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Burden of Proof and Choice of Forum in Tax Litigation

The authors consider the burden of proof rules in Tax Court and in refund suits as these rules bear upon the taxpayer's choice of forum in tax litigation. The article points out that Rule 32 of the Tax Court Rules of Practice, as it regards burden on proof on new matters, is not as straightforward as it may appear and that the apparently contrary rule applied in most refund suits is based upon distinguishable precedents and lack of proper analysis. Because the Tax Court and the refund suit are merely alternative methods of resolving tax disputes, the authors conclude that the choice of forum should not affect the outcome of tax litigation. Therefore, they advocate the formulation of rules which are clear enough to facilitate an enlightened choice of forum, and which either provide consistent treatment regardless of forum or permit an escape from a forum choice made before the full scope of the issues is known.

George L. Whitfield
and
Charles E. McCallum[*]

Since the burden of proof may be a decisive factor in tax litigation, it is important that the taxpayer be aware of the different rules in the various forums to which he may take a tax controversy, and it is essential that those rules operate fairly and consistently to enable the taxpayer to choose his forum intelligently. It is the purpose of this article to examine the burden of proof in tax litigation as it affects the choice of forum problem.

I. CHOICE OF FORUM IN TAX LITIGATION

A. *Factors Governing Choice of Forum*

When a tax controversy reaches the stage at which a statutory notice of deficiency is issued, the taxpayer's counsel must promptly[1] choose the forum in which the matter is to be litigated. Three alternatives[2]

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1. The filing of a petition in the Tax Court within 90 days after the mailing of the deficiency notice is jurisdictional. Because of the time required to prepare a petition, the choice of forum usually must be made within 30 to 60 days after the deficiency notice is received.

2. A fourth alternative—ignore the deficiency notice, fail to pay the tax and wait

are open: a petition in Tax Court, a refund suit in district court, or a refund suit in the Court of Claims. The choice of forum will be determined by weighing a variety of considerations. While these considerations have been adequately explored in the literature,[3] a brief review of some of them will be useful as a background for the subsequent discussion.

1. *Favorable Precedent.*—Although Tax Court decisions are subject to review by the circuit courts, the Tax Court considers itself a national court, free to adopt rules of law in conflict with those laid down by one or more circuit courts.[4] Likewise, the Court of Claims is not bound by decisions of either the Tax Court or a circuit court. Thus, the existence of favorable or unfavorable precedent in the available forums may be the deciding factor in the choice of forum.

2. *Jury Trial.*—A jury trial is available only in district court. It is generally believed that jurors are sympathetic towards taxpayers and are more apt to be influenced by the equities of the case and the manner of presentation. Nevertheless, in a jury trial a taxpayer must convince twelve jurors, rather than one judge, that he is entitled to prevail. Also, the advantage of a jury trial is questionable when the taxpayer is a corporation or other business entity.

3. *Right of Appeal.*—Decisions of the Tax Court or a district court can be appealed to a circuit court. A decision of the Court of Claims is reviewable only in the United States Supreme Court by certiorari, which is infrequently granted. Of course, the decision of the hearing commissioner in the Court of Claims may be appealed to the entire court.

4. *Discovery.*—Liberal discovery will ordinarily operate to the advantage of the government, since the taxpayer already has free access to his own records. In district court refund suits, the full discovery procedures permitted by the Federal Rules of Civil Procedure are available. Discovery in the Court of Claims is much more limited because it requires leave of the court. Discovery in Tax Court is rare.

5. *Familiarity with Tax Litigation.*—Undoubtedly, Tax Court judges have the highest degree of knowledge and sophistication with respect to tax litigation. The Court of Claims would be next, since it handles

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for the government's collection action—is usually to be avoided because of the risk of penalties and expensive interference (through tax liens, garnishments and the like) with business or personal affairs.

3. *See, e.g., Tax Court Litigation—Forum; Pleadings*, BNA TAX MANAGEMENT PORTFOLIO No. 152, at A-18-24 (1967).

4. Arthur L. Lawrence, 27 T.C. 713 (1957), *rev'd on other grounds*, 258 F.2d 562 (9th Cir. 1958).

a substantial number of tax cases, and the distrct courts would be least knowledgeable in the area. Technical and involved claims or defenses would perhaps be more likely to succeed before a forum possessing some measure of expertise.

6. *Burden of Proof.*—In Tax Court, the taxpayer must show the Commissioner's determination to be incorrect. If he succeeds, then the Commissioner must go forward and prove the correct tax liability by a preponderance of the evidence.[5] In a refund suit, the cases have generally implied that the taxpayer has the burden of proving himself entitled to the refund against any claim made by the government, whether or not set forth in the deficiency notice.[6]

7. *Settlement.*—Settlement negotiations in refund cases are normally conducted with the Department of Justice attorney who will try the case, although other government representatives may be present and Internal Revenue Service approval may be solicited. On the other hand, early settlement discussions in Tax Court may not involve trial counsel.

8. *Oral Argument.*—Oral argument is virtually nonexistent in Tax Court. It is freely permitted in the Court of Claims upon request, and is available as of right, in the same manner as in any other suit, in district court.

9. *Payment.*—Payment in full is a prerequisite to a refund suit in the district courts or the Court of Claims. Especially when the deficiency is large, this factor alone may dictate that the matter be taken to the Tax Court.

B. *Choice of Forum and New Matters*

The failure of the taxpayer to file a timely petition in the Tax Court bars his entry into that forum.[7] Likewise, the filing of a petition in Tax Court prevents any later claim for refund for the same taxable year.[8] Thus, the choice of forum, at least as between Tax Court and refund suit, is irrevocable. Therefore it is of utmost importance that counsel be fully aware of all the contested issues in his case prior to making his election.

5. *See* text accompanying notes 13-19 *infra.* As noted there, it has been suggested that when a deduction is disallowed the taxpayer bears the burden of proving not only that the Commissioner's grounds for disallowance are incorrect, but also that all elements necessary to justify the deduction are present.

