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Taxation Survey

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TAXATION SURVEY

INTRODUCTION

This Survey examines selected 1994 opinions and unpublished orders[1] of the Tenth Circuit Court of Appeals involving matters of federal tax law.[2] The Survey begins with an examination of two cases involving deductions. Part II of the Survey addresses *Brooks v. United States*,[3] involving the question of whether a stock option was a qualified stock option eligible for preferential income tax treatment. Part III explores the energy property credit for recycling equipment which was formerly available under the Code. The Survey continues with a look at cases involving administration matters, penalties and interest, last known addresses, refunds, bankruptcies, and criminal prosecutions. Part XI of the Survey concludes with the annual round up of tax protestor cases.

I. DEDUCTIONS

A. Black Gold Energy Corp. v. Commissioner[4]

In *Black Gold*, the Tenth Circuit addressed the interplay of the worthless business debt deduction of I.R.C. § 166 (1988) and the "economic performance" rules of I.R.C. § 461(h)(1) (West Supp. 1994).[5] The taxpayer in *Black Gold* guaranteed two obligations of Tonkawa Refinery of Oklahoma, an affiliated corporation.[6] When the underlying obligations went into default, Black Gold was forced to defend lawsuits brought by two creditors in 1984. The suit settled in early 1985. In settlement of the litigation, Black Gold paid $850,000 to one creditor and delivered a promissory note payable over nine years to the other creditor.[7]

Black Gold first asserted that it was entitled to a worthless business debt

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1. The Tenth Circuit has concluded that

> [c]itation of these unpublished decisions is not favored. Nevertheless, if it is believed that an unpublished opinion or order and judgment has persuasive value with respect to a material issue in a case and would assist the court in its disposition, the decision may be cited, *provided* that a copy of the decision is attached to the brief or other document in which it is cited, or, if cited in oral argument, is provided to the court and all other parties.

General Order of November 29, 1993, superseding 10th Cir. Rule 36.3 until December 31, 1995, or further order.

2. This Survey examines the areas of federal income, estate, and gift taxation.
3. 1994-2 U.S. Tax Cas. (CCH) ¶ 50,399 (10th Cir. 1994), *rev'g* 779 F. Supp. 512 (D. Kan. 1991).
4. No. 93-9002, 1994 WL 139019 (10th Cir. Apr. 8, 1994), *aff'g* 99 T.C. 482 (1992).
5. *Id.*
6. Black Gold Energy Corp. v. Commissioner, 99 T.C. 482, 484 (1992).
7. *Id.* at 484-85.

deduction[8] in 1984, the year Tonkawa defaulted and Black Gold became liable under the guarantees.[9] Black Gold argued that as an accrual basis taxpayer, it could deduct the entire amount of the debt settled in 1984, when the so-called "all events" test was satisfied,[10] notwithstanding that it had made no actual payments on the guarantee.[11] The Internal Revenue Service (IRS), however, pointed to Treasury Regulations which stated the deduction is available only in the year in which payment is actually made.[12] Black Gold contended that these Regulations only apply to cash basis taxpayers.[13] The Tenth Circuit agreed with the IRS and concluded that the Regulations applied equally to accrual basis taxpayers.[14]

Black Gold alternatively argued it was entitled to a bad debt deduction in 1985, the year that it delivered its promissory note to the creditor.[15] The ability of Black Gold to claim a bad debt deduction in 1985 was complicated by I.R.C. § 461(h)(1), which states that the "all events" test is not to be treated as met any earlier than when "economic performance" occurs with respect to the item sought to be deducted.[16] Under circumstances where the liability of the taxpayer requires it to provide property or services, the Code further provides that "economic performance" occurs only when, and as, the taxpayer in fact provides such property or services.[17] Black Gold argued that its delivery of

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8. A guarantor may deduct payments made under its guarantee, if at all, under I.R.C. § 166, and not under the more general loss rules of I.R.C. § 165 (1988). Putnam v. Commissioner, 352 U.S. 82 (1956). In *Putnam*, the Supreme Court held that losses sustained by a guarantor are "bad debts" under I.R.C. § 166 because, upon payment under the guarantee, the guarantor becomes subrogated to the rights of the creditor against the debtor. *Id.* at 85. Thus, a "debt" arises between the debtor to the guarantor, which is governed by the bad debt rules of I.R.C. § 166. *Id.* Only when this debt becomes worthless can the guarantor claim a bad debt deduction under I.R.C. § 166. The loss can be deducted as an ordinary loss if the debt is a so-called "business debt," or less beneficially, as a short-term capital loss if the debt is a "nonbusiness debt." I.R.C. § 166(d).

9. *Black Gold*, 99 T.C. at 485-86.

10. Under the accrual method of accounting, deductions are allowable for the "taxable year *in which all the events have occurred* that establish the fact of the liability" giving rise to such deduction and the amount thereof can be determined with reasonable accuracy. Treas. Reg. § 1.446-1(c)(1)(ii) (1987) (emphasis added).

11. Black Gold also argued that neither guarantee agreement contained a right of subrogation in favor of Black Gold Energy against Tonkawa; therefore, no "debt" arose between Tonkawa and Black Gold, and I.R.C. § 166 was not applicable. *Black Gold*, 99 T.C. at 484. The Tax Court concluded otherwise, stating that "whether a guarantor achieves technical subrogation or not, the guarantor's loss arises by virtue of the worthlessness of the debtor's obligation to the guarantor." *Id.* at 487.

12. Treas. Reg. § 1.166-9(a) (1983) provides that "a payment of principal or interest made during a taxable year . . . by the taxpayer in discharge of part or all of the taxpayer's obligation as a guarantor, endorser, or indemnitor is treated as a business debt becoming worthless in the taxable year in which the payment is made." *Id.*

13. *Black Gold*, 99 T.C. at 485. Under the cash receipts and disbursements method of accounting, "all items which constitute gross income (whether in the form of cash, property, or services) are to be included for the taxable year in which actually or constructively received. Expenditures are to be deducted for the taxable year in which actually made." Treas. Reg. § 1.446-1(c)(1)(i) (1993).

14. *Black Gold*, 1994 WL 139019 at *2.

15. *Id.*

16. I.R.C. § 461(h)(1) (West 1988 & Supp. 1994). The section was added to the Code as part of the Tax Reform Act of 1984 (Division A of the Deficit Reduction Act of 1984). Pub. L. No. 98-369, 98 Stat. 494, 598-600 (1984).

17. I.R.C. § 461(h)(2)(B).

the promissory note satisfied the economic performance requirement referred to by the Code.[18] The Tenth Circuit disagreed, concluding that "true economic performance under the settlement was the payment of the note, not its execution and delivery."[19] Thus, Black Gold was not entitled to a bad debt deduction in 1985, and could only claim the deduction as it actually made payments under the note.[20]

B. True v. United States[21]

The taxpayers in *True* were partners and shareholders in various partnerships and S corporations, through which they conducted business.[22] The IRS made certain adjustments to the taxpayers' taxable incomes. The adjustments apparently arose out of increases made to the reported incomes of the partnerships and S corporations and flowed through to the taxpayers' personal income tax returns.[23] The taxpayers paid the resulting deficiency plus statutorily required interest on the deficiency.[24]

The taxpayers argued that since most of the deficiency interest paid to the IRS was attributable to adjustments made to the reported operations of the businesses, they should be entitled to deduct the interest as an "above the line" business expense[25] without being subject to the Code's restrictions on the deduction of personal interest.[26] This is the rule when, for example, a taxpayer operates his business as a sole proprietorship.[27] The IRS countered that,

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18. *Black Gold*, 1994 WL 139019 at *2.

19. *Id.*

20. Black Gold could, of course, deduct the $850,000 actually paid to the first creditor in 1985.

21. No. 93-8092, 1994 WL 461279 (10th Cir. Aug. 26, 1994).

22. *Id.* at *1.

23. *Id.* A partner in a partnership must include on his personal income tax return his allocable share of the partnership's income, gains, losses, deductions, and credits which are "passed through" to the partner. I.R.C. § 704 (West Supp. 1994). Likewise, a shareholder in a so-called "S corporation", see I.R.C. § 1361(a)(1) (West 1988 & Supp. 1994), must include his pro rata share of the corporation's income, losses, deductions, and credits, as well as certain other items. I.R.C. § 1366 (West 1988 & Supp. 1994).

24. *True*, 1994 WL 461279 at *1. *See also* I.R.C. § 6601 (West 1988 & Supp. 1994).

25. *True*, 1994 WL 461279 at *1 (pursuant to I.R.C. § 62(a)(1) (West Supp. 1994)).

26. The deductibility of interest generally turns on the classification of the interest: "investment interest" is generally deductible only to the extent of net investment income, *see* I.R.C. § 163(d) (West Supp. 1994); "qualified residence interest" consists of either acquisition indebtedness or home equity indebtedness with respect to any qualified residence of the taxpayer, subject to various definitional and other limitations, *see* I.R.C. § 163(h)(3)(West Supp. 1994); interest paid or accrued on indebtedness allocable to a trade or business is generally fully deductible; or "personal interest," generally, all types of consumer interest other than the foregoing, is fully nondeductible for 1991 and later tax years, *see* I.R.C. § 163(h)(2) (West Supp. 1994). The actual controversy in *True* centered around the taxpayers' liability for alternative minimum tax, and the further limitations placed on nonbusiness interest under I.R.C. 56(b)(1)(C) (West Supp. 1994) for purposes of computing a taxpayer's alternative minimum tax liability. *True*, 1994 WL 461279 at *1-2.

27. *See, e.g.*, Miller v. United States, 841 F. Supp. 305 (D.N.D. 1993). Thus, to the extent deficiency interest paid to the IRS is attributable to a deficiency arising out of the operations of the sole proprietorship, the interest is deductible as a business expense under I.R.C. § 162, provided it qualifies as an "ordinary and necessary" business expense." *See* Miller v. United States, 95-1 U.S. Tax Cas. (CCH) ¶ 50,068 (D.N.D. 1994) (while not subject to the "personal interest" limitations, expenditure nevertheless was not deductible under I.R.C. § 162).

unlike sole proprietorships, partnerships and S corporations are separate legal entities undertaking separate business operations, and that if a deduction was allowable at all for the deficiency interest as a business expense, the deduction would belong to the entity.[28] Because such entities do not separately compute their tax liability, they cannot bear responsibility for deficiency interest. Under the IRS view, therefore, the deficiency interest could only be claimed as a "below the line" personal deduction by the taxpayers.[29] This apparently resulted in the taxpayer's interest deductions being in excess of the interest deduction limitations of the Code.[30]

In a brief, unreported decision, the Tenth Circuit agreed with the IRS.[31] Adopting the government's argument, the Tenth Circuit reasoned that partnerships and S corporations are separate legal, non-taxable entities that separately compute and report the results of their operations. This makes them distinguishable from sole proprietorships.[32] The nature, therefore, of the interest deduction to the taxpayers in the instant case was strictly personal and was not a business deduction. The interest must therefore be deducted, if at all, as an itemized deduction subject to the personal interest deduction limitations.[33]

II. STOCK OPTIONS

A. Brooks v. United States[34]

The taxpayer in *Brooks* held a stock option to purchase 60,000 shares of the common stock of Clinton Oil Company. Brooks's stock option was issued under a plan adopted by the company in 1974 and was exercised by Brooks in 1980. The controversy arose when Brooks filed a complaint in district court seeking a refund of tax paid.[35]

Under the federal tax law in effect at the time,[36] such options were eligi-

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28. *True*, 1994 WL 461279 at *2.

29. "Below the line" deductions include, *inter alia*, personal itemized deductions for interest to the extent allowable under I.R.C. § 163. *See* I.R.C. § 63(a) (West Supp. 1994).

30. *True*, 1994 WL 461279 at *2.

31. The Tenth Circuit affirmed an unreported district court order that had granted summary judgment to the government. *Id.* at *1.

32. *Id.* at *3. Both partnerships and S corporations file informational returns with the IRS. Partnerships file on Form 1065 and S corporations file on Form 1120S. These forms are the basis for calculating the taxable income or loss that flows through to the partners and shareholders. The Schedule K-1 attached to each partner's or shareholder's income tax return reflects the income or loss passed through.

33. *Id.*

34. 1994-2 U.S. Tax Cas. (CCH) ¶ 50,399 (10th Cir. 1994), *rev'g* 779 F. Supp. 512 (D. Kan. 1991).

35. *Brooks*, 1994-2 U.S. Tax Cas. (CCH) ¶ 50,399, at 85,396.

36. Under the rules of former I.R.C. §§ 421 and 422, preferential tax treatment was extended to "qualified stock options" meeting certain statutory requirements. I.R.C. §§ 421, 422 (1988) (amended 1990). These rules contrasted with the general tax treatment of stock options under I.R.C. § 83 (West Supp. 1994). Under the rules of former I.R.C. §§ 421 and 422, neither the grant nor the exercise of a qualified stock option resulted in taxable income to the recipient. Only when the stock acquired on exercise was ultimately disposed of was a tax imposed at capital gains tax rates based on the difference between the sale price of the stock and its basis in the optionee's hands (generally, the exercise price). I.R.C. §§ 421, 422. Former I.R.C. § 422 was repealed in 1990, but had been something of a deadwood provision for some time prior to that because under

ble for preferential income tax treatment if they were so-called "qualified stock options" under a series of requirements then set forth in the Code.[37] One requirement stated that the options must have been issued pursuant to a plan reflecting certain features and option terms. Further, the plan must have been "approved by the stockholders of the granting corporation within 12 months before or after the date" the plan was adopted by the company (e.g., by its board of directors).[38]

The question whether the stockholders of Clinton Oil had approved the stock option plan within the required time period was clouded by the fact that the company had been the target of an enforcement action by the Securities and Exchange Commission.[39] Under the terms of the settlement with the SEC, the company agreed that it would be subject to judicial supervision by Judge Wesley E. Brown.[40] Subsequently, on March 18, 1974, Clinton's board of directors adopted the stock option plan under which Brooks's option was later granted.[41] According to the taxpayer, the plan was submitted to Judge Brown and approved by him at a March 1974 meeting with Clinton management. No written record of such a meeting existed.[42] The plan was not presented to Clinton's stockholders within the required 12 month period.[43]

Under Brooks' theory, Judge Brown's approval, if given, was sufficient to constitute approval by the shareholders of the company, because Judge Brooks was representing the interests of the shareholders at the time. Therefore, Brooks' stock option was a qualified stock option, and the exercise of that option did not give rise to a taxable event. The government, on the other hand, asserted that because the plan was not actually submitted to or approved by the shareholders, as required by the literal language of the statute, the option was not a qualified stock option and the exercise of the option was a taxable event.[44]

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its express terms, I.R.C. § 422 did not apply to options issued after May 20, 1976. I.R.C. § 422(b).

