No. 17-60276

IN THE

United States Court of Appeals for the Fifth Circuit

PBBM-ROSE HILL, LIMITED; PBBM CORPORATION, TAX MATTERS PARTNER,

Petitioners-Appellants

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellee.

On Appeal from the United States Tax Court No. 26096-14
Judge Richard T. Morrison

BRIEF OF *AMICUS CURIAE* NATIONAL TAXPAYERS UNION IN SUPPORT OF APPELLANT PBBM-ROSE HILL'S PETITION FOR REHEARING *EN BANC*

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Corporate Disclosure Statement and Statement of Interested Parties

No. 17-60276 PBBM-Rose Hill, Limited, *et al*. v. CIR

Pursuant to Federal Rule of Appellate Procedure 26.1, *Amicus Curiae* National Taxpayers Union, hereby states, by and through counsel, that:

1. National Taxpayers Union is not a subsidiary of any other corporation.
2. No publicly held corporation owns 10% or more of its stock.

Pursuant to 5th Cir. R. 29.2, the undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

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PBBM Corporation, Tax Matters Partner

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Pat Bolin – President of PBBM-Rose Hill and PBBM Corporation; Limited Partner in PBBM-Rose Hill, LTD

Eaglecorp, Inc. – Limited Partner in PBBM-Rose Hill, LTD

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STATEMENT OF INTEREST

National Taxpayers Union is a non-partisan citizen group founded in 1969 to work for less burdensome taxes, more efficient government, and effective statutory as well as procedural safeguards for all taxpayers in the system of tax administration. This case raises fundamental issues about the statutory protections afforded to all taxpayers during the tax assessment process.[1]

INTRODUCTION

Congress passed the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105–206, by a combined total vote of 498–10. The Act implemented reforms aimed at protecting taxpayer rights. In particular, members of Congress expressed concern that IRS examiners were inflating initial penalty determinations to serve as "bargaining chip[s]" in settlement negotiations. S. Rep. No. 105-174, at 65 (Conf. Rep.) ("[T]axpayers are entitled to an explanation of the penalties imposed upon them. The Committee believes that penalties should only be imposed where appropriate and not as a bargaining chip.").

To stem this practice, § 6751 states that "[n]o penalty" under the Internal Revenue Code can be assessed "unless the *initial determination* of such assessment

[1] No counsel for either party authored this brief in whole or in part, and no entity or person, aside from *amicus curiae*, its members, and its counsel, made any monetary contribution toward the preparation or submission of this brief.

is *personally approved* (in writing) by the immediate supervisor of the individual making such determination." 26 U.S.C. § 6751(b)(1) (emphasis added).

The panel's recent decision, *PBBM-Rose Hill, Ltd. v. Commissioner*, No. 17-60276 (5th Cir. Aug. 14, 2018), reads these key words out of the statute.[2] The panel accepted a pure boilerplate cover letter signed by a supervisor as "personal[] approv[al]" under § 6751(b). Yet that cover letter offers no indication that the signer even knew of, let alone "personally approved," the assessed penalty. In addition, the document the panel found sufficed as an "initial determination" conveys on its face that it was not, in fact, "initial," but a final determination after negotiating with the taxpayer.

This case presents a matter of great public importance. Each year, the IRS assesses over 550,000 accuracy-related penalties of the same type at issue here. U.S. Dep't of Treasury, IRS Data Book 2017, at 42.[3] Section 6751's protections apply to each of these assessments. It is vital, therefore, that the judiciary interpret and apply § 6751 correctly. At the same time, this case is the first federal appellate decision to analyze the substantive provisions of § 6751. The panel's published opinion will

[2] Judge Ho concurred in judgment only and thus did not join any of the panel's reasoning.

[3] Available at: https://www.irs.gov/pub/irs-soi/17databk.pdf (last visited Oct. 5, 2018).

carry outsized influence on how the IRS handles hundreds of thousands of penalty cases. This is a billion-dollar issue.

This Court should grant the petition for rehearing. The panel's misinterpretations of § 6751 undermine Congress' stated desire to protect taxpayers and prevent the assessment of unjust and inaccurate penalties.