6. *See* text accompanying notes 53-89 *infra.*

7. INT. REV. CODE OF 1954, § 6213.

8. INT. REV. CODE OF 1954, § 6512.

Not infrequently, however, the Commissioner may raise a new issue in his answer to a Tax Court petition or a refund suit which was not disclosed in the statutory notice of deficiency. In one Tax Court case,[9] the Commissioner's answer asserted that the taxpayer was on an accrual rather than a cash basis, as reported on his return. The deficiency notice was silent as to accounting method. In another case,[10] the deficiency notice and the denial of the claim for refund were based upon the disallowance of a cost of sales deduction for that portion of the purchase price in excess of the legal ceiling, on the ground that to permit such a deduction violated public policy. In the refund suit the government abandoned this ground, but placed in issue by its answer whether over-ceiling prices had in fact been paid.

Although the government ordinarily is not barred from introducing new elements into a tax controversy,[11] the existence of a new issue may frustrate the calculations which led to the taxpayer's choice of forum, and arguably the government should assume, to some extent, the burden of proof as to such new matter. This article analyzes the cases both in Tax Court and in refund suits dealing with burden of proof and offers some suggestions for the resolution of apparent inequities.[12]

II. BURDEN OF PROOF AS TO NEW MATTER IN TAX COURT

The burden of proof in Tax Court is allocated by Rule 32 of the Tax Court Rules of Practice:

9. Thomas W. Briggs, 15 CCH Tax Ct. Mem. 440 (1956).

10. United States v. Harris, 216 F.2d 690 (5th Cir. 1954).

11. Some cases have indicated that the government may be absolutely precluded from raising new issues as to which the substantive law required an "affirmative, discretionary determination" by the Commissioner, such as § 482. In Maxwell Hardware v. Commissioner, 343 F.2d 713 (9th Cir. 1965), an appeal from Tax Court, the court said: "With respect to the tax liability of Maxwell Hardware, no reliance may be placed on section 482 to justify a decision because the Commissioner did not rely upon it and gave no notice of such issues in his Notice of Deficiency to Maxwell Hardware." *Id.* at 721. *Accord,* Luke v. Commissioner, 351 F.2d 568 (7th Cir. 1965), *aff'g* 23 CCH Tax Ct. Mem. 1022 (1964) (dictum); United States v. First Security Bank, 334 F.2d 120 (9th Cir. 1964) (refund suit). Both *Maxwell Hardware* and *First Security Bank* cite Commissioner v. Chelsea Prods., Inc., 197 F.2d 620 (3d Cir. 1952), which held only that § 482 could not be raised for the first time at trial since the Commissioner had the duty to give the taxpayer fair notice of his intention to rely on it. *Contra,* Nat Harrison Associates, Inc., 42 T.C. 601 (1964), *acquiesced in,* 1965-2 CUM. BULL. 5, which may be qualified by the court's observation that although § 482 was not mentioned in the deficiency notice or pleadings, the taxpayer was fully aware that it was at issue. It should also be noted that in some instances the government may be absolutely barred from raising items from a different taxable year. *See* Dysart v. United States, 340 F.2d 624, 627 (Ct. Cl. 1965).

12. This article will not consider the "surprise" cases—those cases where the government raises an issue so late as to prejudice the taxpayer in his trial preparation.

> The burden of proof shall be upon the petitioner, except as otherwise provided by statute, and except that in respect of any new matter pleaded in his answer, it shall be upon the respondent.[13]

This is frequently expressed as a presumption of the correctness of the Commissioner's determination,[14] with the taxpayer having the burden of proving it incorrect.[15] If the taxpayer sustains this burden, then the burden of proving the correct amount of tax due shifts to the Commissioner.[16] However, the initial burden on the taxpayer operates separately as to each item making up the deficiency, and even though the Commissioner's determination is shown to be incorrect as to some items, the presumption of correctness continues as to the others.[17]

The cases generally have failed to distinguish between burden of persuasion and burden of going forward with evidence. The few that have made the distinction indicate that the taxpayer initially has both burdens,[18] and that both burdens shift to the Commissioner once the taxpayer has shown the determination to be incorrect.[19]

A. *Rule 32 Places Burden on Commissioner*

Rule 32 provides that as to "new matter pleaded in his answer" the burden of proof is on the Commissioner. On its face, this provision does not appear difficult to interpret or apply and, indeed, a number of cases support its straightforward application.[20] In *A. F. Lowes*

13. Rule 32 was adopted pursuant to INT. REV. CODE OF 1954, § 7453, and upheld in Golbert v. Renegotiation Bd., 254 F.2d 416 (2d Cir. 1958).

14. *See, e.g.*, 9 J. MERTENS, LAW OF FEDERAL INCOME TAXATION § 50.61 (Zimet rev. ed. 1965).

15. The burden of proof rests on the Commissioner by statute in some instances, as, for example, in fraud or transferee cases. INT. REV. CODE OF 1954, §§ 6902(a), 7454(a).

16. Herbert v. Commissioner, 7 CCH 1967 STAND. FED. TAX REP. (U.S. Tax Cas.) ¶ 9160 (9th Cir. Dec. 30, 1966); Grubb v. Commissioner, 315 F.2d 753 (6th Cir. 1963); Stout v. Commissioner, 273 F.2d 345 (4th Cir. 1959); Cohen v. Commissioner, 266 F.2d 5 (9th Cir. 1959).

17. Anderson v. Commissioner, 250 F.2d 242 (5th Cir. 1957), *cert. denied*, 356 U.S. 950 (1958).

18. Herbert v. Commissioner, *supra* note 16.

19. Herbert v. Commissioner, *supra* note 16; Merritt v. United States, 327 F.2d 820 (5th Cir. 1964) (dictum). Hereafter "burden of proof" will include both the burden of persuasion and the burden of going forward, unless otherwise indicated.

