

TAX SECTION

New York State Bar Association

Report On Jurisdiction Of The United States Tax Court

By the Committee on Practice and Procedure

August 10, 1988

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Tax Court Jurisdiction

Dear Sirs:

I enclose a report on the jurisdiction of the United States Tax Court, prepared by our Committee on Practice and Procedure. The principal draftsman of the report was Richard J. Bronstein.

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The report supports the Tax Court jurisdiction provisions of §.2223 (the Omnibus Taxpayer Bill of Rights). In particular, the report recommends expansion of the jurisdiction of the Tax Court to include refund claims, in order to preserve the character of the Tax Court as an effective prepayment forum for the resolution of tax disputes.

In many tax disputes, if the Internal Revenue Service is successful in asserting a tax deficiency for one year, the grounds on which the deficiency is based would result in an overpayment (i.e., a refund claim) for another taxable year. If the taxpayer cannot resolve the issues for both years in a single judicial forum -- i.e., if the deficiency and refund claim cannot be determined by a single court -- the taxpayer (as well as the government) will unfairly incur additional costs. The taxpayer will pay interest on the full deficiency and then receive interest on the full refund. Although the interest received is fully includible in income, the interest paid by an individual would be nondeductible under Section 163(h) of the Code. Further, the interest rate paid on the deficiency will be higher than the rate received on the refund under section 6621(a) of the Code.

As a result, if taxpayers cannot file refund claims in the Tax Court, the Tax Court will in many instances not be an effective prepayment forum; due to the expertise in tax matters residing in the Tax Court, we believe that any circumstance that would deflect tax litigation from the Tax Court is undesirable.

We will be pleased to answer any questions you have concerning the foregoing or the enclosed report.

Very truly yours,

Herbert L. Camp

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NEW YORK STATE BAR ASSOCIATION

TAX SECTION

Report On Jurisdiction Of The United States Tax Court

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Report on the Jurisdiction of the United States Tax Court^{*/}

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On March 30, 1988, the Senate Finance Committee reported a bill (S. 2223, Title 1 of which is the "Taxpayer Bill of Rights") containing various provisions relating to the jurisdiction of the United States Tax Court. This report will describe the reasons for our support of these legislative proposals (contained in Subtitle D of Title I), the most important of which is an expansion of the jurisdiction of the Tax Court to include certain refund claims. As explained in this report, such an expansion is necessary to preserve and enhance the status of the Tax Court as the most desirable forum for tax litigation and to avoid potentially unfair consequences of recent legislative changes.

^{*/} This report was prepared primarily by Richard J. Bronstein, Co-Chair of the Committee on Practice and Procedure, with the assistance of Sydney R. Rubin (Co-Chair of the Committee), Frank Agostino, Ernest Honecker and Arnold Y. Kapiloff. The Committee would also like to thank James B. Lewis for his helpful comments and suggestions.

We will first describe certain of the current Tax Court jurisdictional rules and certain aspects of the history of the jurisdiction of the Tax Court, including a description of prior proposals to expand the jurisdiction of the Tax Court to include refund claims. We will then describe the reasons for our support of the individual proposals, as well as certain other jurisdictional proposals that should also be considered.

I. Current Jurisdictional Rules

In most tax disputes, the Tax Court is the only judicial body in which a taxpayer can litigate the question of its liability for tax before being required to pay the amount in dispute. The Tax Court currently has jurisdiction of cases involving notices of a deficiency in various taxes, primarily income, estate and gift taxes.^{1/} In general, the Tax Court does not have any jurisdiction over claims for refund of taxes. Jurisdiction over refund claims resides in the United States District Courts and the United States Claims Court

^{1/} The court's deficiency jurisdiction also includes cases relating to generation skipping transfer taxes, certain excise taxes and additions to tax, additional amounts and penalties.

(the "Claims Court"); refund actions in these courts require full payment of the tax.^{2/}

Although the Tax Court does not have jurisdiction over refund claims, the Court has the power to determine an overpayment of tax for a year if a properly-filed petition in response to a notice of deficiency gives the court jurisdiction over the determination of the taxpayer's tax liability for that year. A taxpayer's right to a refund with respect to years that are properly before the Tax Court can therefore be determined by the Tax Court in connection with a dispute that originates with the issuance of a notice of deficiency by the Internal Revenue Service.^{3/}

If a taxpayer receives a notice from the Internal Revenue Service that proposes a deficiency in income, estate, gift or certain other taxes, the taxpayer is entitled (before paying the proposed deficiency) to petition the Tax Court for redetermination of the deficiency.^{4/} Alternatively, the

^{2/} Flora v. United States, 362 U.S. 145 (1960).

^{3/} Section 6512 of the Code. Unless otherwise indicated, all references to the Code are to the Internal Revenue Code of 1986, as amended.

