Berenblatt v. Commissioner, 160 T. C. No. 14 (2023)

In Berenblatt v. Commissioner, the U. S. Tax Court established stringent discovery standards for whistleblower award cases under I. R. C. § 7623. The court ruled that discovery is limited to the administrative record, and only upon a significant showing of bad faith or an incomplete record can additional materials be sought. This decision underscores the court's adherence to the record rule and clarifies the scope of permissible discovery in whistleblower appeals, impacting future cases by setting a high bar for expanding the record beyond what the IRS designates.

Parties

Jeremy Berenblatt (Petitioner) v. Commissioner of Internal Revenue (Respondent). Berenblatt was the appellant in the Tax Court, challenging the IRS Whistleblower Office's (WBO) denial of his whistleblower award claim.

Facts

Jeremy Berenblatt, a stock trader, was interviewed by the IRS in November 2007 regarding a tax shelter involving digital foreign exchange options known as Short Options Strategies (SOS). Berenblatt alleged that the transaction lacked economic substance and was potentially fraudulent. He later claimed that his information led to the IRS's successful use of the economic substance theory in related litigation. In July 2015, Berenblatt filed Form 211 with the WBO, seeking an award based on his 2007 interview. The WBO denied his claim, citing that the IRS had already known the relevant information before Berenblatt's interview. Berenblatt then appealed to the Tax Court under I. R. C. § 7623(b)(4).

Procedural History

Berenblatt filed a petition with the U. S. Tax Court to review the WBO's denial of his award claim. He sought discovery from the IRS, filing motions to compel the production of documents and responses to interrogatories. The IRS produced a 765-page administrative record, asserting it was complete. The court reviewed Berenblatt's motions under the standard of review set by the Administrative Procedure Act and the scope of review limited to the administrative record. The court granted a stay of proceedings to address the discovery disputes and issued its ruling on the motions to compel.

Issue(s)

Whether a whistleblower can compel discovery beyond the administrative record designated by the IRS in an appeal of a whistleblower award denial, and if so, under what circumstances?

Rule(s) of Law

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In whistleblower award appeals under I. R. C. § 7623, the Tax Court's review is governed by the standard of review under the Administrative Procedure Act, which permits reversal of agency action found to be "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law. " The scope of review is generally confined to the administrative record, as articulated by the D. C. Circuit's record rule. Discovery beyond the administrative record is permissible only upon a significant showing of bad faith or an incomplete record by the IRS. Treasury Regulation § 301. 7623-3(e) lists materials that must be included in the administrative record.

Holding

The Tax Court held that Berenblatt's motions to compel discovery were largely unsupported by a significant showing of bad faith or an incomplete record. The court denied most of Berenblatt's document and interrogatory requests, except for a request related to notes taken during his 2007 interview, which the court ordered the IRS to clarify.

Reasoning

The court reasoned that the IRS's designation of the administrative record enjoys a presumption of correctness. Berenblatt's requests for documents and interrogatory responses largely sought materials outside the administrative record and before his involvement with the IRS. The court emphasized that discovery in whistleblower cases must be limited to materials directly or indirectly considered by the WBO or those falling under categories listed in Treasury Regulation § 301. 7623-3(e). Berenblatt's contention that the WBO should have reviewed certain documents was rejected, as there was no evidence that the WBO negligently excluded documents that could have been adverse to its decision. The court noted that the IRS had already developed the economic substance argument before Berenblatt's interview, as evidenced by an expert report dated before the interview. The court allowed limited discovery only regarding notes from Berenblatt's interview, as they were part of the complete record under the regulation.

Disposition

The court denied Berenblatt's motions to compel discovery, except for compelling the IRS to clarify whether notes were taken during his 2007 interview and, if so, their current status.

Significance/Impact

This case sets a precedent for the standards governing discovery in whistleblower award appeals, reinforcing the record rule and the presumption of correctness for the IRS's administrative record designation. It clarifies that whistleblowers must make a significant showing of bad faith or an incomplete record to obtain discovery

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beyond the designated record. The decision impacts future whistleblower cases by limiting the scope of discovery and emphasizing the importance of the administrative record in judicial review. It also highlights the Tax Court's adherence to the D. C. Circuit's precedent in whistleblower matters, affecting how such cases are litigated and the evidence considered by the court.

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