20. *See, e.g.*, James M. Pierce Corp. v. Commissioner, 326 F.2d 67 (8th Cir. 1964); Commissioner v. Erie Forge Co., 167 F.2d 71 (3d Cir. 1948); Commissioner v. Fleming, 155 F.2d 204 (5th Cir. 1946); Commissioner v. Hofheimer's Estate, 149 F.2d 733 (2d Cir. 1945); Athens Roller Mills, Inc. v. Commissioner, 136 F.2d 125 (6th Cir. 1943); Eva Rubin, 22 CCH Tax Ct. Mem. 1089 (1963); A. F. Lowes Lumber Co., 19 CCH Tax Ct. Mem. 727 (1960); Leon Papineau, 28 T.C. 54 (1957); Thomas Wilson, 25 T.C. 1058 (1956); Sheldon Tauber, 24 T.C. 179 (1955), *acquiesced in*, 1955-2 CUM. BULL. 9; Cedar Valley Distillery, Inc., 16 T.C. 870 (1951), *acquiesced in*, 1951-2 CUM. BULL. 2; Kimbell-Diamond Milling Co., 10 T.C. 7 (1948), *aff'd per curiam*, 187 F.2d 718 (5th Cir. 1951), *cert. denied*, 342 U.S. 827 (1951).

Lumber Co.,[21] the deficiency notice disallowed a loss deduction on a ground which was rejected by the Tax Court. In Tax Court, the Commissioner asserted as an additional ground that the loss had not been incurred in the taxable period under review. Holding against the Commissioner on that ground also, the court said that "when respondent departs from the grounds relied on in his deficiency notice to sustain a theory later raised, he has the burden of proving any new matter raised."[22] Again, in *Daniel H. Axelroad*,[23] the deficiency notice attacked the figure reported by the taxpayer as gross profits, but did not challenge his figure for gross sales. When the Commissioner raised this issue in the Tax Court, it was held that he had the burden of proof under Rule 32, and that he had failed to sustain it.

In ruling that the Commissioner has the burden of proof, the courts occasionally appear to rely on the fact that the Commissioner's new assertions resulted in increased deficiencies.[24] This is not required for the operation of Rule 32, and is no more than an unnecessary alternative basis for placing the burden of proof on the Commissioner, as was recognized by the Sixth Circuit Court of Appeals in *Athens Roller Mills, Inc. v. Commissioner*[25] although the Commissioner there asked for increased deficiency.[26] The likely explanation of this and similar cases is that the courts have used an increased deficiency as a signal that "new matter" is involved, rather than simply new theory.[27] For example, in *Leon Papineau*[28] the court noted, in ruling that the Commissioner had the burden of proof, that the new grounds asserted by him resulted in a decreased, rather than an increased, deficiency.

Another line of cases appears to attach some significance to the inconsistency of the new grounds asserted with those alleged in the deficiency notice. In *Cedar Valley Distillery, Inc.*[29] the statutory notice alleged that a partnership was a sham. Later the Commissioner changed his ground and asserted that, while the partnership existed, the interest reported as belonging to one partner actually belonged to another. The court held that the Commissioner had the burden of proving this new assertion, but commented that he could have

21. 19 CCH Tax Ct. Mem. 727 (1960).
22. *Id.* at 743.
23. 21 CCH Tax Ct. Mem. 626 (1962).
24. *See, e.g.*, W. H. Weaver, 25 T.C. 1067 (1956).
25. *Supra* note 20.
26. "The disallowed item here in question was brought into the record as new matter by the respondent. Rule 32 . . . provides that the burden of proof . . . in respect to any new matter plead in his answer . . . shall be upon respondent. *Aside from the rule*, the burden of proof rests on the Commissioner where he seeks an increase in the deficiency on a ground not stated in his statutory notice of deficiency." *Supra* note 20 at 127-28 (emphasis added).
27. *See* text accompanying note 31 *infra*.
28. 28 T.C. 54 (1957).
29. 16 T.C. 870 (1951), *acquiesced in*, 1951-2 Cum. Bull. 2.

protected himself by making alternative inconsistent determinations in the notice. Similarly, in *Eva Rubin*[30] the deficiency notice had characterized certain advances as non-business bad debts, but the Commissioner subsequently argued that they were contributions to capital. The court held that the Commissioner had the burden of proof on this new ground, citing Rule 32 as the basis for so holding, but noting in addition that the new ground was inconsistent with the one previously asserted. Rule 32 does not indicate that new matter must be inconsistent with the previous determination before the burden of proof will be placed upon the Commissioner, and it is suggested that here again the courts have merely used the existence of inconsistency as a convenient indication that the new grounds are "new matter" and not merely new theory.[31]

B. *Contrary Authority Can Be Reconciled*

Despite the apparent abundance of authority for a straightforward application of Rule 32, many courts have found the phrase "new matter" "exceedingly difficult to define and apply."[32] It has even been suggested that the cases are irreconcilable.[33] A careful reading reveals, however, that most of the cases can be reconciled with the analysis set forth above, or convincingly demonstrated to be in error.

1. *Mistaken Reliance on Refund Cases.—Bernstein v. Commissioner*[34] is typical of those cases which have mistakenly imported refund suit rules into Tax Court proceedings. In *Bernstein* the deficiency notice asserted that certain bank deposits represented unreported sales of a partnership. Subsequently, the Commissioner claimed that these deposits were unreported income of the decedent taxpayer, rather than sales of the partnership, and therefore were fully includible in his income. Ruling that the burden of proof remained on the taxpayer, the court said that "the taxpayer has the burden of showing that the assessment is wrong on any proper theory."[35] As discussed below,[36] the burden of proof rule in refund cases has long been held to be different from that in Tax Court.[37] But all of the authorities cited by the Fifth Circuit in *Bernstein* stem from the Supreme Court decision in *Reinecke v. Spalding*,[38] which was

30. 22 CCH Tax Ct. Mem. 1087 (1963).
31. *See* text accompanying note 46 *infra.*
32. Forman, *The Burden of Proof*, 39 TAXES 737, 740 (1961).
33. Marcossan, *The Burden of Proof in Tax Cases*, 29 TAXES 221 (1951).
34. 267 F.2d 879 (5th Cir. 1959).
35. *Id.* at 881.
36. *See* text acompanying notes 53-55 *infra.*
37. *See, e.g.*, DuPont v. United States, 234 F. Supp. 681 (D. Del. 1964).
38. 280 U.S. 227 (1930).

