the government accepted \$9,624.94 from Schultz in full satisfaction of his claim.¹⁶³

Although Schultz appealed all of the trial court's findings, the Federal Circuit addressed only the propriety of the award of costs against the plaintiff. Schultz argued that the government did not "prevail" for purposes of assessing costs because the government

156. 918 F.2d 164 (Fed. Cir. 1990).

157. *Schultz v. United States*, 918 F.2d 164, 167 (Fed. Cir.), *aff'g* 19 Cl. Ct. 280 (1990).

158. *See Schultz v. United States*, 19 Cl. Ct. 280, 280 (1990) (setting forth lower court's opinion in detail); *see also* CL. Cr. R. 54(d) (stating that "costs shall be allowed as a matter of course to the prevailing party unless the court otherwise directs").

159. *Schultz*, 19 Cl. Ct. at 280 (addressing penalty assessment question). To enforce collection when a corporate employer does not pay its employment taxes, section 6672(a) imposes personal liability on persons responsible for ensuring that taxes are paid. I.R.C. § 6672(a) (1986). In essence, any person required by law to collect, account for, and pay any tax who "willfully fails to collect such tax, or truthfully account for and pay over such tax, or willfully attempts in any manner to evade or defeat any such tax or the payment thereof" must pay a penalty in the amount of the tax evaded, not collected, or not accounted for and paid. *Id.*

160. *See Schultz*, 19 Cl. Ct. at 290 (invoking "responsible person" test). The term "responsible person" is not actually found in the Code; rather, it was developed by the courts as a matter of convenience. *See Slodov v. United States*, 436 U.S. 238, 246 n.7 (1978) (setting forth "responsible person" standard).

161. *See Schultz*, 19 Cl. Ct. at 290 (applying "responsible person" test to taxpayer).

162. *Id.*

163. *Schultz v. United States*, 918 F.2d 164, 165 (Fed. Cir. 1990) (providing background).

had accepted an amount less than the amount of its original claim.¹⁶⁴

The court found the law on this issue to be well settled. Generally, the Claims Court's Rules provide that litigation costs are awarded to the prevailing party.¹⁶⁵ In holding in the government's favor, the court looked to analogous cases and statutes for definitions of the term, prevailing party,¹⁶⁶ and found that for purposes of awarding costs, a party need not prevail on all issues to be deemed the prevailing party.¹⁶⁷ In essence, the taxpayer asked the court to look at the amount of the government's settlement of the taxpayer's suit, rather than at the taxpayer's potential liability. Thus, the taxpayer reasoned that because the government accepted \$4,776.88 less than it had initially claimed, he must have "won" in some manner.¹⁶⁸

The Federal Circuit rejected this argument and instead held that the proper method to determine the prevailing party is to look at who prevails on the central issues.¹⁶⁹ The court found the central issues in this case to be: (1) whether the taxpayer was a "responsible person," and (2) whether his failure to pay was willful.¹⁷⁰ The trial court found for the government on both issues, making it the "prevailing party" for Rule 54(d) purposes.¹⁷¹

164. *Id.* at 166.

165. *See* CL. CT. R. 54(d) (allocating costs).

166. *See* *Schultz*, 918 F.2d at 167 (looking to other cases). The court noted that the language of Claims Court Rule 54(d) is nearly identical to Federal Rule of Civil Procedure 54(d), and is similar to the language in the Equal Access to Justice Act (EAJA), 28 U.S.C. § 2412(d)(1)(A) (1990). As a result, the court cited cases defining prevailing party under these analogous statutes. As authority to cite analogous decisions as precedent, the court pointed to *Hensley v. Eckerhart*, 461 U.S. 424, 433 n.7 (1983), which held that the "standards set forth in this opinion are generally applicable in all cases" where a prevailing party may be entitled to an award. *Schultz*, 918 F.2d at 164 n.2.