37. Under the current Code, "qualified stock options" have been replaced by so-called "incentive stock options," which are described in I.R.C. § 422 (West Supp. 1994). The tax treatment of incentive stock options under current law closely resembles that of qualified stock options under old law. Incentive stock options were originally governed by I.R.C. § 422A, which was redesignated as I.R.C. § 422 in 1990 when the old I.R.C. § 422 was repealed.

38. Under then-applicable Treasury Regulations, such approval was required to

> comply with all applicable provisions of the corporate charter and bylaws, and the law of the State of incorporation and must represent the express consent of stockholders holding at least a majority of the voting stock of the corporation voting by person or by proxy at a duly held stockholders' meeting.

Former Treas. Reg. § 1.422-2(b)(1).

An identical rule governs the approval of plans under which incentive stock options are granted. *See* I.R.C. 422(b)(1) (1988). Thus, the holding in *Brooks* would presumably have equal relevance to incentive stock option plans under current law.

39. *Brooks*, 766 F. Supp. at 994. The SEC filed an injunction proceeding in 1973. *Id.*

40. United States District Court, District of Kansas. The SEC had originally sought appointment of a receiver, but because Clinton's oil and gas concessions were subject to cancellation upon appointment of a receiver, the SEC and Clinton's management agreed to the appointment of Judge Brown as a "judicial supervisor." *Brooks*, 1994-2 U.S. Tax Cas. (CCH) ¶ 50,399, at 85,397.

41. *Brooks*, 766 F. Supp. at 995.

42. *Id.* at 997.

43. *Id.* at 995.

44. *Id.* at 996. The resulting taxable income would be measured by the difference between

The district court concluded that, despite the express language of the statute requiring *stockholder* approval, "Judge Brown had the authority to exercise stockholder approval within the meaning" of the statute.[45] The district court thus rejected a strict interpretation of the statute, concluding a contrary result would not further the legislative purpose of the statute.[46] The district court further held that, based on the record — which included a deposition of Judge Brown taken by the taxpayer — Judge Brown did in fact approve the plan at the March 1974 meeting.[47]

On appeal, the Tenth Circuit reversed, holding that the district court's finding that Judge Brown had approved the plan was "clearly erroneous."[48] The court of appeals concluded that "even if [Judge Brown's] approval could satisfy the requirements of [the statute,] there is simply no evidence in the record that Judge Brown approved the plan on behalf of the shareholders for Internal Revenue Code (IRC) purposes."[49] Reviewing the record, the Tenth Circuit concluded that the "approval" alleged to have been given by Judge Brown at the March 1974 meeting was at best given in only a very general manner, and was not intended by Judge Brown to be a substitute for specific shareholder approval if required.[50] The court of appeals thus did not view the general approval of the plan given by Judge Brown as rising to the level of the stockholder approval required by the Code.

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the fair market value of the stock on the date of exercise and the exercise price. I.R.C. § 83 (West Supp. 1994). *See also* Treas. Reg. §1.83-7 (1978).

45. *Brooks*, 766 F. Supp. at 997.

46. *Id.* at 998.

47. *Id.* The district court originally ruled that the record was insufficient to support such a conclusion, and granted summary judgment for the government. *Id.* at 998. However, the taxpayer successfully obtained leave to conduct further discovery, and after taking Judge Brown's deposition, submitted it to the court. Based on the additional information reflected in the deposition, the court granted the taxpayer's motion to reconsider the earlier summary judgment. Brooks v. United States, 779 F. Supp 512 (D. Kan. 1991). After the subsequent trial, the district court ruled that Judge Brown had in fact approved the plan. Brooks v. United States, 797 F. Supp. 909, 913 (D. Kan. 1992).

48. *Brooks*, 1994-2 U.S.Tax Cas. (CCH) ¶ 50,399, at 85,398. Under the "clearly erroneous" standard of review of the Federal Rules of Civil Procedure, the trial court's findings of fact "shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses." FED. R. CIV. P. 52(a). Thus, the trial court's findings of fact will be upheld unless the appellate court is firmly convinced a mistake has been made. *See* Las Vegas Ice & Cold Storage Co. v. Far West Bank, 893 F.2d 1182, 1185 (10th Cir. 1990); LeMaire ex rel. LeMaire v. United States, 826 F.2d 949, 953 (10th Cir. 1987). The Supreme Court has instructed that "[a] finding is 'clearly erroneous' when, although there is evidence to support it, the reviewing court on the entire evidence is left with the definite and firm conviction that a mistake has been committed." United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948).

49. *Brooks*, 1994-2 U.S. Tax Cas. (CCH) ¶ 50,399 at 85,398.

50. *Id.* at 85,399. The court considered several other factors as well: the tax consequences of the plan were not discussed at the meeting, nor was the need to obtain shareholder approval either from Judge Brown or the shareholders themselves; the plan itself stated that stockholder approval was required within 12 months after its adoption; and Judge Brown routinely approved any matter brought to him by Clinton management unless the SEC had an objection, and so did not exercise independent approval authority. *Id.*

III. TAX CREDITS

A. Pepcol Manufacturing Co. v. Commissioner[51]

Pepcol Manufacturing provided the Tenth Circuit with an opportunity to review the standards under which "legislative regulations" of the government may be held invalid.[52] On its 1980 Federal income tax return, the taxpayer in *Pepcol Manufacturing* claimed the special "energy property" investment tax credit which then extended to qualifying "recycling equipment."[53] The IRS disallowed the credit, but the Tax Court sided with the taxpayer and held the credit was available.[54] On appeal, the Tenth Circuit reversed.[55]

Pepcol Manufacturing Co. was engaged in, *inter alia*, the processing of animal bones, obtained from local slaughterhouses, into gelatin bone, which is used in the photographic industry as a raw material for use as a coating on film.[56] Pepcol maintained that its facility for processing bones was "recycling equipment" and thus, eligible for the energy property credit.[57] Noting that there were four requirements to obtain the tax credit in respect to "recycling equipment," the Tax Court focused on the first two of these requirements.[58] The court first addressed whether the process constituted "recycling." The government's argument was that the term recycling envisioned only processes under which waste products are processed back into their original form, such as paper waste (e.g., newsprint) back into paper, metal waste (e.g., cans and other containers) back into metal, and the like.[59] Under the IRS view, this "same type" or "similar end-product" requirement was supported by the legislative history to the energy credit, which had articulated several examples of recycling, all of which fell into this category.[60] Calling the dispute a "semantical orgy," the Tax Court rejected the IRS's restrictive reading of the term

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51. 13 F.3d 355 (10th Cir. 1994), *rev'g* 98 T.C. 127 (1992).

52. Treasury regulations can be either "interpretative" or "legislative." An interpretative regulation is issued pursuant to the Secretary of the Treasury's general authority to "prescribe all needful rules and regulations for the enforcement" of the Code. I.R.C. § 7805 (West Supp. 1994). Legislative regulations are those issued in response to provisions of the Code "that describe the intended law in extremely general terms, expressly leaving it to the Secretary of the Treasury to interpret the provisions in regulations." Fred Feingold and Mark E. Berg, *Whither the Branches?*, 44 TAX L. REV. 205 (1989). Such Regulations "are of a quasi-legislative character; Congress has chosen to delegate to the Treasury authority it might have exercised itself." WILLIAM A. KLEIN, JOSEPH BANKMAN, ET. AL., FEDERAL INCOME TAXATION 68 (8th ed. 1990).

53. Pepcol Mfg. Co. v. Commissioner, 13 F.3d 355 (10th Cir. 1994). The credit, which expired in 1985, was equal to 10 percent of the taxpayer's investment in qualifying property. I.R.C. § 46(a)(2) (amended 1990).

54. Pepcol Mfg. Co. v. Commissioner, 98 T.C. 127, 137 (1992).

55. *Pepcol Mfg.*, 13 F.3d at 355.

56. *Pepcol Mfg.*, 98 T.C. at 128. Gelatin bone is also used as a coating of pharmaceutical products and as an ingredient in food products such as gelatin. *Id.*

57. *Id.* at 130.

58. *Id.* The court summarized the requirements of former I.R.C. § 48(l)(6) as follows: (1) the process must have constituted recycling; (2) the equipment must be used exclusively to process or sort and prepare solid waste for processing; (3) the item produced in the process must be the first marketable product; and (4) the product to be processed cannot contain more than 10 percent virgin material. *Id.* The parties were in agreement that requirements (3) and (4) were met. *Id.*

59. *Id.* at 131-32.

60. *See* S. Rep. No. 95-435, 95th Cong., 1st Sess., 83 (1978), *reprinted in* 1978 U.S.C.C.A.N. 7855, 8014.

recycling and held that Pepcol's processing of animal bones constituted recycling for these purposes.[61]

The second requirement examined by the Tax Court was that Pepcol's equipment must have been used exclusively to process or sort and prepare "solid waste" for processing. The applicable regulations in effect specifically provided that "solid waste," for purposes of the recycling equipment credit, excluded "animal waste," and on this alternative ground the IRS had disallowed Pepcol's credit.[62] The Tax Court acknowledged that Treasury Regulations, including "legislative regulations" such as these, are to be "sustained unless unreasonable and plainly inconsistent with the revenue statutes, and should not be overruled except for weighty reasons."[63] The court nevertheless concluded that for various reasons the Regulations were invalid.[64] The Tax Court's holding meant that the energy credit for recycling equipment was available to Pepcol in respect of its bone processing equipment.

On appeal, the Tenth Circuit reversed the Tax Court on the strength of the second requirement.[65] Taking issue with the court below, the court of appeals found the applicable regulations to be "not unreasonable or plainly inconsistent with Congress' intent in enacting" the relevant statutory provisions.[66] Because the IRS position reflected in the Regulations was therefore permissible, "the Tax Court was constrained to follow it and erred as a matter of law in failing to do so."[67] The Tenth Circuit thus overturned the Tax Court's conclusion that the Regulations were invalid. Noting that Pepcol had "for some reason" stipulated that the bones were "animal waste," the court held that Pepcol was therefore "not entitled to a recycling tax credit under the regulation."[68]

IV. ADMINISTRATION AND ENFORCEMENT[69]

A. Gardner v. United States[70]

The taxpayer in *Gardner* filed a quiet title action in federal district court, seeking clear title to certain property that had belonged to her ex-husband and

61. *Pepcol Mfg.*, 98 T.C. at 132-33.
62. *Pepcol Mfg.*, 13 F.3d at 356. *See also* Treas. Reg. § 1.48-9(g)(1) (1987).
63. *Pepcol Mfg.*, 98 T.C. at 133 (quoting Bingler v. Johnson, 394 U.S. 741, 750 (1969).
64. *Id.* at 134-37.
65. *Pepcol Mfg.*, 13 F.3d at 357.
66. *Id.* "This Court has held that Treasury regulations are generally presumed to be valid and 'are not to be invalidated except for weighty reasons.' The 'presumption of validity is even greater' where regulations have been issued pursuant to a specific legislative authorization." *Id.* (citations ommitted).
67. *Id.*
68. *Id.* at 356-57.
69. In addition to the cases described in the text, the Tenth Circuit has decided numerous cases concerning administration and enforcement. *See e.g.*, Burge v. United States, No. 94-1063, 1994 WL 596586 (10th Cir. Nov. 1, 1994) (upholding dismissal of taxpayer's suit against IRS for wrongful levy under doctrine of sovereign immunity); Hancock v. Commissioner, No. 94-9001, 1994 WL 582140 (10th Cir. Oct. 20, 1994) (upholding dismissal of Tax Court petition for failure to prosecute); United States v. Boucher, No. 93-1453, 1994 WL 446780 (10th Cir. Aug. 19, 1994) (affirming district court's determination of taxpayer's tax liability over objection that he was not given the opportunity to participate in the underlying trial).
70. 34 F.3d 985 (10th Cir. 1994).

had been awarded to her in a divorce. The IRS claimed a federal tax lien against this property.[71] Billie and Terryl Gardner commenced a divorce action in Kansas on January 22, 1985.[72] On August 4, 1986, the IRS filed a Notice of Federal Tax Lien for taxes assessed against Billie three days earlier.[73] The divorce decree was entered on January 12, 1987, granting virtually all the marital property, including the property in question, to Terryl.[74] On December 7, 1990, Terryl filed the instant action.

A federal tax lien attaches "only to the property interests of the delinquent taxpayer at the time of assessment."[75] The government, therefore, merely steps into the shoes of the taxpayer, and cannot accede to a property interest greater than that held by the taxpayer.[76] Thus, the remaining questions involved the nature of the property rights held by Billie on August 1, 1986, after the divorce was filed but was still pending, and whether it was sufficient for a federal tax lien to attach to it. Resolution of the matter was acknowledged to be a pure question of Kansas state law.[77] Examining Kansas law,[78] the Tenth Circuit concluded that upon the filing of a divorce decree in that state, both spouses become the owners of a vested, but as yet undetermined, interest in all the marital property, whether jointly or individually held.[79] This species of common or joint ownership is to be ultimately unraveled by the trial court when the divorce decree is entered and the property is finally divided. This determination, in essence, relates back to the filing of the divorce decree, with the result that the property interest adjudicated in the divorce decree is seen to retroactively vest on the date the divorce action was filed.

Applied to the instant case, this doctrine of relation back meant that, because Billie was ultimately determined in the divorce decree to have no interest in the subject property, he did not have any property interest to which the government's lien could attach in August 1986 while the divorce was pending. Thus, Billie "had no rights to the property in question when the IRS made its assessment against him, no tax lien could attach, and [Terryl] owns that prop-

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71. *Id.* at 985. I.R.C. § 6321 (1988) provides: "If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount . . . shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

The lien secures the amount of the deficiency, plus any interest, additional amount, addition to tax, assessable penalty, and costs. *Id.* The general rule under the Code is that the general federal tax lien arises at the time assessment is made. I.R.C. § 6322 (1988). Assessments are little more than bookkeeping notations entered by the IRS on the taxpayer's account indicating that the amount has been administratively determined to be due and payable. The lien continues until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time. *Id.*

72. *Gardner*, 34 F.3d at 985.

73. *Id.* at 986.

74. *Id.*

75. *Id.* at 987 (citing United States v. Wingfield, 822 F.2d 1466, 1472 (10th Cir. 1987)).