a refund suit. Thus, *Alexander Sprunt & Son v. Commissioner*,[39] cited in *Bernstein*, relies upon *J. & O. Altschul Tobacco Co. v. Commissioner*,[40] also cited in *Bernstein*. *Altschul* in turn relies on *Reinecke*, as does *Gowran v. Commissioner*,[41] the sole remaining authority cited on this point in *Bernstein*. Other cases reflect the same error.[42]

2. *New Theory*.—Some cases have drawn a distinction between "new matter" and new theory, holding that the burden of proof remains on the taxpayer when the Commissioner merely relies on a new theory to sustain a deficiency already asserted in the statutory notice.[43] Such a rule will not stand careful analysis. Burden of proof has meaning only in relation to disputed issues of fact. When the facts are conceded, or when a new claim asserted by the Commissioner places no fact in dispute which was not already in issue under the statutory notice, there is no justification for shifting the burden of proof. Thus, for example, in *Hilbert L. Bair*[44] the facts were stipulated. In the deficiency notice the Commissioner had set forth a theory that the taxpayer constructively received certain unreported income. Subsequently, relying upon the stipulated facts, the Commissioner urged a theory of actual receipt. In such a context, the location of the burden of proof is meaningless, since the court must decide the legal effect of settled facts without regard to any presumptions or burdens.[45] Consequently, the phrase "new matter" in Rule 32 should be read to mean "new factual matter,"[46] and the burden of proof should rest on the Commissioner as to new factual matters raised or relied upon in his answer and not previously in issue under the statutory notice of deficiency. This would permit the reconciliation of almost all of the "new theory" cases, with the possible exception of those following *Burnet v. Houston*,[47] which holds that when a deduction has been disallowed, the taxpayer has the burden of proving not only that the grounds for disallowance in the deficiency notice are erroneous, but also every factual element necessary to support the deduction, apparently on the premise that deductions are matters of legislative grace.

39. 64 F.2d 424 (4th Cir. 1933).

40. 42 F.2d 609 (5th Cir. 1930).

41. 87 F.2d 125 (7th Cir. 1936).

42. *See, e.g.*, Beaumont v. Helvering, 73 F.2d 110 (D.C. Cir. 1934); Crowell v. Commissioner, 62 F.2d 51 (6th Cir. 1932).

43. *See* Helvering v. Gowran, 302 U.S. 238 (1937); Forman, *supra* note 32. In *Gowran* the Court pointed out that the facts were "undisputed."

44. 16 T.C. 90 (1951).

45. Ray v. Commissioner, 283 F.2d 337 (5th Cir. 1960).

46. *See* George B. Markle, Jr., 17 T.C. 1593 (1952).

47. 283 U.S. 223 (1931). *See, e.g.*, Clapp v. Commissioner, 321 F.2d 12 (9th Cir. 1963); Melvin Rogers, 24 CCH Tax Ct. Mem. 36 (1965).

3. *Broadly Worded Deficiency Notice.*—A third line of cases holds that the burden of proof does not shift to the Commissioner if the deficiency notice is stated in terms broad enough to encompass the later asserted ground. In one case,[48] the deficiency notice had stated that a certain distribution was "fully taxable . . . at ordinary income rates under the provisions of the Internal Revenue Code of 1939."[49] The Commissioner subsequently relied on the collapsible corporation provision.[50] The court held that the burden of proof remained on the taxpayer, since the broad wording of the deficiency notice was sufficient to raise the collapsible corporation issue. To the same effect is *C. D. Spangler*,[51] in which the court of appeals opinion stated:

> As the Tax Court points out . . . the deficiency notice originally was in broad terms. There was no inconsistency or conflict between the notice and the Commissioner's later answer to the taxpayer. We therefore agree that the burden of proof did not shift to the Commissioner. . . .[52]

III. Burden of Proof as to New Matter in Refund Suits

The taxpayer's alternative to an action in Tax Court is a suit for refund[53] after payment of the tax in either a United States district court or the United States Court of Claims. As we have noted, there may be compelling reasons for the election of this option and the choice of one of these forums. However, the decision to sue for refund must be weighed carefully in each case because the cases commonly state that the burden of proof is somewhat greater in refund suits.[54]

In the normal case in which the government's position remains consistent with the statutory notice of deficiency throughout, the basic issue involves not only the correctness of the Commissioner's

48. Arthur Sorin, 29 T.C. 959 (1958), *aff'd per curiam*, 271 F.2d 741 (2d Cir. 1959), *acquiesced in*, 1958-1 Cum. Bull. 6.

49. 29 T.C. at 968.

50. Int. Rev. Code of 1939, § 117(m) (now Int. Rev. Code of 1954, § 341).

51. 32 T.C. 782 (1959), *aff'd*, 278 F.2d 665 (4th Cir. 1960), *cert. denied*, 364 U.S. 825 (1960). It should be noted that *Spangler* overruled Thomas Wilson, 25 T.C. 1058 (1956), where on nearly identical facts the Tax Court had said that "[w]hile a statutory notice of deficiency is presumed correct, and a petitioner has the burden of disproving its correctness, when the Commissioner departs from the grounds relied on in his deficiency notice to sustain a theory later raised, he has the burden of proving any new matter raised." *Id.* at 1066.

52. 278 F.2d at 670. *See also* Luke v. Commissioner, 351 F.2d 568 (7th Cir. 1965), *aff'g* 23 CCH Tax Ct. Mem. 1022 (1964); Little v. Commissioner, 273 F.2d 746 (1st Cir. 1960); Barbourville Brick Co., 37 T.C. 7 (1961).

53. There are, of course, refund suits which are not preceded by a statutory notice of deficiency, as in First Nat'l Bauk v. United States, 235 F. Supp. 331 (S.D. Fla. 1964). There is also the possibility of a collection suit by the government, as in United States v. Lease, 346 F.2d 696 (2d Cir. 1965).