167. *See* *United States v. Mitchell*, 580 F.2d 789, 793 (5th Cir. 1978) (commenting that "party need not prevail on all issues to justify a full award of costs"); *Lodges 743 & 1746 Int'l Ass'n of Machinists v. United Aircraft Corp.*, 534 F.2d 422, 448 (2d Cir. 1974) (stating that "[i]t is axiomatic that a plaintiff need not sustain his entire claim to be regarded as the prevailing party"), *cert. denied sub nom. Lodge 743 & 1746 v. NLRB*, 429 U.S. 825, 825 (1976); *K-2 Ski Co. v. Head Ski Co.*, 506 F.2d 471, 477 (9th Cir. 1974) (awarding plaintiff costs even though plaintiff prevailed on only two of twelve trade secrets claims); *see also* *Austin v. Department of Commerce*, 742 F.2d 1417, 1419 (Fed. Cir. 1984) (stating that although EAJA does not define prevailing party, "typical formulation is that plaintiffs may be considered 'prevailing parties' for attorney fees purposes if they succeed on *any significant issue* in litigation which achieves some of the benefit the parties sought in bringing the suit") (quoting *Hensley v. Eckerhart*, 461 U.S. 424, 433 (1983) (emphasis added)).

168. *Schultz*, 918 F.2d at 166 (explaining taxpayer's approach to Claims Court appeals proceeding).

169. *Id.* (citing *Hensley*, 461 U.S. at 433 n.8 (stating that "proper focus is whether the plaintiff has been successful on the central issue as exhibited by the fact that he has acquired the primary relief sought")) (quoting *Taylor v. Sterrett*, 640 F.2d 663, 669 (5th Cir. 1981)).

170. *Id.* at 166 (describing issues on which government prevailed as "controlling").

171. *Id.* at 166 & n.3 (reviewing role of controlling issues in trial court to clarify "correct vantage point" for prevailing party determination).

An interesting question arises in comparing the prevailing party standard of Claims Court Rule 54(d) with the standard set forth in section 7430.¹⁷² Section 7430 permits a taxpayer who is a prevailing party to recover costs and attorneys' fees only when he "substantially" prevails.¹⁷³ Under this provision, the taxpayer must substantially prevail as to either amount¹⁷⁴ or the "most significant issue or set of issues" to be deemed the prevailing party.¹⁷⁵ The court in *Schultz* properly applied the (presumably lower) prevailing party standard of Claims Court Rule 54(d) because section 7430 applies only where the prevailing party is someone other than the United States or a creditor of the taxpayer.¹⁷⁶ Where the award is against the government, however, the Claims Court and the Federal Circuit should evaluate the two standards carefully to reconcile, if possible, any inconsistencies in their application.¹⁷⁷ Regardless of the choice of a standard for awarding costs in a tax controversy, this case illustrates that a taxpayer will have to prevail on at least some substantive issues to avoid an award of litigation costs to the government.

B. Jurisdiction of the Claims Court

In general, a claim may not be brought before a federal district court or the Claims Court if the taxpayer fails to meet any one of the three jurisdictional prerequisites: (1) filing of a timely administrative claim for refund,¹⁷⁸ (2) paying in full any assessed tax,¹⁷⁹ and

172. Compare Cl. Ct. R. 54(d) (allowing costs to prevailing parties as matter "of course") with I.R.C. § 7430(a) (1986) (allowing taxpayer recovery of only specified costs). Costs recoverable by virtue of section 7430(a) include "reasonable administrative costs incurred in connection with such administrative proceeding within the [I.R.S.]" and "reasonable litigation costs incurred in connection with such court proceeding." *Id.* § 7430(a).

173. See I.R.C. § 7430(c)(4) (1986) (defining prevailing party for federal tax purposes). A prevailing party is a party to a proceeding described in section 7430(a) who "establishes that the position of the United States in the proceeding was not substantially justified" and who has either "substantially prevailed with respect to the amount in controversy" or has "substantially prevailed with respect to the most significant issue or set of issues presented." *Id.*; see also *id.* § 7430(a) (allowing cost recovery for any "administrative or court proceeding . . . brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty"). The determination as to who is a prevailing party may be made "by agreement of the parties", by the IRS, or by the court. See *id.* § 7430(c)(4)(B) (setting out method to determine prevailing party status).