^{4/} This petition must be filed within 90 days after the notice of deficiency is mailed (or 150 days if the notice is addressed to the taxpayer outside the United States). Section 6213(a) of the Code.

taxpayer can pay the proposed deficiency and file a refund claim with the Service. If the Service rejects the refund claim (or fails to take any action with respect the refund claim within six months after it is filed), the taxpayer may then bring an action in a District Court or the Claims Court seeking refund of the asserted overpayment.

A taxpayer is also entitled to file a claim for refund of an alleged overpayment of tax that is not attributable to a deficiency, and (if the refund claim is rejected or not allowed by the Service within six months) the taxpayer can likewise bring an action seeking a refund in a District Court or the Claims Court. The Tax Court, however, has no jurisdiction to determine that an overpayment has been made except in the context of a proceeding that begins with the issuance of a notice of deficiency.

Thus, the taxpayer generally has the ability to choose whether to litigate a particular tax controversy in the Tax Court or in a District Court or the Claims Court. If it is desirable to litigate in the Tax Court, the taxpayer can usually do so; if it is not, then payment of the disputed tax and filing a refund claim will allow the taxpayer to sue in a District Court or the Claims Court.

There are a number of differences between the Tax Court and the other judicial bodies that decide tax cases. The Tax Court is a single court that has nationwide jurisdiction

in cases in which the Code grants jurisdiction. The Tax Court has been created by Congress under Article I of the Constitution, and it consists of 19 judges who are appointed by the President for 15-year terms. Although the Tax Court is located in Washington, D.C., its judges (and special trial judges appointed by the Chief Judge) hear cases at various locations throughout the United States. The Claims Court is also a single court with nationwide jurisdiction located in Washington, D.C. The Claims Court consists of 16 judges who are also appointed by the President for 15-year terms, and the Claims Court hears cases at various locations throughout the United States. One or more District Courts are located in each state, and the jurisdiction of each District Court is limited to a single Federal District. Each District Court consists of one or more district judges.

The choice of forum might be influenced by a variety of other factors. The Tax Court judges devote their entire judicial careers solely to tax matters, and this court therefore provides a level of expertise concerning the interpretation and administration of the tax laws that is unique in the judicial system. The court's focus on tax cases has enabled it to develop efficient procedures for the resolution of tax disputes, emphasizing streamlined discovery and stipulation processes. The relatively speedy resolution of tax disputes in the Tax Court (at

least in comparison to alternative judicial avenues) is generally perceived as reducing litigation costs without sacrificing fairness to taxpayers or the government.

Further, every opinion issued by the Tax Court is reviewed by the Chief Judge, who can determine that review by the entire court is appropriate. Accordingly, there is a higher level of uniformity in the resolution of tax cases in the Tax Court, as well as a greater predictability concerning the legal standards that will be applicable in resolving a particular dispute. The Tax Court has also created procedures for small tax cases involving amounts in controversy that do not exceed \$10,000. These small tax cases are generally tried before special trial judges under informal procedures that are intended to expedite resolution and to enable taxpayers to conduct the trials without the benefit of legal representation. Decisions in these small tax cases are not precedents for other cases, and these decisions are not appealable by either the government or the taxpayer. Since the District Courts and the Claims Court do not have comparable procedures for small cases, the Tax Court is generally the only forum in which it is feasible to seek judicial review of small tax cases.

Primarily for these reasons, in addition to the ability to postpone payment of a deficiency until after resolution of the

dispute, the vast majority of Federal tax litigation is conducted in the Tax Court. According to the Senate Finance Committee Report on S. 2223, more than 70,000 tax cases are pending in the Tax Court, compared to fewer than 3,000 tax cases in the District Courts and the Claims Court.^{5/}

There are, however, other facts that might motivate some taxpayers to litigate tax disputes in the District Courts or the Claims Court. First, certain tax cases cannot originate in the Tax Court, because a taxpayer might have erroneously overpaid his tax and there is no determination of a deficiency. Another significant reason for considering the initiation of a tax controversy in the District Court or the Claims Court, instead of the Tax Court, relates to the different precedents applicable in the three jurisdictions. The Tax Court generally abides by its prior decisions, but where its decisions are in conflict with a prior decision of a Court of Appeals, it will follow that Court of Appeals decision in cases in which the appeal from the Tax Court decision lies to that Court of Appeals.^{6/} In these

^{5/} S. Rep. No. 100-309, 100th Cong., 2d Sess. 20.

^{6/} Golsen v. Commissioner, 54 T.C. 742 (1970), aff'd, 445 F.2d 985 (10th cir. 1971).

circumstances, the Court of Appeals decision will also be controlling in the District Court, but it will not be binding in the Claims Court. Accordingly, if a taxpayer wishes to avoid an adverse Court of Appeals decision in his jurisdiction, he should seriously consider litigating the matter in the Claims Court. On the other hand, if the Court of Appeals decision is favorable, then the choice of forum will be between the Tax Court and the District Court. Similarly, a favorable or unfavorable decision in the Claims Court (or in the Court of Appeals for the Federal Circuit, to which appeals are taken from the Claims Court) would also render the Claims Court either more or less attractive than the alternative forums. Finally, where the relevant Court of Appeals has not decided the issue, but the Tax Court has previously decided the issue, the taxpayer might decide to litigate in the Tax Court if the precedent is favorable or to pursue the matter in the District Court or the Claims Court if the Tax Court precedent is not favorable.

