



Connect. Engage. Impact.



# Annual Conference Scottsdale, AZ

**Challenging the Validity of  
Treasury Regulations and IRS  
Guidance – Considerations  
(and Major Questions) for the  
In-House Tax Professional**

*October 25, 2022*

*3:15-4:15*

**Moderator**



**Rich Wireman**  
VP Tax, Principal  
Financial Group



**Robert Kovacev**  
Member, Miller &  
Chevalier Chartered



**Mary Monahan**  
Partner, Eversheds-  
Sutherland (US) LLP



**Andy Roberson**  
Partner, McDermott  
Will & Emery LLP

# Overview of IRS Position on Guidance Challenges



## Challenges at the Exam Team Level

- Focus on fact-finding
- Apply IRS published guidance (and often private guidance) mechanically
- Inability to consider hazards of litigation
- Need to coordinate/seek advice if taxpayer challenges guidance
- Bottom Line – no deal

# Challenges at the Appeals Level

- Historically some ability to reach resolution on regulations/rules challenges
  - No statutory prohibition on Appeals considering such challenges
  - Taxpayer First Act of 2019 – indicated general intention for taxpayers to pursue Appeals except in limited circumstances
- September 13, 2022 Proposed Regulations
  - 24 exceptions to Appeals consideration of issues
  - Appeals will not consider challenges to the validity of regulations
  - Appeals will not consider challenges alleging that a notice of revenue procedure is procedurally invalid
  - Only exception is if there is an unreviewable decision from a federal court holding the guidance invalid
  - Comments due by November 14, 2022
- September 14, 2022 Appeals Memorandum
  - Essentially finalizes the proposed regulations
- Bottom line – no deal

# Background/Legal Framework

# What “Law” is Administrative Law?

- What are the rules?
  - **General Concept** – Administrative law focuses on the process by which federal agencies develop, issue, amend, and repeal regulations, which is commonly called rulemaking.
  - **Administrative Procedure Act (APA) (1946):**
    - Provides the statutory basis for Federal Administrative Law.
    - Categorizes agency actions as rulemaking or adjudication.
    - Creates framework that agency rulemaking can be proposed and evaluated.
  - **Internal Revenue Code:** Gives additional rules for IRS and Treasury Department.
  - **U.S. Code:** Other Federal laws impose additional requirements for agencies.



# Requirements for Agency Rulemaking

- **Notice - 5 USC § 553(b)**—Agency must publish a Notice of Proposed Rulemaking in the Federal Register, which shall include:
  - Time, place, and nature of the public rulemaking proceeding;
  - Legal authority for the proposed rule; and
  - Either terms or substance of the rule or description of the issue.
- **Comment— 5 USC § 553(c)**—
  - Agency must give interested persons the opportunity to participate by submitting written data, views, or arguments (may include oral presentation); and
  - Agency must consider any relevant matter presented and incorporate in any final rules a “concise general statement of the basis and purposes.”
- **Publication - 5 USC § 553(d)**— Final rule must be published at least 30 days before a rule’s effective date, except for:
  - Substantive rule that grants or recognizes an exemption or relieves restriction;
  - Interpretive rules and statements of policy; or
  - Good cause found and published with the rule.



# Requirements for Agency Rulemaking (continued)

- The Attorney's General Manual on the APA (1946) offered working definitions of substantive and interpretive rules:
  - **Substantive:** Rules issued by an agency pursuant to statutory authority and which implement a statute.
  - **Interpretive:** Rules or statement issued by agency to advise the public of the agency's construction of the statutes and rules it administers.
- Before *Mayo* (Sup. Ct. 2011), courts distinguished between “legislative” and “interpretive” based on whether a specific grant of rulemaking authority:
  - Regulations issued under general rulemaking authority in § 7805(a) were considered “interpretive” regulations.
  - Example of legislative regulation: Section 132(o) relating to fringe benefits stated that Treasury “shall prescribe such regulations as may be necessary or appropriate to carry out this section.”
- After *Mayo*, cases have treated § 7805(a) regulations as “legislative” regulations for APA purposes if they are intended to have the force and effect of law. *See Chamber of Commerce* (WD Tex 2017).

