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Taxpayer Bill of Rights 3: 1998 Tax Law Part 2: Burden of Proof

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Summary

This is one of a series of reports designed to analyze taxpayer protection and rights provisions made by the Taxpayer Bill of Rights 3, enacted as Title III of the IRS Restructuring and Reform Act of 1998, P.L. 105-206. This report summarizes the common law justifications for placing the burden of proof on the taxpayer in noncriminal tax cases, mentions the possible reasons for shifting the burden of proof to the government in the Taxpayer Bill of Rights 3, and discusses the possible impact of the provision shifting the burden of proof to the government in cases where the taxpayer has introduced credible evidence on a factual issue. The provision is found in section 3001 of the Act and is codified at IRC § 7491.

Background

Historically, the burden of proof has been on the taxpayer in noncriminal tax disputes.¹ This practice arose out of common law and was not a statutory edict.² At common law there were a number of theories for assigning the burden of proof to a party. Among these theories were that the party who has the affirmative issue should have the burden of proof; that the plaintiff should have the burden of proof; that the party who is alleging a disfavored contention should have the burden of proof; that the party alleging the least likely scenario should have the burden of proof; that the party with the knowledge about a particular issue should have the burden of proof; and that the burden of proof could be allocated by statute.³

¹ In criminal tax cases, the burden of proof has always been on the government.

² Tax Court Rule 142 provides that the burden of proof is on the taxpayer except as otherwise provided by statute or determined by the court.

³ Martinez, *Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases*, 39 HASTINGS L.J. 239, 249-254 (1988).

The general allocation of the burden of proof to the taxpayer was justified by several of the common law principles. It was generally thought to be appropriate to place the burden on the taxpayer because the taxpayer usually has control of the evidence on the issues.⁴ In suits for refunds, it was thought to be reasonable to require the plaintiff to explain why the taxpayer engaged in the seemingly inconsistent actions of voluntarily overpaying the taxes and then requesting the money back.⁵ In collection suits brought by the government, it was thought to be appropriate to place the burden on the taxpayer for a number of reasons. One was that to do otherwise would place a taxpayer who failed to respond to the government's notice of deficiency in a better position than a taxpayer who paid the taxes and then sued for a refund. Another was that the taxpayer was alleging a disfavored scenario or a less likely situation, i.e., the most common scenario is that a citizen owes its government some taxes, and the government is not in the best position to calculate the taxes due. If the citizen disagreed with the government's calculation, then the citizen should prove what the correct amount was. Finally, placing the burden of proof on the taxpayer advanced the goal of making the tax collection system more efficient.⁶

In practice, in a noncriminal tax trial, the government presented the Internal Revenue Service determination or assessment. The IRS determination enjoyed a “rebuttable presumption” that the amount of tax owing was correct. If the taxpayer did not appear or did not defend, the government would win the case. If the taxpayer introduced sufficient evidence to allow a reasonable judge to decide in the taxpayer's favor, the presumption of correctness was rebutted. In order to win, the taxpayer had to prove by a preponderance of the evidence that the IRS determination was incorrect, and if the taxpayer was suing for a refund, the correct amount of the tax. The winner of the case would be the side that established that its interpretation of the facts should prevail. Ties went to the government since the burden of proof was on the taxpayer.

There were (and are) several situations in which the Internal Revenue Code or Tax Court rules placed the burden of proof on the government,⁷ but there was no general statutory provision allocating the burden of proof. In recent years there seemed to a perception that the common law allocation was disadvantageous to individuals and small businesses that were forced to litigate against the IRS.⁸ There also seemed to be a feeling that litigating against the IRS was more like a criminal than a civil proceeding. For example, Representative English made these remarks in urging the adoption of H.R. 2676:

It is stunning, but the IRS is the only place in the American system where a citizen is guilty until proven innocent. Traditionally, the taxpayer, when notified by the IRS

⁴ Saltzman, *IRS PRACTICE AND PROCEDURE*, 2D ED. ¶1.05[2][c] (1991).

⁵ Martinez, *supra*, at 262.

⁶ Martinez, *supra*, at 262-263.

⁷ A few examples where the government has the burden of proof include cases involving the issue of fraud with the intent to evade tax (IRC § 7454(a)), certain taxes on foundation managers (IRC § 7454(b)), transferee liability (IRC § 6902(a)), fraudulent information returns under 6201(d), and, under Tax Court Rule 142, when the IRS asserts affirmative defenses, new matters, or increases in deficiencies.