Other differences that might affect the choice of forum include the availability of jury trials in the District Courts (but not in the Tax Court or the Claims Court), differences in discovery rules and subpoena powers, and the place of trial.

II. History of the Tax Court^{7/}

To evaluate the desirability of the proposed changes in the jurisdiction of the Tax Court, it is useful first to understand the historical development of that court. Congress created the Board of Tax Appeals in 1924, largely in response to the development of the Federal income and profits taxes as the principal means of financing the operations of the government during World War I. To finance the war effort, government revenues increased from approximately \$780 million in 1916 to nearly \$7 billion in 1920. Although taxes were substantially reduced at the end of the war, the income tax remained the principal means of financing the government, and its provisions were significantly more complex than those of prior taxes. It was believed that prior judicial and administrative institutions were not sufficient for the adjudication of the disputes that were arising under the new tax laws.

Congress became concerned about the lack of procedures for obtaining administrative hearings before a taxpayer

^{7/} Much of this section of the report is based on the excellent work of Professor Harold Dubroff. Dubroff, The United States Tax Court: An Historical Analysis. 40 Albany Law Rev. 1, 53, 253 (1976); 41 Albany Law Rev. 1, 639 (1977); 42 Albany Law Rev. 161, 191 (1978).

could be assessed for tax underpayments. Prior to 1921, if the Bureau of Internal Revenue made a tax assessment and the tax was not paid, the Bureau could implement collection proceedings without any prior review by an administrative body. Prior to the Revenue Act of 1924, refund actions could be brought in a District Court or in the Court of Claims. The 1924 Act acknowledged the inadequacy of these judicial remedies and the need for some form of independent administrative review prior to assessment. Thus, the Board of Tax Appeals was created as an independent agency within the executive branch, with the principal purpose of providing a forum for the taxpayer to challenge a proposed deficiency without first paying the amount of tax in dispute. Although the Revenue Act of 1942 changed the name of the Board of Tax Appeals to the Tax Court of the United States, its status as an independent agency in the executive branch remained the same. The Tax Reform Act of 1969 established the Tax Court as an Article I court (and changed its name to the United States Tax Court), with the intention of eliminating any concerns that might have remained as a result of an arrangement in which one agency of the executive branch was

reviewing judgments made by another agency of the executive branch.^{8/}

Although the original reason for the creation of the Board of Tax Appeals was to provide a pre-assessment forum for the resolution of tax disputes, there were proposals as early as 1924 to include refund claims within the jurisdiction of the Board.^{9/} The Board was created to provide a more expeditious and inexpensive remedy than was available in other courts, and some proponents therefore thought that its jurisdiction should include claims by taxpayers who had already paid a disputed tax, as well as those who had not yet paid the disputed tax. The suggestion, which was strongly opposed by the then-chairman of the Senate Finance Committee, was defeated.^{10/}

^{8/} S. Rep. No. 91-552, 91st Cong., 1st Sess. 303.

^{9/} It is interesting to note that some concern was expressed about the fact that the Board was being established as the equivalent of a court, with all of the resulting formalities. It was even predicted that the Board would be unable to handle the business that would come to it, resulting in great delays in the final resolution of tax cases, and that this situation "may ultimately result in the complete breakdown of the administrative machinery for the collection of taxes." Dubroff, supra, 40 Albany Law Rev. at 72.

^{10/} 65 Cong. Rec. 7696-97 (1924). Remarkably, the successful opposition to the proposal was based on the assertion that there would be 5,000,000 refund claims filed with the Board, even though there were at the time only 4,300,000 taxpayers in the United States.

There were renewed proposals in 1925 that the jurisdiction of the Board should be expanded to include refund claims. It was asserted that the Board's procedures were cheaper, quicker and less complicated than those of other courts and that taxpayers who had overpaid their taxes ought to be entitled to the benefit of these more desirable procedures. Again, these proposals were defeated, primarily due to concern that the Board was not equipped to handle the increased workload that could result from expanding its jurisdiction to include refund claims.

The next significant attempt to expand the jurisdiction of the Board occurred in 1942, when Randolph Paul (then Tax Advisor to the Secretary of the Treasury) testified as follows in hearings conducted by the Ways and Means

Committee:

The Board is a tribunal specially skilled in tax matters and there is no sound reason for denying to taxpayers the opportunity to present their refund claims to such a forum. As the great bulk of tax cases are presently tried before the Board of Tax Appeals, the addition of refund jurisdiction will not unduly burden the Board. It is therefore suggested that an appropriate procedure be devised under which the Board may hear refund cases if the taxpayer desires to utilize that forum instead of the district courts or the Court of Claims.^{11/}

^{11/} Dubroff, supra, 42 Albany Law Rev. at 380.