# Challenging Agency Rules

- **Judicial Review:** 5 USC § 702 provides that persons **harmed by** agency actions generally have a right to judicial review.
- **Scope of Review:** Court may hold unlawful and set aside an agency rule found to be:
  - “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law,” 5 USC § 706(2)(A);
  - in excess of statutory authority, 5 USC § 706(2)(C); or
  - “without observance of procedure required by law.” 5 USC § 706(2)(D).
- **State Farm Judicial Review Standard (Sup. Ct. 1983) under APA for “legislative” regulations** – Whether there is a “reasoned basis” for decision making of agency:
  - Relevant factors must be considered.
  - Agency’s explanation of relevant facts and their relation to choices is critical.
  - Clear error of judgment.
- **Where:** U.S. Tax Court (26 U.S.C. § 6214); Court of Federal Claims (28 U.S.C. § 1491); or District Court (28 U.S.C. § 1346).

## Challenging Agency Rules (continued)

- When: In theory, there are three potential times to challenge an agency action.
  - Pre-enforcement;
  - During enforcement; or
  - After enforcement (deficiency or refund litigation).
- Different rules apply to each.
- Taxpayers face the greatest obstacles in pre-enforcement and during enforcement challenges.
  - Obstacles to a taxpayer's challenging IRS rulemaking include standing, the Anti-injunction Act, and the Declaratory Judgment Act.



# Obstacles to Challenges During Enforcement

- Challenges During Enforcement:
  - Is there merit to raising an administrative law challenge to a final Treasury Regulation during an IRS Appeals Conference?
  - What power (if any) does an IRS Appeals officer have to consider litigation hazards regarding the validity of a final Treasury regulation?

# Tools for Attacking Treasury Regulations

- **Procedurally Defective (APA):**
  - **Argument:** Treasury failed to carry out the notice-and-comment process.
  - **Example:** *Encino Motorcars I* (Sup. Ct. 2016).
- **Arbitrary or Capricious (APA):**
  - **Argument:** Treasury lacked a rational basis on the evidence before it.
  - **Examples:** *State Farm* (Sup. Ct. 1983)
- **Substantively Invalid (Chevron deference standard):**
  - **Argument:** Fails under two-step analysis from *Chevron* (Sup. Ct. 1984).
  - **Examples:** *Mayo* (2011) and *Dominion Resources* (Fed. Cir. 2012).

# Deference Standards

<i>Chevron</i>	<i>Auer / Kisor</i>	<i>Skidmore</i>
Potentially applies to tax regulations issued pursuant to authority delegated by Congress and intended to carry the force of law.	Potentially applies to IRS interpretations of ambiguous regulations.	Potentially applies to subregulatory tax guidance (revenue rulings and procedures, notices, and announcements) interpreting statutes.
Step One – has Congress directly spoken on the precise issue? If so, Step Two – is the IRS’s interpretation reasonable. If both prongs passed, regulation will be controlling.	Five preconditions: 1. Regulation must be “genuinely ambiguous.” 2. Interpretation must be reasonable. 3. Interpretation must be the IRS’s authoritative or official position. 4. Interpretation must implicate the IRS’s substantive knowledge. 5. Interpretation must reflect fair and considered judgment.	“Power to persuade” standard. Such guidance is not binding and is akin to a litigating position, but courts may defer to it if found to be persuasive.
Under attack in recent years, but remains the standard for judging regulations.	<i>Kisor</i> significantly limited the situations under which this deference doctrine may apply.	In practice, is usually just used as further support if a court agrees with the IRS’s interpretation.



# *Chevron* Deference

- Courts apply two-step *Chevron* analysis to determine whether regulations are consistent with Congressional intent.
- Step One – use tools of statutory construction to determine whether Congress has addressed the precise question at issue.
  - If Congress has directly addressed the question, its intent controls.
  - If there is ambiguity or silence, the analysis proceeds to Step Two.
- Step Two – determine whether the agency’s rule is based on a permissible interpretation of the statute.
  - A court must defer to the agency’s authoritative interpretation unless it is “arbitrary or capricious in substance, or manifestly contrary to the statute.”
  - Court need not conclude that agency’s construction of statute was only one the agency permissibly could have adopted.
  - Court need not conclude it would have reached the same construction if question had initially arisen in a judicial proceeding.
- Courts differ on extent to which legislative history is analyzed in Step One; it is uniformly analyzed in Step Two.