ARGUMENT

I. The panel adopted a flawed interpretation of § 6751.

The Commissioner bears the burden of establishing compliance with § 6751's supervisor approval requirement. *Chai v. Commissioner*, 851 F.3d 190, 221 (2d Cir. 2017); *Graev v. Commissioner* (*Graev III*), 149 T.C. No. 23, at *9–10 (T.C. Dec. 20, 2017).[4] Based on the two defects described below, the Commissioner failed to meet this burden.

A. No supervisor "personally approved" the penalty assessment.

In 2011, the IRS sent PBBM a "summary report" on its proposed adjustment to PBBM's 2007 tax return. The 58-page packet contained more than a dozen forms, notices, and instructions. It also included a cover letter signed by a supervisor. Ex. 176-R at 1–2.

[4] The panel declined to say who bears the burden under § 6751, *PBBM*, slip op. at 30 n.10, but the statute's text places this burden on the Commissioner, *Chai*, 851 F.3d at 221; *Graev III*, 149 T.C. No. 23, at *9–10.

On page 52, the packet included a "Gross Valuation Overstatement Penalty Lead Sheet" completed by an IRS examiner. Ex. 176-R at 52. The Lead Sheet concluded that PBBM's alleged underpayment was subject to a 40 percent penalty. *Id.* According to the panel, the packet's cover sheet satisfied § 6751. The panel asserted that the "plain language of § 6751(b) mandates only that the approval of the penalty assessment be 'in writing' and by a manager." *PBBM*, slip op. at 30. The panel erred.

First, § 6751 does not merely require "approval . . . 'in writing,'" as the panel quoted, but *personal* approval. 26 U.S.C. § 6751(b)(1). The panel overlooked the "personal" requirement. *See PBBM*, slip op. at 30 (asserting incorrectly that "[t]he plain language of § 6751(b) mandates *only* that the approval of the penalty assessment be 'in writing' and by a manager" (emphasis added)). The panel failed to interpret the statute "so that effect is given to all its provisions, so that no part will be inoperative or superfluous, void or insignificant." *Rubin v. Islamic Republic of Iran*, 138 S. Ct. 816, 824 (2018). Failing to note the "personal approval" element created error.

Second, even a cursory review of the cover letter reveals its insufficiency under the "personally approved" element of § 6751. To start, most of the letter is purely logistical—explaining how to schedule a conference with the examining

agent and noting deadlines for doing so. The sole paragraph that could generously be labeled "substantive" comprises a mere two sentences:

> We have enclosed a copy of our summary report on the examination of the above named partnership for you in your capacity as Tax Matters Partner (TMP). The report explains all proposed adjustments including facts, law and conclusion.

Ex. 176-R at 1. Nothing in these two sentences suggests that the signer of the letter approved of the enclosed penalty *or was even aware of its amount*. The first sentence simply informs the recipient that the packet contains a summary report, and the second sentence describes what summary reports generally include. Judged by its content, the fact that a supervisor signed the cover letter is irrelevant. The cover letter was nothing but a form letter and includes no piece of case-specific information in its body.

Third, the cover letter the panel approved here does not even meet the IRS's own internal rules for compliance with § 6751. The IRS's administrative manual contains several provisions relating to § 6751 compliance. The manual prescribes that, for cases of this type, "written managerial approval . . . should be documented on the *300-Civil Penalty Approval Form* lead sheet." Internal Revenue Manual 20.1.5.1.4.1(2) (Dec. 13, 2016). The IRS failed to follow this procedure here. The Lead Sheet never mentions supervisor approval, much less a signature. Ex. 176-R at 52.

Even more telling are the manual's general instructions on § 6751 compliance. In particular, in documenting approval, the immediate supervisor "must indicate the decision reached, sign, and date the case history document." Internal Revenue Manual 20.1.1.2.3(6) (Nov. 21, 2017). This provision is well-tailored to fit the "personally approved" requirement. By (1) revealing the decision reached, (2) providing a signature, and (3) noting the date, the supervisor verifies that he was (1) personally informed of the decision, (2) approved it, and (3) did so at the time of the initial determination.