The Treasury Department was then working on draft legislation to expand the jurisdiction of the Board, but the work was apparently cut short when Treasury discovered a problem relating to the doctrine of equitable recoupment. Although the Board could determine a tax overpayment for a year that was before it as a result of the issuance of a deficiency notice, and it could also consider facts relating to other years in determining the tax liability for the years before it, it had no jurisdiction to determine overpayments or underpayments of tax for other years. Accordingly, the Board had no power to invoke the doctrine of equitable recoupment, under which parties can offset tax liabilities or refunds for years barred by the statute of limitations against tax liabilities or refunds for open years. On the other hand, no similar limitation applied in the District Courts or the Court of Claims, and the doctrine of equitable recoupment was therefore operative in those courts. Accordingly, it was feared that taxpayers would bring actions before the Board if the government had a recoupment claim, and before a District Court or the Claims Court if the taxpayer was entitled to equitable recoupment. Although a simple solution might have been simply to grant the Board the power to invoke the doctrine of equitable recoupment, it was felt that it would be inappropriate to grant that power to the Board because it did not have full judicial status.

In the late 1960s, various hearings were held in Congress on proposals to establish the Tax Court as an Article III Court and on various suggestions regarding the jurisdiction of the court. The suggestions that were considered were generally stymied by a jurisdictional battle between the Treasury Department and the Justice Department, with the former supporting proposals that would enhance the jurisdiction of the Tax Court (where its lawyers appeared representing the government) and the latter supporting other proposals that would enhance the importance of the District Courts and Claims Court in litigation of tax controversies (where Justice Department lawyers represented the government).

Proposals to expand the jurisdiction of the Tax Court to include refund claims were included in several bills introduced in Congress during 1987. These proposals were all similar or identical to the provisions that were ultimately included in S. 2223.

In addition, an ad hoc committee on Tax Court jurisdiction made various proposals in late 1986. A number of those proposals resulted in certain other provisions (not relating to expansion of the jurisdiction of the Tax Court to include refund claims) that were also included in S. 2223.

III. The Desirability of Allowing Refund Claims in the Tax Court

We believe that the arguments in favor of expanding the jurisdiction of the Tax Court to include refund claims are quite strong. There are a number of instances in which expanding Tax Court jurisdiction in that manner would avoid duplicative litigation, enable taxpayers to make claims that they otherwise would not be able to make in another forum, and allow taxpayers to utilize the expertise of the Tax Court in a greater number of instances. Further, recent changes in deductibility of interest and the statutory rate of interest on underpayments could motivate taxpayers to pay disputed taxes early in the administrative audit process, thus requiring a refund action as the means of obtaining judicial review.

Consider the following examples:

1. The Internal Revenue Service issues a statutory notice of deficiency to a taxpayer for the year 1987. The grounds on which the deficiency is based would, if sustained, result in an overpayment for the year 1988. The taxpayer is then faced with a number of problems. The correlative refund claim for 1988 cannot be adjudicated by the Tax Court if the taxpayer files a petition challenging the deficiency for 1987. As a result, if the taxpayer seeks a single forum in which to resolve this entire

matter, there is no available prepayment forum.

The desire to resolve this entire matter in a single prepayment forum might involve more than consideration of litigation costs and convenience. If any portion of a deficiency for one year is satisfied by a credit of an overpayment for another year, then interest is not imposed on the deficiency for any period for which interest would have been allowable if the overpayment had been refunded.^{12/} If the Tax Court does not have jurisdiction over refund claims, then the taxpayer will not be able to offset the overpayment against the deficiency; instead, the taxpayer will be required to pay the full deficiency to litigate the entire matter in a District Court or the Claims Court, or (if a petition is filed) full payment of the deficiency might be required because the overpayment will not have been determined at the time of the Tax Court decision. In these events, the inability to resolve the entire matter in the Tax Court will result in additional costs for the taxpayer. The interest payable on the deficiency is nondeductible under section 163(h) of the Code, but the interest received on the

^{12/} Section 6601(f) of the Code; Treas. Reg. § 301.6601-1(b).

overpayment is fully includible in income. Further, the rate of interest payable by the taxpayer on the deficiency is higher than the rate receivable by the taxpayer on the overpayment.^{13/}

2. In 1972, a subsidiary was liquidated into its parent. The parent claimed that the subsidiary's liabilities exceeded the value of its assets, and it therefore claimed worthless stock and bad debt deductions. The Service took the position that section 332 prohibited the recognition of losses. This case is now pending in the Tax Court. Counsel for petitioner has discovered, however, that the subsidiary (acquired in 1969) has unutilized pre-acquisition losses that are subject to the separate return limitation year provisions of the consolidated return regulations; if section 332 applies, as the Service claims, these losses would be available to offset the income of the parent in 1972 and in 1973. If the parent loses this case in the Tax Court, the resulting refund claim for 1973 must be litigated in a different court, which will result in duplicative litigation. Further, in the event of an adverse Tax Court decision, the parent would be

^{13/} Section 6621(a) of the Code. The disparity in interest rates will be even greater if the rate on the deficiency is 120 percent of the usual rate under section 6621(c) of the Code.

required to pay a substantial deficiency for 1972, even though it might be entitled to a refund for 1973 that is approximately 80% of the 1972 deficiency.