## *Chevron* Deference (cont'd)

- *Mead* (2001) - Supreme Court provides framework for deciding if *Chevron* applies in the first place.
  - Did Congress delegate authority to the agency to make rules carrying the force of law?
  - Did the Agency make its determination in exercise of that authority?
  - Did Agency exercise notice-and-comment rulemaking?
- *Mayo* (2011) - *Chevron* deference is now generally required for § 7805(a) regulations.
  - Must be intended to have the force and effect of law.
  - Must be issued pursuant to APA's notice-and-comment of procedures.
  - Effectively eliminated the previous distinction between legislative and interpretive regulations.

## *Auer/ Kisor* Deference

- *Auer* (1997) – the Supreme Court reaffirmed prior opinions holding that a court must defer to an agency’s reasonable interpretation of its own ambiguous regulation, even if there is another reasonable interpretation.
  - Used more prominent outside of the tax arena, but more reliance by IRS/DOJ in recent years.
  - How do you determine whether a regulation is ambiguous?
  - Controversial due to concerns that agencies could issue rules and later expand application beyond what was originally intended.
- *Kisor* (2019) – upheld *Auer*, but clarified proper analysis and safeguards to prevent agency overreaching.
- Some courts have applied *Auer*’s “genuinely ambiguous” and “reasonableness” inquiries in the context of *Chevron*.
- Treasury Policy Statement (2019) – Treasury recently announced that IRS would not seek judicial deference under *Auer* in Tax Court cases.
  - Does not apply to DOJ attorneys.
  - Not binding on the IRS and can be changed at any time.



## Skidmore Deference

- *Skidmore* (1944) – lowest level of deference that looks at level of persuasiveness, that is, whether IRS’s interpretation of law is thoroughly considered, well reasoned and consistent with prior and subsequent positions.
  - Unlike *Chevron*, courts have significant flexibility in deciding whether to grant deference under *Skidmore*.
  - At oral argument in *Kisor*, Justice Kavanaugh said *Skidmore* “is really no deference because it applies only when it’s persuasive, which is true of any argument.”
- Prevailing view, currently shared by the IRS and DOJ, is that subregulatory guidance (i.e., IRS guidance published in the Internal Revenue Bulletin) such as revenue rulings and procedures, notices and announcements are analyzed under *Skidmore* because such guidance does not carry the force of law.
- Since *Mead*, circuit courts have recognized the issue but not decided if *Chevron’s* or *Skidmore’s* deference standard applies to revenue rulings.
- What deference standard applies to private guidance such as CCAs, PLRs, TAMs?

# Rules for Treasury Regulations

- Regulations come in proposed, temporary, and final form.
- Proposed – not binding, but sometimes can be relied on by taxpayers.
- Temporary regulations.
  - Must be accompanied by proposed regulations which will go through notice-and-comment process.
  - Generally considered binding.
  - Temporary regulations issued after November 20, 1988 must be finalized within three years or else they expire.
  - If temporary regulations expire, the proposed regulation nevertheless remains in proposed form unless it is withdrawn (e.g., section 482 “all value” temporary regulations expired in Sept. 2018, but parallel proposed regulations were not withdrawn).
  - Must temporary regulations must meet the “good cause” exception APA’s notice and comment requirements in order to have an immediate effective date? (IRS/Treasury recently committed to providing good cause explanation)
  - Should pre-November 20, 1988 temporary regulations that have never been finalized still be treated as binding?
- Final – binding if validly promulgated (i.e., pass *Chevron* and APA requirements).

