Wasie Foundation v. Commissioner, T.C. Memo. 1986-487

In determining whether to award litigation costs under section 7430, the Tax Court will assess the reasonableness of the IRS's position only from the time a petition is filed, focusing on the legal basis and manner in which the IRS maintained its position during litigation.

Summary

The Wasie Foundation, a foundation manager, sought litigation costs after the IRS conceded an excise tax deficiency determination. The deficiency arose from an alleged act of self-dealing between the Foundation and Murphy Motor Freight Lines. The IRS issued a notice of deficiency to the Foundation but not Murphy, the self-dealer, before Congress enacted legislation retroactively relieving Murphy of tax liability. The Tax Court considered whether the IRS's position was unreasonable, focusing on the post-petition conduct. The court held that while the Foundation substantially prevailed, the IRS's position was reasonable, primarily because the IRS's actions were protective of the statute of limitations and its legal position regarding notice requirements was defensible. Consequently, litigation costs were denied.

Facts

The IRS determined excise tax deficiencies against the Wasie Foundation for participating in self-dealing between the Foundation and Murphy Motor Freight Lines. This self-dealing stemmed from Murphy's purchase of its stock from the Foundation using debentures at an interest rate below the prime rate. Murphy qualified as a self-dealer due to a prior small donation to the Foundation. The IRS considered assessing significant excise taxes against Murphy. Anticipating legislative relief for Murphy, the IRS did not issue a statutory notice to Murphy but requested the Foundation to extend the statute of limitations, which the Foundation refused. Subsequently, the IRS issued a deficiency notice to the Foundation. Legislation (section 312 of the Deficit Reduction Act of 1984) was enacted, retroactively eliminating tax liability for Murphy and the Foundation regarding this transaction. The IRS then conceded the case in Tax Court.

Procedural History

1. IRS issued a statutory notice of deficiency to Wasie Foundation on May 9, 1984, for excise taxes under section 4941.

2. Wasie Foundation petitioned the Tax Court on August 6, 1984.

3. IRS conceded the section 4941 issues in its answer filed October 17, 1984, due to retroactive legislation.

4. Case was noticed for trial on April 18, 1985.

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5. Parties stipulated settled issues on September 9, 1985, resolving all deficiency issues in the Foundation's favor.

6. Wasie Foundation moved for litigation costs under section 7430.

Issue(s)

1. Whether the IRS's position in the civil proceeding was unreasonable, warranting an award of litigation costs under section 7430?

2. Whether the IRS's pre-litigation conduct should be considered in determining the reasonableness of its position for purposes of awarding litigation costs?

Holding

1. No, because the IRS's position in the civil proceeding, evaluated from the time of petition, was reasonable given the legal basis for issuing a notice to the foundation manager and the protective nature of the notice regarding the statute of limitations.

2. No, because the court limits its assessment of reasonableness to the IRS's position and conduct during the litigation phase, starting from the filing of the petition.

Court's Reasoning

The Tax Court focused its analysis on the reasonableness of the IRS's position from the time the petition was filed, consistent with the precedent set in *Baker v. Commissioner*, 83 T.C. 822 (1984). The court acknowledged the split among circuits regarding whether pre-litigation conduct should be considered but adhered to the view that section 7430 primarily concerns costs incurred once litigation commences. The court reasoned that the IRS's position was not unreasonable because:

Legal Basis for Notice: The IRS had a defensible legal position that it could issue a statutory notice to a foundation manager without first issuing one to the self-dealer. The court interpreted the word "imposed" in section 4941 as meaning the tax is established by Congress, not necessarily requiring the IRS to first determine and enforce the tax against the self-dealer before proceeding against the foundation manager. The court stated, "The use of 'imposed' in section 4941 is no different from its use in section 3 or 11. The imposition of the tax by Congress merely establishes its existence thereby facilitating its determination, assessment, collection, overpayment, etc., within the context of the internal revenue laws."

Protective Action: Issuing the statutory notice to the Foundation was a protective measure by the IRS to prevent the statute of limitations from expiring, especially given the Foundation's refusal to extend it. The court noted, "Further, the issuance of a statutory notice to petitioner was merely a protective act on respondent's part to protect himself from the running of the statute of limitations on assessment

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should the legislation have failed to be enacted into law."

Concession Due to External Factor: The IRS conceded the case due to the intervening legislation, not necessarily due to an inherently unreasonable initial position. The court emphasized that losing or conceding a case does not automatically equate to the IRS's position being unreasonable.

The court explicitly rejected considering pre-petition conduct to determine reasonableness in this case, finding no indication that the IRS was unreasonable prior to the petition. The court viewed the Foundation as an "instigator of controversy" for refusing to extend the statute of limitations and actively opposing the legislation that ultimately resolved the issue.

Practical Implications

Wasie Foundation reinforces the Tax Court's approach to awarding litigation costs under section 7430, emphasizing that the focus is on the reasonableness of the IRS's position during litigation, specifically post-petition. This case clarifies that:

Post-Petition Focus: When evaluating reasonableness for litigation costs in Tax Court, attorneys should primarily focus on the IRS's actions and legal arguments from the point the petition was filed onwards. Pre-litigation conduct is generally not considered.

Defensible Legal Positions: Even if the IRS ultimately concedes a case, its position may still be deemed reasonable if it was based on a defensible legal interpretation or was taken as a protective measure (like safeguarding the statute of limitations). Taxpayers cannot automatically expect to recover costs simply because the IRS loses or concedes.

Strategic Considerations for Taxpayers: Taxpayers should be aware that refusing to extend the statute of limitations might prompt the IRS to issue a notice of deficiency to protect its position, and such action is not inherently unreasonable. Further, actively lobbying against legislative solutions that could resolve their tax issue might be viewed negatively when seeking litigation costs.

This case highlights that prevailing in the underlying tax dispute is only one part of the equation for recovering litigation costs. The taxpayer must also demonstrate that the IRS's position in court was unreasonable, a bar that is not automatically met simply because the IRS ultimately concedes.

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