3. The Internal Revenue Service determined that a corporation was subject to accumulated earnings tax for 1966, 1967 and 1968. The Service issued a deficiency notice for 1967 and 1968, in response to which the corporation filed a petition in the Tax Court. With respect to 1966, the corporation had filed a refund claim based on carryback of net operating losses from 1969; the Internal Revenue Service denied that refund claim and asserted the accumulated earnings tax liability as a setoff. A refund suit was filed in the Court of Claims. The Court of Claims case was tried, and won by the taxpayer.^{14/} The Service initially refused to concede the Tax Court case and indicated an intention to try that case, even though the issues were virtually identical. A second trial would have been duplicative and expensive-- and avoidable if the entire case could have been litigated in the Tax Court as an initial matter.^{15/} Similarly, in

^{14/} C.E. Hooper, Inc. v. United States. 539 F.2d 1276 (1976)

^{15/} Another feature of the Hooper case is that, in the Tax Court, section 534 of the Code would have permitted the taxpayer to shift the burden of proof to the Commissioner with respect to the issue of whether or not the accumulated earnings were within the reasonable needs of the business. In the Court of Claims, however, the taxpayer had the burden of showing that there was an overpayment, and was thus deprived of the benefit of section 534.

any instance in which a taxpayer seeks a refund as a result of a net operating loss carryback, if the Service denies the refund claim and does not assert a deficiency for the carryback year, there is no remedy in the Tax Court.

In many instances, the availability of a remedy in the Tax Court could determine whether a refund claim can be pursued as a practical matter. Particularly in small tax cases, the lower litigation costs in the Tax Court would suggest that in a number of instances the availability or lack of availability of a remedy in the Tax Court will be the difference between a refund suit being brought or not brought. The other advantages of Tax Court litigation listed above also, in our view, argue in favor of expanding the Tax Court jurisdiction to include refund claims. Because the Tax Court is in many respects a superior forum for the litigation of tax controversies, we see no reason to deprive taxpayers of the availability of that forum simply on the ground that the Service has not claimed a deficiency in tax for a particular year.

One argument that has been made in opposition to expansion of Tax Court jurisdiction is that the expansion might lead to more extensive discovery procedures in the Tax Court, thereby substantially increasing the cost of Tax Court litigation and eliminating or reducing a principal advantage of the Tax Court. In general, discovery is not required in deficiency cases because, prior to the issuance of the notice of deficiency, there is generally an examination that is conducted by a revenue agent. An examination, however, might not have been conducted in a refund case, thus giving rise to a greater need for substantial discovery. We note that the Senate Finance Committee expects that the Tax Court will modify its discovery procedures only for refund cases.^{16/} Thus, there should not be any impact on the current practice in deficiency cases in the Tax Court.

It has also been suggested that the Tax Court's docket is already overcrowded and should not be further burdened by refund cases. As noted in the report of the Senate Finance Committee, however, there are fewer than 3,000 tax cases now pending in the District Courts and the Claims Court. This number is relatively insignificant in comparison to the total case load of the Tax Court, which now numbers over 70,000 pending cases.

^{16/} S. Rep. No. 100-309, 100th Cong., 2d Sess. 20.

Even though the number of refund cases might increase if a remedy in the Tax Court were available, a substantial increase would result only from the desirability, efficiency and lower litigation costs involved in litigation in the Tax Court. That fact is hardly a good reason to limit Tax Court jurisdiction by drawing an arbitrary line between deficiency cases and refund cases. We cannot deny that this jurisdictional expansion might impose a significant burden on the Tax Court, particularly in small tax cases. But the number of cases would undoubtedly be manageable, particularly if funding is sufficient to meet the needs of the court. In any event, it is also possible that the failure to expand Tax Court jurisdiction will, for reasons noted above, increase the number of cases in the other courts -- and it is not clear that those courts have the resources to handle an increased load of tax cases.

Finally, it has also been suggested that we should observe the sometimes popular adage, "if it ain't broke, don't fix it." Although the current system lacks symmetry, it is generally understood and operates efficiently, and there is no overwhelming need for change. But there are circumstances (such as those indicated above) in which certain taxpayers believe that the system is broken, or at least that the system has resulted in substantial unfairness or increased costs in their particular circumstances.

