Stieha v. Commissioner, 89 T. C. 784, 1987 U. S. Tax Ct. LEXIS 144, 89 T. C. No. 55 (1987)

The time for determining a taxpayer's net worth for litigation cost awards is at the commencement of the civil proceeding in the Tax Court.

Summary

In Stieha v. Commissioner, the U. S. Tax Court clarified that the net worth of a taxpayer seeking litigation costs under section 7430 of the Internal Revenue Code should be evaluated at the start of the civil proceeding, not at the time of the motion for costs. Kenneth and Lee Stieha challenged a notice of deficiency, arguing the IRS failed to follow partnership audit procedures. After the IRS conceded the case, the Stiehas sought litigation costs, which the court awarded partially, ruling that the IRS's position was not substantially justified after a relevant precedent (Sparks v. Commissioner) was issued. The court's decision set a precedent on when to assess net worth for cost eligibility and emphasized the importance of the IRS acting diligently in light of new legal developments.

Facts

Kenneth and Lee Stieha received a notice of deficiency from the IRS on August 13, 1986, for tax years 1979 and 1982, based on disallowed losses and credits from their partnership, Missoula Water Works, Ltd. They filed a petition with the Tax Court on November 17, 1986, and subsequently moved to dismiss for lack of jurisdiction, citing the IRS's non-compliance with partnership audit procedures under section 6221 et seq. On December 8, 1986, the court's decision in Sparks v. Commissioner was released, directly relevant to the Stiehas' motion. The IRS sought an extension to respond to the motion, which was granted, but failed to consider Sparks in their objection filed February 17, 1987. The IRS conceded the case on April 21, 1987, leading to the Stiehas' motion for litigation costs.

Procedural History

The Stiehas filed a petition in the U. S. Tax Court on November 17, 1986, challenging the IRS's notice of deficiency. They moved to dismiss for lack of jurisdiction on December 4, 1986. After the IRS's unsuccessful objection and eventual concession on April 21, 1987, the court granted the motion to dismiss. The Stiehas then filed for litigation costs on May 26, 1987, which the court addressed in this opinion.

Issue(s)

1. Whether the time for determining a taxpayer's net worth under section 7430(c)(2)(A)(iii) is at the commencement of the civil proceeding in the Tax Court.
2. Whether the IRS was substantially justified in pursuing the litigation against the Stiehas.

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Holding

1. Yes, because section 7430(c)(2)(A)(iii) incorporates the net worth determination at the start of the civil proceeding in the Tax Court, consistent with the Equal Access to Justice Act's principles.
2. No, because the IRS was not substantially justified in objecting to the Stiehas' motion to dismiss after the Sparks decision was released.

Court's Reasoning

The court interpreted section 7430(c)(2)(A)(iii) to set the time for measuring net worth at the commencement of the civil proceeding, aligning it with the Equal Access to Justice Act's distinction between administrative and court proceedings. The court found that only costs incurred after the civil proceeding begins are compensable, thus the taxpayer's net worth should be assessed at that point. Regarding substantial justification, the court noted that the IRS's position was justified until the Sparks decision but became unreasonable afterward due to their failure to consider Sparks despite requesting additional time for research. The court emphasized the IRS's lack of diligence in reviewing the case in light of new legal developments, leading to unnecessary litigation costs for the Stiehas. The court awarded attorneys' fees for the period after the Sparks decision, but at the statutory rate of $75 per hour, finding no special factors justifying a higher rate.

Practical Implications

This decision establishes that for litigation cost awards under section 7430, a taxpayer's net worth should be assessed at the filing of the petition, not at the motion for costs. It underscores the importance of the IRS acting promptly and diligently in response to new legal precedents, impacting how similar cases are handled. The ruling affects legal practice by clarifying the timing for net worth assessments and encourages the IRS to reassess its position in light of new case law to avoid unnecessary litigation and associated costs. Subsequent cases have referenced Stieha for its interpretation of the net worth requirement and the substantial justification standard.

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