76. *See* 4 BORIS I. BITTKER, FEDERAL TAXATION OF INCOME, ESTATES, AND GIFTS ¶ 111.5.4 (1981) ("[T]he tax collector not only steps into the taxpayer's shoes but must go barefoot if the shoes wear out.").

77. *Gardner*, 34 F.3d at 986.

78. *Id.* at 987 (citing Smith v. AIFAM Enters., 737 P.2d 469, 472, 474 (Kan. 1987) and Cady v. Cady, 581 P.2d 358 (Kan. 1978)). *See also* KAN. STAT. ANN. § 23-201(b) (Supp. 1994).

79. *Gardner*, 34 F.3d at 987 (citing *Cady*, 581 P.2d at 362-63).

erty free of any such lien."[80]

B. Codner v. United States[81]

The taxpayer in *Codner* filed a petition to quash several administrative summonses served by the IRS[82] on various third-party recordkeepers.[83] The summonses were to determine if the taxpayer was in violation of the Internal Revenue laws.[84] Affirming an unreported District Court determination, the Tenth Circuit concluded that the summonses had been issued in compliance with the applicable statutory requirements[85] and were to be enforced, over the taxpayer's objections that (1) the special agent who issued the summons exceeded his authority in doing so,[86] and (2) the copies of the summonses delivered to the taxpayer were required to be attested[87] but were not.[88]

C. Home of Faith v. Commissioner[89]

The Internal Revenue Code provides that partnership audits are to be conducted at the entity level, and not the partner level.[90] However, partnerships with less than ten partners, each of whom is a natural person, are exempt from these entity-level audit and litigation procedures.[91] The Code's treatment of S corporations is analogous to the tax treatment of partnerships,[92] and in recognition of this, I.R.C. § 6244 states that the provisions of I.R.C. §§ 6221-

80. *Id.* at 989.
81. 17 F.3d 1331 (10th Cir. 1994).
82. The IRS has broad powers to issue such summons in support of its efforts to ferret out unreported tax liabilities. *See* I.R.C. §§ 7601 and 7602 (1988).
83. For the rules delineating third-party recordkeepers, see I.R.C. § 7609(a)(3) (1988).
84. *Codner*, 17 F.3d at 1332.
85. Under relevant standards, a summons will be enforced if the IRS can show "that the investigation will be conducted pursuant to a legitimate purpose, that the inquiry may be relevant to the purpose, that the information sought is not already within the Commissioner's possession, and that the administrative steps required by the Code have been followed." United States v. Powell, 379 U.S. 48, 57-58 (1964). The government therefore need not meet a "reasonable cause" standard. The burden on the government is slight, and is generally met through the affidavit of the agent issuing the summons. *See, e.g.*, United States v. City Nat'l Bank & Trust Co., 642 F.2d 388, 389 (10th Cir. 1981).
86. The court concluded that while the IRS's own rules precluded revenue agents from issuing summonses without prior approval of their supervisors, this prohibition did not apply to special agents. *Codner*, 17 F.3d at 1333.
87. An attested copy is "one which has been examined and compared with the original, with a certificate or memorandum of its correctness, signed by the persons who have examined it." Mimick v. United States, 952 F.2d 230, 232 (8th Cir. 1991) (quoting Accord Henderson v. United States, 778 F. Supp. 274, 277 (D.S.C. 1991)).
88. *Codner*, 17 F.3d at 1332-33. The summonses served on the recordkeepers in *Codner* had been attested, but the copies sent to Codner had not. In *Mimick*, neither the summons served on the third party nor the copy sent to the taxpayer was attested, and the Eighth Circuit Court of Appeals held that both must be attested. *Mimick*, 952 F.2d at 231-32. Parsing through the technical requirements of I.R.C. §§ 7603 and 7609(a), which set forth the attestation rules relevant to summonses, the Tenth Circuit concluded that only the summons sent to the recordkeeper must be attested. *See Codner*, 17 F.3d at 1333.
89. 39 F.3d 263 (10th Cir. 1994).
90. I.R.C. § 6221-6231 (West 1989 & Supp. 1994).
91. I.R.C. § 6231(a)(1) (1988).
92. *See* I.R.C. § 704 (West Supp. 1994).

6231 which relate to (1) assessing deficiencies and filing claims for refund with respect to partnership items, and (2) the judicial determination of partnership items, are made equally applicable to "subchapter S items."[93] Whether or not the rule of I.R.C. § 6231(a)(1)(B) also applies to S corporations by analogy, such that S corporations with fewer than ten shareholders are exempt from the entity-level audit rules, was the issue in *Home of Faith*.[94] The Fifth Circuit Court of Appeals previously ruled that the exemption does apply,[95] while the Eleventh Circuit has ruled that it does not.[96]

In *Home of Faith*, the IRS had assessed deficiencies against Home of Faith, an S corporation, and mailed notices of adjustment to certain of the corporation's shareholders.[97] One of the shareholders filed a petition in Tax Court, claiming that the IRS was required to assess the deficiency against the shareholders separately because the entity-level procedures are not applicable to S corporations with fewer than ten shareholders. The shareholder also contended that as to him, the statute of limitations had expired, and therefore the IRS was untimely in asserting the deficiency.[98]

In a brief opinion, the Tenth Circuit adopted the view of the Eleventh Circuit and held that the exemption from the entity-level audit and litigation procedures, which is extended to partnerships with fewer than ten partners, is not also applicable to S corporations with fewer than ten shareholders.[99] Therefore, the deficiency was assessed in a timely fashion against Home of Faith.

D. Hall v. Commissioner[100]

In *Hall*, the Tenth Circuit reversed the Tax Court and held, under the facts presented, a minister had timely applied for exemption from self-employment (i.e., social security) tax on amounts earned in the performance of services in his ministry.[101] Under the Code, a duly ordained, commissioned, or licensed minister may apply for such an exemption.[102] The application for exemption[103] must be accompanied by a statement that the taxpayer is opposed to the acceptance of public insurance such as social security, either conscientiously or due to his religious principles.[104] Generally, however, the application must be filed by the due date of the return for the second taxable year in which the minister had self-employment earnings of $400 or more; otherwise,

93. *See* I.R.C. § 6244 (1988). For a definition of "subchapter S itmes," see I.R.C. § 6245 (1988).
94. *Home of Faith*, 39 F.3d at 263.
95. Arenjay Corp. v. Commissioner, 920 F.2d 269 (5th Cir. 1991).
96. Beard v. United States, 992 F.2d 1516 (11th Cir. 1993).
97. *Home of Faith*, 39 F.3d at 263.
98. *Id.*
99. *Id.* at 264. In doing so, the Tenth Circuit affirmed an unreported decision of the Tax Court. *See id.* at 263.
100. 30 F.3d 1304 (10th Cir. 1994), *rev'g* 66 T.C.M. (CCH) 374 (1993).
101. *See id.* at 1307.
102. I.R.C. § 1402(e)(1) (West Supp. 1994).
103. The application is filed on Form 4361.
104. I.R.C. § 1402(e)(1).

the right to apply for exemption is lost forever.[105] Once made, the exemption is irrevocable.[106]

The taxpayer in *Hall* was ordained as a deacon in the Methodist Church in 1979.[107] Although his application for exemption from self-employment tax was due on April 15, 1982, the taxpayer, not being religiously or conscientiously opposed to the acceptance of public insurance, did not file one.[108] After his application for elevation within the Methodist Church to elder status was denied, the taxpayer left the ministry in 1983 and went to work as an engineer for five years. However, in 1988, the taxpayer was ordained as minister in the Community Church of Southport, Indianapolis, and began his ministry in Colorado Springs.[109] On January 9, 1989, the taxpayer — having now developed a belief in opposition to the acceptance of public insurance — filed an application for exemption from self-employment tax. The application was denied on the ground that it should have been filed by April 15, 1982.

Hall presented the question whether the taxpayer's "return to the ministry after a five-year absence, combined with his ordination in a new church and his acceptance of a new belief in opposition to public insurance" provided the taxpayer with a second opportunity to elect exemption from self-employment taxes.[110] If so, his application would not need to be filed until April 15, 1990, and would be timely. Relying on its prior decision in *Ballinger v. Commissioner*,[111] the Tenth Circuit answered this question in the affirmative, concluding that "[w]hen an individual enters the ministry anew in a new church, having adopted a new set of beliefs about the propriety of accepting public insurance, it is logical and consistent with the statutory language . . . to characterize that individual as a 'new' minister for the purpose of seeking an exemption."[112] While concerned that a contrary rule could "arbitrarily and unconstitutionally interfere with the adherence to sincere religious beliefs by individuals . . . who undergo a genuine religious conversion,"[113] the court was at the same time "not concerned that [its] decision will open the floodgates for conniving Elmer Gantrys to dupe the Internal Revenue Service and opt out of the social security system without documenting a legitimate reli-

105. *See* I.R.C. § 1402(e)(3).
106. I.R.C. § 1402(e)(4).
107. Hall v. Commissioner, 66 T.C.M. (CCH) 374 (1993).
108. *Hall*, 30 F.3d at 1305.
109. *Hall*, 66 T.C.M. (CCH) at 374.
110. *Hall*, 30 F.3d at 1305.
111. 728 F.2d 1287 (10th Cir. 1984). In *Ballinger*, the taxpayer had switched churches, but his application for exemption was found to have been untimely *even if* it was true that he was entitled to a second opportunity to so apply — it was filed five years after he assumed ministerial duties in his new church, albeit the same year he was ultimately ordained. The Tenth Circuit concluded that the event triggering the two-year application period was the assumption of duties, and *not* the later ordination date. Although deciding against the taxpayer on the facts in *Ballinger*, the court noted that it did not agree with the general proposition "that an individual who has a change of belief accompanied by a change to another faith is not entitled to the exemption." *Id.* at 1290. The court concluded that the statute "permits ministers who change churches to qualify" if, unlike Ballinger, they timely do so. *Id.* at 1292. The Tax Court in *Hall* chose to treat this language as dicta, rather than binding precedent. *Hall*, 66 T.C.M. (CCH) at 376.
112. *Hall*, 30 F.3d at 1307.
113. *Id.* at 1306.

gious or conscientious reason to justify their exemption."[114] The Tenth Circuit therefore held the taxpayer's application for exemption timely filed.[115]

V. PENALTIES AND INTEREST

A. Mauerman v. Commissioner[116]

In *Mauerman*, the Tenth Circuit concluded that a taxpayer who relied on his tax advisors as to the propriety of a claimed deduction, was not liable for the "substantial understatement" penalty of former I.R.C. § 6661.[117] The taxpayer was a surgeon who had purchased stock in Pre-Paid Legal Services, Inc. ("Pre-Paid"), a company which sold prepaid legal service benefits, a species of insurance under which legal service contracts are sold to individuals for monthly premiums.[118] Subsequently, the taxpayer became involved as an investor in a reinsurance arrangement[119] sponsored by Pre-Paid, under which the investors — which included the principal officers of Pre-Paid — participated in a pooled purchase of contracts issued by Pre-Paid and became reinsurers of the company.[120] Taking the position that this activity qualified the individual investors as "insurance companies"[121] eligible for preferential tax treatment under certain now-repealed provisions of the Code, the investors, including the taxpayer, deducted certain expenditures that would otherwise

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114. *Id.* at 1307.

115. *Id.* The Tax Court had held that the plain language of the statute did not give "any indication that a change in faith would give rise to a second opportunity to file an application for exemption." *Hall*, 66 T.C.M. (CCH) at 376.

116. 22 F.3d 1001 (10th Cir. 1994), *rev'g* 65 T.C.M. (CCH) 1772 (1993).

117. *Id.* at 1005. See I.R.C. § 6661 (1988) (repealed in 1989), as in effect in 1984 and 1986, the tax years in question. I.R.C. § 6661 was repealed by the Improved Penalty Administration and Compliance Tax Act, Subtitle G of Title VII of the Omnibus Budget Reconciliation Act of 1989, Pub. L. No. 101-239, 103 Stat. 2106 (codified as amended in scattered sections of 26 U.S.C. (West Supp. 1994)). The current penalty scheme is set forth in I.R.C. §§ 6662-6664 (West Supp. 1994). *See also* Dennis R. Schmidt and Thomas C. Pearson, *Civil Penalty Provisions Revamped by IMPACT*, 68 TAXES, Mar. 1990, at 187; Richard C. Stark, *IMPACT Makes Fundamental Changes in Civil Penalties*, 72 J. TAX'N, Mar. 1990, at 132.

The substantial understatement penalty of former I.R.C. § 6661 was reenacted as I.R.C. § 6662(b)(2) and (d) (West Supp. 1994). The "substantial authority" standard discussed in the text was retained in I.R.C. § 6662(d)(2)(B) (West Supp. 1994). No penalty is imposed, however, if it is shown that there was a reasonable cause for the underpayment (or a portion thereof) and that the taxpayer acted in good faith with respect thereto. I.R.C. § 6664(c)(1) (West Supp. 1994). Therefore, the holding of the Tenth Circuit in *Mauerman*, to the extent it addresses circumstances under which a taxpayer will be deemed to have acted in good faith and under which reasonable cause will be seen to be present, will continue to be of import.

118. *Mauerman*, 22 F.3d at 1002. For the current tax treatment of such plans when offered as a qualified employee fringe benefit, see I.R.C. § 120 (West Supp. 1994)

119.

> Reinsurance is a common business practice for many insurance companies. Basically, it is a contract whereby risk is transferred between two parties. The parties to the contract are the ceding company (reinsured) which wrote the original policy, and the assuming party (reinsurer) which pays a ceding commission and accepts the business risks and rewards of the insurance (claims and premium income).

Mauerman, 65 T.C.M. (CCH) at 1774.

120. *Id.* at 1774-75.