174. See *id.* § 7430(c)(4)(A)(ii)(I) (elaborating on prevailing party definition).

175. See *id.* § 7430(c)(4)(A)(ii)(II) (expanding prevailing party definition with alternate ground to determine status).

176. See *Schultz v. United States*, 918 F.2d 164, 164-66 (Fed. Cir. 1990) (examining Claims Court's application of Rule 54(d) and basing Federal Circuit's finding on application of same rule); see also I.R.C. § 7430(c)(4)(A) (1986) (defining scope of application of prevailing party definition).

177. Interestingly, the Tax Court Rules incorporate the "substantially prevail" standard of section 7430(c)(4). See U.S. Tax Ct. R. 232(c) (providing for disposition of costs and allocating burden to moving party to show that party "substantially prevailed").

178. See I.R.C. § 7422(a) (1986) (stating that no court may maintain an action to recover "any revenue tax alleged to have been erroneously or illegally assessed or collected" until

(3) meeting prescribed time limits within which a suit must be brought.¹⁸⁰ In three unpublished opinions, the Federal Circuit addressed these jurisdictional requirements.¹⁸¹

In *Schiff v. United States*,¹⁸² the taxpayer filed a claim for refund on April 4, 1988.¹⁸³ The facts surrounding the taxpayer's refund claim were undisputed.¹⁸⁴ The issue was whether the tax (plus penalties and interest) had been paid within two years prior to this filing date, thus enabling the taxpayer to claim a refund within the statute of limitations.¹⁸⁵ In connection with the taxpayer's 1975 tax year, the IRS assessed \$1,380 on March 25, 1985, in complete satisfaction of his liability for the earlier year.¹⁸⁶ Taxpayers generally must file refund claims no later than three years from the time they file their tax return, or as in this case, two years from the time the tax is paid.¹⁸⁷ Consequently, the taxpayer cannot sue the United States for a refund where a timely refund claim has not been filed.¹⁸⁸ In *Schiff*, the taxpayer contended that his refund claim was timely in that a \$190 interest assessment attributable to taxes collected from tax year

taxpayer files refund or credit claim with the Secretary); see also *id.* § 6511(a) (setting forth as limitation to filing claim within later of three years from date return filed or two years from date tax paid or "if no return was filed by the taxpayer, within [two] years from the time" taxpayer paid tax).

179. See *Flora v. United States*, 357 U.S. 63, 69-75 (1958) (interpreting 28 U.S.C. § 1346(a)(1) (1990) as requiring full payment before federal courts have jurisdiction to hear claim brought against United States). There are certain exceptions to this requirement. For example, sections 6694(c) and 6703(c) permit taxpayers to file suit against the United States after only 15% of certain penalties have been paid. See I.R.C. § 6694(c) (1986) (providing that if taxpayer files refund claims and has paid at least 15% of contested amount, action for collection of remainder will not occur until filed claim resolved); *id.* § 6703(c) (providing similar extension of collection period).

180. See I.R.C. § 6532(a) (1986) (setting time limits to bring suit). Generally, "[n]o suit or proceeding . . . for the recovery of any internal revenue tax, penalty, or other sum, shall be begun before the expiration of 6 months from the date of filing the claim . . ." *Id.* In addition, no claim may be brought "after the expiration of [two] years from the date of mailing by certified mail or registered mail by the Secretary to the taxpayer of a notice of the disallowance of the part of the claim to which the suit or proceeding relates." *Id.*

181. See FED. CIR. R. 47.8 (specifying that unpublished decisions may not be employed as precedent except in matters on same case such as *res judicata*).

182. No. 90-5025, slip op. at 1 (Fed. Cir. Aug. 21, 1990) (LEXIS, Genfed library, CAFC file).

183. *Schiff v. United States*, No. 90-5025, slip op. at 1 (Fed. Cir. Aug. 21, 1990) (LEXIS, Genfed library, CAFC file).

184. The taxpayer was a "tax protester" who had refused to pay income taxes for several years and published a book entitled *How Anyone Can Stop Paying Income Taxes*. See *Schiff v. Commissioner*, 751 F.2d 116, 116 (2d Cir. 1984) (upholding IRS assessment of additional taxes for failure to pay and fraudulent underpayment, and assessing double costs and damages), *aff'g* 47 T.C.M. (CCH) ¶ 1706 (1984).