54. *See, e.g.*, Commissioner v. R. J. Reynolds Tobacco Co., 260 F.2d 9 (4th Cir. 1958).

specific determinations but also the more general question of whether the taxpayer has overpaid his tax.[55] Inherent in this statement is the imposition of the burden of proof upon the taxpayer to demonstrate sufficient facts from which a correct determination of the tax, insofar as the items and theories cited in the deficiency notice are concerned, may be made.[56] But the problems are to determine what the rule is with respect to new factual issues subsequently advanced by the government to support the same deficiency, and to determine what principles are to govern when the Commissioner asserts new items in the same return or other deficiencies in unrelated returns as defenses to the refund suit.[57] The danger of confrontation with an unanticipated issue in this respect cannot be ignored in any consideration of the factors relevant to the choice of forum. A cursory review of the language frequently expressed to describe the nature and function of refund suits intimates that the burden of proof must remain with the taxpayer across an extremely broad framework of potential defenses.[58] Nevertheless, the extent to which the burden of proof has been imposed upon claimants in refund suits faced with new matters, and the extent to which it ought to be, is far less clear than the language of many opinions would imply.

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55. Compton v. United States, 334 F.2d 212 (4th Cir. 1964); Light Aggregates, Inc. v. United States, 225 F. Supp. 253 (W.D.S.D. 1963), *rev'd on other grounds*, 343 F.2d 429 (8th Cir. 1965); Myers v. United States, 134 F. Supp. 520 (Ct. Cl. 1955), *further opinion*, 142 F. Supp. 365 (Ct. Cl. 1956); 10 J. Mertens, Law of Federal Income Taxation §§ 58A.01, 58A.35 (Zimet rev. ed. 1965).

56. Roybark v. United States, 218 F.2d 164 (9th Cir. 1954).

57. Any generalization of this nature has exceptions. For example, the same item is in issue when the government belatedly raises tax liability which would result from its inclusion in a return for another year, Ryan v. Alexander, 118 F.2d 744 (10th Cir. 1941); or for another closely related taxpayer, Stone v. White, 301 U.S. 532 (1937). Furthermore, the nature of the "item" in dispute is not always clear as in David v. Phinney, 350 F.2d 371 (5th Cir. 1965), in which it could have been the purchase price of an option or the entire capital gains of the taxpayer under permissible interpretations. Finally, the new matter can be a distinct, non-tax debt. Woodward v. United States, 109 F. Supp. 414 (Ct. Cl. 1953).

58. Examples are cited at notes 87 & 88 *infra*. The principal example and leading case is Lewis v. Reynolds, 284 U.S. 281 (1932). Any discussion of burden of proof in refund suits must be formulated in view of this case, for it illustrates both the unrestricted statements and the absence of a squarely presented issue with respect to burden of proof; and these two factors form the basis of many of the conclusions in this section. At issue was the right of the government to raise a new and different item on the same tax return in defense of a refund claim, when a new deficiency based upon the new item was barred by the limitations period. No issue as to the burden of proof upon the defense is revealed by the opinion, and the rationale of the decision must be limited to approval of the defense. The broad language adopted by the court, however, could imply burden of proof rules: "It follows that the ultimate question presented for decision, upon a claim for refund, is whether the taxpayer has overpaid his tax. This involves a redetermination of the entire tax liability. . . . The action to recover on a claim for refund is in the nature of an action for money had and received and it is incumbent upon the claimant to show that the United States has money which belongs to him." 284 U.S. at 283.

In a refund suit in which the government does not depart from the statutory notice, both the burden of going forward and the burden of persuasion require that the taxpayer produce sufficient evidence to justify the tax consequences which he contends should flow from the challenged items.[59] He may conclusively demonstrate that the theory of the deficiency is erroneous in law or fact or both and yet have the issue resolved against him.[60] Thus, he may be faced with an adverse decision in a case which would have been successful in the Tax Court forum,[61] where the only burden is to prove the incorrectness of the Commissioner's determination.[62] *Roybark v. United States*[63] is a classic example, for the decision is often cited in cases involving new defenses. The claimant was an automobile retailer who had deducted cost increments above the legal ceiling price of automobiles on the returns in question. Statutory notice was based upon the theory that these deductions were invalid. At trial, the taxpayer offered no proof other than the tax returns. By that time, decisions in several other cases had reached conclusions unfavorable to the government upon the same legal theory for the deficiency, and the trial court had no difficulty in agreeing.[64] Nevertheless, noting an obvious inaccuracy in the returns before the court, the government contended that the taxpayer had failed to meet his burden of proof.[65] Reluctantly, the court held that in spite of proving the Commissioner's theory erroneous, the taxpayer must fail, because he had not offered persuasive evidence on the precise amount of the deductions in question.[66] The Ninth Circuit affirmed with the observation that the principles relied upon by the lower court and argued by the govern-

59. *See, e.g.,* Compton v. United States, *supra* note 55.

60. "There can be little doubt that the theory behind the Commissioner's assessment was legally wrong, but that is not sufficient." Roybark v. United States, 104 F. Supp. 759, 762 (S.D. Cal. 1952), *aff'd,* 218 F.2d 164 (9th Cir. 1954) (taxpayers failed to offer sufficient proof to show they overpaid their taxes for the years in question). *See also* DuPont v. United States, *supra* note 37.

61. Undoubtedly in some cases there will be no difference in the quantum of proof sufficient to prove error on a factual issue by the Commissioner and to prove the correct amount of the tax liability.

62. *See* note 13 *supra* and accompanying text.

63. 104 F. Supp. 759 (S.D. Cal. 1952), *aff'd,* 218 F.2d 164 (9th Cir. 1954).

64. 104 F. Supp. at 760-61.

65. *Id.* at 761. Because black market prices were involved, taxpayer's records did not reflect details of the transactions, and he was presumably unwilling to testify. The government argued successfully that such records were not acceptable under the annual accounting concept of income tax reporting, and therefore failed to show adequately an overpayment.