## Rules for Treasury Regulations (cont'd)

- Congress has delegated authority to IRS to issue regulations in two ways:
  - Section 7805(a) general grant of authority.
  - Specific authority granted in the relevant statute.
  - Is there any distinction in the deference analysis after *Mayo*?
- Both before and after *Mayo*, courts have invalidated § 7805(a) regulations that cannot point to a gap in the relevant Code section that needs to be filled, or that add a requirement or restriction not supported by Congressional intent.
- Recent cases include:
  - *Mayo Clinic* (D. Minn. 2019): invalidating § 7805(a) regulations where they imposed conditions on the definition of “educational organization” that were not in the statute.
  - *Good Fortune Shipping* (D.C. Cir. 2018): invalidating § 883 regulation as an unreasonable interpretation of operative code section because failed *Chevron* Step Two; Treasury’s interpretation “comes close to violating plain language of statute.”
  - *Wisconsin Central* (S. Ct. 2018): Reg. § 31.3231(e)-1, promulgated pursuant to section 7805(a), held invalid because insufficient statutory ambiguity to move to *Chevron* Step Two.
  - *Loving* (D.C. Cir. 2014): Held that 31 USC § 330 did not authorize Treasury to regulate tax return preparers because key statutory term (“representatives”) was unambiguous; *Chevron* Step One failed.



# Rules for Treasury Regulations (cont'd)

- Section 7805(b) restricts use of retroactive regulations.
  - **General Rule** — effective date of final, temporary or proposed regulation may not be before earliest of (i) final rule published in the Federal Register, (ii) proposed or temporary rule published in the Federal Register, or (iii) notice substantially describing expected contents of regulation issued.
  - **Exceptions**—include
    - “Promptly Issued Regulations” (issued within 18 months of statute).
    - Regulations to “prevent abuse.”
    - Correction of procedural defects in prior regulations.
    - Congress explicitly authorizes Treasury to issue retroactive regulations.
    - Taxpayer is given election to apply regulation retroactively.

# I.R.B. Guidance

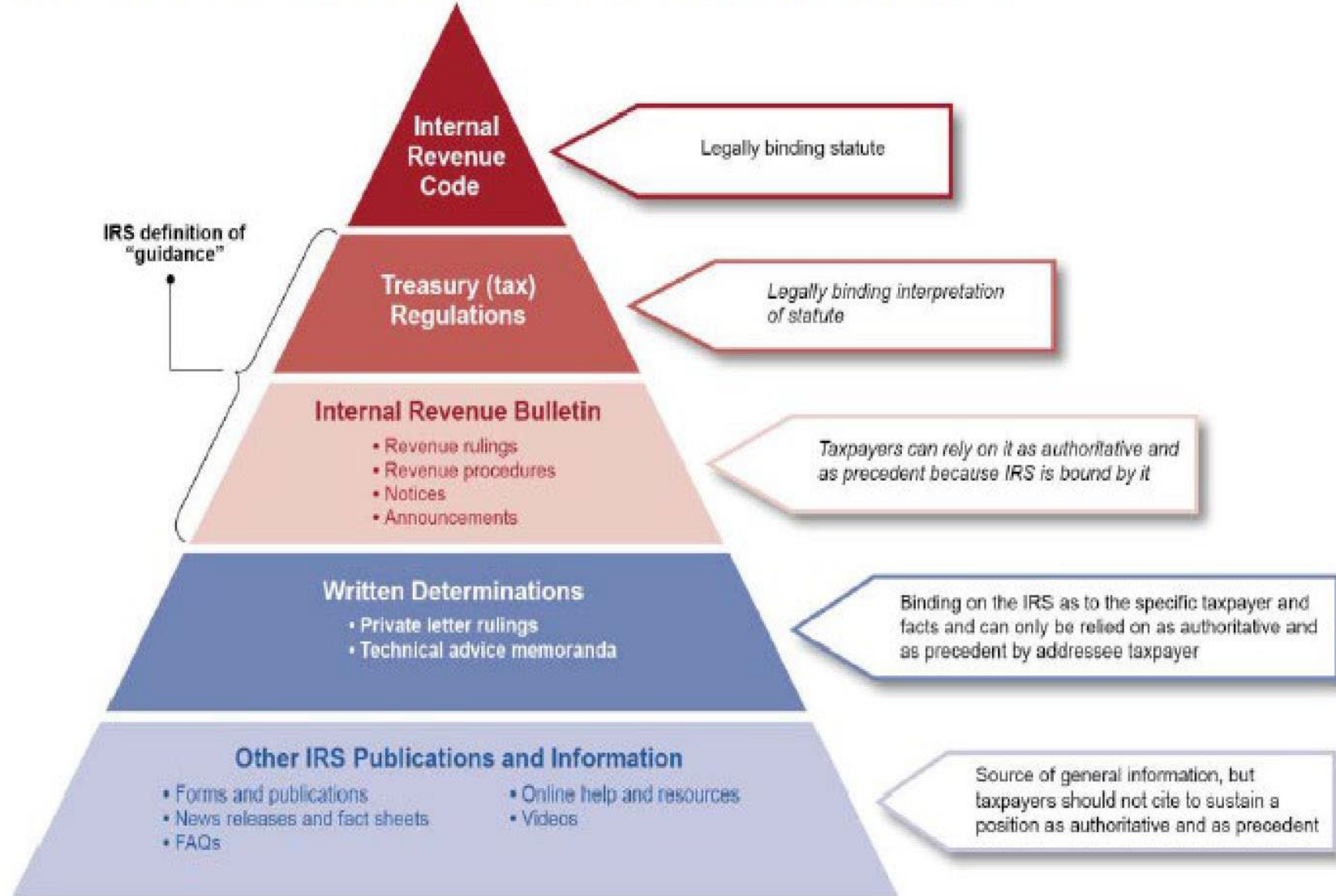
- I.R.B. Guidance
  - I.R.B. is the “authoritative instrument of the Commissioner . . . for announcing official rulings and procedures of the Internal Revenue Service . . . .”
  - What level of deference should apply?
    - If the IRS issues a public notice and takes comments?
    - If it does not issue a public notice and take comments?
  - The Department of Justice has stated that it will not argue for *Chevron* deference for IRB guidance.

