Moran v. Commissioner, T.C. Memo. 1987-89

In determining whether to award litigation costs under Section 7430, the 'reasonableness' of the IRS's position is judged from the date the petition was filed, and the taxpayer bears the burden of proving the IRS's position was unreasonable.

Summary

John C. Moran, a tax attorney, sought litigation costs after settling a tax deficiency case with the IRS. The Tax Court denied his motion, finding that while Moran substantially prevailed on the amount in controversy, he failed to prove that the IRS's position in the civil proceeding was unreasonable. The case involved unreported interest income and unsubstantiated business expenses related to Moran's law practice, a typical substantiation case. The court emphasized that the IRS's position was reasonable given the significant portion of expenses Moran failed to substantiate and unreported income.

Facts

The IRS issued a notice of deficiency to John C. Moran for the 1981 tax year, citing unreported interest income and unsubstantiated travel and entertainment expenses. Moran protested, and the case went to the Appeals Office. Moran refused to extend the statute of limitations, and the IRS issued a notice of deficiency. In Tax Court, the parties reached a settlement significantly reducing the original deficiency. Moran then moved for litigation costs, arguing the IRS's initial position was unreasonable.

Procedural History

1. IRS District Director issued an examination report for 1981.

2. Moran filed a protest with the Appeals Office.

3. Appeals Office requested an extension of the statute of limitations, which Moran refused.

4. IRS issued a notice of deficiency.

5. Moran petitioned the Tax Court.

6. Parties settled the tax deficiency issues.

7. Moran filed a motion for litigation costs in Tax Court.

8. Tax Court denied Moran's motion for litigation costs.

Issue(s)

1. Whether petitioners exhausted all administrative remedies available within the

© 2025 SCOTUSreports.com. All rights reserved.

IRS as required by Section 7430(b)(2) to be awarded litigation costs?

2. Whether petitioners satisfied the statutory definition of "prevailing party" under Section 7430(c)(2), specifically whether the position of the United States in the civil proceeding was unreasonable?

Holding

1. Yes. The Tax Court, following *Minahan v. Commissioner*, held that filing a pre-petition protest with the Appeals Office satisfied the exhaustion requirement, even if settlement was not reached due to refusal to extend the statute of limitations.

2. No. The Tax Court held that petitioners failed to establish that the IRS's position in the civil proceeding was unreasonable because the case was essentially a substantiation case and petitioners failed to substantiate a significant portion of the deductions and omitted income.

Court's Reasoning

The court reasoned that to be a prevailing party entitled to litigation costs under Section 7430, petitioners must prove both that they substantially prevailed and that the IRS's position was unreasonable. The court focused on the reasonableness of the IRS's position as of the date the petition was filed. The court noted the original notice of deficiency was based on unreported interest income and a large amount of unsubstantiated travel and entertainment expenses. Even in settlement, a significant portion of the originally claimed deductions were disallowed, and a substantial amount of interest income remained unreported. The court stated, "Petitioners have failed to substantiate almost 87 percent of the asserted travel and entertainment expenses resulting in the disallowance of such expense in the amount of $10,521.20. Furthermore, petitioners omitted the amount of $10,962.01 interest income as determined by respondent. In this context, we find that respondent's position in the civil proceeding was reasonable." The court rejected Moran's arguments of IRS overreach and found no evidence the IRS acted arbitrarily or to harass. The court was critical of Moran's uncooperative attitude and his assertion that the IRS bore the burden of proof in a substantiation case, calling it a "tax protester concept".

Practical Implications

Moran v. Commissioner reinforces that taxpayers seeking litigation costs bear a significant burden to prove the IRS's position was unreasonable, even if they prevail on the amount in controversy. For tax practitioners, this case highlights: (1) The importance of thorough substantiation of deductions, especially business expenses. (2) The 'reasonableness' standard is judged from the IRS's position at the start of litigation. (3) Uncooperative behavior and weak legal arguments can negatively impact a claim for litigation costs, even for prevailing taxpayers. (4) Taxpayers cannot automatically recover costs simply by achieving a settlement; they must

© 2025 SCOTUSreports.com. All rights reserved.

demonstrate the IRS’s initial stance lacked reasonable basis in law and fact. This case serves as a reminder that substantiation cases are inherently difficult to win litigation costs in unless the IRS’s initial deficiency notice is demonstrably without merit from the outset.

© 2025 SCOTUSreports.com. All rights reserved.