121. For federal income tax purposes as relevant to the issue at hand for the years at issue, "insurance companies" were defined in Treas. Reg. § 1.801-3(a)(1) (as amended in 1972).

have been capitalizable under rules applicable to taxpayers other than insurance companies.[122] These deductions were disallowed on audit, on the ground that the taxpayer was a surgeon, not an "insurance company."[123] Under I.R.C. § 6661(a) as then in effect, the IRS further imposed a penalty equal to 25 percent of the deficiency, concluding that the resulting underpayment was attributable to a substantial understatement of tax and that the taxpayer did not have "substantial authority" for his tax return position.[124]

The only issue in *Mauerman* was the correctness of the substantial understatement penalty. The Tax Court first concluded that, based on applicable law, the IRS was correct in asserting that the taxpayer did not have "substantial authority" for taking the position that he qualified as an "insurance company."[125] Therefore, the substantial understatement penalty was properly imposed, and the only relief available to the taxpayer was to seek a waiver of the penalty from the Commissioner on the grounds that there was reasonable cause for the understatement and that the taxpayer acted in good faith.[126] The taxpayer had done this, claiming that he acted in good faith because he had reasonably relied on his accountants in the preparation of his return.[127] However, the Commissioner had denied the waiver. Both the taxpayer's accountants were attorneys and one was a C.P.A., and neither had any relationship with Pre-Paid. However, as the Tax Court pointed out, in evaluating the deductibility of the expenses in question, the accountants had relied on information provided by sponsors of the program, without independent research.[128] Moreover, as the Tax Court further noted, the taxpayer had made several investments over the years and "was not a 'babe in the woods'" and should

122. *Mauerman*, 65 T.C.M. (CCH) at 1775-76. The bulk of the amounts claimed as deductions were ceding commissions currently paid in respect of the contracts purchased, the premium income from which would be earned over time. Rather than require capitalization of such amounts, the Code formerly allowed insurance companies to currently deduct them, even though the deduction would not be properly matched with the income subsequently to be derived. Former I.R.C. §§ 809(c)(1) (1988). *See also* David B. Tatge, *Tax Planning Opportunities Through Reinsurance Still Available Despite TEFRA*, 59 J. TAX'N, Oct. 1983, at 260. In the present case, normal tax accounting rules would have required the up-front ceding commissions to be capitalized and amortized over the 5-year term of the purchased contracts. *Mauerman*, 65 T.C.M. (CCH) at 1781.

123. *Mauerman*, 65 T.C.M. (CCH) at 1776. Other participants in the arrangement likewise had their deductions successfully disallowed by the IRS. *See, e.g.*, Estate of Baxter v. Commissioner, 63 T.C.M. (CCH) 1706 (1992); Fisher v. Commissioner, 64 T.C.M. (CCH) 1670 (1992); Krizer v. Commissioner, 62 T.C.M. (CCH) 1598 (1991).

124. *Mauerman*, 65 T.C.M. (CCH) at 1777. An understatement was "substantial" if it exceeded the greater of 10 percent of the correct tax or $5,000. I.R.C. § 6661(a) (repealed in 1989). This requirement was satisfied in *Mauerman*. Under I.R.C. § 6661(b)(2)(B), the understatement could be reduced by any portion thereof if either (1) the treatment of the item in question was based on "substantial authority" or (2) the taxpayer adequately disclosed on the tax return or in an attached statement the relevant facts affecting the item's tax treatment. The taxpayer in the instant case had made no such disclosure. *See Mauerman*, 65 T.C.M. (CCH) at 1780.

125. *See Mauerman*, 65 T.C.M. (CCH) at 1777-80.

126. I.R.C. § 6661(c) (repealed in 1989).

127. *Mauerman*, 22 F.3d at 1004. Under the then-applicable Regulations, reliance on the advice of an accountant or an attorney constituted a showing of reasonable cause and good faith if "under all the circumstances, such reliance was reasonable and the taxpayer acted in good faith." Treas. Reg. § 1.6661-6(b) (1985).

128. *Mauerman*, 65 T.C.M. (CCH) at 1782

have known to have the touted tax benefits of this investment thoroughly "checked out."[129] Nevertheless, the Tax Court viewed the matter as "a close question, on which petitioner might prevail" if it were viewing the matter fresh.[130] The Tax Court, however, concluded that its limited inquiry in this case was to determine whether the Commissioner had abused her discretion in failing to grant the waiver, and had acted arbitrarily, capriciously, or without sound basis in fact.[131] The Tax Court concluded that such was not the case, and upheld the denial of waiver.[132]

On appeal, the Tenth Circuit reversed this latter determination, holding that the substantial understatement penalty should have been waived.[133] The taxpayer argued that he had provided his tax accountants with all the information in his possession, had not limited the scope of their research in any way, and merely had "an honest misunderstanding as to the facts or the law which was reasonable in light of his experience, knowledge, and education."[134] The Tenth Circuit agreed, concluding that because of the accountants' expertise and the taxpayer's long-standing relationship with them, it was reasonable for the taxpayer to trust their advice and not be required "to make sure they had done sufficient research to give knowledgeable advice."[135]

B. Littfin v. Commissioner[136]

In *Littfin*, the Tenth Circuit joined the Second,[137] Fourth,[138] and Fifth[139] Circuits in concluding that the Tax Court lacks jurisdiction to review refusals by the IRS to abate interest under the IRS's discretionary authority to do so.[140] In so holding, the Tenth Circuit did not articulate its own analysis, but simply adopted that of the Second Circuit.[141] Although the Tax Court has been granted jurisdiction to make redeterminations of interest in certain circumstances, such jurisdiction is limited to those cases where the taxpayer has paid the entire amount of the deficiency plus statutory interest.[142] In the present case, the taxpayer had not prepaid the interest component, so jurisdiction

129. *Id.* The accelerated deductions claimed by the taxpayer eliminated 61 percent of his tax liability in 1984 and 73 percent in 1986. *Id.*

130. *Id.*

131. *Id.*

132. *Id.*

133. *Mauerman*, 22 F.3d at 1006.

134. *Id.* at 1004.

135. *Id.* at 1006.

136. 17 F.3d 1345 (10th Cir. 1994). *See also*, Goetz v. Commissioner, No. 94-9000, 1994 WL 446766 (10th Cir. Aug. 18, 1994) (applying *Littfin* to another taxpayer involved in same underlying transaction).

137. Bax v. Commissioner, 13 F.3d 54 (2d Cir. 1993).

138. Amlie v. Commissioner, No. 93-1120, 1993 WL 533249 (4th Cir. Dec. 22, 1993).

139. Frantz v. Commissioner, 4 F.3d 990 (5th Cir. 1993) (table); Job v. Commissioner, 4 F.3d 990 (5th Cir. 1993) (table).

140. *Littfin*, 17 F.3d at 1346-47. I.R.C. § 6404(e)(1) (1988) gives the Commissioner the discretionary authority to abate interest on deficiencies to the extent attributable to error or delay by the IRS.

141. *Littfin*, 17 F.3d at 1346-47 (agreeing with the Second Circuit's reasoning in *Bax v. Commissioner*, 13 F.3d 54 (2d Cir. 1993)).

142. *See* § I.R.C. 7481(c) (1988).

was lacking.[143] Moreover, even assuming the taxpayer had prepaid the requisite amounts, the relief sought — judicial review of the IRS's decision not to abate interest — is beyond the scope of the determinations contemplated by the statutory provision which grants such jurisdiction, and so in any case is simply not available.[144]

The decision of the Tenth Circuit in this regard is consistent with its earlier decision in *Selman v. United States*,[145] in which the court held that the Federal district court below did not have jurisdiction to review an interest abatement decision of the IRS.[146] It now seems well-settled that the decision whether or not to abate interest is committed to the IRS, and taxpayers may not obtain judicial review of that decision in either the Tax Court or in district court.[147]

VI. NOTICE OF DEFICIENCY; LAST KNOWN ADDRESS

A. *Background*

The Code provides that the Commissioner of Internal Revenue must make an assessment of taxes, if at all, within three years after a taxpayer files a return.[148] If the Commissioner determines that there is a deficiency[149] in respect to any tax, the Commissioner is authorized to send a statutory Notice of Deficiency to the taxpayer by certified or registered mail, informing the taxpayer of the deficiency proposed to be assessed by the Commissioner.[150] The mailing of the Notice of Deficiency is a prerequisite to the making of the assessment.[151] The taxpayer to whom the Notice of Deficiency is sent may then file a petition with the United States Tax Court for a redetermination of

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143. *Littfin*, 17 F.3d at 1346. The taxpayer in *Littfin* was one of many who accepted settlement offers arising out of the same tax shelter investment which had been challenged by the government. The matter had taken several years to come to a closure, and several of the investors sought abatement of the statutory interest ultimately assessed on the ground of IRS delay. *See id.*

144. *See Bax*, 13 F.3d at 58. The Tax Court is only allowed to determine whether or not the interest was correctly computed or otherwise exceeds the amount prescribed by the Code. I.R.C. § 7481(c). Here, the taxpayers were seeking an abatement based on alleged delays by the government, but there was no claim that the amount assessed by the IRS was not otherwise correctly calculated. *Littfin*, 17 F.3d at 1346.

145. 941 F.2d 1060 (10th Cir. 1991). *See* James Serven, *Taxation Survey*, 69 DEN. U. L. REV. 1037, 1060-63 (1992).

146. *Selman*, 941 F.2d at 1064.

147. Review in the Claims Court is also not available. Brahms v. United States, 18 Cl. Ct. 471 (1989).

148. I.R.C. § 6501(a) (West Supp. 1994). Under certain circumstances, the three year statute of limitations is extended. For example, if the return omits to include items of gross income that exceed twenty-five percent of the amount of gross income otherwise reflected in the return, the statutory limitations period is increased to six years. I.R.C. § 6501(e)(1) (West Supp. 1994). In addition, the statute of limitations is completely open-ended where there has been a false or fraudulent return with the intent to evade tax, where there has been a willful attempt to defeat or evade tax, or where no return has been filed. I.R.C. § 6501(c).

149. A "deficiency" is defined by I.R.S. § 6211(a) (1988) to mean, in the context of the income tax, "(1) the excess of statutorily imposed tax over the total of the amount shown on the taxpayer's return, (2) plus previous assessments, (3) less abatements, credits, refunds, or other repayments." Keado v. Commissioner, 853 F.2d 1209, 1210 n.1 (5th Cir. 1988).

150. I.R.C. § 6212(a) (1988).

151. I.R.C. § 6213(a) (West Supp. 1994).

the deficiency set forth in the Notice.[152] Such a petition must be filed within ninety days after the date of mailing of the Notice of Deficiency, assuming the notice is addressed to a person within the United States.[153] During this ninety day period, the Commissioner is precluded from entering an assessment against the taxpayer in respect of the deficiency proposed in the Notice of Deficiency.[154] However, if the taxpayer fails to timely file a petition for redetermination with the Tax Court within the ninety day statutory period, the Commissioner is directed to assess the deficiency.[155] The Commissioner may then commence collection activities against the taxpayer and his assets.

The running of the three-year statute of limitations is tolled during the time that the Commissioner is precluded from assessing a deficiency — that is, for the ninety days following the mailing of the Notice of Deficiency — and for sixty days thereafter.[156] Whether or not a Notice of Deficiency has been validly delivered to the taxpayer so as to be sufficient to toll the statute of limitations, can be a question of crucial importance to the Commissioner, particularly where the Notice is sent just prior to the expiration of the three year period. In the case of an income tax deficiency, the Code provides the Commissioner with a safe harbor which states that a Notice of Deficiency will be deemed sufficient if it is mailed by certified or registered mail to the taxpayer at his "last known address."[157] Thus, if the Commissioner mails the Notice by certified or registered mail to the taxpayer's last known address, the Notice will operate to suspend the statute of limitations as to the taxpayer, despite the fact that the taxpayer may never receive the Notice and may therefore be unaware of the proposed assessment.[158] Such a Notice provides a form of *deemed* notification to the taxpayer that will ordinarily result in actual notice; however, actual notice is not required.[159]

Whether or not the Notice of Deficiency has been validly delivered is also of importance to the taxpayer. If the taxpayer fails to file his Tax Court petition within ninety days of the date of a valid Notice of Deficiency, the taxpayer will be forever precluded from bringing his matter to the Tax Court, and may only obtain redress by paying the asserted deficiency and suing for a refund.[160] Taxpayers who have failed to meet the ninety-day deadline often

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152. *Id.* The Notice of Deficiency, also known as the "90 day letter," has been described as the taxpayer's "ticket to the Tax Court." Delman v. Commissioner, 384 F.2d 929, 934 (3d Cir. 1967), *cert. denied*, 390 U.S. 952 (1968).

153. I.R.C. § 6213(a).

154. *Id.* If the taxpayer does file a timely petition with the Tax Court, the Commissioner is further precluded from assessing the deficiency "until the decision of the Tax Court has become final." *Id.*

155. I.R.C. § 6213(c). An " 'assessment,' essentially a bookkeeping notation, is made when the Secretary or Secretary's delegate establishes an account against the taxpayer on the tax rolls." Laing v. United States, 423 U.S. 161, 170 n.13 (1976).

156. I.R.C. § 6503(a)(1) (West Supp. 1994). The statute of limitations is further tolled during the pendency of court proceedings, if a Tax Court petition is timely filed. *Id.*

157. I.R.C. § 6212(b)(1) (1988).

158. *See* Tadros v. Commissioner, 763 F.2d 89, 91 (2d Cir. 1985).

159. Brown v. Lethert, 360 F.2d 560, 562 (8th Cir. 1966).

160. *See* I.R.C. § 7422 (1988). The Tax Court is the only forum available for the litigation of tax cases that does not require prepayment of the deficiency. "If the taxpayer fails to timely file a Tax Court petition, but still desires to contest the merits of the deficiency, he must pay the defi-

seek to invoke Tax Court jurisdiction after the fact by claiming that the Notice of Deficiency was not properly mailed to the taxpayer's "last known address."[161]

The question of whether a Notice of Deficiency has been mailed to the taxpayer's last know address is a mixed question of law and fact.[162] However, because the inquiry usually is primarily one of fact, it is generally reviewed at the appellate level under the "clearly erroneous" standard.[163] The phrase "last known address" has been interpreted by the Tenth Circuit to mean "'that address to which the IRS reasonably believes the taxpayer wishes the notice sent.'"[164] While the IRS is required to use "reasonable diligence" to ascertain the taxpayer's correct address, "the burden is on the taxpayer to provide 'clear and concise' notice of his current address to the IRS; the IRS is otherwise entitled to rely on the address shown on the taxpayer's tax return for the year in question."[165] Clear and concise notice "is notice by which the taxpayer indicates to the IRS that he wishes the new address to *replace* all old addresses in subsequent communication."[166] A "subsequent tax return bearing a new address provides the IRS with 'clear and concise notice;'" therefore, the address on the taxpayer's most recent tax return is ordinarily deemed to be his last known address.[167] "Reasonable diligence" on the part of the IRS does not require the IRS to send duplicate notices to every address of the taxpayer known to the IRS.[168] Moreover, the IRS's duty to exercise reasonable diligence in ascertaining a taxpayer's last known address does not extend beyond the time when the deficiency notice is mailed, and events subsequent to that time are ordinarily irrelevant.[169]

In 1994, the Tenth Circuit took up two cases which required the application of these principles to determine whether a Notice of Deficiency was sent to the taxpayer's "last known address."