185. *Schiff*, No. 90-5025, slip op. at 2-3 (stating issue of case).

186. *Id.* at 3.

187. See I.R.C. § 6511 (1986) (providing period of limitation on filing credit or refund claim).

188. See *id.* § 7422 (maintaining that taxpayers may not bring suit prior to filing refund claim).

1975 was recorded on May 15, 1986, bringing April 4, 1988 within the permitted filing time.¹⁸⁹

The issue in the case was whether the interest assessment was a separate payment, and therefore subject to its own two-year statute of limitation for refunds, or whether it was merely a reclassification of an assessment that was made on March 25, 1985.¹⁹⁰ The Federal Circuit, applying a clearly erroneous standard, refused to overturn the Claims Court opinion that determined Schiff's tax liability was fully paid on March 25, 1985, and characterized the subsequent assessment of interest on May 15, 1986 as a mere reclassification of the prior assessment.¹⁹¹ The court also affirmed the imposition of sanctions¹⁹² on Schiff for abusing the judicial process by filing a frivolous appeal because all of the substantive theories he advanced had been explicitly rejected by the courts, not only in unrelated cases, but in cases where Schiff himself was a party.¹⁹³

The second case in which the Federal Circuit addressed a jurisdictional question was in *Murray v. United States*.¹⁹⁴ In *Murray*, the Federal Circuit overturned the Claims Court's dismissal of a refund suit. The Claims Court had dismissed the taxpayer's action *sua sponte* because it concluded that the taxpayer had failed to pay the entire amount assessed against him for his 1985 tax liability.¹⁹⁵ The Federal Circuit overturned the Claims Court holding by finding that in subject matter jurisdiction dismissal actions, the court must take as true all allegations in the complaint.¹⁹⁶ In addition, all inferences must be interpreted in favor of the party whose action would be dis-

189. *Schiff*, No. 90-5025, slip op. at 4.

190. *See id.* (pointing out critical issue was whether assessment of interest qualified as separate payment).

191. *Id.* (citing *Heisig v. United States*, 719 F.2d 1153, 1158 (Fed. Cir. 1983) (setting forth Federal Circuit standard of review as clearly erroneous)).

192. *See* FED. R. APP. P. 38 (authorizing damages and costs against filers of frivolous appeals).

193. *See Schiff v. United States*, No. 90-5025, slip op. at 5-6 (Fed. Cir. Aug. 21, 1990) (LEXIS, Genfed library, CAFC file) (reviewing these cases); *see also United States v. Schiff*, 801 F.2d 108, 110-12 (2d Cir. 1986) (stating that "disagreement with law is no defense to tax violation"), *cert. denied*, 480 U.S. 945 (1987); *Newman v. Schiff*, 778 F.2d 460, 467 (8th Cir. 1985) (explaining that filing of federal income tax return is mandatory under section 6012); *United States v. Schiff*, 612 F.2d 73, 83 (2d Cir. 1979) (finding fifth amendment privilege unavailable against all disclosures on income tax return).

194. No. 90-5068, slip op. at 1 (Fed. Cir. Oct. 2, 1990) (LEXIS, Genfed library, CAFC file).

195. *Murray v. United States*, No. 90-5068, slip op. at 1-2 (Fed. Cir. Oct. 2, 1990) (LEXIS, Genfed library, CAFC file) (citing *Flora v. United States*, 362 U.S. 145, 146 (1960) (stating rule that entire amount assessed must be paid and refund sought before Claims Court has jurisdiction)).