# Treasury Policy Statement

- Department of the Treasury issued a Policy Statement on the Tax Regulation Process (March 5, 2019)
  - Commitment to notice and comment rulemaking, even for interpretive rules.
  - Limited use of temporary regulations, with “good cause” statement.
  - Limits on sub-regulatory guidance
    - IRS will not seek judicial deference under Auer v. Robbins or Chevron USA, Inc. v. Natural Resources Defense Council, Inc. in Tax Court litigation.
    - Limit effectiveness of notices setting forth anticipated proposed regulations after 18 months (taxpayers may rely but IRS will not assert adverse position based on notice).
- Current Administration has thus far not rescinded or modified this Policy Statement



## Hierarchy of Authority for IRS Guidance and Other Information Sources



Source: GAO analysis of IRS documents. | GAO-16-720

The background of the slide is a faded, high-angle photograph of a large, multi-story building with a central tower and two side wings. The building has a reddish-brown facade and many windows. It is situated on a hill, and a road or path leads up to it. The image is very light and serves as a backdrop for the title text.

# Pending/Recent Challenges

# Recent Developments

- Several recent and pending cases highlight the current state of affairs
- These challenges can be broken down as:
  - Cases involving IRS/courts purportedly not following regulations
  - Cases involving challenges to the substantive and/or procedural invalidity of regulations
  - Challenges to the procedural validity of subregulatory guidance



# Challenges to Failure to Follow Regulations

- *Bittner v. US*, S.Ct. No. 21-1195 (cert granted)
  - Whether the \$10,000 FBAR penalty applies per annual FBAR form or per account
  - Taxpayer arguing, in part, that the regulations confirm the statutory text that a single invalid form gives rise to only a single violation (*i.e.*, only on penalty)
- *Whirlpool Financial Corp. v. Commissioner*, S.Ct. No. 22-9 (petition for cert pending)
  - Whether courts can disregard otherwise valid regulations, expressly required by Congress to be promulgated, and focus solely on an interpretation of the statutory text