B. Gille v. United States[170]

Charles and Vicki Gille filed a joint income tax return for 1982, listing an Orem, Utah, address.[171] Neither Charles nor Vicki filed a tax return for 1983. They moved to Oklahoma City in early 1985, and filed a change of address form with the post office. However, they did not inform the IRS of their new

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ciency in full and sue for a refund in a United States District Court or the United States Claims Court." *Keado*, 853 F.2d at 1212 n.10.

161. *See e.g.*, Gille v. United States, 33 F.3d 46 (10th Cir. 1994).

162. Armstrong v. Commissioner, 15 F.3d 970, 973 (10th Cir. 1994).

163. *Id.* (citing Estate of Hall v. Commissioner, 967 F.2d 1437, 1438 (10th Cir. 1992)).

164. Cyclone Drilling, Inc. v. Kelley, 769 F.2d 662, 664 (10th Cir. 1985) (quoting United States v. Ahrens, 530 F.2d 781, 785 (8th Cir. 1976)).

165. *Id.* It is the taxpayer's responsibility to notify the IRS of any address changes. *Tadros*, 763 F.2d at 91.

166. *Cyclone Drilling*, 769 F.2d at 664 (emphasis added).

167. *Id.*

168. Marks v. Commissioner, 947 F.2d 983, 986 (D.C. Cir. 1991).

169. *See, e.g.*, Pomeroy v. United States, 864 F.2d 1191, 1195 (5th Cir. 1989).

170. 33 F.3d 46 (10th Cir. 1994), *rev'g* 838 F. Supp. 521 (N.D. Okla. 1993).

171. *Gille*, 838 F. Supp. at 522.

address. A Notice of Deficiency in respect of their 1982 return, mailed to Orem was forwarded to the Oklahoma City address.[172] In May 1985, Vicki paid the 1982 deficiency proposed in the Notice, stating in a letter from her attorney, that she did "not wish to involve her husband in her efforts to resolve this matter."[173] In a subsequent letter the next month, she wrote again to the IRS, identifying herself as "Vicki Lynn Rebeck (Gille)," giving her social security number, and providing the IRS with her new address in Oklahoma City.[174] The IRS recorded Vicki's change of address in October, but did not record a change of address for Charles. In response to her July letter, the IRS wrote back to Vicki, specifically referencing Charles' social security number.[175]

In early 1986, Vicki filed a "married but filing separately" return for 1985, reflecting the Oklahoma City address but containing no information regarding Charles.[176] Soon thereafter, the IRS began to look into the couple's failure to file a 1983 return, and in May 1986 issued a Notice of Deficiency to Charles at the Orem address. This was returned as undeliverable, as was a second Notice mailed soon thereafter.[177] Working on parallel tracks, the IRS mailed a 1986 Form 1040 to Vicki at the Oklahoma City address in December 1986. Vicki completed the form and filed it in early 1987, again filing as "married filing separately" and setting forth no information about Charles.[178]

In January 1987, the IRS filed a "dummy" 1983 Form 1040 for Charles, using his name and both spouses' social security numbers. The dummy return still listed the Orem address, despite the IRS's separate correspondence with Vicki. The tax deficiency shown on the dummy return was assessed on March 23, 1987.[179] A third Notice of Deficiency sent to Charles at the Orem address in December of 1987, as well as two notices of assessment similarly mailed in August and September of 1988, were returned as undeliverable.[180]

In January 1989, Charles moved to Broken Arrow, Oklahoma, not having filed a tax return since 1982. An IRS revenue officer finally located Charles through postal tracers. In a letter to the IRS in June 1989, Charles protested that he had never actually received any of the Notices of Deficiency sent to him in respect of the unfiled 1983 income tax return.[181]

The district court agreed with Charles that the IRS has not used "reasonable diligence" to ascertain Charles' address, particularly given the ease with which the IRS could have cross-referenced Charles' social security number with Vicki's and identified the Oklahoma City address as Charles' probable new address.[182] The district court did not accept the IRS's argument that "ad-

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172. *Id.*
173. *Id.* at 523.
174. *Id.*
175. *Id.*
176. *Id.*
177. *Id.*
178. *Id.*
179. *Id.*
180. *Id.* at 524.
181. *Id.*
182. *Id.* at 526.

ministrative realities" precluded the IRS from having to cross-reference between husband and wife.[183] The court therefore held that the Notices of Deficiency sent to Orem were not sent to Charles's "last known address."[184]

On appeal, the Tenth Circuit reversed in a brief opinion.[185] The court noted that the fact that "Vicki had corresponded with the IRS and had notified the agency of her new address is not tantamount to notice from [Charles] that he had also moved, particularly since Vicki had filed separately and pointedly stated earlier that she did not want to involve her husband in her tax matters."[186] The Tenth Circuit concluded that "[u]nder these circumstances, taxpayer, who did not bother to file a tax return after 1982, will not now be heard to complain that the IRS was not adequately diligent in its efforts to track him down."[187]

C. Armstrong v. Commissioner[188]

The taxpayer in *Armstrong* filed a 1988 income tax return showing his address as P.O. Box 74153, Tulsa, Oklahoma 74153.[189] Preparatory to sending taxpayer a Notice of Deficiency on March 2, 1990, the IRS had identified this tax return as the taxpayer's most recent filed return, and therefore the address given was considered by the IRS to be taxpayer's last known address. However, in researching the file, the IRS revenue agent noted that the address given on taxpayer's 1985 and 1986 tax returns was P.O. Box *35343*, Tulsa, Oklahoma 74153.[190] In addition, in connection with the audits of the taxpayer's returns, the taxpayer had in early 1989 filed a Form 872, Consent to Extend the Time to Assess Tax, and a Form 2848, Declaration of Representative, both indicating his address to be P.O. Box 35343, Tulsa, Oklahoma 74153.[191]

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183. *Id.* The Tenth Circuit has held that cross-referencing between business-related and individual return information amounts to an "unreasonable administrative burden." Howell v. United States, No. 92-3016, 1992 WL 372409, at *2 (10th Cir. Dec. 11, 1992) (citing Stein v. Commissioner, 60 T.C.M. (CCH) 211, 216 (1990)).

184. *See Gille*, 838 F. Supp. at 526. Finding that the IRS did not act in good faith in failing to ascertain Charles' correct address, the district court also awarded $16,000 to Charles under I.R.C. §§ 6103 and 7430 for 16 perceived unauthorized disclosures by the IRS of Charles' tax return information (mainly as set out in various notices of levy arising from the assessment arising out of the invalid Notices of Deficiency). *Id.* at 526-29.

185. *Gille*, 33 F.3d at 48.

186. *Id.*

187. *Id.*

188. 15 F.3d 970 (10th Cir. 1994), *aff'g* 63 T.C.M. (CCH) 3116 (1992).

189. *Armstrong*, 63 T.C.M. (CCH) at 3117.

190. *Id.* The taxpayer had quite obviously and erroneously entered 74153 as both the ZIP code and as the P.O. Box number on his 1988 return. Additionally, the taxpayer had made a transposition error on his 1986 return and listed the ZIP code as 74135. However, the revenue officer had caught this mistake, and used 74153 on the Notice of Deficiency. *See id.* at 3118 In any case, while it is "recommended" by the courts that ZIP codes be used, "the ZIP code is not a requirement for proper delivery" and the use of an incorrect ZIP code on a Notice of Deficiency and the mailing envelope "is a de minimum error not fatal to a notice of deficiency." Watkins v. Commissioner, 63 T.C.M. (CCH) 1710, 1711 (1992).

191. *Armstrong*, 63 T.C.M. (CCH) at 3117. The incorrect ZIP code was spotted again and corrected by the revenue agent in the Notice of Deficiency. *Id.* at 3118.

The taxpayer previously filed a 1987 tax return indicating his address to be 4150 S. 100th E. Ave., Ste. 308, Tulsa, Oklahoma 74146.[192] However, this was the address of his then-accountant, and in response to a letter sent to that address during the audit in 1989, the accountant informed the IRS that he was no longer engaged by the taxpayer.[193] The accountant named in the subsequent Form 2848 advised the revenue agent by telephone that the taxpayer's business address was 417 West 7th, Tulsa, Oklahoma, and that the taxpayer could be reached there.[194] A series of phone calls to that address by the revenue agent were not returned, and at no time did either the taxpayer or his accountant inform the IRS that the West 7th address was intended by the taxpayer to be the address to replace the taxpayer's previously-provided addresses.[195]

In late 1989, the revenue agent sent a second Form 872 to the P.O. Box 35343 address which was returned marked "unclaimed." In addition, a Form 870, Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment mailed in January 1990, were also returned marked "unclaimed." Finally, the IRS sent a Notice of Deficiency to the P.O. Box 35343 address, which likewise was returned unclaimed.[196]

In the Tax Court, the taxpayer asserted that the Notice of Deficiency should have been sent to the West 7th address, not the P.O. Box 35343 address, and therefore was not sent to his "last known address."[197] The court noted, however, that the only indication the IRS had of this address was a phone call from the taxpayer's accountant, and that the IRS was unsuccessful in ever reaching the taxpayer at this address by telephone.[198] In response to the taxpayer's contention that the IRS should have used more diligence in ascertaining the address after the last three pieces of correspondence sent to the Post Office address were returned "unclaimed," the court countered that they were *not* returned marked "address unknown", "insufficient address", or "no such street."[199] The fair implication of this was that the correspondence was correctly addressed, but simply refused by the taxpayer.[200] In light of all the facts, the court concluded that the Post Office address was in fact the taxpayer's correct and last known address, and that the IRS "reasonably believed that petitioner wished the notice of deficiency in this case to be sent to P.O. Box 35343, Tulsa, Oklahoma, 74153."[201]

The Tenth Circuit affirmed, concluding that the Tax Court's conclusions that the taxpayer had failed to carry his burden of proof in showing that he

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192. *Id.* at 3117.
193. *Id.*
194. *Id.* at 3118.
195. *Id.*
196. *Id.*
197. *See id.*
198. *Id.* The IRS did in fact contact the taxpayer at that address by telephone, but not until after the Notice of Deficiency had been mailed. *Id.*
199. *Id.*
200. *Id.* The taxpayer testified that he had not refused delivery of the correspondence, but the Tax Court found that he was not a credible witness. *Id.*
201. *Id.* at 3119.

provided the IRS with "clear and concise" notice that his last known address was the 7th Street address, and that the IRS had exercised reasonable diligence in ascertaining his last known address, were not "clearly erroneous."[202] In so doing, the Tenth Circuit reiterated that "reasonable diligence does not require that the IRS send duplicate notices to every address of which it has knowledge,"[203] and that "the IRS's duty to exercise reasonable diligence in ascertaining a taxpayer's last known address extends only to the point in time when the deficiency notice is mailed."[204]

VII. REFUND CLAIMS

A. Richards v. Commissioner[205]

In *Richards*, the Tenth Circuit affirmed a Tax Court decision, which denied the taxpayer's refund claim as untimely.[206] During 1987, Richards had $14,131 of income taxes and $1,158 of excess Social Security taxes withheld from her wages.[207] Under the Code, these amounts were deemed paid in respect of her 1987 income tax return as of April 15, 1988.[208] However, Richards did not file her 1987 tax return until January 23, 1991, subsequent to her receipt of a statutory notice of deficiency mailed by the IRS on October 22, 1990. Her return claimed a refund of the entire amount of $15,289 of taxes described above.[209] The IRS determined that the refund claim was untimely.[210]

The ability of a taxpayer to claim a refund is dependant on at least two factors: the "filing period" within which the refund claim must be filed; and the "refund period" for calculating the amount of the refund. Under the Code, the filing period depends on whether the taxpayer ever filed a return. If a return is filed, the refund claim must be filed within the later of "3 years from the time the return was filed or 2 years from the time the tax was paid."[211] However, if no return is filed, the claim must be filed "within 2 years from the time the tax was paid."[212]

The refund period is dependant upon which of the filing periods the taxpayer has satisfied. If the taxpayer has met the general three-year filing period requirement, then "the amount of the . . . refund shall not exceed the portion of the tax paid within the period, immediately preceding the filing of the

202. *Armstrong*, 15 F.3d at 974-975.
203. *Id.* at 974.
204. *Id.* at 975.
205. 37 F.3d 587 (10th Cir. 1994), *aff'g* 65 T.C.M.(CCH) 2137 (1993). *See also* Devich v. United States, No. 93-1067, 1994 WL 247028 (10th Cir. June 8, 1994) (rejecting taxpayer's convoluted argument that a past overpayment, now time-barred as to the refund claim, should be credited to a current underpayment, with the difference refunded to the taxpayer).
206. *Richards*, 37 F.3d at 587.
207. *Richards*, 65 T.C.M. (CCH) at 2137.
208. *Id. See also* I.R.C. § 6513(b)(1) (1988).
209. *Richards*, 65 T.C.M. (CCH) at 2137.
210. *Id.* at 2138.
211. I.R.C. § 6511(a) (West Supp. 1994).
212. *Id.*

claim, equal to 3 years, plus the period of any extension."[213] On the other hand, if the taxpayer did not meet the three-year filing period requirement, then "the amount of the . . . refund shall not exceed the portion of the tax paid during the 2 years immediately preceding the filing of the claim."[214]

When a refund claim is asserted in a Tax Court proceeding, however, a further refund period limitations is applicable. The Tax Court may determine that an overpayment of tax exists and may allow a refund, but the amount of the refund depends upon whether, alternatively, (i) the tax was paid after the mailing of the notice of deficiency,[215] (ii) the tax was paid and the refund claim was filed before the date the notice of deficiency was mailed,[216] or (iii) the tax was paid before the notice of deficiency was mailed but no refund claim had yet been filed on the date the notice of deficiency was mailed (in which case, notably, the refund claim is deemed filed on the date the notice of deficiency was mailed).[217] In *Richards*, the latter circumstances were present; therefore, Richards' refund claim was deemed filed on October 22, 1990.[218]

In the circumstances present in *Richards*, the Code provides that the amount of the refund depends upon whether the three-year filing period or the two-year filing period described above is applicable.[219] The question in Richards was, which of the filing periods *was* applicable? The Tax Court concluded that a refund claim made on October 22, 1990, would be timely for either: (i) a return filed on or after October 22, 1987, and before October 22, 1990, or (ii) taxes paid on or after October 22, 1988, and before October 22, 1990.[220] Richards did not qualify under either of these filing periods, and therefore her refund claim was untimely.[221]