Further, the number of instances in which this apparent or actual unfairness exists will undoubtedly increase as a result of the disallowance of personal interest deductions under section 163(h) and the difference in interest rates on underpayments and overpayments under section 6621(a). Although a number of practitioners might be satisfied with the present system, we suspect that this satisfaction is (to some extent) motivated by the benefits that are hoped to be achieved from forum-shopping. This factor, we believe, suggests the need for change, rather than a reason to retain the present system.

IV. Explanation of Provisions

Section 136(a) of S. 2223 would expand the Tax Court's jurisdiction to claims for refund of taxes that are within that court's deficiency jurisdiction. Certain other provisions of the bill are also worth noting. The bill is apparently designed to require that all issues relating to one taxable period be resolved in a single proceeding. Thus, a new section 7422(j) would prohibit taxpayers from filing refund claims in the Tax Court during the period within which the taxpayer is able to file a petition challenging a statutory notice of deficiency. Similarly, section 6212(c) of the Code would be amended to provide that, if a taxpayer has instituted a refund proceeding in the Tax Court, deficiency notices may not be issued by the

Service with respect to the tax and period that are the subject of the refund proceeding. Instead, additional deficiencies would be asserted in appropriate pleadings filed in the Tax Court refund action.

These provisions should be implemented in such a manner that both taxpayers and the Service have the same rights in Tax Court refund proceedings that they currently have in refund actions in the District Courts or the Claims Court. Some modification of the legislation might be needed to accomplish that goal with respect to burden of proof. We believe that the burden of proof should not be shifted to the government simply because a deficiency is asserted in a responsive pleading in a refund claim, rather than in a statutory notice of deficiency. This allocation of the burden of proof is consistent with the allocation that now exists in refund actions in the District Courts and the Claims Court^{17/} and, in any event, an alternative rule would encourage taxpayers to file "preemptive" refund actions in the Tax Court solely for the purpose of shifting the burden of proof in instances in which the taxpayer expects the Service to assert a deficiency. To make certain that this is the result, it might be necessary to modify Tax Court Rule 142, or to

^{17/} Section 7422(e) of the Code.

add a legislative provision dealing with this subject.

V. Other Provisions

S. 2223 also includes five less important jurisdictional proposals that were initially developed by an ad hoc committee composed of attorneys in private practice, the Internal Revenue Service, the Department of Justice and Tax Court personnel. We support these five proposals, as well as two other proposals (numbers 6 and 7 below) that were also made by the ad hoc committee. These proposals are as follows;

1. Premature Assessments. To preserve the right of taxpayers to utilize the Tax Court as a prepayment forum to challenge deficiency determinations, the Code prohibits any assessment or collection of a deficiency until the decision of the Tax Court has become final. If this restriction is violated, the taxpayer is entitled to enjoin assessment and collection, but jurisdiction over this injunction action exists only in the District Court.^{18/} The proposed bill would give the Tax Court jurisdiction, concurrent with the District Courts, to restrain the assessment and collection of any tax in

^{18/} Section 6213 (a) of the Code.

circumstances in which the tax is the subject of a timely-filed petition that is pending before the Tax Court.

2. Overpayment Determinations. If the Internal Revenue Service asserts a deficiency, the Tax Court has jurisdiction (if a petition is filed challenging the deficiency) to determine that the taxpayer is entitled to a refund. But if the Service fails to refund the overpayment that has been determined by the Tax Court, the Tax Court does not have the power to order payment of the refund; instead, the taxpayer must seek relief in another court. The proposed bill gives the Tax Court jurisdiction to order that an overpayment be refunded, together with interest, if it has not been repaid within 120 days after the Tax Court decision becomes final. Thus, the Tax Court would have jurisdiction to enforce its own decisions, rather than requiring the taxpayer to seek enforcement in a District Court.

3. Sales of Seized Property. In jeopardy assessment cases, a lien on the taxpayer's property arises in favor of the United States, and the Service can immediately seize such property. If the taxpayer contests the assessment in either the Tax Court or a District Court, the Service is then prohibited from selling the property without the taxpayer's consent, unless the Service determines that the expenses of conservation will greatly reduce the ultimate proceeds, or that the property

is liable to perish or become greatly reduced in value.^{19/} Under present law, the taxpayer may contest a determination in this regard only in a District Court. The bill would grant the Tax Court jurisdiction to review a determination by the Service to sell seized property, under the same standards that exist in District Court actions, in circumstances in which the taxpayer has properly challenged the assessment in the Tax Court.

4. Determination of Interest on Deficiencies. After the Tax Court decides a case, the Service then assesses the amount of the deficiency determined by the Tax Court, and the Service adds to the deficiency an amount of interest that is computed at the applicable statutory rate. If the taxpayer disagrees with the interest computation made by the Service, the Tax Court does not have jurisdiction to resolve the dispute.^{20/} The bill would grant the Tax Court jurisdiction to review the interest computation, if within one year after the date on which the Tax Court decision becomes final, the taxpayer moves to reopen the proceeding to

^{19/} Section 6863(b)(3)(B) of the Code.