Although the IRS manual is not legally binding, *Chai*, 851 F.3d at 220, its provisions are highly instructive as to what the IRS believes is necessary to satisfy § 6751. Yet here, the cover letter lacked any indication that the supervisor's signature reflected awareness, much less "personal approval" of the penalty stated on a Lead Sheet buried 52 pages below. The leap of faith required to reach this conclusion violates the plain meaning of § 6751.

B. The Commissioner failed to establish that the Lead Sheet was the "initial determination" of PBBM's penalty.

Section 6751 requires that a supervisor "personally approve[]" the "initial determination" of a tax penalty. 26 U.S.C. § 6751(b)(1). "Initial determination" means "the action of the IRS official who first proposes that a penalty be asserted." *Graev III*, 149 T.C. No. 23, at *20 (Lauber, J., concurring). In other words, the

supervisor should personally approve the *proposed* penalty *before* the IRS uses it to negotiate with the taxpayer. *See Chai*, 851 F.3d at 221.

The panel concluded that the "Gross Valuation Overstatement Penalty Lead Sheet" qualified as an "initial determination," which the cover letter "approved." *PBBM*, slip op. at 29. But the Lead Sheet relied on by the panel bears two tell-tale signs that it is *not* an "initial determination" under § 6751.

First, the conclusion block on the Lead Sheet includes the parenthetical that its narrative "[r]eflects the final determination of the issue." Ex. 176-R at 52. Suffice it to say, a document that announces it is the "final determination" should not also be the "initial determination."

Second, the Lead Sheet includes a block captioned "Taxpayer Position," which is filled out with the word "Agreed." Ex. 176-R at 52. Of course, before a taxpayer like PBBM can agree to a proposed penalty, the IRS must have notified it of its proposed penalty. A record created after this communication—so that it includes the taxpayer's response—is not "initial" in any sense.[5] The very fact that the form includes a block for the taxpayer's position suggests that it was designed to

[5] PBBM notes that the "Agreed" comment was inaccurate. Appellant's Pet. for Reh'g 16. In any event, this block demonstrates that there was prior communication between PBBM and the IRS about the penalty.

be used after negotiations had already begun. This was too late to qualify as an "initial determination" under § 6751. *See Chai*, 851 F.3d at 220–21.[6]

Under the panel's ruling, a generic cover letter omitting any mention of a tax penalty buried fifty pages below, and signed *after* bargaining that underlying penalty with the taxpayer, suffices under § 6751. *PBBM*, slip op. at 30 ("[T]he aforementioned managerial signature on the cover letter of a summary report . . . met this statutory requirement."). That conclusion is wrong. Section 6751 cannot do its job—protecting taxpayers from low-level examiners overstating penalties as bargaining chips—if the panel's ruling stands. The IRS has succeeded in evading the thrust of § 6751.

II. The importance of this issue merits *en banc* review.

The Fifth Circuit is the first federal Court of Appeals to analyze § 6751's substantive requirements.[7] As the first voice on this matter, this Court's resolution of this case will affect the development of this area of the law nationwide. The panel, however, spent barely two pages of its opinion addressing an issue that will reverberate through many thousands of current and future penalty assessments. This issue deserves *en banc* rehearing.

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[6] At trial, the Commissioner stipulated that he could not produce the earlier penalty approval form requested by PBBM's counsel. Tr. 1192.

[7] *See Chai*, 851 F.3d at 190 (IRS conceded no compliance); *Mellow Partners v. Comm'r*, 890 F.3d 1070, 1082 (D.C. Cir. 2018) (waiver); *Kaufman v. Comm'r*, 784 F.3d 56, 71 (1st Cir. 2015) (same).

This case also arises at a critical juncture in the history of § 6751 interpretation. Before the Second Circuit intervened in *Chai*, the IRS had largely succeeded in stripping § 6751 of its potency before the Tax Court. For instance, the IRS had obtained rulings that § 6751-based objections at trial were premature, *Graev v. Comm'r* (*Graev II*), 147 T.C. 460, 478 (2016), but also that failure to object at trial forfeited the claim, *Chai v. Comm'r*, 109 T.C.M. 1206, at *11 (T.C. 2016). In addition, the Tax Court had held that supervisor approval of an "initial determination" could occur at *any point* in the assessment process, even after completion of all appellate review. *Graev II*, 147 T.C. at 478. *Chai* exposed the interpretive defects in each of these holdings and applied an interpretation of § 6751 that comported with its text and purpose. 851 F.3d at 220–23. After *Chai*, the Tax Court reversed course and adopted the bulk of its holdings. *Graev v. Comm'r* (*Graev III*), 149 T.C. No. 23 (Dec. 20, 2017).