# Challenges to Validity of Regulations

- *Oakbrook Land Holdings, LLC v. Commissioner*, S.Ct. No. 22-323 (petition for cert pending)
  - Split between the Sixth Circuit (*Oakbrook*) and the Eleventh Circuit (*Hewitt v. Commissioner*, 21 F.4th 1336 (11th Cir. 2021) regarding whether there was an APA violation for failing to respond to public comments when promulgating a regulation governing charitable donations
  - Raises issues regarding whether a comment is significant enough to require an agency response and, if so, the standard for a sufficient response
- *Liberty Global, Inc. v. US*, No. 1:20-cv-03501-RBJ (D. Colo., Apr. 4, 2022)
  - Holding that the APA's notice-and-comment requirement applies to temporary regulations and the government lacked good cause in not complying with the requirement
  - Regulations impermissibly retroactive
  - Did not address the issue of whether the regulations, which changed the effective date of the statute, were invalid under *Chevron* as conflicting with the plain language of the statute

# Challenges to Validity of Regulations

- *Natl. Assn. of Mfrs. v. Department of the Treasury*, No. 2020-1732 (Fed. Cir., Aug. 23, 2021)
  - Validity of regulations interpreting the term “drawbacks” relating to the interaction of federal excise taxes and duty drawbacks for wine
  - Regulations held invalid for conflicting with the unambiguous text of the statute (*i.e.*, failed to pass *Chevron* Step One)
- *Kyocera AVX Components Corp. v. US*, No. (D.C.S.C., complaint filed July 28, 2022)
  - Validity of regulations that provide an effective date different than in the enacted legislation
  - Anticipated to be addressed in summary judgment filings in 2023
- *3M Co. v. Commissioner*, Tax Court No. 5816-13
  - Validity of transfer pricing regulations arguable in conflict with prior Supreme Court precedent
  - Fully briefed and argued since 2016



# Challenges to Subregulatory Guidance

- *Mann Construction, Inc. v. US*, 24 F.4th 1138 (6th Cir. 2022)
  - Notice 2007-38 held procedurally invalid for failure to follow APA's notice-and-comment requirements
  - Notice was determined to be a legislative rule, not exempt from APA
  - Government did not appeal case
- *CIC Services, LLC v. IRS*, No. 317-cv-110 (E.D. Tenn. 2022)
  - Notice 2016-66 held procedurally invalid for failure to follow APA's notice-and-comment requirements
  - Followed Sixth Circuit precedent in *Mann*
- *GBX Associates, LLC v. US*, No. 1:22-cv-401 (N.D. Ohio)
  - Challenge to procedural invalidity of Notice 2017-10
  - Government conceded invalidity (for taxpayers in the Sixth Circuit based on *Mann*); parties dispute proper scope of relief
  - Several cases pending in Tax Court with issue

# Penalties and Protection

## Original Returns – Penalty Standards

### Accuracy Related Penalties - §6662 – Baseline is 20%

- Negligence or disregard of rules or regulations
- Substantial understatement (=the lesser of 10% of the tax required to be shown on the return or \$10M (5% for 199A deduction))
- Substantial valuation misstatement (value is 150% or more of the correct amount, price in related party transaction is 200% or more or 50% or less of the correct amount, net transfer price adjustment exceeds \$5M or 10% of gross receipts)
- Gross valuation misstatement (value is 200% or more of the correct amount, price in a related party transaction is 400% or more or 25% or less of the correct amount, net transfer price adjustment exceeds \$20M or 20% of gross receipts) (40%)
- Transactions lacking economic substance under §7701(o) or failing to meet the requirements of any similar rule of law (40% if not disclosed)

- If the regulation/rule is not invalid, penalties could apply to the resulting underpayment
- The penalty regulations provide for non-imposition of a penalty if certain conditions are met
- Regulations are specific to each penalty
- Reasonable cause/good faith exception applies to all penalties except lack of economic substance



## Amended Returns – Penalty Standards

### Erroneous Claim for Refund or Credit - §6676 – 20%

- Claim for refund or credit with respect to income tax is made for an excessive amount and not due to reasonable cause
- An excessive amount is the amount by which the claim exceeds the allowable amount of the refund
- Any excessive amount which is attributable to a transaction that lacks economic substance is treated as not due to reasonable cause