On appeal, the Tenth Circuit agreed with the Tax Court. The court of appeals first noted that the phrase "3 years from the time the return was filed," as used in the Code, "implies that the taxpayer must file the return *prior* to filing the claim in order to benefit from the three-year refund period."[222] However, under a technical reading of the Code, Richards's return was filed *after* the date her refund claim was deemed filed. This relegated her to the two-year refund period. Because the taxes in question were deemed paid on April 15, 1988, however, her October 22, 1990, refund claim was not timely.[223]

The implication of the Tenth Circuit's decision is that a taxpayer seeking

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213. I.R.C. § 6511(b)(2)(A).
214. I.R.C. § 6511(b)(2)(B).
215. I.R.C. § 6512(b)(3)(A) (1988).
216. I.R.C. § 6512(b)(3)(C).
217. I.R.C. §§ 6512(b)(3)(B).
218. *Richards*, 65 T.C.M. (CCH) at 2138.
219. I.R.C. §§ 6512(b)(2)(B).
220. *Richards*, 65 T.C.M. (CCH) at 2138.
221. *Id.* at 2139.
222. *Richards*, 37 F.3d at 589 (emphasis added).
223. *Id.*; *cf.* Galuska v. Commissioner, 5 F.3d 195 (7th Cir. 1993) (reaching the same conclusion as the *Richards* court on similar facts). In *Galuska*, however, the taxpayer's refund claim would not have been timely even if he had brought the suit in a federal district court. *Id.* at 197. Thus, the "choice of forum" anomaly was not present in *Galuska*.

a refund may be adversely affected by her choice of forum when the taxpayer receives a notice of deficiency and has not yet filed a tax return for the relevant period. If Richards had filed a refund suit in a federal district court, her refund claim would have been deemed made by virtue of—and therefore not earlier than—her filing of the tax return, and not by the earlier date of the notice of deficiency.[224] Therefore, she would have been eligible for the three-year filing period, and in turn, the three-year refund "look-back" period would have been measured from the date of the return. Under the circumstances present in her case, her refund claim would have been timely because the date the taxes were deemed paid—April 15, 1988—was within three years of January 23, 1991. While the Tenth Circuit recognized "the potential inequities and ramifications when the outcome may be dependent on the forum in which the case was litigated,"[225] the court nevertheless acknowledged that its "task is not to scrutinize the wisdom underlying the laws enacted by the representative branch of government."[226]

VIII. BANKRUPTCY

A. Tanaka Brothers Farms, Inc. v. Berger[227]

The taxpayer in *Tanaka Brothers* was engaged in the onion farming business. The corporation filed a Chapter 11 petition for reorganization on January 7, 1991.[228] The case was later converted to a Chapter 7 liquidation in May 1991, and a bar date of September 3, 1991, was set. During March of that year, the IRS had filed a timely proof of claim, clearly indicating that a portion of the claim—that relating to fourth quarter 1990 payroll taxes—was an estimate, and that the debtor had yet to file payroll tax returns for that period. Subsequent to the bar date, the debtor filed the relevant tax returns. Based on the information contained therein, on May 8, 1992, the IRS filed an amended proof of claim which was some $355,000 greater than the estimated proof of claim. In the meantime, however, the trustee had negotiated settlement of the two most substantial claims against the bankruptcy estate, and the bankruptcy court had approved the settlements. The trustee objected to the second proof of claim "on the basis that the increased amount was so substantial as to constitute a new and untimely claim rather than a mere amendment."[229] Following notice and a hearing, the bankruptcy court determined that the increased claim constituted "unfair surprise" to other creditors and the trustee. The district court affirmed.

On appeal, the Tenth Circuit reversed, holding that the district court had

224. *Richards*, 37 F.3d at 590.

225. *Id.* at 591.

226. *Id.* The court concluded, "[a]lthough we find the statutes and their cross-references somewhat convoluted, their import is clear to us and compels the conclusion we have reached in this case, notwithstanding the fact that a contrary result may have been reached had this case been litigated in a different forum." *Id.*

227. 36 F.3d 996 (10th Cir. 1994).

228. *Id.* at 997.

229. *Id.* at 997-98.

abused its discretion.[230] The court of appeals noted that in a bankruptcy proceeding, "amendment of a proof of claim is *freely permitted* so long as the claim initially provided adequate notice of the existence, nature, and amount of the claim as well as the creditor's intent to hold the estate liable."[231] The only question in *Tanaka Brothers* was whether the IRS's original proof of claim provided adequate notice of the amount of the claim, since it clearly provided notice of the existence and nature of the claim, and of the IRS's intent to hold the estate liable.[232] Considering all relevant equitable factors,[233] the Tenth Circuit concluded that the original proof of claim provided adequate notice of the amount of the claim despite its subsequent increased amount, and reversed the lower courts' disallowance of the amended proof of claim.[234]

IX. TAX SHELTERS

A. Hildebrand v. Commissioner[235]

In *Hildebrand*, the Tenth Circuit has, one hopes, finally laid to rest protracted test case litigation[236] involving investors in Barton Enhanced Oil Production Income Fund and Technology Oil and Gas Associates 1980, sometimes referred to as the Manhattan partnerships[237] litigation and the Wichita

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230. *Id.* at 997. The decision of a bankruptcy court to disallow an amended proof of claim is reviewable under an "abuse of discretion" standard. Unioil, Inc. v. Elledge (In re Unioil), 962 F.2d 988, 992 (10th Cir. 1992). Under this standard, an appellate court will not disturb a bankruptcy court's decision unless the bankruptcy court made a clear error of judgment or exceeded the bounds of permissible choice under the circumstances. *Tanaka Brothers*, 36 F.3d at 998.

231. *Tanaka Brothers*, 36 F.3d at 998 (quoting *In re Unioil*, 962 F.2d at 992) (emphasis added).

232. *Id.*

233. Courts consider a variety of equitable factors in deciding whether to allow a claim to be amended. *See, e.g.*, In re Oasis Petroleum Corp., 130 B.R. 89, 91-92 (Bankr. C.D. Cal. 1991). These factors include:

> (1) Whether the parties or creditors relied on the IRS's initial claim, or whether they had reason to know subsequent proofs of claim would follow pending the completion of the audit.
>
> (2) Whether other creditors would receive a windfall to which they are not entitled on the merits by the court not allowing the amended proof of claim.
>
> (3) Whether the IRS intentionally or negligently delayed in filing the amended claim.
>
> (4) The justification, if any, for the failure to request a timely extension of the bar date.
>
> (5) Any other general equitable considerations.

Tanaka Brothers, 36 F.3d at 999.

234. *Tanaka Brothers*, 36 F.3d at 1000-01. Among other factors, the Tenth Circuit noted that: (1) the estimate was clearly denoted and that all parties were aware that the corrected figures would be provided when tax returns were filed for the debtor; (2) the creditors and the trustee could have protected themselves from this eventuality by negotiating a settlement that was conditional upon the final IRS figure; and (3) the increased figure was substantially less than was present in the case of In re Stavriotis, 977 F.2d 1202 (7th Cir. 1992), where the Seventh Circuit affirmed a bankruptcy court's disallowance of an amended IRS proof of claim. *Tanaka Brothers*, 36 F.3d at 1000.

235. 28 F.3d 1024 (10th Cir. 1994), *cert. denied*, 115 S. Ct. 726 (1995).

236. Over 2,000 related cases are before the Tax Court pending resolution of the test cases. Krause v. Commissioner, 99 T.C. 132, 133 (1992), *aff'd*, 28 F.3d 1024 (10th Cir. 1994), *cert. denied*, 115 S. Ct. 726 (1995).

237. Technology Oil and Gas Associates 1980 was one of several so-called Manhattan part-

partnerships[238] litigation.[239] The tax deficiencies at issue in these cases relate back to the early 1980's, and aggregate to an estimated $2 billion.[240] The core issue in *Hildebrand* involved the validity of deductions claimed by the partnerships in respect to certain "enhanced oil recovery" (EOR) operations proposed to be undertaken by the partnerships on land they leased in the late 1970's and early 1980's.

Generally speaking, the net losses of a partnership may not be deducted by its partners unless the partnership had actual and honest profit objectives.[241] Whether the partnership had actual and honest profit objectives is analyzed at the partnership level.[242] The test is "whether profit [is] the dominant or primary objective of the venture," and the burden of proof is on the taxpayer.[243] Whether a taxpayer engages in an activity with the objective of profit is a question of fact, and is reviewable by the appellate court under a "clearly erroneous" standard.[244] The Treasury Regulations set forth nine objective factors to be examined in determining when a taxpayer engages in activities with the objective of realizing a profit.[245] This list is nonexclusive, and the courts are free to consider other factors.[246]

Applying the relevant factors, the Tax Court concluded, in a lengthy opinion, that the activities of the partnerships in question "were not engaged in with actual and honest profit objectives."[247] Among other factors, the Tax Court found that (1) the consideration the partnerships agreed to pay to license the EOR technology they required and to lease their properties "bore no relation to the value of that which was acquired, did not conform to industry norms, and precluded any realistic opportunity for profit,"[248] (2) the EOR

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nerships. The partnership sold 211.5 units to 132 investors. *Krause*, 99 T.C. at 137.

238. Burton Enhance Oil Production Income Fund was one of three partnerships that comprised the Wichita partnerships. *Id.* at 150.

239. *Id.* at 133.

240. *Id.*

241. Nickeson v. Commissioner, 962 F.2d 973, 976 (10th Cir. 1992); Cannon v. Commissioner, 949 F.2d 345, 350 (10th Cir. 1991), *cert. denied*, 112 S. Ct. 3030 (1992).

242. Antonides v. Commissioner, 91 T.C. 686, 694-95 (1988), *aff'd*, 893 F.2d 656 (4th Cir. 1990); Brannen v. Commissioner, 78 T.C. 471, 505 (1982), *aff'd*, 722 F.2d 695 (11th Cir. 1984).

243. *Cannon*, 949 F.2d at 350.

244. *See supra* note 48 and accompanying text (discussing the "clearly erroneous" standard of review).

245. *See* Treas. Reg. § 1.183-2(b) (1972) (listing nine factors indicative of a good faith intent on the part of the taxpayer to recognize a profit). The *Cannon* court paraphrased the nine factors as follows: (1) the extent to which the taxpayer carries on the activity in a businesslike manner, (2) the taxpayer's expertise or his reliance on the advice of experts, (3) the time and effort the taxpayer expends in carrying on the activity, (4) the expectation that assets used in the activity may appreciate in value, (5) the taxpayer's success in similar activities, (6) the taxpayer's history of income or loss in the activity, (7) the amount of occasional profits, if any, (8) the taxpayer's financial status, and (9) the elements of personal pleasure or recreation. *Cannon*, 949 F.2d at 350.

246. *See Cannon*, 949 F.2d at 350. Other important factors may include a heavy emphasis on tax benefits of an investment in the venture, and the structure and amount of the fees agreed to be paid by the venture. *See, e.g.*, Karr v. Commissioner, 924 F.2d 1018, 1022-23 (11th Cir. 1991), *cert. denied*, 502 U.S. 1082 (1992).

247. *Krause*, 99 T.C. at 169.

248. *Id.* The Tax Court found that "all but two of the [EOR] technologies licensed by the partnerships were undeveloped, untested processes for which no prudent investor would pay any substantial fixed fees," and that the remaining two processes "could have been licensed by the partnerships directly from the inventors thereof for running royalties based solely on income real-

technology itself was for the most part recently developed and commercially untested, a fact that was inaccurately and misleading disclosed to the partners in the offering materials,[249] (3) the partnerships' estimates of projected oil recovery from the use of current EOR technology were "not supportable by credible expert testimony in this case and were not reasonable,"[250] (4) the partnerships relied on economic projections that "did not even take into account or note the abnormal nature and high cost of the license fees and royalties, nor the significant costs of conducting tests and of establishing commercial operations,"[251] (5) the partnerships further reliance on "projections of tar sands hydrocarbons or of oil in place, rather than projections of oil reserves" was a "significant fla[w]" where "[p]rojections based on oil reserves . . . would have provided a much more realistic basis" for projections and fees associated with the EOR technology,[252] (6) the partnerships further relied on projections that "world oil prices would continue increasing from 1979 and 1980 prices on a continuing upward spiral for the next 20 years,"[253] (7) in general, the validity and reasonableness of the assumptions used in the offering materials "were never ascertained, nor was any meaningful or credible comment or opinion as to the validity and reasonableness of those assumptions set forth in the offering memorandum or other material,"[254] (8) the partnerships marketed the investments largely on the basis of projected tax benefits,[255] (9) the fees paid to sponsors and advisors were exorbitant and unwarranted,[256] (10) the properties which were to be drilled or mined were over 90 percent depleted,[257] and in some cases were controlled by affiliates of the partnerships' promoters, who benefitted financially from the inflated and non-arms'-length consideration paid for the rights to develop the properties,[258] (11) the millions of dollars of debt incurred by the partnership in payment of its licensing fee obligations did not constitute genuine debt and was to be disregarded,[259] and (12) the partnerships never did in fact turn a profit for any year of their operations. In the final analysis, the Tax Court concluded that the arrangement was "a chain or multilayered series of obligations, stacked or multiplied on top of each other via the numerous partnerships to produce debt obligations in staggering dollar amounts, using a largely undeveloped and untested product, in a highly risky, very speculative, and nonarms'-length manner in an attempt to generate significant tax deductions for inves-

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ized therefrom." *Id.* at 171.

249. *Id.* at 158-59.

250. *Id.* at 169.

251. *Id.* at 170.

252. *Id.* at 169.

253. *Id.* at 174. This assumption was derived from a "worst case" report published by the Department of Energy in 1980, prepared at the height of the world energy crisis of the late 1970's. *Id.*

254. *Id.* at 169-70.

255. *See, e.g.*, *id.* at 146.

256. *See, e.g.*, *id.* at 150.

257. *See, e.g.*, *id.* at 138, 155-56.

258. *See, e.g.*, *id.* at 138-39.

