Smith v. Commissioner, 159 T. C. No. 3 (2022)

In a significant ruling, the U. S. Tax Court upheld the validity and enforceability of a closing agreement under I. R. C. § 7121, affirming that such agreements are final and conclusive unless fraud, malfeasance, or misrepresentation of material fact is shown. Cory H. Smith, a U. S. citizen employed at Pine Gap in Australia, challenged the agreement which required him to waive his right to exclude foreign earned income. The court's decision clarifies the authority of IRS officials to execute such agreements and the strict conditions under which they can be set aside, impacting future tax treaty interpretations and the finality of closing agreements in tax law.

Parties

Cory H. Smith, as the Petitioner, challenged the notice of deficiency issued by the Commissioner of Internal Revenue, as the Respondent, in the U. S. Tax Court. The case proceeded through the Tax Court's jurisdiction, with both parties filing competing motions for partial summary judgment.

Facts

Cory H. Smith, a U. S. citizen and engineer, was employed by Raytheon at the Joint Defense Facility at Pine Gap in Australia. As part of his employment, he entered into a closing agreement with the IRS under I. R. C. § 7121, waiving his right to elect the foreign earned income exclusion under I. R. C. § 911(a) for the tax years 2016-2018. Despite the agreement, Smith filed amended returns claiming the exclusion for 2016 and 2017 and made the same election on his 2018 return. The Commissioner issued a notice of deficiency disallowing these elections, leading Smith to petition the U. S. Tax Court for a redetermination of the deficiencies.

Procedural History

The case originated with Smith's challenge to the notice of deficiency in the U. S. Tax Court. Both parties filed motions for partial summary judgment. The Commissioner argued that the closing agreement was valid and enforceable, while Smith contended that it was invalid due to lack of authority of the IRS official who signed it and alleged malfeasance and misrepresentation by the IRS. The Tax Court, after hearing arguments, ruled on the motions, applying a de novo standard of review.

Issue(s)

Whether the closing agreement entered into by Cory H. Smith with the Commissioner under I. R. C. § 7121 was valid and enforceable?

Whether the Director, Treaty Administration, had the authority to execute the closing agreement on behalf of the Commissioner?

Whether the closing agreement could be set aside under I. R. C. § 7121(b) due to malfeasance or misrepresentation of fact?

Rule(s) of Law

I. R. C. § 7121 authorizes the Secretary to enter into closing agreements with taxpayers, which are “final and conclusive” once approved by the Secretary, unless set aside for fraud, malfeasance, or misrepresentation of material fact. I. R. C. § 7121(b) specifies that closing agreements cannot be annulled, modified, set aside, or disregarded in any proceeding, and any determination made in accordance with such agreements is similarly protected. The authority to enter into closing agreements has been delegated by the Secretary to the Commissioner, and further delegated within the IRS, including to the Director, Treaty Administration, under Delegation Order 4-12.

Holding

The U. S. Tax Court held that the closing agreement between Cory H. Smith and the Commissioner was valid and enforceable. The court found that the Director, Treaty Administration, had the requisite authority to execute the agreement on behalf of the Commissioner. Additionally, the court determined that the agreement could not be set aside under I. R. C. § 7121(b) as Smith failed to show malfeasance or misrepresentation of material fact.

Reasoning

The court’s reasoning centered on the interpretation of the statutory framework governing closing agreements and the delegation of authority within the IRS. The court applied principles of statutory construction to Delegation Order 4-12, concluding that the Director, Treaty Administration, had the authority to act as the competent authority under tax treaties and execute closing agreements related to specific treaty applications. The court rejected Smith’s arguments regarding the lack of authority of the IRS official, the necessity of a formal competent authority request, and the exclusivity of delegation orders. Regarding malfeasance, the court found no violation of I. R. C. § 6103 in the IRS’s handling of the closing agreement process. The court also distinguished between misrepresentations of fact and law, holding that the recitals in the agreement were legal conclusions and not misrepresentations of material fact. The court emphasized the finality intended by Congress in enacting I. R. C. § 7121, which supports the strict enforcement of closing agreements unless the statutory exceptions are met.

Disposition

The U. S. Tax Court granted the Commissioner’s Motion for Partial Summary Judgment and denied Smith’s competing motion. The court upheld the validity and enforceability of the closing agreement, affirming the notice of deficiency issued by the Commissioner.

Significance/Impact

The decision in *Smith v. Commissioner* reinforces the finality and conclusiveness of closing agreements under I. R. C. § 7121, impacting how such agreements are viewed in tax litigation. It clarifies the delegation of authority within the IRS for executing closing agreements, particularly in the context of international tax treaties. The ruling underscores the stringent conditions under which closing agreements can be set aside, emphasizing the need for clear evidence of fraud, malfeasance, or misrepresentation of material fact. This case has broader implications for U. S. citizens working abroad and the application of tax treaties, particularly those involving the waiver of domestic tax rights to avoid double taxation. It may influence future negotiations and interpretations of tax treaties between the U. S. and other countries, ensuring that closing agreements remain a reliable tool for resolving tax liabilities.