- Prior to 2007, no penalty for requesting an excessive refund
- Choice of a refund claim over original return may have consequences for judicial review
  - Forecloses Tax Court as a forum unless other adjustments produce a deficiency
  - May shorten the administrative process—under §6532(a)(1) taxpayers may file suit if no action on the claim for 6 months

# Original Returns – Penalty Exceptions

## Negligence/Disregard of Rules and Regulations – §1.6662-3, -7

- Negligence = failure to make a reasonable attempt to comply
- Disregard = careless, reckless or intentional disregard of rules or regulations (Code, temporary or final regulations, revenue rulings or notices published in the IRB)

## Requirements for Non-application of Negligence/Disregard Penalty

- Adequate disclosure on Form 8275 (non-regulations) or 8275-R (regulations) (not applicable to negligence, §1.6662-7(b)).
- Reportable transaction disclosure (if required)
- If a regulation is involved – the position is a good faith challenge to the validity of the regulation
- Reasonable basis (significantly higher than not frivolous or not patently improper, more than arguable or colorable, must be based on same types of authorities as substantial authority)

Reasonable cause & good faith

# Original Returns – Penalty Exceptions

## Substantial Understatement – §1.6662-4

- If there is substantial authority for the tax treatment of an item, the item is treated as if it were shown properly on the return.
- Items for which adequate disclosure is provided (including reasonable basis, not attributable to a tax shelter, and properly substantiated) are treated as if they were shown properly on the return.

## Substantial Authority

- Objective standard involving analysis of the law and application of law to facts
- Requires evaluating specified types of authorities (including logical reading of the Code)
- Weight of authorities supporting treatment must be substantial in relation to the weight of authorities supporting contrary treatment

Adequate disclosure on Form 8275 or 8275-R + reasonable basis (and not a tax shelter)

Reasonable cause & good faith



## Original Returns – Penalty Exceptions

### Penalties to which Reasonable Cause & Good Faith Exception Applies - §6664(c)(1)

- Negligence/Disregard of Rules and Regulations – §1.6662-3, -7
- Substantial Understatement - §1.6662-4
- Valuation Misstatement - §1.6662-5, -5T, -6 (no disclosure or level of authority exceptions)
- Erroneous Claim for Refund or Credit - §6676
- Does not apply to transactions covered by §7701(o) (either on original return or through refund claim) - §6664(c)(1), 6676(c)

## Reasonable Cause & Good Faith - §1.6664-4

- Facts and circumstances test
  - Most important factor is the extent of the taxpayer's effort to assess the proper tax liability
  - Taxpayer must demonstrate ordinary business care and prudence
  - Good faith = honest belief and free of any intention to defraud

# Original Returns – Penalty Exceptions

## Reliance on the advice of others

- Facts and circumstances/minimum requirements - §1.6664-4(c)
- Fulfilling minimum requirements does not guarantee reasonable cause relief
- A taxpayer may not rely on an opinion or advice that a regulation is invalid to establish that the taxpayer acted with reasonable cause and good faith unless the taxpayer adequately disclosed the position - §1.6664-4(c)(1)(iii)

## Reasonable Cause and Good Faith – Reliance on an Advisor/*Boyle*

- Facts and circumstances test with minimum requirements
  - Taxpayer must act in good faith
  - Communication setting forth the analysis of a person other than the taxpayer, provided to or for the benefit of the taxpayer
  - Advisor had sufficient expertise to justify reliance and no conflict of interest
  - Taxpayer must actually rely
  - Advice must be based on all pertinent facts and circumstances
  - Advice must not be based on any unreasonable assumptions

## Privilege

- **Attorney-client privilege** protects confidential communications between attorneys and clients made for the purpose of obtaining legal advice (Can also protect communications with accountants or others engaged to assist an attorney in providing legal advice (*Kovel* arrangements))
- **Section 7525 privilege** protects communications with attorneys, CPAs and enrolled agent for purposes of federal tax advice (if tax shelter/crime not involved)
- **Work product doctrine** protects documents prepared in anticipation of litigation (only a qualified privilege—opinion work product, i.e., attorney’s opinion, strategies, etc. are virtually undiscoverable but other documents (e.g., facts) are discoverable if requestor establishes substantial need and can be obtained without undue hardship)
- Attorney-client/7525 privilege does not apply to:
  - Communications that are not confidential (e.g., disclosed to any third party including auditor)
  - Underlying facts
  - Communications not for the purpose of legal advice (e.g., return preparation)
- Work product doctrine does not apply to:
  - Documents not prepared in anticipation of litigation (majority cases—because of litigation, includes dual purpose documents, minority cases-primary motivating purpose)
  - Communications that are provided to a potential adversary or conduit to an adversary (majority cases—auditor not an adversary)