66. The reasoning of the court was based principally upon the statements quoted from *Lewis v. Reynolds* in note 58 *supra,* and statements in Taylor v. Commissioner, 70 F.2d 619 (2d Cir. 1934), *aff'd sub nom.* Helvering v. Taylor, 293 U.S. 507 (1935), a Tax Court suit which contrasted, by way of dicta, the responsibilities of claimants in refund suits and in Tax Court cases.

ment in the appeal appeared to be settled law.[67] Thus, in *Roybark* there was no new theory. On appeal the government virtually conceded the erroneous basis for its deficiency assertion and relied upon the burden of proof.[68]

If, as *Roybark* demonstrates, the taxpayer must not only show error by the Commissioner but also prove the essential facts establishing the correct tax consequences of the items challenged in the deficiency notice, the result cannot logically be different where the government asserts new factual theory for the same deficiency based upon the same items.[69] There is no real distinction between the two situations, except that in the latter the government has assumed a more affirmative role by pointing expressly to new and different ways in which the taxpayer's case on the items in issue may be deficient. Moreover, it is reasonable to require a taxpayer to anticipate and be prepared for such defenses when he knows the item is in issue.

Although it would appear, as the Ninth Circuit observed, that the basic burden of proof rule with respect to the items encompassed by the statutory notice, with or without new factual issues, is settled law, there are cases which demonstrate otherwise.[70] If these cases are not erroneous, they are deprived of vitality by their complete reliance upon Tax Court cases or by unsupported reasoning similar to that in many Tax Court decisions.[71] Arguments by the taxpayer based upon

67. 218 F.2d at 166.

68. It should be noted for purposes of the subsequent discussion that, in spite of the broad language of the opinion and its reliance upon cases with similarly general expressions, the rationale of the decision is necessarily confined to instances where no new factual matter or new items are raised in defense.

69. The statement may be illustrated by comparing Roybark, *supra* note 60, with United States v. Harris, 216 F.2d 690 (5th Cir. 1954), which also involved deduction of over-ceiling prices of automobiles. In *Harris*, though, the government specifically denied the fact of such payments even though the earlier revenue agent's report indicated that they had been made. Reversing an order granting summary judgment for the taxpayer, the court held that this new theory for the disallowed items created a factual issue upon which the taxpayer clearly bore the burden of proof. Aside from *Harris*, cases illustrating the point are rare. If it be assumed that David v. Phinney, 350 F.2d 371 (5th Cir. 1965), imposes the burden upon the taxpayer to prove the absence of value for a covenant not to compete, which issue was subsequently raised in further support of the deficiency, then that case is illustrative. The applicability of DuPont v. United States, *supra* note 37, is unclear since the new basis for the defense, if any, was not described. Morrill v. United States, 228 F. Supp. 734 (S.D. Me. 1964), is technically in point, but there the new basis for the deficiency appears to have resulted from a mere administrative error that should have been apparent to the taxpayer. Finally, Blansett v. United States, 283 F.2d 474 (8th Cir. 1960) (see also opinion below at 181 F. Supp. 637), is considered inapplicable on close analysis.

70. United States v. First Wis. Trust Co., 92 F.2d 840 (7th Cir. 1937); Service Life Ins. Co. v. United States, 189 F. Supp. 282 (D. Neb. 1960), *aff'd on other grounds*, 293 F.2d 72 (8th Cir. 1961); Massingale v. United States, 59-1 U.S. Tax Cas., ¶ 9298 (D. Ariz. 1959).

71. In Massingale v. United States, *supra* note 70, the court held, without citing authority, that the taxpayer has the burden of proving the incorrectness of the statutory

two of them were ill-fated in the only case which has discussed them to date, in which the Delaware district court rejected them in favor of what it described as the more persuasive reasoning in *Roybark*.[72] They should, therefore, be given little credence as contrary authority or a minority view.[73]

The more difficult question is the rule to be applied in cases where the government raises a new and unrelated item in the same return or an item in another return. With respect to the former, two cases discuss the issue and clearly impose the burden of proof upon the taxpayer.[74] However, both of these cases place total reliance upon earlier decisions which are either distinguishable on the facts or did not involve burden of proof as an issue.[75] Other cases in point which contain broad language implying burden upon the taxpayer similarly do not indicate that burden of proof was raised and argued by either party.[76] Two cases reach a contrary result, placing the burden of proof upon the government, but one has been expressly overruled and the other relies indiscriminately upon Tax Court decisions.[77]

With respect to new items in a different return, it appears that the only case of current vitality which meets the question directly and persuasively is the 1964 decision of the Court of Claims in *Missouri Pacific R.R. v. United States*.[78] This case also discusses the rule with respect to new items in the same return. At issue in *Missouri Pacific*

notice, but the burden of proof is on the Commissioner to prove any new matter raised when he departs from the assertions of the statutory notice to sustain a theory later raised.

72. DuPont v. United States, *supra* note 37.

73. *See* 10 J. MERTENS, *supra* note 55, § 58A.35 at 98.

74. United States v. Pfister, 205 F.2d 538 (8th Cir. 1953); First Nat'l Bank v. United States, 235 F. Supp. 331 (S.D. Fla. 1964).

75. First Nat'l Bank, *supra* note 53, states that the burden is upon the taxpayer with respcct to the entire return or returns in question, citing Roybark v. United States, 218 F.2d 164 (9th Cir. 1954) and Lewis v. Reynolds, *supra* note 58, without discussion. *See* notes 58 & 69 *supra*. Pfister, *supra* note 74, clearly imposes the burden upon the claimant with respect to a new item in the same return. The opinion paraphrases conclusions from a number of cases which are either from Tax Court, Helvering v. Taylor, *supra* note 66; or did not involve a new item, Roybark, *supra* note 56; or involved no issue on burden of proof, Rothensies v. Electric Storage Battery Co., 329 U.S. 296 (1946); Champ Spring Co. v. United States, 47 F.2d 1 (8th Cir. 1931). Again there is no comparative discussion of the authorities cited in the ease.

76. *See* Lewis v. Reynolds, *supra* note 58; Cuban R.R. v. United States, 254 F.2d 280 (2d Cir. 1958); Larrabee v. United States, 254 F. Supp. 613 (S.D. Cal. 1966).

77. In Squire v. Denman, 18 F. Supp. 287 (N.D. Ohio 1936), in which the new matters were not raised until trial, the court distinguished Lewis v. Reynolds, *supra* note 58, as not bearing upon burden of proof, but then cited only Tax Court cases for its conclusion that the burden was upon the government. The question of new matter was not considered on appeal. Squire v. Denman, 111 F.2d 921 (6th Cir. 1940).

