TAX COURT TRIALS: AN UPDATED VIEW FROM THE BENCH

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I. INTRODUCTION

Over the past twenty years, much has happened in the tax litigation arena that has impacted the tax bar and the operations of the United States Tax Court. The publication of comprehensive Tax Court Rules of Practice and Procedure, and the complexities of case management encountered in the flood of shelter cases in the 1980s and the current crop of so-called "jumbo" litigation (particularly transfer pricing disputes arising under section 482) are probably the most notable examples of such changes. This Article is prompted by these developments as well as my own constantly evolving experience as a judge of the Tax Court. It is an updated version of an article I wrote in 1973.[1] Most of what I said then remains pertinent today, especially as to the importance of understanding the judge in terms of his or her background, personality, and attitude toward specific issues that are likely to arise in the course of preparation for trial and the trial itself, as well as post-trial activity. To this should be added the continued need for professionalism, that is, the pursuit of excellence on the part of the members of the tax bar. Professionalism involves not only being right but also doing things right—that is, thoroughly, a standard which seems to be vanishing from the legal landscape.[2]

II. TAX COURT LITIGATION: A HUMAN PROCESS

Justice Cardozo wrote in *The Nature of the Judicial Process* that there may be

> . . . the grandeur of the conception which lifts [judges] into the realm of pure reason, above and beyond the sweep of perturbing and deflecting forces. Nonetheless, . . . they do not stand aloof on these chill and distant heights; and we shall not help the cause of truth by acting and speaking as if they do. The great tides and currents which engulf the rest of men do not turn aside in their course, and pass the judges by.[3]

Clearly, what this statement means is that the trial of a case is a human process and that judges, as well as litigants, are human beings with all the concomitant attributes, both good and bad. This is why, to use the words of the Supreme Court, decisions on many tax issues "must be based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct"[4] and "[c]ommon understanding and experience are the touch-

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[*] Senior Judge, United States Tax Court. The views expressed in this Article are personal to the writer and do not necessarily represent the views of the Tax Court or any of its other judges.

[1] Judge Theodore Tannenwald, Jr., *Tax Court Trials: A View from the Bench*, 59 A.B.A. J. 295 (1973) (reprinted here in part with permission from the American Bar Association Journal).

[2] The author has recently expressed his views on this aspect of tax practice in *Tax Lawyering: A Changing Profession*, 46 TAX LAW. 665, 672-78 (1993).

[3] BENJAMIN N. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 168 (1921).

[4] Commissioner v. Duberstein, 363 U.S. 278, 289 (1960).

stones for the interpretation of the revenue laws."[5] The lesson that flows from these characterizations of the judicial process is that trial preparation requires a knowledge of the judge who will handle the case, including his or her background, prior opinions that reveal his or her approach to a problem (especially opinions bearing on the issues in the current case) and propensities for particular aspects of a trial such as opening and closing statements, evidentiary issues, and attitude toward objections to testimony. Time will be well spent researching these matters, including efforts to talk to other lawyers who have tried cases before the judge.

If one accepts the premise that judges have many of the same instincts and traits as other human beings, one's concept of the trial of a tax case may change considerably. Some lawyers view the trial of a case in the Tax Court as the modern version of the feudal trial by battle, with mental instead of physical weapons. Victory is thought to go to the side scoring the most points, which is sometimes achieved through an incomplete disclosure of material facts. Other lawyers see the trial merely as a continuation of the informal procedures of the Service. They believe victory will go to the one who talks (at trial) and writes (on brief) with an appearance of persuasiveness, irrespective of the facts or the efforts at trial to bring those facts to the court's attention.

Not only are these approaches demeaning to the judge, in that they assume that he can either be ignored or deceived, but they are wrong. The object of a tax trial is to find out whether the taxpayer should properly be required to pay the taxes claimed. The taxpayer has a direct interest in the outcome; his money is at stake, and he is entitled to assurance that he will not be required to pay a penny more than he legally owes. But, unlike the ordinary tort or contract case, the other real party in interest is the taxpaying public. If the taxpayer gets off the hook for what he really should be required to pay, the pockets of all have been depleted. Thus, the public is equally entitled to assurance that the taxpayer will not be permitted to "eat, drink, and be merry" at the expense of the Federal fisc.[6]

The best way to assure the accomplishment of this balancing of interests is to view a tax trial as being investigatory in nature rather than a simple adversary proceeding. This seems to me to require that the judge be an activist. He should be willing to seek out all the facts, even when his doing so may prove embarrassing or even harmful to one party's case. He should follow this path, however, only after he has given each lawyer a full opportunity to bring out his client's case. He should try not to become deserving of the comment that a lawyer once made, in interrupting a judge who had taken over the questioning: "Your honor, I have a good case; please don't throw it away."

[5] Helvering v. Horst, 311 U.S. 112, 118 (1940).

[6] Burde v. Commissioner, 352 F.2d 995, 1003 (2d Cir. 1965) (Friendly, J., concurring).