## Privilege Waiver

- *AD Investment 2000 Fund LLC v. Commissioner*, 142 T.C. 248 (2014) – Holding that taxpayer waived attorney-client privilege by asserting a reasonable-belief defense to 6662 penalties – petitioners could still protect documents by abandoning reasonable cause defense
- *Eaton Corp. v. Commissioner*, Order Apr. 26, 2015, 2015 U.S. Tax Ct. LEXIS 66 - Granting respondent's motion to compel production of documents covered by attorney-client privilege, tax practitioner privilege and work product based on reasonable belief/reasonable cause/good faith defenses
- *United States v. Micro Cap KY Ins. Corp.*, 246 F. Supp. 3d 1194 (E.D. Ky 2017) – Assertion of reasonable cause in a pleading does not automatically waive privilege. Taxpayer should be given the opportunity to withdraw the defense before compelling production of privileged documents
- Taxpayers asserting reliance on an advisor can expect to be required to disclose the advisor's opinion
- There is no such thing as a selective waiver—disclosure to any third party (including auditor) waives attorney-client/7525 privilege and could potentially waive work product
- FRE 502 (2008) – waiver of a disclosed document is absolute but waiver of undisclosed communications on the same subject matter only if waiver is intentional, communications relate to the same subject matter, “ought in fairness” to be considered together
- Intentionally nonprivileged documents and effect on undisclosed privileged documents

# What to Expect in Litigation

# What to Expect in Litigation – Choice of Forum

Factors to consider:

- Advisability of a jury trial
  - Time to resolution
  - Extent of discovery
  - Substantive precedent
  - Technical background of judges
  - “Home court” advantage?
- Tax Court/Court of Appeals for Taxpayer’s Circuit
    - Statutory notice of deficiency is required
    - Prepayment forum
    - No jury trials/technical specialist judges
  - Court of Federal Claims/Federal Circuit
    - Nationwide jurisdiction over claims against the government
    - Full payment required
    - No jury trials/judges may have technical expertise
  - Federal District Courts/Court of Appeals for Taxpayer’s Circuit
    - Venue in taxpayer’s principal place of business
    - Full payment required
    - Either side can demand a jury trial/generalist judges



## What to Expect in Litigation - Discovery

- Discovery period is often set as a matter of months (e.g., 120/180 days) but frequently exceeds this period
- Discovery responses are generally due within 30 days although extensions are common
- Tax Court has a more informal discovery process than federal District Courts
- More discovery in the District Courts, less in the Tax Court (generally)
- Requests for production of documents/information (including “e-discovery”)
- Interrogatories – responses to questions
- Exchange of expert reports
- Depositions (fact and expert witnesses)
- Factual stipulations – more in Tax Court, fewer in District Court (generally)
- Discovery disputes and motions
- Discovery from IRS/Treasury, including FOIA (and resistance to such discovery)

## What to Expect in Litigation - Resolution

- Difficult to find statistics on time to resolution in Tax Court
  - Tax Court has an internal deadline of 1 year after the completion of post-trial briefing for issuance of opinion, but this is not an absolute deadline and many opinions are issued more than 1 year after completion of briefing
- No tax-case specific statistics on federal district courts
  - Criminal cases have strict deadlines and may delay trial of tax refund suits
  - Court of Federal Claims is required to address bid protest cases by strict deadlines
- Settlement negotiations
  - IRS Exam and Appeals not permitted to settle cases based on regulatory invalidity
  - DOJ may be technically permitted but needs to consult IRS
- Effect of other pending cases
  - Cases on the same subject matter may get ahead and limit options
- Dispositive motions
  - Partial or complete motions for summary judgment/motion to dismiss



