Moran v. Commissioner, 88 T. C. 738 (1987)

To recover litigation costs under section 7430, a taxpayer must exhaust administrative remedies and prove the government's position was unreasonable.

Summary

In Moran v. Commissioner, the Tax Court addressed whether the Morans were entitled to litigation costs under section 7430 after settling a dispute over unreported income and unsubstantiated deductions. The court held that while the Morans exhausted their administrative remedies, they did not qualify as a prevailing party because the government's position was not unreasonable. The case underscores the necessity for taxpayers to substantiate their claims and cooperate during IRS audits to potentially recover litigation costs.

Facts

The Commissioner issued an examination report to John C. and Ruth E. Moran for their 1981 tax return, alleging unreported interest income and unsubstantiated travel and entertainment expenses. After filing a protest, the Morans refused to extend the statute of limitations, leading to a notice of deficiency. The parties settled the case, with the Morans substantiating some but not all of their claims. John Moran, representing himself, then sought litigation costs.

Procedural History

The IRS issued an examination report, followed by a notice of deficiency after the Morans declined to extend the statute of limitations. The case was settled before trial, and the Morans filed a motion for litigation costs under section 7430.

Issue(s)

1. Whether the Morans exhausted all administrative remedies available within the IRS.
2. Whether the Morans were a prevailing party under section 7430(c)(2)(A)(i), requiring the government's position to be unreasonable.

Holding

1. Yes, because the Morans filed a pre-petition protest and were not required to extend the statute of limitations.
2. No, because the Morans failed to prove the government's position was unreasonable, given the substantial unsubstantiated claims.

Court's Reasoning

The court found that the Morans exhausted their administrative remedies by filing a protest, following the precedent set in Minahan v. Commissioner. However, to be a prevailing party under section 7430, the Morans needed to show the government's position was unreasonable. The court determined that the government's position was reasonable, as the Morans failed to substantiate nearly 87% of their travel and entertainment expenses and omitted significant interest income. The court emphasized that the burden of proof in substantiation cases lies with the taxpayer, not the IRS, and criticized John Moran's uncooperative attitude and tax protester-like assertions.

Practical Implications

This decision reinforces the importance of substantiation in tax disputes and the need for taxpayers to fully cooperate with IRS audits. It clarifies that refusal to extend the statute of limitations does not preclude exhaustion of administrative remedies, but taxpayers must still demonstrate the government's position was unreasonable to recover litigation costs. For practitioners, this case serves as a reminder to advise clients on the importance of substantiation and cooperation during audits. Subsequent cases have further refined the standards for awarding litigation costs under section 7430, emphasizing the need for clear evidence of government unreasonableness.

