Haas & Associates Accountancy Corporation v. Commissioner of Internal Revenue, 117 T. C. 48 (2001)

In *Haas & Associates Accountancy Corporation v. Commissioner*, the U. S. Tax Court ruled that taxpayers must exhaust administrative remedies within the IRS to be eligible for litigation costs under IRC § 7430. The court rejected the notion that a 'qualified offer' could substitute for participation in an IRS Appeals Office conference, emphasizing the importance of engaging with the administrative process before seeking judicial relief. This decision underscores the procedural hurdles taxpayers face when challenging IRS determinations and seeking cost recovery, setting a precedent for future litigation involving tax disputes.

Parties

Haas & Associates Accountancy Corporation (Petitioner at trial and on appeal) and Michael A. Haas and Angela M. Haas (Petitioners at trial and on appeal) versus Commissioner of Internal Revenue (Respondent at trial and on appeal).

Facts

In early 1993, Michael A. Haas severed his employment with Dean, Petrie & Haas, an Accountancy Corp. (DPH), and purchased the right to serve certain former DPH clients. Haas then established Haas & Associates Accountancy Corp. (Haas & Associates), a new accounting firm, and divided the clients between his individual practice and the new corporate practice. In June 1996, the IRS initiated an audit of Haas and his wife's 1993 joint Federal income tax return, later expanding to include Haas & Associates' 1994 and 1995 returns. The audit focused on the tax treatment of the separation agreements between Haas, DPH, and other parties. During the audit, the IRS requested copies of schedules and exhibits related to the separation agreements, which were not provided by Haas or his prior counsel. In October 1997, the IRS sent revenue agent reports proposing adjustments, which Haas rejected and requested the audit be closed as unagreed. In March 1998, the IRS sent 30-day letters outlining the same adjustments and explaining protest rights, but no protest was filed nor was an Appeals Office conference requested. Notices of deficiency were mailed in July 1998, and petitions were filed in October 1998. In January 1999, the cases were set for trial in June 1999. In May 1999, petitioners made a 'qualified offer' to settle, which was rejected by the IRS. The trial occurred in June 1999, and in June 2000, the Tax Court ruled on the underlying tax issues. Petitioners then moved for an award of litigation costs.

Procedural History

The IRS audited Haas and his wife's 1993 tax return and Haas & Associates' 1994 and 1995 returns, proposing adjustments in October 1997. Haas rejected these adjustments and requested the audit be closed as unagreed. The IRS sent 30-day letters in March 1998, to which no protest was filed nor an Appeals Office

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conference requested. Notices of deficiency were mailed in July 1998, and petitions were filed in October 1998. The cases were set for trial in January 1999, with the trial occurring in June 1999. In June 2000, the Tax Court ruled on the underlying tax issues, and petitioners subsequently moved for litigation costs under IRC § 7430. The court considered the motion under the de novo standard of review.

Issue(s)

Whether evidence excluded at trial may be considered by the court in ruling on a motion for litigation costs under IRC § 7430?
Whether a 'qualified offer' made under IRC § 7430(c)(4)(E) and (g) satisfies the requirement under IRC § 7430(b)(1) that a taxpayer must exhaust available administrative remedies to be eligible for an award of litigation costs?
Whether, under the facts of these cases, petitioners exhausted their administrative remedies and are eligible for an award of litigation costs under IRC § 7430?

Rule(s) of Law

IRC § 7430(b)(1) requires that a taxpayer must exhaust available administrative remedies within the IRS to be eligible for an award of litigation costs. The regulations under IRC § 7430 specify that taxpayers generally must participate in an Appeals Office conference to be considered as having exhausted available administrative remedies. IRC § 7430(c)(4)(E) and (g) establish the 'qualified offer' rule, which allows a taxpayer to be treated as a prevailing party if the liability determined by the court is equal to or less than what it would have been had the IRS accepted the qualified offer. However, this rule does not supersede the exhaustion requirement under IRC § 7430(b)(1).

Holding

The court held that evidence excluded at trial may be considered in ruling on a motion for litigation costs under IRC § 7430. The court further held that a 'qualified offer' does not satisfy the requirement under IRC § 7430(b)(1) that a taxpayer must exhaust available administrative remedies. Finally, the court held that petitioners did not exhaust their administrative remedies and are not eligible for an award of litigation costs under IRC § 7430.

Reasoning

The court reasoned that under IRC § 7430, evidence not admitted at trial can be considered for the purpose of determining litigation costs, as the statute and regulations anticipate the submission of such evidence. Regarding the 'qualified offer,' the court interpreted IRC § 7430(c)(4)(E) and (g) as not providing an exception to the exhaustion requirement of IRC § 7430(b)(1). The court emphasized that the regulations under IRC § 7430 require taxpayers to participate in an Appeals Office conference to be considered as having exhausted administrative remedies.

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The court found that petitioners' failure to request an Appeals Office conference, despite having the opportunity to do so, meant they did not exhaust their administrative remedies. The court noted that the legislative history of IRC § 7430 suggests limited exceptions to the exhaustion requirement, but none applied to petitioners' circumstances. The court also addressed petitioners' argument that the imminent expiration of the assessment period of limitations precluded an Appeals Office conference, finding that petitioners had sufficient time to request such a conference and that the choice to bypass the administrative process was a strategic decision that did not excuse the exhaustion requirement.

Disposition

The court denied petitioners' motion for an award of litigation costs under IRC § 7430.

Significance/Impact

The *Haas & Associates* decision reinforces the requirement under IRC § 7430 that taxpayers must engage with the IRS's administrative process, specifically the Appeals Office, to be eligible for litigation costs. This ruling clarifies that a 'qualified offer' does not serve as a substitute for exhausting administrative remedies, impacting taxpayers' strategies in tax disputes. The decision has been cited in subsequent cases to support the strict application of the exhaustion requirement, influencing tax practitioners' approaches to IRS audits and appeals. The case highlights the tension between taxpayers' desire to expedite judicial review and the statutory mandate to utilize administrative remedies, shaping the procedural landscape of tax litigation.

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