259. *Id.* at 175.

tors."[260]

On appeal the Tenth Circuit determined that the findings of the Tax Court, including its ultimate fact finding that the partnerships were not engaged in activities with the actual and honest objective of realizing a profit, were not clearly erroneous.[261] Affirming the decision of the Tax Court, the Tenth Circuit noted that the Tax Court did a thorough job of considering the profit motive issue, "ably addressed" all the taxpayers' arguments, and rested its conclusion on a "solid foundation."[262]

X. CRIMINAL PROSECUTIONS[263]

A. United States v. Owen[264]

In *United States v. Owen*, the Tenth Circuit affirmed the conviction of David C. Owen, a former Kansas state senator and lieutenant governor, on two counts of filing false tax returns.[265] The tax returns in question were those of two companies in which Owen was a founder. The first company, Owen & Associates, had claimed deductions for certain expenses labelled as "consulting fees."[266] It was proven at trial, however, that these amounts were actually reimbursements to associates of Owen for political contributions they had made to Mike Hayden's 1986 campaign for governor, at Owen's request.[267] In addition, Owen & Associates failed to include in taxable income a $100,000 payment received by Owen for assisting an associate to obtain race track licenses. The company had classified the payment as a loan, but at trial it was determined that the $100,000 was never expected to be repaid, and was therefore includable in income when received.[268] The second company, Eagle Distributors, engaged in "a kind of Tinkers-to-Evers-to-Chance transaction"[269] the end result of which was to reimburse political contributions made

260. *Id.* at 175-76.

261. *Hildebrand*, 28 F.3d at 1028.

262. *Id.*

263. In addition to the cases described in the text, see United States v. Holland, 19 F.3d 1444, *unpublished order reprinted at* 1994 WL 56937 (10th Cir. 1994) (upholding the district court's refusal to dismiss a criminal tax prosecution because the government failed to act in good faith in bringing the prior criminal prosecution); United States v. Wilson, 19 F.3d 34, *unpublished order reprinted at* 1994 WL 75872 (10th Cir. 1994) (affirming conviction on four counts of willful failure to file income tax returns), *cert. denied*, 115 S. Ct. 360 (1994); United States v. Belcher, 41 F.3d 1516, *unpublished order reprinted at* 1994 WL 642195 (10th Cir. 1994) (affirming a district court order that (i) retrial after an initial reversal based on trial court's improper jury instructions does not constitute double jeopardy, and (ii) date of original indictment was proper measure for tolling of statute of limitations even as to charges set forth in subsequent superseding indictment where charges not substantially dissimilar to those set forth in original indictment).

264. 15 F.3d 1528 (10th Cir. 1994), *habeus corpus granted*, 1994 WL 608607 (D. Kan. 1994).

265. Under I.R.C. 7206(1) (West 1994), it is a felony for an individual to make or subscribe to a tax return which the individual "does not believe to be true and correct as to every material matter."

266. *Owen*, 15 F.3d at 1531 n.1.

267. Such contributions, if made by Owen & Associates, would have been nondeductible under I.R.C. § 162(e) (West 1994).

268. *Owen*, 15 F.3d at 1531, 1533-34.

269. *Id.* at 1532.

to the Hayden campaign under the guise of expenditures for "storage/rent."[270]

Owen was tried before a jury and convicted. On appeal, the Tenth Circuit affirmed the conviction over Owen's objections that (1) the government failed to prove that Owen acted willfully,[271] (2) the government had failed to show that the payment for storage/rent was anything but that,[272] and (3) the district court had made errors under the Federal Rules of Evidence.[273]

B. United States v. Hagedorn[274]

Lewis Hagedorn and two other persons were charged under a 15-count indictment arising from certain loan brokerage activities.[275] In return for a dismissal of all counts against him, Hagedorn pled guilty to one count of filing a false corporate tax return.[276] The presentence investigation report placed Hagedorn's base level offense at level 12, on the assumption that Hagedorn had failed to report income arising from a "criminal activity."[277] The district court adopted this finding in sentencing Hagedorn. On appeal of his sentence, Hagedorn argued that the district court erred in finding that the unreported income came from criminal activity.[278]

The Tenth Circuit agreed with Hagedorn that the district court's finding of fact on this issue was erroneous.[279] The only proof the government could offer that Hagedorn was engaged in criminal activity was Hagedorn's admission that the government could prove all the allegations contained in the Information.[280] However, Hagedorn had never admitted committing the offenses set out in the Indictment, and the government had not proven that Hagedorn possessed the necessary criminal intent to commit the relevant crime.[281] The Tenth Circuit therefore reversed the district court's sentence, and remanded for a redetermination.[282]

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270. *Id.* at 1534-35.
271. *Id.* at 1532-34.
272. *Id.* at 1534-35.
273. *Id.* at 1535-38.
274. 38 F.3d 520 (10th Cir. 1994).
275. Hagedorn had agreed to act as a loan broker for the Centurion Group of Manhattan, Kansas, after doing business with another Centurion broker, Vincent Perri. The principal of the Centurion Group was Eduardo McIntosh. Hagedorn processed several loan applications for Centurion and received advances from the potential borrowers, but Centurion failed to fund the loans. After unsuccessfully pressing McIntosh for the funds, Hagedorn and Perri broke away from Centurion and attempted to get the loans funded from other sources. These efforts were also unsuccessful. Following customer complaints, all three were indicted. Perri and McIntosh pled guilty to one count each of mail fraud. *Id.* at 521.
276. *See* I.R.C. § 7203 (West 1994) (imposing criminal liability on persons who willfully fail to file a tax return). Hagedorn also agreed to refund advance fees to the potential borrowers. *Hagedorn*, 38 F.3d at 521.
277. *See* former U.S.S.G. § 2T1.2 (1987 version).
278. *Hagedorn*, 38 F.3d at 522.
279. The Tenth Circuit noted that in criminal cases it will approach claims that the lower court erred in making a finding of fact deferentially, using a clearly erroneous standard of review. *Id.* (citing United States v. Miller, 987 F.2d 1462, 1465 (10th Cir. 1993)).
280. *Id.*
281. *Id.* at 522-23. Under former U.S.S.G. § 2T1.2.(b)(1), the government was required to prove that the defendant participated in "criminal activity," defined to mean "racketeering activity" as defined in 18 U.S.C. § 1961 as then in effect.
282. The only remaining issue related to whether the presentence investigation report improp-

C. United States v. Fleming[283]

William Fleming was convicted of two counts of conspiracy to violate the transfer tax provisions of the National Firearms Act[284] and one count of making false statements in order to avoid paying applicable transfer taxes on firearms.[285] Fleming was found to have participated in a scheme whereby machineguns and silencers were transferred between private citizens without payment of the applicable transfer taxes. This was accomplished by employing "straw" transfers through the Seminole, Oklahoma, police department and the Creek County, Oklahoma, district attorney's office.[286] The Tenth Circuit upheld Fleming's conviction[287] over Fleming's objections, *inter alia*, (1) that the trial court erred in not granting his motion for acquittal,[288] (2) that certain counts of the indictments were multiplicitous,[289] and (3) that the government failed to disclose certain evidence as it is required to do under *Brady v. Maryland*.[290]

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erly failed to reduce the magnitude of Hagedorn's unreported income by neglecting to deduct certain of Hagedorn's expenses. If so deducted, Hagedorn would be guilty of committing a lesser offense. *Hagedorn*, 38 F.3d at 523.

283. 19 F.3d 1325 (10th Cir. 1994), *cert. denied*, 115 S. Ct. 93 (1994).

284. I.R.C. §§ 5811, 5812 (West 1994).

285. *Fleming*, 19 F.3d at 1327. I.R.C. § 5861(1) (West 1994) makes it unlawful for any person to knowingly "make, or cause the making of, a false entry on any application required by the Act."

286. *Fleming*, 19 F.3d at 1327. Transfers to or from such entities are exempt from payment of the transfer tax under 27 C.F.R. § 179.90(a) (1993).

287. Fleming was sentenced to 46 months imprisonment and a $25,000 fine. *Fleming*, 19 F.3d at 1327.

288. *Id.* at 1328. Fleming argued that he had not lied on the applicable transfer forms, because in form the transactions were structured just as disclosed on the forms. The Tenth Circuit, however, invoking a familiar rule of construction, stated that it would look "to the substance and not merely the form of the transfers." The court concluded that "[f]rom the testimony given, a reasonable jury could decide that the alleged transfers to government agencies were sham transactions." *Id.* at 1329.

289. *Id.* at 1330. Fleming claimed there was only one conspiracy. The Tenth Circuit disagreed, finding instead that Fleming had entered into separate agreements to transfer weapons without paying the applicable transfer taxes. *Id.*

290. 373 U.S. 83, 87 (1963) (holding that suppression by the prosecution of evidence favorable to an accused violates due process where the evidence is material to guilt or punishment and the defendant has requested its disclosure). The Tenth Circuit, however, found that the prosecution's failure to disclose certain information to Fleming did not amount to a *Brady* violation. *Fleming*, 19 F.3d at 1331.

XI. ANNUAL ROUND-UP OF TAX PROTESTORS[291]

A. National Commodity and Barter Ass'n v. United States[292]

An annual feature of the Tenth Circuit's calendar is the appearance of the National Commodity and Barter Association[293] and its service wing, the National Commodity Exchange.[294] In this year's case, the NCBA and the NCE sued the government for a refund of penalties assessed under I.R.C. § 6698 (for failing to file a partnership tax return),[295] and I.R.C. § 6700 (for promoting an abusive tax shelter).[296]

As to the first penalty, the IRS determined that the NCBA was a "partnership" for federal income tax purposes,[297] and therefore required the organization to file partnership informational returns. On review, the district court

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291. In addition to the cases described in the text, see Jacob v. United States, 39 F.3d 1191, *unreported decision reprinted at* 1994 WL 596798 (10th Cir. 1994), *cert. denied*, 115 S. Ct. 1364 (1995) (rejecting "patently frivolous tax protestor rhetoric" and imposing a $500 sanction); United States v. Scheckel, 21 F.3d 1123, *unpublished order reprinted at* 1994 WL 145991 (10th Cir. 1994) (rejecting tax protestor's claims); United States v. Moore, 21 F.3d 1122, *unpublished order reprinted at* 1994 WL 95217 (10th Cir. 1994) (enjoining taxpayer from further filing of state UCC documents, resembling financing statements or security agreements, improperly creating security interests in personal assets of IRS agents). For background information regarding Moore's dispute with the IRS, see Moore v. United States, *unreported decision reprinted at* 1993 WL 260701 (D.D.C. 1993).

292. 42 F.3d 1406, *unreported decision reprinted at* 1994 WL 664970 (10th Cir. 1994), *cert. denied*, 64 U.S.L.W. 3239 (U.S. Oct. 2, 1995) (No. 94-1825).

293. The National Commodity and Barter Association (NCBA), conceived by libertarian John Grandbouche and formed in 1979, is an organization which "'espouses dissident views on the federal tax system and advocates a return to currency backed by gold and/or silver.'" United States v. National Commodity & Barter Ass'n, 1990-1 U.S. Tax Cas. (CCH) ¶ 50,284 (D. Colo. 1990) (quoting Voss v. Bergsgaard, 774 F.2d 402, 405 (10th Cir. 1985)). The NCBA's leaders advocate and promote opposition to federal income tax laws. United States v. Stelten, 867 F.2d 446, 448 (8th Cir. 1989), *cert. denied*, 493 U.S. 828 (1989). For a lengthy but by no means exhaustive list of reported decisions involving the NCBA, see National Commodity and Barter Ass'n v. United States, 843 F. Supp. 655, 659 (D. Colo. 1993), *aff'd*, 42 F.3d 1406, *unreported decision reprinted at* 1994 WL 664970 (10th Cir. 1994).

294. The National Commodity Exchange (NCE) is "operated by NCBA members as a private or warehouse bank" which the government views as a vehicle designed, among other things, to obscure the paper trail surrounding the financial affairs of its members. National Commodity & Barter Ass'n v. United States, 951 F.2d 1172, 1173 (10th Cir. 1991). The NCE carries out a wide variety of financial transactions in its own name, but on behalf of the NCBA's members. Thus, individual NCBA members are afforded a "high degree of privacy." *Id.*

295. I.R.C. § 6698 (West 1994) imposes a penalty on any partnership that fails to file an informational return in compliance with I.R.C. § 6031 (West 1994). The amount of the penalty is $50 per month multiplied by the number of partners in the partnership. The IRS had assessed the NCBA $4,223,000 in such penalties for failure to file informational returns for the period 1979-1988. *National Commodity and Barter Ass'n*, 843 F. Supp. at 657.

296. I.R.C. § 6700 (West 1994) imposes a penalty upon persons who organize or promote an organization, plan, or arrangement and, in connection therewith, either provide false or fraudulent statements as to its tax benefits, or make a "gross valuation overstatement." The penalty is based on the gross income derived therefrom. *Id.*

297. I.R.C. § 761(a) (West 1994) defines the term "partnership" to include a "syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not . . . a corporation or a trust or estate."

upheld the IRS's penalty assessment,[298] and rejected the NCBA's argument that it was not a taxable entity and simply fell "through the cracks" of the federal tax laws.[299] The Tenth Circuit held that this issue was not preserved on appeal.[300]

As to the second penalty, the district court once again agreed with the IRS, and concluded that the NCBA was an abusive tax shelter for purposes of I.R.C. § 6700.[301] On appeal, the Tenth Circuit affirmed this determination.[302]

B. National Commodity and Barter Ass'n v. Archer[303]

The NCBA and NCE have also pursued so-called "*Bivens* claims"[304] against the IRS and several of its employees, alleging violations of the First Amendment (right to free speech, press, and association) and Fourth Amendment (right to be free from unreasonable searches and seizures). In the latest chapter to this prolonged saga, the NCBA was successful in winning a reversal of the district court's dismissal of the organizations' First and Fourth Amendment claims, at least as to several of the named defendants.[305]

The original lawsuit had been dismissed on the grounds that the claims against the individual defendants in their *official* capacities were barred by sovereign immunity, and that the claims against the defendants in their *individual* capacities were barred by the doctrine of qualified immunity.[306] The dismissal was reversed in part in *National Commodity and Barter Ass'n v. Gibbs* ("*NCBA I*").[307] In *NCBA I*, the Tenth Circuit remanded NCBA's First and Fourth Amendment claims for repleading and reconsideration.[308] The qualified immunity defense was likewise remanded for possible reconsideration in the event the district court determined that the amended complaint stated a cause of action on the remanded First and Fourth Amendment claims.[309] On remand, in *NCBA II*, the district court once again dismissed the First and Fourth Amendment claims for failure to state a claim with sufficient specifici-

298. *National Commodity and Barter Ass'n*, 843 F. Supp. at 663.

299. *Id.* at 662-63. The district court concluded that "[t]he amount of economic activity engaged in by the NCE and NCBA—buying and selling metals, selling books, underwriting an insurance program—simply cannot fall through the cracks of the federal tax laws." *Id.* at 663.