78. 338 F.2d 668 (Ct. Cl. 1964). In reaching its conclusion, Stone v. White, *supra* note 57, and Ryan v. Alexander, *supra* note 57, were rejected, beeause the burden of proof was not in issue. United States v. Anderson, 269 U.S. 422 (1926), was rejected because, though different years were involved, this was clear from the outset.

was the effect of the commissioner's disallowance in the statutory notice of certain depreciation deductions on taxpayer's liability to pay excess profits tax. In defense of the suit for refund, the government alleged improprieties in the foreign tax credit in the claimant's 1950 income tax return as a set-off.[79] Taxpayer moved for an order fixing the burden of proof upon this defense, and the court commissioner imposed the burden upon the government.[80] The government appealed this pre-trial ruling to the full court. The court first discussed factual distinctions between new matters raised as defenses which involved new items in the same or a related and dependent return for the same year and new items involving an unrelated tax.[81] In this connection, the court viewed a new item involving the same type of tax for a different year as falling within the unrelated category.[82] The court discussed favorably prior authority which viewed a refund suit as in the nature of an action for money had and received, and which asserted that the entire tax liability of the claimant was thereby put in issue. Concluding, however, that these principles did not extend to new items involving an unrelated tax and, more importantly, that they were not controlling as to the burden of proof,[83] it stated that the burden of persuasion would remain upon the taxpayer with respect to new items in the same or a related return and that both the burden of going forward and the burden of persuasion would remain upon the government throughout as to new items involving

79. The government also maintained its position with respect to the items included in the original deficiency notice.

80. The hearing commissioner described his ruling as following a minority view, but he felt compelled to follow the earlier Court of Claims decision, Continental Ill. Bank & Trust Co. v. United States, 18 F. Supp. 229 (Ct. Cl. 1937), which was expressly overruled at the outset in the principal case on the finding that the burden of proof issues had not been adequately presented in the former.

81. Specifically, the court described the following four situations: "An item (1) found in the same tax year involving the same type of tax for which a refund is sought, (2) in the same year involving a different type of tax which, however, is related and ultimately affects the amount of tax liability involved in the suit for refund, (3) in the same year involving a different type of tax which is independent of and unrelated to the tax involved in the suit for refund, (4) in another year involving any type of tax whether related or unrelated." 338 F.2d at 670. This general language was given further explanation and limitation in a subsequent passage in the opinion: "Thus, when the government by way of a setoff challenges the validity of the tax treatment accorded an item found in the same return or in a related and dependent tax return (situations (1) and (2) outlined above), we think the burden of proving the correctness of the challenged item is ultimately on the taxpayer. When the challenged item is found in an unrelated tax return (situations (3) and (4)), we think that the burden of proof remains on the government throughout the entire proceedings." 338 F.2d at 671. The court also noted that it was not concerned with the right of the government to challenge items found in unrelated returns but only with the burden of proof once that right had been established.

82. *See* note 80 *supra.*

83. 338 F.2d at 671.

an unrelated tax. It further held, however, that the burden of going forward with evidence sufficient to demonstrate a reasonable basis in law or in fact, as opposed to mere theory, would rest upon the government in the first instance with respect to new items in the same or a related return.[84]

While it may not be possible to derive a general rule for refund suits on the basis of this case alone,[85] the case must be viewed as a welcomed venture beneath the surface of sterile phrases that have been repeated without careful scrutiny for more than thirty years. Its underlying conclusions should provide substantial assistance to counsel in seeking to avoid mechanical extensions of the basic burden of proof rules to more remote issues.

From the foregoing, it can be seen that any attempt to formulate currently applicable rules with respect to new items in the same or a different return is difficult. Most of the modern cases rely only upon *Lewis v. Reynolds* and *Roybark*, both of which can be distinguished; and *Roybark* in turn relies upon Tax Court cases,[86] cases that do not involve new items,[87] and cases which do not indicate that the burden of proof was directly in issue.[88] Aside from *Missouri Pacific R.R. v. United States*,[89] the cases demonstrate a common failure closely to analyze the prior decisions and to reach an informed conclusion. Further analysis is essential to careful development of rules which are both certain and fair.[90] It is hoped that the *Missouri Pacific* case is the first step in this direction.

84. In this connection the court commented upon the heavy cost to taxpayers if they were required to prove every item involved in a tax return. The court instructed its hearing commissioners to determine whether the government has met the burden of going forward at the pretrial.

85. While it was only necessary for the court to determine the burden of proof with respect to items in unrelated returns for purposes of the decision, it must be noted that the court was consciously establishing general burden of proof rules for the future in the Court of Claims.

86. Helvering v. Taylor, *supra* note 66; Beaumont v. Helvering, *supra* note 42; Alexander Sprunt & Son v. Commissioner, *supra* note 39. In this connection both opinions in *Roybark* are considered together.

87. Stone v. White, *supra* note 57; Reinecke v. Spalding, *supra* note 38; United States v. Harris, *supra* note 69; Harvey v. Early, 189 F.2d 169 (4th Cir. 1951); Maroosis v. Smyth, 187 F.2d 228 (9th Cir. 1951); Forbes v. Hassett, 124 F.2d 925 (1st Cir. 1942); Champ Spring Co. v. United States, *supra* note 75; Globe Gazette Printing Co. v. United States, 13 F. Supp. 422 (Ct. Cl. 1936).

88. Lewis v. Reynolds, *supra* note 58; Ryan v. Alexander, *supra* note 57; Routzahn v. Brown, 95 F.2d 766 (6th Cir. 1938); Swift Mfg. Co. v. United States, 12 F. Supp. 453 (Ct. Cl. 1935). Some of the cases cited in note 87 *supra* may be included in this category also.

89. *See* note 78 *supra*.

90. Morgan states that the test for allocating the burden ought to be and is under many modern decisions determined by considerations of fairness, convenience and policy. E. MORGAN, BASIC PROBLEMS OF EVIDENCE 17 (4th ed. 1963).