After the Second Circuit dispensed with the procedural hurdles to adjudicating Chai's § 6751 objection, the IRS admitted that it could not produce *any* evidence of compliance. *Chai*, 851 F.3d at 223. For this reason, *Chai* had no occasion to consider what evidence would be sufficient under § 6751.

The panel's decision here largely undercuts *Chai* by gutting the substantive requirements of "personal approval" and the timing of that approval in § 6751. After all, if the cover letter here satisfies the "personally approved" requirement, it is

difficult to conceive of any supervisor's signature, anywhere in the remote vicinity of a penalty determination, that would be judged deficient. Congress could not have intended for the IRS to bypass § 6751 so readily.

Section 6751 impacts an enormous number of Americans. Tax penalties subject to § 6751's procedures are assessed against more than 550,000 taxpayers each year. IRS Data Book 2017, *supra*, at 42. Those penalties generate more than $1 billion in annual revenue. *Id.*

Congress enacted § 6751 based on its concern that the IRS had fostered a "culture of threats, intimidation, quotas, and unfair treatment of . . . taxpayers." *IRS Restructuring: Hearings on H.R. 2676 Before the S. Comm. on Finance*, 105th Cong. 2 (1998) (Statement of Sen. Lott).

Despite § 6751, warnings have been issued for many years that the IRS does not comply with its provisions. *See Penalty and Interest Provisions in the Internal Revenue Code: Hearings Before the S. Comm. on Finance*, 106th Cong. 250 (2000) ("The [Joint Committee on Taxation] recommends that the IRS improve its supervisory review of penalty imposition . . . and establish oversight committees . . . ."); *see* Taxpayer Advocate Service, *IRS policy weakens requirements for penalties*, NTA Blog (Oct. 4, 2017) (characterizing the IRS's position on supervisor approval as "contraven[ing] the intent of the statute").[8]

[8] Available at: https://taxpayeradvocate.irs.gov/news/nta-blog-irs-policy-weakens-

A 2013 Inspector General investigation estimated that nearly ten percent of penalty determinations violated § 6751, and warned that the "[l]ack of proper approval could hinder the IRS's ability to successfully litigate these penalt[ies]." Treasury Inspector General for Tax Administration, 2013-30-075, *Improvements are Needed in Assessing and Enforcing Internal Revenue Code Section 6694 Paid Preparer Penalties* (Sept. 9, 2013), perma.cc/SB4X-T958. Indeed, taxpayers represented by counsel prevail in roughly 43 percent of cases challenging accuracy-related penalties. 2 National Taxpayer Advocate, 2008 Annual Report to Congress at 13 (Dec. 31, 2008); *see id.* (noting that the success rate for *pro se* taxpayers is only 17 percent). Those taxpayers who are able to retain counsel must often do so at considerable expense. The IRS's systemic neglect of § 6751 puts all taxpayers at risk of unjustified penalty assessments, and this burden falls most heavily on those least able to defend themselves.

This Court should grant rehearing to vindicate the plain meaning of the statute and protect the rights of all taxpayers.

requirements-for-penalties (last visited Oct. 5, 2018).

CONCLUSION

For these reasons, the Court should grant rehearing *en banc*, vacate the panel opinion, and reverse the Tax Court's judgment.

Respectfully submitted,

Dated: October 5, 2018

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Dated: October 5, 2018

/s/ Matthew A. Fitzgerald
Matthew A. Fitzgerald

CERTIFICATE OF SERVICE

I hereby certify that the foregoing motion was electronically filed with the Clerk of the Court for the United States Court of Appeals for the Fifth Circuit through the appellate CM/ECF system on October 5, 2018. All counsel of record in the case are registered CM/ECF users and will be served through the appellate CM/ECF system.

Dated: October 5, 2018

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