300. *National Commodity and Barter Ass'n*, 1994 WL 664970 at **2.

301. *Id.* at 665. The district court also rejected the NCBA's constitutional claims, holding that the penalties did not violate any member's Fifth Amendment privilege against self-incrimination, or First Amendment rights of free association and free speech. *Id.* at 665-66.

302. *National Commodity and Barter Ass'n*, 1994 WL 664970 at **3.

303. 31 F.3d 1521 (10th Cir. 1994).

304. *See* Bivens v. Six Unknown Named Agents of Federal Bureau of Narcotics, 403 U.S. 388 (1971) (allowing plaintiff to recover money damages where six federal agents violated his Fourth Amendment rights).

305. National Commodity and Barter Ass'n v. Gibbs, 886 F.2d 1240, 1244 (10th Cir. 1989), *aff'd in part, rev'd in part*, 31 F.3d 1521 (10th Cir. 1994).

306. *See Archer*, 31 F.3d at 1523 (explaining the background and procedural history of the litigation).

307. 886 F.2d 1240 (10th Cir. 1989).

308. *Id.* at 1248.

309. *Id.* at 1249.

ty.[310] The dismissal of these claims mooted the qualified immunity defense.[311] The instant appeal challenged this dismissal.

On appeal, the Tenth Circuit found that the NCBA had pleaded its First Amendment claim with sufficient specificity.[312] The court made a similar determination with respect to the organizations' Fourth Amendment claim,[313] particularly because some of the warrants at issue had previously been found constitutionally defective in *Voss v. Bergsgaard*.[314] The remaining defendants' qualified immunity defenses in respect to the First and Fourth Amendment claims were also remanded for certain determinations concerning the availability of the defenses as to each of the claims.[315] The Tenth Circuit did not remand with directions for trial, and if the qualified immunity defense is found to exist, the defendants would be entitled to summary judgment (although the NCBA would presumably appeal such a result).[316]

C. Conklin v. United States[317]

One of the NCBA's more litigious members is William T. Conklin. Conklin, a self-described "known tax protestor like Jesus Christ, Thomas Jefferson, Benjamin Franklin and George Washington,"[318] has frequently appeared before the courts[319] in his individual capacity,[320] as a member of the NCBA,[321] and as representative of various putative church organizations, including the Universal Life Church,[322] the Church of World Peace,[323] and the Church of Ethereal Joy.[324] In the most recent controversy, Conklin was

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310. National Commodity & Barter Ass'n v. Gibbs, 790 F. Supp. 233, 238 (D. Colo. 1991).

311. *Id.*

312. *Archer*, 31 F.3d at 1527-31.

313. *Id.* at 1531-32.

314. 774 F.2d 402, 406 (10th Cir. 1985).

315. *Archer*, 31 F.3d at 1532-35.

316. *Id.* at 1532 n.8.

317. 1994-1 U.S. Tax Cas. (CCH) ¶ 50,263 (D. Colo. 1994), *aff'd*, 36 F.3d 1105 (10th Cir. 1994), *cert. denied*, 115 S. Ct. 583 (1994).

318. *Id.* Conklin also describes himself as a "house-husband and homemaker." Church of Ethereal Joy v. Commissioner, 83 T.C. 20, 23 (1984).

319. Conklin has been described as "'an active participant in a widespread abuse of the revenue laws through the promotion of mail-order "churches"' based on findings of fact showing his connection to the Universal Life Church in Denver and various other 'churches.'" Church of World Peace, Inc. v. Commissioner, 67 T.C.M. (CCH) 2282, 2287 (1994) (quoting *Church of Ethereal Joy*, 83 T.C. at 27).

320. *See, e.g.*, Conklin v. United States, 812 F.2d 1318 (10th Cir. 1987); Conklin v. Commissioner, 91 T.C. 41 (1988), *rev'd*, Conklin v. United States, 897 F.2d 1027 (10th Cir. 1990).

321. *See, e.g.*, Pleasant v. Lovell, 974 F.2d 1222 (10th Cir. 1992).

322. The Universal Life Church's tax exemption was originally upheld by the courts. Universal Life Church, Inc. v. United States, 372 F. Supp. 770 (E.D. Cal. 1974). Some years later, as the true activities of the church came to light, the Claims Court held that this earlier determination did not bar the IRS from later revoking the church's tax-exempt status based on a new issue or theory. Universal Life Church, Inc. v. United States, 9 Cl. Ct. 614 (1986). The church's tax exemption was subsequently revoked by the IRS. *See* Universal Life Church, Inc. v. United States, 13 Cl. Ct. 567 (1987), *aff'd*, Universal Life Church, Inc. v. United States, 862 F.2d 321 (Fed. Cir. 1988).

323. The Church of World Peace was founded by Conklin in 1977 and was operated from his residence. The Church's tax-exempt status has now been revoked. *See Church of World Peace*, 67 T.C.M. (CCH) at 2295.

324. The Church of Ethereal Joy has also had its tax-exempt statuts revoked by the IRS. The

assessed a penalty under I.R.C. § 6702(a) for filing a frivolous tax return.[325] Conklin paid the tax due and filed a refund suit. Conklin's 1987 income tax return contained little information, was unsigned,[326] and reflected a general Fifth Amendment objection to the return. The district court upheld the imposition of the penalty and entered summary judgment for the government, concluding —in line with Tenth Circuit case law[327]—that Conklin's Fifth Amendment claim was without merit. On appeal, the Tenth Circuit affirmed,[328] and additionally, imposed attorneys fees and double costs against Conklin.

D. Tavery v. United States[329]

Mary Ann Tavery is the wife of William Conklin.[330] The case involving Tavery, however, did not implicate her as a tax protestor. Conklin had been issued a summons to produce certain records which the government needed for its investigation of the Colorado Reform Baptist Church. The investigation was initiated because the IRS did not believe the church qualified as a tax-exempt entity.[331] Conklin did not respond to the summons. In subsequent contempt proceedings, Conklin claimed the right to court-appointed counsel, alleging he could not afford counsel of his own.[332] A brief filed by the government contesting Conklin's lack of wherewithall contained certain statements of Tavery's income level, and a list of tax refunds she had recently received.[333] Tavery then sued the government, alleging improper disclosure of tax return information.

The district court held that, under applicable provisions of the Code which sanction the disclosure of tax return information in a judicial proceeding if the information is "directly related to the resolution of an issue in the proceeding,"[334] the government had acted within its rights when it disclosed the in-

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revocation was affirmed in Church of Ethereal Joy v. Commissioner, 83 T.C. 20 (1984).

325. I.R.C. § 6702(a) (West 1994) imposes a penalty of $500 on any individual who files "what purports to be a return" but which "does not contain information on which the substantial correctness of the self-assessment may be judged," and the conduct is due to "a position which is frivolous" or due to "a desire . . . to delay or impede the administration of Federal income tax laws."

326. Conklin had filed his 1987 personal income tax return, Form 1040, "bereft of information, except for a pre-printed label with plaintiff's name and address." *Conklin*, 94-1 U.S.T.C. (CCH) ¶ 50,263, at 84,069. In an accompanying letter, Conklin explained that he had not completed the return because he had previously "given District Counsel power of attorney to sign my returns for me if they can be signed without waiving my constitutional rights." *Id.* The IRS was not amused and, after a further exchange of correspondence which resolved nothing, assessed the $500 penalty against Conklin under I.R.C. § 6702(a).

327. *See, e.g.*, Betz v. United States, 753 F.2d 834 (10th Cir. 1985) (holding that a general Fifth Amendment objection to filing a tax return "is not a valid claim of constitutional privilege").

328. Conklin v. United States, 36 F.3d 1105 (10th Cir. 1994) *cert. denied*, 115 S. Ct. 583 (1994).

329. 32 F.3d 1423 (10th Cir. 1994).

330. *See* Tavery v. United States, 897 F.2d 1032 (10th Cir. 1990).

331. Tavery v. United States, 32 F.3d 1423, 1425 n.1 (10th Cir. 1994).

332. *Id.* at 1426.

333. *Id.* at 1425.

334. *See* I.R.C. § 6103(h)(4)(B) (West 1994) (tax information may be lawfully disclosed "in a Federal or state judicial or administrative proceeding pertaining to tax administration . . . if the

formation. On appeal, the Tenth Circuit agreed, concluding that Tavery's income level and tax refunds were relevant to the issue of Conklin's eligibility for appointment of counsel. Therefore, the government's disclosure of the information was permissible.[335]

E. Okon v. Commissioner[336]

Christa Okon, a paralegal living in Santa Fe, New Mexico, declined to file federal income tax returns for 1985 and 1986. When contacted by the IRS concerning the unfiled returns, Okon raised a series of specious tax protestor arguments.[337] In response, the IRS issued Okon a statutory Notice of Deficiency. Okon filed a timely petition[338] in Tax Court for review of the proposed deficiency. The Tax Court dismissed her "very contrived" claims as frivolous.[339]

The Tax Court's order was entered on January 27, 1993.[340] Okon had 90 days from that date to perfect an appeal to the Tenth Circuit.[341] Okon filed a motion with the Tax Court to vacate its decision, which tolled the appeal period until April 23, 1993, at which time the motion was denied.[342] Okon then filed a second motion to vacate, not sanctioned by Tax Court rules. This motion was denied on May 28, 1993, and Okon filed an appeal to the Tenth Circuit within 90 days of that date, but beyond the original appeal period.

The Tenth Circuit dismissed the appeal as untimely, noting the general principle that under existing case law "tolling motions may not be tacked together to perpetuate the prescribed time for appeal."[343] This principle was seen to be applicable to Okon's actions in filing successive motions to vacate. Absent a tolling of her appeal period, Okon's appeal was deemed out of time. The court proceeded to place future Tenth Circuit litigants on notice that,

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treatment of an item reflected on such return is directly related to the resolution of an issue in the proceeding").

335. *Tavery*, 32 F.3d at 1429.

336. 26 F.3d 1025 (10th Cir. 1994), *cert. denied*, 115 S. Ct. 583 (1994).

337. Reflective of the tenor of her positions regarding the Federal income tax, Okon maintained that although she was a United States citizen, she was not liable for income tax unless she worked abroad, imported goods into the United States, or manufactured or sold alcohol, tobacco, firearms or narcotics. Additionally, she argued that the Commissioner of Internal Revenue had no jurisdiction over her or authority to determine deficiencies in her income tax. Okon v. Commissioner, 65 T.C.M. (CCH) 1783, 1784 (1993), *appeal dismissed*, 26 F.3d 1025 (10th Cir. 1994), *cert. denied*, 115 S. Ct. 583 (1994).

338. According to I.R.C. § 6213(a) (West 1994), Okon's petition had to be filed within 90 days following the date of the Notice of Deficiency. Okon's "petition" consisted of a letter to the Tax Court requesting an extension of time in which to file a petition. The court accepted the letter itself as a petition, and gave Okon 60 days to amend the petition with a further filing. Okon timely filed her amended petition. *Okon*, 26 F.3d at 1026.

339. *Okon*, 65 T.C.M. (CCH) at 1784. Okon's only claim of merit was that the Notice of Deficiency had not been mailed to her last known address as required by I.R.C. § 6212(b)(1) (West 1994). The Tax Court, however, noted that Okon received the Notice in plenty of time to file a timely petition, and that she had in fact done so. *Okon*, 65 T.C.M. (CCH) at 1786. Therefore, the Notice was sufficient.

340. *Id.*

341. *See* I.R.C. § 7483 (West 1994).

342. *Okon*, 65 T.C.M. (CCH) at 1784.

343. *Okon*, 26 F.3d at 1026.

while the instant case involved successive motions asserting essentially the *same* grounds, the doctrine applied by the court here was equally applicable under appropriate circumstances to "litigants who parcel out objections over successive post-trial motions,"[344] even if on *unrelated* grounds.

F. *Miscellaneous Tax Protestor Cases*

In 1994, the Tenth Circuit was called upon to summarily dispose of a variety of other tax protestor claims, including: (1) that citizens are not subject to the jurisdiction of the IRS;[345] (2) that judges who pay taxes or otherwise have a "financial stake" in the outcome of a tax case should disqualify themselves from presiding over the case;[346] (3) that the jurisdiction of the IRS does not extend beyond the boundaries of the District of Colombia and federal territories;[347] (4) that as a citizen of one of the states, such as Colorado or Wyoming, a person is a "nonresident alien" not subject to federal taxation;[348] (5) that the IRS has not been and cannot be delegated authority to administer the Code;[349] (6) that there is no statutory authority for imposing federal income taxes on individuals;[350] and (7) that wages are not "income."[351]

The Tenth Circuit has ruled that a flat fee of $1,500 will be awarded to the government as a sanction for frivolous tax protestor appeals.[352] In 1994, this sanction was imposed in several cases.[353]

James Serven[354]

344. *Id.* at 1027 n.2.

345. *See, e.g.*, Booth v. Internal Revenue Serv., 37 F.3d 1509, *unpublished order reprinted at* 1994 WL 563437 (10th Cir. 1994).

346. *See, e.g.*, *id.*

347. *See, e.g.*, Cotton v. Unites States, 39 F.3d 1191, *unpublished order reprinted at* 1994 WL 563459 (10th Cir. 1994); Zabel v. Commissioner, 28 F.3d 114, *unpublished order reprinted at* 1994 WL 263713 (10th Cir. 1994).

348. *See, e.g.*, *Cotton*, 39 F.3d 1191 (10th Cir. 1994); Haines v. Commissioner, 21 F.3d 1121, *unpublished order reprinted at* 1994 WL 117763 (10th Cir. 1994).

349. *See, e.g.*, *Haines*, 21 F.3d 1121 (10th Cir. 1994); Zabel v. Commissioner, 28 F.3d 114 (10th Cir. 1994).

350. *See, e.g.*, *Haines*, 21 F.3d 1121 (10th Cir. 1994).

351. *See, e.g.*, Booth v. Internal Revenue Serv., 37 F.3d 1509 (10th Cir. 1994).

352. *See, e.g.*, Casper v. Commissioner, 805 F.2d 902, 906 (10th Cir. 1986).

353. *See, e.g.*, *Zabel*, 1994 WL 263713 at *1-2; *Cotton*, 1994 WL 563459 at *2; *Booth*, 1994 WL 563437 at *2.

354. B.S.B.A., Accounting, University of Denver, 1977; Masters in Taxation, University of Denver, 1978; J.D., Stanford University, 1981; Lecturer in Law, University of Denver.