IV. CONCLUSION AND PROPOSALS

The foregoing discussion may be conveniently summarized by distinguishing several different contexts:

(a) Different Return. When in a refund suit the government asserts as a defense or set-off that the taxpayer owes a deficiency in tax for a different taxable year, or for a different tax, than that put in issue by the taxpayer, the government has the burden of proof as to such new matter.[91] This situation cannot arise in Tax Court, since it may only determine whether a particular deficiency is correct.

(b) Same Return—New Item. Suppose a statutory notice of deficiency is based upon the disallowance of a deduction for charitable contributions, and the government, at the litigation stage, claims for the first time that the taxpayer had unreported income from gambling in the same taxable year. This may be conveniently described as a "new item" which relates to the same taxable period. In Tax Court the government bears the burden of proof as to such a new item. Although the language in many cases suggests a contrary result in refund suits, the holdings of most of these cases do not support such a proposition. The cases squarely holding that the burden is on the taxpayer are of questionable authority. And one soundly reasoned case has suggested that at least the burden of going forward with the evidence is on the government.[92]

(c) Same Return and Same Item—New Factual Matter. Suppose in the previous situation the charitable deduction was originally disallowed on the ground that the donee did not qualify, and that the government later put in issue whether the amount reported was actually contributed. The same "item" is under scrutiny, but whereas the government formerly appeared to accept the taxpayer's statement as to the amount given, it subsequently introduced a new factual issue. In refund cases the taxpayer has the burden of proof with respect to such new matter. In Tax Court, on the other hand, most of the cases can be aligned with the view that, when the new ground asserted by the Commissioner raises new factual disputes, the burden of proof as to such fact questions will be on the Commissioner.[93] Some Tax Court cases have indicated that, in case of deductions, the more stringent refund suit rule may apply, but such a position is difficult to justify.

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91. Missouri Pac. R.R. v. United States, 338 F.2d 668 (Ct. Cl. 1964).

92. The Tax Court cases have not distinguished between "new item" and "same item" situations, but have applied the same rule in both. For example, Eva Rubin, *supra* note 20, and A. F. Lowes Lumber Co., *supra* note 20, both of which are in the "same item" category, hold that the burden of proof is on the Commissioner as to new factual matter.

93. *See* note 47 *supra* and accompanying text. A special rule for deductions would appear to have little to commend it.

(d) Same Return and Same Item—New Legal Theory. Finally, when the new ground asserted by the Commissioner is merely a new legal theory, and involves the allegation of no facts which were not previously in dispute, the burden of proof is not affected. For example, suppose the Commissioner disallowed a deduction on grounds of lack of substantiation. If he later claimed in addition that, even if the payment were made, to allow the deduction would be contrary to public policy, this new theory might involve no new facts. Both in Tax Court and in a refund suit the taxpayer would have the burden of proving the payment was made; a decision as to whether the law permits such a deduction would be made without the benefit of presumptions or burdens.[94]

Because refund suits and actions in Tax Court are today but alternative methods of contesting a tax deficiency, the choice of forum should not affect the result in litigation. Moreover, because of the finality of the taxpayer's choice of forum, fairness dictates that, if the taxpayer is to be afforded such a choice, he be permitted to make it with some assurance that the factual issues on which he must bear the burden of proof will not be changed.

For example, suppose an estate tax deficiency is based upon the inclusion in the estate of property allegedly transferred in contemplation of death. The taxpayer may well decide that this issue should be heard by a jury, and therefore follow the refund suit route. Now, if the Commissioner in his answer abandons this ground, but asserts that the decedent retained an interest in the property in question, the taxpayer is committed to a district court trial of a technical issue which he might have preferred to submit to the Tax Court.

Of course, the Commissioner is always free in the first instance to assert alternative, inconsistent bases for a deficiency. But if he does make such an assertion, the taxpayer is then informed as to what issues he must be prepared to meet. A tax case will commonly involve several issues, some of which might point to the Tax Court, while others indicate a district court or the Court of Claims. Since it is administratively impractical to allow separate trials on each issue, the taxpayer must weigh all the considerations and decide which forum, on the balance, would be the best for his case as a whole. What is important is that he have all the cards on the table when he makes that decision.

In order to avoid the burden of proof as to new matter, the Commissioner, in some instances, has worded the deficiency notice in broad and general terms. Carried to its logical extreme, this practice would, if condoned by the courts, permit a deficiency notice merely

94. *See* note 45 *supra* and accompanying text. *See also* United States v. Hover, 268 F.2d 657 (9th Cir. 1959).

to declare that so much is owed "under Section 11 of the Internal Revenue Code of 1954," with the burden of proof remaining on the taxpayer as to a later specification of how the deficiency is determined. Unfortunately, the Code does not require the deficiency notice to be in any particular form, or to specify the nature of the deficiency. And although the government can be compelled to make a vague deficiency notice more definite once the case is in the Tax Court, a district court, or the Court of Claims, the additional information will be too late to guide the taxpayer in the choice of forum. The law should be amended to require deficiency notices to specify the grounds for the deficiency in reasonable detail, and to extend the time for petition to Tax Court to permit a taxpayer to seek clarification of a vague deficiency notice.

In any discussion of the tax law, consideration must be given to the public policy in favor of protecting the tax revenues. On the question under discussion, considerations of fairness outweigh this policy. However, it may be urged that there should be a means for the government to change its grounds for a deficiency without assuming the burden of proof. Under present law, the sending of an amended deficiency notice is beyond the authority of the Commissioner.[95] If amended deficiency notices were permitted, a provision similar to that in section 7422(e),[96] which permits a fresh choice of forum in one situation, would satisfy consideration of fairness while affording the government the opportunity to inject new matters without assuming the burden of proof.

Whether or not remedial legislation is adopted, protection of the taxpayer in his choice of fornm is a factor which ought to be considered in fixing the burden of proof in tax litigation. If the proper weight is attached to this factor, and prior decisions are analyzed carefully in light of their precedential value, future courts in refund cases may arrive at a rule closer to that presently followed in the Tax Court.

95. Agnes McCue, 1 T.C. 986 (1943).
96. Int. Rev. Code of 1954, § 7422(e).