196. *Murray*, No. 90-5068, slip op. at 3 (setting forth proper standard in actions for subject matter jurisdiction dismissal).

missed.¹⁹⁷ Applying this standard, the court found that the record indicated the possibility that the 1985 tax liability had been entirely paid, thereby enabling the taxpayer to bring his claim.¹⁹⁸

The final case in which the Federal Circuit addressed a jurisdictional question was *Taylor v. United States*.¹⁹⁹ In *Taylor*, the Federal Circuit partly affirmed and partly reversed and remanded the Claims Court's dismissal for lack of jurisdiction over petitioner's refund claims. The appellant filed suit in the Claims Court on June 3, 1988, claiming income tax overpayments for 1982, 1985, 1986, and 1987.²⁰⁰ The Federal Circuit affirmed the Claims Court summary judgment ruling that it lacked jurisdiction with respect to the 1985, 1986, and 1987 tax years because the appellant failed to file a refund claim with the IRS before filing the Claims Court suit.²⁰¹ With respect to the 1982 year, however, the court overturned the Claims Court ruling that it lacked jurisdiction on the grounds that the taxpayer had failed to file a claim for refund within the limitation period of section 6511.²⁰² The court found that the refund claim attributable to tax year 1982 arose out of a credit of an overpayment on the taxpayer's 1985 return applied on April 14, 1986.²⁰³ Consequently, the taxpayer's refund claim on April 20, 1987 was timely under the two year statute of limitations of section 6511(a), and the Court remanded the case with respect to tax year 1982.²⁰⁴

CONCLUSION

The court found for the taxpayer in only two of the thirteen tax decisions handed down by the Federal Circuit this term.²⁰⁵ One

197. *Id.*

198. *Id.* at 3-4 (making finding based on facts of case). The Court found two items of evidence supporting the petitioner's contentions: (1) the original complaint alleged complete payment, and (2) other evidence, including an attorney's letter and a check corroborating this claim. *Id.*

199. No. 90-5050, slip op. at 1 (Fed. Cir. Sept. 25, 1990) (LEXIS, Genfed library, CAFC file).

200. *Taylor v. United States*, No. 90-5050, slip op. at 1 (Fed. Cir. Sept. 25, 1990) (LEXIS, Genfed library, CAFC file) (recounting procedural history), *aff'g* 18 Cl. Ct. 713 (1989).

201. See I.R.C. § 7422(a) (1986) (requiring filing of claim to bring suit).

202. *Taylor*, No. 90-5050, slip op. at 2; see also *supra* note 187 (discussing § 6511).

203. *Taylor*, No. 90-5050, slip op. at 2 (citing I.R.C. § 6402 (1986) (concerning tax refunds or credits) and *id.* I.R.C. § 6407 (1986) (concerning date of allowance of refund or credit)).

204. *Taylor*, No. 90-5050, slip op. at 2-3. In a footnote, the Claims Court stated that summary judgment would have been granted to the government even if it had found the 1982 refund claim timely because the taxpayer offered no evidence to support its refund claim. See *Taylor v. United States*, 18 Cl. Ct. 713, 717 n.3 (1989) (stating holding below). The Federal Circuit, however, apparently remanded in order to allow the Claims Court to determine whether such a claim was made and whether this would entitle the taxpayer to file suit under sections 6511(a) and 7422(a). See *Taylor*, No. 90-5050, slip op. at 2-3 (remanding case).

205. *Murray v. United States*, No. 90-5068, slip op. at 1 (Fed. Cir. Oct. 2, 1990) (LEXIS, Genfed library, CAFC file); *Schiff v. United States*, No. 90-5025, slip op. at 1 (Fed. Cir. Aug.

legal scholar suggests that the Claims Court is a useful arena to bring "test cases" for those federal tax issues which apply to a large number of taxpayers in a variety of circuits because the only appeal is to the Federal Circuit.²⁰⁶ Before proceeding with their claims, taxpayers should, therefore, take notice that most of this term's decisions favored the government and plan accordingly.

21, 1990) (LEXIS, Genfed library, CAFC file); see also *supra* notes 182-93 and accompanying text (discussing *Schiff*) and notes 194-98 and accompanying text (discussing *Murray*).

206. See *Refund Litigation*, 124-4th Tax Mgmt. (BNA) at A-8 (Dec. 17, 1990) (examining advantages of Claims Court as test case forum). This remark is especially true where taxpayers from different circuits seek to resolve the same issue. If one taxpayer succeeds in the Federal Circuit, the Claims Court would be bound to follow that ruling in subsequent cases on the same issue.