^{20/} The Tax Court does, however, have jurisdiction to consider the proper amount of interest relating to an overpayment. See Estate of Baumgardner v. Commissioner. 85 T.C. 445 (1985).

obtain a determination of the proper amount of interest. The taxpayer would be required, however, to pay the deficiency determined by the Tax Court and the interest determined by the Service before challenging the interest computation of the Tax Court. Although this proposal is an improvement over present law, we do not believe that taxpayers should be required to pay potentially erroneous interest before challenging the interest computation in the Tax Court. Although it might be sensible to require the taxpayer to pay the deficiency -- so that the taxpayer could not use the procedure of challenging the interest computation to further delay payment of tax that has been determined to be due -- we believe the taxpayer should be permitted to challenge the interest computation prior to payment. Further, rather than allowing the taxpayer to make a motion at any time within a year after the Tax Court decision becomes final, the taxpayer should be required to file a timely motion (e.g., within 60 or 90 days after receipt of the interest computation) challenging the interest computation.^{21/}

5. Certain Estate Tax Cases. Interest that is paid by an estate on Federal or State estate tax liabilities

^{21/} More detailed procedures should probably be developed to insure that disputes are resolved expeditiously and that only genuine disputes are dealt with by the Tax Court.

is allowed as an income tax deduction or, alternatively, as an estate tax deduction as an expense of administration under section 2053 of the Code. In addition, section 6166 of the Code allows certain estates (consisting primarily of interests in closely-held businesses) to elect to pay Federal and State taxes in installments, with interest. In Estate of Bailly v. Commissioner. 81 T.C. 949 (1983), the Tax Court concluded that the entry of its decision had to be postponed until the final installment of tax was paid or due (whichever occurred earlier) under section 6166. The delay was necessitated by the belief that a final decision of the Tax Court cannot later be modified, and finalizing the decision would therefore preclude the estate from deducting interest paid under section 6166 subsequent to the final Tax Court decision. The situation prompted the court to note that its holding would result in "inconvenience, hardship and administrative expenses to this Court and to the parties involved," and to suggest that "a congressional solution to this problem is needed". 81 T.C. at 958. The bill would authorize the Tax Court, in cases in which the time for payment of taxes has been extended under section 6166, to reopen the case solely to modify its decision to reflect the estate's entitlement to an interest deduction under section 2053 for interest that the estate has actually paid.

6. Hearings in Territories and Possessions. The ad hoc committee proposed that section 7445 of the Code be amended to authorize the Tax Court to sit in territories and possessions over which the United States exercises jurisdiction, in addition to the 50 states and the District of Columbia. The Tax Court occasionally receives petitions from residents of Puerto Rico, Guam and the Virgin Islands. We believe that this proposal would promote convenience and reduce the expenses of taxpayers having cases before the Tax Court, and that it is particularly desirable in small tax cases.

7. Treating Tax Court Decisions as Judgments. Section 7459 of the Code authorizes the Tax Court to enter a "decision", although other Federal Courts are authorized to enter "judgments." As a result, under present law, if the Commissioner is unable to collect the full amount of an assessment within the six-year statutory period provided in section 6502(a) of the Code, the Commissioner must bring suit in a District Court to reduce the assessment to judgment. The ad hoc committee proposed that the Tax Court could denominate its decision a "judgment" and that the decision would then be treated as a judgment for collection purposes, so that either the taxpayer or the Commissioner could register the decision with the Clerk of the District Court in which suit to reduce the assessed judgment would have been brought. This procedure would eliminate the

necessity of a separate suit in the District Court prior to expiration of the statutory limitations period on collections.

VI. Recommendations

For the reasons described above, we support the various jurisdictional proposals discussed above, and we believe that all of these proposals should be enacted as promptly as practicable, either as part of S. 2223 or otherwise.

Most importantly, the expansion of the jurisdiction of the Tax Court to include certain refund claims is required for the various reasons suggested above, including the need to preserve the Tax Court as an effective prepayment forum; without this expansion of its jurisdiction, the Tax Court would become a much less effective prepayment forum in light of changes in the deductibility of interest on tax deficiencies and the application of a higher interest rate to underpayments than to overpayment.

VII. Other Areas for Study

There are other jurisdictional questions that should also be the subject of further study. For example, the advantages of Tax Court litigation inevitably lead one to wonder why the Tax Court should not have jurisdiction that is concurrent with the District Courts and the Claims Courts in all tax cases. The Tax

Court does not have jurisdiction over suits by the United States to recover erroneous tax refunds,^{22/} but it should have such jurisdiction for taxes that are within that court's deficiency jurisdiction.