III. THE PRETRIAL PROCESS

A. *The Petition*

The trial process begins with the petition. That document is where the taxpayer first tells his story. For years, there have been conflicting views with respect to a bare-bones versus a detailed petition. In earlier times, when pretrial memoranda were not the order of the day, a detailed petition (not, however, setting forth every piece of evidence to support the taxpayer's case) was important, as the only means of informing the judge before trial as to what the case was all about. With the advent of required pretrial memoranda, the need for a detailed petition is not as acute. However, the need to inform the judge in the petition still exists in those cases in which pretrial activity involving the judge is anticipated.

Beyond these considerations, one should not overlook the fact that a claim of overpayment needs to be pleaded in order to assure that it will not be rejected by the Tax Court for untimeliness. The petition is the most logical place to make certain that it will not be overlooked. Similar action should be taken in respect of alternative grounds for disputing a deficiency. Nor should one fail to include, in the petition, every year in respect of which a deficiency is asserted and disputed. If any such year is omitted, the petition will be dismissed for lack of jurisdiction as to that year. An amended petition to cure the defect will not be accepted by the Tax Court since the timely filing of a petition (usually ninety days after the mailing of the deficiency notice) is jurisdictional.[7] The recently expressed view toward expanded equitable power of the Tax Court does not provide any sustenance in such situations.[8]

B. *Other Pleading Considerations*

Two other pleading-related matters warrant mention. First, when the answer alleges facts to support an affirmative defense, an assertion of fraud, or otherwise, usually no reply is required. The allegations are deemed denied under Rule 37(c), contrary to the comparable provision of Rule 7(d) of the Federal Rules of Civil Procedure, which provides that, in the absence of a reply, the allegations of the answer are deemed admitted. If a reply is filed, however, any allegations not denied therein are admitted. Thus, a reply must be carefully crafted to avoid the pitfalls of an omission. It should be noted that a reply may have to be filed if the Service moves, as permitted by Rule 37(c), to deem admitted the affirmative allegations of the answer.

Second, it is important that practitioners adhere scrupulously to Rule 33(b), which states:

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[7] Monge v. Commissioner, 93 T.C. 22, 27 (1989); O'Neil v. Commissioner, 66 T.C. 105, 107-08 (1976). *See* I.R.C. § 6213(a) (providing for 150 days if the deficiency notice is addressed to a person outside the United States).

[8] *See* Estate of Mueller v. Commissioner, 101 T.C. No. 37 at 4496 (CCH), 281 (RIA) (Dec. 13, 1993).

> The signature of counsel or a party constitutes a certificate by the signer that the signer has read the pleading, that, to the best of the signer's knowledge, information and belief *formed after reasonable inquiry*, it is well grounded in fact and is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law, and that it is not interposed for any improper purpose, such as to harass or to cause unnecessary delay or needless increase in the cost of litigation. . . . If a pleading is signed in violation of this Rule, *the Court, upon motion or upon its own initiative, may impose upon the person who signed it, a represented party, or both, an appropriate sanction*, which may include an order to pay to the other party or parties the amount of the reasonable expenses incurred because of the filing of the pleading, including reasonable counsel's fees (emphasis added).

The Tax Court has become increasingly concerned with the apparent disregard of this Rule by counsel and has begun to impose sanctions for nonobservance.[9] It has recently taken the same approach under Rule 24(b) in situations involving conflicts of interest.[10]

C. *Pretrial Settlement*

It is rare that the trial of a tax case is inevitable. Most cases can and should be settled. Outstanding examples are cases in which the question is merely substantiation of the amount of an otherwise concededly deductible item or the valuation of property. Particularly in valuation cases, litigants should frankly recognize that a precise determination is impossible and that the most that can be hoped for is that the judge will make an intelligent guess.[11] If this recognition occurs, the imperative as well as the desirability of settlement will become obvious. But whatever the issue, no litigant should expect to obtain an undue advantage in a settlement. In fact, the best settlement is one that leaves both sides dissatisfied. Failure to settle can produce the least desirable result, namely, the judge's adopting the position of one party in its entirety rather than seeking to find a middle ground; this is an approach that the Tax Court has warned it will apply.[12] To this should be added the admonition that minor issues, particularly those that are factual in nature, such as substantiation, demand settlement in order to avoid diverting the attention of the judge from the larger and more important issues. Not every issue is deserving of blood, sweat, and tears!

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[9] *See, e.g.*, Versteeg v. Commissioner, 91 T.C. 339 (1988); Shamam v. Commissioner, 63 T.C.M. 2014 (CCH), T.C.M. ¶ 92,077 at 328 (RIA) (1992).

[10] *See* Para Technologies Trust v. Commissioner, 64 T.C.M. 922 (CCH), T.C.M. ¶ 92,575 at 2952 (RIA) (1992).

[11] *See* Messing v. Commissioner, 48 T.C. 502, 512 (1967) (stating that "[t]oo often in valuation disputes the parties have convinced themselves of the unalterable correctness of their positions and have consequently failed successfully to conclude settlement negotiations—a process clearly more conducive to a proper disposition of disputes such as this. The result is an overzealous effort, during the course of the ensuing litigation, to infuse a talismanic precision into an issue which should frankly be recognized as inherently imprecise and capable of resolution only by a Solomon-like pronouncement" (citations omitted)).

[12] *See* Buffalo Tool & Die Mfg. Co. v. Commissioner, 74 T.C. 441, 452 (1980), explained and applied in Snyder v. Commissioner, 86 T.C. 567, 583-84 (1986).