⁸ Staff of the Joint Committee on Taxation, *General Explanation of Tax Legislation Enacted in 1998*, JCS 6-98, at 56-57 (Nov. 24, 1998).

that his tax payments failed, in their view, to satisfy his tax obligation, carried the burden of proof in demonstrating that his tax payment is accurate. The presumption is for the IRS and against the taxpayer. In my view, this is just plain wrong.⁹

Mr. Traficant made similar remarks:

In America, an American citizen accused shall be considered innocent until proven guilty, and the accuser shall carry the burden of proof in that matter. Where, ladies and gentlemen, in God's name have the bureaucrats been able to seduce Congress over the years to change that provision? If it is good enough for mass murderers, it should be good enough for Mom and Dad, our taxpayers.¹⁰

Bill Provisions

Section 3001 of the bill added a new IRC § 7491. The general rule is that if a taxpayer introduces credible evidence on a factual issue in a court proceeding dealing with income taxes, estate and gift taxes, self-employment taxes, or generation-skipping taxes, then the IRS has the burden of proof on that issue. Credible evidence is, according to the conference report, H.Rept. 105-599, at 240-241,

the quality of evidence which, after critical analysis, the court would find sufficient upon which to base a decision on the issue if no contrary evidence were submitted (without regard to the judicial presumption of IRS correctness). . . . The introduction of evidence will not meet this standard if the court is not convinced that it is worthy of belief.

The taxpayer still has to comply with any substantiation requirements; maintain all records required by the Code and regulations; and cooperate with reasonable IRS requests for witnesses, information, documents, meetings, and interviews. If the taxpayer is not an individual, there are maximum net worth requirements. Corporations, trusts, and partnerships with a net worth of more than \$7 million are ineligible to use this provision.

This new provision does not override any existing Code section which provides for a specific burden of proof. The new provision always imposes the burden on the IRS in two specific situations. First, if an item of income was reconstructed by the IRS solely through the use of statistical information on unrelated taxpayers, the IRS will have the burden of proof. Second, the IRS has the burden of production in court proceedings where an individual is liable for a penalty, addition to tax, or additional amount under the Code.

The provision applies to court proceedings arising in connection with examinations commencing after the date of enactment, July 22, 1998. If there is no IRS examination, the provision applies to court proceedings arising in connection with taxable periods or events beginning or occurring after the date of enactment.

Since taxpayers have to maintain records required to substantiate any item and to cooperate with the IRS, including providing access to witnesses and records in a timely

⁹ 143 Cong. Rec. H10024 (daily ed. Nov. 5, 1997).

¹⁰ 143 Cong. Rec. H10031 (daily ed. Nov. 5, 1997).

fashion, this provision may not have a great impact on the conduct of tax trials.¹¹ Many tax disputes are settled before trial. Presumably, those kinds of disputes will continue to be resolved as they were before; however, the shifting of the burden of proof might induce more taxpayers to risk the hazards of litigation because the balance of proof would be tilted in their favor. Shifting of the burden of proof might induce the IRS to favor settling more cases administratively because of the hazards of litigation.

If the case goes to trial, the IRS will have to do careful trial preparation. With the government bearing the burden of proof, the IRS will have to produce more, and more credible, evidence than the taxpayer. The IRS will not be able to rely on statistics alone to make its case. If neither the taxpayer nor the IRS introduces evidence about penalties, then the IRS will not be sustained on the penalty issue. Under prior law, many of the penalties were automatically calculated and imposed based on amount owed and length of time the tax was owed.

Because taxpayer cooperation is a condition of shifting the burden of proof, taxpayers have at least as great an incentive to cooperate with the IRS at the administrative level as they did under prior law. It is possible the first part of any court proceeding will involve a determination as to whether the taxpayer has cooperated with the IRS and which party should bear the burden of proof. This could add to the length and complexity of trials and could create a new ground for appealing an adverse decision. If the burden is not shifted to the government because of lack of taxpayer cooperation, taxpayers would continue to litigate under the same conditions as under prior law.

If the burden is shifted to the government, there may or may not be a change in the trial outcomes. Since it is possible that courts will continue to operate much as they do now, retaining a presumption of correctness for IRS determinations and the requirement that taxpayers produce the evidence over which they have control, the shift in the burden of proof may simply mean that ties go to the taxpayer. It is possible that a shift of the burden of proof may cause the government to become more intrusive in its search for evidence and in its demands for cooperation in order to build its case. Congress may be asked to impose more onerous record keeping requirements, or the IRS may impose such requirements on its own authority, so that taxpayers could be required to generate and keep information that the IRS might need should litigation arise. Failure to keep such records could give rise to unfavorable presumptions against the taxpayer. Increased intrusiveness and increased record keeping burdens could affect all taxpayers, not just those with tax disputes they are litigating against the government.

¹¹ E.g., Tax Court Rule 91 requires parties to stipulate to all relevant matters on which complete or partial agreement can be reached, regardless of whether the matters involve fact, opinion, or the application of law to fact. Rules 120-124 describe various procedures for decisions without trial, including judgment on the pleadings and summary judgment.