There are many circumstances in which the Tax Court either has or does not have jurisdiction over particular tax cases, with the only apparent distinction being the wording of a particular statutory provision, rather than any policy ground. For example, the Tax Court has jurisdiction over the penalty for late filing of returns under section 6651(a)(1) of the Code because the amount of such penalty is determined on the basis of a deficiency in tax. But the Tax Court apparently has no jurisdiction over late-payment penalties assessed under section 6651(a)(2) of the Code because the amount of such penalties is not determined on the basis of a deficiency amount.^{23/} The taxpayer's defense to each of these penalties is identical (i.e., reasonable cause). This circumstance caused the court to make the

^{22/} Bregin v. Commissioner, 74 T.C. 1097 (1980).

^{23/} Estate of Young v. Commissioner, 81 T.C. 879 (1983); Judge v. Commissioner, 88 T.C. 1175 (1987). Judge and Young also indicate that the Tax Court's jurisdiction over penalties under section 6651(a)(2) will depend primarily on which party is seeking to recover the amount of the penalty.

following comment regarding "fractionalizing litigation":

. . . if we are going to decide whether there was reasonable cause to excuse the late-filing addition, why should we decline to decide whether there was reasonable cause to excuse the late-payment addition and thereby force the taxpayer to litigate that issue before another tribunal? However, as we have previously remarked, our jurisdiction is purely statutory and not dependent on policy considerations.^{24/}

Other oddities exist as well. The Tax Court has jurisdiction to render declaratory judgments in cases involving the qualification of organizations as exempt organizations described in section 501(c)(3) of the Code, but it does not have jurisdiction to render declaratory judgments in cases involving organizations that claim to be tax-exempt organizations under other such sections of section 501(c), such as social welfare organizations, business leagues, fraternal orders and the like. The Tax Court has no jurisdiction in cases arising under section 6672 of the Code, relating to 100% penalty cases against corporate officers or other persons for willfully failing to collect, account for and pay over payroll taxes. The reasons for these jurisdictional limitations -- and others as well -- are not at all obvious.

^{24/} Estate of Young v. Commissioner. 81 T.C. at 887-88.

In 1972, the Committee on Tax Policy of the Tax Section prepared a report entitled "A Report on Complexity and the Income Tax."^{25/} That report contained the following recommendations:

In order to secure a much more prompt resolution of tax questions, it would seem desirable to broaden the jurisdiction of the Tax Court to cover refund cases in the income, estate, gift and excise tax fields. Apparently this would not involve any significant increase in the volume of Tax Court litigation. Furthermore, it would appear desirable to divest the district courts of jurisdiction in cases involving income, estate, gift and excise taxes, except those involving liens or collections and other matters of prime district court jurisdiction, such as bankruptcy or criminal proceedings. This would relieve congestion in the district court, eliminate jury trials in civil tax matters, vest jurisdiction in a court having much more expertise in the subject and eliminate forum shopping. Similarly, it would appear desirable to divest the Court of Claims of jurisdiction in tax matters.^{26/}

The same report also recommended the creation of a court of tax appeals, with sole jurisdiction to hear appeals of Tax Court decisions. In 1975, the Executive Committee of the Tax Section approved a report adopting the recommendations of the Complexity Report recommending the establishment of a court of tax appeals, and containing the following further discussion:

In proposing an expanded jurisdiction for the United States Tax Court, the Complexity Report contemplates withdrawing

^{25/} 27 Tax Law Review 327 (1972).

^{26/} 27 Tax Law Review at 353-54.

refund suit jurisdiction from the Court of Claims and the district courts. Trial by jury is not available in the Court of Claims; the proceedings before the Court's Trial Judges are equivalent to those in a district court and the Court itself is equivalent to a Court of Appeals. The Executive Committee believes that incident to the creation of a court of tax appeals, tax refund suit jurisdiction should be withdrawn from the Court of Claims. However, in significant part because of the availability of a jury trial in the district courts, the Executive Committee neither approves nor disapproves the Complexity Report's recommendation that first instance jurisdiction over tax refund suits also be withdrawn from the district courts and lodged exclusively in the Tax Court. If district court jurisdiction is maintained, appeals from the tax decisions of the district courts, like appeals from the decisions the Tax Court, should be to the court of tax appeals.

Although the current proposal to expand Tax Court jurisdiction to include refund claims addresses only a part of this important topic, it is consistent with the views previously expressed in the 1975 report of the Executive Committee.

There have also been proposals to make the jurisdiction of the Tax Court, District Courts and Claims Court fully equivalent by granting the Tax Court concurrent jurisdiction over refund suits and granting the District courts and the Claims Court jurisdiction over deficiency actions.^{27/} Although we have reservations about such proposals—primarily because it is generally undesirable to deflect tax litigation away from the Tax

^{27/} See the Legislative Recommendation of the American Bar Association, 23 Tax Lawyer 965 (1970).

Court, where there is great expertise in tax matters--they should be considered in any complete study of jurisdictional questions involved in tax litigation.

All of these matters merit further study, but whether or not such a study is undertaken, we should not postpone further the adoption of a proposal that has been considered again and again for over 60 years--the expansion of the jurisdiction of the Tax Court to include refund claims.